Romania budget gap at mid-year: controlled slippage

After six months of 2020 the budget deficit reached a new record high at 4.17% of GDP. We still believe that the official forecast for the budget deficit to reach 6.7% of GDP this year is not realistic and maintain our 8.6% estimate. Fiscal consolidation is not a story for this year

Source: Shutterstock

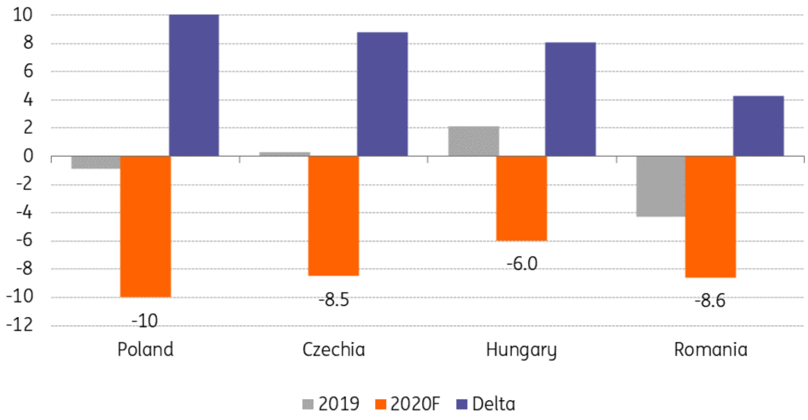
The details of the mid-year budget execution reveal a somewhat foggy picture as the data has clearly been influenced by the numerous one-off effects which occurred over the last few months, e.g. Covid-19 related expenses, the prorogation of some fiscal obligations, accelerated VAT reimbursements etc. Nevertheless, the bigger picture looks broadly in line with our expectations.

The good

This could be a short section but, as happens with most statistics, nothing is clearly one-sided; we can find some silver linings in almost any data set, the question being just how relevant these views are. Let's see.

In comparison to its regional peers, Romania's budget deficit this year doesn't look out of place at all. The downside to this is that because of the weak starting point (4.5% budget deficit in 2019) the incremental fiscal impulse in Romania will be the smallest (4.3% ING estimation), very far from Poland's 10.1%. Nevertheless, we retain this argument as a positive one, particularly in the context of Romania's troubled rating prospects.

Budget deficits (% of GDP) across CEE



Source: National sources, ING estimates

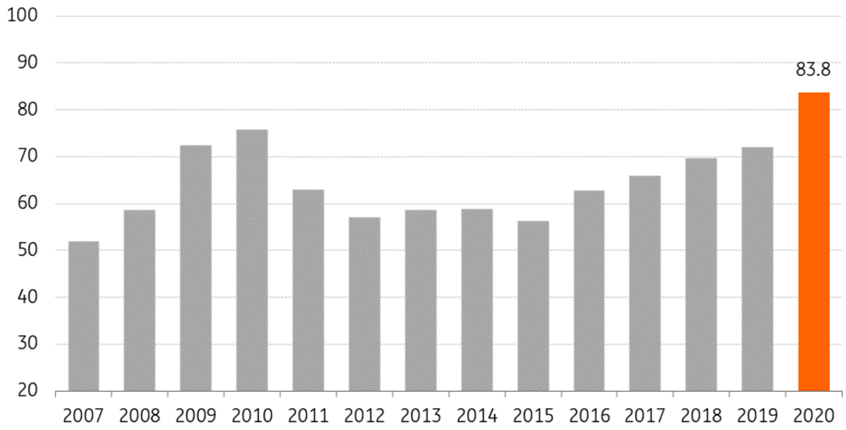
Capital spending continues to be positive. After six months, it is almost 19% higher than in the same period of 2019, which is something noteworthy given the unfavourable context. There are promising signs that the current trend of increasing investment will at least consolidate, building the case for a robust post-pandemic rebound. At the latest EU summit, Romania was allocated EUR33.5 billion through the Next Generation fund (more on this here). The majority of these funds (70%) will need to be contracted in the following two years, infrastructure investment being a top priority. Considering that Romania also has the cohesion funds allocated for the 2021-2027 EU budget (EUR46.3 billion) and the still accessible funds related to the 2014-2020 EUR budget, it looks as though boosting investment in the upcoming years will be more a matter of administrative capacity than available funding. And although this is not the point of these funds, it could alleviate some of the pressure on the national budget – namely that related to investment spending.

Despite the sheer size of the deficit which reached RON45.1 billion in June, the financing part continues to run smoothly. Over the last few weeks at least, the Ministry of Finance has even started to exert some downward pressure on yields by not accepting more than the indicated amount or even rejecting all bids. Obviously, the central bank plays a pivotal role here, backing up the market whenever bumps appear. The almost EUR10 billion issued this year on the external markets have apparently taken the MinFin's cash buffer to record levels (no up-to-date numbers available though, just official statements). Of course, there is no time for complacency here as the financing needs will remain at similar levels at least going forward, but it does seem that the MinFin has more room to breathe in the second part of 2020.

The bad

Rigidity: the share of wages and social assistance (mainly pensions) in total revenues has reached record levels this year (84% as of June). Given the inherent rigidity of these expenses (they cannot really be scaled back quickly, if at all) we believe that the government will favour an approach where they try to cap such spending while waiting for the economy to catch up and dilute their large share in overall revenues. At least this could be the intention. In practice, pensions are still scheduled to be increased (most likely by 10% starting in September) and we might need to wait quite a bit longer to see this ratio drop towards more sustainable levels.

Wages and social assistance as % of revenues (at midyear)



Source: MinFin, ING

Size: while the 4.17% of GDP at mid-year is broadly in line with expectations and with what other regional economies are experiencing, we should nevertheless put things into perspective here: a RON45.1 billion deficit means almost 31% of total revenues (versus say Poland where the ratio at mid-year stands at around 9.0% or Hungary at 14%). These are not easy numbers to digest.

Perspectives: unlike its regional peers where even deficits above 10% in 2020 could be swiftly scaled back in the coming years given the transitory nature of the stimulus, doing the same in Romania would not only be difficult to implement (see reason no.1) but also contractionary for the economy. Unfortunately, we will probably not have a clearer picture on what lies ahead until a new government is sworn in. One thing that becomes more and more clear in our view is that it will be very difficult for any government to avoid tax hikes in 2021. VAT is probably the main suspect, but we wouldn't rule out measures on higher wages and/or pensions as well.

> We maintain our forecast for an 8.6% budget deficit in 2020 and a measured correction towards -5.2% in 2021, though a lot is missing from next year's picture. Financing the deficit looks very much on track this year, but after the elections we expect some form of tax revamp. Everything is based on the assumption of a 10% pension hike starting in September.

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