IMF Country Reports 22/310

Romania: 2022 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Romania

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 22/310

ROMANIA

September 2022

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ROMANIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with Romania, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 21, 2022, consideration of the staff report that concluded the Article IV consultation with Romania.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 21, 2022, following discussions that ended on June 10, 2022, with the officials of Romania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 29, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Romania.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2022 Article IV Consultation with Romania

FOR IMMEDIATE RELEASE

WASHINGTON, DC – September 21, 2022

On September 21, 2022, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Romania.

After a solid recovery from the pandemic, Romania is now, like other EU countries, facing headwinds related to the war in Ukraine, with further spillovers due to its proximity. In the run-up to the war, output had reached pre-crisis levels in H1 2021 and growth in H1 2022 remained strong. Driven primarily by the energy price shock and its impact on associated goods and services, headline inflation has risen rapidly. Inflation expectations have risen more moderately but are also above the target band (1.5-3.5 percent). Nonetheless, the labor market remains less tight than pre-pandemic levels. The authorities have implemented an energy price cap and subsidy scheme to help alleviate the pressures on the economy and the vulnerable.

Given this backdrop, GDP growth is expected to moderate to 4¾ percent in 2022 (2021: 5.9 percent), supported mainly by momentum in domestic demand. Energy and food prices are expected to keep inflation relatively elevated until the end of 2023. The fiscal deficit narrowed in 2021 after the pandemic-induced widening and is projected to consolidate moderately further in 2022 as nominal revenue growth has been strong. The current account deficit is projected to remain elevated, but the rebound in FDI and the start of the EU-supported National Recovery and Resilience Plan provide substantial funding, with the latter anchored to a path for reforms and growth-enhancing investment into the medium term. Monetary and financial sector policies have more than reversed the pandemic easing and have further tightened to buttress price and financial stability.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Romania's strong economic recovery from the pandemic but noted that the spillovers from Russia's war in Ukraine—mainly through indirect channels—and tighter financial conditions have clouded the outlook with downside risks and higher uncertainty. Against this backdrop, Directors underscored the importance of implementing

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

prudent macroeconomic policies that safeguard macroeconomic stability and of reenergizing structural reforms to boost economic growth.

Directors stressed the need to pursue medium-term fiscal consolidation to rebuild buffers, safeguard fiscal sustainability, and reduce external imbalances. They generally agreed that the current energy price caps should be temporary and encouraged the authorities to gradually phase them out and replace them with measures targeting the most vulnerable. To help improve medium-term budgeting and ensure predictability, Directors recommended reforms to pensions and public sector wages. While welcoming the recent tax measures, they encouraged the authorities to consider a more ambitious reform of the personal income tax and improvements to the efficiency of the value added tax.

Directors stressed that monetary policy needs to stay nimble to firmly guide inflation and inflation expectations back toward the central bank’s target. They agreed that policy rates will need to rise further to prevent the entrenching of inflationary pressures and the emergence of a wage-price spiral. Noting the weakening of external competitiveness and the rising current account deficit, Directors encouraged gradually moving toward a more flexible exchange rate that—together with fiscal consolidation—would help address external imbalances and absorb potential future external shocks. Directors agreed that the banking sector remains resilient and that the macroprudential stance is appropriate. They called for continued vigilance of financial stability risks and for further strengthening the AML/CFT framework.

Directors stressed the need to reenergize structural reforms to boost economic growth and address regional inequalities. In this context, they emphasized the importance of implementing Romania’s National Recovery and Resilience Plan while further strengthening public investment management to make the most out of the funds available under the European Recovery and Resilience Facility. They underscored that reforms in the areas of green transition and energy security, digitalization, health and education, as well as governance and anticorruption are especially critical.

It is expected that the next Article IV consultation with Romania will be held on the standard 12-month cycle.

Romania: Selected Economic Indicators

Population: 19.3 million (2020)
Quota: 1,811 million SDRs (0.4% of total)

Per capita GDP: US$14,667 (2021)
Literacy rate: 99% (2019)
People at risk of poverty: 31.2% (2019)

Key export markets: European Union (Germany, Italy, France)
Main products and exports: Machinery and transport equipment, manufactured goods

	2020	2021	2022	2023
			Proj.	
Output				
Real GDP growth (%)	-3.7	5.9	4.8	3.4
Output gap (%)	-2.3	-0.6	0.2	0.0
Employment				
Unemployment (%)	6.0	5.6	5.7	5.5
Prices				
CPI inflation (%, period average)	2.6	5.0	13.3	10.0
General government finances (% GDP)				
Revenue	28.8	30.6	31.4	30.6
Expenditure	38.6	37.5	38.2	35.7
Fiscal balance	-9.8	-6.9	-6.4	-5.1
Primary balance	-8.5	-5.4	-5.2	-3.4
Structural fiscal balance 1/	-5.3	-7.6	-6.1	-4.9
Public debt (including guarantees)	49.6	51.4	51.7	52.0
Money and credit				
Broad money (% change)	15.3	15.8	15.1	12.5
Credit to the private sector (% change)	5.5	14.8	17.2	12.8
Policy rate (%)	1.5	1.75	...	...
Balance of payments				
Current account (% GDP)	-5.0	-7.0	-7.7	-7.4
FDI (% GDP)	-1.4	-3.0	-2.5	-2.7
Reserves (months imports)	4.6	4.2	3.6	3.1
External debt (% GDP)	57.9	55.9	52.2	51.0
Exchange rate				
REER (% change), CPI based	1.5	0.9	...	...

Sources: Romanian authorities, World Bank, Eurostat and IMF staff calculations.
1/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.

INTERNATIONAL MONETARY FUND

ROMANIA

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

July 29, 2022

KEY ISSUES

Context: After a solid recovery from the pandemic, Romania is now, like other EU countries, facing strong headwinds related to the war in Ukraine. Output reached pre-crisis levels in H1 2021 and growth in Q1 2022 was strong. But inflation has risen rapidly, and the external and fiscal positions are weak. The authorities are implementing a support package of energy price caps and subsidies for vulnerable groups.

Outlook and risks: Lower demand from EU trading partners, lower private investment, and the adverse impact of higher inflation on consumption are expected to moderate growth to around 4 percent in 2022. Key risks include further spillovers from the war, in particular an EU-wide shut-off of Russian gas, and financial conditions tightening further.

Key Policy Recommendations:

- *Fiscal consolidation:* Rising public debt and financing costs require ambitious medium-term consolidation, including strong revenue measures. Reform of income and property taxes is needed, and removing exemptions and loopholes, to make the system more efficient and fair. Strengthening revenue administration and broadening the base would raise VAT efficiency. Taxing carbon emissions—once the current price spike has abated—would support the green transition.
- *Phasing out energy price caps.* While targeted support for the vulnerable is needed, pricing policies should incentivize energy conservation and avoid an abrupt increase in prices when the current price cap scheme expires in April 2023.
- *Monetary policy:* The National Bank of Romania should firmly guide inflation and inflation expectations back toward its target band. Continuing the recent pace of policy tightening is appropriate, while standing ready to react flexibly to evolving conditions. Gradually increasing exchange rate flexibility is warranted.
- *Absorbing EU funds:* The authorities will need to make every effort to strengthen public investment management to ensure that the large available EU funding is efficiently utilized.
- *Structural reforms:* A broad range of structural reforms in the areas of digitalization, anti-corruption efforts, and health and education, is needed to boost Romania’s growth potential.

Approved By **Jörg Decressin (EUR) and Eugenio Cerutti (SPR)**	Discussions for the 2022 Article IV consultation were held in Bucharest during May 30 – June 10, 2022. The mission team comprised Mssrs. Martijn (head), Pitt, Toh (all EUR), and Norton (MCD), and Ms. Babici (local economist). Mmes. Cerrato, Pardi and Zhao assisted from headquarters. Mr. Voinea (OED) joined part of the discussions.

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