



Weekly Briefing

**Romania Economy briefing:
Moody's rating confirmed at Baa3 for Romania, but downward
revisions for the GDP growth
Oana Cristina Popovici**

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

 1052 Budapest Petőfi Sándor utca 11.

 +36 1 5858 690

 office@china-cee.eu

 china-cee.eu

Moody's rating confirmed at Baa3 for Romania, while institutions announce downward revisions for the GDP growth

The economic events were less effervescent during the summer, with the exception of the first budget amendment for 2018 and the analysis of the Moody's rating agency on the Romanian economy on the occasion of announcing that it maintains the country rating at Baa3. The GDP growth is reconfirmed at 4% in the first semester of this year and the budgetary deficit ameliorated as compared to the last official statistics, based on revenues due to seasonality and a new nominal GDP forecast. Still, there are fears that the actual level of social expenses is hard to be supported in the long run, which could lead to a budgetary deficit that will exceed the limits. Moreover, several institutions announced downward revisions for the GDP growth in the following period.

The National Institute for Statistics confirmed the GDP growth at 4% in the first semester of 2018, based especially on the good evolution of industry and trade. The Moody's rating agency forecast a similar level of economic growth for the entire year (of 4%), while it expects a decrease of the economic dynamics in 2019, where the GDP growth is forecasted to hit 3.5%. The decline from a peak of 6.9% in GDP growth in 2017 points to the lack of sustainability of a growth beyond potential in the last year, according to the agency. In addition, Moody's rating agency maintains the Baa3 rating for Romania's long and short-term government debt in both foreign and local currency, previously established in 2017.

The analysis of the institution points to several strengths, such as a moderate growth potential, that is enhanced by a low level of the governmental

debt (35% of the GDP at the end of 2017) and a future amelioration of the investments. Still, private consumption will remain the main factor supporting growth. On the other hand, the weaknesses are attributed to the lack of structural and governmental reforms, especially those related to the improvement of the business environment and the development of the infrastructure.

Several threats were identified, which could lead to the deterioration of the rating in case of misbehaviour of the institutional framework, worsening of fiscal trends and increase of the macroeconomic imbalances with negative effects on the balance of payments and the international investment position. Among these, pro-cyclical fiscal policies could affect the level of the public debt and the fiscal capacity, while a potential significant exchange rate depreciation could have important negative effects on the debt dynamics, since more than half is denominated in foreign currency. In addition, the lately tensions with the EU related to the fiscal decisions and judicial reforms could compromise the credibility of policies and therefore affect the investors' perception related to Romania, which will increase the country's sensitivity to external events.

Alejandro Hajdenberg, the IMF representative for Romania and Bulgaria, also considers that Romania will be less prepared in the case of a negative shock, due to the fact that the structural deficit is deteriorated as a result of one of the largest fiscal expansion in Europe and the decrease of the funds directed towards investments. Instead, Romania's representatives are more optimistic. In a meeting with the foreign investors, the Deputy Prime Minister Viorel Stefan drew the attention that Romania is underestimated and undervalued by the financial markets. Instead, the perspective of growth on the long term is brighter, especially due to solid fundamentals which could further improve if accompanied by investments in infrastructure.

The major issue for Romania in this period is to keep the budgetary deficit below 3% of the GDP, therefore the situation of the deficit is carefully monitored. The most recent data show that the deficit of the consolidated general budget reached 1.26% of the estimated GDP for the current year in the

first seven months, namely almost 12 billion lei, as compared to only 0.6% of the GDP in the first half of the previous year. Although the comparative situation points towards a negative situation, the deficit is lower with 0.35% of GDP as compared with the last statistics, mainly due to increased revenues as a result of seasonality (such as profit tax or non-tax revenues) and the new forecasted GDP for the current year, higher in nominal value, which is rather influenced by the high level of inflation Romania recorded in the last period. The good news is that the revenues from taxes increased by 0.6% of GDP, representing 17% of the GDP. Still, the expenses also followed a growth path, representing 18.3% of GDP. This points to the fact that the deficit is caused by the way of allocating expenses, rather than poor efforts in collecting money. In fact, some analysts point that the budget could have been balanced if the pace of expenses would have followed the economic growth. Expenditures for investments, including capital expenditures, as well as those related to development programs financed from domestic and external sources, were 29.8% higher than in the same period of the previous year. At present, the largest increase of expenses as compared to the last year have as destination the supplementation of the public servants' payments and social assistance, while less than a quarter are additionally allocated to projects with non-reimbursable external financing, capital expenditures, goods and services. There are some opinions suggesting that the amount of the social expenses is hard to be supported on the long term, especially in the view of the future pension law; the solution would be to either increase taxation, either to reduce investment. Another problem that should be supervised are the payments for the interest rates, which grew by 20% as compared to the same period of the last year, although the public debt amounts to only 35% of the GDP.

The Government adopted, at the beginning of September, the first budget amendment for 2018. As compared to the budget draft firstly presented in August, for the rectification that was then postponed, the amount allocations are being changed to almost all the important chapters. The consolidated budget

revenues are revised upwards, with 8.8 billion lei, as compared to the version of the rectification in August (6 billion lei), while the expenses will see an increase by 9.9 billion lei (as compared to 7.09 billion lei, previously). The amendments to the budget stipulate an increase of revenues for the personnel, social assistance and goods and services expenditures in the state budget, while the most favoured ministries are those of Finance, Interior, Health, Communication, Education and Transportation. Instead, the Presidential administration and special services saw their budget cut. Under these circumstances, the budget amendments were discussed in a meeting of the Country's Supreme Defense Council (CSAT), as their approval is mandatory whenever the budgets of the institutions in the field of national security are affected. Due to the fact that unanimity and consensus for rectification could not be obtained, the meeting was suspended. Still, the Government adopted the rectification of the budget, based on the consideration of the minister of Justice that the government is responsible for requesting the CSAT's approval but is not bound to wait for it.

The Government justifies that the delay in the budget rectification will have negative effects on providing the public wages, will hinder investments and will affect the compensation provided to farmers affected by swine fever. In response, the President declared that the government is forcing the limits of the Constitution and has asked the Ombudsman to seize the Romanian Constitutional Court in this matter. Analysts consider that the revenues forecasts are even more optimistic than in first draft of the budget amendment, and the VAT revenue projections are even more resilient.

At the moment, Romania remains under the sign of the doubtfulness related to its capacity to frame in the limits of a budgetary deficit no larger than 3% of GDP. Not only institutions, but also banks are under the process of re-examining the economic growth for this year. The representatives of Raiffeisen Bank consider that the actual growth forecast of 4.2% is optimistic and will be reduced below 4%. BCR, the largest bank in Romania, maintains the forecast of growth at 4.1%, but also warns that the new official data indicates increasing

risks that could determine a lower performance. IMF representative for Romania and Bulgaria announced that the economic growth of Romania, previously estimated at 5.1%, will be revised downwards towards 4-4.5% in October. In an analysis related to the capacity of Romania to face a new economic crisis, in which the evolution of the last 10 years is observed, the deputy governor of the National Bank of Romania, Liviu Voinea, considers that Romania is more developed and better prepared to cope with external shocks, but the risks stemming from domestic policies remain. Therefore, the economic growth projected by the Government at 5.5% is quite unlikely. The problem is that, even if the economic policies will remain unchanged until the end of the year and if the rectified budget will be executed, the probability of exceeding the 3% of GDP deficit threshold is very high, according to Ionut Dumitru, the president of the Fiscal Council.