ROMANIA

VIBRANT GROWTH

The Romanian economy is in the midst of a spectacular rebound. Real GDP has already returned to pre-Covid levels, and growth should reach 8.2% in 2021. But this performance has been accompanied by high fiscal and external deficits. Consequently, contrary to the other Central European countries, public debt is unlikely to narrow by 2022. Private-sector borrowers benefited from a moratorium on debt payments, but debt formerly under moratorium now presents a non-performing loan ratio of 10.9%. Nonetheless, the banking system should be able to absorb these losses. However, one factor worth monitoring is the rapid growth in housing loans.

GDP HAS ALREADY RETURNED TO PRE-COVID LEVELS

In Q1 2021, Romanian GDP returned to pre-pandemic levels, the first of the Central European countries to do so. Household consumption is the main growth engine: in April 2021, retail sales were 3.4% higher than pre-Covid levels.

Exports are also contributing increasingly to this dynamic momentum. In March-April 2021, exports were already 10% higher than the 2019 level, and they were the main driver of the key increase in manufacturing production in April, up 6.2% for the month.

Romania should continue to benefit from vibrant economic growth, thanks especially to the easing of health restrictions following two waves of the pandemic in Q4 2020 and Q1 2021, and to a buoyant international environment.

Inflation rose to a rapid 3.7% in May 2021, back to the pre-Covid level. The main cause of inflation is a base effect: the prices on some goods declined during the pandemic and are gradually returning to pre-crisis levels. This is notably the case with oil prices. The central bank has already communicated about a future monetary tightening, but with inflation slightly lower than in its neighbouring countries and an unemployment rate that is still higher than pre-crisis levels (5.7% in April 2021, vs 3.8% in early 2020), it can still bide its time a bit. Yet inflationary pressures should begin rising again by year-end 2021.

Romania's economic growth goes with imbalances. The country's twin deficits – fiscal and external – have both widened since 2017. The pandemic worsened the fiscal deficit while the current account deficit levelled off with the decline in imports. As economic growth returns to normal (and oil prices rise), the current account deficit is likely to widen again, to a projected 6.5% of GDP in 2021.

LESS FISCAL LEEWAY

The public deficit swelled before the Covid-19 crisis and the European authorities were about to launch an excessive deficit procedure. After a series of pension increases (+14% in September 2020 after +15% in 2019), the public deficit risks holding above the threshold of 3% of GDP, even after all the long-term fiscal consequences of Covid have been absorbed. Yet the 3% rule for the fiscal deficit was suspended after the pandemic broke out, and is unlikely to be reinstated for several years to come.

In January 2021, the constitutional court allowed the government to cancel an additional 40% increase in retirement pensions, which should help limit the deterioration of the fiscal deficit.

Even so, public debt is expected to continue swelling through the end of 2022, even though nominal GDP growth is strong. Fiscal consolidation is likely to be slower than for the other countries of Central Europe.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	4.1	-3.6	8.2	4.7
Inflation (CPI, year end, %)	3.8	2.6	3.5	3.5
Gen. Gov. balance / GDP (%)	-4.3	-9.2	-6.5	-4.5
Gen. Gov. debt / GDP (%)	35.3	47.3	49.0	50.0
Current account balance / GDP (%)	-4.6	-5.2	-6.5	-6.7
External debt / GDP (%)	49.2	57.7	55.3	53.3
Forex reserves (USD bn)	37.5	42.5	43.5	42.5
Forex reserves, in months of imports	4.5	5.6	4.9	4.4

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

MANUFACTURING PRODUCTION

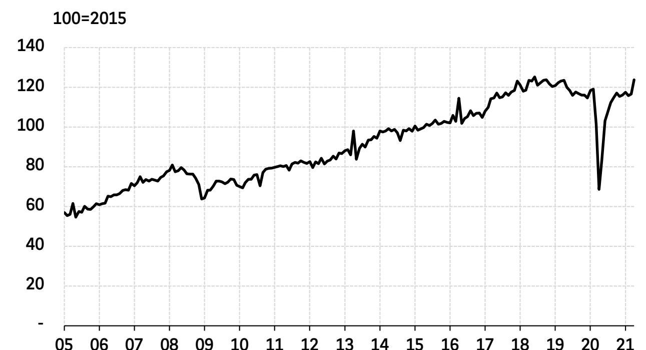
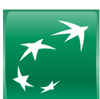


CHART 1 SOURCE: CEIC

Numerous support measures introduced in 2020 were renewed in 2021, including deferred tax payments. State-backed loans also amounted to 4% of GDP, and essentially cover loans maturing between 2023 and 2025.

The interest charge is also expected to rise (4.8% of fiscal revenue; 1.1% of GDP in 2019). In addition to a rising debt, the government must deal with the structurally higher cost of debt as well. Ten-year yields on RON government bonds rose to 3.4% at 1 July 2021, 60 basis points higher than in February. Moreover, they could rise even higher due to expectations of monetary tightening in response to accelerating inflation. The interest charge should rise to 2% of GDP by 2025. Higher



financing costs in the local currency have encouraged the government to use the Eurobond market, which increases the share of public debt in foreign currencies (nearly 50%).

There is also a risk of fiscal slippage. The coalition government formed after the December 2020 elections confirmed the domination of the National Liberal Party (PNL), with Florin Citu as Prime Minister. Fiscal consolidation is still a future goal. Yet the previous government, which was also dominated by the PNL, failed to prevent Parliament from approving a substantial increase in pensions (the 40% increase mentioned above, which was later cancelled after a constitutional court decision). The fragility of the coalition implies upside risks for the public deficit and debt in the future.

In terms of financing, the central bank's support was limited, because its securities purchases (0.4% of GDP) aimed simply to smooth liquidity in the secondary market and not to finance the public debt. Implementation of the 2021-27 European budget and the European recovery plan should provide a bigger financial windfall, with potential cumulative disbursements of EUR 8 bn a year via subsidies in 2021 and 2022. This is the equivalent of nearly half of the projected fiscal deficit in both years.

SOVEREIGN BOND RATE 10-YEAR (%)

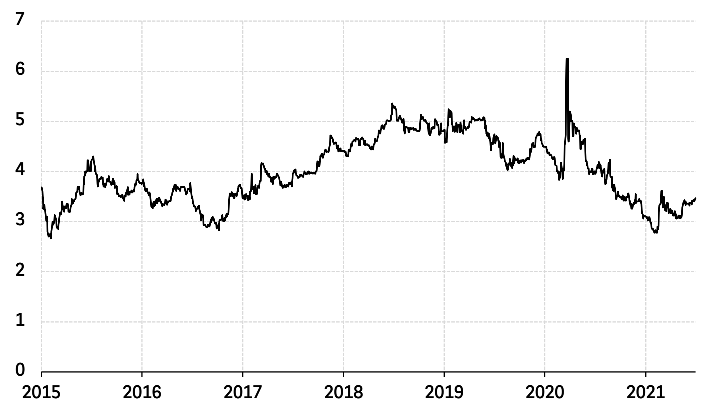


CHART 2

SOURCE: DATASTREAM

CREDIT RISK: MANAGEABLE FOR THE MOMENT, BUT SEVERAL POINTS ARE WORTH MONITORING

The government granted the non-financial private sector a moratorium on debt payments. Applications were initially covered through the end of 2020, but the deadline was later extended to 31 March 2021 (with a maximum grace period of 9 months).

After peaking at 6% in June 2020, the share of loans still under the moratorium is very small. Few borrowers used the window opened by the waiver, and virtually all of the loans covered by the moratorium are now payable again. The non-performing loan ratio for these loans was 10.9% at the end of March 2021, compared to an average of 4.5% for the European Union. At the same date, however, the non-performing loan ratio for all Romanian bank loans outstanding held steady at 3.9%: the credit risk on loans subjected to the moratorium was offset by the natural increase in lending (+10% in May 2021). Moreover, provisions cover 61% of the non-performing loans that arose following the moratorium, one of the highest provisioning ratio in Europe.

The profitability of Romanian banks picked up strongly with a return on equity (ROE) of 17.1% in March 2021. The banks are benefiting from the elimination of the bank tax (although it was eliminated in January 2020, it was still payable in 2020 on net financial assets reported for 2019). Profitability has almost returned to the level that prevailed before the tax was introduced. The capital adequacy ratio rose to nearly 22% in March 2021. Consequently, Romanian banks seem to be well positioned to absorb any losses following the moratorium.

The risks generated by the natural growth of lending, in contrast, could evolve differently. A major part of this lending is generated by housing loans for households. Over the past ten years, they have increased by nearly 12% a year on average, and are expected to rise further in 2021, by nearly 18%. In 2019, the household debt to income ratio was limited to 24%, but this figure has probably deteriorated with the Covid-19 crisis. Moreover, the European Banking Authority reports that the exposure of the Romanian banks to real estate companies has generated more doubtful loans at the end of March 2021 (13.9%) than the European average (2.5%).

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