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In-Depth Review 2025

Romania

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European Commission
Directorate-General for Economic and Financial Affairs

In-Depth Review 2025

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EUROPEAN ECONOMY

Institutional Paper 314

This in-depth review presents the main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Romania for the purposes of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances. It provides technical input to the Commission for the Communication "European Semester – 2025 Spring Package" that will set out the Commission's assessment as to the existence of imbalances or excessive imbalances in Romania. That Communication will be published in June 2025.

European Commission

Romania

In-Depth Review 2025

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1. INTRODUCTION

This in-depth review (IDR) analyses the evolution of Romania's vulnerabilities related to large external and fiscal deficits, and possible deterioration of cost competitiveness. This year's IDR, which follows the 2025 Alert Mechanism Report (AMR) published in December 2024, assesses the persistence or unwinding of the vulnerabilities identified last year, potential emerging risks, and relevant policy progress and policy options that could be considered for the future [(1)].

Romania's economic growth decelerated markedly in 2024 and although a pick-up is expected in 2025, downside risks remain significant. Real GDP increased in 2024 at around 0.9%, after 2.4% in 2023. Buoyant private consumption supported by lax fiscal and incomes policies had only a limited impact on GDP growth, which was dampened by the high negative contribution of net exports, and investment underperformance. Sluggish external demand from Romania's main trading partners, a rapid increase in wages and high energy prices weighed on industrial production, residential construction, IT and transport services, while a severe drought led to a significant decline in agriculture output. Economic growth is projected to accelerate to around 2.5% in 2025 and 2.9% in 2026, supported by a gradual pick-up in external demand, a further easing of financial conditions, resilient private consumption and public investment[(2)]. However, the balance of risks to the economic outlook is tilted to the downside as political instability and fiscal uncertainty could affect investor confidence, the pace of reforms and the absorption of RRF funds. A deceleration of energy and food price growth supported a decline in headline inflation, while core inflation remained sticky. Headline inflation fell from close to 10% on average in 2023, to 5.8% in 2024 and is forecast to hover at around 4% in 2025 and 2026. Core inflation declined less to around 8.5% on average in 2024 as high increases in wages and pensions and a pick-up in lending reinforced underlying domestic demand and price pressures, and core inflation is expected to be 4.7% and 4.1% in 2025 and 2026 respectively[(3)]. Labour demand eased somewhat, but remained resilient, and nominal wages continued growing at a double-digit rate in 2024.

(1) European Commission (2024), Alert Mechanism Report 2025, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, COM(2024) 702 final; and European Commission (2024), Alert Mechanism Report 2025, Staff Working Document, SWD(2024) 700 final.

(2) All forecast data used in the IDR come from the Commission Autumn 2024 Forecast (European Economy, Institutional Paper 296), unless stated otherwise, in order to ensure the coherence of the various figures and calculations. The cut-off date for the data for the preparation of this IDR was 24 March 2025. Actual outturn data that have become available after the Autumn Forecast, and before the cut-off date for the IDR, are mentioned.

(3) Input-output analysis indicates that over the period 2020-2024, foreign demand contributed 0.7 pps. to Romania's cumulated GDP growth of ca. 9.8%; conversely, due to its limited size, the Romanian domestic demand had little impact on the EU growth. Over that same period, imported value-added inflation accounted for 3.2 pps. of the 38.2% cumulated inflation. See European Commission Institutional Paper 2025 (forthcoming) – "Economic spillovers and financial linkages in the EU".

2. ASSESSMENT OF MACROECONOMIC IMBALANCES

Since the pandemic, Romania has been marked by large current account deficits and high price pressures, primarily due to persistently high and growing government deficits supporting generous income policies. Rapid credit growth, high nominal wage increases, and a very large fiscal deficit allowed real GDP to grow close to 5% on average in 2021 and 2022, well above Romania's potential growth rate. Together with the surge in energy prices it pushed average HICP inflation to 12% in 2022 (Graph 2.1.a) and the current account deficit to above 9% of GDP (Graph 2.1.b). In 2023, monetary policy tightening, which began in 2022, and, as a result subdued credit activity decelerated domestic demand, real GDP growth and inflation. In 2024, the fiscal deficit widened to 8.7% of GDP from an already high 6.6% of GDP in 2023. The boost in domestic demand mainly increased imports, while exports remained muted, denting real economic growth and widening again the current account deficit to around 8.3% of GDP in 2024, while inflation moderated to 5.8%, but remained among the highest in the EU.

2.1. EXTERNAL SECTOR

Assessment of gravity, evolution and prospects of vulnerabilities

The current account deficit widened again in 2024 as private consumption and imports picked up while exports underperformed. In 2023, the current account deficit had narrowed by more than 2 percentage points of GDP, due to a strong deceleration of private consumption and a smaller deficit in the energy trade balance as energy prices moderated. This favourable development changed in 2024, when private consumption accelerated again by close to 6%, stimulating import growth of about 3.5% in nominal terms, while exports fell slightly due to weak external demand. The trade deficit increased by more than 1 percentage point of GDP, while the deficit of the primary incomes balance widened slightly and the surplus of secondary incomes balance almost halved. As a result, the current account deficit increased to about 8.3% of GDP[4].

From a savings-investment perspective, the larger current account deficit was primarily driven by a further increase in the fiscal deficit[5]. Fiscal policy turned expansionary in 2024, with a fiscal impulse estimated at around 2 percentage points of GDP. Romania's general government deficit worsened significantly in 2024 from already high levels, reaching 8.7% of GDP according to the budget for 2025, up from 6.6% of GDP in 2023. The sizeable deficit increase in 2024 was primarily driven by higher government spending, particularly on public sector wages and pensions, goods and services, capital expenditure and cost of debt.

The current account deficit is expected to decline gradually in 2025 and 2026, subject to fiscal consolidation and moderation of domestic demand. According to the Commission's 2024 Autumn forecast, the current account deficit is expected to decrease to still high levels of 7.6% of GDP in 2025 and 6.9% of GDP in 2026. A pick-up in external demand in main trading

[4] According to data from the National Bank of Romania (NBR).

[5] On the interlinkage between the general government and external deficits in Romania please see a more detailed analysis in Annex 1 below.

partners, full accession to the Schengen Area and a further expansion of transport infrastructure are likely to support export activity going forward. In addition, a notable deceleration in domestic demand, due to a more restrictive income policy, underpinned by the freezing of public wages and pensions in 2025 should dent imports. Fiscal consolidation in line with Romania's 2025 budget, would further support the gradual downward adjustment of the trade and current account deficits. Risks to fiscal sustainability are overall high in the short and the medium term and medium in the long-term (see Box 2.1).

Despite the large current account deficits recorded in recent years, Romania's external indebtedness remained relatively low. At about 57% of GDP at end-2024, Romania has one of the lowest gross external debt ratios in the EU. The net international investment position (NIIP) improved somewhat from -45% of GDP in 2021 to below -40% of GDP at end-2024 (Graph 2.1.c), mainly on account of the strong nominal GDP growth. It remains more favourable than the estimated prudential benchmark of -54% of GDP. In 2023 a majority of Romania's external financing needs was covered by non-debt-creating financial flows, but this share declined significantly in 2024. The NIIP excluding non-defaultable instruments (NENDI), which takes into account Romania's large stock of net FDI, a key contributor to Romania's economic development, remained very low at about -5% of GDP at end-2024.

While private debt remains low, government debt levels have been increasing (Graph 2.4). Private debt in Romania remains low and fell from approximately 50% of GDP in 2021 to around 40% by end-2024, with both household and corporate debt ratios being among the lowest in the EU. In contrast, government debt rose rapidly to almost 55% of GDP at end-2024, with around half of this debt being held by non-residents.

The financial sector is overall stable, while domestic credit growth has accelerated. The banking sector is well capitalised with the common equity tier 1 (CET1) ratio reaching 20% in Q3 2024 – significantly above both the EU average and pre-pandemic levels. Profitability metrics also remain exceptionally strong, with a return on equity (ROE) of above 19%. Asset quality indicators remain solid, despite a marginal increase in the non-performing loan (NPL) ratio to 2.7% in Q3 2024. Overall, the debt servicing capacity of the real sector remains at adequate levels, despite the comparatively weak payment discipline in the economy and the fraction of non-financial corporations with significant capitalisation weaknesses and less access to external finance. Romania's banking sector exposure to claims on the government sector (securities and loans) has further strengthened, reaching the highest level among EU countries at about 25% of total assets in September 2024. This is due to the large government debt securities issuance in 2024, against the backdrop of low financial intermediation. While this enhances solvency and liquidity, it also increases concentration and interest rate risks. The growth of domestic bank loans to private sector picked up from around 8.8% y-o-y at end-2023 to 11.7% at end-2024[(6)], but the increase in real interest rates and strict lending prudential regulations prevented a stronger acceleration. The increase was driven by consumer loans which accelerated rapidly, at a double-digit rate, due to the strong increase in nominal incomes, while corporate credit growth slowed somewhat relative to 2023 and mortgage lending was subdued.

The financing of the large current account deficit has not been problematic so far, but deteriorated in 2024, as the share of debt creating instruments has increased. Despite rising and persistent twin deficits, Romania's low stocks of debt and robust medium-term growth prospects continued to facilitate access to external financing. In 2023, around 60% of the current account financing needs were covered by non-debt creating instruments, such as EU funds and net FDI, but this share dropped to less than a third in 2024. At the same time, portfolio inflows reached almost 4.5% of GDP in 2023 and remained high at around 3.5% of GDP in 2024, resulting mainly

(6) See BSI.M.RO.N.A.A20T.A.I.U6.2250.Z01.A | ECB Data Portal.

from the issuance of government bonds, financing the large government deficits from external sources. These portfolio inflows led to an almost equivalent increase in foreign reserves in 2023, while the growth of reserves was rather modest in 2024. Yet, Romania's foreign reserves seem broadly adequate, covering more than five months of imports and more than 100% of the short-term external debt at end 2024.

In 2024 and early 2025, financing costs for the sovereign increased due to fiscal risks. Yields on government bonds have edged up towards the end of 2024 and in early 2025, as the fiscal deficit widened, and political uncertainty increased following the cancellation and postponement of the presidential elections. Spreads to benchmark government bonds widened from around 350 bps to close to 400 bps signalling higher borrowing costs for the sovereign. In addition, Fitch Ratings, S&P Global Ratings and Moody's Ratings revised the outlook on Romania's sovereign credit ratings (currently at lowest investment grade) to negative from stable, confirming that without resolute fiscal consolidation Romania may be vulnerable to changes in investor sentiment, making government and external financing more difficult.

Assessment of MIP relevant policies

The implementation of fiscal consolidation and fiscal-structural reforms are necessary to address domestic and external vulnerabilities. Tackling these vulnerabilities requires the implementation of a credible and sustained multiannual fiscal consolidation path. This would avoid putting excessive burden on other macroeconomic policy instruments, including monetary policy, and considerably reduce risks associated with competitiveness, external sector and market financing. The implementation of the medium-term fiscal-structural plan and the reforms and investment included in Romania's recovery and resilience plan are necessary steps for Romania to make meaningful progress in addressing its vulnerabilities on both the internal and external side.

In its medium-term fiscal-structural plan (MTFSP), Romania commits to a net expenditure growth[(7)] that does not exceed 37.6% in cumulative terms by 2028. In particular, Romania commits to a net expenditure growth that does not exceed 5.1% in 2025, 4.9% in 2026, 4.7% in 2027, and 4.3% in 2028[(8)]. If the net expenditure path committed to in the plan and the underlying assumptions materialise, general government debt would, according to the plan, increase from 52.2% of GDP in 2024 to 62.6 % of GDP in 2029, before declining to 61.4 % of GDP in 2031. It is then projected to continuously decline to levels well below 60 % of GDP during the 10 years following the end of the period covered by the plan. The adjustment path outlined in the MTFSP is also the path recommended by the Council for Romania to correct its excessive deficit under the Excessive Deficit Procedure (EDP) by 2030. Fiscal reforms will be essential for Romania to remain on track with the Council's recommendations under the EDP, which was opened in 2020.

According to the indicative fiscal strategy in the plan, the commitments on net expenditure will be delivered mainly through expenditure restraint. All expenditure categories are projected to decline as a share of GDP. This commitment is supported to some extent by the expenditure reforms presented in the plan (spending reviews, pension reforms, reform of state-owned enterprises governance) but rigorous implementation, and additional measures relative to those included in the plan, will be necessary to achieve the targets. In addition, Romania

(7) Net expenditure as defined in Article 2 of Regulation (EU) 2024/1263, namely government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on Union programmes fully matched by revenue from Union funds, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure and (vi) one-offs and other temporary measures.

(8) These are also the growth rates that the Council recommended. The cumulative growth rates are calculated by reference to the base year of 2023. Council Recommendation of 21 January 2025 endorsing the national medium-term fiscal-structural plan of Romania, Official Journal of the European Union C/2025/647, 10 February 2025.

committed to a set of reforms and investments with the view to extending the fiscal adjustment period to 7 years (2025-2031). In particular, Romania committed to implement a tax reform in 2025 and to accelerate and deepen annual spending reviews, systematically quantifying savings targets.

A first step towards fiscal consolidation was made at the end of 2024 with the approval of several consolidation measures. On 31 December 2024, Romania's newly formed government adopted an emergency ordinance introducing significant fiscal consolidation measures. Collectively, the measures are projected to yield savings equivalent to 2.0% of GDP in 2025. The package includes several cost-containment measures, in particular a freeze of pensions and public sector wages, and revenue enhancing actions, such as the removal of remaining sectoral exemptions for personal income tax and social contributions, together with a reduction in the eligibility threshold for the microenterprise regime.

Effectively implementing ambitious tax reforms included in the MTFSP and the RRP would go a long way in helping tackle fiscal vulnerabilities. Romania's RRP includes key reforms to strengthen the tax system and its administration, make it more supportive of growth and easier to administrate, with a view to increasing the revenue collected by at least 3 percentage points of GDP by 2026, through better tax administration and a comprehensive reform of the tax framework. To this end, the MTFSP states that the tax reform should generate a permanent increase in the government revenue ratio by 1.7 percentage points of GDP. The RRP includes a reform of the National Agency for Fiscal Administration, which aims to address the urgent need for its modernisation and digitalisation. In addition, the pension reforms adopted in 2023 (reform of special pension regimes) and 2024 (reform of the general system) should help limit ad-hoc increases in pensions.

The National Bank of Romania (NBR) maintained a tight monetary policy and started reducing cautiously its key interest rate in July 2024. Two cuts of 25 bps each were operated, bringing the key rate to 6.5% by the end of 2024. Money market and bank rates followed closely the key rate while inflation dropped relatively faster leading to an increase in real interest rates and rendering the monetary stance more restrictive. In parallel, the ample liquidity surplus in the banking sector, which had been placed at the NBR deposit facility, almost halved over 2024. With upside inflationary risks, still robust domestic demand and uncertain impact from fiscal policy measures, prudence in the conduct of monetary policy seems appropriate.

Amidst the overall favourable banking sector developments, the NBR has maintained the countercyclical capital buffer at 1% in 2024. NBR implemented further macro-prudential measures to restrict lending to households with high loan-to-value ratios (85% is the benchmark for leu-denominated mortgages) and elevated debt service costs (40%), aiming at reducing risks of financially distressed loans. The National Committee for Macroprudential Oversight (NCMO) recommended the NBR to impose, starting 1 April 2025, at the highest level of consolidation, a capital buffer for other systemically important institutions (O-SII buffer).

2.2. COST AND NON-COST COMPETITIVENESS

Assessment of gravity, evolution and prospects of vulnerabilities

Cost competitiveness

In 2024, wage increases remained high, fuelling inflation pressures and negatively impacting cost competitiveness. Following double-digit growth in 2023, nominal wages

increased by more than 13% in 2024, according to the National Statistical Institute, while real wages accelerated by around 7% y-o-y due to falling inflation. Over the past 5 years, real wages increased by more than 20%, in excess of productivity growth. Generous income policies were a key contributor as the minimum wage grew by about 30% in 2023 and another 12% in 2024, aiming at alleviating the fairly high in-work poverty and income inequality, while public sector wages increased by close to 20% in 2024. As a result, in both 2023 and 2024 the growth of nominal unit labour costs (ULCs) was higher in Romania than in the EU on average, while productivity growth decelerated and turned slightly negative in 2024, also due to a significant decline in agricultural output (Graph 2.1.e). As the nominal exchange rate remained fairly stable over the period, Romania lost ground in terms of cost competitiveness, reinforcing the export sector's problems caused by weak external demand [(9)].

The leu has been kept stable against the euro, despite significant geopolitical challenges and the increase in domestic political uncertainty following the 2024 elections. In recent years, the NBR focused on a relatively steady exchange rate, particularly against the euro, to ensure financial stability and anchor inflation expectations. In 2024, a decline in net EU funds and portfolio capital inflows limited the appreciation pressures on the leu and led to a much smaller increase in foreign exchange reserves relative to 2023. The real effective exchange rate (REER) deflated by ULCs appreciated by close to 5% annually in both 2023 and 2024 (Graph 2.1.f). In a longer-term perspective, according to the IMF's EBA CA model, the REER (deflated by the CPI) is estimated to be overvalued relative to fundamentals, this trend being somewhat mitigated by productivity growth [(10)].

Non-cost competitiveness

Important bottlenecks still limit investment and productivity growth. According to the Worldwide Governance Indicators[(11)], Romania performs worse than its EU peers regarding government effectiveness, regulatory quality, control of corruption and rule of law. Government effectiveness remains among the lowest in the EU and has deteriorated in relative terms in 2023. In its 2024 Economic Survey on Romania[(12)], the OECD notes that simplified business registration and licencing has reduced firms' costs. But weak management and oversight of state-owned enterprises (SOEs) hinder competition in some sectors and undermine an efficient resource allocation. The efficiency of judiciary is another bottleneck to doing business, also due to lengthy insolvency procedures. Despite improvements, the government's administrative capacity and public procurement remain suboptimal, delaying RRP implementation and public investment. Policy predictability remains an issue, not least due to the volatile tax burden. The recent acceleration in civil engineering works starts to yield notable results, but large gaps in transport and IT infrastructure remain. On the labour market, the shortage of skilled workers is partly driven by the poor educational attainment and digital skills[(13)]. Credit demand from corporates, in particular SMEs, is constrained by patchy access to finance, including to venture capital, poor financial literacy, and

(9) The impact of wage increases on export competitiveness has been different across sectors according to the intensity of the labour input in the production structure and productivity gains.

(10) See International Monetary Fund. 2023. "Romania: 2023 Article IV Consultation." IMF Country Report No. 23/395. Washington, D.C. Romania: 2023 Article IV Consultation-Press Release; and Staff Report; IMF Country Report No. 23/395.

(11) See Daniel Kaufmann and Aart Kraay (2024). Worldwide Governance Indicators, 2024 Home | Worldwide Governance Indicators (worldbank.org).

(12) See OECD. 2024. "Romania", in OECD Economic Surveys, March 2024. OECD Publishing, Paris. OECD Economic Surveys: Romania 2024 | OECD.

(13) See European Commission. June 2024. 2024 Romania Country Report. 2024 European Semester: Country Reports - European Commission.

a large informal economy. Romania continues to rank poorly in Transparency International's indicator of perceived corruption [14].

Assessment of MIP relevant policies

Macroeconomic adjustment will require more prudent income policies. Minimum gross wages increased in a short succession by close to 30% cumulated in 2023, by another 12% in 2024 and close to 10% in January 2025. The minimum wage reform adopted in early 2025 should improve the predictability of minimum wage increases, keeping them in line with productivity gains and inflation, and consistent with job creation and competitiveness. The commitment taken in the context of the MTFSP that public sector wages be kept within the envelope foreseen in the plan should ensure moderation in civil servant remuneration relative to developments in the last few years.

Accelerating structural reforms with a focus on implementing existing commitments in the RRP would contribute to a durable reduction of current external vulnerabilities. Romania has continued structural reforms and made some progress in simplifying business registration and licencing, upgrading transport infrastructure and adopting legislation to address the weak corporate governance in SOEs. Moreover, the implementation of the RRP delivered some welcome results in terms of good governance, digitisation of businesses and economy at large, green transition and education. Additional reforms to improve public administration and procurement, infrastructure, education, access to finance and the functioning of judiciary and control of corruption, would strengthen the business environment and competitiveness, and could help in the reduction of vulnerabilities. All these reforms are to a large extent contained in Romania's RRP.

Table A: **Main policies increasing or reducing risks of imbalances considered in this IDR**

Vulnerability	Policies	Implementation status
External sector	*Policy 1 Fiscal* Romania adopted its medium-term fiscal-structural plan (MTFSP) foreseeing a reduction of the budget deficit to 2.5% of GDP until 2031, mainly through expenditure restraint.	Adopted in 2024 for implementation over 7 years
	Policy 2 Fiscal The government adopted an emergency ordinance introducing significant fiscal consolidation measures to the tune of 2% of GDP in 2025.	Implemented at end 2024
	Policy 3 Fiscal An ambitious tax reform to generate additional tax revenues is included in both RRP and MTFSP.	To be detailed and start implementation in 2025
	Policy 4 Banking supervision The NBR has maintained the countercyclical capital buffer at 1% and implemented further macro-prudential measures for prudent lending	Implemented in 2024
	Policy 5 Banking supervision The NCMO recommended the NBR to impose a capital buffer for other systemically important institutions (O-SII buffer).	Announced in 2024 for implementation in 2025
	Policy 6 Public sector wages MTFSP commitment to reducing personnel expenditure by approximately 1 percentage point of GDP between 2025 – 2031	Announced in 2024 and valid for the following 7 years

[14] See Transparency International. 2024. Corruption Perceptions Index 2023. 2023 Corruption Perceptions Index - Explore... - Transparency.org.

	Policy 7 Public sector wages Public sector wages were frozen via an emergency ordinance in 2025	Announced in 2024 for implementation in 2025
Price competitiveness	*Policy 1 Minimum wage* The minimum wage reform should improve the predictability of minimum wage increases in line with productivity gains and inflation	Announced for implementation in 2025
Non-price competitiveness	*Policy 1 SOEs* Updated legislation and new institutions to address and monitor the weak corporate governance in SOEs (RRP)	Implemented in 2024
	Policy 2 Infrastructure Progress with building up transport infrastructure	Implemented in 2024
	Policy 3 Digitisation Progress with the digitalisation of public administration, businesses and simplification of licensing (RRP)	Implemented in 2024
	Policy 4 Education and vocational training Progress with the reform in education and dual vocational training (RRP)	Implemented in 2024
	Policy 5 Green transition Progress with the green transition (RRP)	Implemented in 2024

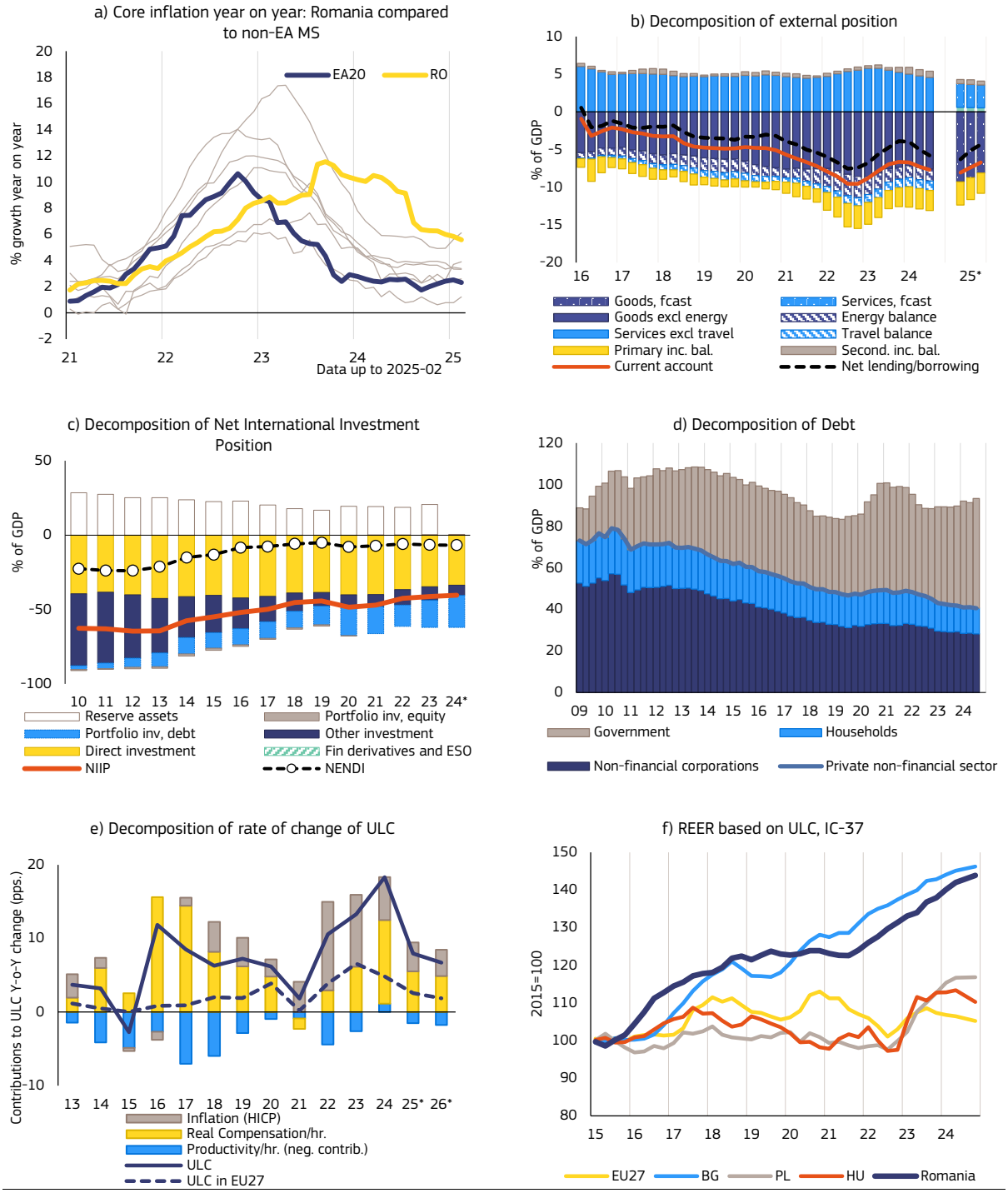
Note: This table lists the main measures that may increase or reduce the risks of macroeconomic imbalances. The measures are described more at length and reviewed in the text of this IDR.

CONCLUSIONS

Vulnerabilities have increased as Romania's twin deficits widened, and cost competitiveness deteriorated further in 2024. The sustained growth in the government deficit, in particular the increases in public sector wages and pensions, spurred private consumption and exacerbated the already large current account deficit. Real wages grew faster than productivity, partly due to significant minimum wage hikes, which eroded cost competitiveness. The sound external financing mix, based on sizeable net FDI and EU inflows that had so far contained the increase of the external debt stock, weakened in 2024. Political uncertainty increased towards year-end leaving the country more vulnerable to changes in investor sentiment, higher borrowing costs for the sovereign and prompted the three major rating agencies to revise their outlook on Romania's sovereign credit ratings to negative from stable. Overall, macroeconomic risks increased despite the still moderate levels of domestic and external debt stocks, as well as the resilience of the banking sector.

Overall, policy progress was minimal in 2024, including a notable deterioration in the fiscal stance. The main drivers of the elevated current account deficit - the large underlying fiscal deficit and generous income policies - continued in 2024. They contributed to a further increase in macroeconomic risks, which were partly mitigated by a prudent monetary policy stance, pro-active banking supervision and further structural reforms. A significant fiscal consolidation package adopted at end-2024 was a positive sign but has to be complemented by further measures to ensure full compliance with the MTFSP targets. The implementation of the MTFSP and a tax reform in 2025, would be a first important step to reduce fiscal vulnerabilities. However, risks remain elevated, and additional measures may be needed. Vigorous efforts are also required to preserve cost competitiveness, including by keeping minimum wage adjustments in line with productivity developments. Finally, structural reforms, and in particular those embedded in the RRP, are needed to strengthen the economy's overall competitiveness and export performance and support a reduction in the current account deficit. Without resolute action on both fiscal and structural reform levers, fiscal and external deficits are likely to remain too high, inflating debt stocks and leaving Romania significantly exposed to change in investor sentiment and exogenous shocks.

Graph 2.1: **Selected graphs, Romania**



Source: ECB, Eurostat, and European Commission forecasts and calculations.

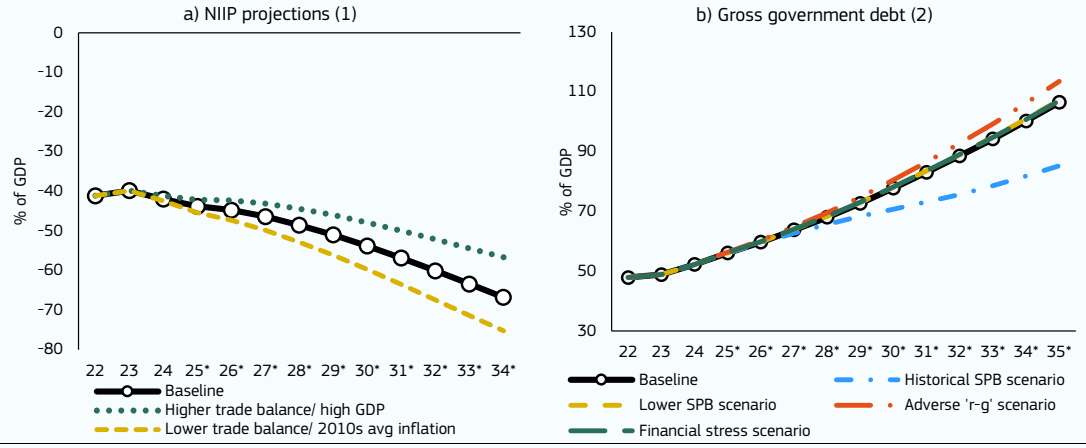
Box 2.1: **Medium-term external and government debt projections**

This Box summarises external and internal debt-to-GDP projections for Romania over the next decade, based on scenario analysis conducted by the Commission. It covers scenarios to take into account different underlying assumptions for external debt stocks, as well as the outcomes of the latest government debt sustainability analysis conducted by the Commission.

Romania's net international investment position (NIIP) is projected to substantially deteriorate in a range of scenarios, based on different underlying assumptions. In the baseline projections the NIIP falls below the estimated prudential benchmark to reach around -65% of GDP at the end of the forecast period. A large trade balance deficit and a worsening income balance owing to a growing interest rate spread are key contributors. The first scenario assumes an improvement in the trade balance and a 1 pp. increase in GDP growth compared to the baseline assumptions, which would still imply a mild worsening in the NIIP at the end of the forecast period. In an adverse scenario of a lower trade balance and if the annual inflation is assumed to be on average 0.7 pp below the baseline (assuming an annual average inflation rate of 4%), the NIIP ratio would still deteriorate to around 75% of GDP. Risks to the country's external position are partly mitigated by the favourable NIIP structure, as non-defaultable instruments account for the bulk of net liabilities and are composed mostly of foreign direct investments. The NENDI (NIIP net of non-defaultable instruments) in Romania was around -5% of GDP in 2023.

Short and medium-term risks to fiscal sustainability are overall high, whereas they are overall medium in the long term. The debt sustainability analysis carried out by the Commission indicates that, under the baseline scenario, the government debt-to-GDP ratio is projected to increase to around 73% in 2029 and to around 100% in 2034 (Graph 1.b) [(1)]. This Commission's assessment of fiscal sustainability risks does not take into account Member States' commitments as outlined in the medium-term fiscal-structural plans. In line with standard practice, it only incorporates fiscal measures that have been legislated or agreed for 2025 and assumes unchanged policy afterwards.

Graph 1: **External and government debt projections, based on scenario analysis for Romania**



(1) The baseline NIIP projections are based on the Commission's medium-term forecasts for GDP and interest rates. Additionally, assumptions are made about the drawdown of NGEU and MFF funds, and the median value of the last 3 years is used for non-investment income. The 'higher trade balance/ high GDP' scenario assumes higher trade balance in 2025 and beyond, with the difference to the baseline calculated as half the interquartile range of the annual 10-year-average trade balance to GDP ratios over 2013-2023 and additionally reflects a permanent 1 pp increase in GDP growth relative to the baseline scenario. The 'lower trade balance/ 2010s avg inflation' scenario assumes the same as the first scenario but with an opposite sign in the trade balance and also reflects an inflation rate that is set to the country-specific average inflation rate observed over the 2010s.
(2) The baseline projection for government debt is stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions: 'historical structural primary balance (SPB)' scenario, in which the SPB returns to its historical 15-year average of –2.6% of GDP; 'lower SPB' scenario: the improvement in the SPB forecast for 2025 is halved compared with the baseline; 'adverse interest-growth rate differential' scenario: the interest-growth rate differential is 1 pp. higher compared with the baseline; 'financial stress' scenario: interest rates temporarily increase by 1 pp. compared with the baseline.
Source: Eurostat, Debt Sustainability Monitor 2024, European Commission forecasts and calculations.

(1) European Commission (2025), Debt Sustainability Monitor 2024, European Economy Institutional Paper 306.

(Continued on the next page)

Table 2.1: **Key economic and financial indicators, Romania**

	average	average			forecast	
	2017-2019	*2020-2022*	*2023*	*2024+*	*2025*	*2026*
Output and Prices						
Real GDP (1 year % change)	6.1	1.9	2.4	0.9	2.5	2.9
Real GDP per capita (1 year % change)	6.6	2.4	2.3	0.8	2.6	3.0
GDP deflator (1 year % change)	5.9	7.2	12.8	9.1	5.9	5.3
Harmonised index of consumer prices (1 year % change)	3.0	6.1	9.7	5.8	3.9	3.6
Core inflation (HICP excluding energy, food, alcohol and tobacco) (1 year % change)	1.8	3.7	9.7	8.4	4.7	4.1
External position						
Current account balance, balance of payments (% GDP, 3y average)	**-3.2**	**-5.9**	**-7.8**	**-8.1**	**-7.3**	**-7.3**
Current account balance, balance of payments (% of GDP)	-4.2	-7.3	-6.6	-8.0	-7.3	-6.7
of which: trade balance (% GDP)	-3.4	-5.6	-4.8			
of which: income balance (% GDP)	-0.8	-1.6	-1.8			
Current account norm (% of GDP) (1)	-0.6	-0.1	-0.3	-0.3	-0.2	-0.2
Current account req. to reach fund. NIIP (% of GDP) (2)	-3.0	-2.6	-1.7	-1.3		
Net international investment position (% of GDP)	**-44.8**	**-45.2**	**-39.5**	**-38.0**	**-39.0**	**-39.2**
NENDI - NIIP excluding non-defaultable instruments (% of GDP)	-4.5	-5.9	-4.8			
Net lending-borrowing (% of GDP)	-3.0	-4.9	-4.9			
Competitiveness						
Nominal unit labour cost index per hour worked (3y % change)	**23.6**	**18.8**	**27.5**	**48.2**	**44.7**	**36.3**
Nominal unit labour cost index per hour worked (1 year % change)	7.3	6.2	13.3	18.3	7.9	6.7
Real effective exchange rate - 42 trad. part., HICP defl. (3y % ch.)	**-2.0**	**2.4**	**6.8**	**9.7**	**6.8**	**5.5**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)	0.1	0.9	5.5	2.7	1.3	1.5
Export performance against advanced economies (3y % change)	**11.5**	**5.5**	**6.8**	**-1.1**	**0.3**	**-1.1**
Export performance against advanced economies (1 year % change)	3.0	1.3	5.1	-3.8	1.3	1.6
Core inflation differential vis-à-vis the euro area (pps.)	0.8	1.7	4.7	5.5	2.3	2.1
Corporations						
Non-financial corporate (NFCs) debt, consolidated (% of GDP) (3)	**32.6**	**31.3**	**28.2**	**27.1**		
NFCs debt fundamental benchmark (% of GDP) (4)	14.2	20.4	23.6	26.1		
NFC (excl. FDI) credit flow, cons. (% debt stock t-1, excl. FDI)	2.5	10.2	9.6	9.2		
Households and housing market						
Household debt, consolidated (% of GDP) (3)	**15.8**	**15.3**	**12.5**	**12.5**		
Household debt fundamental benchmark (% of GDP) (4)	6.4	11.4	14.1	15.9		
Household debt, consolidated (% of Households' GDI)	22.4	24.3	26.0	19.4		
Household credit flow, consolidated (% debt stock t-1)	**8.0**	**5.7**	**2.8**	**9.4**		
Household gross saving rate (&)	-6.6	-2.5	-6.8			
House price index, nominal (1 year % change)	**5.0**	**5.4**	**3.3**	**4.8**		
House prices over/undervaluation gap (5)	-12.9	-17.8	-24.2	-28.3		
Standardized price-to-income ratio	76.8	66.5	58.7			
Building permits (m2 per 1000 inh)	541.6	593.5	456.9			
Government						
General government gross debt (% of GDP)	**34.9**	**47.6**	**48.9**	**52.2**	**56.1**	**59.7**
General government balance (% of GDP)	-3.2	-7.6	-6.5	-8.1	-8.0	-8.0
Banking sector						
Return on equity of banks (%)	12.5	12.6	16.8			
Tier-1 capital ratio banking sector (% risk-weighted assets)	18.1	20.5	19.9			
Gross non-performing loans, domestic and foreign entities (% gross loans)	5.3	3.4	2.5	2.7		
Cost of borrowing for households for house purchase (%)	4.9	4.8	7.3	6.4		
Cost of borrowing for NFCs (%)	5.4	5.7	9.0	8.2		
Labour market						
Unemployment rate (% labour force Y15-74)	**5.4**	**5.8**	**5.6**	**5.4**	**5.4**	**5.3**
Labour force participation rate - % pop. aged 15-64 (3y change in pp)	**2.9**	**3.0**	**2.7**	**1.8**	**1.0**	**1.5**

+ If actual data were unavailable at the cut-off date, forecast or nowcast data are presented instead; * Denotes values above prudential thresholds;

(1) Current accounts in line with fundamentals (current account norms): derived from reduced form regressions capturing the main determinant of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.

(2) Current account required to reach the prudential level of the NIIP over 10 years: calculations make use of Commission's T+10 projections. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.

(3) Prudential threshold for non-financial corporate and household debt-to-GDP ratio: corresponds to the level above which banking crises become more likely. It is derived from regressions minimising the probability of missed crises and that of false alerts. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.

(4) Fundamentals-based benchmarks for non-financial corporate and household debt-to-GDP ratios: assesses private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.

(5) House prices over/undervaluation gap: is the simple average of the price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. Based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU", European Economy - Discussion Papers 2015 - 048, DG ECFIN, European Commission.

Source: Eurostat and ECB; European Commission for forecast figures.

ANNEX 1 - THE EFFECT OF FISCAL EXPANSION ON THE EXTERNAL BALANCES OF ROMANIA

Overview

Romania experienced a significant decline in its external net lending balance since 2017, that went hand-in-hand with a sizeable increase in fiscal deficits. While this co-movement might suggest that fiscal policy played a role in driving the rise in external deficits, it is not enough for establishing an exact causal effect, since the Romanian economy was also subject to other types of shocks beyond fiscal policy. In order to isolate such causal contribution of fiscal policy changes to the external balance, in this exercise we run simulations by DG ECFIN's general equilibrium macroeconomic model, QUEST, where we aim to replicate the observed changes in Romanian fiscal policy and ignore other economic disturbances.

The main result is that, through the lenses of the model, the post-2017 Romanian fiscal expansion contributed significantly to the decline in the trade balance, which by 2024 becomes 2.6 percentage points lower than it would have been without the modelled fiscal policy changes. This result is mainly driven by the relatively high import content of domestic spending, which leads to "import leakage" from increases in domestic demand. On the other hand, the impact on the net lending/borrowing balance of the economy [(15)] is less pronounced and mostly vanishes by 2024. The reason is the sizeable inflow of EU transfers to Romania during that period (an integral part of the modelled increase in government investment), which roughly offsets the effect of larger trade deficits on net lending. It follows that the modelled scenario cannot explain the 5.5 pp decline in net lending as observed in the data, which may have been caused by other, non-fiscal shocks. The results also underline the crucial role EU transfers played in supporting the fiscal and external balances of Romania. At the same time, they also demonstrate how nationally financed fiscal expansion contributes to the external deficit.

The model and simulation setup

The analysis aims to simulate the observed changes in Romanian fiscal policy since 2017 with the QUEST model [(16)]. The simulations apply a four-region model setup covering Romania, the euro area (EA), the rest of the European Union (EU-6), and the rest of the world. Steady state import shares and trade flows are calibrated based on input/output tables from the FIGARO database. Romanian monetary policy is modelled as pegging the exchange rate of the leu to the euro. The main scenario considers fiscal shocks, identified as observed changes since 2017 in government consumption, public investment, and transfers to households (as share of potential GDP), changes to the tax rate on labour income, as well as inflow of EU transfers which were the direct counterpart for some of the observed increase in government spending, especially on public investment (see Appendix for details). To the extent that EU transfers were not used just to lower national debt, but instead financed additional government investment that would not have happened without them (e.g. in line with RRF requirements), it makes sense to treat them as an integral part of the fiscal expansion scenario.

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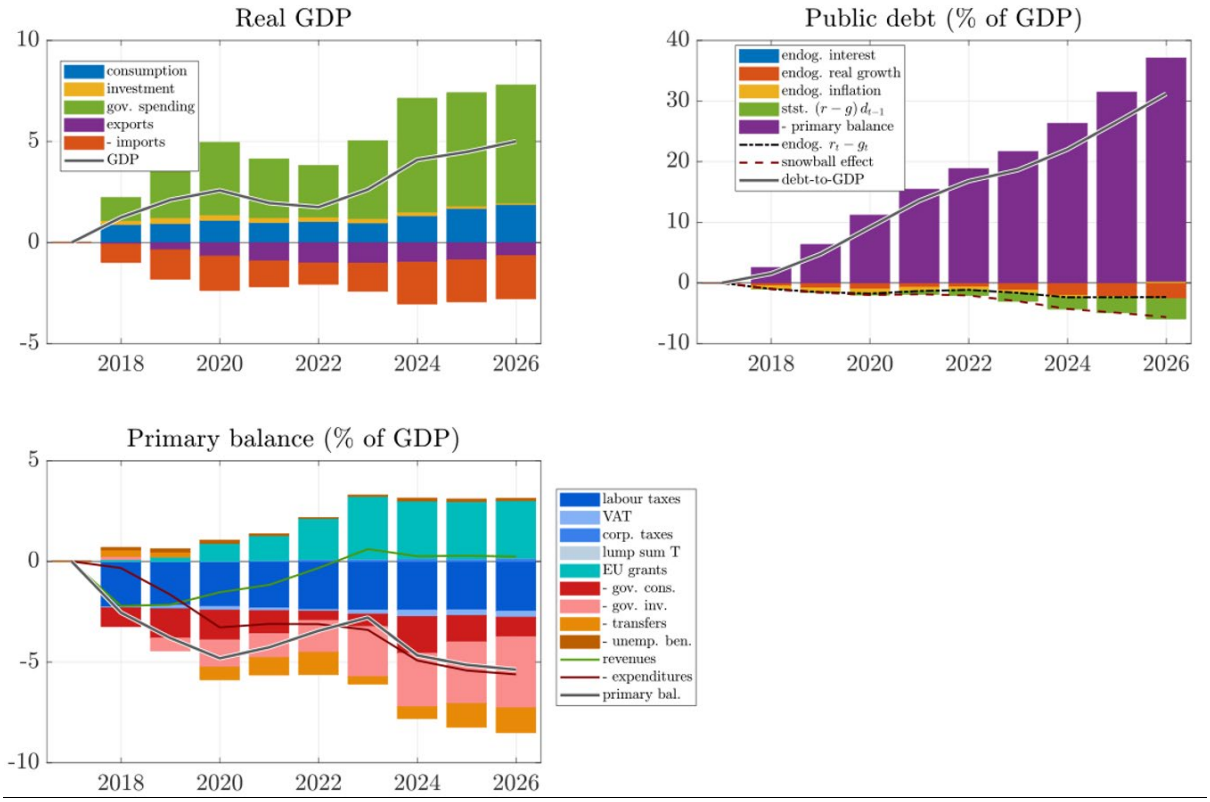
(15) Net lending/borrowing is the sum of the current account (CA) balance (which consists of the trade balance and the cross-border balance of primary and secondary incomes) and the capital account (KA) balance (which includes the balance of capital transfers where most of the investment grants from the EU are recorded).

(16) QUEST is a New Keynesian open economy dynamic stochastic general equilibrium (DSGE) model. The framework includes the main features relevant for the analysis of fiscal policy and international trade, such as liquidity-constrained households with high marginal propensity to consume (raising fiscal multipliers), productive public capital (leading to supply side effects of government investment), and *direct* import content of domestic demand. The model distinguishes between a tradable and a non-tradable sector, and it also includes trade in intermediate inputs for both sectors, capturing linkages through cross-border value chains, and allowing for *indirect* import content through domestically produced goods. The model features imperfect substitutability of goods produced in different regions, and sluggish adjustment of import volumes in response to relative price changes. Trade flows and nominal exchange rates are modelled bilaterally, via integrated international goods and financial markets.

Results and transmission channels

The modelled fiscal expansion leads to a decline in the primary budget balance and to rising public debt. As shown in Graph A1.1, the primary balance declines by an average of 4 percentage points of GDP over the simulation horizon (relative to 2017, bottom left panel), which drives a steep increase in the debt-to-GDP ratio (purple bars in top right panel). This cumulative change in the budget balance is roughly in line with the data [17]. The main contributors to the increase in primary deficits are the decline in labour tax revenues and rising public investment spending (especially towards the end of the horizon), but higher government consumption and transfers to households also display a steady negative contribution, while the higher inflow of EU transfers mitigate the rise in budget deficits.

Graph A1.1: **The effects of a stylised fiscal expansion (relative to 2017)**



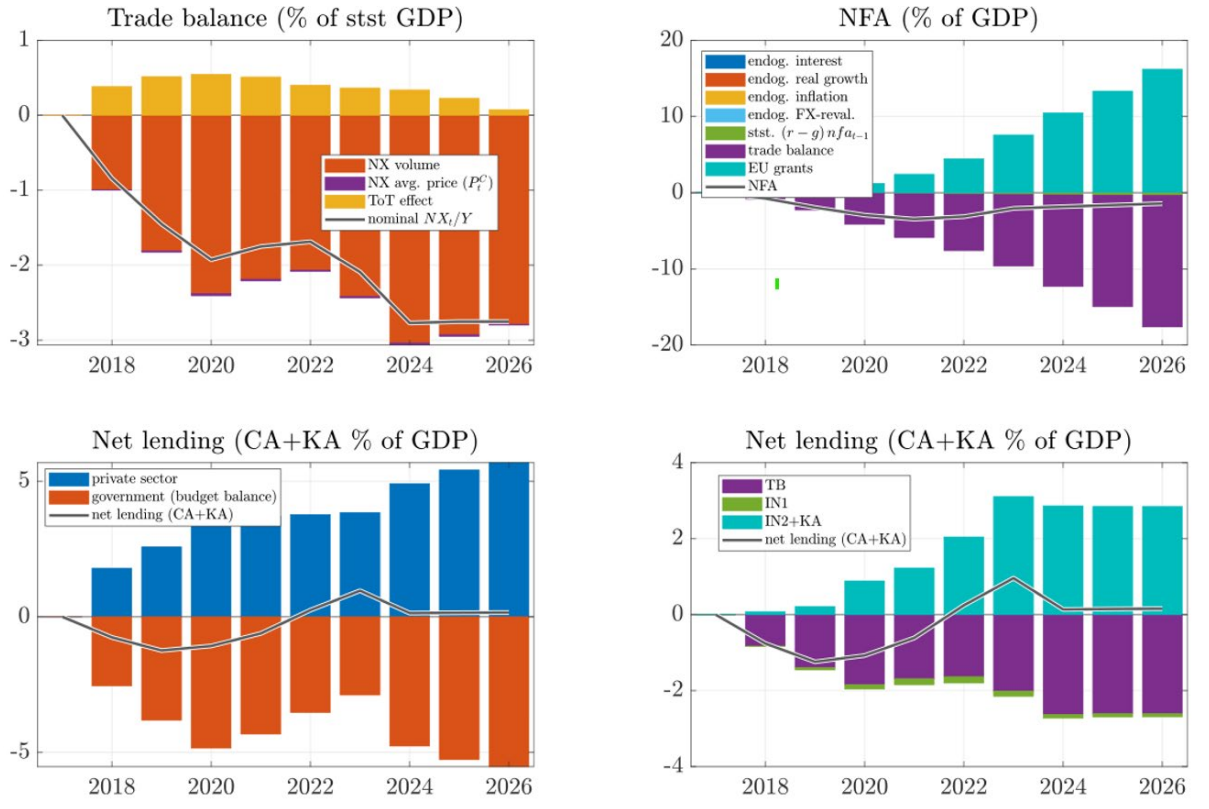
***Note**:* Real GDP is reported in terms of %-deviation, while public debt and the primary balance are in percentage point deviations (as a share of GDP), relative to a counterfactual scenario where fiscal instruments would have stayed unchanged at their 2017 level. Bars indicate *contributions* to the deviation in the main variable (which is shown by the black line). Consumption and investment in upper left panel are private.
Source: European Commission services.

Real GDP rises in response to the fiscal stimulus, being 4.1% higher in 2024. As the upper left panel in Graph A1.1 shows, this result is mostly driven by the increase in government spending (both on consumption and investment goods) that raises aggregate demand directly. At the same time, an indirect Keynesian multiplier channel operates via raising household incomes that stimulates private consumption, which is further supported by the labour tax cuts and higher transfers to liquidity-constrained households (even though rising government consumption also has

[17] The results indicate a 20 pp increase in debt-to-GDP between 2017 and 2024, which is somewhat larger than the 17pp observed in the data (from 35% to 52%), despite the cumulative primary balance changes being roughly the same. The reason is that nominal GDP has grown more in reality than in our simulations which only include the effects of fiscal shocks but ignore other disturbances (e.g. the inflationary period following the pandemic), that raised the denominator effect in the snowball term (red and yellow bars in the upper right panel of Graph A1.1).

a crowding out effect on private consumption as it raises the strain on the economy's limited resources). In addition to these demand side channels, more government investment into productive public capital and lower distortionary labour taxation has a beneficial supply side effect on economic output, easing the strain on resources and *crowding in* private investment.

Graph A1.2: **The external effects of a stylised fiscal expansion (relative to 2017)**



***Note**: All variables are reported in terms of percentage point deviation (as a share of GDP), relative to a counterfactual scenario where fiscal instruments would have stayed unchanged at their 2017 level. Bars indicate *contributions* to the deviation in the main variable (which is shown by the black line). For the trade balance contributions refer to export-import (NX) volumes, average price level change and terms-of-trade (ToT, relative price) changes. Net lending is the sum of the capital account (KA) and the current account (CA) balance, where the latter includes the trade balance (TB), and the primary and secondary income balances (IN1, IN2).*
***Source:** European Commission services.*

The trade balance declines, mainly due to import leakage from rising domestic spending. Graph A1.1 (upper left panel) shows how rising import and falling export volumes contribute negatively to the change in GDP. This is also reflected in Graph A1.2 (upper left panel) where falling net export volumes drive the decline in the trade balance. The key channel behind this is "import leakage" from increased domestic spending (expenditure *changing*), which happens both directly by importing final goods, as well as indirectly due to imported intermediate inputs used for domestically produced goods. This channel is rather strong as the total import content of domestic demand in Romania is around 30% [18]. The fall in net export volumes is amplified by a second channel due to an appreciating terms-of-trade (expenditure *switching*), as the rise in aggregate demand creates domestic inflationary pressures, making exporters less competitive abroad, and inducing substitution by domestic firms and households towards imports that become relatively less expensive [19]. Finally, the terms-of-trade gain makes a direct positive contribution to the trade

[18] See also Thematic Section: The Import Content of Final Demand and Industrial Sectors in Romania.

[19] The real exchange rate appreciates despite the nominal peg of the leu to the euro, but this appreciation is more gradual than it would be under a floating exchange rate regime. Nonetheless, the elasticity of trade volumes to relative price

balance (yellow bars), as it reduces the import bill and boosts export revenues through changes in relative prices, mitigating somewhat the negative effect of the volume component (dark orange bars). In the end, the trade balance becomes 2.6 percentage point lower by 2024 due to the modelled fiscal shocks, which is roughly three quarters of the decline observed in the data.

The inflow of EU transfers supported a net lending balance more favourable than implied by the trade deficit. As shown in the right panels of Graph A1.2, rising grants received from the European Union are a significant positive component of net lending/borrowing flows, cumulatively amounting to more than 10% of GDP by 2024, raising the Net Foreign Asset (NFA) position by this much (turquoise bars). Apart from mitigating the fiscal deficit, this offsets much of the negative effect of trade deficits on the external balance: after initially declining by around 1 percentage point of GDP, net lending/borrowing returns to its starting level (and temporarily even surpasses that) as the inflow of EU grants picks up pace with Next Generation EU [20]. Importantly, we consider EU transfers an integral part of the modelled fiscal expansion scenario, as it is likely that some of the increase in government spending (the effect of which we have already considered) would not have occurred without them. This assumption is also in line with the additionality requirement in RRF.

The saving-investment (S-I) balance of the private sector increases, offsetting much of the fiscal deficits. Another way to look at net lending/borrowing of the total economy is as the sum of sectoral net lending balances for the government and the private sector (see bottom left panel in Graph A1.2). While EU transfers mitigate the fiscal deficits, the budget balance still declines (just not as much as without EU grants), roughly in line with observed data. At the same time, the fiscal expansion leads to S-I surpluses in the private sector as the GDP-boom, transfer handouts and tax cuts raise the disposable income of households. This extra income is not fully spent on higher consumption and investment (which is also visible on the top left panel of Graph A1.1), but some of it is saved in the form of higher government (or foreign) bond holdings [21].

Table A1.1: **The effects of a stylised fiscal expansion (relative to 2017)**

	2018	2019	2020	2021	2022	2023	2024
GDP (level, % dev)	1.24	2.11	2.58	1.95	1.75	2.62	4.10
CPI inflation (pp dev)	0.56	0.62	0.23	−0.13	−0.20	−0.08	−0.03
Terms-of-trade (% dev)	0.35	0.83	1.05	1.02	0.89	0.76	0.63
Trade balance	−0.82	−1.40	−1.84	−1.69	−1.63	−2.01	−2.63
Net lending	−0.76	−1.24	−1.08	−0.61	0.25	0.96	0.14
NFA position	−0.47	−1.49	−2.55	−3.27	−3.26	−2.46	−1.92
Primary balance	−2.54	−3.80	−4.81	−4.27	−3.44	−2.79	−4.66
Public debt	0.76	3.38	7.36	11.97	15.64	17.84	20.50

Note: Unless indicated otherwise, values are express percentage point deviations in terms of GDP share, relative to a counterfactual scenario where fiscal instruments would have stayed unchanged at their 2017 level.
Source: European Commission services.

changes is low in the short run. At the same time, the FX-peg (i.e. not tightening in response to inflation) also implies a relatively looser monetary policy that benefits domestic demand and raises import leakage.

[20] The distinction between the current account (CA) and net lending/borrowing is important in this case, since the latter also includes the capital account (KA), i.e. the balance of capital transfers. A large portion of EU grants, financing investments, is recorded as capital transfers in KA, and only a smaller portion is categorised as current transfers in the secondary income balance (IN2) within the CA.

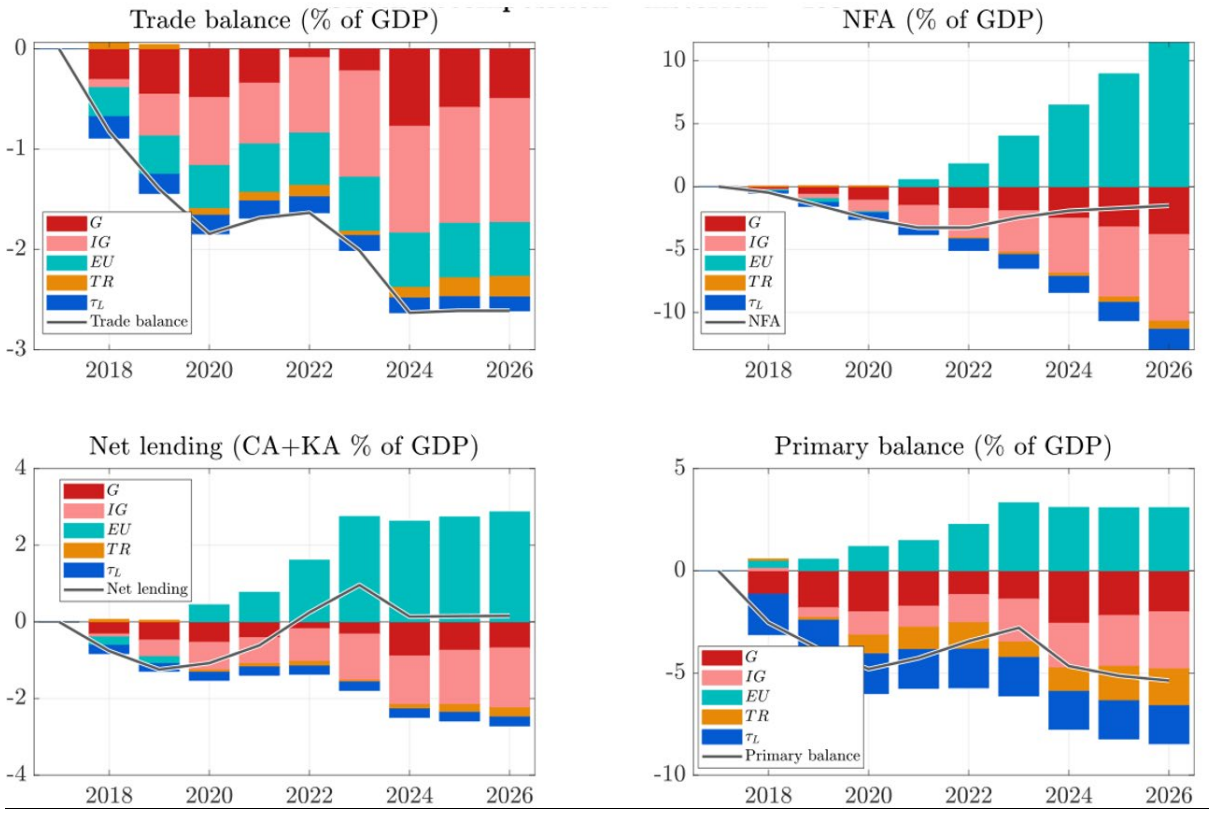
[21] In QUEST the portfolio choice of households between government and international bonds is not modelled. By assumption, all government bonds are held by domestic households, who can residually also save/borrow in international bonds (thereby potentially intermediating between the government and foreigners). This international bond is the sole component of the net foreign asset (NFA) position, the dynamics of which is governed by the balance of payments.

In conclusion, according to the simulations, the net effect of the modelled fiscal expansion on the net lending balance of Romania is small. It follows that the additional decline in net lending/borrowing as observed in the data may have been caused by other, non-fiscal shocks, that brought down the private sector's fiscally-induced surplus to the actually observed lower levels (e.g. the terms-of-trade loss incurred during the energy crisis, or a looser monetary policy than implied by the current simulations, see Graph A1.7). At the same time, the results also demonstrate the crucial role played by the inflow of EU transfers in supporting the fiscal and external balances of Romania, implying that without them, a purely *nationally financed* fiscal expansion contributes significantly to the external deficit.

The composition of fiscal expansion

The composition of fiscal expansion is highly consequential for the macroeconomic effect. Fiscal multipliers or the amount of import leakage depend a lot on how a given increase in the budget deficit is split between various fiscal instruments. To analyse the contribution of each type of fiscal measure to our results, we ran alternative simulations with each individual shock added one-by-one. The results are displayed in Graph A1.3.

Graph A1.3: **The external effects of a stylised fiscal expansion (relative to 2017), contributions by individual fiscal instruments**

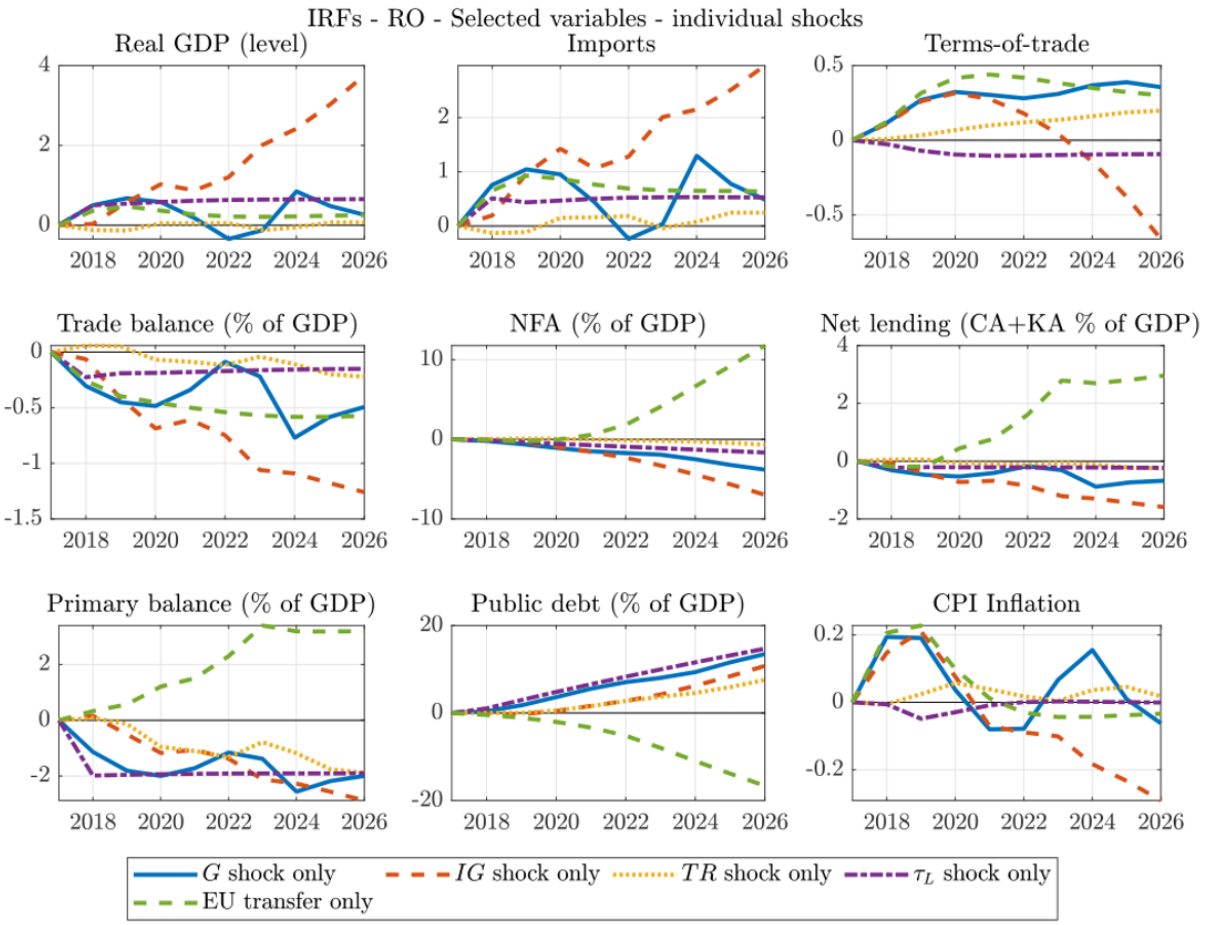


***Note**:* All variables (depicted by black lines) are reported in terms of percentage point deviation (as a share of GDP), relative to a counterfactual scenario where fiscal instruments would have stayed unchanged at their 2017 level. Bars indicate contributions to the deviation in the main variable, by the 5 individual fiscal shocks we consider. 'G' refers to government consumption shocks, 'IG' to public investment shocks, 'EU' to foreign grants, 'TR' to fiscal transfer shocks to households, while 'tau_L' to changes in the labour tax rate.
Source: European Commission services.

The main contributors to rising trade deficits are shocks to government consumption and public investments. While their role in the widening budget deficit is roughly comparable to other fiscal instruments (see bottom right panel in Graph A1.3), government consumption and

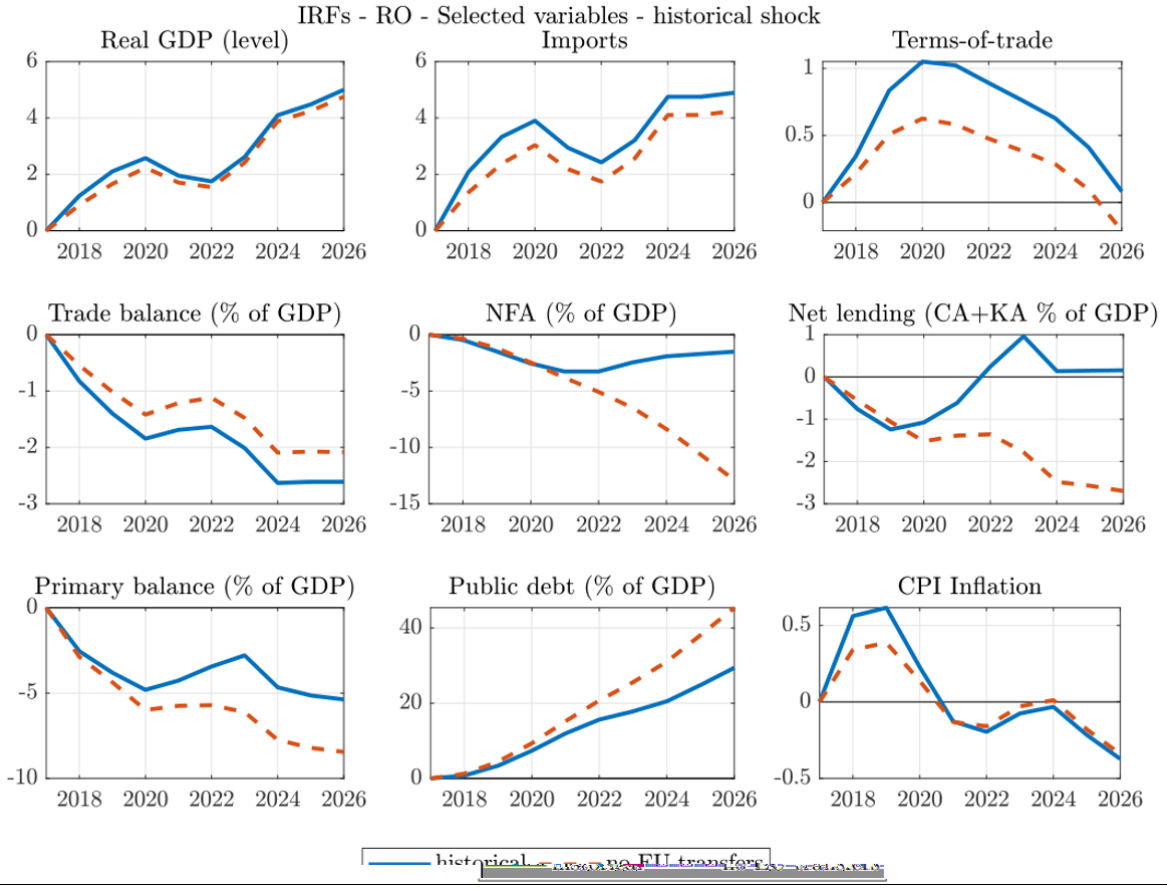
investment shocks contribute disproportionately more to the declining trade balance (top left panel). Higher government spending directly leads to import leakage, which drags down the trade balance. In contrast, transfer handouts and labour tax cuts raise domestic demand less than one-to-one, as some of these handouts are saved by households. As Graph A1.4 illustrates, this also implies that the stimulus to aggregate demand and the corresponding inflationary and real appreciation pressures are larger for government spending shocks. Importantly, however, after the initial boost to demand, government investment shocks will exert downward pressure on inflation and the terms-of-trade, as the gradually increasing public capital stock raises the supply potential of the economy. This also true for cuts in the distortionary labour tax rate, which lowers gross nominal wages and acts as a positive shock to labour supply. The majority of the long-term GDP effect is driven by these beneficial supply-side effects, especially that stemming from productive public investments.

Graph A1.4: **The effects of alternative fiscal expansions with different compositions**



Note: IRFs refer to impulse-response functions. Lines depict percentage deviations, except for variables expressed as a share of GDP (where they depict pp deviations), relative to a counterfactual scenario where fiscal instruments would have stayed unchanged at their 2017 level.
Source: European Commission services.

Graph A1.5: **The effects of historical fiscal expansions with or without EU transfers**



Source: European Commission services.

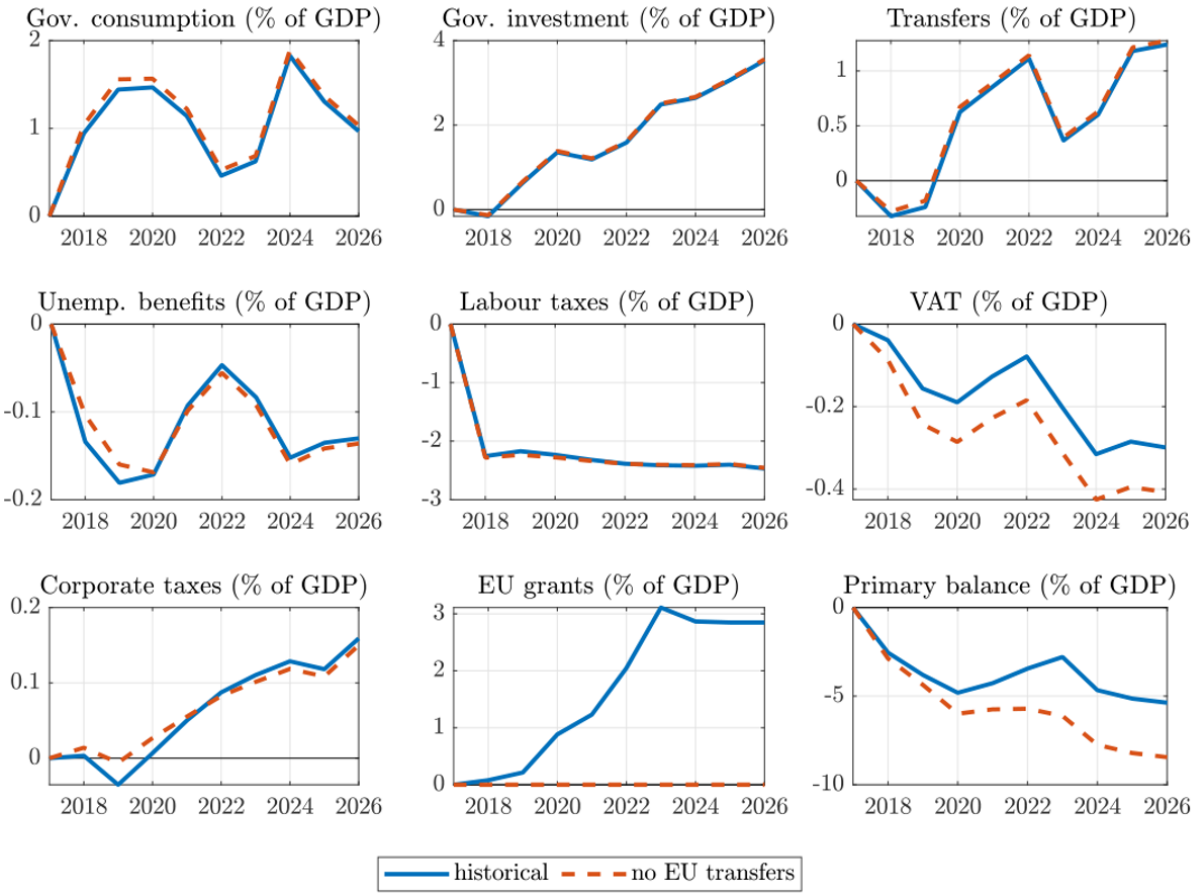
The role of EU transfers is crucial in supporting the fiscal and external balance of the economy. As shown in Graph A1.5, in the hypothetical scenario where Romania implements the same fiscal measures and increase in government spending, but without receiving the corresponding EU transfers (red dashed line), the budget balance and the economy's net lending/borrowing declines much more sharply than in our main fiscal expansion scenario (blue solid line)[(22)]. By 2024 these differences would imply a cumulatively 10 percentage points higher public debt-to-GDP ratio and a 6-percentage point lower NFA position relative to our main scenario. The marginal effects of EU transfers (the difference between the blue solid and red dashed lines in Graph A1.5) are also illustrated in Graph A1.4 (green dashed lines), or in Graph A1.3 (turquoise bars).

(22) While they have beneficial effect on net lending, the trade balance is actually somewhat *lower* with EU transfers than without them. The reason is that in present value terms these transfers constitute a "gift" from foreign taxpayers to domestic ones, to the extent that Romania's current and future contributions to the EU budget are smaller than the grants it receives. These grants lower public debt, which requires smaller primary surpluses and a smaller tax burden on domestic households in the future, stimulating their consumption (and the corresponding import leakage) already in the present.

Appendix – Fiscal instruments

The fiscal shocks modelled in our main scenario are identified from the data as observed changes since 2017 in government consumption, public investment, and transfers to households (as share of potential GDP [23]), a permanent 4 percentage point cut to the labour income tax rate (labour tax revenues as a share of the gross wage bill), as well as the observed inflow of EU transfers. Graph A1.6 depicts how the simulated GDP share of various fiscal instruments changes in response to these shocks.

Graph A1.6: **Fiscal instruments**



***Note**: Lines depict percentage point deviations (in terms of GDP share), relative to a counterfactual scenario where fiscal instruments would have stayed unchanged at their 2017 level. Fiscal shocks to government consumption, government investment and transfers were identified from the data based on changes in their ratio to potential GDP. The average labour tax rate (labour tax revenues as a share of the gross wage bill) is lowered permanently by 4 percentage points after 2017.*

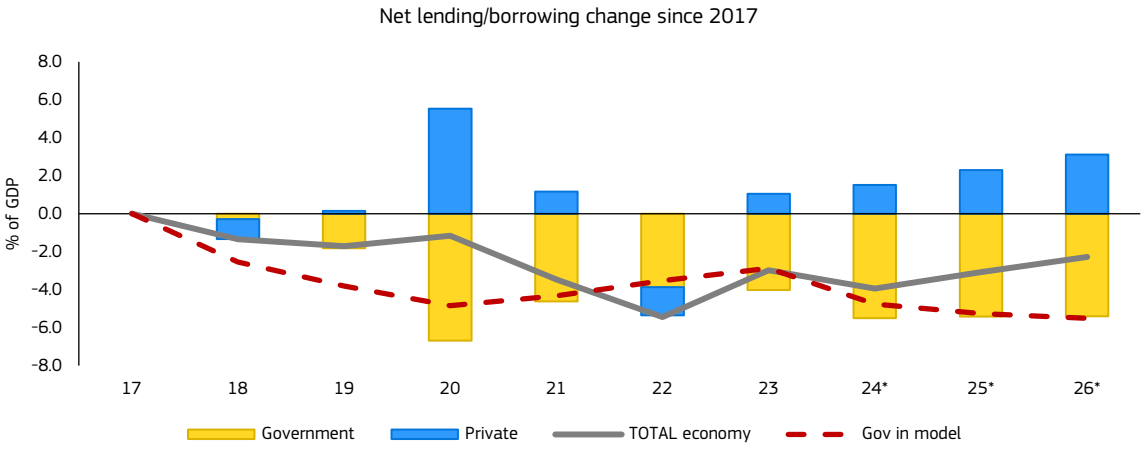
Source: European Commission services.

As referred to before, the simulated response of the government's net lending/borrowing tracks the changes observed in the data since 2017 relatively well, yielding roughly the same cumulative effect by the end of our horizon. This is shown in Graph A1.7 that is the data counterpart of the bottom left panel in Graph A1.2. The main difference between these figures lies in the net lending of the private sector that is lower in the data, also pulling down the net lending of the total economy. But recall that the simulation results include only the effect of the modelled fiscal shocks, while the data reflects the effects of *all* kinds of disturbances that hit the Romanian economy. The scenario does not consider non-fiscal shocks that occurred during 2017-2024 that

[23] Potential GDP chosen to avoid endogeneity issues created by the impact of fiscal measures.

may have affected the private sector's fiscally induced surplus to the actually observed lower levels, such as a looser monetary policy than implied by the FX-pegging of the leu or the terms-of-trade loss incurred during the energy crisis, etc.

Graph A1.7: **Net lending/borrowing by sector (data vs model)**



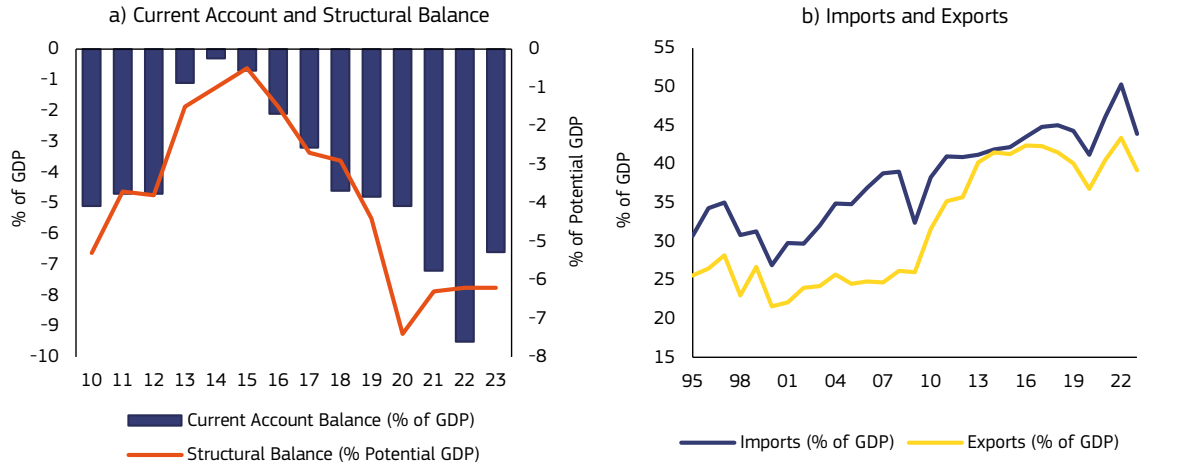
Note: Bars depict the observed percentage point changes relative to 2017 (in terms of GDP share), of the net lending/borrowing balances of the Romanian government and private sector. The grey solid line is the sum of those bars, yielding the observed change in the net lending of the total economy. The model-simulated change in the government's net lending balance (in response to the modelled fiscal shocks) is shown by the red dashed line, that tracks observed changes relatively well and yields roughly the same cumulative effect by the end of the horizon shown.
Source: European Commission services

ANNEX 2 - THE IMPORT CONTENT OF FINAL DEMAND AND INDUSTRIAL SECTORS IN ROMANIA

Introduction

Romania's macroeconomic stance over the past two decades has been marked by recurring "twin deficits". Since 2015, a widening current account deficit (mainly caused by the trade deficit) and persistent fiscal deficits have exacerbated external vulnerabilities (Graph A2.1). Before the Global Financial Crisis (GFC), rapid economic growth was accompanied by widening fiscal and current account deficits. In the aftermath of the GFC, Romania adopted substantial fiscal consolidation measures and reforms, which led to a swift and significant reduction in both fiscal and current account deficits. By the mid-2010s, the trade balance had improved. However, expansionary fiscal policies, including tax cuts and increased public spending, drove the fiscal deficit to 4.3% and the current account deficit to 4.8% of GDP by 2019. Rising domestic demand fuelled imports, while exports stagnated. The COVID-19 pandemic worsened the current account balance as government spending surged to stabilise the economy. By 2023, trade deficits persisted, driven in large part by generous income policies, including significant increases in pensions, public sector wages and the minimum wage, as well as public investment.

Graph A2.1: **Current Account, Structural Balance, and Trade Flows**



Source: Eurostat and European Commission forecasts.

The trade deficit in goods represents the single largest component of the current account deficit. Analysing the import content of the Romanian economy can help better understand some of the underlying factors driving the deficit. By examining the share of imports in government consumption, household consumption, investment, exports, and sectoral outputs, the analysis highlights how final demand and production patterns contribute to import dependency.

This thematic section investigates the import dependence of Romanian sectors and final demand components. The analysis is based on a Leontief input-output analysis, which captures interdependencies between industries and countries through technical coefficient matrices[(24)]. Drawing from similar studies, the analysis calculates the direct and indirect import content of government consumption, household consumption, investment (gross capital formation), and exports[(25)]. In addition, it also estimates the import content of domestic production to measure the

[(24)] Miller, R. E., & Blair, P. D. (2022). Input-Output Analysis: Foundations and Extensions, Third Edition. Cambridge University Press; See also Leontief, W. (1986). Input-Output Economics, Second Edition. Oxford University Press.

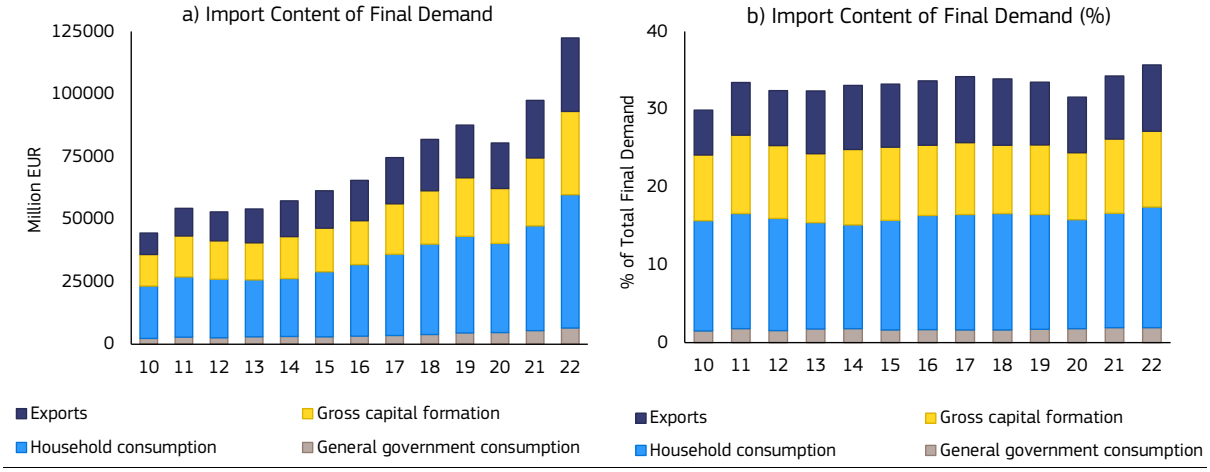
[(25)] Cardoso, F., & Rua, A. (2019). The import content of final demand in Portugal: Nominal and real evolution. Banco de Portugal Economic Studies, 5(3), 51-73; See also Bussière, M., Callegari, G., Ghironi, F., Sestieri, G., & Yamano, N. (2013).

extent to which sectors in the Romanian economy rely on foreign inputs[26]. The analysis employs the 2024 edition of the FIGARO inter-country input–output tables (EU IC-SUIOTs) from Eurostat, covering 64 industries from 2010 to 2022, as classified under the NACE system.

Import Content of Final Demand

The import content of final demand is a measure of the extent to which a country's final demand is satisfied by imported goods and services. The results of the input-output model show that household consumption consistently accounts for the highest nominal import content in Romania, followed by investment and exports. Household consumption consistently drives the highest import volumes, reaching over EUR 53 billion in 2022, followed by investments and exports (Graph A2.2.a). Government consumption remains the smallest direct contributor to the import content of final demand throughout the period. However, while household consumption is the largest driver of imports, both investments and exports show a growing reliance on imported inputs (Graph A2.2.b).

Graph A2.2: **Import Content of Final Demand**



Total import values are measured in million euros at basic prices and differ from the international trade statistics, which are measured in CIF values and do not follow national accounts concepts.
Source: European Commission services

Import dependence varies across final demand categories, with investment and household consumption having the highest reliance on foreign inputs. To calculate the import dependence of final demand, the import content (direct and indirect[27]) for each category of final demand is expressed as a share of total expenditures in each respective category. The results (Table A2.1) show that investment exhibits the highest level of import dependency. The import dependency of investment expenditure rose from 46.4% in 2010 to 60% in 2022. This reflects both direct imports, such as machinery and construction materials, and indirect imports embedded in domestically produced investment goods. The final expenditure of households also displays

Estimating Trade Elasticities: Demand Composition and the Trade Collapse of 2008-2009. American Economic Journal: Macroeconomic, 5(3), 118-151.

(26) Mikulić, D., & Lovrinčević, Ž. (2018). The import content of Croatian economic sectors and final demand. Economic Research-Ekonomska Istraživanja, 31(1), 2003–2023; See also Bravo, A. C., & Alvarez, M. T. (2012). The import content of the Industrial sectors in Spain. Economic Bulletin, Banco de España, 81-92.

(27) The indirect import content refers to the share of imports embedded in domestically produced goods and services, arising from the use of imported intermediate inputs, raw materials, or capital goods by domestic suppliers. These imports are not directly purchased by the final consumer or producer but are instead incorporated into the production process through domestic supply chains.

substantial import dependency, rising to 39.5% in 2022 from 31.8% in 2010. Exports also exhibit a growing import dependency as a result of Romania's further integration into global value chains (GVCs), primarily driven by foreign inputs used in export-oriented production. In contrast, general government consumption maintains the lowest level of import penetration, at just 14.1% of government expenditure in 2022.

Table A2.1: **Import Dependence of Final Demand (% of Total Expenditures for Each Component)**

	2010			2015			2022		
	Total	Direct	Indirect	Total	Direct	Indirect	Total	Direct	Indirect
Household Consumption	31.8	16.4	15.4	34.5	20.2	14.3	39.5	22.8	16.6
Government Consumption	11.6	-	11.6	13.8	2.8	11.1	14.1	2.1	12
Gross Capital Formation	46.5	21.4	25	65.2	42	23.2	60	32.8	27.2
Exports	23.7	-	23.7	24.6	-	24.6	27.6	-	27.6

Source: European Commission services

Government spending influences imports and the trade deficit primarily through its effects on public investment and private consumption, rather than through direct government consumption [(28)]. Final expenditure by the public sector is primarily directed towards public services such as healthcare, education, and defence. However, direct government purchases from abroad are relatively small, which keeps the import content low. Instead, a significant portion of public spending influences indirectly other items like investment and household consumption, which are relatively more import-dependent (import leakage).

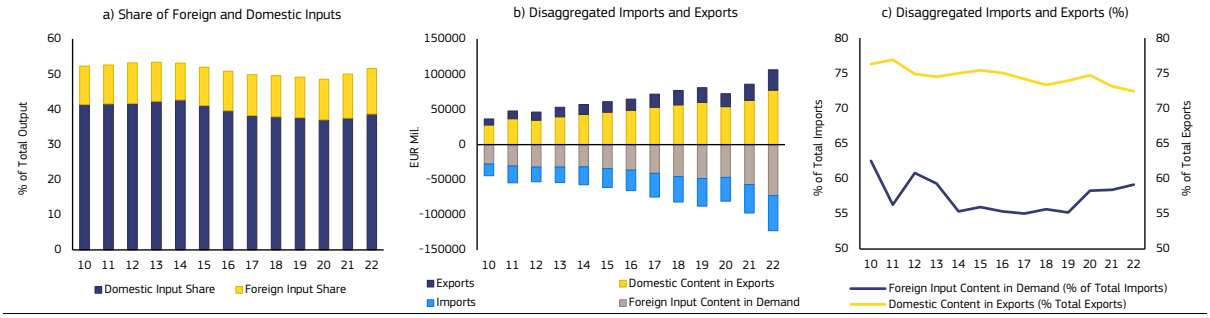
The import content of exports has also increased as a result of Romania's growing integration in GVCs. While not particularly high compared to other EU countries, a higher import intensity of exports mitigates the positive effects of exports on the trade balance as it also entails an increase in imports of intermediate goods[(29)]. Given that a large share of domestic consumption and investment, as well as a growing part of exports rely on imported inputs, a surge in domestic demand stimulated by fiscal expansion, rising incomes, or public and private investment will also "leak" into greater import flows.

While the import content of final demand shows how much of consumption, investment, and exports rely on goods and services produced abroad, analysing domestic versus foreign inputs shares shows how industries meet their production needs. Domestic inputs comprise all intermediate inputs purchased from domestic sectors, while foreign inputs refer to imported intermediates used in domestic production. Examining these shares complements the final demand import content analysis by revealing how much of Romania's total inputs are sourced locally versus from abroad. While domestic inputs continue to be the primary source for production, their share declined from around 41% to 39% from 2010 to 2022, whereas the foreign share rose slightly from roughly 11% to 13% (Graph A2.3.a).

(28) See Annex 1: Fiscal expansion impact on the external balance of Romania. QUEST simulations.

(29) European Commission. (2012). A closer look at some of the drivers of trade performance at Member State level. Quarterly Report on the Euro Area, 11(2), 29-39. Retrieved from https://ec.europa.eu/economy_finance/publications/qr_euro_area/2012/pdf/qrea2_en.pdf.

Graph A2.3: **Foreign and Domestic Inputs in Output and Trade**



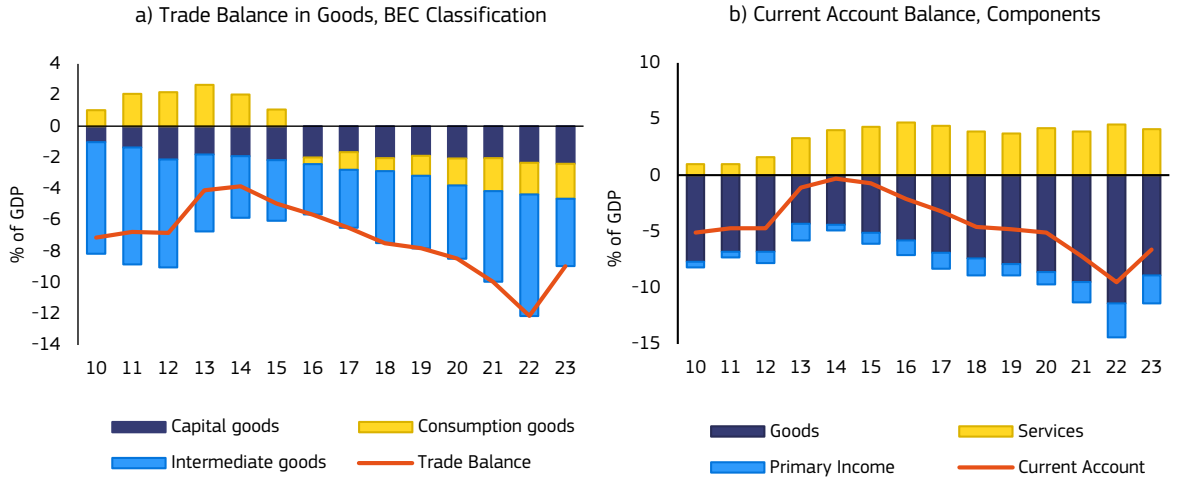
The "domestic content in exports" measures the share of value added by the country's own industries that is embedded in foreign demand, while "foreign input content in demand" refers to the imported intermediate inputs used to satisfy production of goods or services for consumption, investment, or exports.
Source: European Commission services.

To further analyse how Romania's production structure underpins its trade flows, imports and exports can be further disaggregated into domestic and foreign components or factor content. From 2010 to 2022, the domestic content of Romanian exports has steadily expanded in absolute terms. However, its share of total exports has declined slightly, indicating that a slightly larger proportion of exported goods rely on foreign inputs. Similarly, the foreign input content of domestic demand has grown in absolute volume, though its share has fluctuated, declining in the mid-2010s before rising again in recent years (Graph A2.3.b). Since 2020, the foreign input share of domestic demand increased slightly from 58.3% to 59.1%, while the domestic content share of exports fell from 74.7% to 72.4% (Graph A2.3.c).

Import Dependence of Romanian Industries

The structural drivers of Romania's import dependency are closely tied to the sectoral composition of the economy. Since joining the European Union, Romania has attracted a considerable amount of foreign direct investment. The arrival of large foreign-owned firms strengthened trade ties with global suppliers and increased both imports and exports, especially in the industrial sector. Foreign-owned companies account for the bulk of both imports and exports, whereas Romanian firms play a more modest role in international trade, with many importing but fewer exporting. Since 2015, Romania's trade balance has been increasingly driven by rising net imports of both consumption and intermediate goods, marking a shift from its previous role as a net exporter of consumption goods. Meanwhile, imports of intermediate goods, mainly industrial inputs and parts, have also increased. Imported intermediate goods still represent the largest single component of Romania's trade-in-goods deficit (Graph A2.4.a). Growing reliance on foreign inputs and imported consumer goods, combined with domestic demand pressures, is a key factor behind Romania's persistent trade-in-goods deficit, the primary driver of the current account deficit (Graph A2.4.b). While the growing share of imported inputs reflects the successful integration of Romania's industry in European and GVCs, it also suggests that Romania could reduce its external deficit through a combination of further developing the human and physical capital needed to boost production of tradable goods and implementing policies to curb excess domestic demand relative to output capacity.

Graph A2.4: **Breakdown of the Trade and Current Account Balances**



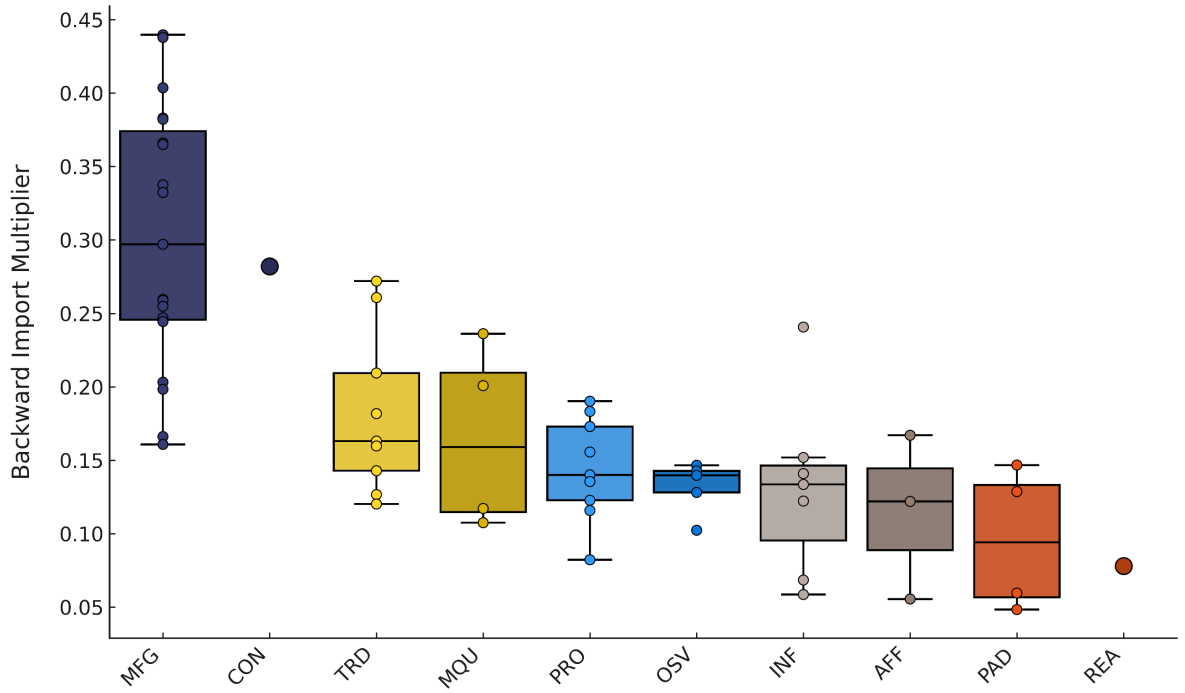
Source: Eurostat

To measure the magnitude of import leakage, backward import multipliers are calculated to quantify the extent to which domestic economic activities depend on foreign inputs [30]. Backward linkages measure how much total output is needed to meet a change in final demand for any given sector. When domestic industries rely on foreign inputs, some of the economic gains from production accrue or "leak" to the external sector. Backward import multipliers capture this by measuring how much foreign production is needed to support an additional unit of final demand for each domestic sector. While direct import shares show the reliance on imported inputs in a sector's own production, the total backward import multiplier includes both direct and indirect foreign input use across the full supply chain. A higher backward import multiplier indicates that a sector's production depends relatively more on foreign inputs. Although backward leakages indicate that a share of economic gains from domestic production flows to foreign economies, they do not necessarily impede potential output as imports can be used to increase the competitiveness of domestic production.

The sectoral distribution of backward import multipliers highlights industries most reliant on foreign inputs, with manufacturing sectors exhibiting relatively higher import dependency. The backward import multipliers are plotted by aggregated sectors and indicate the share of inputs sourced from foreign markets for each sector (Graph A2.5). Import multipliers are highest among medium-low technology manufacturing and resource-intensive industries such as rubber and plastic products (0.44), base metals (0.44), and coke and refined petroleum products (0.38). High and medium-technology manufacturing industries that are more integrated into GVCs and require more imported specialised components also exhibit higher import dependency as well. These include manufacturing industries such as motor vehicles (0.40), computer, electronic, and optical products (0.37), chemicals (0.38), electrical equipment (0.34), and machinery (0.33). These also align with categories in which Romania runs persistent trade deficits, particularly in chemicals and plastics, mineral products (crude oil and natural gas), base metals, and machinery and electronics. At the same time, manufacturing is also the main driver of Romania's exports, with machinery, transport equipment, and other industrial goods playing a particularly significant role. Conversely, sectors such as forestry (0.06), public administration (0.06), education (0.05), and financial services (0.06), which are linked to services and materials available domestically, exhibit the lowest import multipliers (see Table A2.5 for details).

[30] Asian Development Bank. (2022, July). Economic Insights from Input-Output Tables for Asia and the Pacific. Retrieved from https://dx.doi.org/10.22617/TCS220300-2.

Graph A2.5: **Sectoral Distribution of Backward Import Multipliers, 2022**



AFF = Agriculture, forestry, fishing; CON = Construction; INF = Information and communication; MFG = Manufacturing; MQU = Mining, quarrying, other industry; OSV = Other services; PAD = Public administration, defence, education, health and social work activities; PRO = Professional, scientific, technical, administration and support service activities; REA = Real estate activities; TRD = Wholesale and retail trade.
Source: European Commission services.

Conclusion

Romania's current account deficit has been fuelled by persistent fiscal deficits, rising domestic demand, and increasing reliance on imports. Over the past two decades, fiscal deficits, higher incomes, and increased public and private investment have exacerbated external vulnerabilities. The most recent surge in the current account deficit, reaching record levels since the COVID-19 pandemic, stems largely from a widening trade deficit driven by expansionary fiscal policies, despite government consumption having the lowest import content in final demand. This comes as a result of public spending influencing other items like investment and household consumption, both of which are relatively more import dependent. At the same time, there are structural factors that influence the trade balance, including sectoral value-added differences, the country's position in international supply chains, and reliance on imports. Romania's manufacturing and construction sectors are particularly reliant on imported inputs to meet production demands. In the short term, reducing excess domestic demand relative to output capacity and aligning wage increases more closely with productivity growth will help contain import growth and improve export competitiveness. In order to enhance potential growth prospects, Romania would also benefit from structural improvements such as expanding domestic production capacity in the tradable sector, improving its position in global value chains, and encouraging higher-value activities, as well as better integrating domestic firms into international markets.

Table A2.2: **Direct, Indirect, and Total Backward Import Multipliers (%), 2022**

Sectors	Direct	Indirect	Total
Manufacture of rubber and plastic products	34.0	10.0	44.0
Manufacture of basic metals	30.2	13.6	43.8
Manufacture of motor vehicles, trailers and semi-trailers	27.7	12.6	40.4
Manufacture of chemicals and chemical products	28.4	9.9	38.3
Manufacture of coke and refined petroleum products	27.6	10.7	38.2
Manufacture of fabricated metal products, except machinery and equipment	26.3	10.3	36.6
Manufacture of computer, electronic and optical products	28.5	8.0	36.5
Manufacture of electrical equipment	24.3	9.4	33.8
Manufacture of machinery and equipment n.e.c.	24.0	9.2	33.2
Manufacture of other transport equipment	20.3	9.4	29.7
Construction	17.1	11.1	28.2
Warehousing and support activities for transportation	20.7	6.5	27.2
Land transport and transport via pipelines	15.5	10.6	26.1
Repair and installation of machinery and equipment	19.3	6.6	26.0
Manufacture of other non-metallic mineral products	15.1	10.8	25.9
Manufacture of paper and paper products	16.3	9.2	25.5
Manufacture of textiles, wearing apparel, leather and related products	18.1	6.6	24.7
Manufacture of furniture; other manufacturing	17.0	7.4	24.5
Telecommunications	16.8	7.2	24.1
Electricity, gas, steam and air conditioning supply	12.6	11.0	23.6
Air transport	11.7	9.3	20.9
Manufacture of wood and of products of wood and cork, except furniture	11.8	8.5	20.3
Sewerage, waste management, remediation activities	12.1	8.0	20.1
Manufacture of basic pharmaceutical products and pharmaceutical preparations	13.1	6.8	19.8
Advertising and market research	10.4	8.7	19.0
Scientific research and development	13.3	5.0	18.3
Wholesale trade, except of motor vehicles and motorcycles	10.1	8.1	18.2
Travel agency, tour operator and reservation service	8.9	8.4	17.3
Crop and animal production, hunting and related service activities	9.6	7.1	16.7
Printing and reproduction of recorded media	10.8	5.8	16.6
Wholesale and retail trade and repair of motor vehicles and motorcycles	9.1	7.3	16.3
Manufacture of food products; beverages and tobacco products	7.3	8.8	16.1
Retail trade, except of motor vehicles and motorcycles	9.0	7.0	16.0
Architectural and engineering activities; technical testing and analysis	9.4	6.1	15.6
Publishing activities	10.3	4.9	15.2
Human health activities	8.8	5.8	14.7
Activities of membership organisations	8.2	6.5	14.7
Postal and courier activities	6.5	7.8	14.3
Repair of computers and personal and household goods	8.0	6.3	14.3
Motion picture, video, and TV production; programming and broadcasting	9.0	5.1	14.1
Other professional, scientific and technical activities; veterinary	7.8	6.2	14.0
Other personal service activities	7.9	6.1	14.0
Rental and leasing activities	7.5	6.1	13.6
Insurance, reinsurance and pension funding, except compulsory social security	6.5	6.9	13.4
Residential care and social work activities	8.1	4.8	12.9
Sports activities and amusement and recreation activities	7.1	5.7	12.8
Water transport	7.3	5.4	12.7
Legal and accounting activities; head offices; management consultancy	6.7	5.6	12.3
Computer programming, consultancy, and information service activities	8.7	3.6	12.2
Fishing and aquaculture	6.4	5.8	12.2
Accommodation and food service activities	4.2	7.8	12.0
Water collection, treatment and supply	5.2	6.5	11.7
Security, investigation, landscape, office administrative and support activities	6.3	5.3	11.6
Mining and quarrying	5.3	5.5	10.8
Creative, arts and entertainment; libraries, archives, museums; gambling	5.3	4.9	10.2
Employment activities	4.5	3.8	8.2
Real estate activities	4.7	3.1	7.8
Activities auxiliary to financial services and insurance activities	3.5	3.4	6.9
Public administration and defence; compulsory social security	2.6	3.4	6.0
Financial service activities, except insurance and pension funding	3.0	2.8	5.9
Forestry and logging	2.7	2.9	5.6
Education	2.4	2.5	4.8

Direct import multipliers are per unit of sectoral output. Indirect and total multipliers reflect import requirements per unit of final demand for sectoral output.

Source: European Commission services.

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