

ROMANIA

Key conditions and challenges

Table 1 **2022**

Population, million	19.9
GDP, current US\$ billion	300.3
GDP per capita, current US\$	15076.5
International poverty rate (\$2.15) ^a	2.2
Lower middle-income poverty rate (\$3.65) ^a	4.7
Upper middle-income poverty rate (\$6.85) ^a	10.7
Gini index ^a	35.2
School enrollment, primary (% gross) ^b	87.8
Life expectancy at birth, years ^b	73.0
Total GHG emissions (mtCO ₂ e)	83.9

Source: WDI, Macro Poverty Outlook, and official data.
 a/ Most recent value (2020), 2017 PPPs.
 b/ WDI for School enrollment (2020); Life expectancy (2021).

The Romanian economy decelerated to 1.7 percent in the first half of 2023, in spite of resilient private consumption and investment aided by EU funds. Growth will moderate in 2023, in alignment with EU's weakened economic activity, but rebound in the medium term. Fiscal and current account deficit pressures will remain elevated, necessitating structural reforms. Poverty reduction is set to decelerate due to high food and energy costs, partly offset by government support. Tackling energy poverty is key to poverty alleviation and social inclusion.

Romania has made impressive strides in enhancing its economic performance and prosperity over the past two decades, supporting convergence in living standards with the EU. However, several constraints, including weak institutions, shortages of skilled workforce, poor connectivity, low resilience to natural hazards, and the effects of climate change, hold Romania back from making growth more inclusive and more sustainable economically and environmentally.

Romania's persistently high at-risk-of-poverty rate, particularly compared to EU peers with comparable or lower per capita incomes, remains concerning and could worsen due to ongoing inflation, especially among lower-income groups. In December 2022, a 3.1 ppts inflation gap existed between Romania's lowest and highest quintiles.

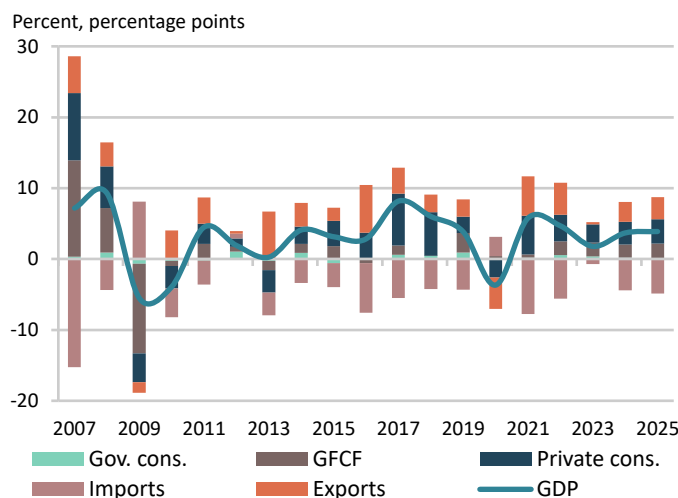
The key challenges in the short term are to curb the increase in the cost of living and sustainably address the significant twin deficits, while mitigating the impact of rising energy prices with targeted transfers to help the most vulnerable. The surge in inflation prompted a tightening of monetary policy, while elevated core inflation points to persistent inflationary pressures. Achieving a sustainable recovery and supporting fiscal consolidation efforts will hinge on implementing structural reforms in key areas, including education and

health sectors, public administration, tax, and pension systems; and decarbonization reforms along with an efficient use of EU Multiannual Financial Framework and Next Generation EU funds.

Recent developments

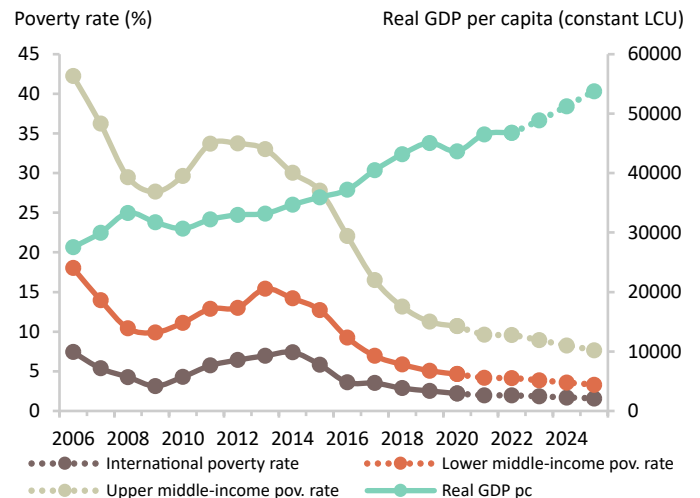
Romania's economic growth decelerated to 1.7 percent y-o-y in H1, 2023. Private consumption remained the main driver of growth, up 3.9 percent y-o-y, benefiting from higher wages and muted unemployment. Investment, up 11.2 percent y-o-y, was boosted by increased public investment supported by EU funds. Temporary factors notably dampened growth, with inventory changes contributing negatively to GDP dynamics. Despite weakening export volumes, trade and current account deficits narrowed, supported by higher services surplus and modest import compression. On the supply side, although construction (up 6.8 percent y-o-y) was the main driver of growth, its momentum waned, reflecting a slowdown in both residential and non-residential constructions. Industry continued to contract (down 3.3 percent y-o-y) due to elevated production costs, especially in energy-intensive sectors, which experienced among the highest output declines. Unemployment remains contained at 5.4 percent in June 2023. Nominal net wages grew by 15.4 percent y-o-y in June 2023, above inflation, driven by wage increases in the private sector propelled by a minimum gross wage rise fueling companies' labor

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.

costs. July's annual inflation slowed to 9.4 percent from 12.2 percent in March, driven by lower energy costs. Food prices remain high but should temper given the Government's temporary cap on markups for 14 staple items starting end of July 2023. Following 575 basis points of hikes from October 2021, the National Bank of Romania has maintained its policy interest rate at 7 percent since January 2023. Private sector credit growth decelerated to 6.4 percent y-o-y in June 2023 from 17.5 percent in June 2022, reflecting a slowdown in loans to households (0.1 percent y-o-y).

The fiscal deficit widened to 2.3 percent of GDP in the first half of 2023, a 0.7 ppts increase from the previous year. The deterioration resulted from slower fiscal revenue growth, notably VAT, coupled with increased expenditures, mainly stemming from social assistance spending, higher investments, and record high interest expenditures. Narrowing the fiscal deficit is a key challenge given its structural nature. To meet the deficit target agreed with the European Commission, the Government is working on a comprehensive fiscal reform package which includes measures aimed at increasing the equity of the tax system and reducing distortions, as

well as measures supporting public wage and pension reforms.

Poverty (\$6.85/day PPP) is projected to decrease from 10.7 percent in 2020 to 9.6 percent in 2022, due to positive GDP per capita growth and rising employment rates, but at a slower pace due to inflationary pressures. Microsimulation shows higher food and energy prices could increase short-term poverty (\$6.85/day PPP) by 0.9 ppts without government support. Existing energy price caps temper this, but energy hikes' ripple effects are even more impactful via core inflation. In 2023, energy affordability remains a concern. The July 2023 World Bank rapid survey shows that 15 percent of households struggled to heat their homes during the past winter, and 30 percent found it difficult to cool in summer. Over half were dissatisfied with the Government's energy price caps, finding them insufficient against increasing prices. Poverty (\$6.85/day PPP) is projected to decrease further to 8.9 percent in 2023.

Outlook

Growth is projected to decelerate in 2023 to 1.8 percent but firm over the medium

term, supported by private consumption and EU funds aided investment. The outlook depends on multiple factors, including the extent and duration of Russia's invasion of Ukraine and its repercussions on the European economy, alongside fluctuations in global prices and domestic inflation. Romania's capacity to efficiently absorb the EU funds will be critical for a sustainable, green, and inclusive recovery, aiding private investment amid higher interest rates and uncertainty. The sizable funds and associated structural reforms will also be critical in supporting a sustainable reduction of the fiscal deficit over the medium term, particularly aimed at reducing inefficient expenditures and strengthening revenue mobilization. Strengthened lifelong skills formation and private capital mobilization will be pivotal in boosting potential growth.

Due to the growth slowdown, 2024 may see slower poverty reduction. However, the poverty trajectory will hinge on the duration of the war in Ukraine and its impacts on food and energy prices, as well as the approach to tackle the fiscal deficit while protecting the more vulnerable. The Government's role in mitigating energy cost effects through targeted support is vital.

TABLE 2 Romania / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-3.7	5.8	4.7	1.8	3.7	3.9
Private consumption	-3.9	8.1	5.5	3.7	4.5	4.8
Government consumption	1.1	1.3	4.3	2.9	1.4	1.2
Gross fixed capital investment	1.1	1.9	8.0	7.9	7.2	7.5
Exports, goods and services	-9.5	12.6	9.6	0.7	5.8	6.3
Imports, goods and services	-5.2	14.9	9.9	1.2	7.5	8.0
Real GDP growth, at constant factor prices	-3.4	5.4	4.0	1.8	3.7	3.9
Agriculture	-15.3	5.9	-11.6	2.8	2.1	2.1
Industry	-6.5	6.6	-2.3	-2.5	1.9	2.1
Services	-0.8	4.8	8.2	3.7	4.5	4.7
Inflation (consumer price index)	2.6	5.1	13.8	10.1	5.4	4.2
Current account balance (% of GDP)	-4.9	-7.2	-9.3	-7.4	-6.3	-6.1
Net foreign direct investment inflow (% of GDP)	1.4	3.7	3.7	3.1	3.2	3.2
Fiscal balance (% of GDP)	-9.2	-7.1	-6.2	-6.0	-4.8	-3.7
Revenues (% of GDP)	32.8	32.5	33.5	32.7	32.9	33.1
Debt (% of GDP)	46.9	48.6	47.3	50.8	51.5	51.9
Primary balance (% of GDP)	-7.8	-5.5	-4.6	-4.6	-3.4	-2.3
International poverty rate (\$2.15 in 2017 PPP)^{a,b}	2.2	2.0	2.0	1.8	1.7	1.6
Lower middle-income poverty rate (\$3.65 in 2017 PPP)^{a,b}	4.7	4.2	4.2	3.9	3.6	3.3
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	10.7	9.6	9.6	8.9	8.3	7.7
GHG emissions growth (mtCO₂e)	-3.8	6.3	4.7	1.1	3.7	4.2
Energy related GHG emissions (% of total)	92.6	93.1	93.9	94.3	94.8	95.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast.

a/ Calculations based on ECAPOV harmonization, using 2014-EU-SILC and 2021-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.

b/ Projection using point-to-point elasticity (2013-2020) with pass-through = 0.7 based on GDP per capita in constant LCU.