ROMANIA

ALPHA BANK

ECONOMIC & FINANCIAL OUTLOOK

ECONOMIC RESEARCH DIVISION

SEPTEMBER 2022

The Romanian economy rebounded strongly in 2021, as the Gross Domestic Product (GDP) increased by 5.9%, fully recovering to its pre-pandemic level. However, Russia's invasion of Ukraine clouds the economic outlook for EU Member States. Romania's trade and financial relations with Russia and Ukraine are limited. However, the war intensified the already existing inflationary pressures, due to higher energy and commodity prices, as well as supply chain disruptions. Risks to the outlook are tilted to the downside and are linked with the implications of the energy crisis. On the other side, the implementation of the national Recovery and Resilience Plan (RRP) is an upside risk, as it is expected to support investment. The fiscal position - which deteriorated drastically following the outbreak of Covid-19- remains a challenge, with a large negative primary balance expected in 2022. Overall, economic output is expected to increase in 2022, despite the high degree of uncertainty.

(cut-off date 31.07.2022)

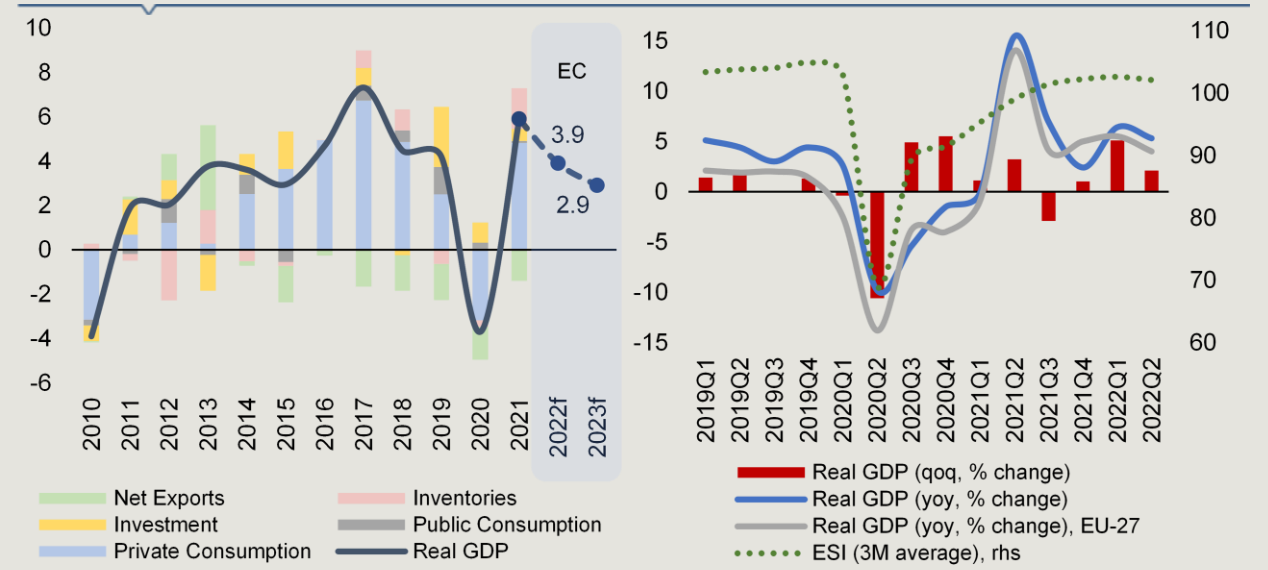
Impressive V-shaped recovery in 2021, positive albeit weakened outlook for 2022

Following the recession in Romania in 2020 (-3.7%), real GDP increased by 5.9% in 2021 (Graph 1), surpassing pre-pandemic levels. On the expenditure side, domestic demand was the main driver of GDP growth, as the country's main trading partners such as Italy, Germany and France and therefore the external sector of the economy, recovered only partially. Private consumption rose by 7.9% in 2021, making the largest contribution to overall GDP growth (4.8 pps), as the improved economic sentiment supported household spending. Gross fixed capital formation, which increased in 2020 (4.1%), remained on an upward trajectory, rising by 2.3% in 2021 and contributing 0.6 pps to real GDP growth. Inventories and public consumption (0.4%) added 1.8 pps and 0.1 pps to real GDP growth. Net exports contributed negatively to GDP growth by 1.4 pps, as imports of goods and services (14.6%) respectively, fueled by robust domestic demand, increased more than exports (12.5%). Net exports have had a negative contribution to real GDP growth since 2014. On the resources side, agriculture, industry, services, and net taxes on products contributed positively to growth at 0.5 pps, 1pps, 3.7pps and 0.8 pps, each, while construction contributed negatively by 0.1 pps. Robust real GDP growth ensured Romania continued to make progress in its in convergence with the EU-27, in terms of GDP per capita (in PPS). Standing at 52% of the EU-27 average in 2010, GDP per capita in Romania increased to 73% in 2021 and has followed an upward trajectory over the last decade.

Despite a strong rebound in 2021, GDP growth lost momentum in the final quarter of the year, as the rising prices, the resurgence of Covid-19 and a political turbulence in October-November 2021 weighed on economic activity. However, real GDP increased by 6.4% y-o-y and 5.1% q-o-q (seasonally and calendar

GRAPH 1 & 2

Contributions to GDP and the positive growth prospects despite the high degree of uncertainty



Sources: Eurostat, European Commission

adjusted) in Q1 2022 (Graph 2). GDP growth in Q1 2022 exceeded expectations, because the deceleration of GDP rate of increase in the previous quarter, was estimated to last. The main driver was private consumption (6.9% y-o-y), fueled by higher wages, followed by public consumption (1.8% y-o-y), gross fixed capital formation (0.5% y-o-y). Imports (9.2% y-o-y) meanwhile increased by more than exports (8.7% y-o-y). The Q2 2022 reading indicates GDP growth rates above expectations at 5.3% y-o-y and 2.1% q-o-q.

Despite the strong economic activity in the first half of 2022, the Romanian economy will inevitably be affected by heightened geopolitical tensions. The Russian invasion of Ukraine and the sanctions imposed on Russia increased the uncertainty for the short and medium term global economic outlook, given the dominant position of Russia in global energy markets and the key role that both countries play in agricultural commodities' trade (see Box 1).

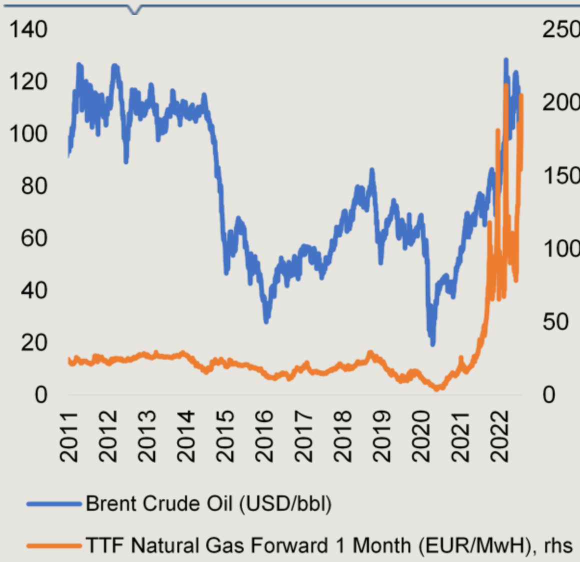
Box 1: The key role of Russia and Ukraine in commodities

- ✓ According to International Energy Agency (IEA) Russia is the world's third largest oil producer, behind the US and Saudi Arabia, the world's largest exporter of oil to global markets and the second largest crude oil exporter, behind Saudi Arabia. About 60% of Russia's oil exports go to OECD Europe, and another 20% to China.
- ✓ Russia is the second-largest producer of natural gas, behind the US, the largest gas exporter and has the largest gas reserves.
- ✓ Russia and Ukraine are among the most important producers of agricultural commodities in the world. Both countries are net exporters of agricultural products and they both play leading supplier roles in global markets of food and fertilisers, where exportable supplies are often concentrated in a handful of countries. The Food and Agriculture Organization (FAO) of the United Nations states: *"In 2021, either Russia or Ukraine (or both) ranked amongst the top three global exporters of wheat, maize, rapeseed, sunflower seeds and sunflower oil, while Russia also stood as the world's top exporter of nitrogen fertilisers and the second leading supplier of both potassic and phosphorous fertilisers"*.

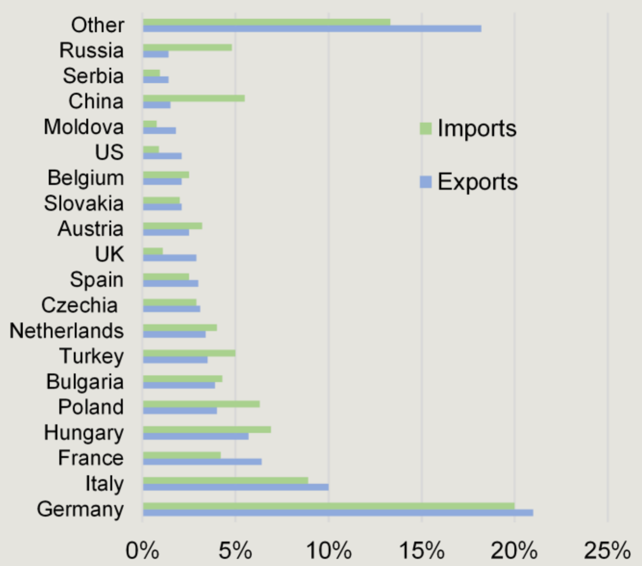
Inflation is the main channel through which the Romanian economy is affected. Although prices were rising even before the war, Russia's invasion of Ukraine intensified inflationary pressures due to higher commodities prices, particularly in natural gas (Graph 3), as well as supply chain disruptions attributed to delays in shipments of inputs (new lockdowns in key Chinese cities such as Shanghai also strained supply chain operations). High inflation is eroding households' real incomes and dampening private consumption, which represented around 68% of Romanian GDP in 2021 (52% in EU-27). The European Commission (*Economic Forecast, Summer 2022*) forecast growth of 3.9% in 2022 and 2.9% in 2023 (Graph 1), driven by domestic demand. The forecast is by 1.3 pps higher for 2022 and 0.7 pps lower for 2023, compared to the Spring 2022 forecast and by 0.3 and 1.6 pps, respectively, lower than the Winter 2022 forecast. According to the National Commission of Prognosis (*Summer 2022*) GDP is expected to increase by 3.5% in 2022 and by 3.7% in 2023 (+0.6 and -0.7 pps compared to previous forecasts), with private consumption and gross fixed capital formation being the main growth drivers. The evolution of the energy crisis constitutes a major concern for European economies. Natural gas prices could rise further if Russia decides to cut off its flows

GRAPH 3 & 4

The sharp rise of oil and natural gas prices



Romania's main trading partners (2021)



Sources: Bloomberg, United Nations

to Europe, intensifying inflationary pressures and putting Europe at risk of stagflation. The implications of a deteriorating energy crisis would adversely affect all European economies, although not to the same extent.

The direct negative effects of the war are likely to be limited

Romania's trade and financial relations with Russia and Ukraine are limited. In 2021, according to the United Nations, the country's exports to Russia and Ukraine stood at 1.21 and 0.84 billion USD respectively, representing around 1.4% and 1% of total exports. In turn, imports from these countries stood at 5.62 and 1.62 billion USD, representing around 4.8% (Graph 4) and 1.4% of total imports each. Both Russia's and Ukraine's shares of exports and imports have remained relatively stable over the past decade. Regarding Foreign Direct Investment (FDI), stock FDI from Russia stood at Euro 137 million by end of 2020, representing only 0.2% of total stock FDI (*BNR, Foreign Direct Investment in Romania in 2020*).

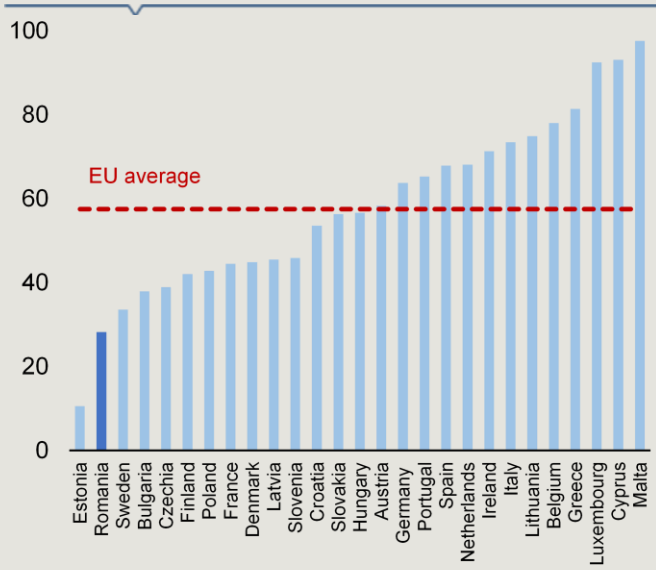
Although the energy crisis is negatively affecting EU Member States, which are net energy importers, Romania is in a relatively more favorable position. In 2020, the country had the second lowest energy import dependency ratio (see Note) in the EU-27 (28.2%), just behind Estonia (Graph 5). According to Eurostat data, the ratio has ranged from 16.7% to 31.5% since 2000. By product classification, the energy import dependency ratio is lower for natural gas (16.6%) and solid fossil fuels (22%) and higher for oil and petroleum products (64.7%). The reason for this low energy import dependency ratio is that Romania produces most of its natural gas domestically, making it the second largest gas producer in the EU. However, the country is heavily dependent on a Russian pipeline via Ukraine; thus, Romania will be affected if Russia cuts off its gas flows to Europe, although to a more limited extent than other EU countries, such as Germany.

In 2020, Russia supplied 45% of the imported natural gas, 33% of the imported oil and petroleum products and 56% of imported solid fossil fuels (Graph 6), on which Romania still relies heavily. The share of Russian natural gas imports averaged around 95% in the period 2000-2018, but has fallen sharply since. In 2021, Romania's electricity production increased by 5.3%. The country's primary energy mix comprised of: Oil (including petroleum products) 41%, natural gas 30%, primary electricity (nuclear, hydraulic, wind, solar, photovoltaic and geothermic electricity) 17% and coal 11%. The shares of nuclear power and renewables are set to increase, while the share of fossil fuels is expected to decline over time. In its RRP, Romania plans to phase out coal and lignite power by 2032 and further deploy renewables and hydrogen.

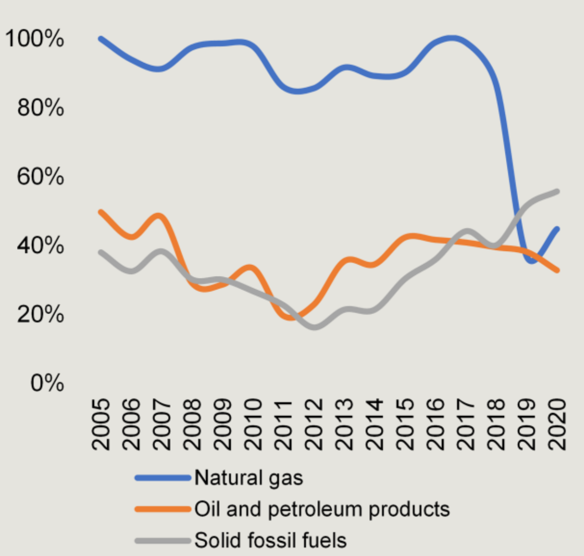
However, the EU's intention to reduce dependency on Russian natural gas is an opportunity for Romania to become not only completely energy independent in the medium term, but also become a key player in the regional gas market. In May, Romanian senators passed a bill through which the government intends to encourage gas extraction from the Black Sea. The legislation aims to ensure the country's energy security and allow it to eventually become a gas exporter. To boost investment projects in the Black Sea, which have been put on hold since 2018, taxes on future income from offshore gas projects have been lowered. In June, the first quantities of natural gas were extracted, while approximately 500 million cubic metres are expected to be extracted in 2022 and one billion cubic metres per year in 2023-2025.

GRAPH 5 & 6

Energy import dependency ratio* in EU-27 (2020)



Imports from Russia as a % of total imports



Sources: Eurostat, Alpha Bank Calculations

Note: * The indicator shows the share of total energy needs of a country met by imports from other countries. It is calculated from energy balances as net imports divided by the gross available energy. Energy dependence = (imports – exports) / gross available energy.

The indirect effects of the war in Ukraine are significant

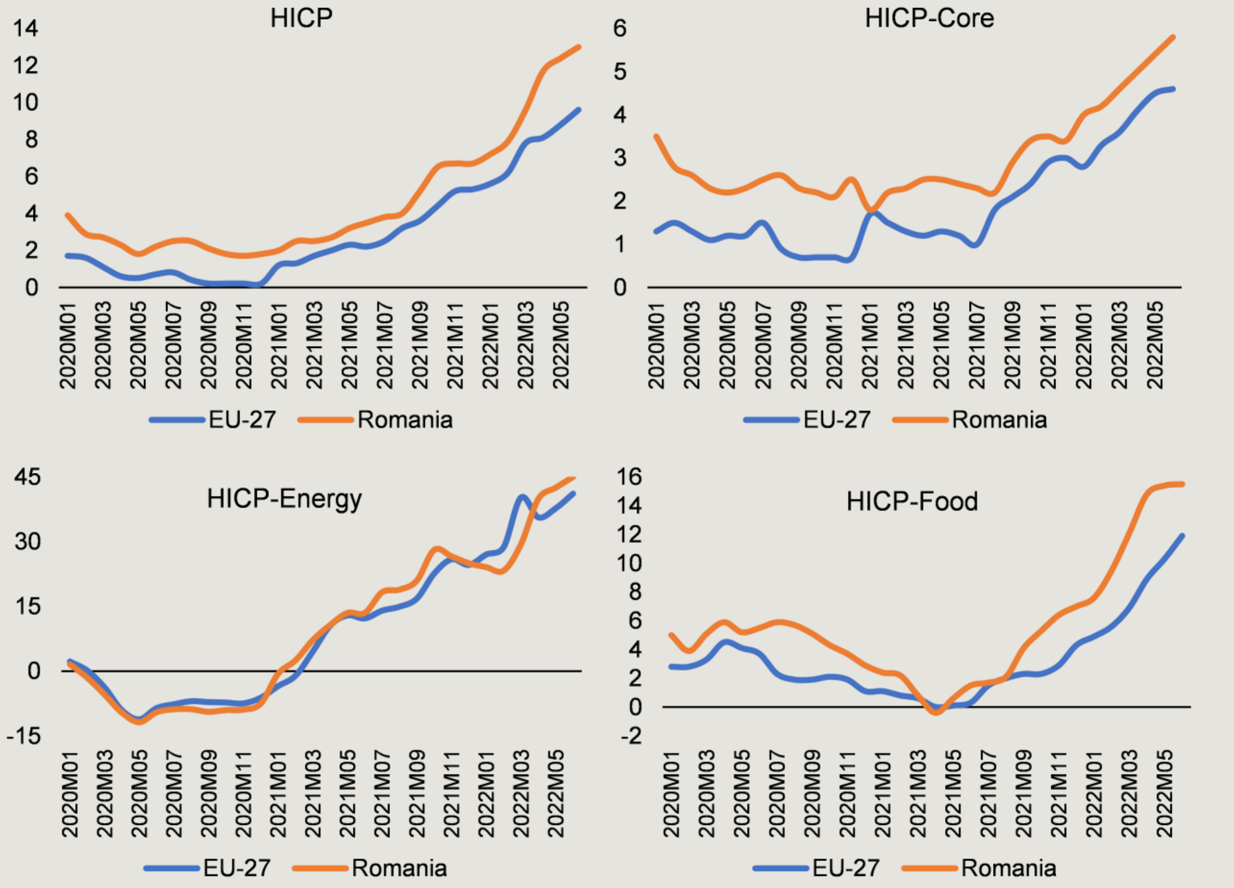
After the Russian invasion of Ukraine, soaring prices are the main challenge for policy-makers worldwide. High inflation was noted even before the onset of the war. Strong demand for goods and services (demand-pull inflation), as economies recovered from the Covid-19 pandemic, coupled with the increase in production costs (cost-push inflation), due to disruptions in the global supply chain and the energy crisis, resulted in the general price level rising in 2021. The war provides an additional supply shock to the international economy, triggering further inflationary pressures worldwide, due to higher energy and commodities prices, and intensifying supply chain disruptions. High inflation is expected to remain for longer than previously projected, threatening the outlook for the global economy.

In Romania, annual HICP inflation stood at 4.1% in 2021, exceeding the EU-27 average (2.9%). The rise in prices accelerated in the second half of 2021 (Graph 7), while double-digit inflation has been recorded since April 2022. HICP in Romania increased by 13% y-o-y in June 2022 (EU-27: 9.6% y-o-y) and 10.3% on average in the first half of 2022 (EU-27: 7.7%). Energy prices in Romania follow the same trajectory as in the EU, recording similar annual changes since the outbreak of the pandemic. In June 2022, energy prices increased by 45% y-o-y compared to 41.1% y-o-y in the EU-27. However this is not the case for food prices, which have been recording much larger increases in Romania compared to the EU-27 as of September 2021. In June 2022, food prices increased by 15.5% y-o-y compared to 11.9% y-o-y in the EU-27, with much of this difference being attributed to a larger increase in bread prices (Romania: 23.6%, EU-27: 15.9%), a category representing about 17% of Romania's food price index.

Households in eastern Europe are being hit hardest among EU member states by rising food prices. In June 2022, the largest annual increases in food prices were recorded in Lithuania (28.6%), Bulgaria (24.5%), Hungary (24.2%), Latvia (22.5%), Estonia (19.6%) and the Czech Republic (19.1%). The above mentioned countries with the highest food price dynamics are also the countries with the largest share of food in total household spending. In 2020, Romanian households spent 25.1% of their total expenditure on food, the largest among EU Member States (Graph 8), followed by Lithuania (20.1%), Estonia (19.9%) and Bulgaria (19%). Romanian food prices increased relatively slowly, however, compared to these countries. One reason behind this is that Romania is a large producer of cereals (wheat, corn, sun-flower). In fact, Romania benefitted from the global price rise in food commodities, as its terms of trade for vegetable products improved.

GRAPH 7

Energy price dynamics in Romania as in EU-27, but food dynamics faster



Source: Eurostat

The share of electricity, gas and other fuel expenses was 3.6% in 2020, following a downward trend since 2010. Provisional Eurostat data indicates that in 2021 the shares of food and electricity in total household spending declined to 24% and 3.5%; however, according to the World Bank (*War in the Region, Europe and Central Asia Economic Update Spring 2022*), poor and vulnerable households spend nearly 65% of their budget on these necessities.

According to the European Commission (*Summer 2022 Economic Forecast*) HICP inflation is set to reach 11.1% in 2022 (EU-27: 8.3%), before falling to around 7.2% in 2023 (EU-27: 4.6%), when energy price increases are projected to moderate and base effects are expected to kick in. Risks to the inflation outlook are mainly skewed to the upside and relate to the implications of the war in regards to food and energy prices, particularly natural gas prices. Other aspects, such as an increasingly tight labour market, contribute to the uncertainty of the inflation forecast.

Despite the adverse effects of high inflation on income, there are several facts supporting the household purchasing power: i. The poorest households are in rural, agricultural areas, representing 5.6% of total households. Practicing subsistence farming acts as a shield for these households against food inflation: (ii) A government scheme running from April 2022 to March 2023 forsees zero increases in energy prices for households and businesses. The support measures announced in April are expected to mitigate the negative impact of high prices, keeping private consumption growing, (iii) Up until April 2022, net average wages and average pensions increased y-o-y positively in real terms, (iv) The governmental programme “Support for Romania” will distribute 250-RON food acquisition vouchers every two months, from June to the end of the year, to people in material deprivation or at risk of poverty (around 3 million retirees, people with disabilities, low-income families and the homeless), while for retirees with monthly incomes under 2000 RON a financial aid of 700 RON was disbursed in July 2022.

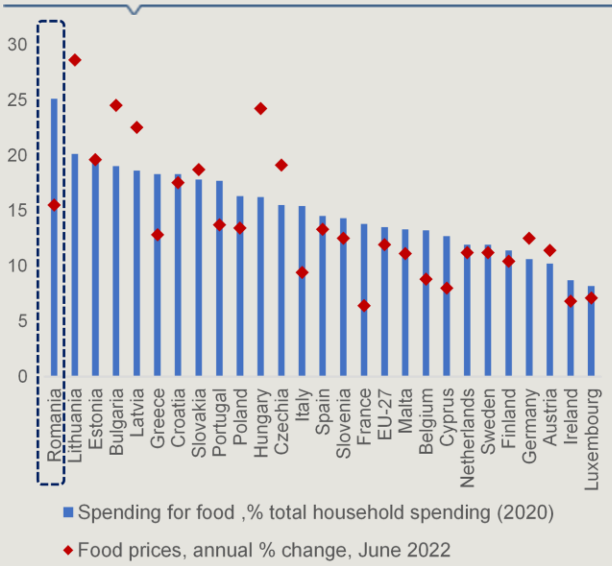
Second-round effects and the labour market

The wage-price spiral is a challenge for all economies facing high inflation, provided that consumers' inflationary expectations remain elevated. In this case, workers try to renegogiate their nominal wages, in order to maintain their purchasing power. However, in a vicious cycle, higher wages result in higher production costs and higher prices of goods and services. According to the European Commission (*Romania 2022 Country report*), nominal wage growth (proxied by nominal compensation per employee) rebounded to 5.7% in 2021 following a milder increase of 2.6% in 2020. In early 2021, the government raised the minimum gross salary to RON 2,300 (EURO 466) and approved an increase to RON 2,550 (EURO 515) as of January 2022. However, public wages were frozen in 2021, after increasing by 37.5% over the past 4 years. The European Commission estimates stronger growth for 2022 and 2023, in overall nominal wages of up to 8.3% and 7%, respectively (*Spring 2022 Economic Forecast*).

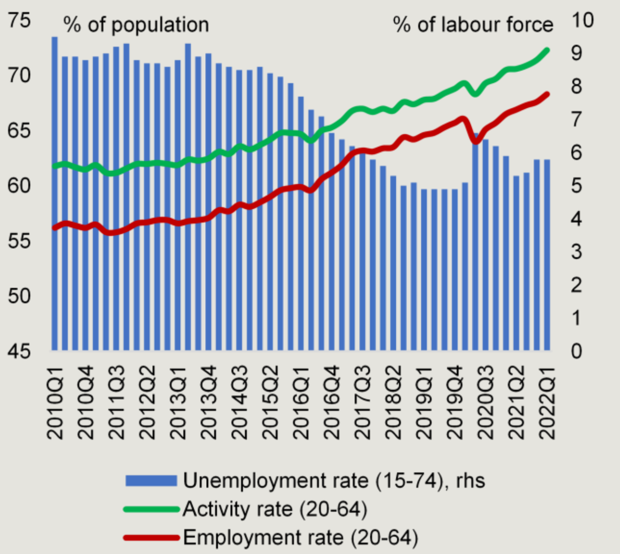
Labour market conditions have been improving since the second half of 2020, after deteriorating due to the pandemic shock, in the first half of 2020. The employment rate increased from 64% in Q2 2020 to 68.3% in Q1 2022 (Graph 9), supported by measures financed by The European instrument for temporary Support to

GRAPH 8 & 9

Relationship between food prices and spending (s.a.)



Activity, employment and unemployment rates



Source: Eurostat

mitigate Unemployment Risks in an Emergency (SURE). The activity rate (occupied labour force+unemployed/total population) also increased from 68.3% in Q2 2020 to 72.3% in Q1 2022. The unemployment rate continued to decline, from 6.7% in June 2020 to 5.4% in May 2022, although it has not declined to pre-pandemic levels (2019: 4.9%). According to the European Commission (Spring 2022 Economic Forecast), the unemployment rate is projected to stay at levels close to 5.5% in the next two years.

The European Commission notes that adverse demographics negatively affect the labour market, as current trends point to an 8.8% reduction in the workforce in 2030 compared to today (Romania 2022 Country report). In order to avoid the workforce contraction higher productivity levels and an increase in the participation in the labour market e.g. amongst women are required. The labour market could also integrate more people fleeing Ukraine than initially assumed.

In conclusion, the tighter the labour market is, the more likely a wage-price spiral will occur. Low unemployment rates, low labour market slack and an ageing population (Romania still has a relativeily young population) increase the likelihood of second-round effects, but rising activity and employment rates, especially among women, has the opposite effect.

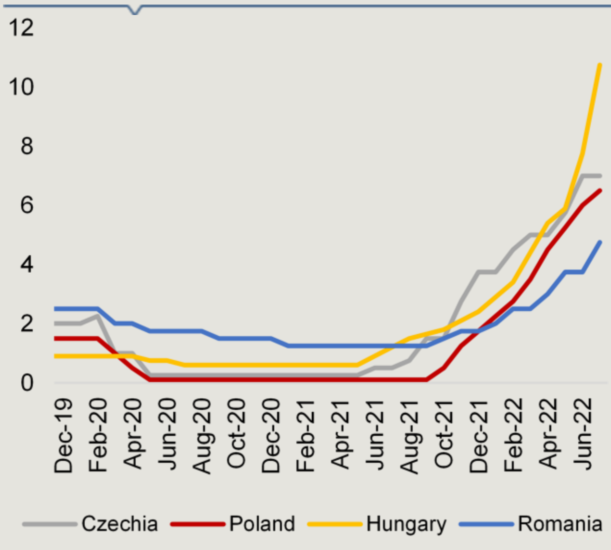
Tightening monetary policy in response to high inflation

The National Bank of Romania (NBR) has implemented an expansionary monetary policy since the outbreak of the pandemic. In April 2020, the NBR started purchasing government bonds in the secondary market to consolidate structural liquidity in the banking system, thereby supporting favourable financing conditions for the economy. Furthermore, the NBR gradually cut the monetary policy interest rate from 2.5% in February 2020 to a historical low of 1.25% in January 2021, which remained unchanged until October 2021. However, the monetary policy interest rate in Romania was the highest amongst neighbouring countries (Czech Republic, Poland and Hungary) from the outbreak of the pandemic to August 2021, when it was exceeded by Hungary (Graph 10).

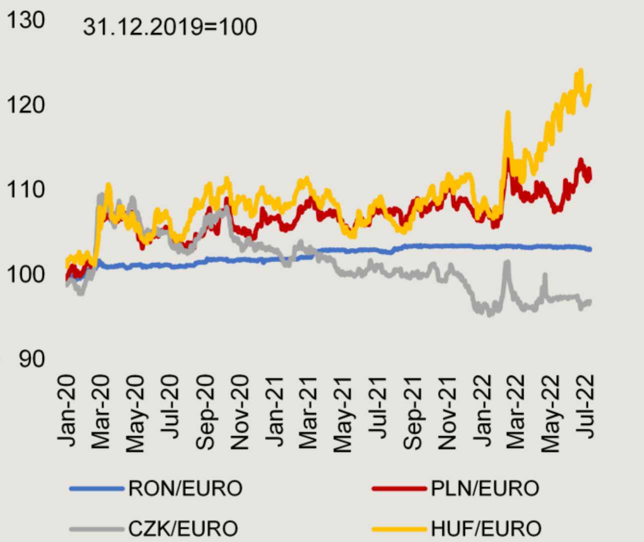
The NBR started the gradual normalisation of its monetary policy stance during 2021, ending the purchases of RON-denominated government securities on the secondary market in May and increasing its monetary policy interest rate in the last quarter of the year. From October 2021 to July 2022, the NBR increased the monetary policy interest rate seven times, by a total of 350 basis points, to 4.75%. The last increase became in effect in July, when the NBR raised the monetary policy interest rate by 100 basis points. This one-percent increase was unexpected, not because it was unusually high, but because the NBR had so far shown that it preferred less aggresive rate hikes. This move shows that the central bank's expectations regarding the evolution of inflation have become more pessimistic, in terms of both magnitude and duration. The argument is supported by the fact that inflation increased faster than the NBR expected in April-May 2022, as shown by the minutes of the monetary policy meeting of the NBR Board on July 6, 2022. It is also most likely a move aimed at anchoring inflation expectations over the medium term and preventing second-round effects. The Czech Republic, Poland and Hungary raised monetary policy interest rates as well in response to high inflation, the latter by 300 basis points in July, to 10.75%.

GRAPH 10 & 11

Monetary policy tightening gradual



Currency stability against euro



Sources: Central banks, Bloomberg

Despite the most recent increase, the monetary policy interest rate in Romania remains the lowest amongst the previously mentioned group of countries. Romania's less expansive monetary policy during the pandemic compared to its neighbouring countries explains the slower pace of its strengthening after the acceleration of inflation. The interest rate shock transmitted to the economy is comparable to that of the same group of countries and an amplification of that shock is not desirable. Therefore, the strengthening monetary policy in Romania is and will be slower than in neighbouring countries.

The RON has been gradually depreciated against the euro since 2017. However, it has remained remarkably stable against the common EU currency since the outbreak of the pandemic. Between end-2019 and end-July 2022, the leu weakened against the euro by 2.9.%, with limited volatility compared to its neighbouring countries' currencies (Graph 11). Over this period, the Polish zloty and the Hungarian forint weakened by 11.4% and 22.2%, respectively, whereas the Czech Koruna was appreciated by 3.2% against the euro. The NBR's objective during the pandemic and after the outburst of the war was to maintain the confidence in RON. As a result, its remarkable stability against the euro helps to moderate imported inflation.

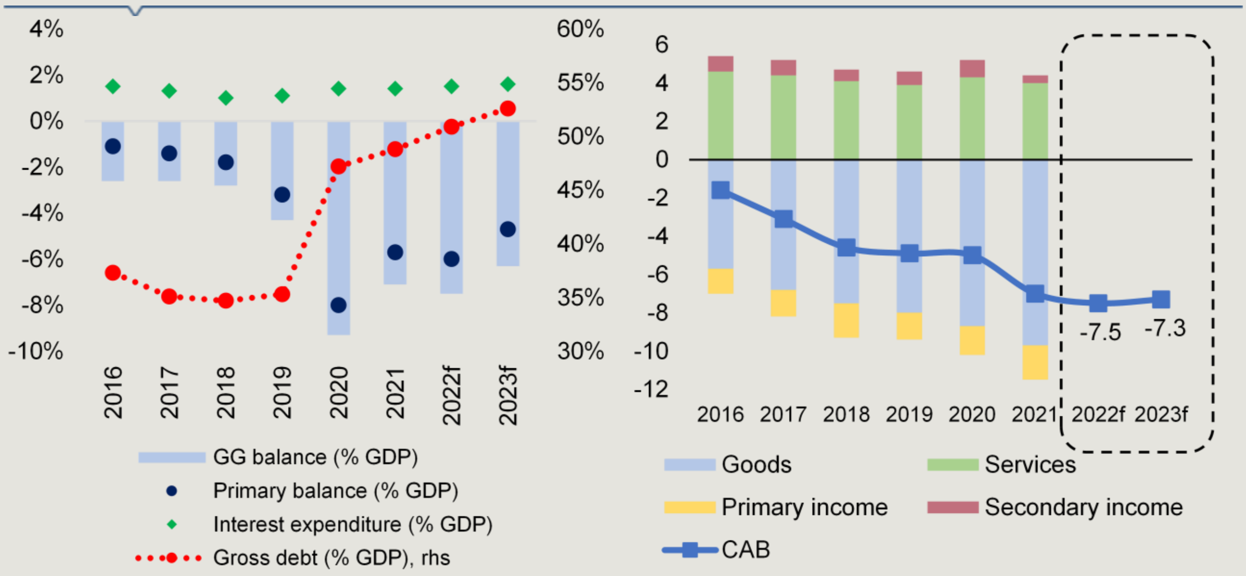
Fiscal and current account balance deficits remain a challenge

Large fiscal deficits pre-date the Covid-19 pandemic, as a result of ad hoc pension and wage increases and low public revenues. In 2020-2021, with the aim of mitigating the negative effects of pandemic-related disruption, the government introduced fiscal measures to support the healthcare sector, households and businesses, including incentives to protect employment. Expansionary fiscal policy benefited from the low interest rate environment, as a result of monetary easing by central banks. However, in 2021 the authorities enacted consolidation measures (i.e., public wage freeze), while the robust growth resulted in increased revenues. Overall, in 2021, the general government (GG) deficit and the primary deficit stood at 7.1% and 5.7% of GDP, down from 9.3% and 8% of GDP, respectively, in 2020 (Graph 12).

In 2022, the large fiscal deficit is expected to persist. The main deficit-increasing factors are: i) the increase in minimum wages and pensions and ii) the measures taken to support households and companies against rising energy prices, which amounted to 0.7% of GDP (*European Commission, Convergence Report 2022*). Regarding the humanitarian crisis due to the war, the Commission estimates a budgetary cost for support measures of 0.1% for both 2022 and 2023. Instead, the increased revenues due to robust expected growth and the expiry of the emergency health and labour market support measures constitute significant deficit-decreasing factors. For 2022, the European Commission (*Spring 2022 Economic Forecast*) forecasts that the GG deficit and the primary deficit will reach 7.5% and 6% of GDP. Romania entered an Excessive Deficit Procedure in the spring of 2020, as a result of the expansionary fiscal stance and the high fiscal deficit recorded in 2019 and previous years. On 5 May 2022, Romania submitted its 2022 Convergence Programme, according to which the headline deficit is projected to decline to 6.2% of GDP in 2022 and 4.4% in 2023. The target is for the GG deficit to drop below 3% of GDP, in line with the European Council's recommendation. On 24 May 2022, the authorities announced a 10% cut of expenses other than wages and social benefits (around 2.4% of GDP). In H1 2022, the GG consolidated budget deficit (in cash terms) stood

GRAPH 12 & 13

Fiscal and current account balance deficits pre-dated the pandemic crisis



Source: European Commission

at 23.51 billion RON (1.71% of GDP), from 33.81 billion leu in H1 2021 (2.86% of GDP). GG revenues were 216.7 billion leu (+22.9% y-o-y), while GG expenditures were 240.2 billion RON (+14.3%).

Increasing fiscal deficits had spurred the negative current account balance (CAB) even before the Covid-19 pandemic. The current account deficit increased from 4.6% of GDP in 2018 to 4.9% in 2019, 5% in 2020 and 7% in 2021 (Graph 13), as robust private consumption deteriorated the trade balance. In the first five months of 2022, the current account deficit amounted to Euro 10.2 billion, up by 80% y-o-y. The deficit was created by the balance of goods (Euro 11.9 billion) and primary income balance (Euro 2.6 billion), partially offset by the surplus of the balance of services (Euro 4 billion) and of the secondary income balance (Euro 0.3 billion). The high current account deficit is not forecast to improve in 2022 and 2023. According to the European Commission, the current account deficit is projected to reach 7.5% of GDP in 2022 and 7.3% in 2023.

The debt-to-GDP ratio rose significantly, from 35.3% in 2019 to 47.2% in 2020 and 48.8% in 2021, as policy measures to address the negative impact of the pandemic weighed on fiscal performance. The debt-to-GDP ratio is projected by the European Commission to rise to 50.9% in 2022 and 52.6% in 2023. Rising debt and borrowing costs affect interest expenditure, which is projected to rise from 1.4% of GDP in 2021 to 1.5% in 2022 and to 1.6% in 2023. Despite the increase in the debt-to-GDP ratio, debt sustainability risks appear moderate, as the ratio is much lower compared to the EU-27 average (88.1% of GDP in 2021). According to the European Commission's baseline debt projections, the debt-to-GDP ratio is expected to follow an upward path during the current decade, reaching 72.7% of GDP in 2032 (*Romania 2022 Country report*).

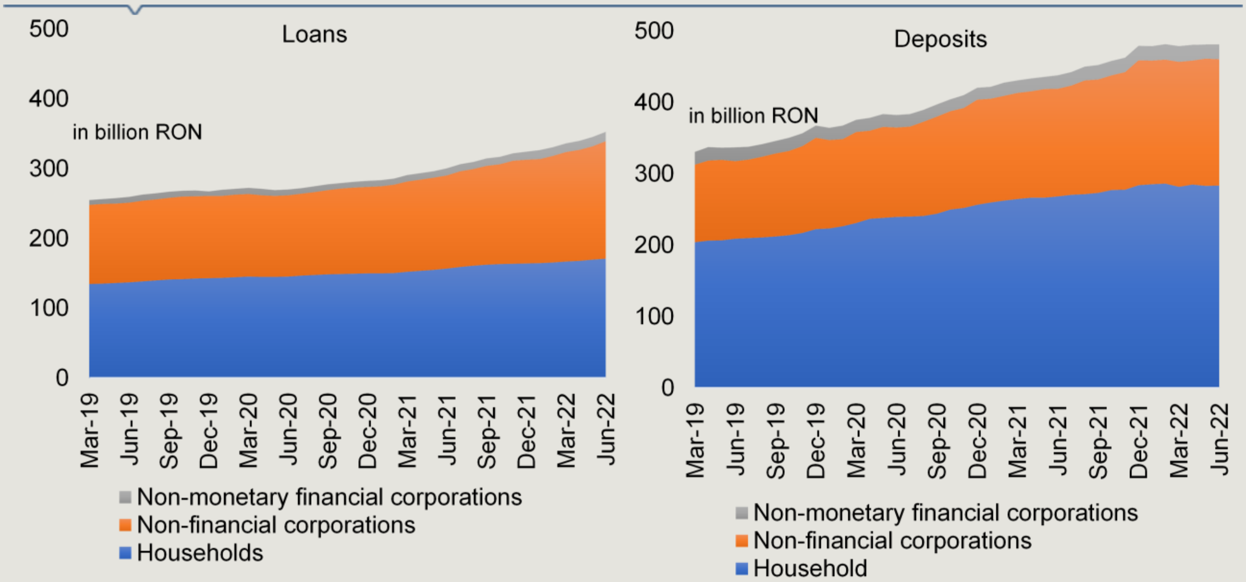
Bank lending supported the economy in the pandemic and after the outbreak of the war

The banking sector in Romania remained well capitalised and liquid during the pandemic, being in a favourable position to address the negative impacts of the ongoing war. The Common Equity Tier 1 (CET1) capital ratio and the Tier 1 capital ratio stood at 20.76% and 20.86% at end-2021, significantly above the EU average (15.7% and 17% respectively). In Q1 2022, the CET1 capital ratio and Tier 1 capital ratio retreated at 18.91% and 19%. The ratio of non-performing loans (based on the EBA's definition), which has been steadily decreasing in recent years contributing to asset quality improvement stood at 3.35% in 2021 (EU average 2%) and 3.31% in March 2022, while the non-performing loan coverage by provisions stood at 66.1% in 2021 (EU average 44.5%) and 67.22% in March 2022. According to recent NBR data, the ratio of non-performing loans declined further in May, to 3.19%. The profitability of the sector, as measured by return-on-equity (ROE), stood at 12.28% in 2021 (EU average 7.3%) and 11.62% in March 2022.

Non-government sector loans and deposits are on the rise, reaching almost double-digit annual growth rates in June 2022. Loans to the non-government sector grew by 17.5% y-o-y to 352.8 billion RON in June 2022 (Graph 14). June 2022 was the 14th consecutive month with a double-digit increase on an annual basis. Loans to households increased to 170.9 billion RON in June 2022 (8.9% y-o-y), representing 48.4% of total non-government sector loans. 105.2 billion RON are housing loans (11.7% y-o-y) and 62.9 billion RON

GRAPH 14 & 15

The loans and deposits of the non-government sector are on the rise



Source: NBR

consumer loans (4.1% y-o-y). Loans to non-financial corporations increased to 168.6 billion RON (26.3% y-o-y) and to non-monetary financial corporations to 13.4 billion RON (34.1%).

Non-government sector deposits increased by 9.8% y-o-y to 481.1 billion RON in June 2022 (Graph 15), compared to an annual increase of 10.4% in May 2022. Household deposits account for 58.9% (283.4 billion RON) of total non-government sector deposits, deposits from non-financial corporations for 36.8% (177.1 billion RON) and deposits from non-monetary financial corporations for 4.3% (20.6 billion RON). Since the outbreak of the pandemic, non-government sector deposits have increased by 30.9% or 113.6 billion RON (February 2020 - June 2022). The largest share of this increase is attributed to households (56.6 billion RON), followed by non-financial corporations (55.1 billion RON) and non-monetary financial corporations (1.9 billion RON). General government deposits stood at 81.8 billion RON in June 2022 (64.3% y-o-y). Clients' loans-to-deposits ratio increased to 73.3% in June 2022. Since the beginning of the pandemic, the ratio has decreased as a result of the large increase in deposits; however, it has been on an upward trend since March 2021.

The sovereign-bank nexus remains significant, as according to the NBR (*Financial Stability Report, June 2022*), in March 2022, the share of claims on the government sector in aggregate assets stood at 22.9%, the highest in the EU-27. Among these, government securities issued by Romania's central government prevail (20.1% of assets). The direct effects of the war on Romania's banking sector are currently limited, due to its low exposure to Russia and Ukraine. Indirect effects could be a challenge and are mainly related to a possible increase in credit risk, on the back of negative effects of the war on economic activity, combined with higher interest rates.

The RRP and other EU funding programmes enhance a positive economic outlook

The Romanian RRP contains important measures aimed at accelerating the green (41% of the funds) and digital transitions (20% of the funds), strengthening the country's economy for the long-term. The plan is expected to address macroeconomic imbalances such as fiscal sustainability and other challenges like education, increasing greenhouse gas emissions and the lack of digital connectivity. The plan forsees the absorption of Euro 14.2 billion in grants and Euro 14.9 billion in loans to support the implementation of 122 investments and 64 reforms by 2026. Funds under the RRP will be allocated accross six policy pillars (see Box 2). The total amount of funds equals 13.1% of 2019 GDP (Graph 16), which is the second highest percentage in the EU-27, just behind Greece (16.6%).

Box 2: Policy pillars and timeline of RRP

- ✓ Green transition
- ✓ Digital transformation
- ✓ Smart, sustainable and inclusive growth
- ✓ Social and territorial cohesion
- ✓ Health, economic, social and institutional resilience
- ✓ Policies for the next generation

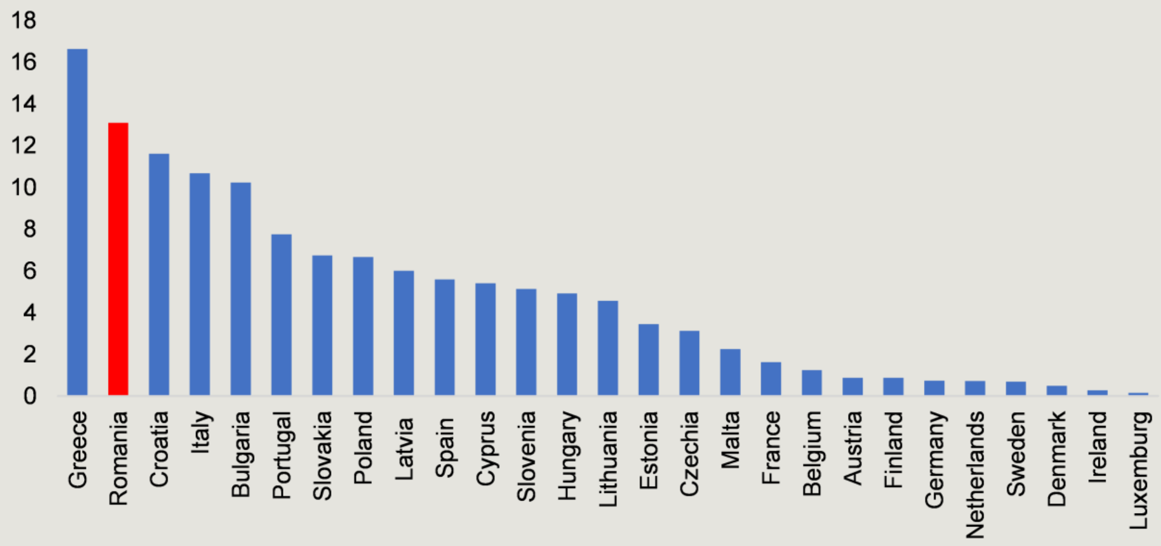
- ✓ 31.05.2021: Romania submitted its RRP
- ✓ 27.09.2021: The EC endorses Romania's RRP
- ✓ 29.10.2021: The Council approves the RRP
- ✓ 02.12.2021: Disbursement of Euro 1.8 billion
- ✓ 13.01.2022: Disbursement of Euro 1.9 billion
- ✓ 01.06.2022: Payment request of Euro 2.6 billion

Romania is expected in addition to receive funds from other EU funding programmes, such as the 2014-2021 EU budget frameworks (Euro 11.6 billion not yet accessed) and the 2021-2027 multi-annual budget framework (Euro 31.3 billion). The country will also benefit from the exceptional flexibilities provided in the framework of the Cohesion's Action for Refugees in Europe (CARE) initiative and from additional pre-financing under the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) programme to urgently address the reception and integration needs of those fleeing Ukraine as a result of the Russian invasion.

Romania benefits from generous EU funds, which could mobilise additional investment resources. Absorbing these funds is a key challenge for authorities, as the implementation of investment projects could transform the Romanian economy, boosting economic activity. According to the European Commission (*Convergence Report 2022*), the implementation of investments in the Romanian plan, along with other investments under Next Generation EU, is estimated to increase Romania's GDP 2.9% by 2026, of which 0.2% is due to positive spillover effects.

GRAPH 16

RRP allocation as a % of 2019 GDP



Source: European Commission

Macroeconomic indicators	2018	2019	2020	2021	2022.05	2022.06	Annual Data
Real sector							
GDP, real annual grow th, %	4,5	4,2	-3,7	5,9		5,8	
GDP, € bn	204,5	223,2	218,9	240,2		123,1	
Unemployment rate ILO*, %	5,3	4,9	6,0	5,6	5,4	5,3	
Average net monthly w age, €	579	653	684	720	794		
Balance of payments (€ m)							
Export (goods+services), FOB	85.614	90.123	81.339	98.080	47.435		
Import (goods+services), FOB	92.592	99.322	90.837	111.700	55.361		
Trade balance	-6.978	-9.199	-9.510	-13.620	-7.926		
Current account deficit	-9.495	-10.903	-10.898	-16.755	-10.238		
Current account deficit, % GDP	-4,6	-4,9	-5,0	-7,1			
Foreign direct investment, net	-4.944	-4.848	-2.960	-7.278	-3.783		
Foreign direct investment, net, % GDP	-2,4	-2,2	-1,4	-3,0			
General consolidated budget							
Income, RON bn	295,1	321,1	322,5	379,6	179,0	216,7	
Expenses, RON bn	322,5	369,4	424,4	459,6	199,9	240,2	
Deficit (-)/Surplus(+), RON bn	-27,3	-48,3	-101,9	-80,0	-20,9	-23,5	
Deficit, % GDP	-2,9	-4,6	-9,6	-6,8			
Banking sector (€ m)							
Non-government credit	53.839	55.986	57.989	65.526	69.851	71.342	
Foreign currency credit	18.318	18.116	17.672	18.065	19.065	19.942	
Deposits	70.687	76.933	86.416	96.866	97.325	97.286	
Foreign currency deposits	23.437	26.364	30.068	33.925	36.343	36.424	
External debt (€ m)							
Medium and long term external debt (MLT)	67.966	72.740	93.541	97.043	96.257		
Public administration	34.948	39.657	57.770	58.687	57.900		
Companies accepting deposits, w ithout central bank	9.038	7.839	7.227	7.718	8.269		
Other sectors	23.001	24.343	24.101	25.521	26.616		
Direct investment: debt instruments	31.655	36.727	36.548	38.966	41.073		
Short term external debt (TS)	31.451	33.260	33.266	37.213	41.028		
Debt service MLT	17.338	16.110	16.840	15.968	69.905		
Debt service TS	48.825	50.029	55.530	70.002	35.119		
International reserves							
Gross reserves, € m	36.800	37.450	42.517	45.831	46.661	47.823	
Gross reserves, % GDP	18,0	16,8	19,4	19,1			
Prices and exchange rates, end period							
Inflation Eurozone (%)	1,6	1,3	-0,3	5,0	8,1	8,6	
Inflation Romania (%)	3,27	4,04	2,06	8,19	14,49	15,05	
RON/€	4,6639	4,7793	4,8694	4,9481	4,9430	4,9454	
Nominal depreciation (+)/apreciation (-), annual %	0,09	2,47	1,89	1,62	0,47	0,38	
Real depreciation (+)/apreciation (-), annual, %	-1,58	-0,27	-0,47	-1,57	-5,92	-6,07	

Source: NBR, National Institute for Statistics, ECB

* International Labour Organization

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