CEE SPECIAL REPORT

# Romania fiscal outlook: Between a rock and a hard place

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February 4, 2025

# Ambitious fiscal consolidation plans for 2025 enough to calm the markets?

Romania ended 2024 with a budget deficit of 8.7% of GDP, likely one of the largest in the EU. By the latter half of the year, markets had largely priced in this deficit.

The general expectation was that 2025 - following the heavy election cycle - would mark the start of much-needed fiscal consolidation under the seven-year plan agreed upon with the European Commission. However, political instability disrupted these expectations, triggering a significant repricing at the end of 2024.

In response, rating agencies acted swiftly, with two out of three changing Romania's credit rating outlook to negative. The rescheduling of the presidential elections to May is expected to dampen reform appetite in the first half of 2025.

The initial budget target for 2025 aims for a deficit of 7.0% of GDP, implying a fiscal consolidation of around 1.7pp. The government already implemented measures to curb public spending and increase revenues in late 2024, with an estimated impact of approximately 2pp of GDP.



Source: BCR Research

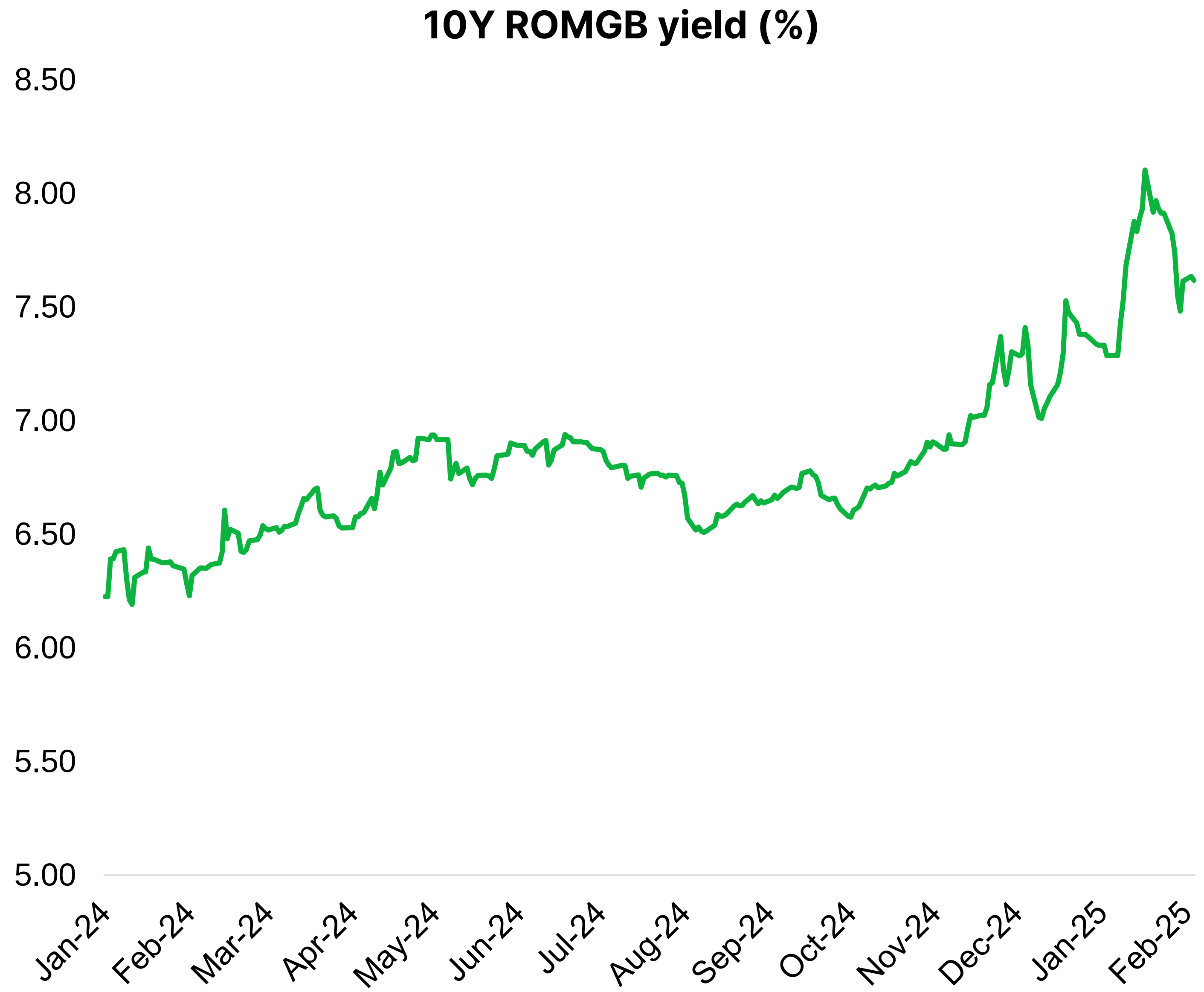
# Ambitious fiscal consolidation plans for 2025 enough to calm the markets?

Considering the structure of the budget and the full implementation of public pension recalculations this year, achieving the 2025 target appears somewhat ambitious.

Additional fiscal consolidation measures of around 0.8pp may be necessary. Budget revenues are projected to rise by about 2.3pp of GDP in 2025, with improved tax collection contributing roughly 0.5pp. Given these factors, the 7% deficit target seems optimistic. After the presidential elections, the government will likely explore further fiscal measures, balancing revenue increases with expenditure controls, while also aiming to support economic growth.

Gross funding needs for 2025 are estimated at approximately RON 235bn, with net issuance expected to account for about half, of which around 60% likely to be financed domestically.

Our models indicate that the fair value of 10-year ROMGBs is currently below market levels, suggesting that political uncertainty and rating adjustments may have led to an overreaction. That said, for a market rally to materialize, positive developments will be needed—the first potential catalyst being the unlocking of the Recovery and Resilience Plan (RRP). A rating downgrade to "junk" is possible, but not our baseline currently. The patience of both investors and rating agencies has been tested in recent years.




# Sailing through dangerous waters

Market stress, driven by a combination of global and domestic factors, has recently eased. The decline in yields has enabled Romania to access the international bond market, reinforcing confidence in its ability to finance its debt at reasonable costs until the presidential elections in May. In the meantime, the market is likely to remain sensitive to political developments.

We remain optimistic that Romania will avoid a credit rating downgrade and present a credible multi-year fiscal consolidation plan, which should revive the rally and lead to spread compression.



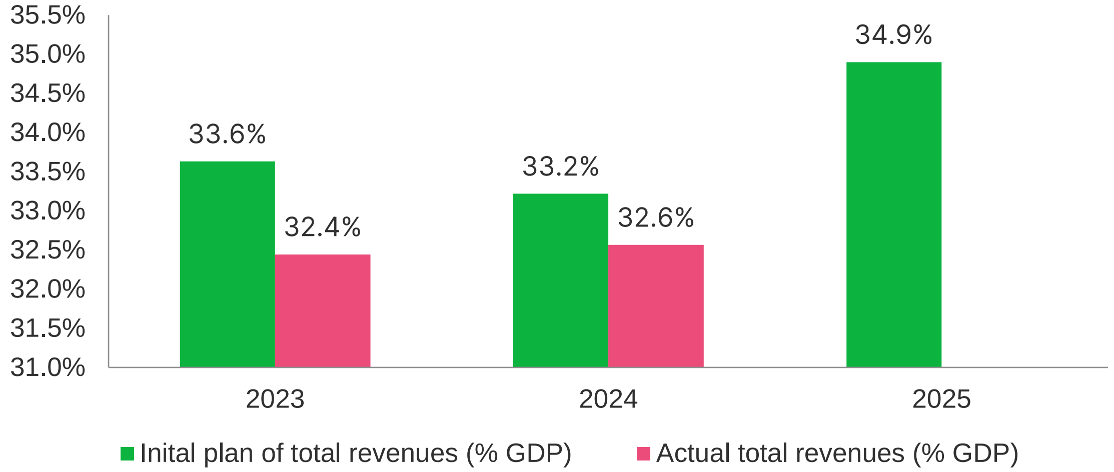


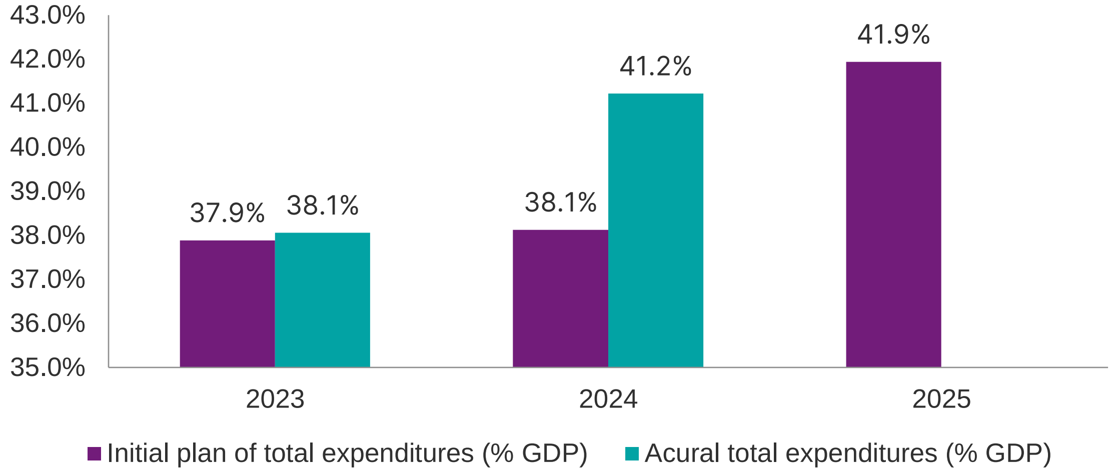
Source: BCR Research
February 4, 2025

# Fiscal backdrop & outlook

Romania committed to a 7-year fiscal consolidation plan to bring the budget deficit back to the 3% of GDP target from 8.7% in 2024. The 2025 budget has an initial deficit target of 7%. However, to achieve this, an estimated 0.8 percentage points' worth of additional consolidation measures might be required this year.

# In the past couple of years, Romania tended to overestimate revenues and underestimate expenditures




| | 2024 (%GDP) | 2025* (%GDP) | Change (pp) |
|---|---|---|---|
| Total revenues | 32.6 | 34.9 | +2.3 |
| - Fiscal revenues | 16.5 | 16.7 | +0.2 |
| - Social security contributions | 10.7 | 10.8 | +0.1 |
| - EU funds | 2.4 | 4.6 | +2.1 |
| - Other | 3.0 | 2.8 | -0.1 |

| | 2024 (%GDP) | 2025* (%GDP) | Change* (pp) |
|---|---|---|---|
| Total expenditures | 41.2 | 41.9 | +0.7 |
| - Personnel expenses | 9.3 | 8.9 | -0.5 |
| - Social payments | 12.7 | 12.7 | -0.02 |
| - Investments | 6.7 | 7.8 | +1.1 |
| - Other | 12.5 | 12.5 | +0.0 |

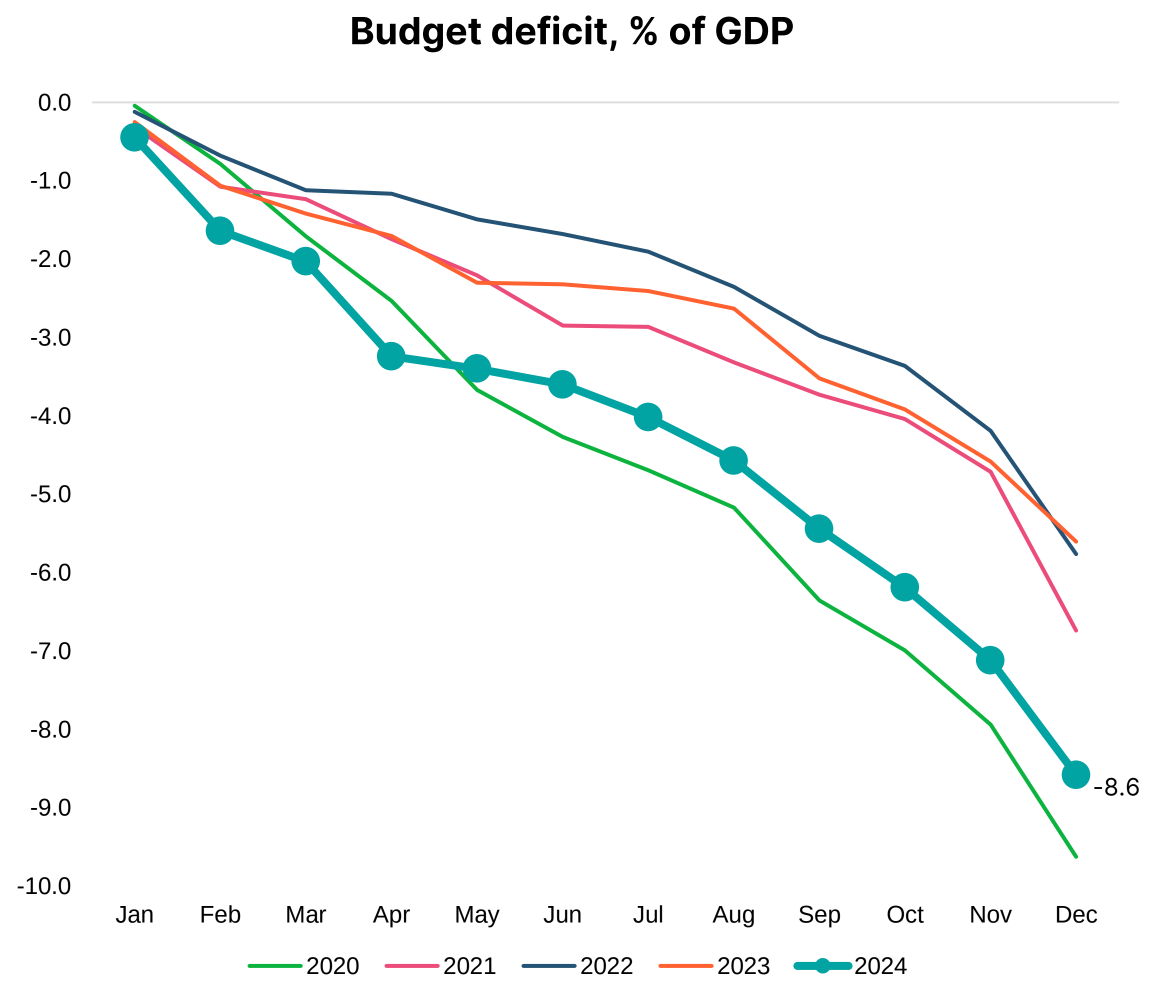
Source: MinFin, BCR Research

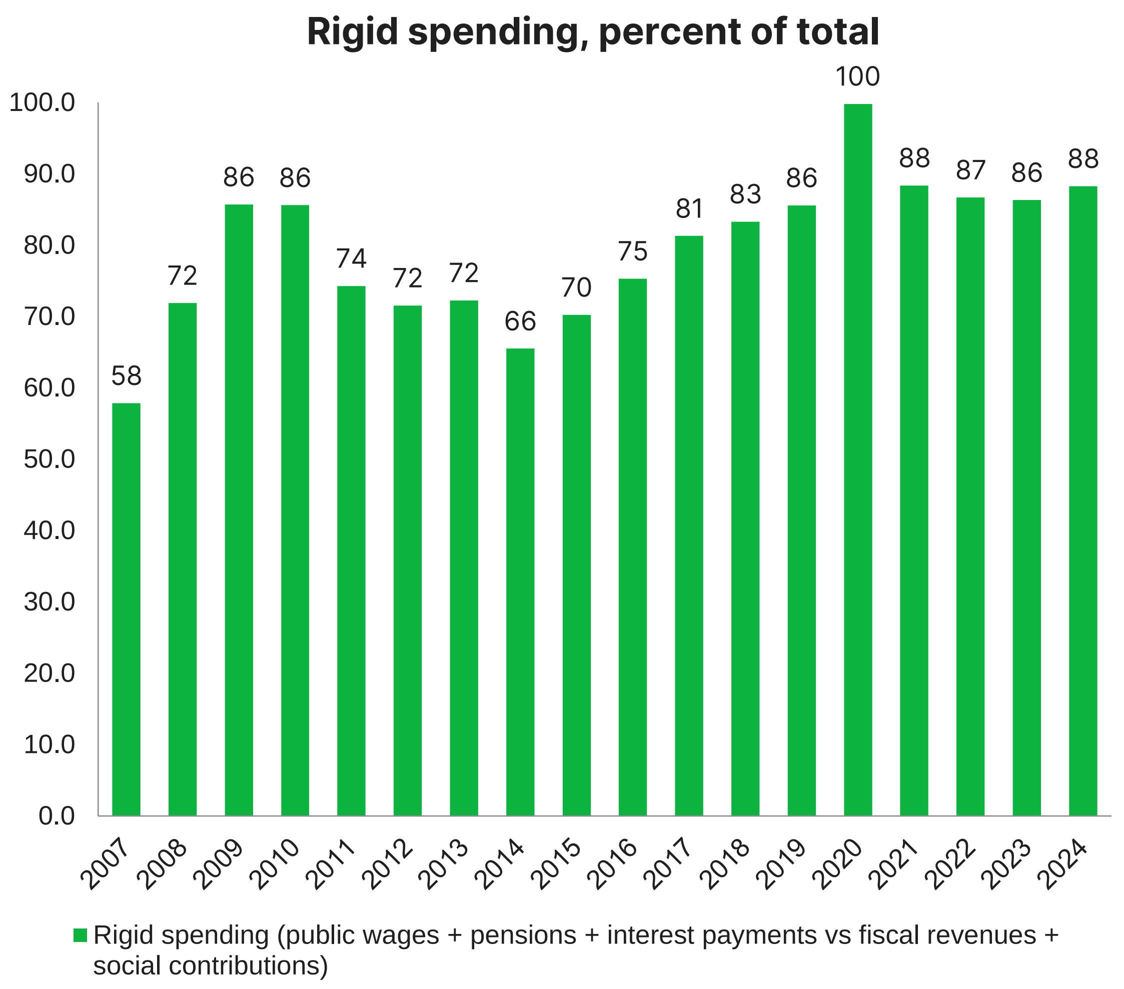


ERSTE Group

*) Based on the 2025 Budget plan published by the Ministry of Finance (due to rounding components might not add up to total)

# Budget deficit: 6% of GDP seems the new 3% post-Covid; adjustment likely via broadening the tax base and higher revenues, given the limited headroom for public spending cuts

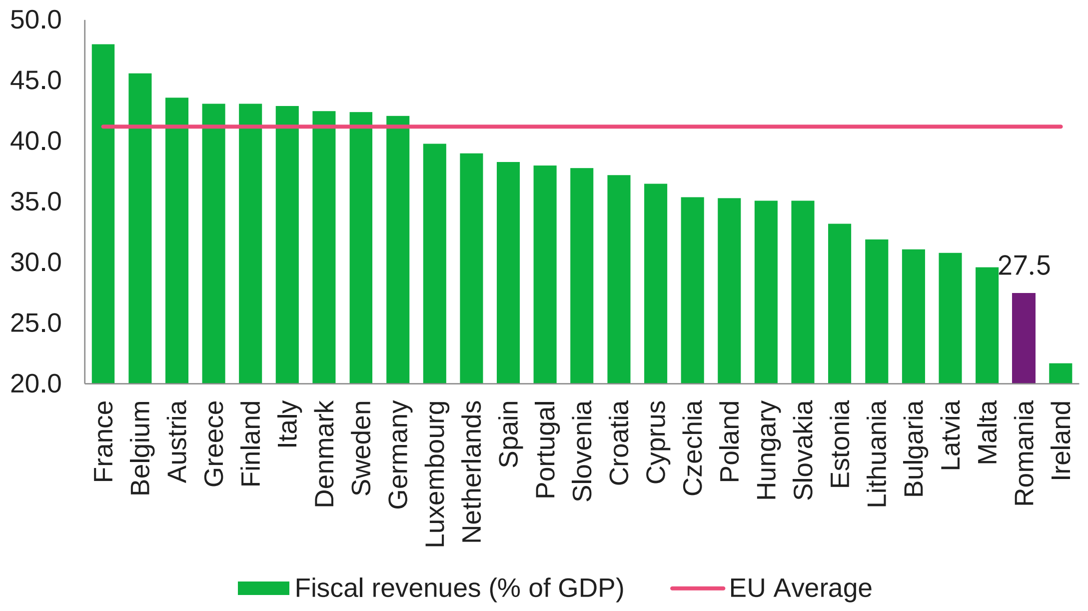


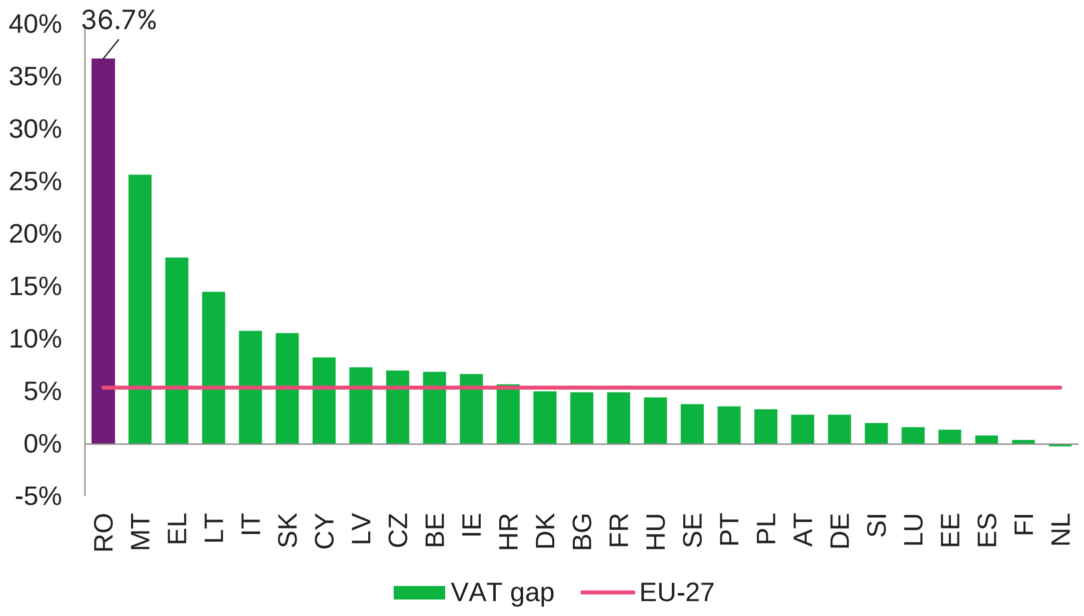




Source: MinFin, BCR Research

February 4, 2025

# The overdue fiscal consolidation process likely to tackle the issue of low budget revenues




Fiscal revenues are among the lowest in the EU at 27.5% of GDP. Romania lost 1.3pp of GDP in fiscal revenues between 2015 and 2019 as unnecessary fiscal stimulus was provided to the economy.

The fiscal corrective measures are likely to be mainly from the revenues side, given the rigid structure of the government spending. Empirically, fiscal adjustment on the revenue side is less growth-negative than on the expenditure side, though it is likely to be inflationary in the short run.

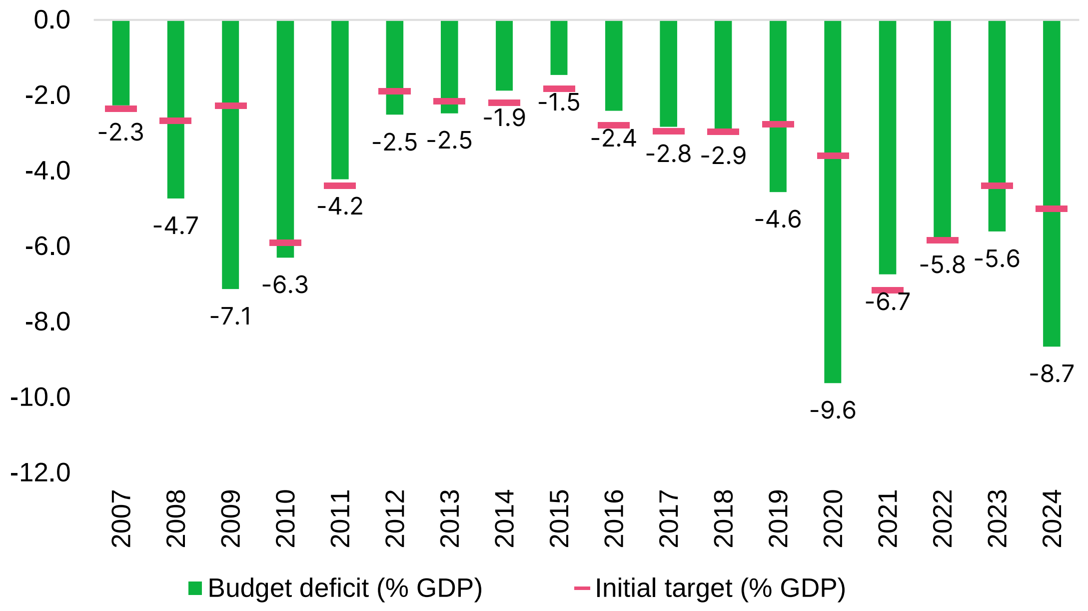
Closing the VAT gap towards the EU average would yield **extra revenues to the state budget of at least 2% of GDP**, which is a lot and would almost entirely solve the structural deficit problem.

To do that, however, the government needs to accelerate the digitalization of the public sector and take serious steps to combat fiscal evasion.

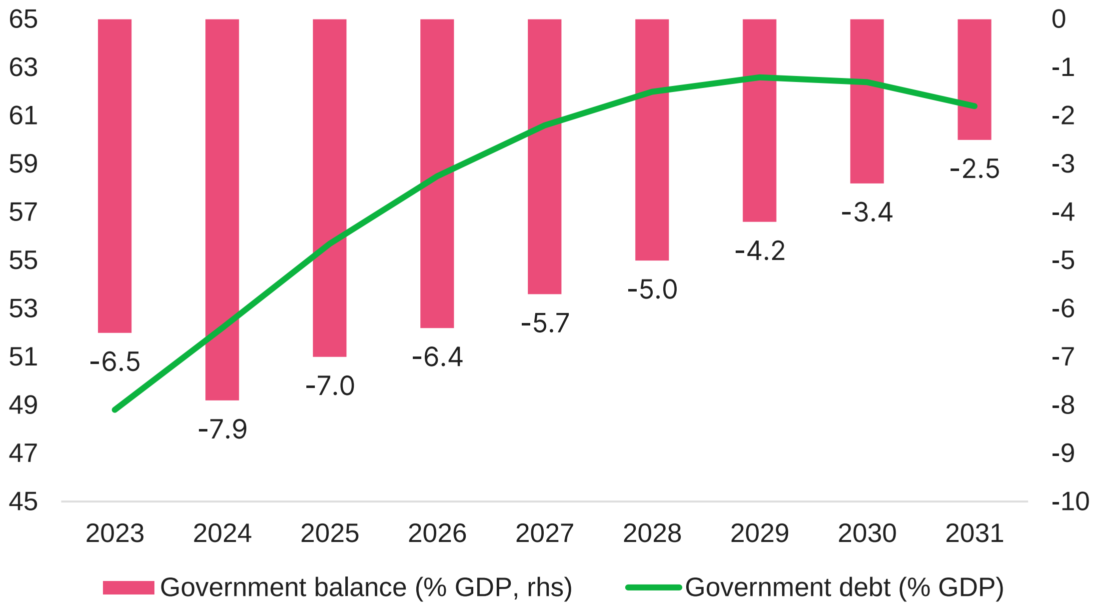
Source: Eurostat, European Commission, BCR Research

# Fiscal consolidation agreed with the EC implies large gross financing needs in 2025-2026

Inconsistent fiscal policy weakened the credibility of the EU fiscal anchor




7Y fiscal-structural plan is likely not seen ambitious enough by the markets




Post-Covid marked significant overshooting of the budget deficit targets and a widening in the structural deficit by 3pp of GDP vs. pre-Covid.

The 2024 budget ended with a deficit of 8.6% of GDP in cash terms. In ESA terms, the deficit may be narrower by 0.3–0.4pp, but it will exceed the EC's agreed target of 7.9% of GDP in ESA terms. Consequently, further corrective measures beyond the initial plan are necessary to address the shortfall.

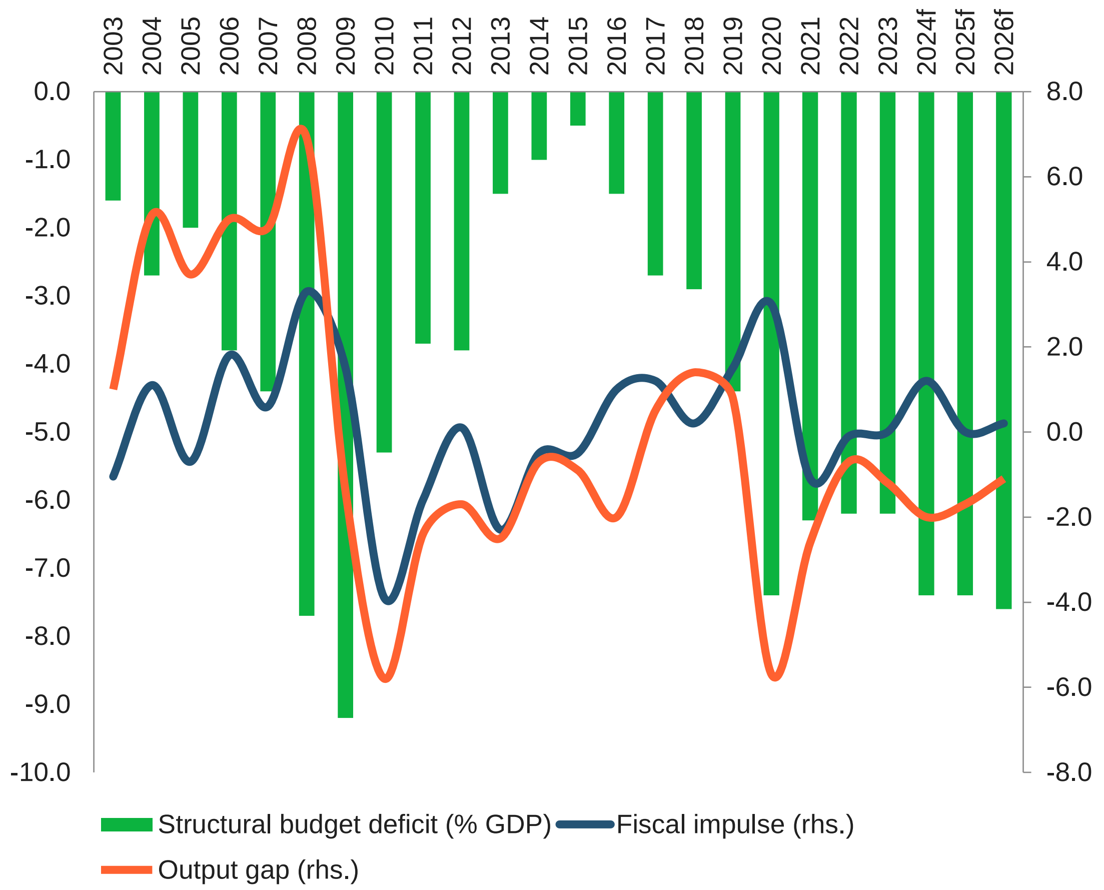
The government has frozen public sector pension and wage indexations scheduled for January 2025, avoiding a market meltdown scenario, generating around 1.5pp of GDP in spending savings, and closed several fiscal loopholes and exceptions, adding roughly 0.35pp of GDP to state revenues. To meet the 2025 deficit target, an additional fiscal adjustment of 0.8–1.0pp will be required. Delays increase the size of the adjustment.

Source: MinFin, European Commission, BCR Research

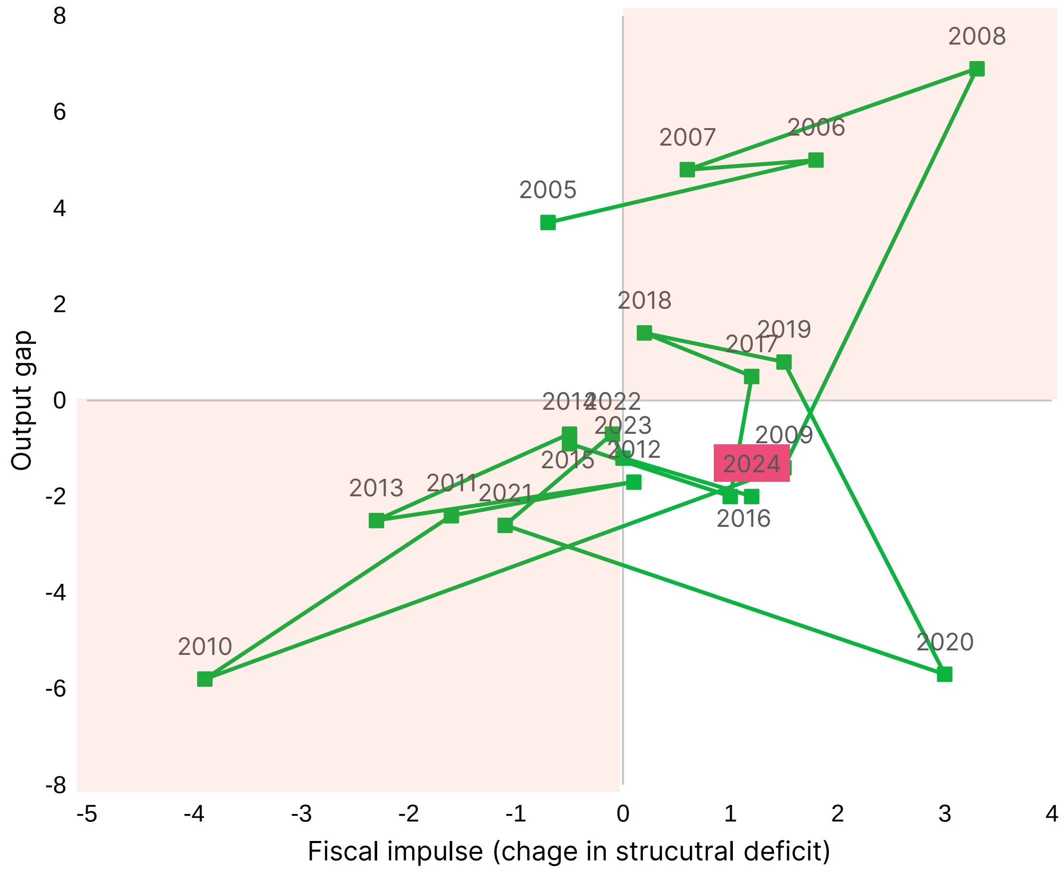
February 4, 2025

# In general, Romania followed pro-cyclical fiscal policies which amplified business cycle fluctuations. Compared to 2019, the structural deficit increased to 7.4% of GDP (up by 3pp).

**Structural deficit, fiscal impulse and excess demand**




**Fiscal impulse and excess demand in Romania – orange boxes reflect years with pro-cyclical policies**




Source: Ameco, BCR Research

February 4, 2025

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# Debt metrics and sustainability

The debt-to-GDP ratio remains relatively low in Romania, but it has been going up in recent years. Large primary deficits and climbing interest payments have been the main drivers. Nominal GDP growth has been helping to keep the dynamic at reasonable levels. Gross funding needs for 2025 are estimated at around RON 235bn, net issuance should be around half of it with around 60% domestic financing.


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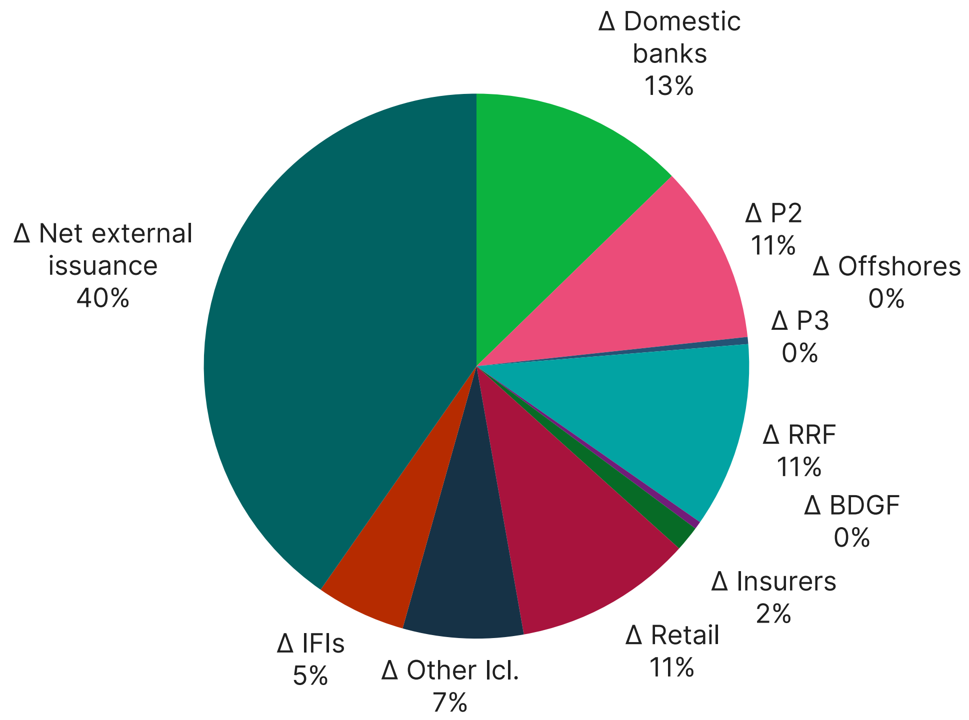
# RON 235bn gross financing needs in 2025. Who are the potential buyers?

**Potential split and buyers for 2025 net issuance**

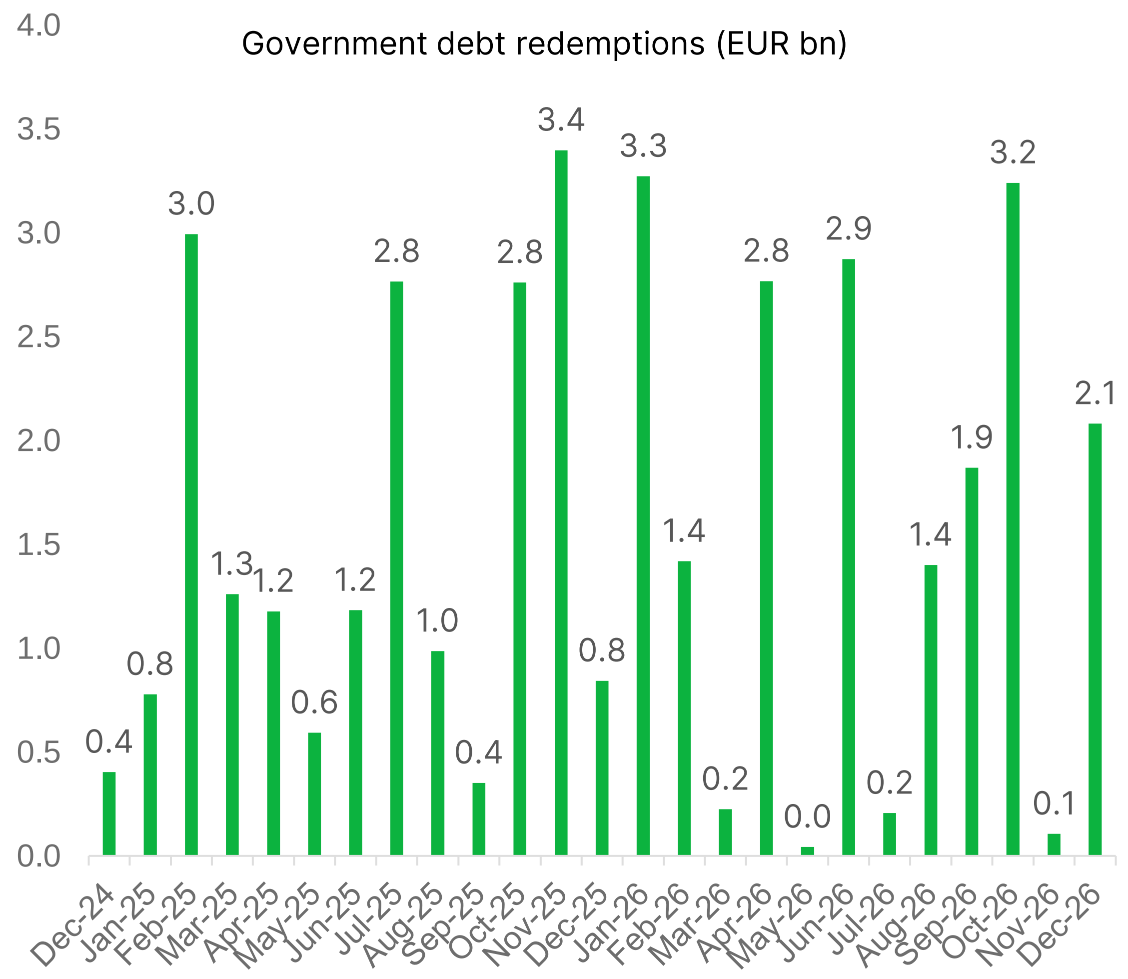


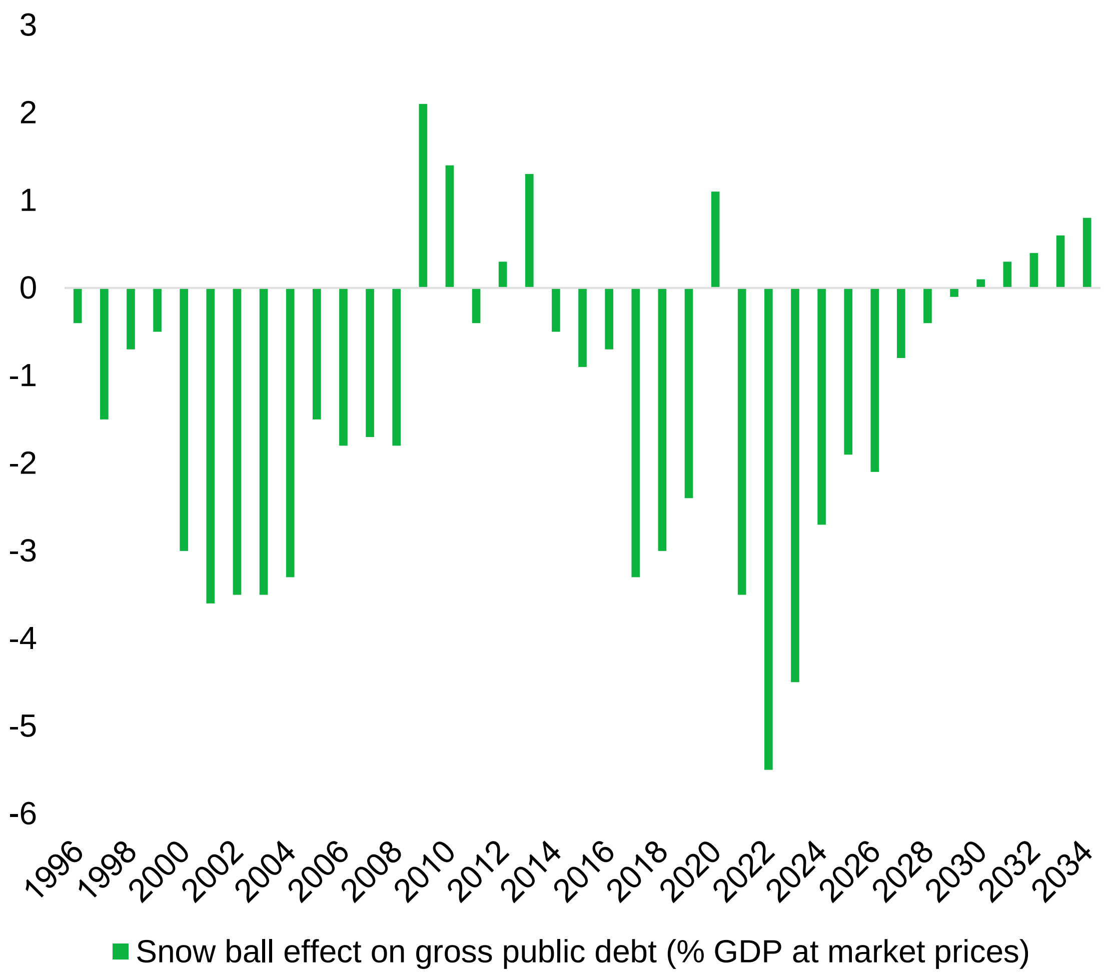

Main assumptions: primary domestic buyers of ROMGBs - banks and mandatory private pension funds - maintain their exposure to sovereign risk as a percentage of total assets, and no net outflows from offshores.

| | 2025 | | 2026 | |
|---|---|---|---|---|
| | RON bn | % of GDP | RON bn | % of GDP |
| **Gross funding needs** | 235.1 | 12.1% | 233.0 | 11.1% |
| **Budget deficit** | 136.4 | 7.0% | 134.5 | 6.4% |
| **Maturing debt** | 98.7 | 5.1% | 98.5 | 4.7% |
| **Domestic Total** | 85.3 | 4.4% | 76.3 | 3.6% |
| **International Markets** | 13.3 | 0.7% | 22.2 | 1.1% |

Gross funding needs for 2025 estimated at RON 235bn assuming a budget deficit of 7.0% of GDP - net issuance of RON 136bn, out of which RON 59bn can be financed domestically. Equivalent to EUR 15.5bn, it is likely to be funded through the RRF loan component (with EUR 11.3bn available until August 2026), loans from IFIs and borrowing from international markets. EUR 2bn in redemptions is due from international markets in 2025. The head of DM mentioned EUR 13bn in external issuance in 2025 vs. EUR 17.6bn in 2024.

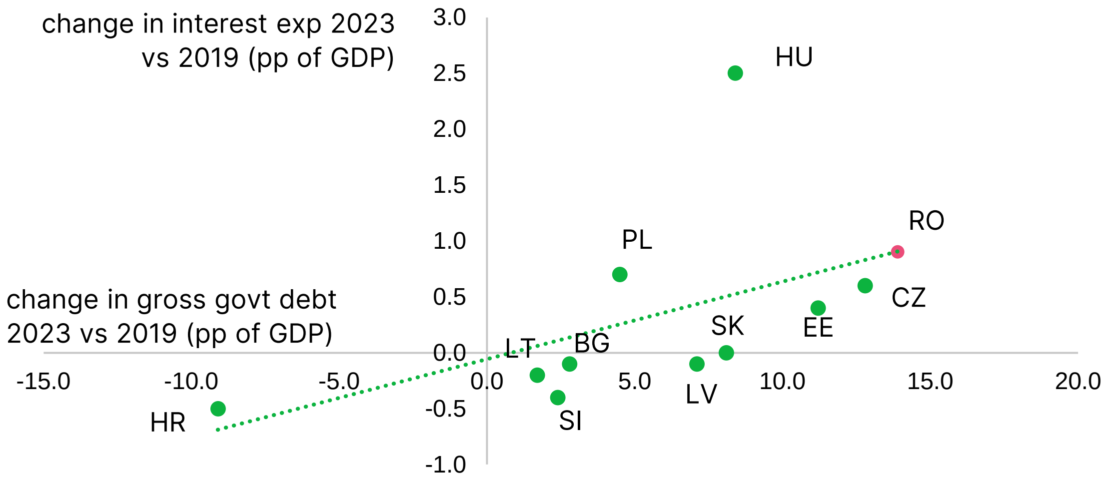
# Redemptions profile: four months with large maturities, out of which one in EUR in late October. Snowball effect expected to add to debt-to-GDP ratio starting 2030.

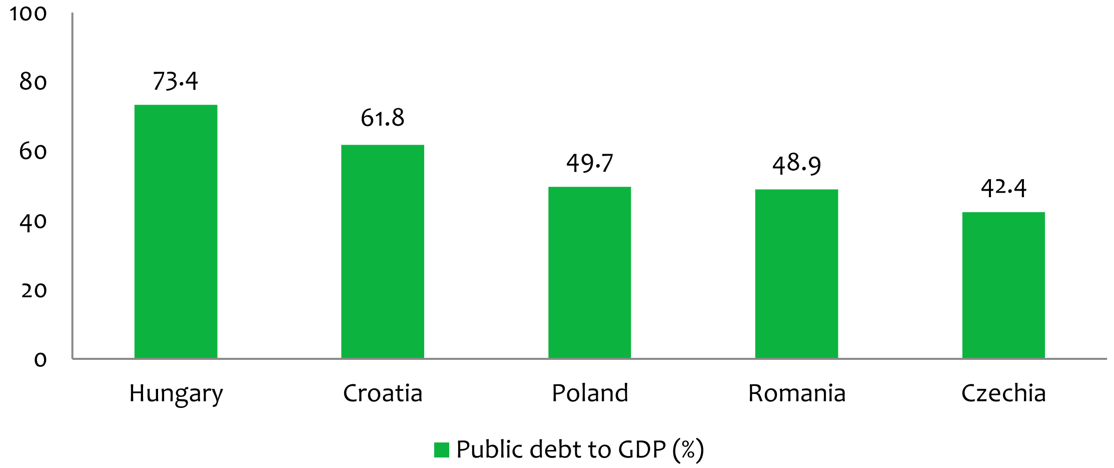


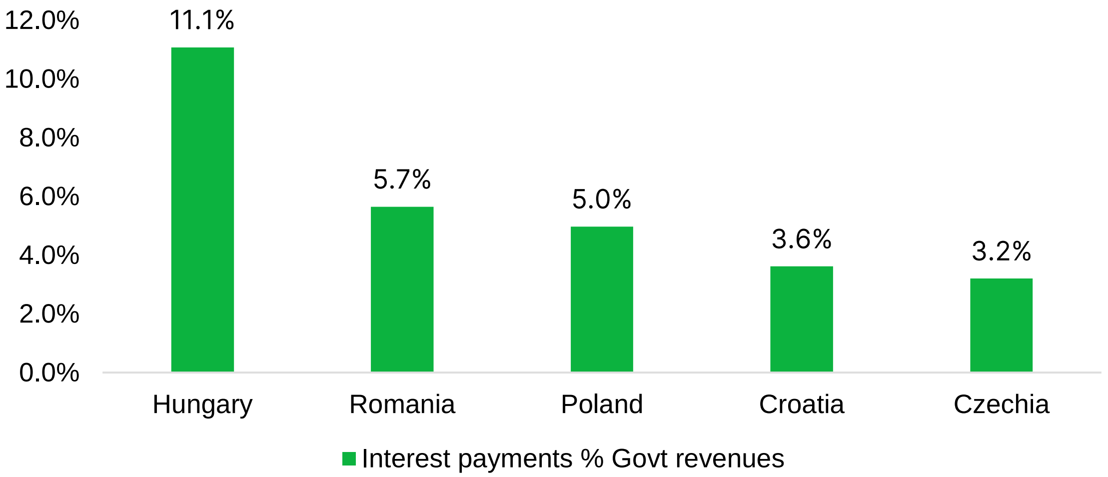



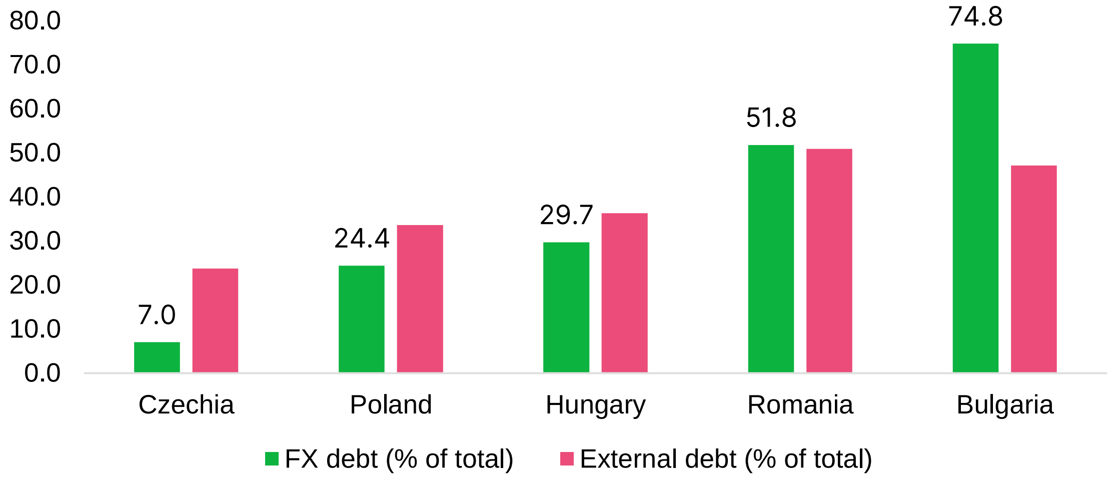

Source: European Commission, MinFin, BCR Research

# Debt metrics strengths: still low debt and interest payments levels.
# Debt metrics weakness: high FX-denominated debt



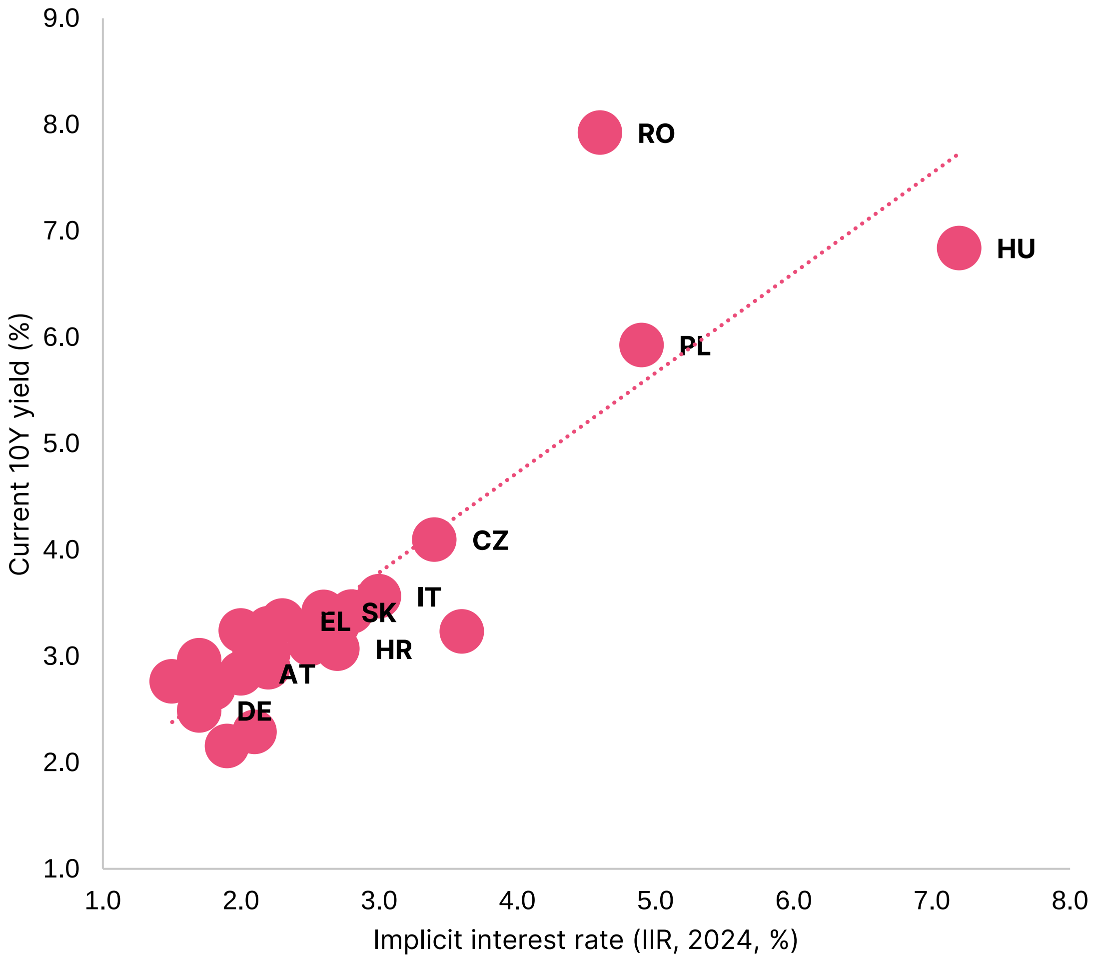



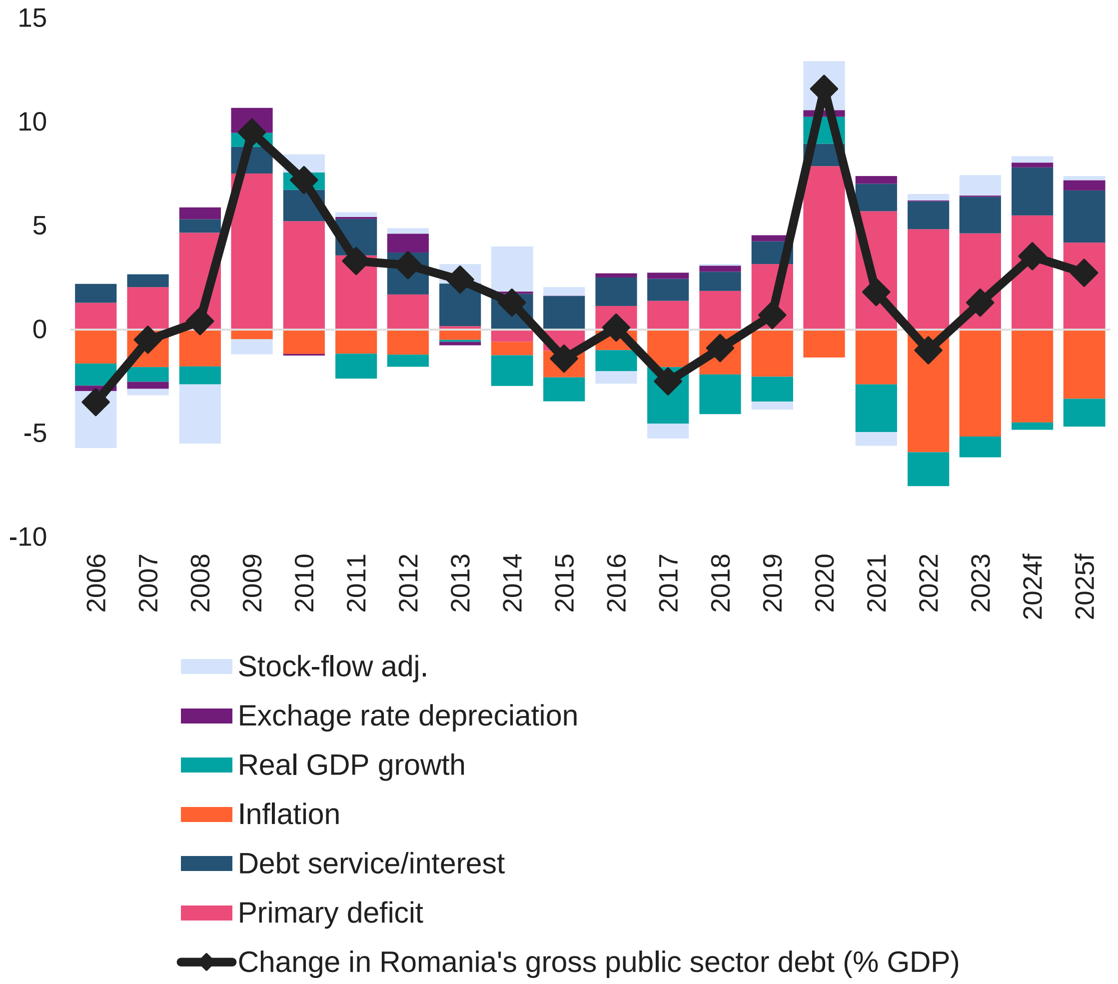




Source: Ameco, Eurostat, BCR Research

February 4, 2025

# Debt sustainability questions at current borrowing costs: nominal rates (r) > nominal GDP growth (g). Primary balance surplus needed to reverse the uptrend in debt-to-GDP ratio.



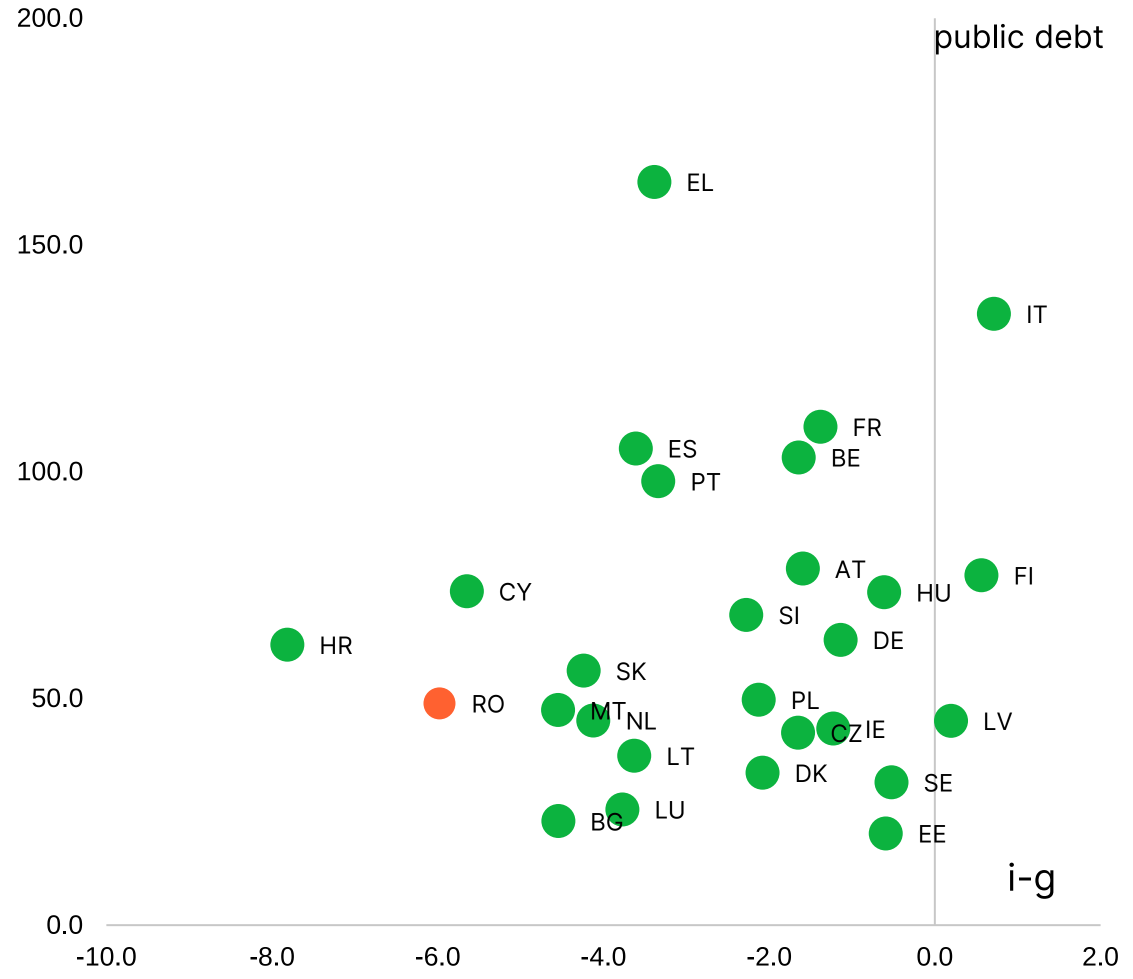






Source: MinFin, Eurostat, Bloomberg, BCR Research

February 4, 2025

# Interest-growth rate differential and public debt and breakdown of ‘r-g’ differential In EU (2023): Romania not in a bad position, but deteriorating fast.




# Credit rating sensitivities

The patience of rating agencies has been tested in recent years. Large twin deficits and rising public debt are the main points of concern. Fitch and S&P recently changed the rating outlook of Romania to negative. We believe that the risk of a rating downgrade to “junk” is there, but only if Romania shows no credible fiscal consolidation plans, which currently is not the case.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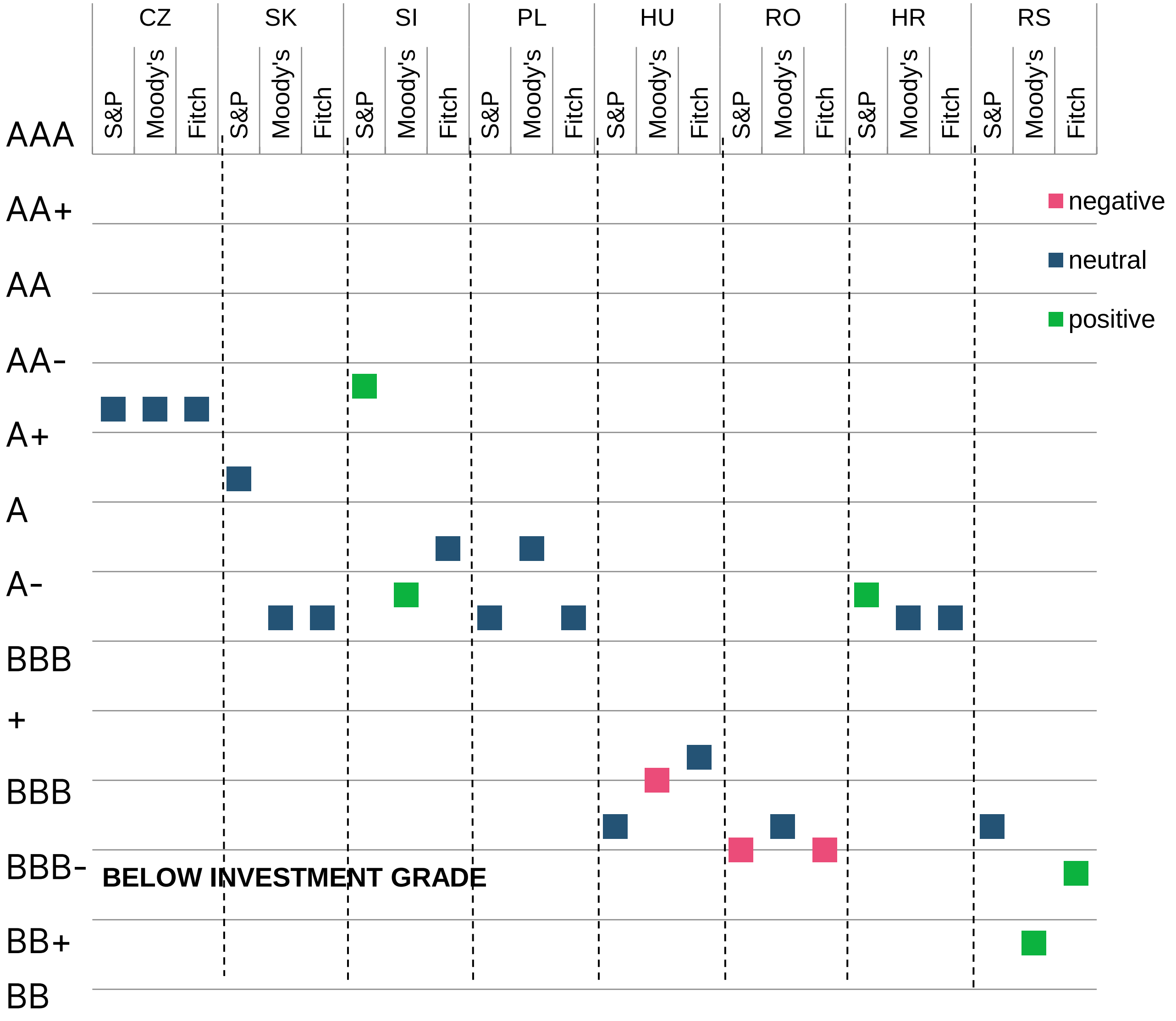
# Outlook revised to negative by two major rating agencies

In an unscheduled review in December, Fitch revised Romania's outlook to negative from stable while affirming the rating at 'BBB-'. High political uncertainty, likely to 'have a significant adverse effect on fiscal consolidation', was cited as the primary reason. The absence of consistent and credible fiscal consolidation given that the credibility of the medium-term fiscal anchor has weakened substantially due to unfunded expenditure measures and repeated fiscal slippages, or weak economic growth, could trigger a rating downgrade.

S&P followed Fitch in January with a change in outlook to negative from stable, citing the higher than expected budget deficit in 2024 and likely delayed fiscal consolidation, due to lingering political instability.




Source: Bloomberg, BCR Research

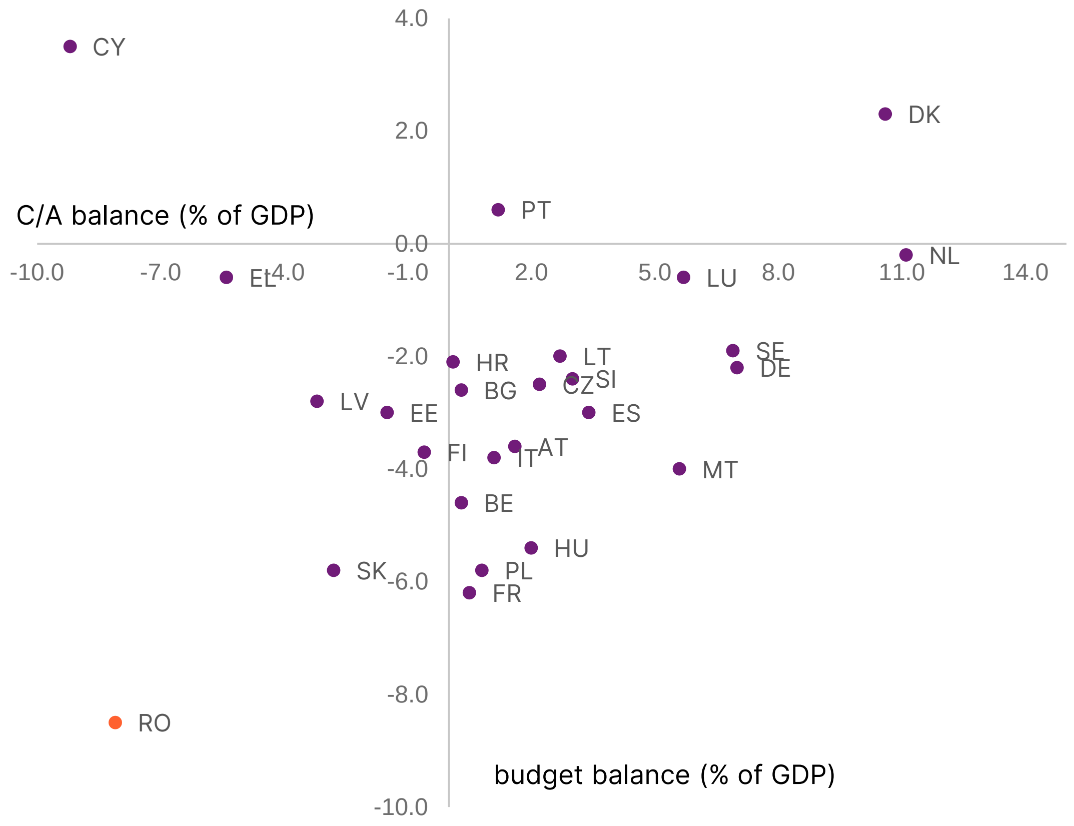
# Rating sensitivities and scheduled reviews

We believe a rating downgrade is unlikely by fall 2025 and can likely be avoided if the government introduces a fiscal adjustment plan, expected to follow the rerun of the presidential elections scheduled May 4-18.

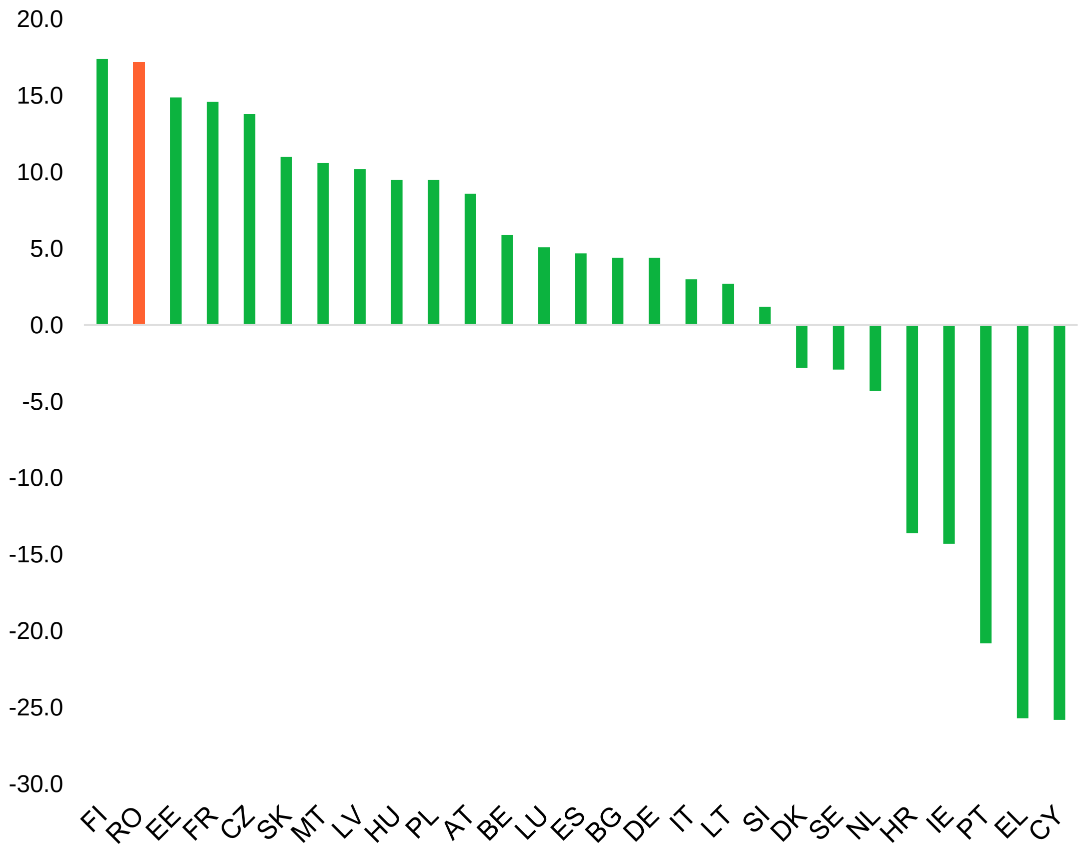
| | Moody's | S&P | Fitch | Main idiosyncratic downside rating sensitivities |
|---|---|---|---|---|
| 21-Feb-25 | | | BBB- NG | Rapid increase in government debt over the medium term due to failure to implement measures that support sustained and credible fiscal consolidation, or weak economic growth; political domestic shocks. |
| 14-Mar-25 | Baa3 ST | | | Deterioration of fiscal metrics, increased external vulnerability, weakening institutional effectiveness, inability to absorb RRF funding. |
| 11-Apr-25 | | BBB- NG | | Government policies alongside subdued economic growth leading to higher-than-expected fiscal deficits over the medium term, resulting in a steeper increase of public debt and the interest burden, while also weighing on Romania's substantial CADs. |
| 15-Aug-25 | | | BBB- NG | |
| 12-Sep-25 | Baa3 ST | | | |
| 10-Oct-25 | | BBB- NG | | |

# Romania is an outlier in the in terms of twin deficits.

C/A account and budget balances (% of GDP, 2024)



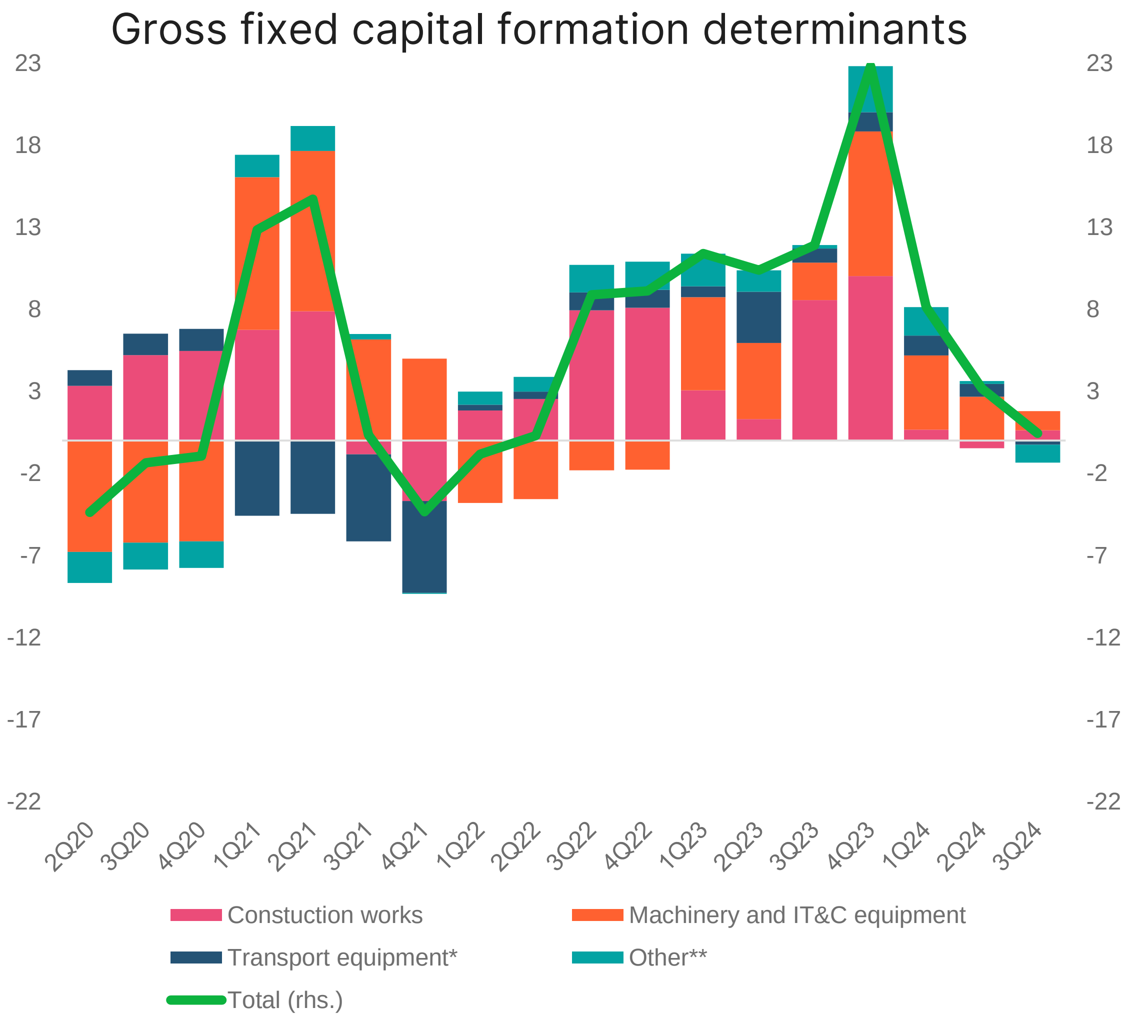

Change in public debt, 2024 vs. 2019 (pp of GDP)



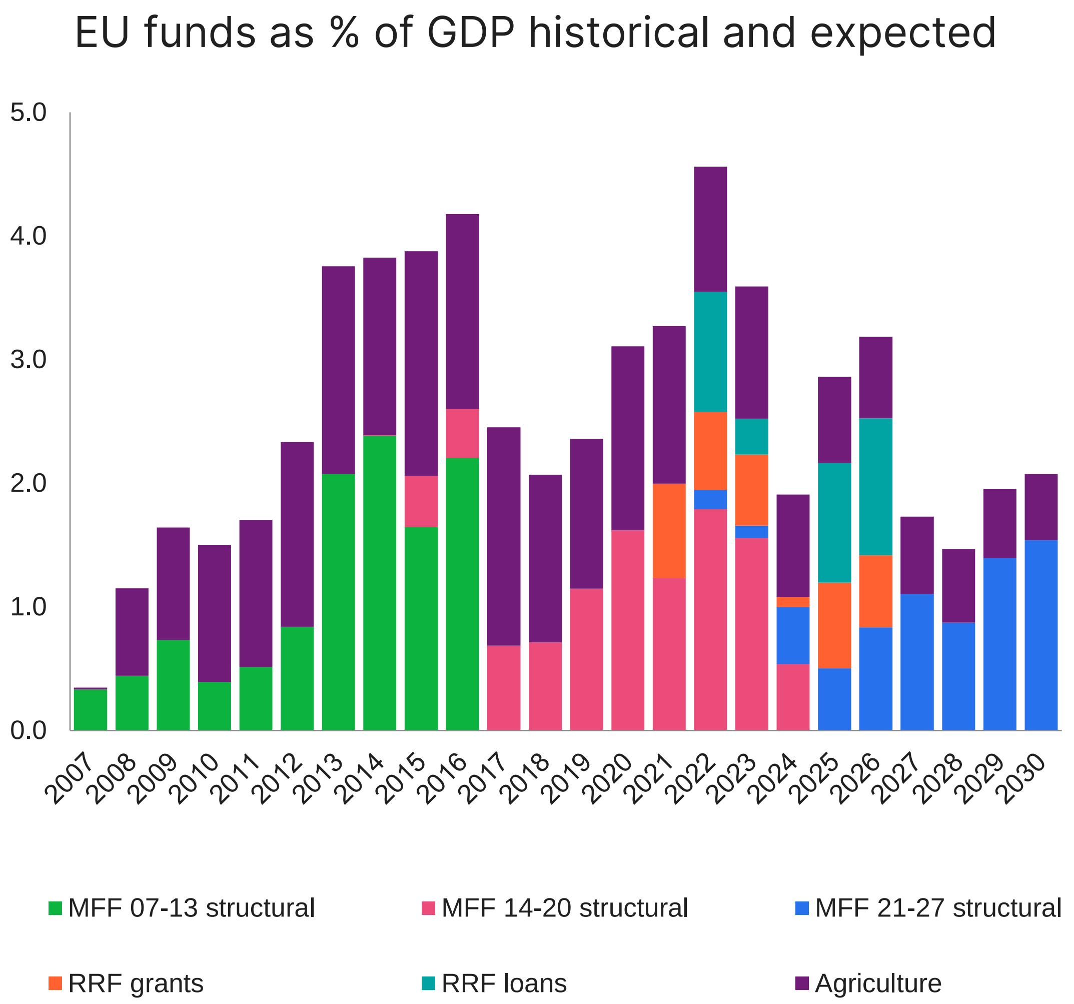

Source: Ameco, BCR Research

February 4, 2025

# GDP growth might disappoint, again. Unfreezing RRF money is key for 2025 GDP growth, after state investments disappointed in 2024, due to lower EU funds absorption.



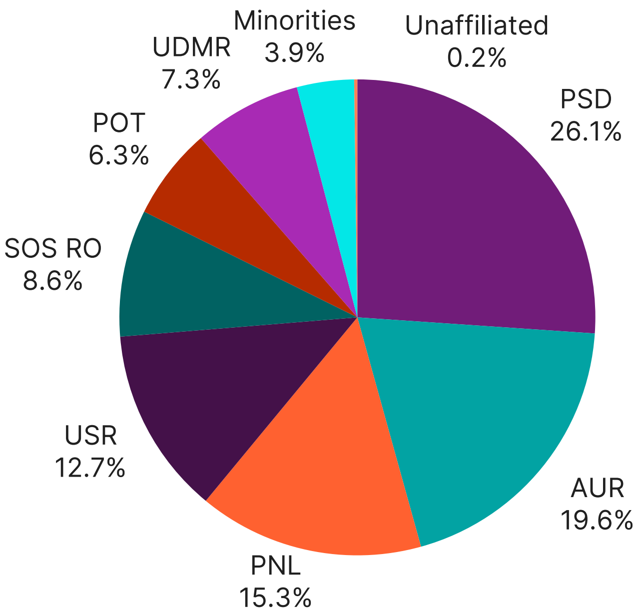

*) purchased by private companies and public institutions
**) IT&C software, agriculture investments, R&D, real estate, etc.




Source: Eurostat, European Commission, MinFin, BCR Research

# Politics: Another source of uncertainty. Relatively thin yet stable parliamentary majority.

## Government coalition relies on ~53% of total MPs




Source: cdep.ro

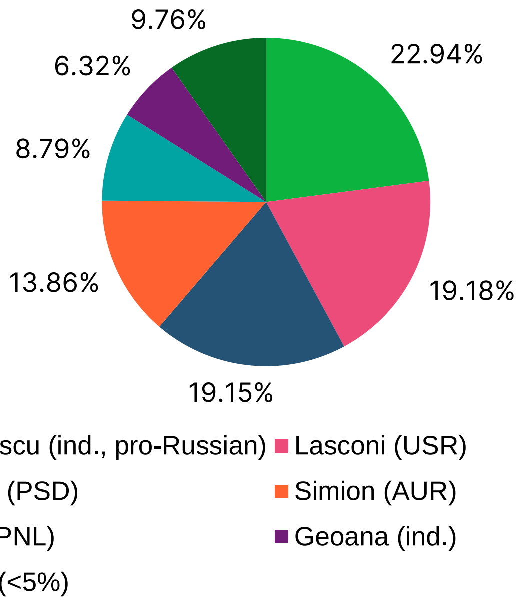
Government coalition (PSD + PNL + UDMR + Minorities) is backed by 53% of the MPs.

Pro-European parties hold 65% of parliamentary seats.

35% of MPs are affiliated with far-right parties.

## Presidential elections rerun scheduled for May 4-18

**Results of the first round of presidential elections in Nov-24**




Source: BEC

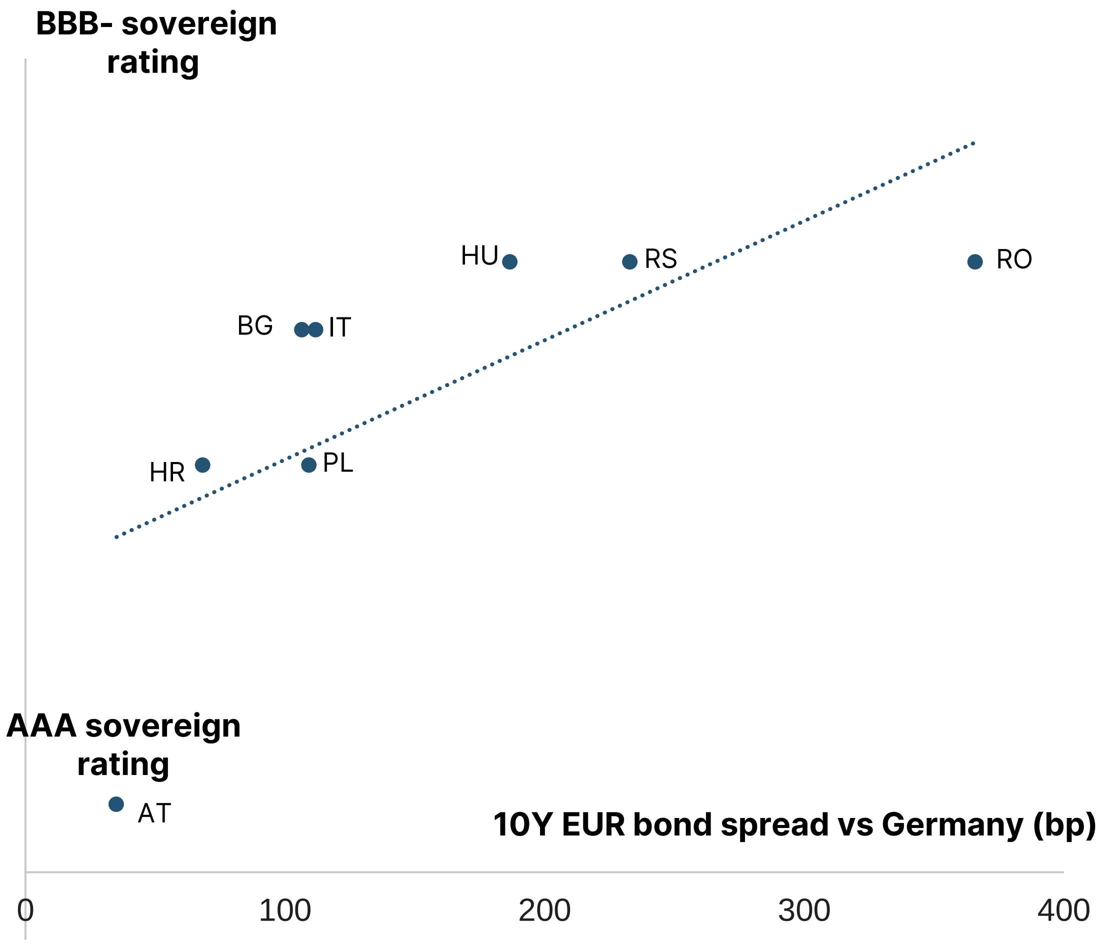
Government coalition supports a common candidate for the presidential elections. Crin Antonescu, former PNL head, was picked.

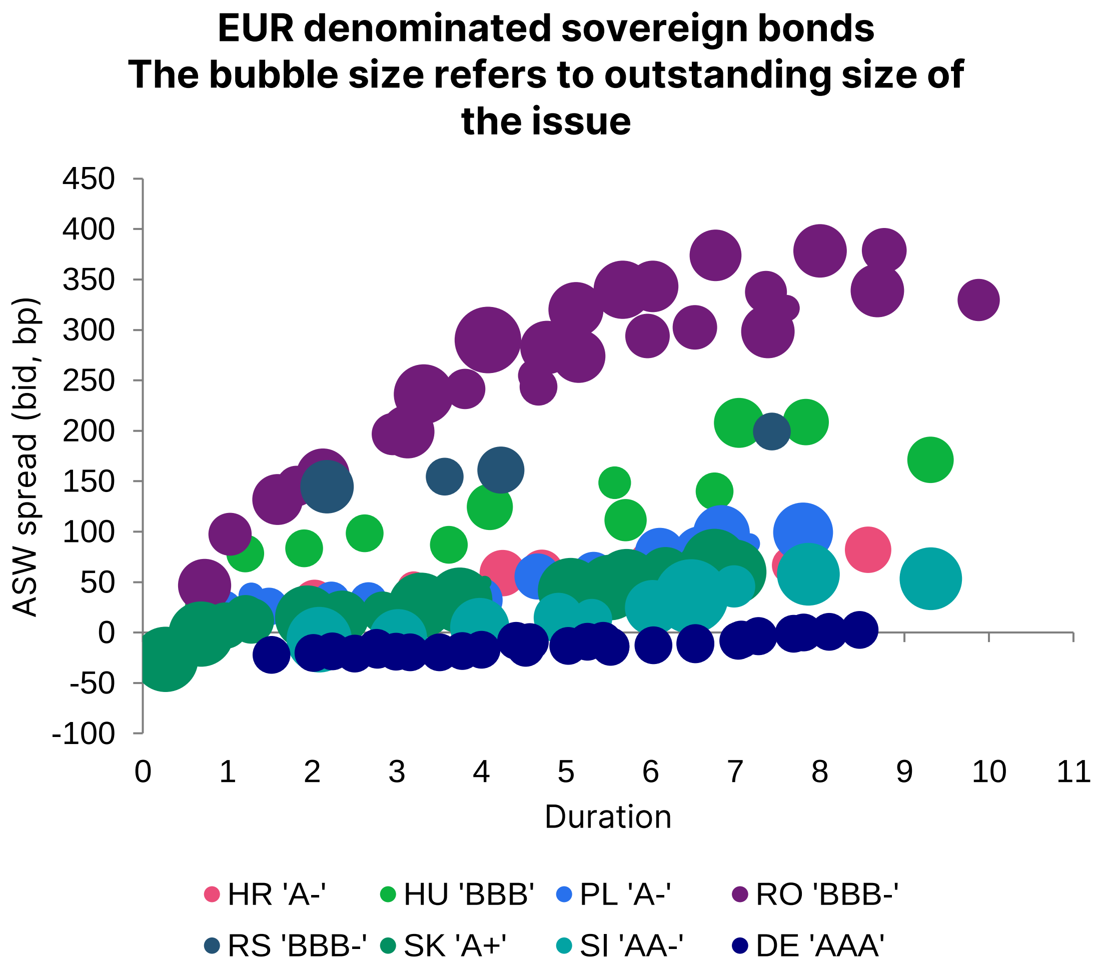
Bucharest Mayor Nicusor Dan is running for the presidency, USR backing is unclear.

The runoff is likely between a far-right candidate and Antonescu/Dan. Unclear if Calin Georgescu would be allowed to run again.

Source: BCR Research

# Markets trading ahead of rating agencies: Romanian EUR-bonds at much wider spreads vs. countries with a similar rating. Heavy supply from the issuer is partially to blame.



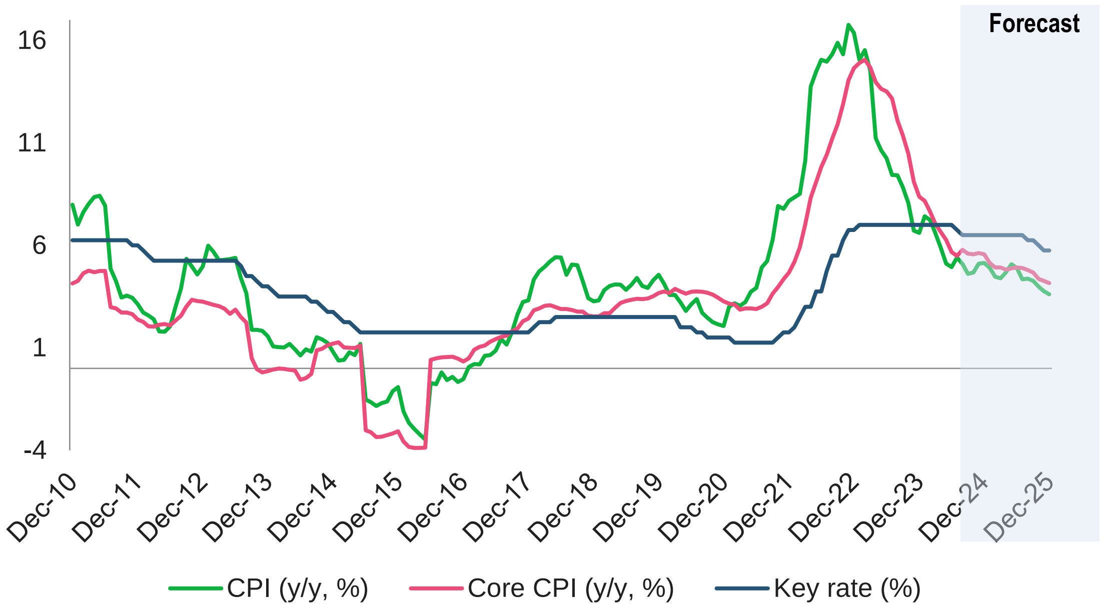



# Outlook for ROMGBs

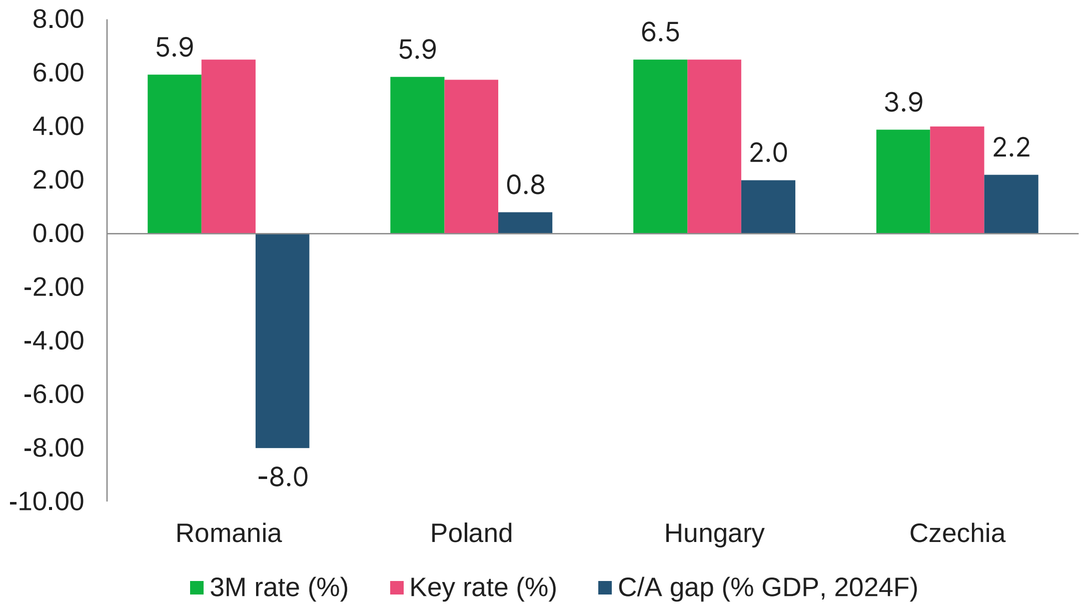
Our models show the 10-year ROMGBs fair value below the current level, suggesting that markets have slightly overreacted in pricing, due to the political uncertainty and rating changes. That said, we believe that, for an eventual rally, some positive news is required. The first thing that comes to mind is unlocking the RRP.

# NBR in 'on hold' mode, 'fiscal-dependent' rather than 'data-dependent'.

Sticky core inflation, upward risks to headline CPI outlook




Wider C/A gap should require higher nominal interest rates




We forecast headline inflation at 3.7% by end-2025, down from 5.1% y/y in Dec-2024 . We forecast core inflation above the headline inflation, at 4.0% for end-2025.

The deceleration in core inflation last year was mainly driven by the food component, with core services and core non-food components displaying more stickiness. This is further evidence of a wage-price spiral.

We expect the NBR to resume cutting rates in August and deliver three key rate cuts of 25bp each to 5.75% by end-2025.

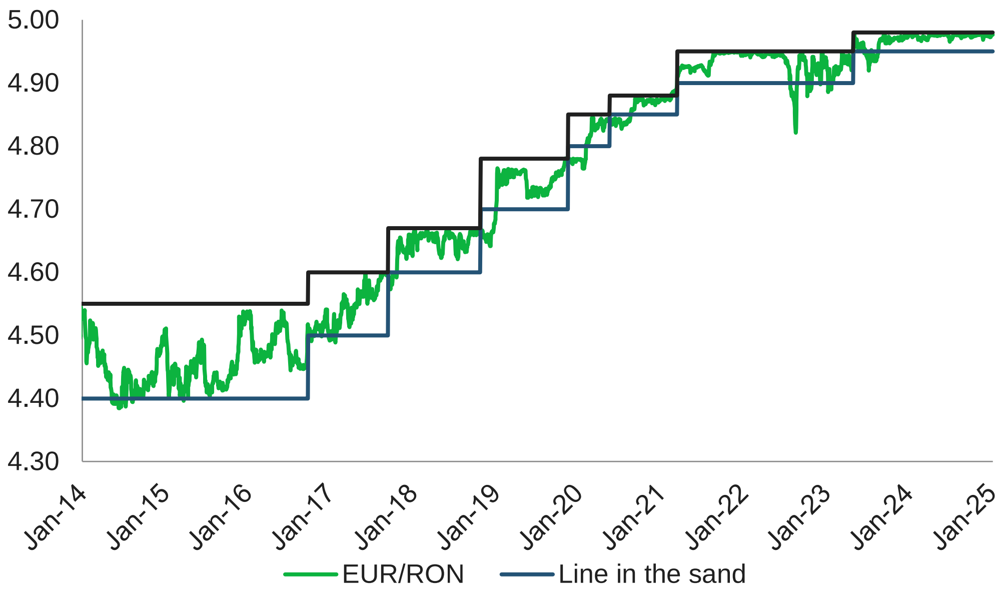
The NBR governor reiterated that the monetary policy is counter-cyclical, the current policy stance remains restrictive and, as inflation continued to decelerate, it became tighter.

Source: Ameco, Bloomberg, NBR, NIS, BCR Research

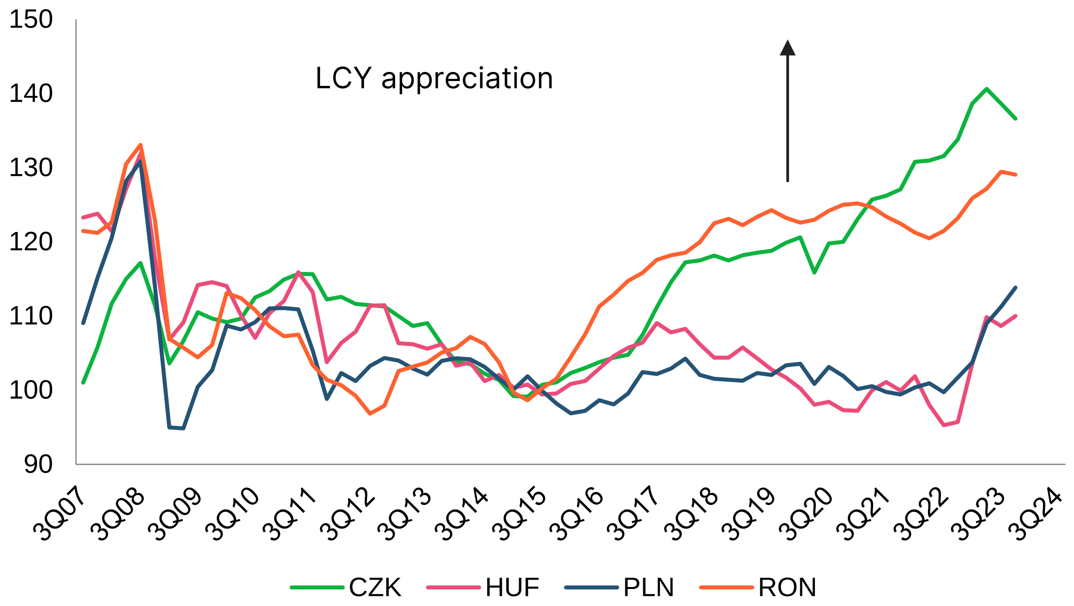
February 4, 2025

# FX remains a policy anchor for the NBR at the expense of higher rates. The higher share of government debt is factored-in by the central bank.

NBR signalled its discomfort with stronger RON, asymmetric risk




ULC (unit labour cost) adjusted REER (real effective exchange rate)




The 4.98 level for the EUR/RON seems to be the new NBR 'line in the sand'. The risk to the EUR/RON outlook is asymmetrical, as the NBR governor reiterated that the economy cannot afford leu appreciation.

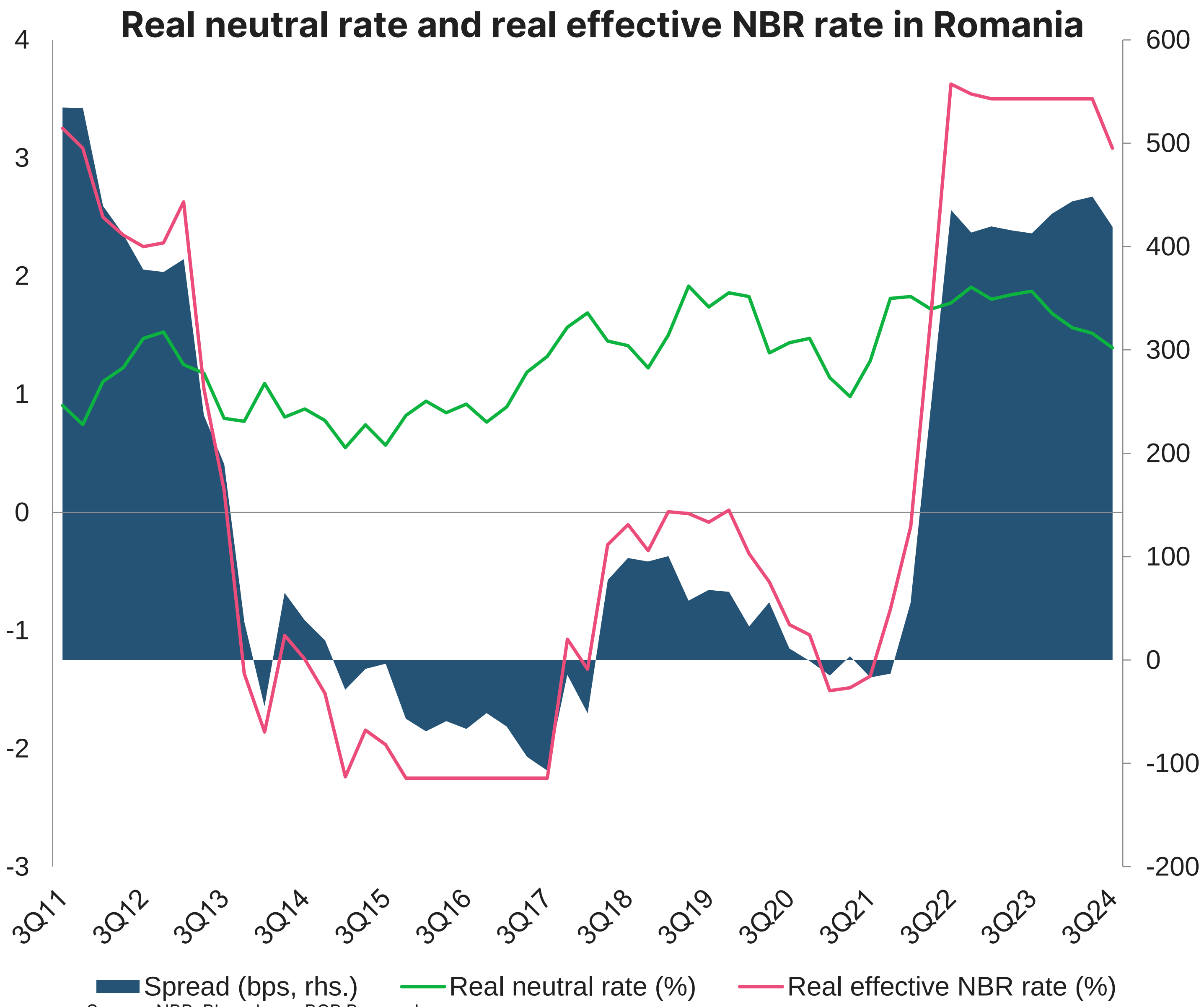
We expect a minor narrowing of the C/A deficit in 2025 to 7.8% of GDP, from 8.1% in 2024. Thus, Romania remains the outlier in terms of external imbalances vs. peers. Our models suggest that the RON is overvalued in real terms by roughly 6-7% vs. the EUR.

The RON remains overvalued vs. the PLN & HUF on ULC-based REER. We noticed some currency overvaluation issues, affecting especially sectors employing a low-skilled labor force with tight margins.

The NBR governor mentioned that real effective exchange rate measures (to be presented in February) suggest a minor overvaluation of the Romanian currency, of below 5%, which does not explain the large external deficit.

Source: EC, Bloomberg, NBR, BCR Research

February 4, 2025




Source: NBR, Bloomberg, BCR Research

# Finding the right balance

Based on our estimates, the **neutral nominal rate for the NBR should be between 4.00% and 4.50%**.

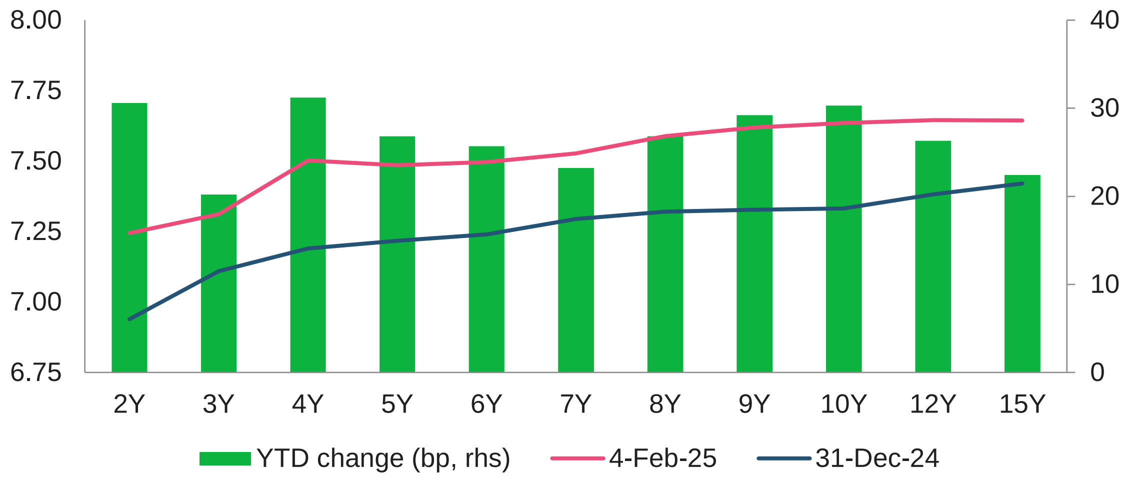
Over the last decade, the real effective rate of the NBR has been well below the neutral rate, suggesting that monetary policy was supportive for economic growth.

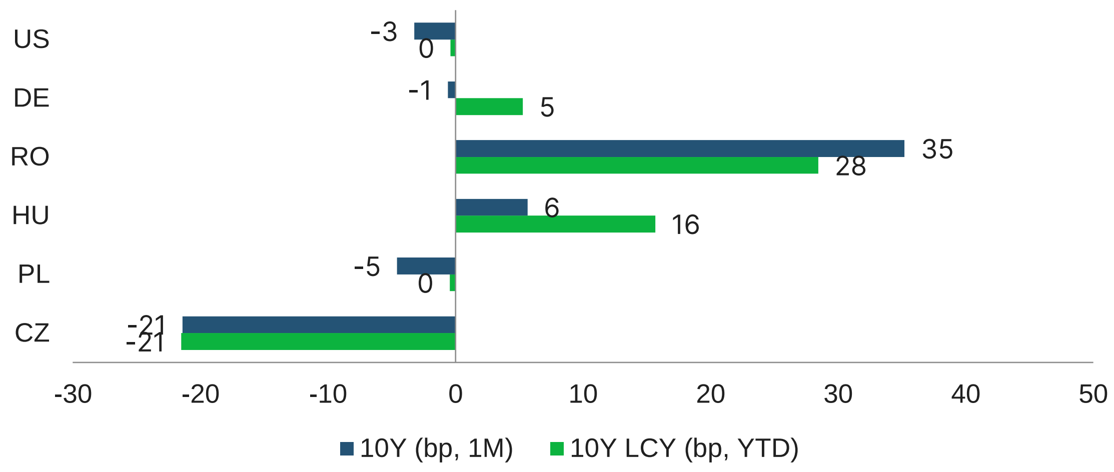
The recent inflationary episode prompted a sudden change and the NBR real effective rate went well above the neutral rate.

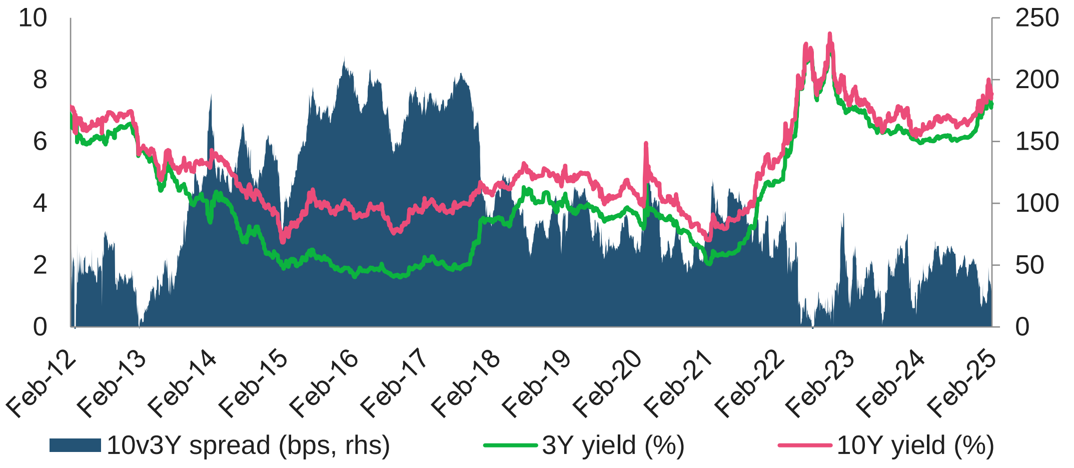
**We expect the NBR key rate to reach a neutral level in 4Q26.**

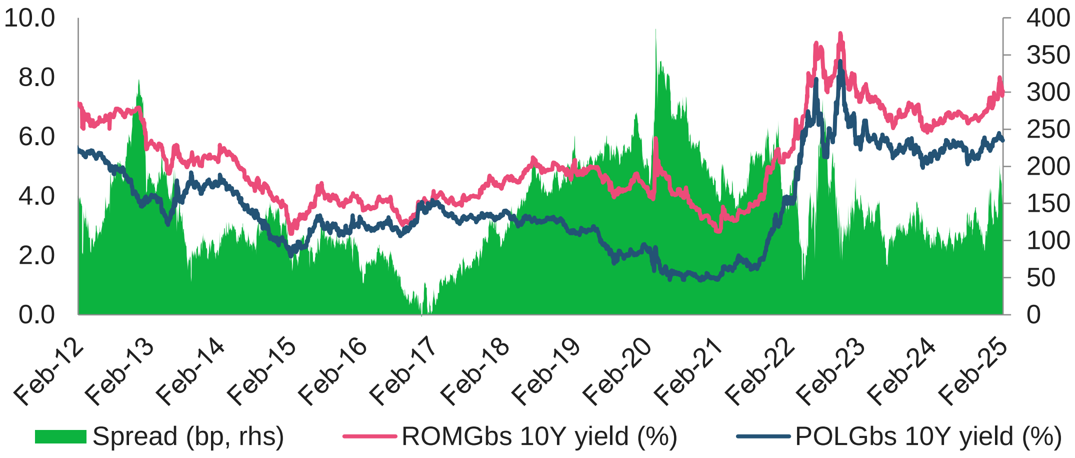
Note: the neutral rate is estimated using HLW model and the real effective NBR interest rate is calculated as nominal EFFECTIVE rate minus inflation target

# ROMGBs curve & relative performance



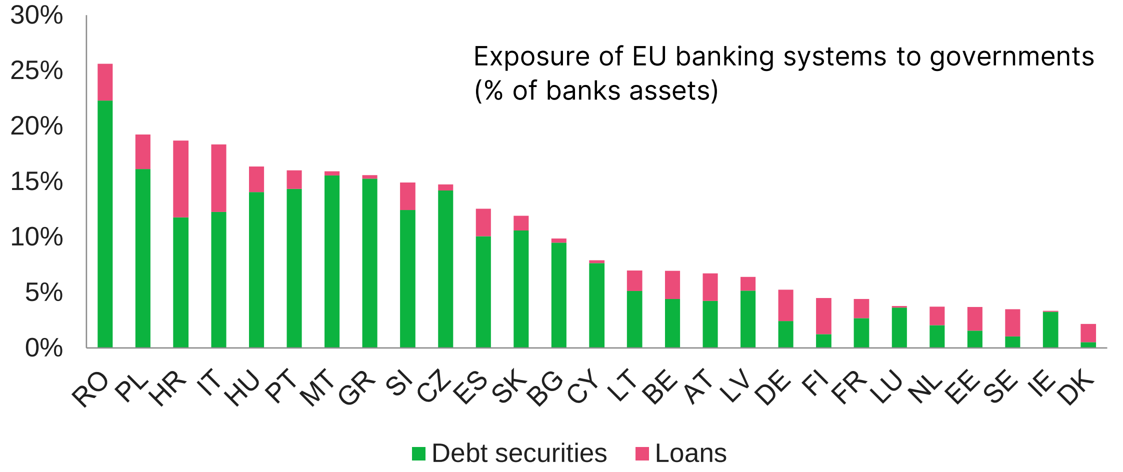



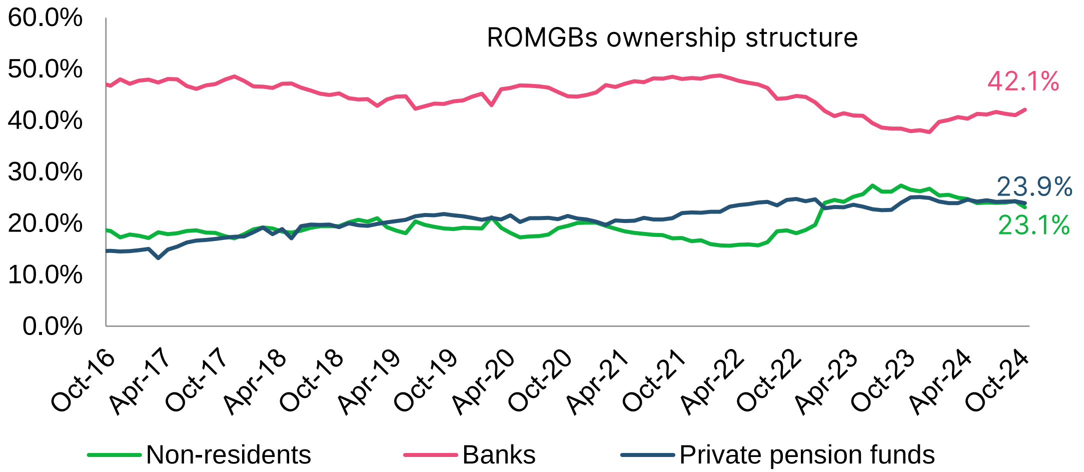

Source: Bloomberg, BCR Research

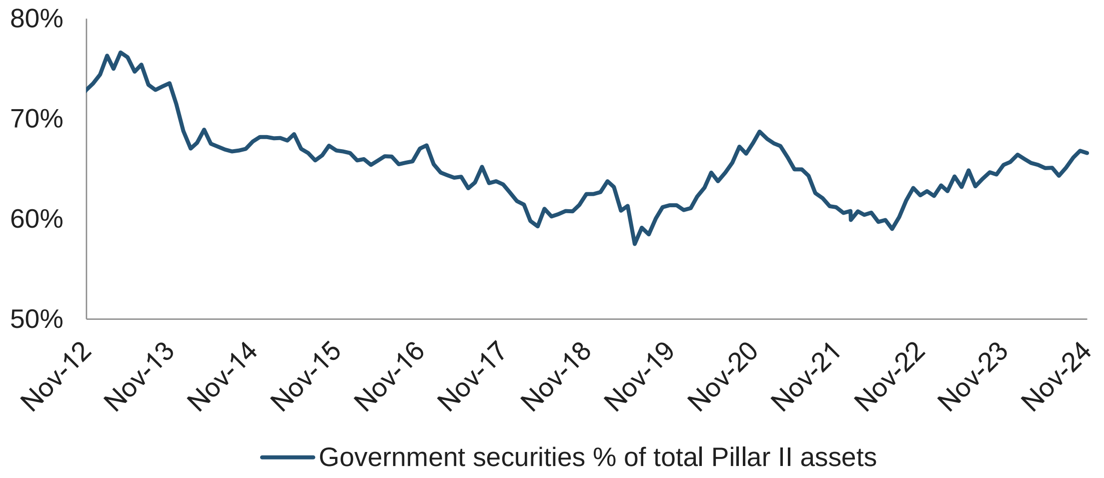
February 4, 2025

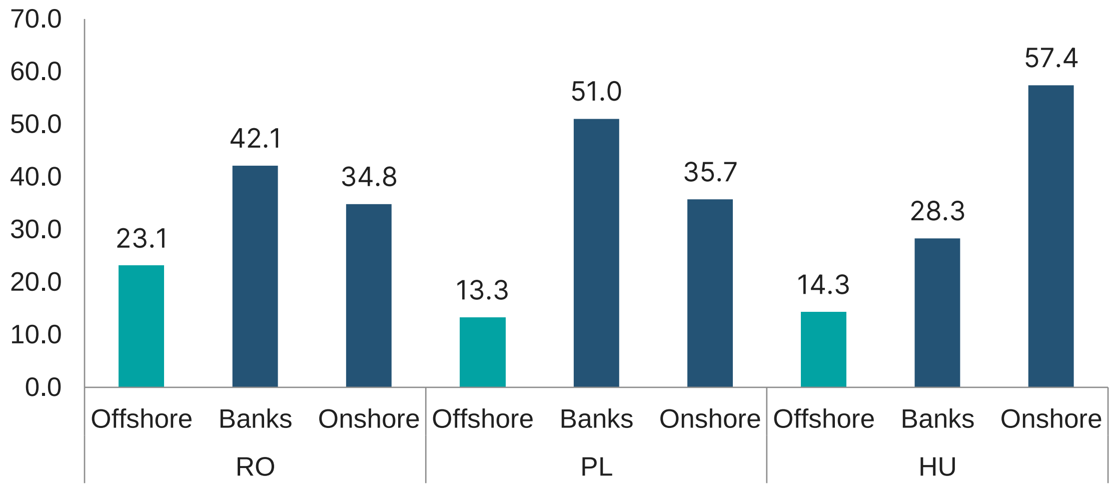
BCR

# ROMGBs market infrastructure




Source: ECB, AKK, Polish government, Romanian MinFin, Romanian FSA, BCR Research

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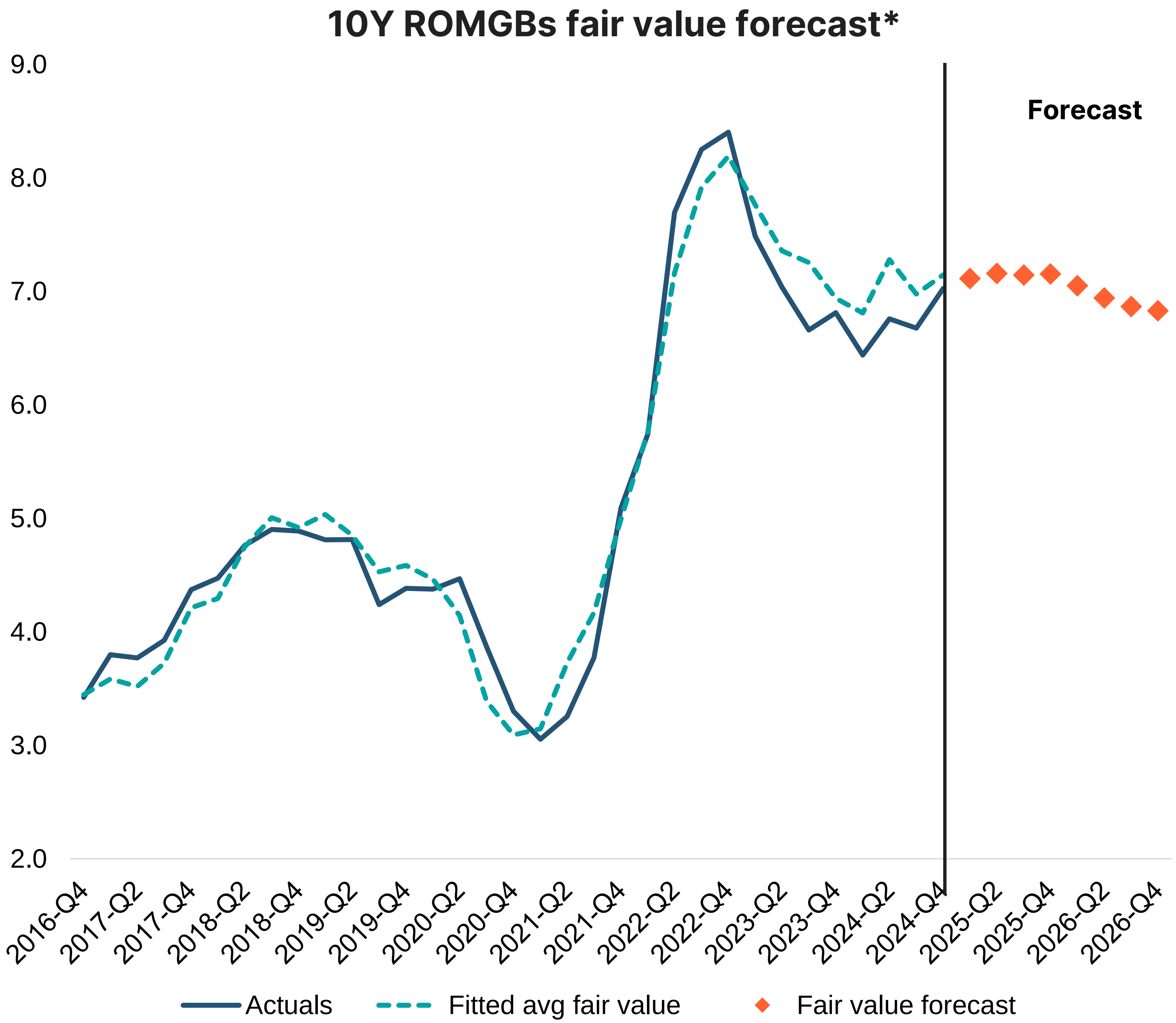
## ROMGBs valuations




Our models estimate a **'fair value' for 10Y ROMGB yields at 7.2% in 4Q25**, implying some room (~30bp) for a rally from current levels, and 6.8% in 4Q26.

We see scope for steepening of the ROMGB yield curve, with the **10Y-2Y spread's 'fair value' projected at 120bp in 4Q25** compared to ~40bp currently.

ROMGBs less sensitive to rating actions vs ROMANIs.

*) the fair value is calculated as an average of three different models using relevant macro variables and financial data (relative fiscal performance, different interest rates and inflation measures, C/A balance, 10y German Bunds, etc.)

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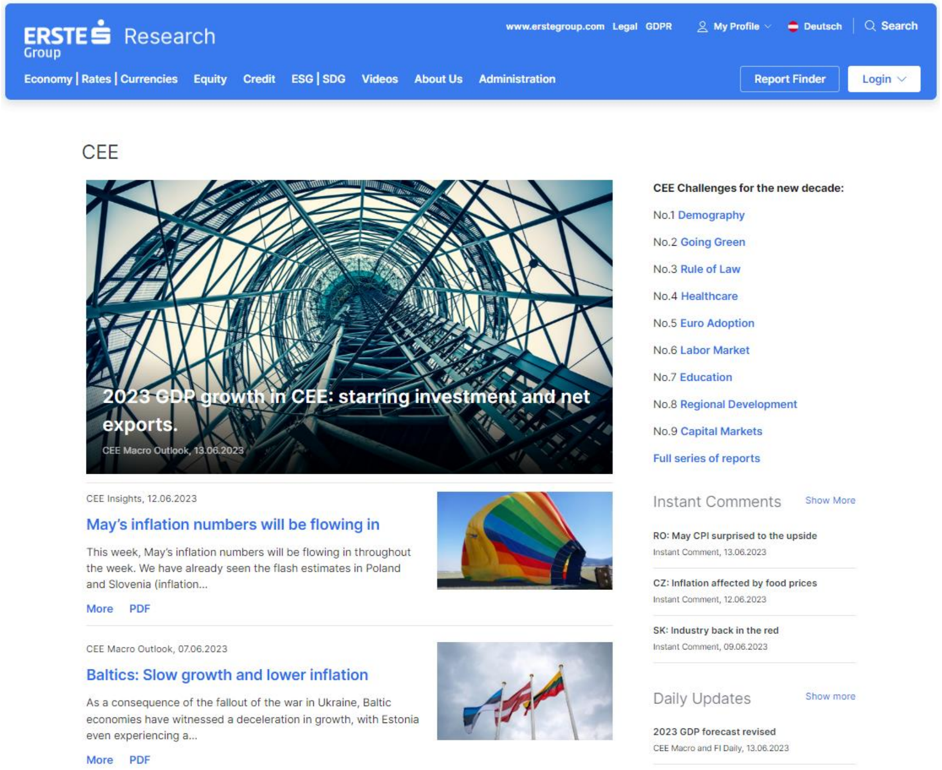


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**Published by:**

**Erste Group Bank AG**
**Group Research**
**1100 Vienna, Austria, Am Belvedere 1**
**Head Office: Wien**
**Commercial Register No: FN 33209m**
**Commercial Court of Vienna**

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