

Country note, July 2019

## Key messages:

- After a growth of 4.1% in 2018, the GDP advance is estimated to record a somewhat slower advance in 2019.
- In 2018 the Government's target for the headline deficit was met at the upper level 3% of GDP, but on the account of lower than planned investment spending, while the structural deficit widened further up.
- For 2019, the headline deficit target of 3% of GDP as projected by the MPF is backed by large one-off revenues, while the EC estimates shows a more realistic 3.6% of GDP to be attained, as the balance of risks is tilted on the downside.
- The structural deficit for 2019 is estimated to deepen with another 0.4 pp compared to 2018, even if Romania is the second time under the Significant Deviation from MTO Procedure.
- In its Opinion on the 2019 Draft Budget, the Romanian Fiscal Council (FC) noted the continuous derogation from both national and European fiscal rules, the deepening of the deviation from MTO and ignoring the path towards it and warned about the high possibility of breaking also the 3% of GDP limit for the headline deficit.

## Macroeconomic outlook

After a strong economic growth of 7% in 2017, in 2018 the economic advance was 4.1% in real terms, being mostly driven by private consumption stimulated by the continuation of a loosening fiscal policy (tax cuts, significant increases in public wages), high inflation rate and a positive output gap. In 2019 real GDP growth is expected to record an advance between 3.3% (EC estimate) and 5.5% (Romanian authorities' estimate).

## Short-term and medium-term fiscal outlook

The general consolidated budget deficit for 2018 reached 3.02% of GDP and for 2019 the government estimates 2.78% of GDP on the background of estimated large one-off revenues. The fiscal policy stance remains expansionary also in 2019, when the revised Pension Law entered into force (linking the pension point to both wage and inflation and setting additional increases by 15% in September 2019 and 40% in September 2020). According to the Convergence Program 2019-2022, the structural balance estimated by the Ministry of Public Finance (MPF) will continue to deteriorate in 2019 and 2020, and only starting 2020 it is planned to enter on a 0.4 pp/year adjustment path towards the MTO, in contradiction with EC recommendation for a structural adjustment of 1 pp in 2019 and 0.75 pp in 2020.

## Fiscal framework and national fiscal rules

On several occasions, the FC warned about the non-compliance with the majority of fiscal rules when drafting the budgetary laws, to the systematic recourse to derogation from the Fiscal Responsibility Law and to the persistence of placing the budgetary deficit in the immediate proximity of the 3% reference level, an approach that in the context of positive output gaps deepen the deviation from MTO. In its Opinion on the 2019 budget, the Fiscal Council noted that, similar to 2018, for the 2019 budgetary construction only the 3% of GDP for the headline deficit SGP rule was taken into account, all the other rules being broken *ex-ante*, even setting the adjustment path towards MTO starting 2019 as it was recommended by the EC in December 2018, Romania being the second time placed under the preventive arm of SGP, due to the major deviation from the MTO starting with 2016. In addition, the FC signaled the high probability for the headline deficit to significantly surpass the assumed target, as the revenue projections included large one-off measures and the 3% of GDP reference value being likely to be broken under a no policy-change scenario.

## Key indicator forecast

		2017	2018	2019 f	2020 f	2021 f	Source
Real GDP growth rate	[% y-to-y]	7.0	4.1	5.5	5.7	5.0	1
Real GDP growth rate	[% y-to-y]	7.0	4.1	3.3	3.1	-	2
GG headline balance	[% of GDP]	-2.7	-3.0	-2.8	-2.7	-2.4	1
GG headline balance	[% of GDP]	-2.7	-3.0	-3.5	-4.7	-	2
GG public debt.	[% of GDP]	35.2	35.4	35.8	35.4	34.5	1
GG public debt	[% of GDP]	35.2	35.0	36.0	38.4	-	2
GG structural balance	[% of GDP]	-2.9	-2.7	-2.8	-3.0	-2.8	1
GG structural balance.	[% of GDP]	-2.9	-3.0	-3.6	-4.8	-	2

Sources:

1 - Ministry of Public Finance (MPF), 2019-2022 Convergence Programme;

2 - European Commission (EC), 2019 Spring Forecast

f- forecast

Chart 1: Revenue, expenditure and public debt as % in GDP

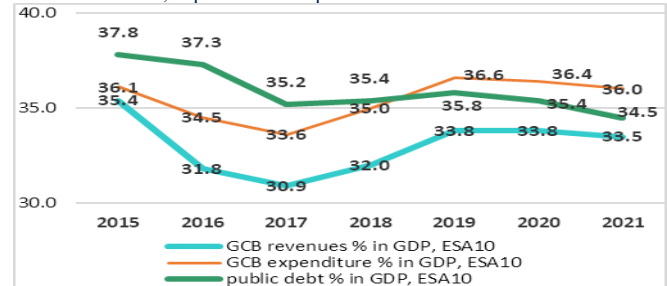
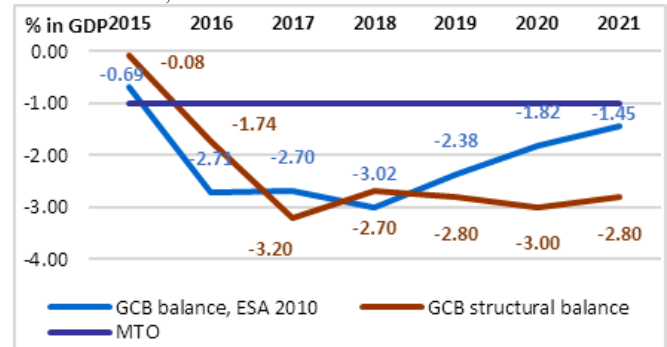


Chart 2: Headline, structural balances and MTO



Sources: Eurostat, MPF projections (for both charts)