

ROMANIA : MAGRO OUTLOOK

Romania: Short-term fixes trump long-term investments

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Romania: Short-term fixes trump long-term investments

"Growth is never by mere chance; it is the result of forces working together." – James Cash Penney. Romania's recent economic expansion reflects this reality - a dynamic interplay of consumer-driven momentum, fiscal policies and external constraints. While domestic demand continues to power ahead, the sustainability of this growth model is increasingly in question. Structural imbalances, policy uncertainty and global headwinds cast a shadow over an otherwise resilient economy.

Romania's economy continues to expand, fueled by a robust consumption boom driven by rising wages and fiscal stimulus. However, this momentum is increasingly at odds with persistent structural imbalances. Net exports remain a drag on growth, with the external deficit widening as imports surge to meet strong domestic demand. Meanwhile, the government's large budget deficit limits room for maneuver, adding pressure to an already complex policy environment.

Looking ahead, economic growth is expected to accelerate in 2025, but only if investment evolves as planned, supported by EU funds and, more specifically, RRF money. Consumption, which has been a key driver of expansion, is likely to slow down. Uncertainty remains elevated, stemming from both internal and external factors, including political developments, fiscal policy choices, and global economic conditions.

Inflation, though easing from its peak, remains sticky, complicating the central bank's efforts to balance economic support with price stability. At the same time, the political landscape remains highly uncertain, with upcoming elections and fragmented policymaking raising concerns about fiscal discipline and reform implementation. Against this backdrop, Romania's near-term outlook is defined by both opportunity and risk - where strong domestic demand provides resilience, but persistent macroeconomic vulnerabilities and political uncertainty could weigh on investor confidence and long-term stability.

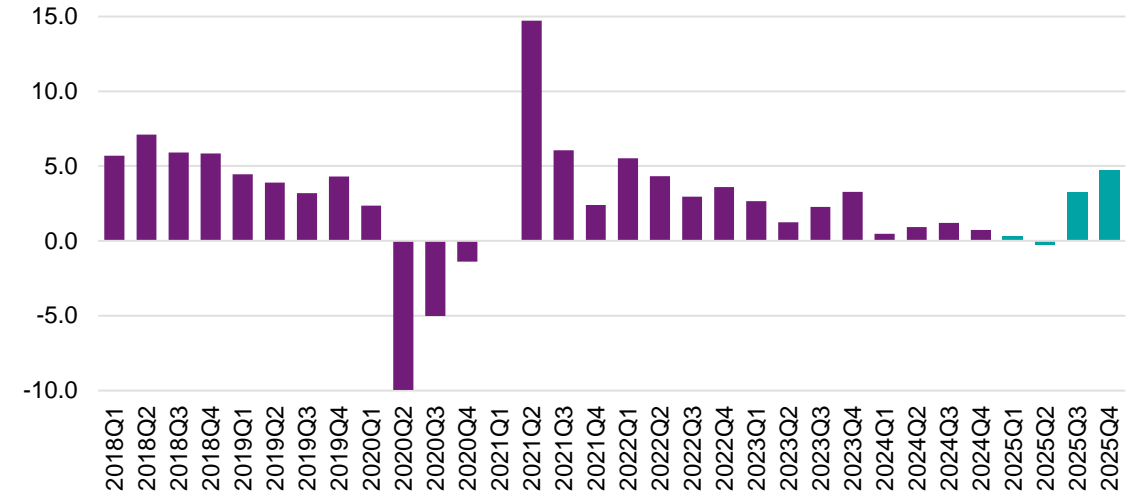
In short, Romania's economy is running ahead, just with a few obstacles on the track. It is a bit like driving an old car: reliable, surprisingly fast on the straights, but every now and then, you hit a pothole and wonder if the wheels will stay on.

GDP growth

Annual GDP growth, percent

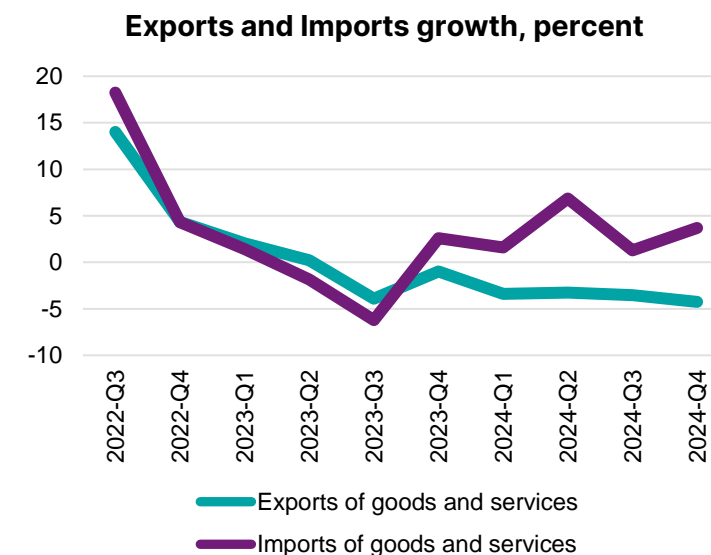
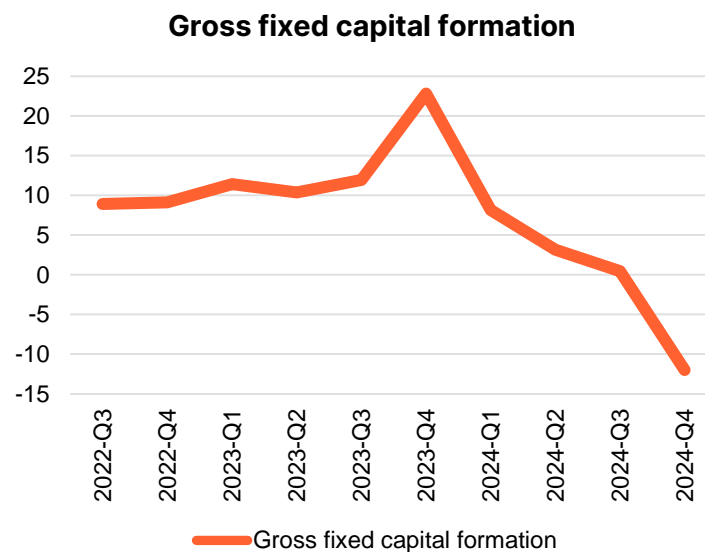
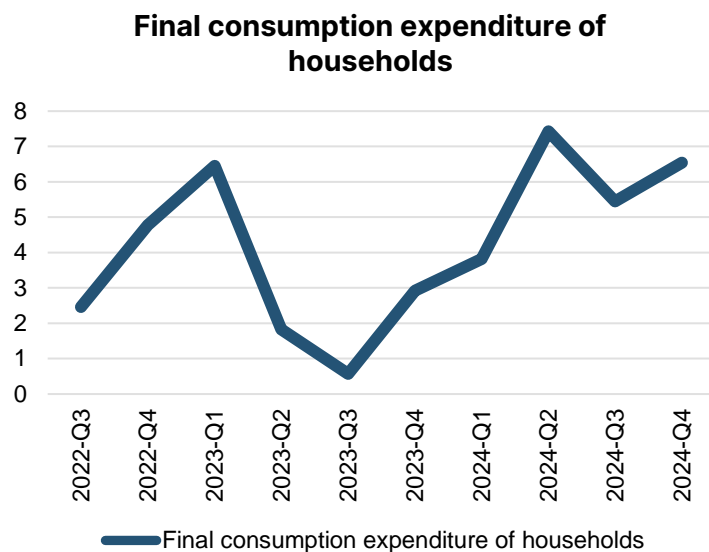


Quarterly GDP growth, y/y percent



In 2024, the economic growth decelerated to 0.9%, based on preliminary data from the National Institute of Statistics. Consumption was strong, supported by robust real wage growth, but GDP data reveals that, due to structural issues, most of the boom in consumption came as a form of imported goods and services. After a strong 2023, investments ended 2024 with a slightly negative contribution. Looking ahead, uncertainty remains high. The announced fiscal consolidation will most likely weigh on consumption, which we see decelerating significantly in 2025. Investments will be a key driver for this year's growth story, and it will be very important to follow the EU Funds absorption development. The strong negative effect from net exports should be less severe this year, due either to improved external demand or base effects, combined with weaker domestic consumption. We keep our forecast of +2.0% GDP growth in 2025, but we see risks rather tilted to the downside. Base effects and carry-over from the last quarter of 2024 are helping this year. In a zero quarterly growth scenario in each quarter, the GDP growth in 2025 should come in around 0.5-0.6%. In 2026, expectations are somewhat higher. If the external environment is helping, the last stretch for RRP funds absorption should boost the growth potential.

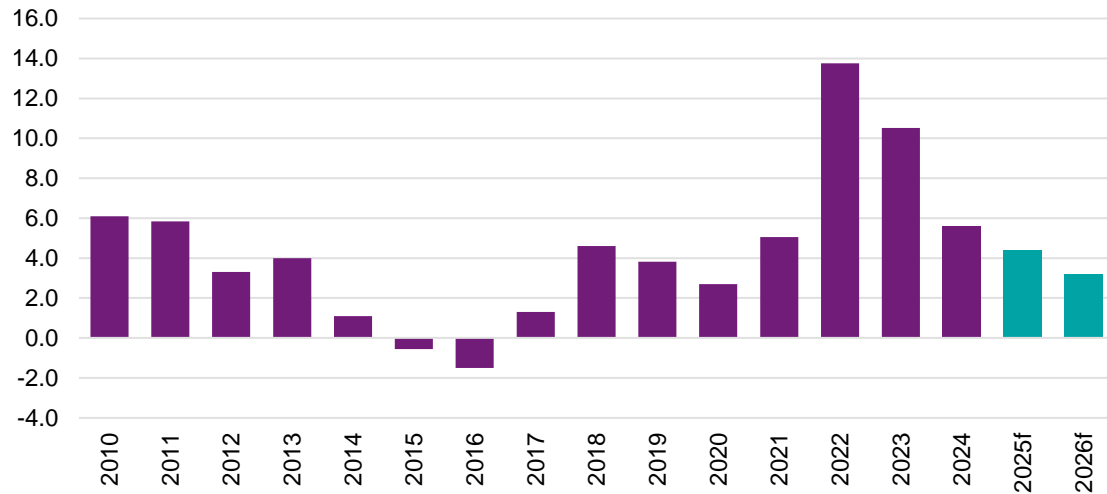
GDP structure



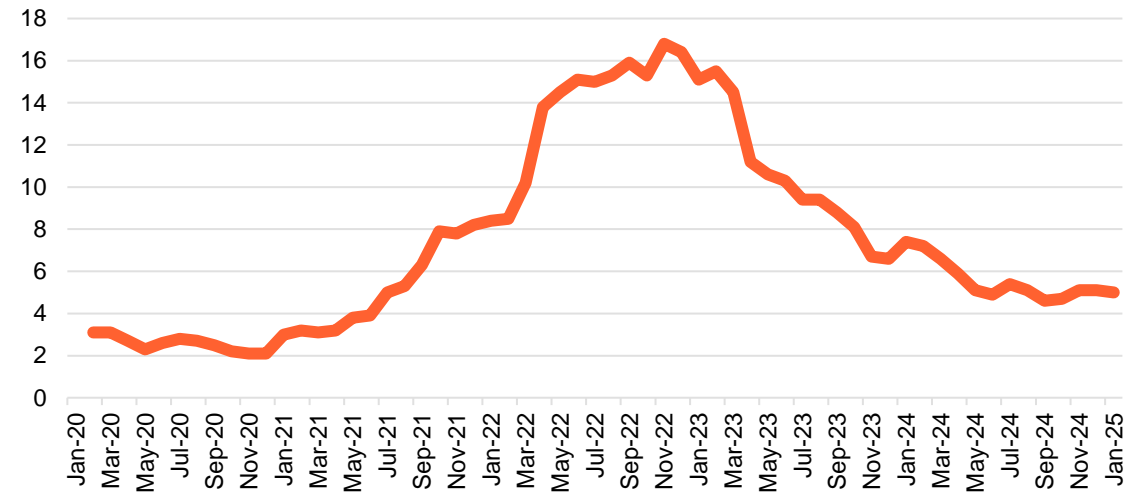
The growth story in 2024 is straightforward. Private consumption accelerated sharply and contributed 3.4pp to the +0.9% GDP growth, while investments took away -0.4pp. Exports did not perform well in the context of subdued external demand and geopolitical instability; at the same time, imports surged, as internal supply could not accommodate the boom in demand. As a result, net exports shaved-off -2.9pp of annual growth. On the supply side, agriculture took away -0.4pp from the GDP growth last year, affected by severe weather conditions. Construction also contributed negatively with -0.2pp, after a strong performance in 2023. Services continued to decelerate and had a +0.6pp contribution, while industry was neutral. In 2025, consumption is expected to decelerate, as wages will most likely increase at a much slower pace and political noise will negatively affect consumer confidence in the first half of the year. The expectation is for investments to pick up the pace. Our view is based on the state's commitment of EU funds absorption included in the budget for this year (+2.1pp of GDP).

Inflation development

Annual inflation, percent

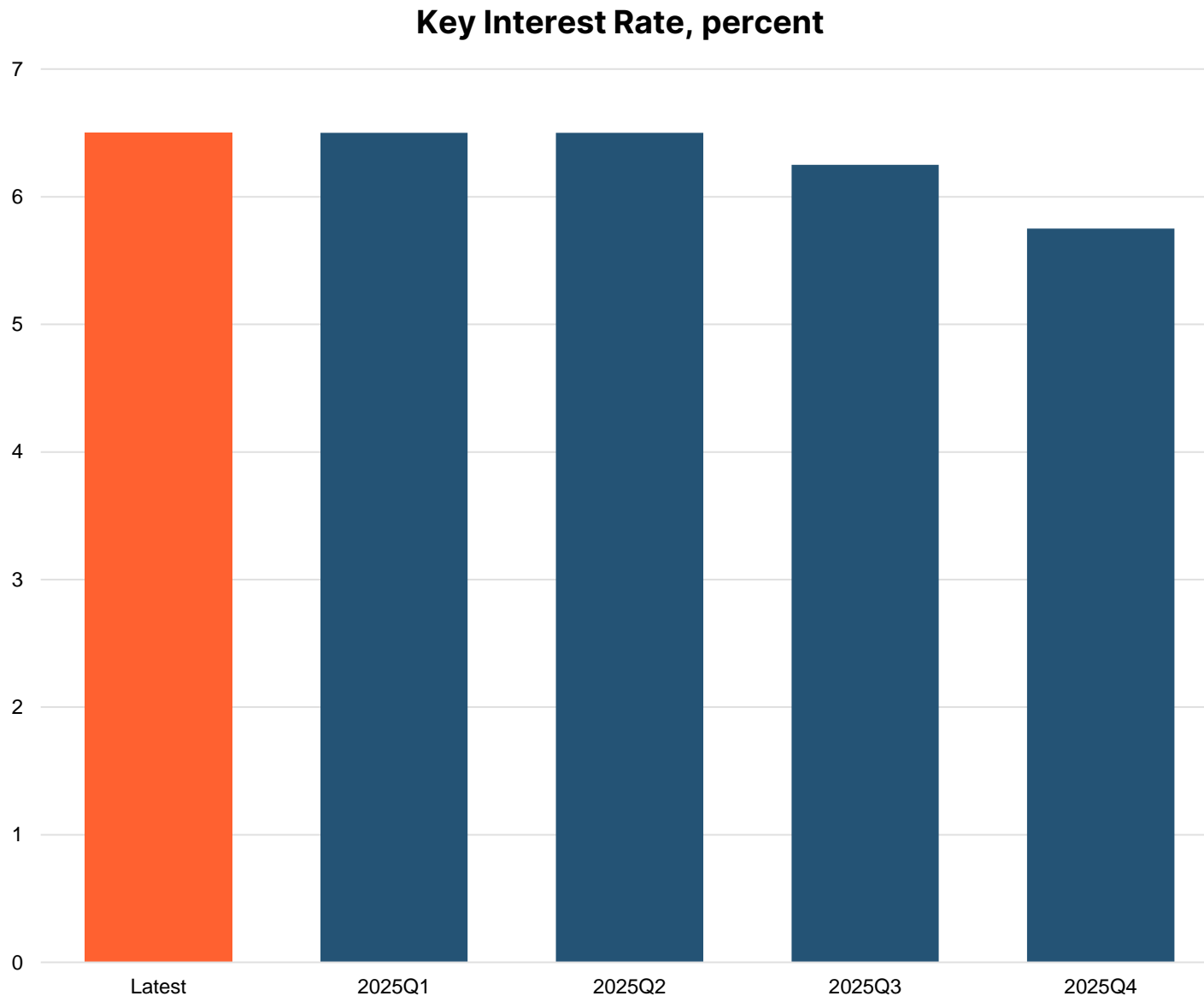


Monthly inflation development, y/y percent



The slow disinflation process continued through most of 2024, driven by lower food price inflation, predominantly its core components, and lower energy prices. A bad agricultural year pushed food prices higher and triggered a trend reversal toward year-end. Strong wage growth also translated into sticky services and non-food components. Core inflation stagnated toward the end of the year, mainly due to the core food component. We forecast headline inflation at the end of 2025 at 3.7% y/y, down from 5.1% y/y at the end of 2024, and we expect it to re-enter the target band only in 2026. Core inflation is projected to mostly hover above headline inflation throughout this year and end at 4.0% y/y. Fiscal policy remains the primary idiosyncratic source of uncertainty for the inflation outlook. We believe that additional fiscal measures are needed to reach the assumed deficit target in 2025, and whether those measure will have an influence on inflation remains to be seen. The cap on electricity is due to expire mid-2025, while for gas prices 1Q26, and it is unclear what will happen afterwards. However, our baseline is that a solution will be found to not significantly affect consumer prices. The ongoing “tariff war” between the US and several countries adds an extra degree of uncertainty. On the other hand, lower Brent prices could be a source for a positive surprise regarding

Monetary policy



The NBR delivered two 25bp cuts in summer last year, but opted for hold decisions at subsequent meetings in 2024. The inflationary risks and political noise most likely were behind the NBR's cautious approach. The key rate is currently at 6.50% and we expect the next rate cut of 25bp at the August meeting; we see the end-2025 key rate at 5.75%. We expect the NBR to wait for the presidential elections, especially considering the multitude of risks and uncertainties regarding the inflation trajectory. The current monetary conditions are considered restrictive in the NBR's view. We agree with this statement, as we see the real neutral rate at around 1.8% and the exchange rate remains about 7-8% overvalued.

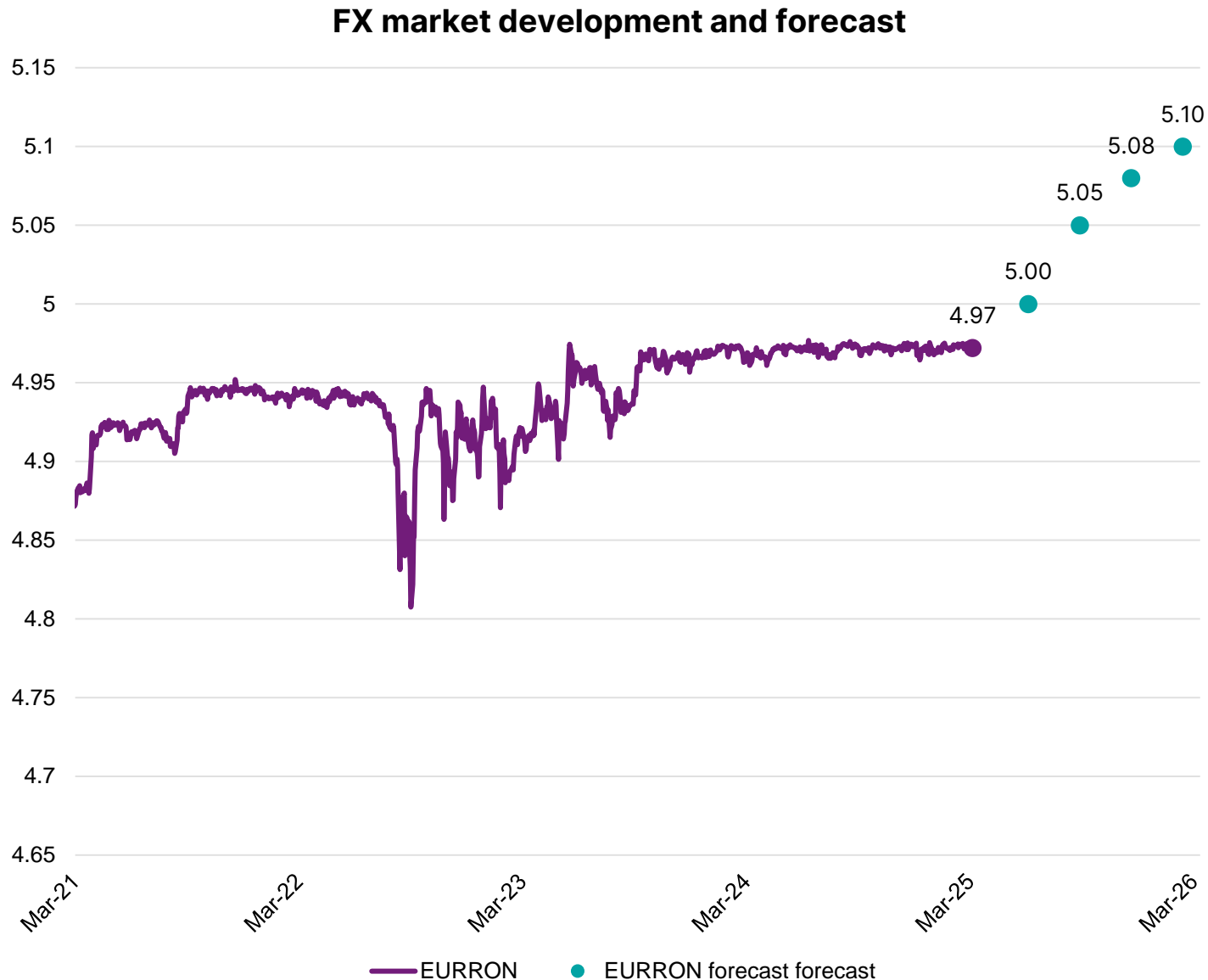
Yields and spreads

The general expectation was that 2025 - following the heavy election cycle - would mark the start of much-needed fiscal consolidation under the seven-year plan agreed upon with the European Commission. However, political instability disrupted these expectations, triggering a significant repricing at the end of 2024. In response, rating agencies acted swiftly, with two out of three changing Romania's credit rating outlook to negative. Gross funding needs for 2025 are estimated at approximately RON 232bn, with net issuance expected to account for about half, of which around 60% is likely to be financed domestically. Our models indicate that 10-year ROMGBs are currently undervalued, and we see gradual adjustment in the coming quarters. Some positive news is needed for a significant rally to happen. We see the curve as too flat currently, with the fair value of the 10Y-2Y spread estimated above

10Y yield development and forecast



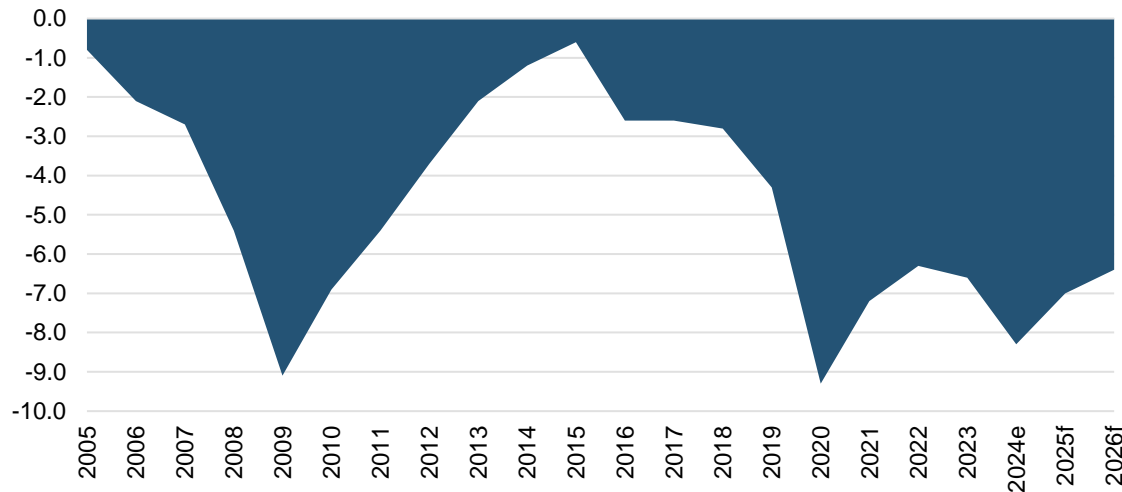
FX market



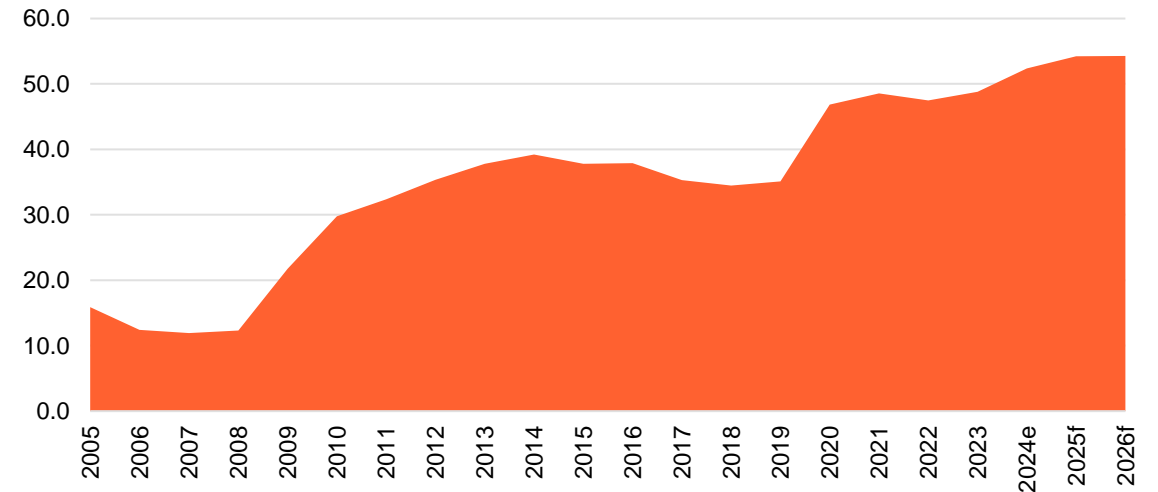
Back in November, the NBR governor mentioned that, based on the central bank's real effective exchange rate measures, which were due for public release, the RON is up to 5% overvalued. In the meantime, the domestic political turmoil prompted the central bank to hold on to its FX policy anchor, which was firmly adopted due to Covid, the Russian invasion and subsequent energy crisis. At the February press conference, the governor said that there was not yet the right timing for a weaker RON, given the tense domestic political backdrop. He added that, once the political tensions subside and confidence returns, the central bank could gradually become more flexible towards a weaker RON. Our models currently evaluate the EURRON as 7-8% overvalued. We see RON depreciation as only gradual, even after macro and political conditions become more favorable. High FX passthrough into consumer prices is one of the main reasons.

Fiscal situation

Budget balance, percent of GDP



Public debt, percent of GDP

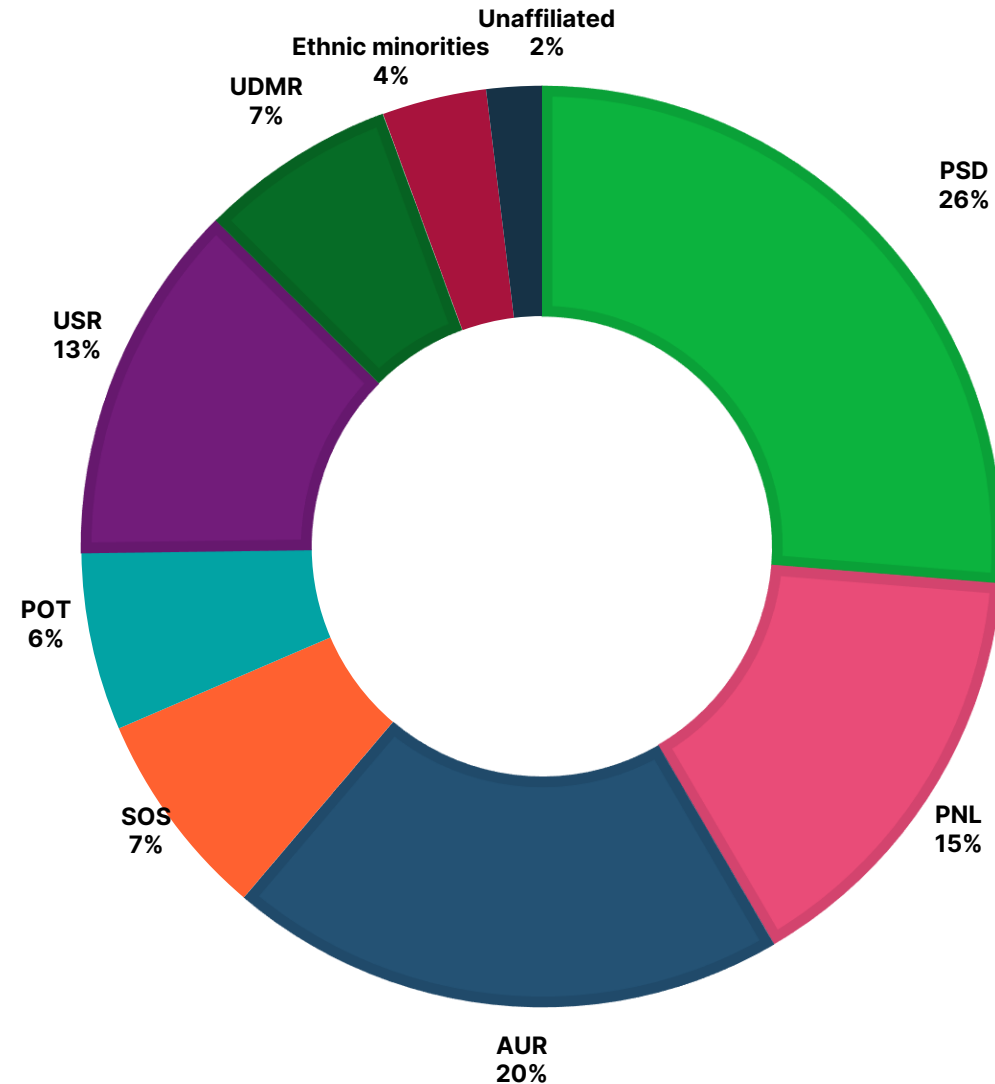


Romania ended 2024 with a budget deficit of 8.7% of GDP in cash terms and will likely have one of the largest budget deficits in the EU in 2024. By the latter half of the year, markets had largely priced-in in this deficit. The initial budget target for 2025 aims for a deficit of 7.0% of GDP, implying a fiscal consolidation of around 1.7pp. The government already implemented measures to curb public spending and increase revenues in late 2024, with an estimated impact of approximately 2pp of GDP. Considering the structure of the budget and the full implementation of public pension recalculations this year, achieving the 2025 target appears somewhat ambitious. Additional fiscal consolidation measures of around 0.8pp may be necessary. Budget revenues are projected to rise by about 2.3pp of GDP in 2025, with improved tax collection contributing roughly 0.5pp. Given these factors, the 7% deficit target seems optimistic. After the presidential elections, the government will likely explore further fiscal measures, balancing revenue increases with expenditure controls, while also aiming to support economic growth. EU funds absorption is very important for this year's budget expectation. The 7-year fiscal consolidation plan agreed with the European Commission needs to be implemented, as the patience of both rating agencies and investors is getting thin. A rating downgrade this year is not our baseline scenario, but without meaningful fiscal consolidation, it is a risk that cannot be ruled out.

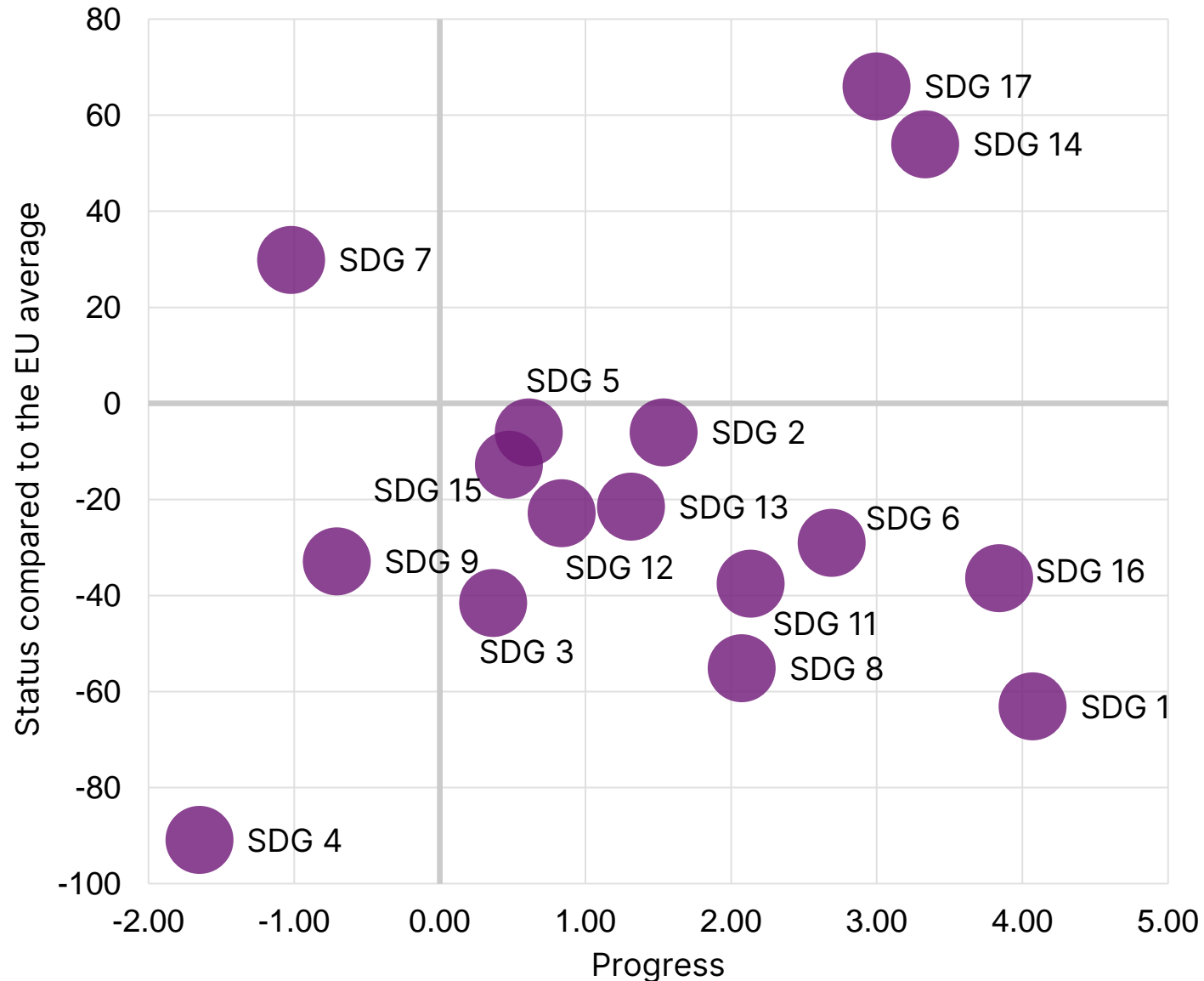
Political landscape

The current government coalition holds roughly 52% of Parliamentary votes. The political consensus is that fiscal consolidation is needed, and the 7-year plan agreed with the European Commission needs to be implemented. EU funds absorption is also a priority for the current government. The rescheduling of the presidential elections to May is expected to dampen reform appetite in the first half of 2025. The Constitutional Court's ruling barred Georgescu from the presidential race. Georgescu's apparent hesitation to endorse other far-right candidate increases the likelihood of a runoff between the two mainstream contenders, Dan and Antonescu. This prospect is likely to be market-positive, though the political backdrop remains highly fluid. While the emergence of another far-right candidate is still possible, such a candidate is unlikely to garner the same level of popular support as Georgescu and stands lower chances of winning in the second round. The situation remains hard to predict, but the backstop of a 65% strong pro-EU majority in the Parliament should limit a significant short-term negative change.

Parliamentary seats



Social Development Goals



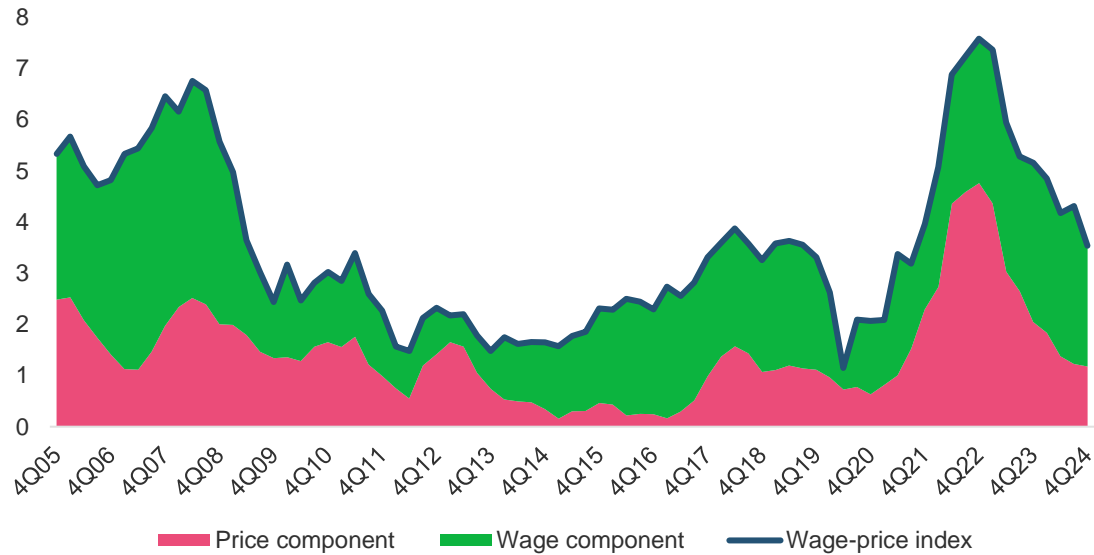
Romania performs better than the EU average and is making progress in two Sustainable Development Goal (SDG) areas: Partnerships for the Goals and Life Below Water. While Romania shows improvement in most other SDGs, it starts from a weaker position compared to the EU. Notable progress has been made in No Poverty and Peace, Justice, and Strong Institutions, where its performance stands out positively. However, Quality Education and Industry, Innovation, and Infrastructure remain key challenges. Romania not only lags the EU average in these areas, but is also moving further away from achieving the SDGs. To address these gaps, Romania needs to fully utilize EU funds and undertake significant reforms to its economy and society, particularly as part of its efforts toward OECD accession.

Wage-price spiral risk

Wage growth in Romania has been a serious challenge for the NBR in 2024. Services inflation remains persistent, and concerns grew in the second half of last year about a potential wage-price spiral. Using a relatively new approach, we demonstrate that the risk of a wage-price spiral remains high and that it likely occurred at least once in the past two to three years.

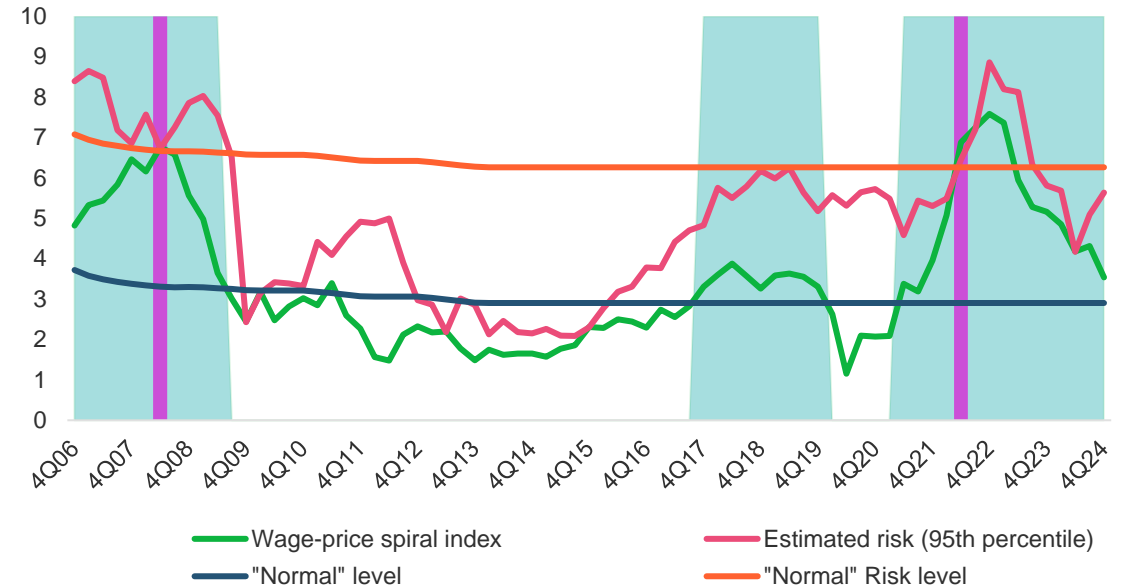


Macro-at-risk approach: Evidence of wage-price spiral manifesting in recent years



Following the methodology proposed by Franta and Viček (2024), a wage-price index was constructed using annual growth rates of private sector wage growth and CPI adjusted for the first-round effects of VAT changes and accounting for historical volatility.

Recent evolution shows that the price component had a large contribution in 2022 and 2023, but recently wages are growing at an accelerated pace.



(the green shaded zones indicate periods were wage-price index situated above the "normal" level; the purple bars indicate periods where it was above the "risk level")

Using a quantile regression estimation method, the evolution of the 95% percentile of the index was estimated. Several macro variables were included in the estimation to account for exogenous shocks and more robust coefficients.

The results reveal three periods of increased risk of wage-price spiral, which are highlighted in the chart. The most recent one started in 2Q21. The risk remains elevated currently.

Romania: Forecasts

	2018	2019	2020	2021	2022	2023	2024e	2025f	2026f
Percent				Annual average					
Real GDP growth	6.1	3.9	-3.7	5.5	4.0	2.4	0.9	2.0	3.4
Private consumption growth	10.3	3.0	-3.8	7.3	5.2	2.8	5.9	2.0	2.2
Fixed capital formation growth	-1.8	14.9	-0.5	4.0	5.4	14.5	-1.7	4.0	5.7
Inflation	4.6	3.8	2.7	5.1	13.7	10.5	5.6	4.4	3.2
Unemployment rate	5.3	4.9	6.1	5.6	5.6	5.6	5.5	5.3	5.2
Percent of GDP									
Budget balance	-2.8	-4.3	-9.3	-7.2	-6.3	-6.6	-8.3	-7.0	-6.4
Public debt	34.5	35.1	46.8	48.5	47.5	48.8	52.4	54.2	54.3
Current account balance	-4.6	-4.8	-5.1	-7.2	-9.5	-6.6	-8.3	-7.8	-6.8
				End of year					
EURLCY	4.66	4.78	4.87	4.95	4.95	4.97	4.97	5.08	5.18
Central bank policy rate	2.50	2.50	1.50	1.75	6.75	7.00	6.50	5.75	4.50
3M interbank offer rate	3.0	3.2	2.0	3.0	7.6	6.2	5.9	5.1	4.4
2Y Yield	3.7	3.6	2.5	4.2	7.0	6.1	6.9	6.3	5.8
5Y Yield	4.3	3.9	2.6	4.8	7.8	6.2	7.2	6.6	6.1
10Y Yield	4.8	4.4	3.0	5.1	8.2	6.2	7.4	6.8	6.3

Romania: Country overview

Official EU language: Romanian

Capital: Bucharest

Geographical size: 238 398 km²

Population: 19 064 409

GDP per capita: EUR 17 000, below the EU average

Currency: Romanian leu RON

Credit Ratings:

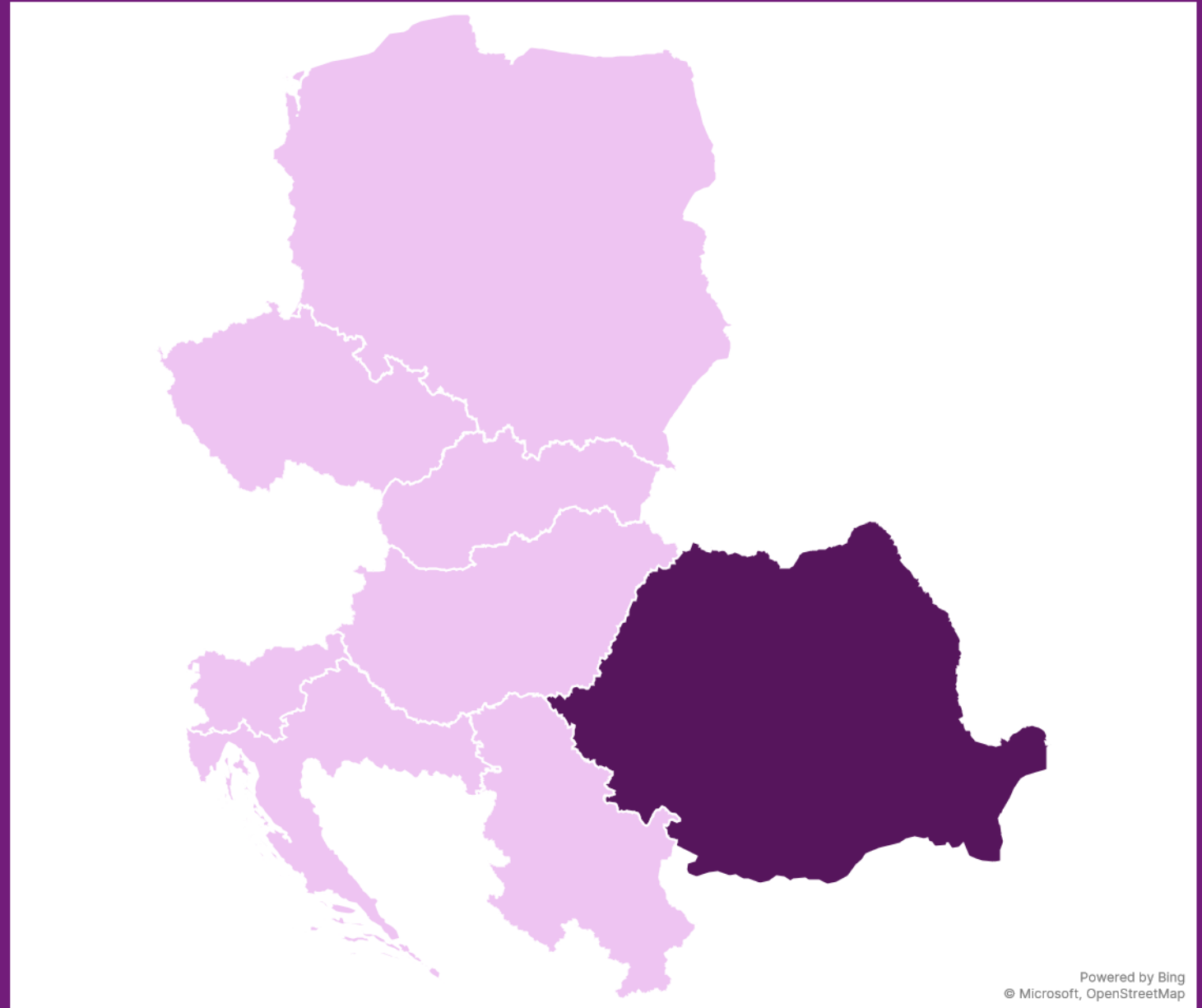
Moody's: Baa3, outlook stable

S&P: BBB-, outlook stable

Fitch: BBB-, outlook stable

EU member state: since 1 January 2007

Schengen: expected membership as of January 2025



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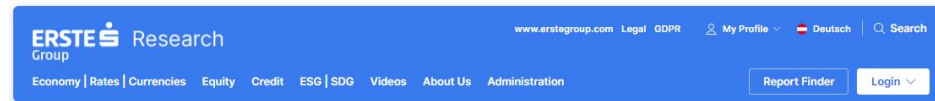


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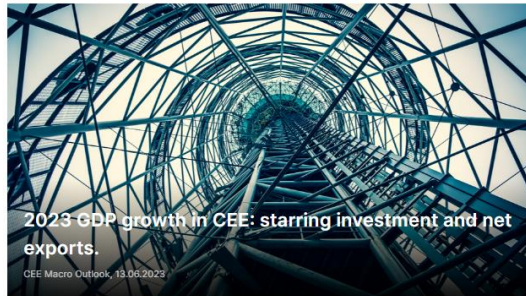


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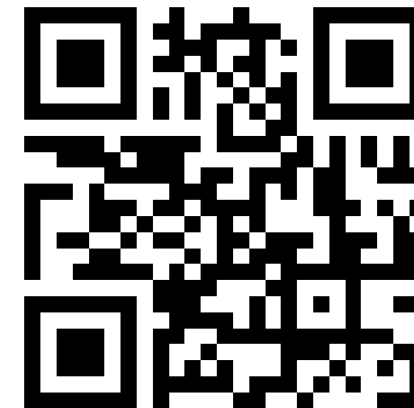
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