ROMANIA

Table 1	2020
Population, million	19.2
GDP, current US$ billion	245.4
GDP per capita, current US$	12757.5
International poverty rate ($ 19)[a]	2.6
Lower middle-income poverty rate ($3.2)[a]	5.3
Upper middle-income poverty rate ($5.5)[a]	11.0
Gini index[a]	35.9
School enrollment, primary (% gross)[b]	87.3
Life expectancy at birth, years[b]	75.4

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2018), 2011PPPs.
(b) Most recent WDI value (2018).

The Romanian economy performed better than anticipated, contracting by 3.9 percent in 2020. A proactive but constrained fiscal response, at 4.4 percent of GDP, supported firms to retain employees and fed into household incomes. Economic growth is expected to rebound to 4.3 percent in 2021, supported by a pick-up in economic activity in the second half of the year. Poverty is anticipated to increase in the short term as the protracted impacts of COVID-19 affect domestic income sources and remittances.

Key conditions and challenges

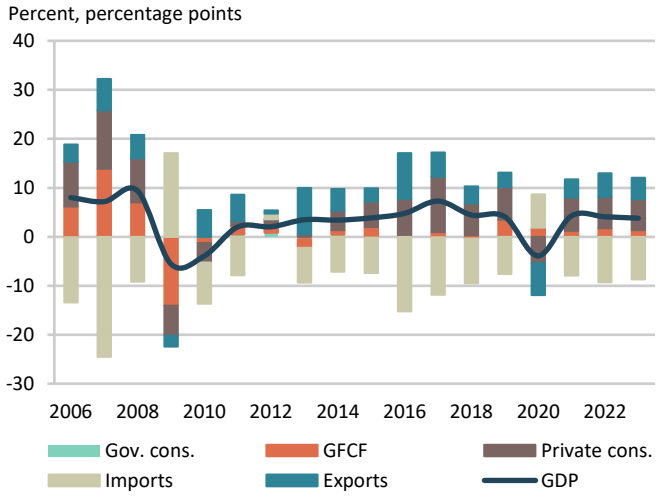
Prior to the COVID-19 pandemic, Romania enjoyed a decade of economic growth; however, the COVID-19 crisis has affected economic activity and household incomes, exposing Romania's structural issues. Fiscal policy has historically been procyclical. The budget deficit averaged -2.8 percent of GDP between 2011-2019 as GDP growth averaged 3.9 percent over the same period. Economic growth was strong despite weak fundamentals. Elevated private consumption, driven in part by unsustainable wage growth, has triggered inflationary pressures and placed the current account deficit on a widening path. The quality and quantity of labor and capital, as well as slower productivity dynamics, have limited potential growth. Private investment has remained at fairly high levels, but a shallow financial sector limits the availability of long-term finance. The Government responded rapidly to the COVID-19 crisis by providing a fiscal stimulus of 4.4 percent of GDP in 2020. This is one of the lowest stimuli in the EU, reflecting the limited fiscal space. In the first COVID wave, poor and vulnerable households were less supported by the fiscal response measures, which extended more directly to those in formal employment structures; subsequent programs for daily wage and seasonal workers extended protections to typically more vulnerable segments.

The key challenge in the short term is to contain the COVID-19 crisis and limit its health, economic and social consequences. The Government's policy response alongside the European Union (EU) support, as well as a successful rollout of the COVID-19 vaccine, will be critical in ensuring recovery. Bringing down the fiscal deficit alongside structural reforms to reduce inefficient expenditures and strengthen revenue mobilization will be paramount for the consolidation of public finance and for averting a sharp increase in public debt over the medium term. Additional challenges stem from Romania's historically low EU fund absorption rates, raising questions on the country's capacity to take advantage of the new recovery funds.

Recent developments

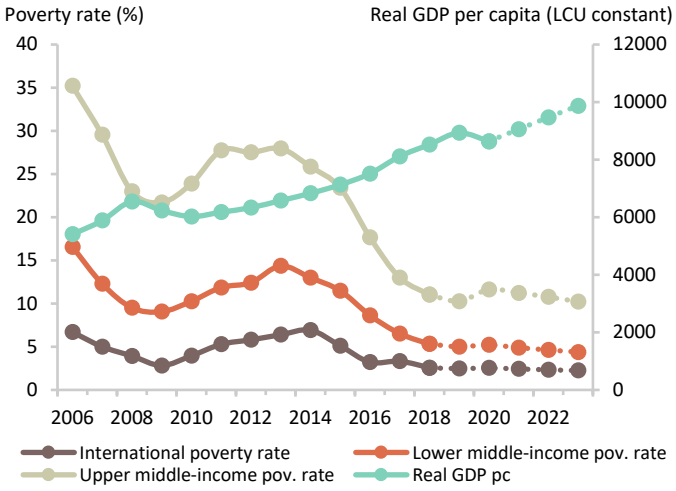
The Romanian economy contracted by 3.9 percent in 2020 on the back of better than expected fourth-quarter performance at -1.4 percent yoy. This reflects in part a smaller disruption of employment and production in the second wave of the pandemic in Q4 2020 compared to the first. Trade and services decreased by 4.7 percent in 2020, and high-frequency indicators point to a quicker recovery contributing to the fourth quarter GDP rebound, although certain sectors – such as tourism and hospitality – remained heavily affected. Industry contracted by 9.3 percent, over the same period, reflecting the weakening of external demand from Europe alongside pandemic-related restrictions

FIGURE 1 Romania / Real GDP growth and contributions to real GDP growth



Source: World Bank.

FIGURE 2 Romania / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

and supply chain disruptions. The biggest contraction was seen in agriculture, linked to persistent droughts affecting crops. The output contractions led to deteriorating labor market conditions and increased unemployment affecting household income. The unemployment rate reached as high as 5.5 percent in July 2020 before edging down to 5.3 percent in December 2020.

Rapid household assessments of COVID-19 impacts showed a substantial rise in the share of the population at risk of poverty in April 2020, which gradually declined between July 2020 and January 2021 as temporarily inactive workers returned to work. Poverty levels at the start of 2021, however, remain elevated – linked to the combination of the sharp agricultural contraction and the persistence of the pandemic. Lower-earning workers and those on non-standard contracts continue to be more affected by employment stoppages during the second pandemic wave and approximately 20 percent of households reported lower incomes in January 2021 than prior to the pandemic, with impacts felt across income groups.

The fiscal deficit surged to 9.8 percent of projected GDP at the end of 2020 on the back of COVID-19 related expenditures and lower revenues due to the economic downturn and tax relief. Tax facilities, investments, and exceptional expenditures allocated to combat the effects of the COVID-19 pandemic totaled 46.3 billion Ron (4.4 percent of GDP). This included 4.2 billion Ron for benefits granted during the period of temporary suspension of individual employment contracts, 2.7 billion Ron in VAT refunds supporting firm liquidity, and 0.9 billion Ron in bonuses granted for the payment at maturity of the tax on the income of micro-enterprises and the corporate income tax.

To reduce the effects of the COVID-19 crisis, the National Bank of Romania (NBR) has pursued a quantitative easing policy which included the purchase of government bonds from the secondary market, repo operations to provide liquidity to credit institutions and monetary policy rate cuts amounting to 1.25 percentage points from 2.5 percent in February 2020 to 1.25 percent in January 2021.

Outlook

The economy is projected to grow at around 4.3 percent in 2021 on the back of strengthened economic activity in the second half of 2021. The strength of the recovery will depend on the success of the vaccine rollout and the policy response to the health crisis, as well as on developments in the EU. The impact of the stimulus pursued at the EU level will play a critical role in the recovery given limited fiscal space. The NBR will continue its quantitative easing policy, further supporting the recovery. However, as growth recovers, inflationary and current account deficit pressures are expected to reemerge, requiring an appropriate policy response.

A substantial reduction of the fiscal deficit in 2021 is improbable, as the government will have to support the economic recovery process. Over the medium term, the deficit will follow a downward trajectory but is likely to remain above 3 percent throughout the projection period. The widening fiscal deficit would push public debt to 62.2 percent in 2023, from 37.3 percent in 2019. However, public debt remains one of the lowest in the EU.

Poverty is projected to remain elevated due to the triple-hit in incomes facing poorer segments of the population, in the form of the persistent pandemic, the poor agricultural year, and declining remittance incomes.

TABLE 2 Romania / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	4.5	4.1	-3.9	4.3	4.1	3.8
Private Consumption	6.5	6.4	-5.1	6.5	6.0	5.9
Government Consumption	6.8	5.0	6.5	1.2	3.5	3.0
Gross Fixed Capital Investment	-1.1	13.0	5.6	3.9	5.1	3.9
Exports, Goods and Services	5.3	4.6	-10.0	6.2	7.8	6.8
Imports, Goods and Services	8.6	6.8	-6.0	7.1	8.1	7.3
Real GDP growth, at constant factor prices	3.9	4.0	-3.3	4.3	4.1	3.8
Agriculture	9.4	-5.0	-16.2	14.2	6.1	2.9
Industry	4.3	-0.6	-9.3	5.2	4.3	4.1
Services	3.2	7.6	0.9	3.1	3.8	3.7
Inflation (Consumer Price Index)	4.6	3.8	2.6	3.0	3.2	2.9
Current Account Balance (% of GDP)	-5.3	-4.7	-5.0	-5.4	-5.7	-6.3
Net Foreign Direct Investment (% of GDP)	2.3	2.3	0.9	2.1	2.3	2.4
Fiscal Balance (% of GDP)	-2.9	-4.4	-9.8	-7.2	-6.0	-4.7
Debt (% of GDP)	36.4	37.3	47.7	53.6	58.1	62.2
Primary Balance (% of GDP)	-1.6	-3.1	-8.4	-5.5	-4.0	-2.8
International poverty rate ($1.9 in 2011 PPP)[a,b]	2.6	2.5	2.5	2.4	2.3	2.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	5.3	5.0	5.2	4.9	4.6	4.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	11.0	10.3	11.6	11.2	10.8	10.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2007-EU-SILC, 2017-EU-SILC, and 2018-EU-SILC.Actual data: 2018. Nowcast: 2019-2020. Forecasts: 2021to 2023.
(b) Projection based off elasticities calibrated on 2007-2018 growth periods and rapid assessment data, allowing for elasticities to vary between periods of contraction, recovery and expansion.