Macroeconomic
and Strategic Analysis

Quarterly Report

UniCredit Bank

20 February 2025

“Fiscal consolidation on the way”

Outlook – We expect an acceleration of economic growth to 1.9% in 2025 due to favorable base effects, after a disappointing 0.9% in 2024. Yet, Romania will have one of the lowest growth rates in the CEE region. Consumption is likely to slow down, while investment could accelerate, supported by the government's plans to increase public investment this year with the help of EU funds. The long-awaited economic recovery in the eurozone, particularly in Germany, is yet to come, offering limited support to exports and the local industry. Inflationary risks remain high and we expect inflation to miss the target in 2025 due to local factors and possibly even in 2026 given the high probability that additional revenue-boosting fiscal measures will be implemented in 2H25 and 2026. The NBR could cut the key rate by 0.75pp in 2H25, depending on the timing of implementation and exact structure of the future fiscal measures. We continue to expect a move of the EUR-RON to the 5.00-5.10 trading range this year, but after the presidential elections.

Fiscal consolidation on the way

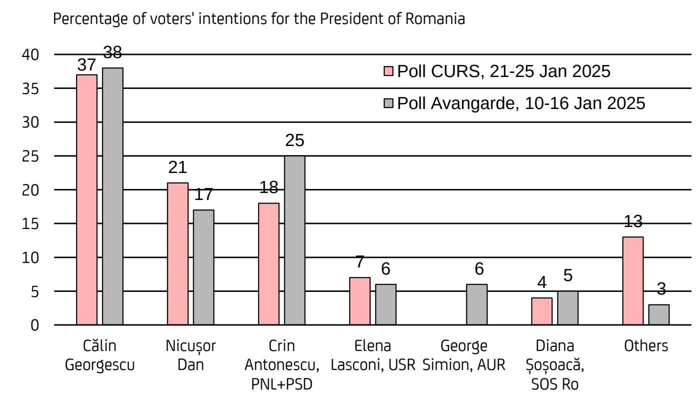
The upcoming presidential elections imply fiscal and political risks

Romania will face a prolonged period of political and fiscal uncertainties, with the presidential elections re-scheduled for this spring (4 and 18 May), after the first round of the elections organized on 24 November 2024 was invalidated by the Constitutional Court on suspicion that the electoral campaign was altered by an illegal support from a foreign country in favour of one of the candidates. The parliamentary elections at the end of 2024 generated a fragmented parliament, leading to a governing coalition supported by a narrow majority, formed by the former governing parties: the Social Democrats (PSD), the Liberals (PNL) and the Hungarian Minority Party (UDMR), with the support of the other minorities. Therefore, we expect continuity for the reforms and the fiscal commitments. Yet, the rising popularity of the sovereigntist candidates and the later-than-expected date of the elections generate four problems: 1. prolonged campaign instead of shifting the focus towards correcting the economic imbalances; 2. lack of fiscal clarity deterring private investment in 1H25; 3. increasing risk of not meeting the budget deficit target this year; and 4. risk of a government change in mid-2025 given the possible migration from one party to another depending on the outcome of the presidential elections. Opinion polls, which proved to be unreliable last year, currently indicate the sovereignist Călin Georgescu as a frontrunner. The top 3 also includes Nicușor Dan, an independent candidate and currently mayor of Bucharest and Crin Antonescu, the candidate supported by the governing coalition, with the order of preferences depending on the poll. Yet, the winner will most probably be decided in the second round. After acting as an interim president since 21 December, President Klaus Iohannis resigned in mid-February, following the intensified pressure by the opposition to initiate a procedure for his suspension. According to the provision of Romania's Constitution, he was replaced by the President of the Senate, Mr. Ilie Bolojan, the leader of the Liberal party.

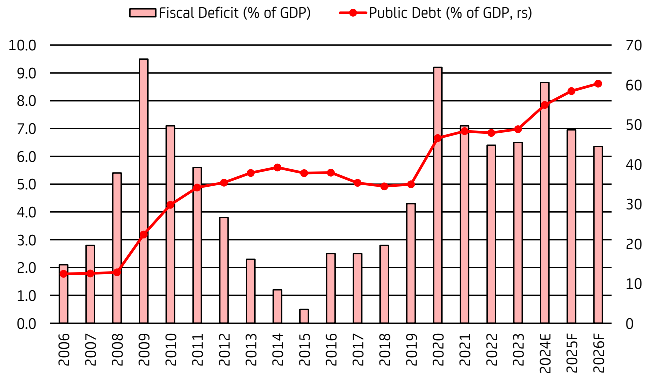
The 2025 budget plan, in its current form, is not convincing…

According to Romania's medium-term fiscal structural plan 2025-2031, the budget deficit must decrease to 7% of GDP in 2025, after ending 2024 at 8.65% of GDP, significantly above the 7.9% estimate included in the plan and the 5% target set initially. In the last days of 2024, the new government took the first steps for fiscal consolidation, through an emergency odinance to: 1) freeze several categories of public expediture at the level of November 2024; 2) freeze public sector hiring; 3) eliminate the tax breaks for employees in IT, constructions, agriculture and food industry; 4) increase the dividend income tax by 2pp to 10%; 5) lower the income ceiling for microenterprises from EUR 500,000 to EUR 250,000; and 6) re-introduce the 1% tax on special constructions, after consultations with the affected stakeholders (especially companies in energy and logistics). According to our calculations, the measures announced so far will fall short of meeting the deficit target by up to 1pp of GDP and we continue to believe that a rise in taxes cannot be avoided. The 2025 budget plan is overestimating revenue to accommodate the higher

POLLS INDICATE PREFERENCE FOR INDEPENDENTS



BUDGET DEFICIT IN 2024 SIMILAR TO THE PANDEMIC LEVEL



Source: Ministry of Finance, Eurostat, Polls Insomar-Avangarde and CURS, UniCredit Bank Romania

… but it is good enough to buy some time and prevent a downgrade to junk by mid-2025

expenditure, with two thirds of the impact from the pensions' recalculation last September, i.e. 1% of GDP, to be felt this year. We are likely to get more clarity on the additional taxation only after the presidential elections, with implementation in 2H25. The rating agencies already signaled that Romania must respect its fiscal commitments and restore the confidence in the future adjustment, with Fitch and S&P changing Romania's rating outlook from „stable" to „negative". There is a high risk that Moody's will do the same in March. We regard the 7% of GDP target as attainable (with additional measures) and the current 2025 budget plan as good enough to prevent a downgrade to junk by mid-year. Yet, adhering to fiscal discipline and avoiding additional spending commitments are extremly important in the following months.

We forecast a mild acceleration of growth to 1.9% in 2025, although it remains among the lowest rates in CEE…

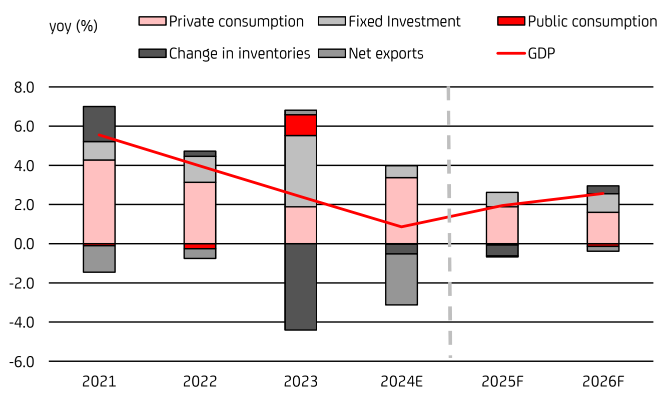
… and will depend on improved absorption of EU funds

We forecast a higher GDP growth of 1.9% in 2025, benefitting from favorable base effects, after the dissapointing 0.9% in 2024. Yet, Romania will have one of the lowest growth rates in CEE, with the other countries in the region expected to expand by 2%-4.0%. Consumption is likely to slow down, impacted by the fiscal consolidation and a sharp deceleration of the real wage growth, after the strong boost it received in the electoral year 2024. Investment could accelerate, supported by the government's plans to increase public investment by 1.1pp to 7.8% of GDP, with the help of EU funds. In spite of the ambitious absorption plans, we remain cautiously optimistic for the following reasons: 1) only EUR 0.33bn were received from the Recovery and Resilience Facility (RRF, PNRR locally) during 2024, as only one fourth of the agreed milestones have been met so far; 2) only EUR 4.1bn of the EUR 9.4bn total received have actually been invested, denoting a lack of proper planning and execution of investment projects; and 3) access to the EU funds could be suspended at the beginning of June if the fiscal adjustment will be deeemed unsatisfactory. We hope that the government will prioritize absorption, considering that the milestones and targets, including the related payment requests, must be completed by August 2026 according to the PNRR regulation. These funds are among the few sources of growth available to Romania at the moment. A quick recovery in Germany remains elusive, implying bleak prospects for the Romanian exports and industry. Private investment could be discouraged by the fiscal uncertainty and higher contributions to the state budget, considering that the tax breaks for employees in IT, agriculture, the food industry and constructions were eliminated and the 1% tax on special constructions was reintroduced. Yet, the construction sector might benefit from a continued development of infrastructure.

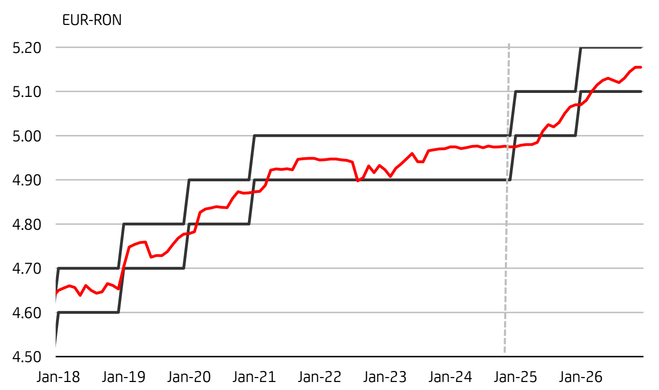
We expect the C/A deficit to narrow slightly in 2025 and the EUR-RON to increase to the 5.00-5.10 trading range

With fiscal adjustment on the way, we expect the C/A deficit to begin a gradual correction, down to around 7% of GDP in 2025 from 8.2% of GDP in 2024, with the external shortfall fully covered by FDI, EU transfers and government borrowing from abroad. We expect EUR-RON to move to the 5.00-5.10 trading range in 2025 given the high twin deficits, although we now expect this to happen after the presidential elections instead of 1Q25, as we were anticipating in our previous report.

ECONOMIC GROWTH WILL STAY BELOW 2% IN 2025



WE EXPECT THE RON TO DEPRECIATE MILDLY IN 2025



Source: NIS, NBR, UniCredit Bank Romania

Inflation to stay above the target range in 2025, increasingly probable in 2026 as well

Although we expect the overall disinflationary trend to continue, according to our calculations annual inflation will remain above the target range throughout 2025 and reach 4.6% at year-end. Yet, core inflation could drop to levels around the 3.5% upper bound of the target range in 4Q25. We see the balance of risks tilted to the upside due to the still strong consumption, higher food and gas prices, new or increased taxes affecting directly or indirectly consumer prices, along with risks of a rise in the oil price towards USD 100/bbl if OPEC+ will not increase the production of crude oil. Moreover, given the expected tax hikes in 2H25 and 2026, we see an increasing risk of inflation overshooting the 1.5%-3.5% target range in 2026 as well.

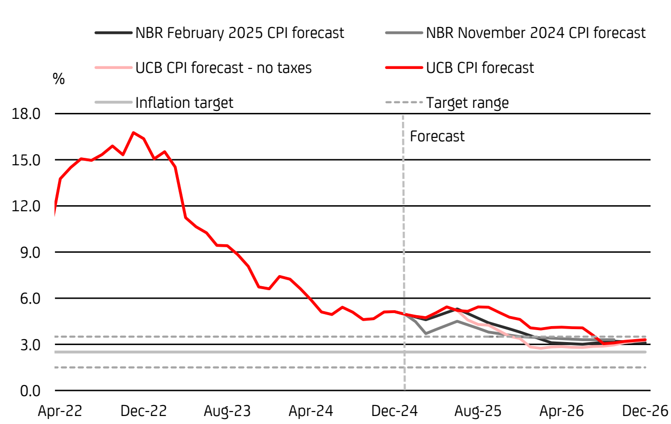
NBR to stay on hold in 1H25 and resume cuts in 2H25 to support the economic activity

We expect the NBR to stay on hold at 6.50% in 1H25, due to the still high level of inflation, the strong consumption and demand for consumer loans coupled with the lack of clarity on the future fiscal policy and its impact on inflation. In the current environment of high local and external uncertainty, a premature cut of the key rate would imply a signifcant risk of outflows, with Romania affected by shocks to a larger extent than the rest of CEE, due to its large economic imbalances. The NBR is likely to resume the key rate cuts in 2H25 in order to offer a much-needed support to the Romanian economy, for a total 0.75pp by year-end depending on the exact fiscal measures adopted in the following months. Monetary conditions tightened in 4Q24 due to a decrease in excess liquidity, lifting the ROBOR curve by up to 60bp above the 5.50% deposit facility rate. We believe that the ROBOR rates are unlikely to re-approach the facility rate as we expect the excess liquidity to remain low in 2025, due to the tigher fiscal stance and the high financing needs by the Ministry of Finance.

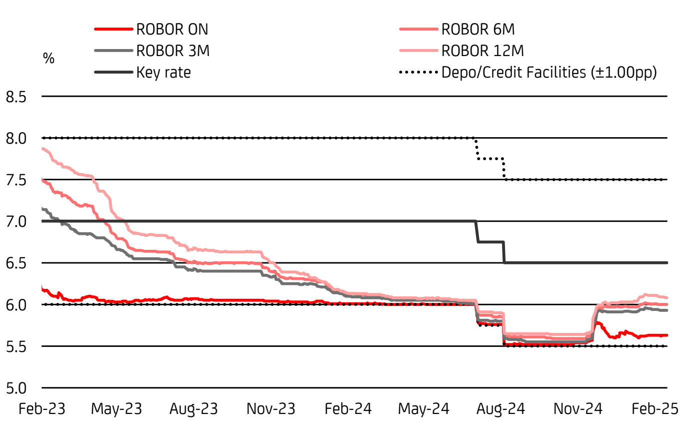
KEY DATES/EVENTS

- 7 March, 10 April: 4Q24 GDP (structure)
- 13 March, 11 April: inflation
- 14 March: rating review by Moody's
- 7 April: monetary policy decision
- 11 April: rating review by S&P

ANNUAL INFLATION ABOVE THE TARGET RANGE IN 2025



THE TIME OF ROBOR RATES AT THE DEPO FACILITY IS BEHIND US



Source: NIS, NBR, UniCredit Bank Romania

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MACROECONOMIC DATA AND FORECASTS

	2021	2022	2023	2024E	2025F	2026F
GDP (EUR bn)	242.3	281.7	324.4	356.5	384.1	405.0
Population (mn)	19.2	19.0	19.1	19.1	19.0	19.0
GDP per capita (EUR)	12,601	14,790	17,024	18,711	20,188	21,321
Real economy, change (%)						
GDP	5.5	4.0	2.4	0.9	1.9	2.6
Private Consumption	7.0	5.1	3.0	5.5	3.0	2.5
Fixed Investment	4.0	5.4	14.5	2.2	2.7	3.5
Public Consumption	-0.6	-1.4	6.3	-0.2	-0.4	-0.8
Exports	12.6	9.3	-0.8	-3.3	2.4	4.8
Imports	14.6	9.3	-1.1	3.0	2.1	4.7
Monthly wage, nominal (EUR)	1175	1303	1489	1710	1805	1878
Real wage, change (%)	2.0	-2.2	3.6	9.4	1.2	2.5
Unemployment rate (%)	5.6	5.6	5.6	5.3	5.2	5.4
Fiscal accounts (% of GDP)						
Budget balance	-7.1	-6.4	-6.5	-8.7	-7.0	-6.4
Primary balance	-5.6	-4.3	-4.6	-6.6	-4.8	-4.0
Public debt	48.3	47.9	48.8	54.9	58.4	60.3
External accounts						
Current account balance (EUR bn)	-17.4	-26.8	-21.5	-29.4	-28.7	-28.2
Current account balance/GDP (%)	-7.2	-9.5	-6.6	-8.2	-7.5	-7.0
Extended basic balance/GDP (%)	-1.8	-4.1	-1.9	-5.6	-4.3	-3.6
Net FDI (% of GDP)	3.7	3.3	2.0	1.6	1.6	1.8
Gross foreign debt (% of GDP)	58.8	54.6	56.5	57.1	56.9	58.1
FX reserves (EUR bn)	40.5	46.6	59.8	62.1	59.8	59.1
Months of imports, goods & services	4.3	4.0	5.1	5.1	4.8	4.5
Inflation/Monetary/FX						
CPI (pavg)	5.0	13.7	10.5	5.6	5.1	3.7
CPI (eop)	8.2	16.4	6.6	5.1	4.6	3.3
Central bank target	2.50	2.50	2.50	2.50	2.50	2.50
Central bank reference rate (eop)	1.75	6.75	7.00	6.50	5.75	4.50
3M money market rate (Dec avg)	2.83	7.66	6.25	5.91	5.48	4.63
USDRON (eop)	4.37	4.63	4.50	4.78	4.97	4.95
EURRON (eop)	4.95	4.95	4.97	4.97	5.07	5.15
USDRON (pavg)	4.16	4.68	4.57	4.60	4.86	4.98
EURRON (pavg)	4.92	4.93	4.95	4.97	5.01	5.12

GOVERNMENT GROSS FINANCING REQUIREMENTS

EUR bn	2023	2024E	2025F	2026F
Gross financing requirement	**35.3**	**47.5**	**47.6**	**49.3**
Budget deficit	18.2	30.7	26.7	25.7
Amortization of public debt	17.1	16.8	20.9	23.6
Domestic	14.9	12.5	16.4	20.2
Bonds	10.5	7.6	7.4	12.9
Bills	1.1	1.4	4.1	3.0
Loans and retail bonds	3.3	3.6	4.9	4.2
External	2.1	4.3	4.5	3.4
Bonds and loans	1.7	3.7	3.9	2.8
IMF/EU/Other IFIs	0.4	0.6	0.6	0.6
Financing	**35.3**	**47.5**	**47.6**	**49.3**
Domestic borrowing	25.7	27.0	25.8	24.5
Bonds	19.9	16.9	16.8	17.0
Bills	1.4	4.1	3.0	3.0
Loans and retail bonds	4.4	6.0	6.0	4.5
External borrowing	12.6	16.7	21.0	20.0
Bonds	10.3	15.7	15.5	13.0
IMF/EU/Other IFIs	2.3	1.0	5.5	7.0
Fiscal reserve change (- = increase)	-3.0	3.8	0.8	4.8

GROSS EXTERNAL FINANCING REQUIREMENTS

EUR bn	2023	2024E	2025F	2026F
Gross financing requirement	**57.3**	**67.4**	**67.7**	**66.3**
C/A deficit	21.5	29.4	28.7	28.2
Amortization of medium and long term debt	14.2	18.3	18.9	17.8
Government/central bank	3.0	5.0	5.3	4.5
Banks	4.9	6.5	6.5	6.2
Corporates/Other	6.3	6.8	7.1	7.1
Amortization of short-term debt	21.6	19.8	20.1	20.3
Financing	**57.3**	**67.4**	**67.7**	**66.3**
FDI (net)	6.4	5.7	6.1	7.3
Portfolio equity, net	0.6	0.1	0.1	0.1
Medium and long-term borrowing	26.2	29.5	33.3	32.0
Government/central bank	14.8	17.9	21.3	20.3
Banks	4.4	5.2	5.2	5.0
Corporates/Other	6.9	6.4	6.8	6.7
Short-term borrowing	19.4	19.7	19.9	19.9
EU structural and cohesion funds	8.9	3.8	6.0	6.3
Change in FX reserves (- = increase)	-4.1	8.7	2.3	0.7
Memoranda:				
Nonresident purchases of LC govt bonds	6.7	-0.2	2.2	1.9
International bond issuance, net	8.6	12.1	11.6	10.2

Data Source: Eurostat, NBR, NIS, Ministry of Finance, UniCredit Bank Romania

Legal Notices

Glossary

A comprehensive glossary for many of the terms used in the report is available on our website: https://www.investmentinsights.unicredit.eu/glossary.

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