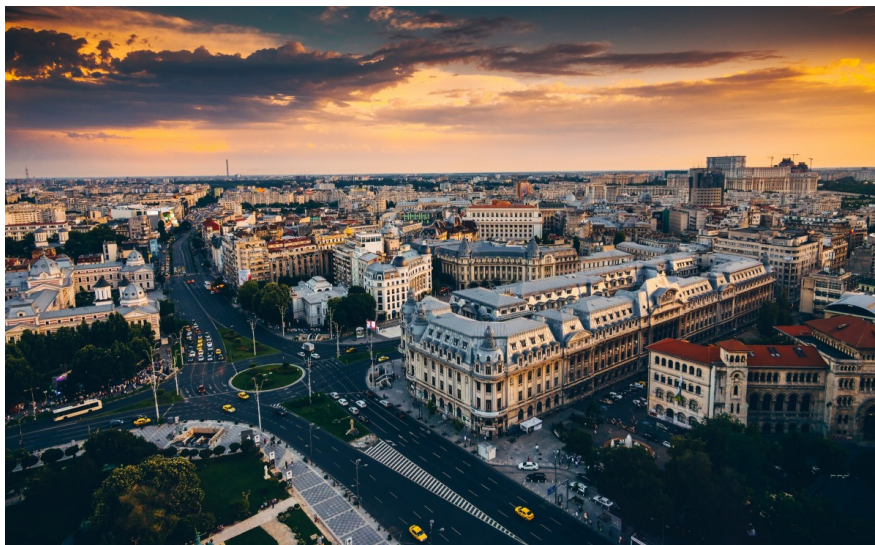


## Monitoring Romania: Balancing progress and risks

Romania's economy is picking up speed in 2025, but growth will stay below potential. Fiscal position remains tricky, external risks are present, and the National Bank of Romania (NBR) will stay cautious. Investments and the benefits of Schengen membership offer some positives, but structural challenges continue to test the country's resilience



Bucharest, Romania

Romania's economy continues to grow, but it faces several challenges. Policymakers are juggling long-awaited fiscal consolidation, external imbalances, and persistent inflation, making their task akin to walking a tightening rope that becomes more precarious with each election cycle. The key question is whether Romania will implement responsible policies for medium and long-term sustainability or succumb to short-term populism. The next few months will be crucial in determining the country's trajectory. Buckle up.

### Romania at a glance

- We expect growth to marginally pick up from 0.9% in 2024 to 1.6% in 2025, mainly on the back of stronger investments and a lower negative contribution of net exports. This remains

our base case, although geopolitical risks cloud the outlook

- We continue to see the fiscal deficit at 7.0% of GDP in 2025, with upside risks at play. NRPP renegotiations are a key factor to watch. A lower-than-expected performance in EU funds absorption could either boost the deficit (as some investment projects will need to be financed from the national budget) or simply lead to some investments not being delivered.
- More positively, we should soon see the benefits of the Schengen ascension and infrastructure upgrades will start translating into productivity improvements.
- On the trade deficit, even with moderating private consumption growth, corrections will be marginal and could even be non-existent should the ambitious investment plans laid out in the 2025 budget materialise.
- We expect the current account deficit to remain elevated in 2025 as well, as we estimate only a small improvement from -8.2% to -7.4% of GDP.
- We expect inflation to end 2025 at 4.8% and average 5.0% throughout 2025, and our base case is for the NBR to deliver 50bp of rate cuts in the second half of the year, with risks tilted towards less easing and more policy space preservation in the face of both internal and external risks.
- With the May elections approaching, the evolving political landscape may influence the country's direction. The decisions made in the coming months will be pivotal, steering Romania's trajectory for some time to come.

## GDP – growing well below Romania's potential

The latest data confirmed a weak economic performance over 2024 – economic growth sat at 0.9%, well below Romania's potential growth rate. This was not due to a weak internal demand – on the contrary, both private consumption and investments performed well (though the latter decelerated sharply towards the year-end), while fiscal policy was particularly loose with an eye-catching deficit of 8.7%. As such, it was rather the supply side of the economy which was largely unable to meet these demand requirements.

Both consumption and investment required imports, which ended up stimulating Romania's trading partners' exports, weighing visibly on GDP growth and pointing to the limits of Romania's consumption-driven model.

Granted, the past two years have not been all about consumption. In 2023, investments picked up at the strongest pace since Romania joined the EU, and it is set for healthy growth in 2024 as well (detailed fourth-quarter data is due on 7 March). Many once-in-a-generation infrastructure investments have already started to impact growth positively and are set to boost productivity and potential GDP more broadly in the years to come. The Schengen ascension will add to this as well.

However, a strong consumer response and fiscal stimulus have stimulated activity in parallel with these investments, amplifying Romania's twin deficit issue.

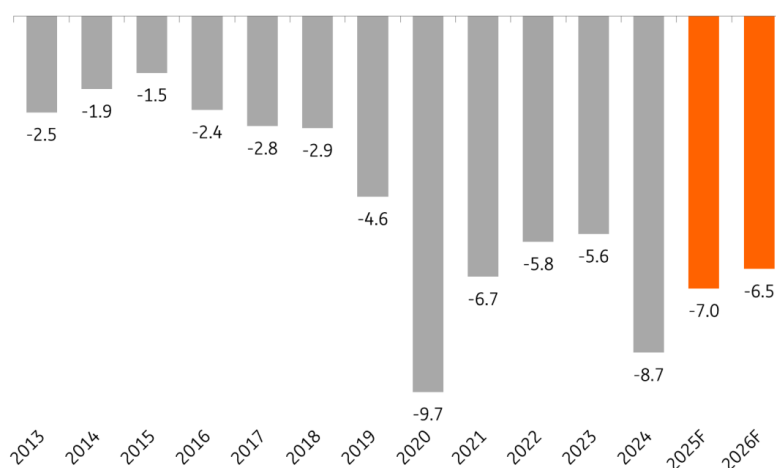
In 2025, we expect growth to rise from 0.9% to 1.6%. Key reasons are related to:

- Investments – which we expect to strengthen compared to last year.
- Net-exports – we anticipate a reduction of their negative contribution to growth, as private consumption is due to moderate while external demand should remain weak but constant.
- Base effects – strong carryover effect from the last quarter of 2024.
- Early gains in productivity – on the back of newly opened infrastructure and the Schengen

ascension.

Needless to say, the geopolitical implications of potential tariffs on the EU bring downside risks to our current base case, especially on the export front. At the same time, the prospects of a European Defence Fund and further spending in Europe's arguably underinvested areas like defence and technology bring some upside potential in the short run, despite their worsening effect on the continental fiscal situation. The terms and the subsequent evolution of the peace talks are a key factor to watch as well.

## Fiscal – more decisive actions needed



Source: MFin, ING

The public finance outlook and financial markets' patience constantly deteriorated in 2024, leading to an 8.7% deficit. What's more, rolled-over spending from 2024 reportedly showed up in an above-expectations deficit in January 2025, of 0.6% of GDP.

Our main thoughts on the fiscal situation:

- An ideal scenario for restoring financial markets confidence likely remains a combination of better collection, higher taxes and contained spending.
- Looking at their evolution over the last decade – most fiscal revenues (including the key ones like VAT and income tax) have declined as a percentage of GDP, leaving them as more suitable candidates for tax hikes, at least when compared to social contributions, which have increased as a % of GDP in the meantime.
- Authorities explicitly assume that a 7.0% deficit is achievable under a rigorous control of spending and a normal evolution of revenues. The former is under their control, but the latter much less so.
- 2025 is set to be the first true test of the digitisation measures:
  - The e-Factura and e-Transport (invoice digitisation and high-value fiscal goods transport monitoring) are compulsory as of 1 January 2025 and 31 March 2025, respectively.
  - All SMEs have been required to complete the SAF-T declaration as of 1 January 2025.
  - e-VAT is set to begin as of 1 July 2025.
- The rationale of this implementation timing (sometimes postponements) is likely the

balance between not pressing the private sector with all the simultaneous changes while also ensuring the necessary administrative capacity to process such changes

- As such, more visible revenue collection gains are likely to come in the second half of the year.
- Fiscal revenues are set to witness the largest increases, but non-fiscal revenues will increase as well due to more efficient ways to spot inconsistencies at non-compliant firms and enforce penalties.
- Spending-wise, 2025 has started on the wrong foot with the negative surprise of 0.6% of GDP in January's deficit – rolled-over spending from last year and, potentially, hard-to-suddenly-stop spending engagement could mean that more optimal conclusions about the fiscal policy stance might be drawn after the first quarter.
- On the NRPP front, ongoing negotiations are likely to result in fewer payment requests. An outcome that's likely on the table could bring together the already achieved milestones from the future tranches and repackage them into a tranche that would be easier to disburse this year.
- At this stage, focusing more on grant-related projects and looking into potential synergies between NRPP loans and Cohesion Funds projects, which have less pressing deadlines, is also likely on the table. We believe that Romania will, in the end, not be able to absorb all NRPP loans.
- Some spending savings can result from lower-than-planned investments, as the ambitious plan laid out by the government (at 7.8% of GDP) could likely bring its own sort of administrative challenges at a time when policymakers would also be committed to optimise public sector employment.

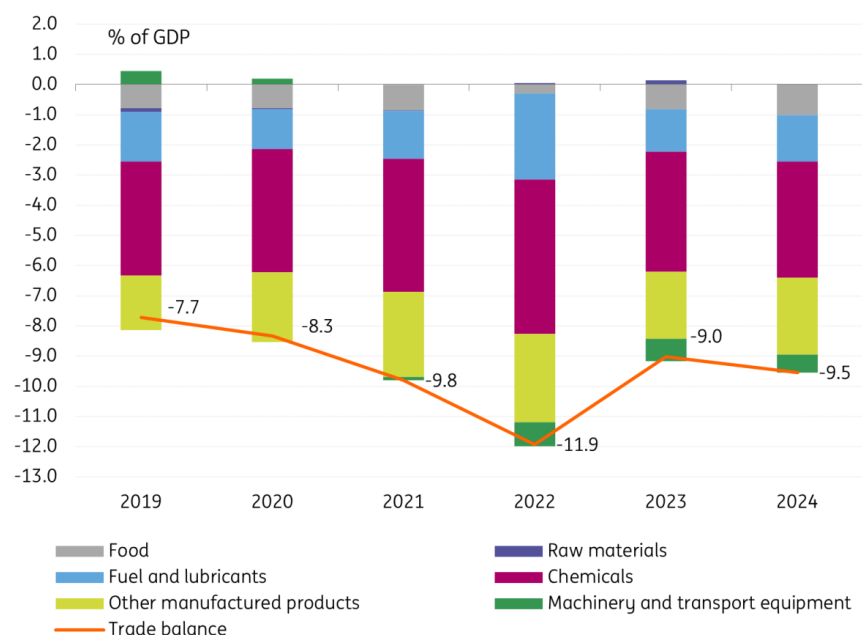
## Balance of Payments – an expected worsening last year

Throughout 2024, the trade balance (the most important driver of the BoP) worsened visibly as the deficit increased 15.0% YoY, reversing the gains made in 2023. The negative drivers were quite widespread – namely, growing deficits in food, fuels, chemicals and manufacturing sectors, accompanied by a smaller surplus in raw materials. A positive contribution came from a smaller deficit in machinery and transport equipment.

Overall, the trade balance reading continued to reflect the strong internal demand generated by a sharp response of consumers to real wage gains, a significant fiscal slippage, and large-scale investments. This has boosted imports significantly at a time when the supply side of the economy was unable to prevent the benefits of this strong activity from dissipating externally towards Romania's trading partners. The German industry and European activity as a whole remained in a rather weak state, weighing on exports.

For 2025, we don't expect significant structural changes in the trade balance, as we highlighted in our latest trade [note](#). The upshot is that only a significant and sudden cooling of the economy, which we do not expect, could bring again visible and immediate gains to the trade deficit. Otherwise, the same structural factors should continue to fuel the existing imbalances. What's more, while we expect some marginal gains on the back of moderating private consumption, improvements compared to this year's outturn could even be non-existent should the ambitious investment plans laid out in the 2025 budget materialise.

## Strong internal demand pushing the trade imbalance higher



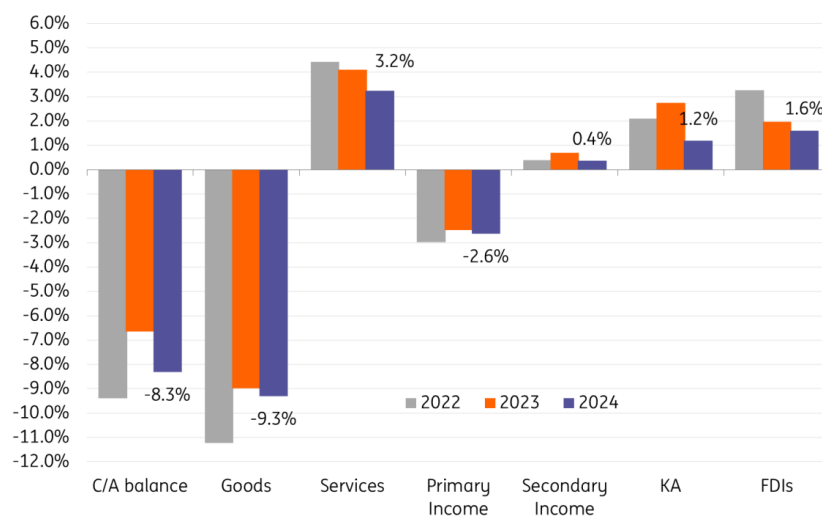
Source: NSI, ING

Risks to our trade deficit outlook are mostly tilted to the upside due to the threat of tariffs on European exports in light of the recent geopolitical events. That said, should these large risks result in ambitious industrial and defence developments across a more unified European economy, there is some potential for some counterbalancing positive outcomes, too. What's more, early productivity improvements on the back of the ongoing large-scale infrastructure projects should also come up as a tailwind for exports.

Turning to Romania's EUR 11.5bn surplus on the services front, 2024's developments brought a 13.2% decline compared to 2023's EUR 13.5bn surplus. Transport and IT activities continued to bring most of the surpluses. That said, the former experienced a double-digit decline, mainly on the back of road transportation of goods, while the latter experienced only a small decline overall. Meanwhile, the stronger appetite for tourism abroad weighed visibly more negatively on the services trade balance throughout 2024.

On other items of the BoP, the primary income balance also worsened last year. Somewhat surprisingly, but not that unexpectedly, a worsening of public administration secondary incomes had the strongest effect this time, outpacing the likes of a worsening portfolio investments deficit and a lower surplus in salary income from abroad. Meanwhile, an important positive contribution came from a stronger surplus in income from reserve assets, possibly as the still-unspent EU money and a solid performance of gold prices facilitates gains on this front.

## The current account deficit worsened



Source: NBR, ING

On the capital account, we expect EU funds directed towards infrastructure projects to continue to stimulate inflows, while on FDIs, the positive impact of the once-in-a-generation infrastructure projects and the Schengen ascension might be temporarily muted by the ongoing geopolitical conflicts.

All in all, we expect the current account deficit to remain elevated in 2025 as well. We estimate the deficit to end up at -7.4% of GDP, from -8.2% in 2024.

## Monetary policy and inflation – rate cuts not a priority for the moment

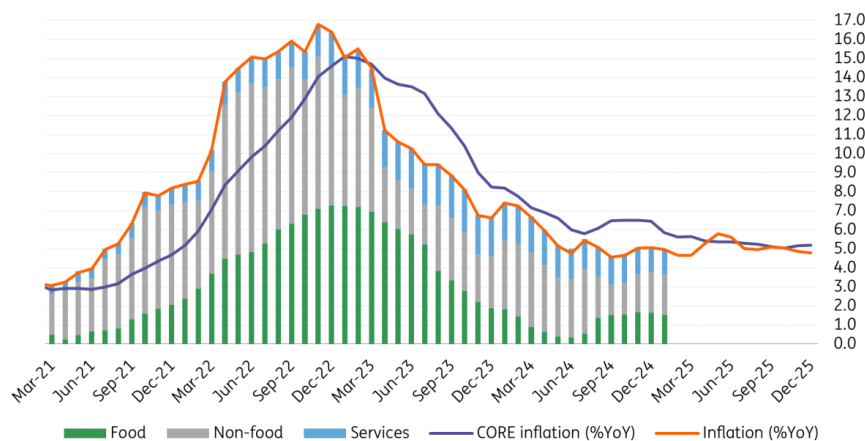
The NBR continued to leave its policy unchanged through the first two policy meetings of the year, following similar policy decisions since the two back-to-back cuts in July-August 2024. Multiple factors were at play. The fiscal story, the evolution of wages and private consumption, as well as the sticky nature of inflation were the key domestic considerations. On the external side, Romania's current account deficit, a resilient US economy keeping the Federal Reserve prudent, as well as mounting trade and geopolitical tensions were key factors behind NBR's cautious policy approach.

On the inflation front, last year's drought has been leaving its mark on food inflation. Meanwhile, non-food inflation has recently started to rise again, primarily due to energy-related factors. Services inflation, on the other hand, has continued its modest deceleration but remains relatively high.

Looking ahead, we anticipate a moderation in consumer demand and a negative fiscal impulse. Combined with stable unemployment, this should result in somewhat reduced demand-side inflationary pressures. That said, potentially stronger opposite effects are set to come from the pressures to employment costs stemming from the higher tax burden and minimum wage as of 1 January 2025.

On the energy bills front, a smaller inflationary impact is now due, given the latest announcements that cap schemes for electricity and gas are set to be extended. Meanwhile, upside risks to food inflation stem from a removal of the basic food items' commercial mark-up later this summer. Overall, we expect inflation to end the year at 4.8% and average 5.0% throughout 2025.

## Inflation to see limited improvements in 2025



Source: NSI, ING

We continue to expect policymakers to remain cautious with policy easing ahead. For this year, we expect 50bp of rate cuts in the second half of the year, with upside risks at play. Key factors to watch remain the extent of wage growth moderation, the details of a potential new fiscal package later this year, and energy market developments.

Key to remember is that the necessary conditions for further rate cuts and a return to the previous trend of controlled FX depreciation seem pretty much aligned, namely growing confidence in the inflation outlook stemming from both the fiscal impulse and private consumption behaviour, as well as from lower external uncertainties.

On the interbank excess liquidity, we think that policymakers are more comfortable with the current levels (i.e. around RON15-25bn) compared to last year's much higher levels, given the current risk heatmap. Even if the government performs well at absorbing EU funds this year and at selling FX debt, we think it is rather unlikely that the NBR will be as keen as it was in the past to tolerate large liquidity surpluses. Nevertheless, the surplus should be enough to keep the front end of the FX swap implied yields curve well anchored around the deposit facility.

Concerning the FX markets, we continue to think that there is little room for EUR/RON to move from the current levels in the short run, although we have recently grown more confident that policymakers could loosen their grip on the currency slightly in the second half of the year, should a window of opportunity allow it. We maintain our 5.05 estimate for the EUR/RON by the end of 2025.

However, given all of the uncertainties at play, we think policymakers will need an even stronger conviction in their outlook compared to previous policy easing decisions, which fuels the risks for both rates and FX to continue to remain where they are throughout the whole year. Overall, we think that even if some mildly negative scenarios on private consumption and aggregate demand

were to materialise, as long as fiscal uncertainty persists, the bar for further rate cuts will remain high.

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