*NATIONAL COMMISSION FOR STRATEGY AND PROGNOSIS*

**The evolution of the main macroeconomic indicators for the Romanian economy in 2020-2021**

The forecast of the main macroeconomic indicators for the Romanian economy rely on hypotheses which are based on the evolution of the pandemics in Europe and in our country, on the measures adopted by the European countries to slow down the contagion rate and also on the effects of the measures taken to ensure macro stability which support the estimations on the pace and length of the economic recovery.

Due to the total or partial lockdown of several activity sectors to limit the spread of Sars2-Covid 19 pandemics, the European economy has strongly contracted in the first half of this year.

The preliminary data for the second quarter confirm the biggest decreases for GDP among member states, which have been estimated in the spring forecast. In the second quarter of 2020 as compared to the corresponding quarter of 2019 both the European economy and the Euro area (EA) one have dropped by 14.1% and 15% respectively. The most affected economies in the EA were Spain (-22.1%), France (-19.0%) and Italy (-17.3%). For Germany the decline was less pronounced, namely by 11.7% as compared to Q2 2019 and 10.1% as compared to Q1 2020.

**Hypotheses and risks regarding the future macroeconomic developments**

The extension of the state of alert into the 3rd quarter (hypothesis which has not been taken into account at the previous forecast) will lead to a slower economic recovery than it had been expected in the spring forecast, as the resumption of the economic activities will not be fully completed, in the context of a reduced aggregate demand and the maintenance of certain restrictions. Restaurants, tourism, transport of passengers, especially the air transport - will still be affected. Also, there are recovery prospects regarding the manufacturing industry, linked to the external demand.

Generally, the risks that may influence the growth prospects this year are severe and interconnected, doubled by a high degree of uncertainty regarding the emergence of a second pandemic wave, the lack of a vaccine, the recovery speed of the main trading partners, changes in the customers' behaviour, etc.

The risks upon the economy's dynamics are mostly external, Romania's economy being strongly dependent on the situation of the trade with the Eurozone regarding industry activities with a high added value, such as the manufacture of motor vehicles, transport means, machinery and equipment. The probability of a delayed recovery of the industrial activity conditioned by the external environment will be the main factor that could lead to a negative GDP dynamic in the last two quarters, together with a steeper annual slowdown around the 4% dynamic.

The industrial production is especially affected on the side of the exporting activities, as it is highly dependent on the European production chains. Should the main European trading partners continue to register significant industrial production contractions, the national recovery will be more difficult, although the external negative effects will be compensated by the government support.

A supplementary risk, aside from the one induced by the pandemic, is expected from the agricultural sector, due to the persistent draught during the first months of the year, with negative effects especially on the straw cultures.

The travelling abroad restrictions for the Romanian citizens are still putting pressure on the air and road transport, therefore not supporting a consistent recovery in the second part of the year.

In this background, the macroeconomic effects have been re-evaluated, although the uncertainties regarding the economic and financial evolutions persist and are very high. The recovery speed of the economic deceleration in the second quarter seems to be slower than initially anticipated and its evolution will be in line with the pandemic situation.

Factors such as the sectoral developments during the first part of the year, the recovery of the international context below expectations and the 3-month extension of the social distancing restrictions compared to the hypothesis in the spring forecast, have imposed the revision of the economic growth scenario. The new scenario takes into account the extension of the pandemic period, with a gradual recovery slope, depending on the recovery trajectory of the main economies in the Euro zone but also on the population's behaviour regarding consumption and the companies' precautions to invest.

Nonetheless, on a more positive note, the measures adopted by the government for the support of the affected companies and employees, have had an mitigation effect of the negative impact, regarding both the number of employees and the average gross earnings. Still, the fact that the result on the labour market emerges with a slight delay compared to the moment the restrictions are lifted, must be stressed.

The governmental support is also visible in the positive influence of the government consumption on GDP, as well as in the cost alleviation of the companies in the industrial activities or services, limiting the decline of the supply at least 1 percentage point.

**International context and perspectives for 2020-2021**

In the context of the economic blockages determined by the coronavirus crisis, the main international organisations have adjusted downward their summer forecast regarding the development of both the European and global economies.

According to the most recent OECD estimations, published in June, the two scenarios (without and with a second pandemic wave, manifested until the end of 2020), estimate a contraction of the Euro zone economy between -9.1% and -11,5% for this year.

The recent estimations by IMF from June 2020 also highlight the persistence of the extremely high degree of uncertainty of the forecasts, globally. Therefore, the contraction of the global economy is expected to reach 4.9%, compared to the spring forecast of only -3%, with a more serious decrease of the advanced economies (-8.0%), while the Euro zone economy contraction is estimated at 10.2% (Germany: -7.8%, France: -12.5%, Italy: -12.8%, Spain: -12.8%).

In the interim summer forecast, the European Commission has estimated a decrease of 8.3% for 2020 European economy (compared to the -7.4% estimation in the spring forecast) and of 8.7% in the Euro zone economy, provided that the Euro zone economy functioned approximately 25-30% below capacity in the period when strict lockdown rules applied. For the second quarter, the decrease in GDP is higher (above 13%), as the period of time for the lockdown of certain activities was longer than during the previous quarter and the relaxation of the adopted measures only came in May, gradually, and not in all member states.

In 2021, the European economy is expected to recover and register a 5.8% increase, while de Euro zone economy could advance by 6.1%. Nevertheless, the differences between the economic developments in the member states will be significant.

Regarding inflation, the perspectives are closer to the ones in the spring forecast, 0.3% for the Euro zone and 0.6% for EU 27 and 1.1%, respectively 1.3%, for 2021. The estimations are based on critical hypotheses: i) the restriction measures will be gradually relaxed until total lifting and ii) there will be no second pandemic wave needing new restrictions. Also, it is expected that the announced fiscal and monetary measures prevent the large-scale bankruptcies and loss of jobs.

For the Romanian economy, the European Commission estimates a 6% contraction this year (one of the least striking, along with Poland, Denmark, Sweden and Malta), followed by a 4% increase in 2021. By quarters, the decrease has been estimated at 11.9% for the second quarter (compared to the previous one), followed by increases of over 2% in the following quarters. Romania could thus avoid a technical recession.

The serious decrease in the energy prices, as well as the reduction of the related demand will not cause inflationary pressures in 2020, compensating the expected increase in the food products prices. Therefore, the inflation rate (measured by the Harmonised Index of Consumer Prices) is expected to reach 2.5% this year, followed by a further 2.8% increase in 2021.

The more detailed spring version presents the evolution of the GDP components regarding demand. The decrease in economy by 6% is explained by the large reduction in private consumption (-6.2%) and investments (-15%), along with the positive adjustment of the net export contribution (+1.2 percentage points to GDP dynamic). Still, the statistical data in the first semester demonstrate a more reduced decrease of the internal demand and a real potential for investments in construction works (positive dynamic) as well as governmental spending investments.

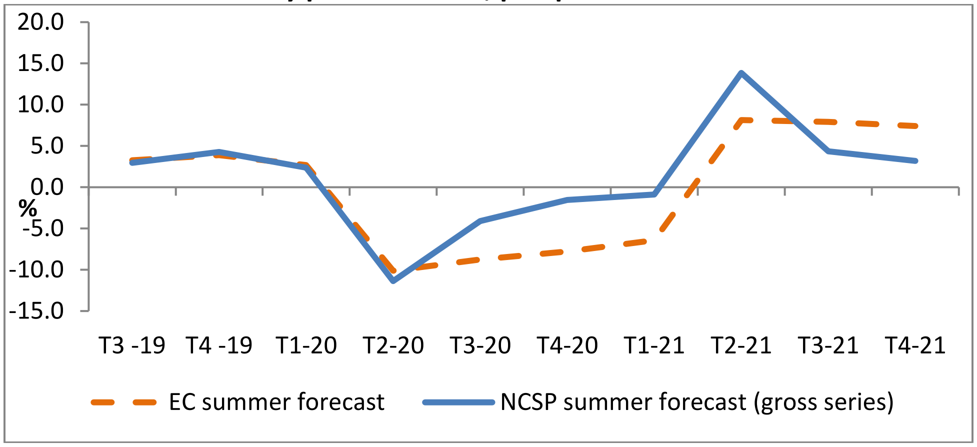
On the other hand, the domestic demand which was supported by the governmental measures to preserve the revenues of the employees within the sectors affected by the pandemics represents a positive factor to compensate the decline of the demand components, and which leads, based on current hypotheses to a real GDP decline of 3.8% in 2020.

As compared to the time when the spring forecast 2020 was released, several changes can be highlighted:

- the extension of the state of alert in Romania during July-August in order to further protect population;
- a weaker recovery of the industrial production, in line with the external demand;
- unfavorable weather conditions which have affected the agricultural output starting Q2;

The combined action of these factors will determine a decline in the economic activity in the second half of this year, leading to a downward revision of GDP growth of 2 percentage points for 2020 as compared to the spring forecast, along with the flattening of the quarterly profile towards a profile between "V" shape and "L" shape.

**Quarterly profile of GDP, perspectives 2020-2021**




Source: NCSP, spring forecast 2020

For 2020, on the supply side there have been estimated decreases in the volume of activity in industry (-8.6%) where Covid-19 crisis has lead to an underlined downward trend in the last quarters as compared to the spring scenario and agriculture (-7.1%).

Covid-19 impact will be higher on agriculture and industry, leading to a revision of about 7 percentage points and 4 p.p. respectively, while in services the revision is 1.3 p.p., cultural and recreational activities being the most exposed (downward revision of around 11 p.p. as compared to the spring scenario) and real estate transactions (-2 p.p.).

On the demand side gross fixed capital formation is expected to decrease by 3.5% as compared to the previous year, influenced on one hand by a more restrictive investment behavior from the private sector and on the other hand by an impulse from public investments programs. The high degree of uncertainty might influence the investment decisions but the great results from the construction sector, estimated to reach a 5.8% growth in GVA terms, will have a positive influence.

The private expenditures are going to be affected to a lesser extent (-2.2%), being supported by the moderate increase of the purchasing power (+1.1%) and by the population's propensity for consumption. Government consumption expenditures (+4.3%) will have a positive impact following the measures adopted by the government to control and limit the pandemics negative effects.

***The revision of GDP's evolution***

| | **2020** | | **2021** |
|---|---|---|---|
| | **Spring forecast (%)** | **Summer forecast (%)** | **Summer forecast (%)** |
| **GROSS DOMESTIC PRODUCT** | **-1.9** | **-3.8** | **4.9** |
| Private consumption expenditures | -0.7 | -2.2 | 5.8 |
| Government consumption expenditures | 2.4 | 4.3 | 2.9 |
| Gross fixed capital formation | -2.6 | -3.5 | 7.4 |
| Export of goods and services | -6.7 | -10.3 | 9.7 |
| Import of goods and services | -5.6 | -7.7 | 11.3 |

| | 2020 | | 2021 |
|---|---|---|---|
| | **Spring forecast (%)** | **Summer forecast (%)** | **Summer forecast (%)** |
| GVA Industry | -4.2 | -8.6 | 7.8 |
| GVA Services - Total | -1.4 | -2.7 | 4.0 |
| - GVA trade, transports and storage, hotels and restaurants | -3.7 | -4.0 | 5.7 |
| - GVA cultural and recreational activities, repair of household products and other services | -6.7 | -17.3 | 22.5 |

*Source:National Commission for Strategy and Prognosis*

Due to the disruptions in the trade chains on the external market, the current account deficit is expected to moderately adjust from 4.6% of GDP in 2019 to 4.4%, and 4.3% respectively, in 2020-2021.

A longer and wider pandemic crisis will affect the growth perspectives and will bring further damages to companies and jobs. The unfavorable weather conditions which might affect the agricultural output in 2020 should also be mentioned, with an impact up to 0.5 p.p. on GDP contraction.

The Romanian economy is going to accelerate towards the potential during the last two quarters of 2021, following a sharp increase in Q2 (slightly above 10%), supported by the recovery of the activity and by the pronounced base effect.

Overall, the recovery of the external environment will positively influence the national economic growth in 2021 towards 4.9%, but following 2020, a year with relative bottlenecks. The recovery is prudent in the current scenario, as compared to the economic potential in the previous years, given the fact that Covid crisis will leave damages at structural level, especially for SMEs. The incentive for investment will be high (+7.4%), being supported by the governmental programs and by the EU funds absorption.