Economic Alert iQ

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Research & Analytics

Friday 16th March 2018 – 10:55am
International
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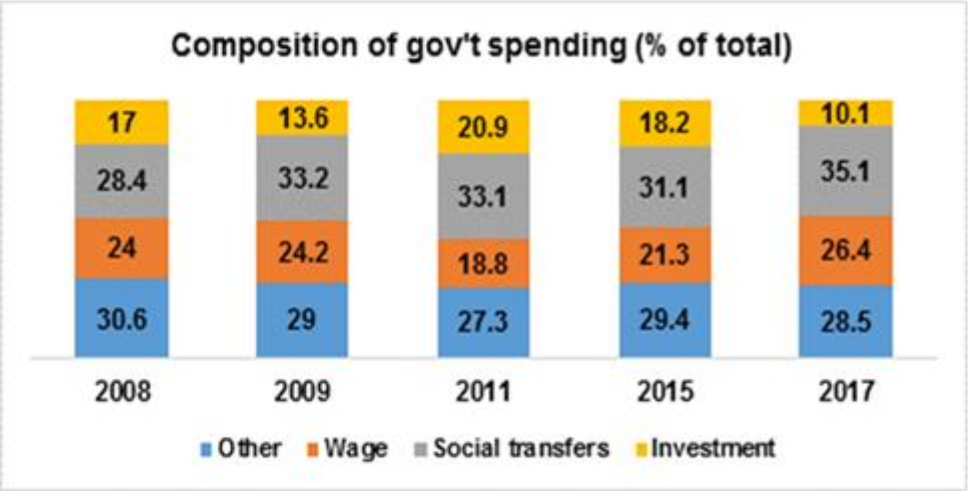
Economic Alert: Romania: IMF Staff Concluding Statement of the 2018 Article IV Mission

- On March 16, 2018, the IMF released its preliminary findings following its official staff visit to Romania.
- Romania's economic growth surged to 7% in 2017, the highest recorded in the European Union (EU). The strong growth has been fueled by domestic consumption, on the back of a multi-year fiscal expansion and minimum wage hikes. An improving EU economy combined with an accommodative monetary policy stance also contributed to the strong growth.
- The current account deficit widened, as expanding imports offset the improving demand for Romania's exports.
- A tight labor market in Romania is expected to result in private sector wages growing at double-digit rates.
- The inflation target of the National Bank of Romania (NBR) of 2.5% was met in 2017, but inflation rose to around 4.7% in February.
- As stated by the IMF, growth is expected to decelerate from last year's high level due to multiple factors; a waning fiscal impulse, low public investment, slow progress on structural reforms, and tightening financial conditions.
- GDP growth is projected to be about 5% in 2018 and to slow towards 3% over the medium term.
- Global financial volatility, further deterioration in fiscal and external balances, or weakening of institutions could dent investor confidence in Romania.
- The IMF noted that the continuation of current expansionary policies would undermine the country's capacity to withstand a severe shock.
- A prudent mix of fiscal consolidation and monetary tightening would avert overheating, while reducing the fiscal and external deficits, and enhancing macro-financial stability.
- As indicated by the IMF, monetary policy needs further tightening to rein in inflation and anchor expectations, given the pressure from global energy prices, strong domestic demand, a tight labor market, and recent currency dynamics.
- The recent monetary tightening was welcomed, and the IMF encouraged the NBR to continue raising the policy rate, while also managing liquidity to align the market and policy rates.

- The IMF noted that a smaller fiscal deficit is warranted, given the strong cyclical upswing. The deficit should be reduced below a cyclically neutral level in the short run and further to 1.5% of GDP by 2020, contributing to a smooth return to Romania's medium-term budgetary objective (MTO) under its EU commitments.



Source: International Monetary Fund (IMF)

- Romania's comparatively low (and declining) tax revenue as a share of GDP underscores the importance of effective revenue mobilization and expenditure management.
- The IMF stated that Romania's progress on the fight against corruption has been recognized internationally, and needs to continue. Reducing corruption would help improve government revenue, enhance spending efficiency, and strengthen competitiveness.
- Banks are well capitalized and liquid, profitability is increasing, and non-performing loans (NPLs) have declined to 6.4% of total loans in December 2017, close to the EU average.
- Potential new risks to financial stability arise from the high exposure of banks to the Romanian sovereign and to the real estate sector, banks' funding in foreign exchange (FX), and the fast growth of non-bank financial lenders.

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