ROMANIA

Table 1	**2018**
Population, million	19.5
GDP, current US$ billion	228.7
GDP per capita, current US$	11745
International poverty rate ($1.9)[a]	5.7
Lower middle-income poverty rate ($3.2)[a]	13.3
Upper middle-income poverty rate ($5.5)[a]	25.6
Gini index[a]	35.9
School enrollment, primary (% gross)[b]	89.4
Life expectancy at birth, years[b]	75.0

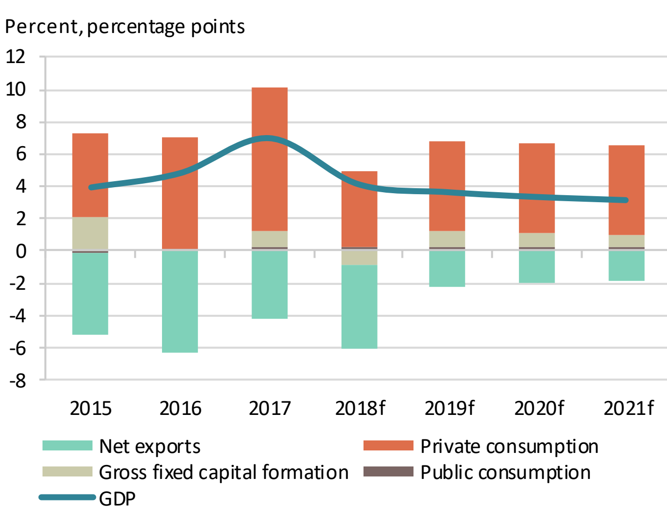
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Economic growth remained strong at 4.1 percent in 2018, largely in line with the country's long-term potential. Growth was driven by private consumption, supported by expansionary fiscal policy, while investment was subdued. Improved labor market outcomes, including historically low unemployment, have contributed to the further reduction of poverty. Risks to the growth outlook have increased, stemming mainly from weaker demand from the major export markets, a tightening labor market and fiscal policy uncertainties.

Recent developments

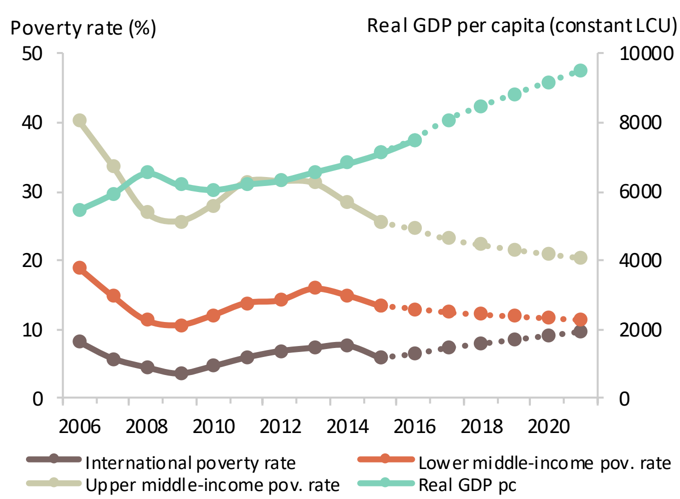
The economy grew by 4.1 percent in 2018, in line with potential but down from a post-crisis high of 7 percent in 2017. Growth was driven by private consumption (up 4.7 percent yoy) supported by increases in the minimum and public-sector wages and pensions. Investment underperformed, contracting by 3.2 percent yoy, owing to weak performance in construction and a slowdown in industry. Exports grew by 4.7 percent yoy reflecting weaker demand from the major export markets, while imports remained strong (up 8.6 percent). On the production side, ICT (up 7 percent yoy) and industry (up 4.1 percent yoy) were the main drivers. The fiscal deficit was 2.9 percent of GDP in 2018, but fiscal policy continued to be pro-cyclical. Increases in public wages and pensions led to a 23.7 percent hike in the public sector wage bill and a 16.5 percent increase in current budget spending. Social contribution revenues were strong (up 36.8 percent yoy) reflecting the legal transfer of the social contributions from employers to employees and improved collection. The impact was partially offset by the 24.8 percent contraction in personal income tax revenues from the reduction of the income tax rate from 16 to 10 percent in January 2018. The boost in consumption led to a widening of the current account deficit to 4.7 percent of GDP mainly on the back of an increase in the goods trade deficit. FDI inflows amounted to 2.4 percent of GDP in 2018. The domestic demand pressures contributed to a temporary hike in inflation to 5.4 percent in May 2018, prompting the NBR to increase its policy rate by 75 ppts cumulatively (to 2.5 percent) in three rounds in 2018. Slowing consumption growth in H2 2018 eventually brought inflation down to 3.3 in December. The labor market benefited from economic growth, with unemployment falling to 4.2 percent in December 2018, a 27-year low, and real wages increasing by 8.9 percent yoy. Nonetheless, the low employment rate (66.2 percent, below the EU average of 69.1 percent) and high youth unemployment (16.4 percent in Q3 2018) reflect persistent rigidities in the labor market. A key driver of low employment is low female participation - 55.8 percent in 2017, the fifth lowest rate in the EU - and one of the highest participation gender gaps. In line with robust economic growth, boost in private consumption and labor market improvements, the poverty rate corresponding to upper middle-income countries (using the $5.50/day 2011 PPP poverty line) is forecast to have declined to 22.3 percent in 2018, from 25.6 percent in 2015, after peaking at nearly 32 percent in 2012. The incomes of the bottom 40 were boosted by employment gains in sectors with a large share of low-skilled workers. The impact has been stronger for those in the bottom 80 percent of the income distribution, who have seen an increasing share of total incomes over this period. Tightening labor markets and minimum wage increases have contributed to a

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



Sources: World Bank, Romanian National Statistical Institute.

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



Source: World Bank. Notes: see table 2.

reduction in inequality, reversing a rise in the Gini index seen between 2010 and 2014, although Romania's inequality indicators remain high in the EU context. Since 2014 poverty has declined in both rural and urban areas, but in 2016 estimated poverty rates in rural areas remained 6 times higher than in cities and just over twice as high as in towns and suburbs.

Outlook

The economy is projected to grow at a slower pace over the medium term, reflecting the closing output gap, labor market tightening and fiscal policy uncertainties. Fiscal measures promoted at end-December 2018 risk slowing the economy further in 2019 and beyond. These measures include the introduction of a tax on bank assets, a turnover tax for companies in energy and telecoms; and measures to increase the capitalization of the second pension pillar funds. The government has committed to maintaining the budget deficit within 3 percent of GDP in 2019. However, the fiscal measures passed in 2017 and 2018 have put pressure on the consolidated budget deficit and reduced the available fiscal space for investment. Further planned increases in pensions and public wages will exacerbate these pressures. Widening of the fiscal deficit to 3 percent of GDP, coupled with an increase in borrowing costs and a slowdown in growth would push public debt from 43 percent of GDP in 2017 to 43.3 percent at end-2021, still among the lowest ratios in the EU. After peaking in the spring of 2018, inflation is expected to stabilize at current levels of around 3.5 percent, reflecting slowing growth in domestic demand. The expected slowdown in Romania's traditional export markets, coupled with persistently high international commodity prices, would contribute to a further widening of the current account deficit to 5.2 percent in 2019 from 4.7 percent in 2018. Strong private consumption aided by the expansionary fiscal policy and continued growth in real wages, partly supported by minimum wage increases, should boost real incomes and lead to further declines in poverty incidence. However, these gains will be eroded by Romania's fiscal system, which deepens rather than alleviates poverty due to the large regressive impact of indirect taxation. The $5.50/day 2011 PPP poverty rate is projected to decline to 21.6 percent in 2019, 21.0 per-cent in 2020, and 20.4 percent in 2021.

Risks and challenges

The slowdown in Romania's export markets in the EU, mainly Germany and Italy, could adversely affect growth and investment. Negative effects could be exacerbated by fiscal policy uncertainties, coupled with a tightening labor market. The partial decoupling of real wage growth and productivity could also affect Romania's competitiveness, putting supplementary upward pressures on the current account deficit. Renewed efforts are needed to improve labor participation, in particular to address labor market barriers for women, and to tackle higher unemployment among the youth and those with secondary education or less, helping to ease labor supply constraints and improve the sustainability of growth. Over the medium term, fiscal policy should be re-balanced from boosting consumption to mobilizing investment, primarily from EU funds, with the aim of supporting a sustainable EU convergence path and social inclusion. Reforms in public administration and SOEs, increased regulatory predictability, reduction in of social and spatial discrepancies should be key government priorities.

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

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.8	7.0	4.1	3.6	3.3	3.1
Private Consumption	7.4	9.2	4.7	5.6	5.5	5.4
Government Consumption	1.8	5.2	6.4	5.2	5.0	4.6
Gross Fixed Capital Investment	-0.2	3.5	-3.2	4.1	3.5	2.9
Exports, Goods and Services	16.0	10.0	4.7	6.7	6.6	6.5
Imports, Goods and Services	16.5	11.3	8.6	7.1	7.0	6.9
Real GDP growth, at constant factor prices	4.9	7.1	4.1	3.6	3.3	3.1
Agriculture	4.2	14.6	9.9	2.1	2.1	2.1
Industry	5.1	8.3	4.1	4.0	3.9	3.8
Services	4.9	5.5	3.4	3.5	3.1	2.8
Inflation (Consumer Price Index)	-1.5	1.3	4.6	3.5	3.4	2.9
Current Account Balance (% of GDP)	-2.1	-3.2	-4.7	-5.2	-5.3	-5.2
Net Foreign Direct Investment (% of GDP)	2.7	2.6	2.4	2.0	2.2	2.4
Fiscal Balance (% of GDP)	-2.4	-2.8	-2.9	-3.0	-3.0	-3.0
Debt (% of GDP)	44.3	43.0	42.5	43.0	43.2	43.3
Primary Balance (% of GDP)	-0.9	-1.7	-1.6	-1.7	-1.7	-1.7
International poverty rate ($1.9 in 2011 PPP)[a,b]	6.3	7.2	7.8	8.5	9.1	9.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	12.9	12.4	12.1	11.9	11.6	11.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	24.6	23.2	22.3	21.6	21.0	20.4

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, 2012-EU-SILC, and 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are 2019-2021.
(b) Projection using annualized elasticity (2007-2012) with pass-through = 0.7 based on GDP per capita in constant LCU.