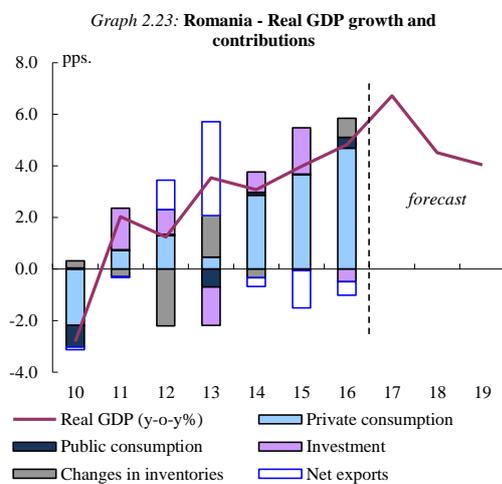


2.23. ROMANIA: CONSUMPTION-DRIVEN BOOM

Economic growth in Romania accelerated in 2017, with real GDP estimated to have grown by 6.7% (y-o-y) - a post-crisis high. The main driver of growth was private consumption, supported by indirect tax cuts and wage hikes both in the public and the private sectors. After contracting in 2016, total investment started to grow again in 2017. Its pace of recovery, however, remained subdued as public investment fell sharply for the second consecutive year. The boom in private consumption has led to an increase in imports. As a consequence, net exports have acted as a drag on real GDP growth, despite relatively strong export growth.

Looking ahead, GDP growth is forecast to decelerate to 4.5% in 2018 and 4.0% in 2019. The growth of private consumption is expected to be more tempered in 2018, as inflation weighs more heavily on real disposable incomes and wage growth slows down. Nevertheless, private consumption is expected to continue acting as the main growth driver over the forecast horizon. Investment is forecast to strengthen on the back of a pick-up in the implementation of projects financed by EU funds.



Labour market conditions have been improving in line with the economic expansion. In 2017, the unemployment rate dropped to its lowest level in more than 20 years. The tight labour market, together with a 16% minimum wage hike in February 2017 and public sector wage increases, led to faster wage growth. Overall, average net wages are estimated to have increased by around 13% in real terms in 2017. Real wages are expected to continue growing in 2018, albeit at a slower pace, due to further increases in public wages and an additional 9% hike in the net minimum wage taking effect in January.

After two consecutive years of falling consumer prices, inflation turned positive in 2017, despite being dampened by VAT rate cuts and lower excise duties on fuel. Inflation started to accelerate in the second half of the year, mainly on account of rising food and energy prices. In December 2017, HICP inflation was 2.6% (y-o-y), while core inflation stood at 1.9%. Headline inflation is projected to further pick up as demand pressures mount and the effect of the January 2017 tax cuts fades away. The reversal of the January excise duties cut in October 2017 should further push up inflation this year. Thus, inflation is forecast to be 4.1% in 2018 and 3% in 2019. As inflation re-entered its target band (2.5% \pm 1 pp.), the National Bank of Romania has started to tighten its highly accommodative monetary policy. In January 2018, the key monetary policy rate was raised by 0.25 pps. to 2%, the first rate hike since 2008.