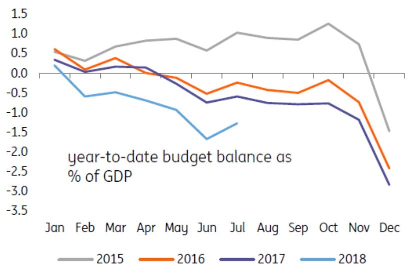
Romania: July budget gap at 1.3% of GDP

The budget shortfall shrank by 0.4 percentage points of GDP compared to June on profit taxes and dividend payments from state owned enterprises (SOEs)

Source: Shutterstock

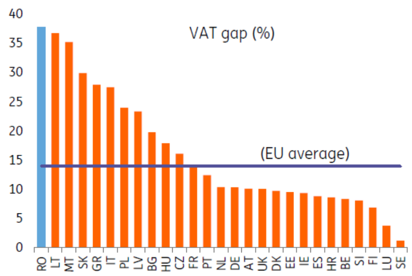
The deficit for the first seven months of the year had been revealed by the government when it presented the budget revision in early August. Fiscal execution, while showing some improvement, remains much wider relative to the previous years and the deficit is more than double the same period a year ago which ended with a 0.6% of GDP gap.

Fig 1 A different execution profile this year



Source: MinFin, ING

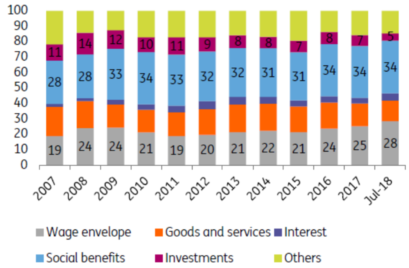
Fig 2 There is a problem with collecting tax



Source: EC, ING

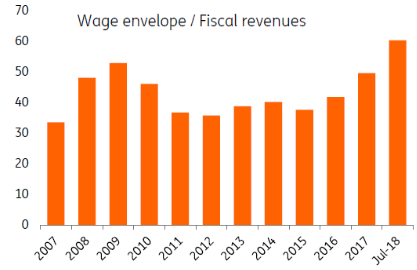
Budget revenues were up 13.9% from a year ago but fiscal revenues posted a meagre 1.3% year-on-year increase versus January-July 2017. Non-fiscal revenues jumped by 20.7% YoY. Hence the budget relies more on one-offs rather than a structural change in revenues to ensure long-term sustainability. Nevertheless, VAT revenues posted a noticeable increase of 9.8% YoY versus the same period of the previous year.

Fig 3 Rigid public spending items gained weight



Source: MinFin, ING

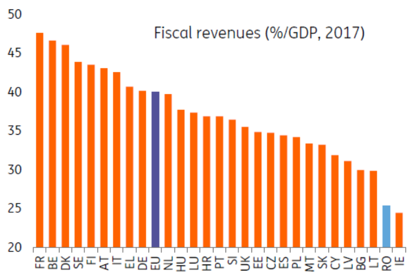
Fig 4 Wage envelope absorbs 60% of fiscal revenues



Source: MinFin, ING

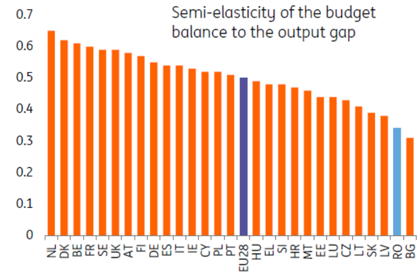
Budget expenditures posted an 18.0% YoY increase in the first seven months of the year with spending on wages ballooning further by 25.1% YoY. Given the cyclical position, revenues are in line with expectations but expenditures are getting out of control. Moreover, the increase in rigid public spending with wages and social benefits exposes public finances to a cyclical downturn.

Fig 5 Relatively low fiscal revenues



Source: EC, ING

Fig 6 Exposes the fiscal outlook to discretionary measures



Source: Mourre, G., Astarita, C. and Princen, S., 2014

It looks like the government remains committed to the 3.0% of GDP budget deficit ceiling and it is likely to be achieved for this year, even if GDP growth underperforms official forecasts, perhaps by cutting down investment and with some one-off help from SOE extra dividends. In the medium-term, there is nothing to cheer about as the composition of public spending points to higher fiscal slippage risks ahead unless there are structural improvements on the revenue side.

> There is a heavy election calendar ahead with four elections scheduled over the next two years, which reduces the chances of material fiscal consolidation. Rating agencies are keeping a close eye on fiscal developments with Moody's noting a week ago that "downward rating pressure would likely develop if the negative institutional and fiscal trends persist, and the susceptibility to event risk continues to rise in consequence, undermining the inherent strengths to a point no longer consistent with a Baa3 rating". To consider an upgrade, Moody's said it needs "evidence of sustained improvement in the fiscal and external metrics accompanied by higher policy predictability and credibility and

institutional effectiveness". We fear that the former scenario is more likely than the latter.