National Bank of Romania

Inflation Report

May 2025

Year XXI, No. 80

Inflation Report
May 2025

N O T E S

Some of the data are still provisional and will be updated as appropriate in the subsequent issues.

The source of statistical data used in charts and tables was mentioned only when they were provided by other institutions.

Foreword

The primary objective of the National Bank of Romania is to ensure and maintain price stability, with monetary policy being implemented under inflation targeting starting August 2005. In this context, active communication of the monetary authority to the public at large plays a key role, and the major tool that the central bank uses to this end is the *Inflation Report*.

Apart from analysing the most recent economic, monetary and financial developments and explaining the rationale and the manner of implementing monetary policy in the previous period, the *Report* provides the National Bank of Romania's quarterly projection on inflation over an eight-quarter horizon, including the associated uncertainties and risks, and an assessment of the recent and future macroeconomic context from the perspective of the monetary policy decision.

By drafting and publishing the *Inflation Report* on a quarterly basis, in accordance with the frequency of the forecasting cycle, the National Bank of Romania aims to provide all those interested with the opportunity of best comprehending its analytical framework and hence the reasons underlying the monetary policy decisions. Securing a transparent and predictable monetary policy is meant to strengthen monetary policy credibility and thus help achieve an effective anchoring of inflation expectations and lower the costs associated with ensuring and maintaining price stability.

The analysis in the *Inflation Report* is based upon the statistical data available at the date of drafting the *Report*, so that the reference periods of indicators herein may vary.

The *Inflation Report* was approved by the NBR Board in its meeting of 16 May 2025 and the cut-off date for the data underlying the macroeconomic projection was 30 April 2025.

All issues of this publication are available in hard copy, as well as on the NBR's website at http://www.bnr.ro.

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Summary

Developments in inflation and its determinants

Following the increase seen in the last three months of 2024, the annual CPI inflation rate resumed its downward path in 2025 Q1, declining to 4.86 percent in March from 5.14 percent in December 2024. This correction, supported *inter alia* by favourable base effects, was driven by large disinflationary contributions from some exogenous components, especially from fuel prices (due to the favourable developments in oil prices) and tobacco product prices. Both components made lower contributions to the annual inflation rate in the period under review than in the last projection. These downward revisions only partly offset the upward revisions of adjusted CORE2 inflation. The average annual CPI inflation rate also continued its downward trend in 2025 Q1, falling to 5.1 percent in March for the indicator calculated based on the national methodology and to 5.4 percent for that calculated in accordance with the harmonised index (HICP). Although the harmonised index continued to converge towards the European average, the gap with the latter is still relatively high (2.8 percentage points in March), indicating a further slower pace of disinflation in Romania.

The annual adjusted CORE2 inflation rate returned to a downward path in 2025 Q1, its level declining to 5.2 percent in March from 5.6 percent at the end of 2024. However, the pace of disinflation remains moderate. Moreover, looking at the monthly pattern, the annual dynamics of core inflation picked up somewhat, i.e. by 0.2 percentage points, in March versus February. The recent developments in the indicator have shown significant inflationary pressures. These were particularly visible in the processed food segment, where the costs of some agri-food commodities and labour costs went up, but also in the services component, where the fast-paced growth of wage costs continues to pass through into final prices. The still high levels of short-term inflation expectations, although relatively stable overall over the recent period, have also contributed to the persistence of core inflation pressures. Cumulatively, these influences partly offset the disinflationary influences generated by the slowdown in the annual dynamics of non-food prices (favoured by the evolution of import prices) and by the impact of the output gap entering negative territory at the beginning of this year.

The annual growth rate of unit labour costs economy-wide slowed down in 2024 Q4, reaching 14.1 percent (-2.6 percentage points versus the previous quarter), as the gap between compensation per employee and labour productivity continued to narrow in late 2024. In industry, the annual growth rate of unit wage costs fell markedly to 10.5 percent in 2024 Q4 (i.e. 8 percentage points below the previous quarter's average) amid a considerable slowdown in the annual dynamics of wage earnings (12.1 percent, -4 percentage points), in parallel with the acceleration in the growth rate of labour productivity (1.5 percent in Q4, i.e. 3.5 percentage points higher than in Q3). However, the hike in the minimum wage starting January 2025 and some fiscal changes provided

for by Government Emergency Ordinance No. 156/2024 are likely to dampen the downward adjustment, with the annual dynamics of the unit wage costs reaccelerating to 16.4 percent January through February.

Monetary policy since the release of the previous *Inflation Report*

In its meeting of 14 February 2025, the NBR Board decided to keep the monetary policy rate at 6.50 percent per annum. The interest rates on standing facilities were also left unchanged, i.e. the deposit facility rate at 5.50 percent per annum and the lending (Lombard) facility rate at 7.50 percent per annum. The annual inflation rate had risen above expectations over the last three months of 2024 to reach 5.14 percent in December, from 4.62 percent in September, mainly as a result of the pick-up in the prices of fuels, but also following new hikes in food prices amid the severe drought in the summer of 2024 and the increase in some commodity prices. In turn, the annual adjusted CORE2 inflation rate had seen a halt in its downward trend in 2024 Q4, remaining flat until December at the level posted at end-Q3, i.e. 5.6 percent. This was ascribable to the opposite influences coming over that period, on the one hand, from the disinflationary base effects in non-food sub-components and from the decline in import price dynamics, and, on the other hand, from the hike in some agri-food commodity prices, as well as from higher wage costs passed through, at least in part, into some consumer prices, *inter alia* amid still high short-term inflation expectations and a robust demand for goods.

Uncertainties and risks further stemmed from the future fiscal policy stance, given, on the one hand, the presumed impact of the corrective fiscal and budgetary measures implemented or adopted so far and, on the other hand, the budget consolidation requirement according to the National Medium-Term Fiscal-Structural Plan agreed with the European Commission and to the excessive deficit procedure. Labour market conditions and wage dynamics in the economy also remained a source of uncertainties and risks. Moreover, significant uncertainties were further associated with the growth rates of energy and food prices, as well as with the future path of crude oil prices, while notable risks came from the expansion trend of trade protectionism, potentially impacting other commodity prices and the prices of some intermediate and final goods. Heightened uncertainties and risks to the outlook for economic activity, implicitly the medium-term inflation developments, arose from the war in Ukraine and the situation in the Middle East, but especially from developments in the global/euro area economy and in international trade amid the trade policy measures of the US administration. Furthermore, the absorption and use of EU funds, especially those under the Next Generation EU programme, are conditional on fulfilling strict milestones and targets. However, they are essential for carrying out the necessary structural reforms, energy transition included, as well as for counterbalancing, at least in part, the contractionary impact exerted by geopolitical conflicts and budget consolidation. The ECB's and the Fed's monetary policy decisions, as well as the stance of central banks in the region, also continued to be relevant.

Subsequently, the annual inflation rate went down in January 2025 to 4.95 percent, from 5.14 percent in December 2024, whereas in February it increased to 5.02 percent. Compared to end-2024, it decreased less than anticipated, as the declines in the

dynamics of food, tobacco product and fuel prices in the first two months of Q1 overall were largely offset by the step-up in the growth rates of energy prices and administered prices. At the same time, the annual adjusted CORE2 inflation rate resumed its decrease during this period at a visibly faster pace, as forecasted, falling to 5.0 percent in February 2025, from 5.6 percent in December 2024, mainly under the impact of disinflationary base effects across non-food sub-components and the slower dynamics of import prices. Moderate opposite influences continued to come from the hike in some agri-food commodity prices, as well as from higher wage costs, passed through, at least in part, into some consumer prices, *inter alia* amid high short-term inflation expectations. In turn, economic activity had posted a faster-than-expected increase in 2024 Q4, to reach 0.8 percent from 0.1 percent in the previous three months (quarterly changes), so that excess aggregate demand was likely to have narrowed at a slower pace over that period compared with the previous forecasts. Annual GDP growth had slowed to 0.7 percent in 2024 Q4 from 1.2 percent in the previous quarter. However, the annual growth rate of household consumption had remained robust during that period, decelerating only slightly versus Q3, while gross fixed capital formation had posted a large contraction compared with the same year-earlier period. At the same time, the contractionary impact of net exports had grown stronger, as the annual dynamics of the import volume of goods and services had seen a renewed pick-up and those of the export volume had continued to fall deeper into negative territory. The trade deficit had posted, however, a slower annual growth over that quarter too – amid the significantly improved terms of trade –, whereas the current account deficit had posted a markedly faster annual pace of increase, given also the severe deterioration of income balances, *inter alia* on account of inflows of EU funds to the current account.

At the time of the NBR Board meeting of 7 April 2025, the latest assessments showed that the annual inflation rate would fluctuate further in 2025 H1, continuing to decline in March on a higher path than in the February 2025 medium-term forecast, before rising moderately in Q2, relatively in line with previous projections, under the impact of unfavourable base effects associated with energy and food price developments in the same year-earlier period.
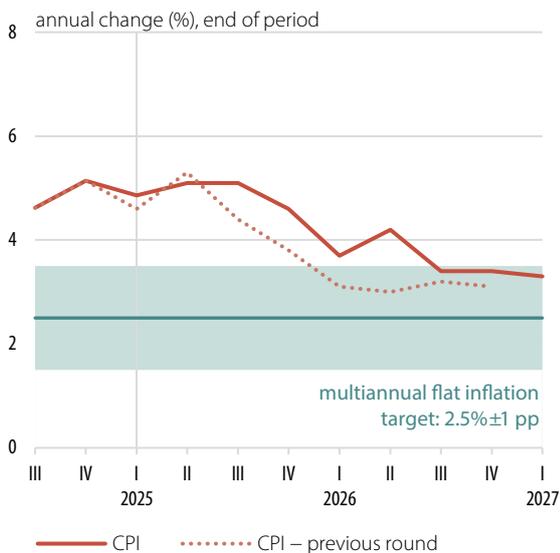
Based on the data and assessments available at that time, as well as in light of the particularly elevated uncertainty, the NBR Board decided in the meeting of 7 April 2025 to keep the monetary policy rate at 6.50 percent per annum. Moreover, it decided to leave unchanged the deposit facility rate at 5.50 percent per annum and the lending (Lombard) facility rate at 7.50 percent per annum. Furthermore, the NBR Board decided to maintain the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions.

Inflation outlook

The global economic environment is marked by heightened unpredictability, with some of the risk sources anticipated in the previous *Inflation Report* having materialised in recent months. These developments have exacerbated divergences between the major economic blocs. In the United States, the Fed took a cautious stance at its March monetary policy meeting as earlier signs of economic resilience were partly dampened by recent actual data, while uncertainties about trade tensions and the risk

of persistent inflationary pressures increased. At the same time, sentiment and confidence indicators released in April signal a noticeable worsening of the euro area economic outlook in response to the newly-announced trade tariffs and amid the persistent weakness in the manufacturing sector. This, together with inflationary pressures seen as more moderate than those in the United States, underpinned the ECB's ongoing policy easing cycle in April. At global level though, disinflation is hampered by the new pressures anticipated on supply chains, as a result of rising protectionism. In the euro area, while medium-term projections point to a gradual convergence of inflation towards the target, challenges persist as to the still high services inflation, fuelled by a slowly adjusting labour market.

According to the updated baseline scenario, after hitting 4.86 percent in March 2025, down from 5.14 percent at end-2024, the annual CPI inflation rate is expected to rise marginally over the next quarter, to 5.1 percent in June, and to remain there in September as well. The indicator will resume its downward path as from 2025 Q4, reaching 4.6 percent in December and will re-enter the variation band of the target in 2026 Q3, two quarters later than in the previous projection. Subsequently, the annual inflation rate will stabilise in the upper half of the variation band of the target and is anticipated to stand at 3.4 percent at end-2026 and 3.3 percent at the projection horizon, i.e. 2027 Q1.

Inflation forecast

annual change (%), end of period

multiannual flat inflation target: 2.5%±1 pp

CPI ········ CPI – previous round

Source: NIS, NBR projection

Compared to the previous *Inflation Report*, the new path of the annual CPI inflation rate is revised upwards almost throughout the projection interval, except 2025 Q2. The revisions are +0.8 percentage points for end-2025 and +0.3 percentage points for end-2026. These adjustments are driven by higher anticipated contributions from core inflation – over the entire interval – and by the impact of the hike in electricity prices – in 2025 H2 and 2026 H1, mirroring the assumption of an about 15 percent increase as from 1 July 2025, when the current capping scheme expires. In the course of 2025, the above-mentioned upward pressures are only partly offset by more favourable expected dynamics for most of the other exogenous components of the CPI basket, i.e. fuels, tobacco, alcohol and VFE. The path of the annual CPI inflation rate in 2026 will be marked by significant base effects induced by the shocks foreseen for this year, especially the hike in electricity prices. Hence, annual inflation is expected to be more volatile in the course of 2026, fluctuating both ways.

The forecast for the annual adjusted CORE2 inflation rate shows a continuous downward path in the next eight quarters, except 2025 Q2. Nonetheless, the pace of disinflation is anticipated to be relatively sluggish, with the indicator being expected to re-enter the variation band of the target no sooner than 2026 Q3, two quarters later than in the previous round, similarly to CPI inflation. Specifically, the annual core inflation rate is projected at 4.5 percent for end-2025 and 3.2 percent for December 2026. This downward, albeit gradual, path of adjusted CORE2 inflation is supported

by fundamentals such as the negative but limited contribution of the output gap, the only gradual decline in inflation expectations and relatively stable dynamics of import prices. The upward revision of the core inflation projection compared to that in February (by 0.8 percentage points at end-2025 and 0.3 percentage points at end-2026) is, however, driven by recent, stronger and more persistent than previously anticipated inflationary pressures from services (due to wage cost dynamics) and processed food items (reflecting spikes in some agri-food commodity prices). Adding to these is the impact of marginal upward adjustments in inflation expectations and import price dynamics.

In Romania, economic activity lost significant momentum in 2024, with average annual real GDP growth dropping to 0.8 percent from 2.4 percent in 2023. Behind this stood the fast-paced dynamics of household consumption, which was however largely accommodated by imports, and a sizeable retrenchment in investment, amid an unfavourable environment that affected industrial activity, exports, as well as the capital inflows in the form of foreign direct investment and EU funds. The short-term prospects point to the economy remaining on a modest path in 2025 H1, reflecting, domestically, the extension of the electoral calendar until 2025 Q2, and, externally, the heightened uncertainty prompted by global trade tensions and their impact, via both direct and indirect channels, on Romania's economy.

Moreover, the projected dynamics of economic activity are also influenced by the start of fiscal consolidation at the beginning of this year. This played a key role in the full erosion of excess aggregate demand in the economy and the output gap becoming negative already in 2025 Q1, when it was assessed at -0.04 percent. Fiscal consolidation measures affect both households' available financial resources for consumption and companies' investment decisions. Thus, over the medium term, the dynamics of domestic demand are envisaged to slow down and the output gap to go deeper into negative territory, with the latter being estimated to reach and remain at a low of -0.9 percent from 2025 Q4 to 2026 Q2. Consequently, while the updated projection maintains, similarly to the previous round, the outlook for a gradual recovery in economic growth over the medium term, supported by the still relatively robust potential GDP growth (albeit slightly revised downwards), the current coordinates point to a moderation in the pace of this recovery in both 2025 and 2026.

The dynamics of households' actual individual consumption are expected to lose momentum, especially in 2025, from the brisk pace seen last year, under the impact of the slowdown in real disposable income and the flagging consumer confidence. Conversely, after falling sharply in 2024 Q4, gross fixed capital formation will resume the growth path sequentially, as early as the beginning of 2025. Nevertheless, the investment path over the medium term is further strictly conditional on the economic agents remaining confident and foreign investors retaining their favourable sentiment, but especially on putting EU-funded projects on a resolute fast track.

Given the domestic and external developments, marked by the increasingly hefty impact of recent protectionist shocks, exports of goods and services are anticipated to be quasi-stagnant in 2025. Their recovery is expected to occur especially in 2026, amid a stronger rebound in external demand. Reflecting domestic demand growth, imports

of goods and services are likely to rise further at a relatively robust tempo. Therefore, the current account deficit is forecasted to stay high, albeit slightly narrowing from 2024 (8.4 percent), reflecting *inter alia* the effects of fiscal consolidation. Overall, the composition of economic growth continues to indicate the major role of private consumption (albeit on the wane), while gross fixed capital formation will have a positive contribution to GDP growth no sooner than 2026. The contribution of net exports, while improving from 2024, remains negative over the projection interval.

The NBR's recent monetary policy stance aimed to bring the annual inflation rate back in line with the 2.5 percent ±1 percentage point flat target on a lasting basis, *inter alia* via the anchoring of inflation expectations over the medium term, in a manner conducive to achieving sustainable economic growth.

The period since the release of the February 2025 *Inflation Report* was marked by the partial materialisation of some of the risks anticipated back then, notably the intensifying trade protectionism that fuels global uncertainty. At the same time, geopolitical tensions are persistent, albeit without recent major escalations, and, domestically, the medium-term configuration of fiscal and income policies continues to be a relevant source of uncertainty. Against this background, the current assessment of the balance of risks to the inflation projection points to the prevalence of upside risks, especially in the event of resurgent trade tensions and pressures associated with the expiry of the electricity and natural gas price capping schemes.

The above-mentioned increase in trade protectionism instils volatility into financial markets, entails the risk of retaliatory measures and potential disruptions in value chains, negatively affecting confidence and investment decisions, and generating potentially divergent prospects for the inflation rate. Specifically, higher prices of imported goods and disruptions in supply chains may fuel inflationary pressures, yet they could be countered by the disinflationary effect of a potential decrease in aggregate demand. At the same time, the risks to economic activity posed by these factors are chiefly tilted to the downside. Against this backdrop, stagflation is looming worldwide. Adding to these risks are the persistent geopolitical tensions, with no signs of lasting relief, and the elevated uncertainty surrounding energy commodity prices, reflecting both supply-side risks and the wavering outlook for global demand.

On the domestic front, in the electoral context prevailing upon the completion of the analysis in this *Report*, additional uncertainties emerged about both the possible short-term reactions of financial markets – including on the dynamics of the leu's exchange rate, yields on government securities and interbank rates, the sovereign risk premium or asset volatility – and the possible implications, over the medium and long term, on the design and continuity of fiscal and structural policies.

The implementation of the fiscal consolidation measures envisaged for 2025 by Government Emergency Ordinance No. 156/2024 contributed to some extent to reducing the short-term uncertainties surrounding the fiscal stance. However, to achieve the authorities' targets in the multiannual plan calls for additional adjustment measures, not specified at the time of preparing the projections, which maintains uncertainty over the medium term. The net inflationary impact of these future measures depends

decisively on their composition: indirect tax hikes would unleash upward pressures, while direct tax increases or cost cuts would fuel disinflation. At the same time, the government fulfilling budget deficit targets could reinforce external credibility, with potential favourable effects on sovereign rating and investor sentiment. This would foster the maintenance of sustainable financing costs for public and external debt, and it would also support the stability of capital flows, of the leu's exchange rate and, implicitly, of the inflation rate.

The risk of incomplete or delayed take-up of EU funds is on the rise, with multiple negative implications for the economy. Attracting funds, in particular from the NRRP given the constraint of the end-2026 deadline, is hampered by the limited administrative capacity, the already-seen difficulties in fulfilling intermediate milestones and targets, and the need for the authorities to revise the plan with a view to maximising the use of available funds. Any significant delays in EU funds absorption would contain investment funded by these programmes, eroding the positive impact on potential GDP growth and the capacity to offset the restrictive effects of fiscal consolidation. In addition, the current account deficit financing would come under pressure, which would increase external vulnerabilities amid the already low level of its coverage from stable sources.

On the domestic front, elevated uncertainties are ascribable to the future movements in electricity and natural gas prices once the related capping scheme has expired. As for electricity, the scheme will expire within a relatively short time (end of June) and current market price offers suggest significant upside risks. At the same time, the direct impact of higher prices could be amplified by the indirect impact, via the producer cost channel, and by the second-round effects, via the inflation expectations channel.

The risks stemming from labour market developments further exert mainly inflationary effects over the medium term. Considerable uncertainties linger over the magnitude of private sector pay rises feeding through to prices, which could be higher than in the baseline scenario, also as a reaction of companies to the removal of some tax breaks (in food, construction, IT&C sectors) at the beginning of this year. In addition, over the medium term, a possible rise in structural imbalances – such as skills mismatches, *inter alia* those in the context of the green and digital transitions – could fuel renewed pressures on wage costs and, hence, lead to higher inflationary pressures than those in the baseline scenario.
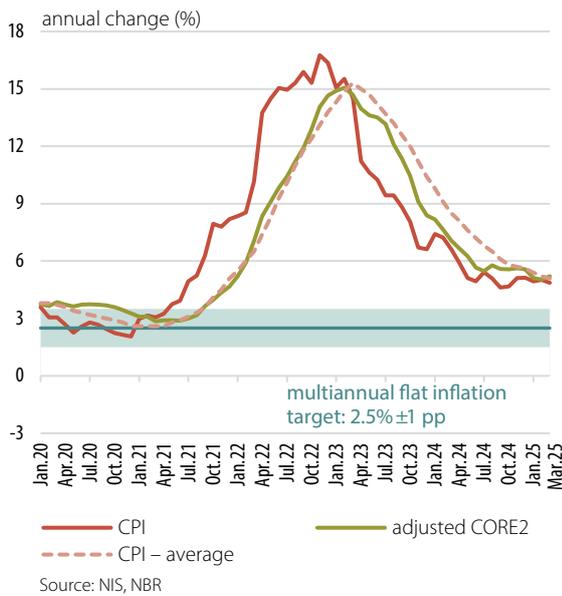
Monetary policy decision

Given the prospects for the annual inflation rate to remain above the variation band of the target until mid-2026 and on a markedly higher-than-previously-expected path, and in view of the associated risks and uncertainties, the NBR Board decided in its meeting of 16 May 2025 to keep the monetary policy rate at 6.50 percent. Moreover, it decided to leave unchanged the lending (Lombard) facility rate at 7.50 percent and the deposit facility rate at 5.50 percent. Furthermore, the NBR Board decided to maintain the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions.

1. Inflation developments

> The annual CPI inflation rate embarked on a downward path in 2025 Q1, falling to 4.86 percent in March (-0.28 percentage points from end-2024), largely attributable to the declining trend of the Brent oil price. The annual adjusted CORE2 inflation rate also followed a downtrend, after two quarters at a quasi-standstill, decreasing to 5.2 percent in March (from 5.6 percent in December 2024), amid lower imported inflation and weaker consumer demand. By contrast, pressures from labour costs and some agri-food commodities have persisted, which fuels short-term inflation expectations (Chart 1.1).

Chart 1.1. Inflation developments

annual change (%)

multiannual flat inflation target: 2.5% ±1 pp

CPI
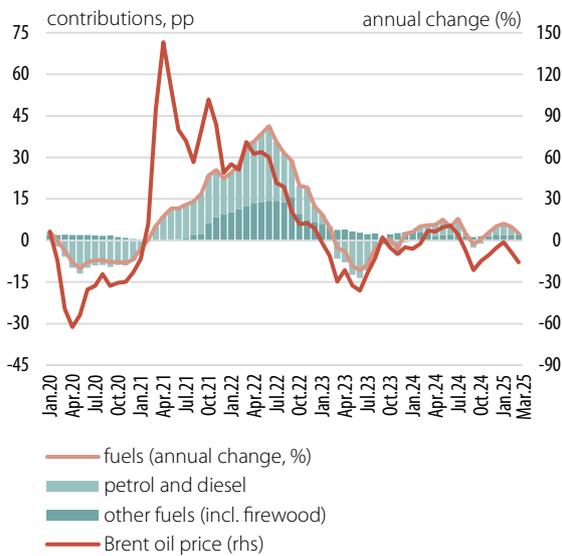CPI – average
adjusted CORE2

Source: NIS, NBR

The downward trend of CPI inflation in the first part of 2025 is mostly ascribable to the fuel segment, as domestic motor fuel prices reflected the correction in the Brent oil price. After a short-lived increase to a peak of USD 82 per barrel in January, the oil price fell to around USD 74 per barrel at end-March, amid the low predictability of the trade policies promoted by the US administration, as well as a potential easing of sanctions imposed on Russia. The OPEC+ announcement on lifting production caps as of May 2025 was also a key factor for the developments in the international oil price. The decline in the annual rate of change of fuel prices was additionally driven by the downward adjustment in firewood prices in 2025 Q1, following a slightly larger rise towards end-2024 (Chart 1.2).

Looking at the breakdown of energy prices, the electricity and natural gas sub-group posted opposite developments, their annual dynamics remaining however in negative territory at the end of Q1. During the first two months of the year, natural gas suppliers passed through the hikes recorded on wholesale markets to consumer prices, raising them to the cap level (which led to a cumulative change in the average price of over 10 percent in the first two months of 2025); nevertheless, the end of the cold season allowed a mild decrease in March. The average electricity price fluctuated slightly in both directions[1].

Tobacco products also made a disinflationary contribution, as the average size of the price increase operated by producers in 2025 Q1 was slightly lower than that in

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[1] As a result of one supplier including some bill adjustments in the price, as well as amid migration between consumption brackets

Chart 1.2. Crude oil and fuel prices

contributions, pp   annual change (%)

- fuels (annual change, %)
- petrol and diesel
- other fuels (incl. firewood)
- Brent oil price (rhs)

Source: NIS, Bloomberg, NBR calculations

the same year-ago period. Moreover, the annual VFE inflation rate went down further (after the sharp hikes in 2024 H2, when it had exceeded 10 percent), the monthly growth rates of fruit and vegetable prices standing below the multiannual averages, given the adequate supply at European level[2].

After remaining virtually flat in 2024 H2, the annual adjusted CORE2 inflation rate embarked on a downtrend, reaching 5.2 percent in March (compared to 5.6 percent in December). The drop in core inflation was driven by the slower annual dynamics of non-food prices (Chart 1.3), which fell to 5.4 percent in March, down by 1 percentage point from December 2024; the trend was underpinned by the easing pressures from imports, as suggested by the indicators used to approximate import prices: the euro area annual HICP inflation excluding energy adjusted to 2.5 percent in March 2025, whereas euro area industrial producer prices for consumer goods on the external market posted a slower annual growth rate of 1.9 percent in February (down 0.2 percentage points and 0.5 percentage points respectively from end-2024). At the same time, the effects of weaker consumer demand have begun to show on this segment.
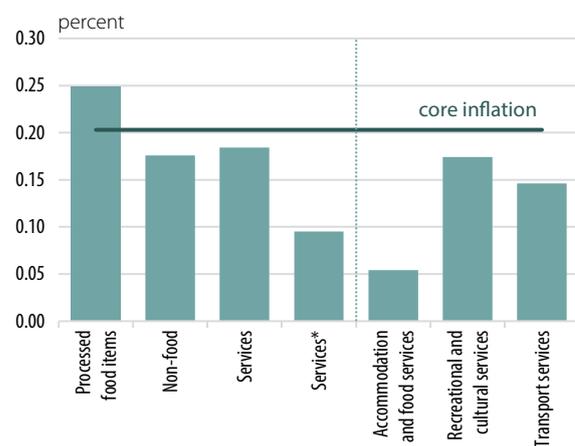
Chart 1.3. Adjusted CORE2 inflation components

contributions to the annual adjusted CORE2 inflation, eop, pp

- services
- non-food
- food
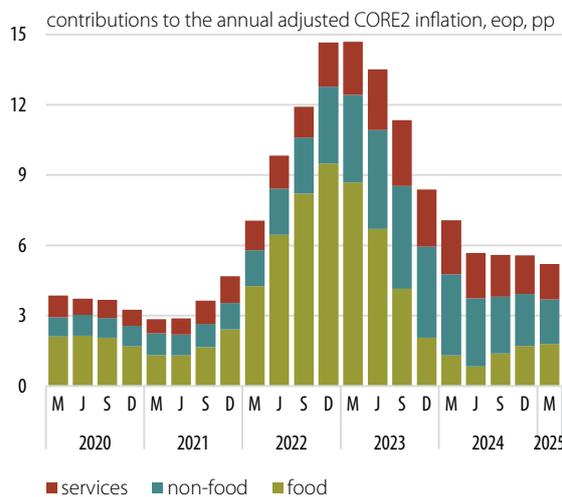
Note: Contributions include VAT rate changes.

Source: NIS, NBR calculations

Chart 1.4. Average monthly frequency of price changes for core inflation and sub-components

percent

core inflation

*) excluding some categories that are very sensitive to exchange rate fluctuations (insurance, telephony)

Source: NIS, NBR calculations

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2   Despite the erratic weather conditions throughout 2024, it is estimated that, at EU level, fruit production was only marginally lower than that in 2023, whereas vegetable production was even slightly higher (*European Statistics Handbook*, Fruit Logistica, 2025).
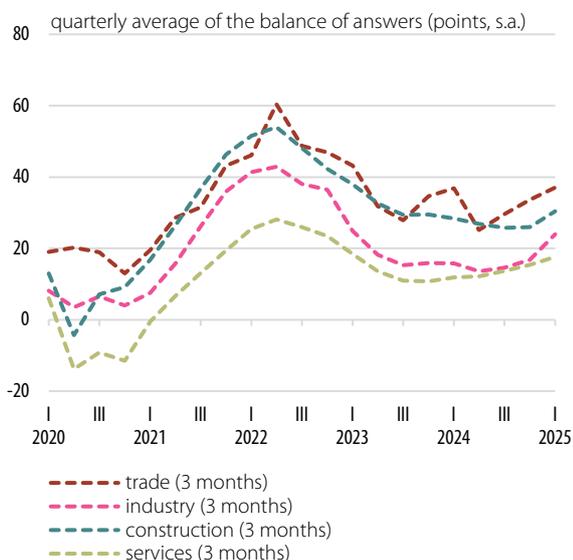
Chart 1.5. Expectations on price developments

quarterly average of the balance of answers (points, s.a.)

- – – trade (3 months)
- – – industry (3 months)
- – – construction (3 months)
- – – services (3 months)

Source: EC-DG ECFIN

Chart 1.6. Average annual HICP in the EU – Mar. 2025

average annual change (%)

EU average = 2.6

Source: Eurostat

The annual dynamics of market services prices also moderated, albeit to a somewhat smaller extent (to 6.3 percent, only 0.5 percentage points down from December), which could be rather attributable to a favourable statistical effect, the seasonally adjusted monthly rates picking up significantly in February and March 2025. A possible explanation for the slow disinflation in the services segment (Chart 1.4) lies with the lower frequency of price changes in this segment, as a significant share of companies set prices under fixed-term contracts, the built-up pressures passing through only when the contracts are updated. Specifically, the high inflation persistence in the case of market services reflects, *inter alia*, the automatic indexation to the inflation rate of some contracts, at certain time intervals. Strong monthly growth rates were also observed in the case of processed food prices, the annual inflation rate in this segment going up to 4.5 percent in March (+0.3 percentage points from end-2024), a level that had not been reached for over a year. One of the main drivers of inflation for both segments remains the still high annual growth of wage costs, given the new hike in the minimum gross wage economy-wide in January 2025, whose impact was amplified in the food industry by the removal of tax breaks, and hence by employers' decisions to raise gross wages so as to cover in part the loss incurred by employees. In addition, processed food inflation is also fuelled by lingering cost pressures associated with some agri-food commodities (dairy and oleaginous plants).

Economic agents in all sectors further adjusted upwards their short-term expectations on price developments in 2025 Q1 (Chart 1.5), the expectation of higher dynamics in the future being another driving factor for high inflation rates at present (as it encourages a larger price adjustment, which would also cover future developments). However, financial analysts' longer-term inflation expectations (one- and two-year horizons) remained similar to those at end-2024 Q4 (moreover, for the two-year horizon, even at the upper bound of the variation band of the inflation target), which suggests a disinflationary outlook in the medium term.

The average annual CPI inflation rate further declined in 2025 Q1, reaching 5.1 percent for the indicator calculated based on the national methodology and 5.4 percent for that calculated in accordance with the HICP structure (-0.5 percentage points and -0.4 percentage points respectively compared to end-2024). Thus, the gap with the EU average narrowed to 2.8 percentage points, (Chart 1.6).

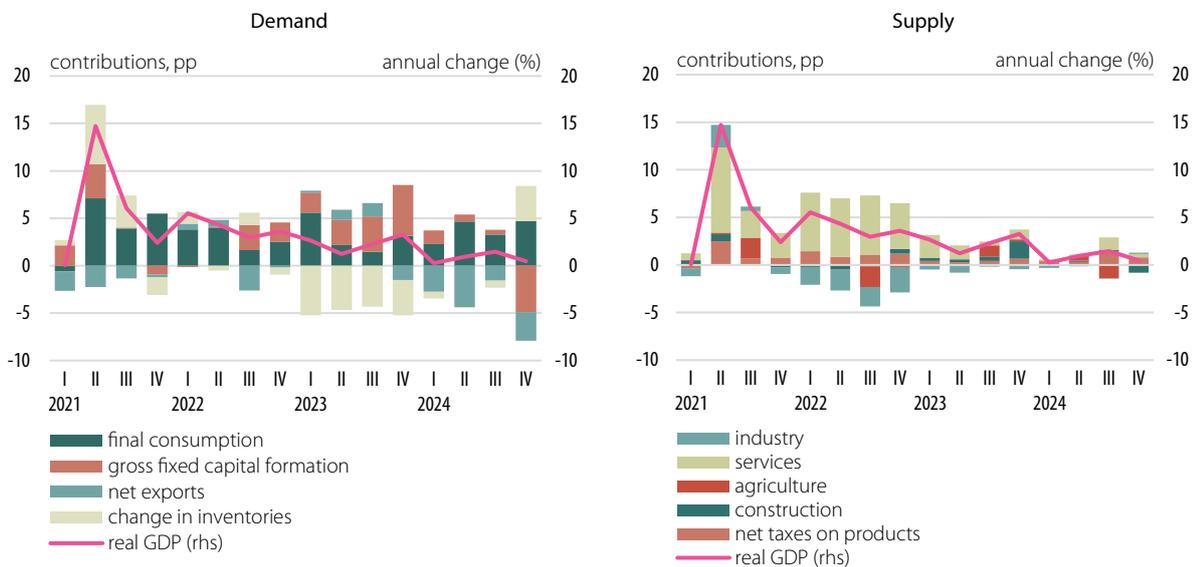At end-2025 Q1, the actual outcome for the annual CPI inflation rate stood 0.3 percentage points above the projection in the February 2025 *Inflation Report*. On the one hand, adjusted CORE2 disinflation was slower than anticipated, and on the other hand, the pass-through of the hike in natural gas wholesale prices into the final prices paid by household consumers was more significant than expected.

2. Economic developments

1. Demand and supply

In 2024 Q4, the real GDP dynamics were 0.5 percent (annual change[3]), thus ending a year of modest quarterly changes that resulted in an economic growth of 0.8 percent, i.e. significantly below the 2.4 percent value recorded in 2023 (Chart 2.1).

Chart 2.1. Contributions to economic growth

Demand

Supply

legend:
- final consumption
- gross fixed capital formation
- net exports
- change in inventories
- real GDP (rhs)

- industry
- services
- agriculture
- construction
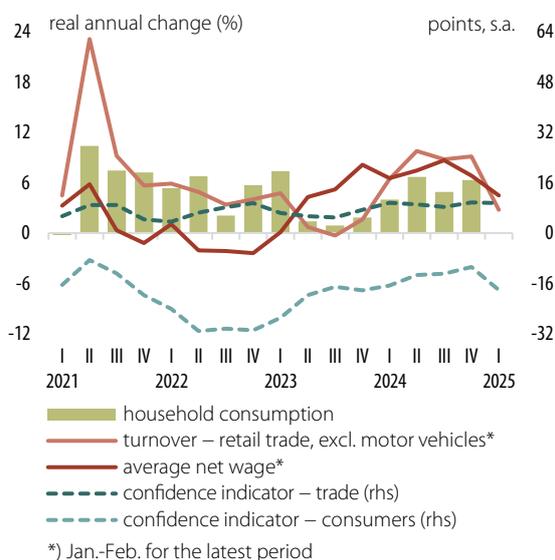- net taxes on products
- real GDP (rhs)

Source: NIS

On the supply side, the same as in the previous quarter, the positive pace was attributed to net taxes on products (with a 0.7 percentage point contribution), on account of both components – taxes rose by 6.4 percent, possibly on the back of the higher VAT collection rate, while subsidies fell by 19.1 percent, due largely to the change in the electricity bill compensation scheme for household consumers, by lowering the settlement limit for the compensation from the government budget for electricity suppliers[4]. By business sector, gross value added (GVA) dropped by 0.2 percent, the mild increases in industry and services (by 0.7 percent in each case) and the higher GVA in agriculture (up 7.1 percent) failing to offset the 5.9 percent contraction in GVA in construction. The economic landscape is also challenging in terms of demand –

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[3] In this section, the analysis of annual GDP dynamics relies on the volume series expressed in the prices of the corresponding quarter of the previous year.

[4] According to GEO No. 32/2024, the maximum weighted average price of electricity used by the Romanian Energy Regulatory Authority (ANRE) to calculate the amounts to be settled from the government budget for the electricity suppliers was set at lei 700/MWh for the consumption recorded as of 1 April 2024 (previously, the cap had been set at lei 900/MWh).

the investment position worsened, while the further robust trend in private consumption gave a renewed impetus to imports, which resulted in a stronger contractionary impact of net exports, given the continued decrease in exports.

Chart 2.2. Household consumption

real annual change (%) points, s.a.

*) Jan.-Feb. for the latest period

legend:
- household consumption
- turnover – retail trade, excl. motor vehicles*
- average net wage*
- confidence indicator – trade (rhs)
- confidence indicator – consumers (rhs)

Source: NIS, EC-DG ECFIN, NBR calculations

Household consumption remained on an uptrend in 2024 Q4 too (+6.3 percent), being supported by the large increases in household real income throughout the year (by more than 7 percent, on average) and consumer loans. Consumer demand may lose momentum in the forthcoming period, amid the measures taken by authorities at the beginning of 2025[5], weighing on net wage dynamics. The slowdown in consumption growth is also shown by households' confidence indicator (-7.4 points in 2025 Q1 as compared to the 2024 Q4 average, Chart 2.2).

Trade data already point to a steep deceleration in the annual dynamics of retail sales, i.e. to 2.8 percent in January-February 2025, special mention deserving the contraction in food sales (-2.3 percent in annual terms). In the latter case, the volume of sales will probably see a recovery in the coming period, the expectations of food retailers in January-March 2025 being higher, on average, than those recorded in 2024 Q4 (13 points versus 8 points), whereas market information hints at these companies' further interest in expanding the store network in 2025 at a pace at least similar to that seen in the year before.

In 2024 Q4, the general government budget execution witnessed a pronounced deterioration as compared with the same year-earlier period, leading to a deficit of lei 56.5 billion (3.2 percent of GDP), well above that in 2023 Q4 (lei 33.6 billion, i.e. 2.1 percent of GDP). Thus, compared to the previous three months, the general government deficit posted a considerably stronger increase than in 2023[6]. This resulted from higher total budget spending[7], primarily owing to current[8] and capital expenditure, unlike the similar year-ago period, when the top contribution came from spending for projects financed from non-repayable external funds[9]. Budget revenues

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[5] Government Emergency Ordinance No. 156/2024

[6] In 2024 Q3, the general government deficit came in at lei 32.6 billion (1.9 percent of GDP), while in 2023 Q3, it was lei 19.2 billion, i.e. 1.2 percent of GDP.

[7] However, in real annual terms, the growth rate of total budget expenditure slowed down to 10.1 percent (from 14.0 percent in the previous quarter), yet this was mostly attributable to the real annual dynamics of spending on projects financed from non-repayable external funds falling deeper into negative territory, inter alia amid the base effect associated with the increase in these expenses in 2023 Q4, in the context of the conclusion of the previous multiannual financial framework (2014-2020).

[8] Mainly spending on goods and services, other transfers, other expenditure, as well as compensation of employees and social security spending, which largely reflected the impact of the pension recalculation at end-2024 Q3); the hike in interest expenses had a similar influence, albeit much lower.

[9] Yet with a lower impact on the budget balance, given the relatively similar evolution of disbursements from the EU
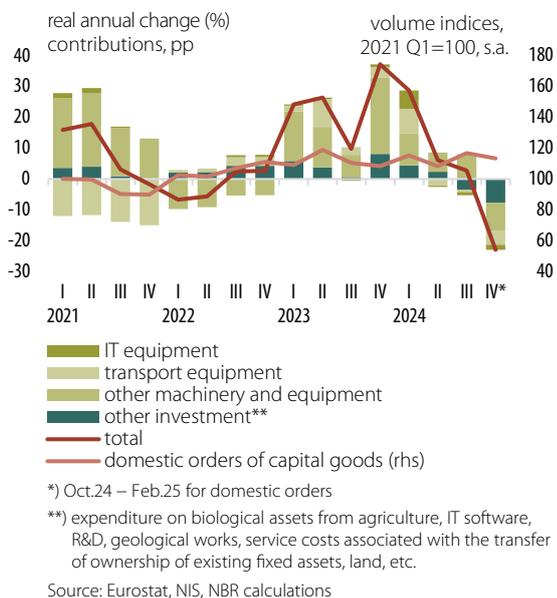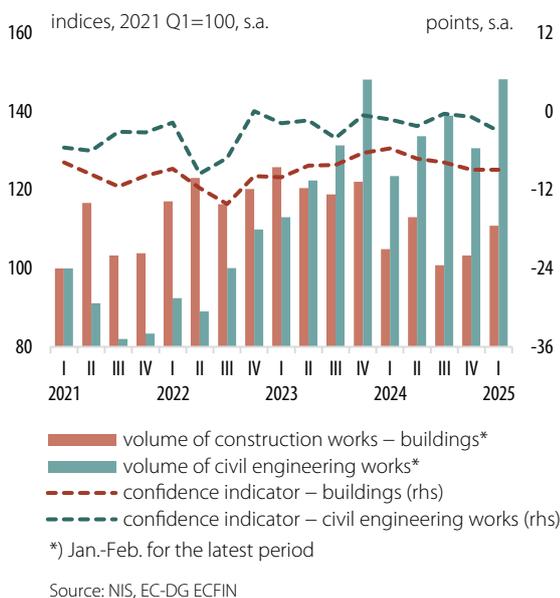
Chart 2.3. Investment, excluding construction

real annual change (%) contributions, pp

volume indices, 2021 Q1=100, s.a.

IT equipment
transport equipment
other machinery and equipment
other investment**
total
domestic orders of capital goods (rhs)

*) Oct.24 – Feb.25 for domestic orders

**) expenditure on biological assets from agriculture, IT software, R&D, geological works, service costs associated with the transfer of ownership of existing fixed assets, land, etc.

Source: Eurostat, NIS, NBR calculations

Chart 2.4. Construction

indices, 2021 Q1=100, s.a.

points, s.a.

volume of construction works – buildings*
volume of civil engineering works*
confidence indicator – buildings (rhs)
confidence indicator – civil engineering works (rhs)

*) Jan.-Feb. for the latest period

Source: NIS, EC-DG ECFIN

also recorded an increase in this period, albeit more subdued[10], mainly on the back of larger disbursements from the EU, as well as higher tax revenues[11] and social security contributions.

In 2024 as a whole, the budget execution posted a deficit of lei 152.7 billion (8.7 percent of GDP), well above the year-earlier shortfall of lei 90.1 billion, i.e. 5.6 percent of GDP[12].

In 2025 Q1, the budget execution ended in a deficit of lei 43.7 billion (2.3 percent of GDP), higher than in 2024 Q1 (lei 35.9 billion or 2.0 percent of GDP).

After the ever slower growth posted since the beginning of the year, gross fixed capital formation witnessed a nearly 18 percent contraction in Q4, due *inter alia* to the approximately 10 percent reduction in the period under review. The weak performance of gross fixed capital formation (and the low likelihood of a recovery in the near future) owed to the modest economic developments over the last year, which eroded the own funds of the corporate sector (the main financing channel of investment). Moreover, the global investment environment further plagued by uncertainty[13] added to the limiting characteristics on the domestic front (the unpredictable and restrictive fiscal framework, the extension of the electoral calendar until 2025 Q2). Against this background, in 2024 as a whole, net FDI inflows in the form of equity, including reinvestment of earnings, to the Romanian economy dropped by 37.5 percent. In addition, the absorption of non-repayable EU funds slowed down, due to the end of the collection period under the 2014-2020 MFF and the low administrative capacity to raise and manage the resources under the existing financial instruments. Specifically, under the 2021-2027 MFF, only 53 percent of the structural and cohesion funds estimated for 2024 were tapped, while under the NRRP, Romania did not succeed in receiving approval for any payment request, ranking among the

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[10] Under the circumstances, the real annual dynamics of budget revenues fell into negative territory, to -1.0 percent (from 6.7 percent in the previous quarter), primarily as a result of the year-on-year drop in amounts from the EU.

[11] Receipts from corporate income taxes, VAT and excise duties

[12] At the same time, the general government deficit slightly exceeded the lei 151.8 billion ceiling set in December 2024 (via Government Emergency Ordinance No. 138/2024), after the deficit target was increased in September to lei 122.9 billion via budget revision (Government Emergency Ordinance No. 113/2024), from lei 86.6 billion as provided in the initial budget programme (Law No. 417/2023).

[13] This entailed a decline in FDI to developing economies (-2 percent, for the second year in a row), according to UNCTAD.

economies with the lowest level of fulfilment of targets and milestones (13.7 percent, i.e. half of the EU average).

In Q4, the decline in gross fixed capital formation was visible for both major components – purchases of machinery and equipment (down by over 20 percent) and construction (-15.2 percent in annual terms), Chart 2.3. In the latter case, the evolution was largely ascribed to civil engineering works, which went down for the first time during 2024 (-8.2 percent). However, this trend is likely to reverse in the first months of 2025, a possible contribution coming from the late settlement of payments for works on projects inaugurated towards the end of the previous year, but not yet commissioned[14] (Chart 2.4).

Chart 2.5. Foreign trade
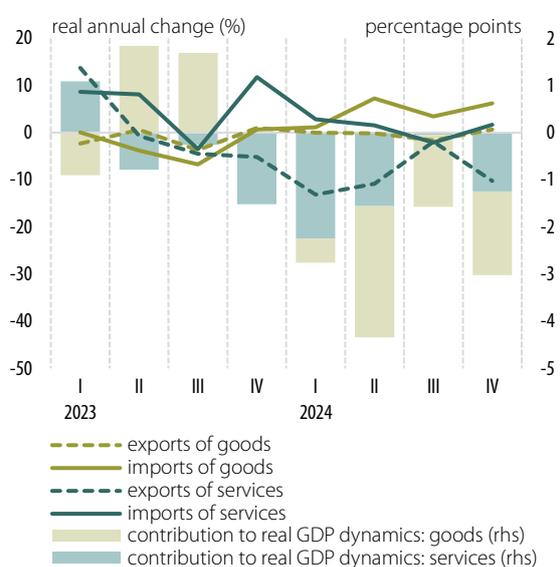
Source: NIS

Net external demand had a stronger negative impact on the annual dynamics of real GDP (-3 percentage points in Q4). Exports of goods saw a modest recovery (+0.6 percent, annual change), but import growth picked up momentum to 6.2 percent. The trade imbalance will probably continue to erode real GDP dynamics in the near term, given that exports are made in a challenging environment (a still weak performance of European economies, further hindered by the trade war with the US, Box 1), while the need to cover domestic demand further fuels the positive dynamics of imports (Chart 2.5).

In Q4 as well, exports of goods were strongly impacted by weather conditions, the 2024 drought causing a severe contraction in the volume of exports of agri-food commodities (by approximately 40 percent), which thus remained the group making the largest contribution to the worsening trade balance. Signals of a recovery in exports this year are not yet encouraging – the low temperatures in February-March affected autumn crops (particularly rapeseed), while foreign transactions will take place in an unstable context, shaped by the new US trade policy.

Exports of industrial goods fared well (turnover volume increased by 3.4 percent), but sources of uncertainty for the near future are also becoming manifest in this segment. Specifically, the automotive industry stood out again due to double-digit rates for exports of cars and car components. However, it is difficult to foresee if this evolution persists, as the recent expansion in domestic supply with the addition of four new models (three of which are Ford-manufactured electric cars), targeting chiefly the European market as export destination, has taken place in a period marked by fiercer competition from Chinese cars. At the same time, the German automotive industry, which accounts for approximately 45 percent of exports of motor parts of local firms, is likely to see a modest performance, also in view of the tense trade relations with

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[14] The actual data for January-February 2025 confirm this assumption – a 13.4 percent increase in the volume of works compared to the 2024 Q4 average, following the contraction by about 6 percent at the end of the previous year.

the US – a market that absorbs around 15 percent of Germany's car exports. Exports were also on a rise in crude oil processing and natural gas extraction segments. However, trade balance in the energy sector overall has deteriorated, as the local motor fuel production is highly dependent on crude oil imports, while the electricity balance was further affected by the drought-induced drop in the hydropower component. The decline in exports was ascribed to the subdued economic activity in the euro area, this influence being accompanied by labour cost pressure – more challenging, in terms of competitiveness, in the labour-intensive sub-sectors (for instance, light industry, but also the manufacture of electronic and optical products and machinery and equipment[15]) –, due also to recurrent increases in the gross minimum wage economy-wide.

Box 1. The impact of the new US customs tariffs on Romania's international trade relations

The global macroeconomic framework is currently undergoing significant transformations driven by the shift in trade policies adopted by the US following the inauguration of the new administration in early 2025. The decision to impose tariffs on imports from trading partners, as well as the entire process surrounding their implementation (waiting times, bilateral negotiations, exemptions and deferrals that have taken place), has already affected the global economy by substantially increasing the level of uncertainty, notably dampening investment decisions – leading to their postponement or revision. The most immediate transmission mechanism of a tariff shock is the trade channel, manifested through declining export volumes to the imposing country. The present analysis aims to assess the effects of the new customs tariffs on Romania's external trade relations. However, this is only one of the transmission channels, as the effects of a tariff shock spread rapidly to other areas of the economy (through higher producer prices, lower employment, rising financing costs, etc.).

As a small open economy, Romania is vulnerable to the negative consequences of trade protectionism. Although the exports of goods to the United States hold a relatively modest share, i.e. about 2.5 percent of total exports, the indirect trade exposure is relevant, given the country's integration in the euro area's production chains which export finished goods to the United States. Romania supplies intermediate goods to the export industries of Germany, France and Italy – in particular to the electrical equipment, automotive and chemicals sub-sectors. Thus, a contraction in US imports following the imposition of tariffs also impacts the Romanian economy through third-party partners of the core euro area.

Theoretical model. Elasticity of substitution

The assessment of the tariffs' impact is based on a theoretical model according to which an economy (US) may opt, within each business sector, for locally produced

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[15] In these two industries as well, the share of labour costs in total production exceeds the average in the manufacturing sector.

or imported goods characterised by a constant elasticity of substitution (essentially, this parameter measures the extent to which imports and local output are substitutable or complementary).

The total consumption of a good is a combination of domestic goods (D) and imports (M), expressed as a CES (constant elasticity of substitution) function:

$$Q = \left[\delta_D \cdot D^{\frac{\sigma-1}{\sigma}} + \delta_M \cdot M^{\frac{\sigma-1}{\sigma}} \right]^{\frac{\sigma}{\sigma-1}}$$

where σ is the elasticity of substitution between domestic goods and imports and δ are the share weights.

It is assumed that economic agents try to minimise the total costs of procurement, while meeting a certain fixed level of demand or production. Total consumption is regarded as a combination of domestic and imported goods, the shares of which depend on consumer preferences.

Consequently, the budget allocation is minimised so that the level of consumption $\tilde{Q}$, is maintained:

$$\min P_D \cdot D + P_M \cdot M$$
$$Q = \tilde{Q}$$

Then a Lagrange optimisation is used:

$$\mathcal{L}(D, M, \lambda) = P_D \cdot D + P_M \cdot M + \lambda \left[\bar{Q} - \left(\delta_D \cdot D^{\frac{\sigma-1}{\sigma}} + \delta_M \cdot M^{\frac{\sigma-1}{\sigma}} \right)^{\frac{\sigma}{\sigma-1}} \right]$$

and, once the Hicksian compensated demand curve has been obtained and the Lagrange parameter has been removed, the demand for imports will be reflected by the equation:

$$M = \tilde{Q} \cdot (\delta_M)^{\sigma} \cdot \left(\frac{P_M}{P_Q} \right)^{-\sigma}$$

where P_M is the price of imported goods and P_Q is the CES price index for the composite good. Intuitively, the demand for imports will be influenced, *ceteris paribus*, by the relative prices and the elasticity of substitution – the more substitutable the goods, the greater the effect of a tariff on the imported volume.

The theoretical framework thus highlights that it is not only the change in price that matters, but also how this change is perceived in relative terms – that is, taking into account the proportional increase in the price of imports compared to the price of the total good consumed. Consequently, in empirical applications, the impact of tariffs is not assessed solely based on the nominal tariff rate (t), but rather through a more refined adjustment that incorporates the structure of consumption.

Logarithmising and differentiating, we get that:

$$\Rightarrow \Delta M / M \approx -\sigma \cdot \frac{t}{1+t} \quad (*)$$

In the equation above, the change in the price of imports was approximated by $\frac{t}{1+t}$, while assuming that their size is small in relation to aggregation Q, so that the effect on the corresponding price is negligible.

Therefore, the judicious choice of elasticity becomes crucial for estimating the tariffs' impact. The literature distinguishes between two types of elasticities: micro elasticities (specific to analyses with a deeper level of disaggregation) and macro elasticities. The micro elasticity, as defined by Feenstra, Obstfeld and Russ (2010), refers to the substitution between goods from two distinct foreign countries – for example, between motor vehicles manufactured in Germany and those produced in Japan – and tends to be higher, reflecting the direct competition between similar suppliers. On the other hand, the macro elasticity indicates the substitution between an imported good as a whole and a similar good produced domestically. The current framework of analysis focuses on the effects of applying a broad range of trade tariffs to the imports from a trading partner as a whole, therefore it is adequate to use macro elasticities. The actual quantification of macro elasticities at NACE section level is based on the figures provided by literature – Feenstra *et al.* (2010), Imbs & Mejean (2015), Riker (2020), Phillips (2024) –, but also on the values calibrated in global CGE models such as GTAP and OECD TiVA. The central moments of elasticities range from 0.4 to 1.8: lower values are found in sectors with limited substitution (e.g. motor vehicles, pharmaceuticals), while sectors with more standardised and highly competitive goods (e.g. electrical equipment, textiles, plastics) display higher elasticities (Table A).

Table A. Macro elasticities of substitution

NACE Rev. 2	Elasticity (σ)			Source
	low	median	high	
Crop and animal production, hunting and related service activities (NACE 01)	0.6	0.80	1	Welsch (2008), Environmental Elasticities of Substitution
Forestry and logging (NACE 02)	0.5	0.70	0.9	Welsch (2008), Environmental Elasticities of Substitution
Fishing and aquaculture (NACE 03)	0.6	0.85	1.1	Feenstra *et al.* (2010), In Search of the Armington Elasticity
Mining of coal and lignite (NACE 05)	0.4	0.65	0.9	Böhringer *et al.* (2012), Sectoral Elasticities in Energy and Trade
Extraction of crude petroleum and natural gas (NACE 06)	0.7	0.95	1.2	GTAP v11 Database Documentation (2023)
Mining of metal ores (NACE 07)	0.6	0.85	1.1	Feenstra *et al.* (2018), Revised Elasticity Estimates from U.S. Data
Other mining and quarrying (NACE 08-09)	0.5	0.70	0.9	GTAP v11 Database Documentation (2023)
Food products (NACE 10)	1.2	1.45	1.7	Phillips (2024), Estimating Sector-Specific Elasticities in EU Trade
Beverages (NACE 11)	1.1	1.30	1.5	Phillips (2024), Estimating Sector-Specific Elasticities in EU Trade
Tobacco products (NACE 12)	1.0	1.20	1.4	Riker (2020), Trade Cost Elasticities Using Import Data (USITC)
Textiles (NACE 13)	0.9	1.15	1.4	Szabó *et al.* (2011), CGE Modelling of the Forest Sector in Europe
Wearing apparel (NACE 14)	0.8	1.05	1.3	GTAP v10 Database Documentation
Leather and related products (NACE 15)	0.8	1.00	1.2	OECD CGE Reference Models (2020)
Wood and of products of wood and cork, except furniture (NACE 16)	0.7	0.90	1.1	OECD I-O models, Wood sector
Paper and paper products (NACE 17)	0.8	1.00	1.2	GTAP-Paper sector; EU data
Printing and reproduction of recorded media (NACE 18)	0.8	1.00	1.2	Printing services, OECD structural elasticity

NACE Rev. 2	Elasticity (σ)			Source
	low	median	high	
Coke and refined petroleum products (NACE 19)	0.2	0.40	0.6	IEA oil product substitution; GTAP energy
Chemicals and chemical products (NACE 20)	1	1.30	1.7	Feenstra *et al.* (2018); OECD TiVA 2023
Basic pharmaceutical products and pharmaceutical preparations (NACE 21)	0.6	0.80	1	Phillips (2024); Pharma-specific studies
Rubber and plastic products (NACE 22)	1.3	1.70	2.2	Fontagné *et al.* (2021), Ahmad & Riker (2020)
Other non-metallic mineral products (NACE 23)	0.7	0.90	1.1	GTAP v11, non-metallic minerals
Basic metals (NACE 24)	1.5	1.80	2.5	Imbs & Mejean (2016), Fontagné *et al.* (2021), Kee *et al.*
Fabricated metal products, except machinery and equipment (NACE 25)	1.0	1.20	1.4	OECD-WTO TiVA; GTAP v9
Computer, electronic and optical products (NACE 26)	1.4	1.60	1.8	Feenstra, Obstfeld & Russ (2010); GTAP v11
Electrical equipment (NACE 27)	1.2	1.40	1.6	OECD Manufacturing Database
Machinery and equipment n.e.c. (NACE 28)	1.1	1.30	1.5	GTAP v11; Phillips (2024)
Motor vehicles, trailers and semi-trailers (NACE 29)	1.2	1.60	2.2	Riker (2020), Automotive CGE
Other transport equipment (NACE 30)	0.7	0.90	1.1	OECD Aerospace; GTAP Transport
Furniture (NACE 31)	0.5	0.70	0.9	OECD Furniture studies
Other manufacturing (NACE 32-33)	0.7	0.90	1.1	TiVA Other Manufacturing

Assessment of impact

The direct impact of tariffs is estimated based on the previously-defined relation (*), the two factors, i.e. the elasticity of substitution and the relative price change, being applied to the value-added content of nominal exports. The direct impact of tariffs is estimated based on the value of Romania's gross exports to the US by NACE sector.

The current set[16] of tariffs imposed by the United States on imports from the European Union was used to assess the impact through the trade channel, implying a general tariff of 10 percent on goods imported from the EU and 25 percent tariffs on imports of motor vehicles and car parts, as well as on all imports of steel and aluminium products from the EU.

Equation: $Direct\ loss\ =\ VA\ *\ Elasticity\ *\ (\frac{t}{1+t})$

It uses macro elasticities, value added shares from OECD TiVA (Trade in Value Added) applied to gross exports from Romania and the above-mentioned tariffs.

The tariffs' impact via the exposure to the euro area takes into account the value added of the domestic economy incorporated in euro area exports to the US. The first step, similarly to the assessment presented above, refers to a direct impact of tariffs on each sector, but for the euro area exports to the US. Subsequently, these values are adjusted by the share of Romania's exports of intermediate goods to the euro area and their value-added content.

$$FVA_{RO,i,s}\ =\ X_{RO \to i,s}\ \times\ \theta_{RO,i,s}\ \times\ \lambda_{i \to US,s}$$

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[16]   The analysis is based on the measures in force as at 30 April 2025.

$X_{RO \to i,s}$: Romania's exports of intermediate goods to the euro area country in the sector

$\theta_{RO,i,s}$: share of Romanian value added in gross exports of the sector

$\lambda_{i \to US,s}$: share of exports in the sector targeting the US

$$Indirect\ loss = FVA_{RO,i,s} * Elasticity * (\frac{t}{1+t})$$

Trade flows refer to 2024, and the value-added content was extracted from the OECD TiVA database, the data covering year 2019[17]. The cumulative sectoral effects point to a negative impact on Romania's economic growth between 0.17 and 0.26 percentage points. Nearly two thirds of this impact are traced to the indirect exposure along the European value chains, confirming the importance of Romania's position as a supplier of intermediate goods in the trade structures of the euro area (Table B).

Table B. Impact of the new US-EU tariff deal (effective as of 2025 Q2) on economic growth in Romania via the trade channel

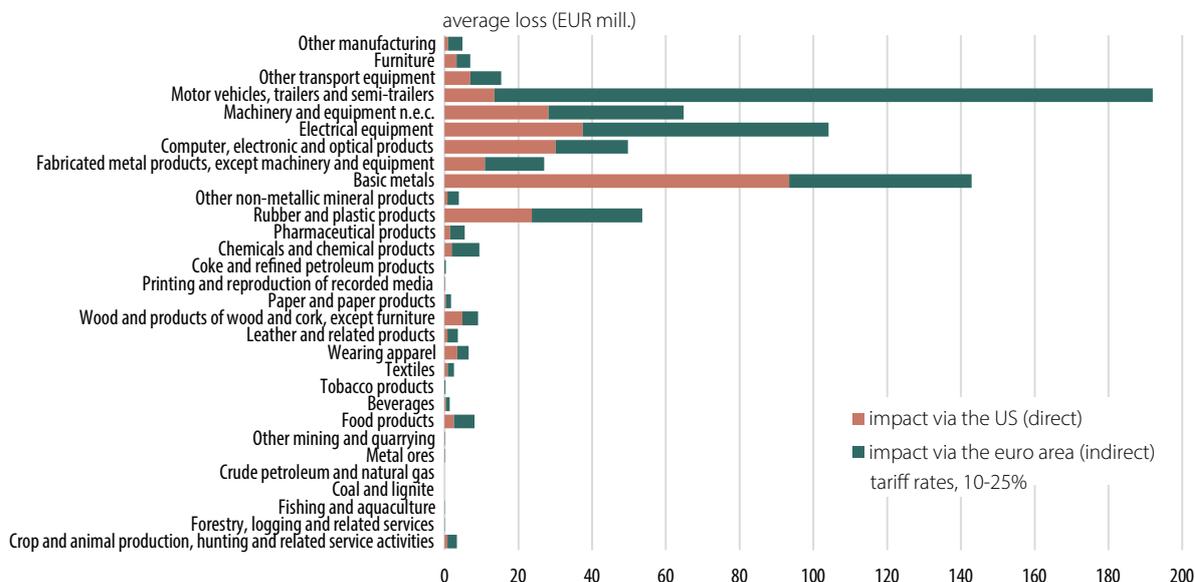|	Loss depending on the elasticity of substitution (EUR mill.)			Tariff rate (%)
Impact via euro area (indirect)	358.3	450.6	578.5	10/25
Impact via the US (direct)	220.2	266.7	337.3	10/25
Cumulative impact: US (direct) + EA (indirect)	578.5	717.3	915.8	10/25
Elasticity of substitution	low	median	high	
percentage points of GDP	**0.17**	**0.20**	**0.26**	

Source: Comext, OECD TiVA, NBR calculations and estimates

The impact of the tariff-related shock differs across Romania's economic sectors, depending on the trade channel. Sectors with direct exposure, such as electrical equipment and basic metals, are primarily impacted through their bilateral trade linkages with the United States. These industries account for notable export flows to the US market and are among the first to experience adverse effects from the tariff increases. In parallel, sectors with indirect exposure, including the automotive and machinery and equipment industries, are affected via their upstream position in European production networks oriented toward the US market (Chart A).

In early April, the US announced its intention to raise the general tariff on all goods imported from the EU (except for those mentioned above) from 10 percent to 20 percent as of 9 April 2025 (the initial date set for the entry into force of this decision). However, the enactment of this measure was subsequently deferred by 90 days through an official administrative decision. Based on the theoretical framework outlined in this section, the entry into force of this new set of measures could enhance the estimated impact to approximately 0.24-0.37 percentage points.

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[17] Although the latest available observations refer to 2020, they were not used to avoid the emergence of pandemic-related distortions.

Chart A. Cumulative (direct and indirect) impact of tariffs via the trade channel

average loss (EUR mill.)

impact via the US (direct)

impact via the euro area (indirect)
tariff rates, 10-25%

Source: Comext, TiVA, NBR calculations and estimates

Although the estimates formulated in this analysis are based on robust and internationally recognized data sources, such as OECD TiVA and Eurostat Comext, they are subject to certain limitations. First, the sectoral aggregation of TiVA data in terms of ISIC 2-digits restricts the in-depth analysis by sub-sector, which can distort the estimated impact. Second, the input-output matrices are static, implying unchanged technologies, which reduces the accuracy in dynamic economic contexts, by leaving aside demand reallocation effects between trading partners. Another limitation derives from the backward-looking nature of TiVA data, which entails a lag of several years relative to current economic conditions. Last but not least, exports redirected via European logistic hubs can distort the real trajectory of value added in Romania.

According to recent FMI assessments published in April 2025, US trade tariffs caused a material adverse shock on the global and European economies. The IMF lowered its global growth forecast for 2025, i.e. to 2.8 percent from 3.3 percent (previous forecast) and to 3.0 percent for 2026. Growth in the euro area is projected at 0.8 percent in 2025 and at 1.2 percent in 2026, both forecasts being revised down by 0.2 percentage points each as compared to the previous values. The IMF relies on its Global Integrated Monetary and Fiscal Model (GIMF) that assesses the direct effects of tariffs on trade and production, as well as the indirect effects by way of trade policy uncertainty and financial markets' response. The identified transmission channels include foreign trade reduction, trade policy uncertainty, financial market volatility and supply chain reconfiguration. Under a similar theoretical framework, Banque de France (2025) estimates an impact of -0.3 percentage points of GDP for the euro area, whereas the European Central Bank assesses the aggregate impact on EU GDP at -0.2 percentage points for 2025 and at -0.1 percentage points for 2026.

Overall, the economic literature and the official estimates converge on the finding that US trade tariffs can have a significant negative impact on economic growth, particularly through declining export volumes and disruption of global value chains. Estimates vary depending on each economy's degree of openness and the depth of trade integration. The present assessment underscores both the direct exposure of Romanian exporters and the country's strategic role in the broader European value chain architecture.

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As for imports, the swiftest dynamics were further reported by consumer goods[18] (approximately 10 percent, real change), but a step-up was also visible for intermediate goods (up to 5 percent). In the latter segment, the major contributors were crude oil, building materials and some chemical products (fertilizers included).

In 2024 as a whole, the negative differential between the annual change in exports of goods and that in imports thereof (in volume terms) led to a 13.5 percent widening of the deficit on trade in goods (according to the balance of payments). However, the deterioration was even steeper for the current account deficit (37.7 percent), owing to the unfavourable developments recorded in all main accounts. Specifically, the services surplus contracted (due mainly to the deepening shortfall of travel, amid households' increased interest in travels abroad, and the decline in net receipts from freight transport, in line with the sluggish trade flows of Romania and at European level, in general). At the same time, the primary income deficit widened (especially on account of higher
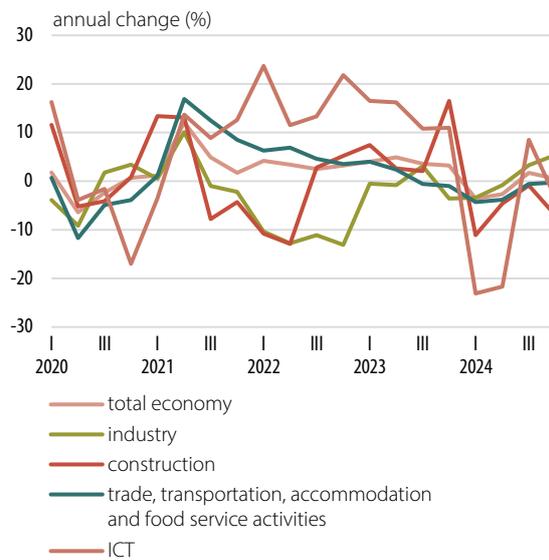
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[18] Based on international trade data – classification by broad economic categories (BEC) (Source: Eurostat)

Chart 2.6. Current account

balance, EUR bn.

secondary income ▪ primary income
goods ▪ services
● current account
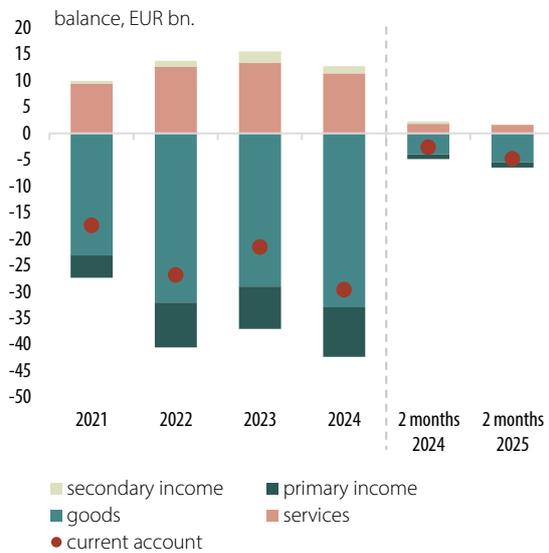
Source: NBR

Chart 2.7. Labour productivity economy-wide

annual change (%)

— total economy
— industry
— construction
— trade, transportation, accommodation
   and food service activities
— ICT

Source: NIS, NBR calculations

interest payments on government securities issued in the international market and lower inflows of compensation of employees working abroad), while the slower absorption of EU funds eroded the secondary income balance. In January-February 2025, the main categories of current external transactions continued to post similar developments, so that the current account deficit deepened by almost 85 percent compared to the similar year-ago period (Chart 2.6).

Labour productivity

In 2024 Q4, labour productivity economy-wide increased slightly in annual terms (+0.5 percent), albeit at a significantly slower pace than in the previous quarter. The relevant sectors that witnessed declines in productivity indicators included construction, on the back of the decrease in civil engineering works, but also ICT, amid the weak demand recorded throughout the year. In 2024 as a whole, labour productivity fell by 1 percent (Chart 2.7).

In 2024 Q4, industry[19] posted the first increase in labour productivity over the past two years (+1.5 percent annual dynamics), bolstered by the further robust performance of new domestic orders and by the halt in the decline in orders from the external market (zero annual growth rate after three consecutive quarters of contraction). Important contributions were made by the launch of new, higher value-added models of locally-produced motor cars, as well as by the favourable developments in the related machinery and equipment sub-sector, the opening of a medicine manufacturing facility, the start of new investment projects in the food industry and by the overhaul of a major refinery in the hydrocarbon processing sub-sector. Nevertheless, it is worth noting that October through December the indicators
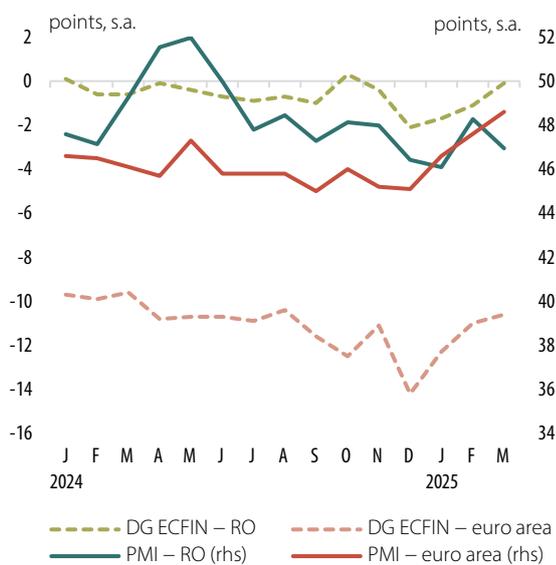
recovered only part of the ground lost in the remainder of the year: in 2024, labour productivity in industry decreased by 1.4 percent.

The beginning of 2025 has given mixed signals on the prospects of industry, mirrored, in fact, also by confidence indicators. Specifically, both in the euro area and Romania, the ESI (DG ECFIN) and the PMI improved in the first months of the year, remaining however in contractionary territory – the unpredictability of tariffs in the US and Europe

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[19] The analysis builds on the indicator calculated based on monthly series on production and the number of employees.

generates frictions in the functioning of global value chains and calls for caution with respect to investment decisions (Chart 2.8). The trend is confirmed in the latest survey released by the Foreign Investors Council, a considerable share of respondents (similarly to the COVID period and the beginning of the war in Ukraine) planning to reduce investments over the next 12 months, amid the uncertainties prevailing both globally and domestically. Under the circumstances, labour productivity witnessed a renewed contraction in January-February 2025 (-1.9 percent in annual terms).

Chart 2.8. Industrial confidence

points, s.a.

Source: BCR, S&P Global, EC-DG ECFIN

However, the decisions taken at EU level on unlocking substantial funding for defence and infrastructure investments might provide an impetus over the longer term. In this vein, some industrial facilities in Europe have already showed signs of a shift: several defence companies in Germany signalled their intention to use the spare capacity of the automotive industry and take on engineers laid off from factories that have faced lower demand over the past years. Influences are also felt locally – the latest relevant announcement refers to the project to build a howitzer production plant catering for the needs of the Romanian Armed Forces and for exports. In addition, Romanian companies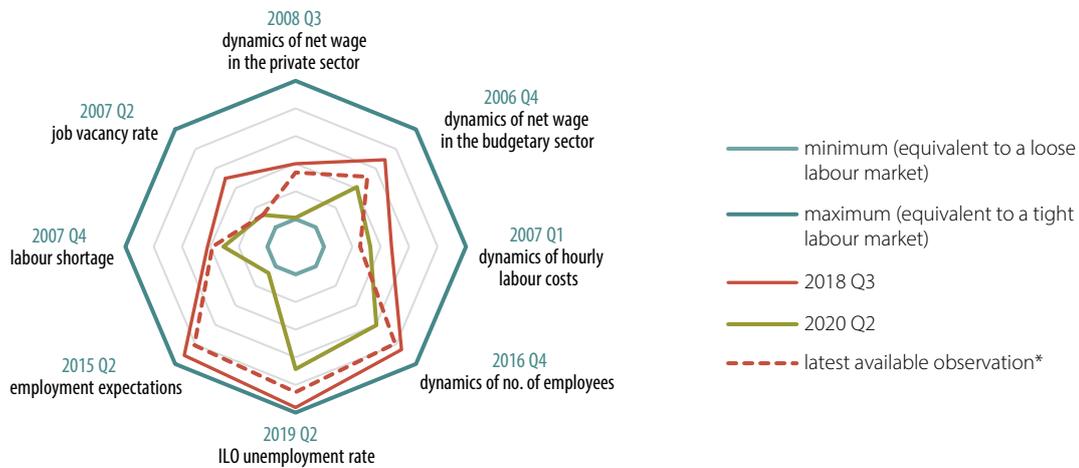 have lately entered partnerships with foreign producers to locally manufacture powders, light weapons or large-calibre ammunition. Defence products may be a source of positive externalities between different countries and industries both on the R&D channel and for the economic sectors along the chain, but these benefits depend on the degree of complexity and technological intensity of production, which is still relatively low in Romania's case. The extent to which Romania will be able to capitalise on these new opportunities by attracting investments in highly-sophisticated domestic manufacturing will be an important driver of future industrial performance.

Labour market developments

In the latter half of 2024, the labour market began to mirror more visibly the modest path of economic activity: the ILO unemployment rate increased, the annual growth rate of wage earnings decelerated markedly and labour demand remained low. Although the number of employees economy-wide followed a slightly upward trend, companies' employment prospects were further modest (Chart 2.9).

The key labour market indicators showed an easing of tensions between employers and job seekers. The job vacancy rate remained at 0.7 percent throughout 2024, amid weak labour demand (linked to the deceleration in economic activity). At the same time, labour supply increased, the ILO unemployment rate climbing to 5.7 percent in 2024 H2, after standing at 5.3 percent during the first half of the year; the provisional data released for January and February 2025 point to a marginal decline in the unemployment rate, to 5.6 percent on average.

Chart 2.9. Overview of labour market developments

minimum (equivalent to a loose labour market)

maximum (equivalent to a tight labour market)

2018 Q3

2020 Q2
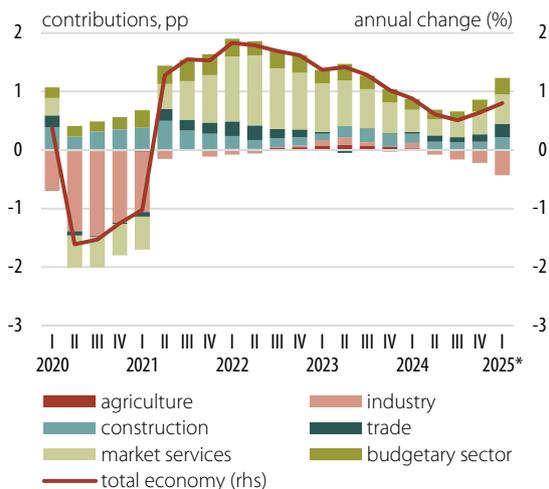
latest available observation*

*) 2025 Q1 for employment expectations and labour shortage; January-February 2025 for dynamics of net wage in private and budgetary sectors, dynamics of no. of employees and ILO unemployment rate (monthly data); 2024 Q4 for job vacancy rate and dynamics of hourly labour costs.

Note: The sample used covers the period from 2006 Q1 to 2025 Q1 and values were normalised for each variable. Maximum is defined as the lowest level of the unemployment rate since 2006 Q1 and the highest level for the other indicators respectively.

Source: NIS, Eurostat, EC-DG ECFIN, NBR calculations

The annual growth rate of the number of employees stepped up slightly in 2024 Q4 to 0.6 percent (+0.1 percentage points from the previous quarter), and again in January-February 2025, to 0.8 percent. Nevertheless, the dynamics are likely to remain modest over the coming months, given that the Employment Expectations Indicator in the DG ECFIN survey was considerably lower than the high recorded during 2024 (104 points in 2025 Q1 versus 108.7 points in 2024 Q2). In fact, the Manpower Employment Outlook Survey reveals some of the weakest net employment outlooks worldwide for Romania in 2025 Q2.
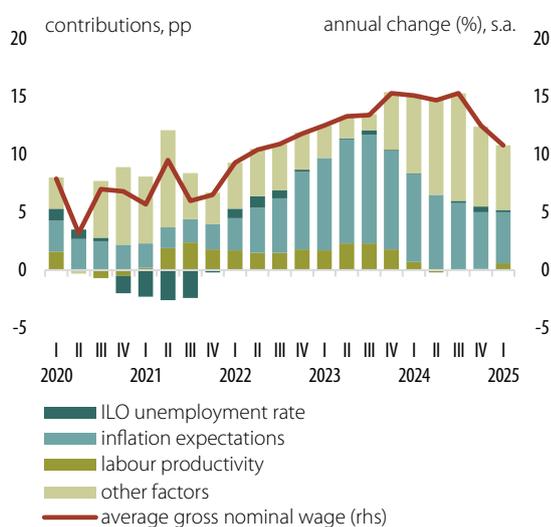
The breakdown by sector further shows mixed developments. Thus, recruitment in administrative services, retail trade and accommodation and food service activities witnessed favourable developments. In addition, the period from January to February 2025 saw a markedly faster pace of increase in hiring in construction, possibly on the back of expectations of better EU funds absorption throughout this year. 2025 brought a change of sentiment in the information technology sector as well, as the annual rate of change of the number of employees re-entered positive territory. After a six-month period of reorganisation of this industry, IT businesses seem to have passed the critical point, exhibiting the strongest hiring intentions among sectors over the coming period (according to the Manpower Employment Outlook Survey). By contrast, manufacturing has further made a negative contribution, a trend that had emerged as early as 2018, driven basically by the substantial contraction in the light industry (sensitive to the successive rises in the minimum wage economy-wide),

Chart 2.10. Number of employees economy-wide

contributions, pp   annual change (%)

agriculture
industry
construction
trade
market services
budgetary sector
total economy (rhs)

*) Jan.-Feb.

Source: NIS, NBR calculations

to which added, in 2024, the decline in the automotive sub-sector, given the layoffs made by major manufacturers of motor parts. In the budgetary sector, the number of employees increased, in annual terms, to 1 percent in 2024 Q4 and to 1.4 percent in the first two months of 2025 (Chart 2.10).

In late 2024, the annual growth rate of average gross wage economy-wide re-embarked on a downward trend, slowing significantly, i.e. to 13.2 percent in 2024 Q4 and 11.7 percent January through February 2025 (from 16.7 percent in Q3). Based on in-house estimates of the wage Phillips curve, this evolution is underpinned by both labour market easing (as indicated by the higher unemployment rate) and the lower impact of inflation expectations and exogenous factors (Chart 2.11). Even though in early 2025 a new hike in the gross minimum wage was implemented (as of January, it increased from lei 3,700 to lei 4,050), the annual dynamics of private sector wages decelerated slightly versus 2024 Q4, to 12.1 percent in January-February 2025 (-0.2 percentage points). The first month of 2025 also witnessed the entry into force of Government Emergency Ordinance No. 156/2024, which stipulated the freezing of wages in the budgetary sector and the removal of tax breaks granted in some economic sectors[20], which weighed directly on net wage earnings; this measure influenced employers' behaviour too, as some of them partly made up for employees' income loss by raising gross wages (particularly in construction and the food industry). Following the provisions of the said ordinance, as well as a base effect associated with the 13 percent hike in wages in education as of 1 January 2024, the annual growth rate of wages in the budgetary sector slowed down markedly, standing at 10.5 percent in January-February 2025 (as compared with 16.6 percent in 2024 Q4 and 18 percent in 2024 Q3).

Chart 2.11. Developments in the average gross wage economy-wide

Note: In this specification of the wage Phillips curve, wage dynamics are determined by labour productivity, labour market conditions and labour market participants' inflation expectations (assumed to be adaptive) as follows:

$$\Delta average\ gross\ wage_t = \beta_1 \Delta average\ gross\ wage_{t-1} + \beta_2 \Delta labour\ productivity_t + \beta_3 \Delta CPI_{t-2} + \beta_4 \Delta ILO\ unemployment\ rate_{t-2} + other\ factors$$

Changes are approximated by logarithmic differences.

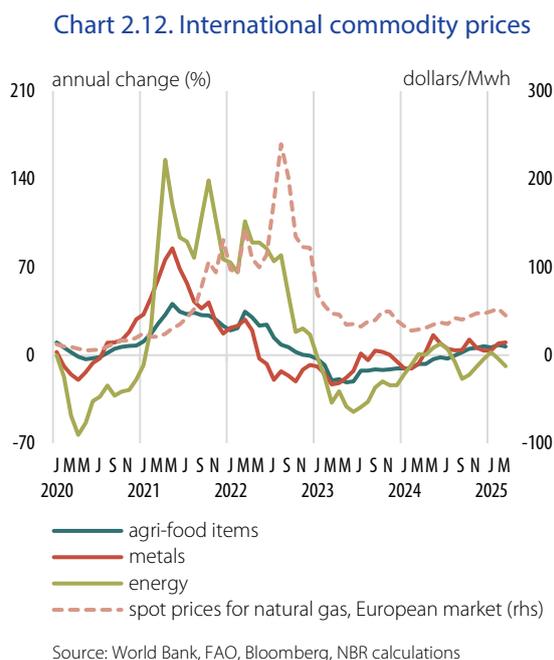Source: NIS, Eurostat, NBR estimates and forecasts

2. Import prices and producer prices on the domestic market

The partial recovery of demand in the first months of 2025 triggered a rebound in international commodity prices, particularly for energy and fertilisers, yet future developments continue to be marked by a high degree of uncertainty. In January-February, the annual dynamics of industrial producer prices on the domestic market re-entered positive territory, driven primarily by the hike in energy prices, while also reflecting rising pressures from unit wage costs (especially in sectors with a significant share of minimum wage earners).

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[20] The food industry, construction, agriculture and ICT

2.1. Import prices

In 2025 Q1, the annual rate of change of commodity prices moved out of the negative territory where it had stood in late 2024, amid a slight recovery in global manufacturing following a period of decline. However, the sustainability of these developments remains uncertain, particularly against the backdrop of the trade tensions sparked by the new US administration, which could adversely affect international trade and global supply chains (Chart 2.12).

Chart 2.12. International commodity prices

annual change (%)   dollars/Mwh

agri-food items
metals
energy
spot prices for natural gas, European market (rhs)

Source: World Bank, FAO, Bloomberg, NBR calculations

The aggregate commodity price index calculated by the World Bank contracted in annual terms in 2024 Q4, on account of the energy sector, before returning to positive values (0.7 percent) in 2025 Q1, owing to both energy and non-energy components. Specifically, after an annual decline of over 10 percent in October-December 2024, amid weak global demand and abundant supply, the Brent oil price rebounded briefly above USD 80/barrel in January, as the new US sanctions against Russia prompted price spikes; subsequently, the uncertainty surrounding global demand (fuelled by the announcement of the sharp shift in US trade policy) pushed prices below USD 70/barrel.

In the latter part of 2024, as the cold season approached, natural gas prices in Europe followed an upward path, despite gas storage facilities being nearly full. This uptrend continued into early 2025, given the higher demand for gas for heating and, more notably, for electricity generation, as weather conditions in Europe hindered renewable energy output. Against this background, natural gas prices hit a two-year high in February. However, a significant correction followed in March, amid rising temperatures.

The positive annual dynamics of metal prices in 2024 Q4, driven by the stimulus measures adopted in China, as well as by the contraction in both output and inventories, continued into 2025 Q1, mainly on the back of expectations regarding the new trade tariffs announced by the US administration.

Agri-food commodity prices posted increases in the first part of 2024 Q4, amid upward movements in prices for oilseeds (given the poor crops in the Black Sea region) and dairy products[21]. Except for the decline recorded in January 2025 (largely reflecting the correction in sugar prices, amid India's resumption of exports and the improved crop prospects), agri-food commodity prices followed a relatively steady path in 2025 Q1. In the case of grains, geopolitical tensions have contributed to lower purchases

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[21] The drought affected the prices of dairy products by increasing feed costs, while decreasing production, as water scarcity led some farmers to reduce their livestock.

by major importing countries (such as China and Egypt), which have increased their domestic production in an effort to reduce import dependency. Upward pressures have persisted in the case of milk, supported by European demand.

In line with the trend in international commodity prices, the unit value index (UVI) of imports fell marginally to 99.8 percent in 2024 Q4. Mineral products made a significant contribution to the dynamics of the aggregate index, with the corresponding sub-index contracting by almost 5 percentage points.

The prices of imported goods holding a share in the CPI basket saw mixed developments. Specifically, fuel prices posted slower growth rates, while prices of most food items rose at a faster pace. The UVI of medicines increased significantly (by 11.5 percentage points compared to Q3), partly reflecting a preference for selling original medicines (considerably more expensive than generic ones), also given that the application of the clawback tax may render the sale of low-margin medicines unprofitable.

2.2. Producer prices on the domestic market

In January-February 2025, the annual rate of change of industrial producer prices on the domestic market returned to positive territory (+ 3.8 percentage points to 0.9 percent). This was mainly attributable to the increase in prices of some energy resources (natural gas and oil), which was reflected in the less pronounced annual decline in energy prices, as well as in the stronger dynamics of prices for energy-intensive intermediate goods. The annual rate of change of producer prices for consumer goods also stayed on an upward path, mirroring pressures from unit wage costs, as these sub-sectors are particularly vulnerable to changes in the minimum wage (Chart 2.13). The results of the March DG ECFIN survey do not show significant changes in expectations on price developments, with the balance of answers remaining at a high level (22.9 percent), just slightly below the January-February reading (24.6 percent).

In the first two months of 2025, the negative annual dynamics of energy prices stood at -1.9 percent, 7.9 percentage points higher than in 2024 Q4. A significant contribution to this sharp movement came from electricity, gas, steam and air conditioning, where the annual dynamics picked up from -9.5 percent in 2024 Q4 to -0.6 percent. The main driver is the hike in natural gas and electricity prices on the domestic market, largely linked with the trends in European energy markets. This development was due to the deterioration in the demand-to-supply ratio – on the one hand, consumption increased considerably, owing, *inter alia*, to seasonal developments and higher demand for gas for electricity generation, in the context of a limited contribution from renewable sources; on the other hand, supply declined,

Chart 2.13. Industrial producer prices on the domestic market
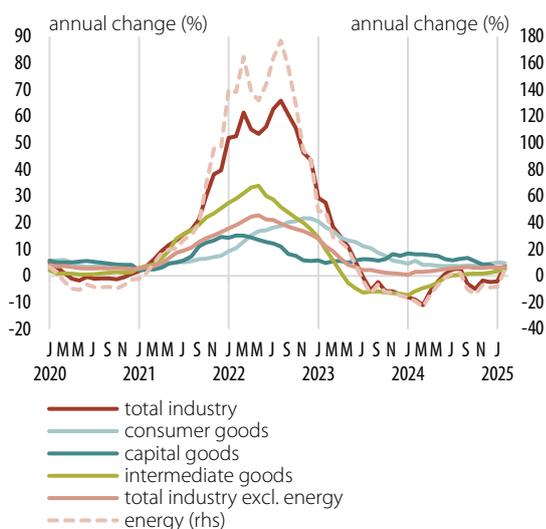
Source: NIS, Eurostat, NBR calculations

following the unexpected closure of the liquefied natural gas (LNG) terminal in Alexandroupolis and the halt, as of 1 January, in Russian gas transit via Ukraine. Moreover, in the case of Romania, natural gas storage levels dropped more rapidly than in other EU countries, falling from over 100 percent in October 2024 to less than half by February 2025, amid one of the lowest storage capacities in the EU. In fact, given the very low storage levels, the main storage company decided to reduce the extraction volumes starting in February 2025.

At the same time, the annual rate of decline of producer prices in hydrocarbon processing slowed down, in line with developments in oil prices. On the domestic front, the influence on price dynamics was enhanced by the annual depreciation of the domestic currency against the US dollar.

The annual dynamics of producer prices for intermediate goods remained modest, stepping up, however, compared to Q4 (2.1 percent versus 1.0 percent), mainly on account of developments in the chemical industry. Specifically, the hike in natural gas prices led to a drop in the supply of fertilisers both locally and globally (amid the halt in the activity of some major producers in Europe, Romania included), resulting in a significant rise in prices.

The annual growth rate of producer prices for consumer goods also stayed on an upward path (+0.6 percentage points to 4.9 percent), largely underpinned by increasing labour cost pressures, with sectors having a high share of minimum wage earners (such as the food and light industries) being the most vulnerable to both the size and frequency of minimum wage increases. Moreover, in order to retain workers, food producing companies chose to increase gross wages so as to cover part of the income loss incurred by employees following the removal of tax breaks at the beginning of the year, with wage cost pressures thus overlapping those stemming from agri-food commodity markets, particularly in the case of oleaginous plants and milk. In this context, the annual dynamics of producer prices in the food industry picked up to 3.6 percent in February 2025, from 0.4 percent in July 2024.

The annual dynamics of producer prices for capital goods decelerated by 1.9 percentage points to 2.8 percent, on the back of developments in the manufacture of motor vehicles. One possible explanation is that the closure of some motor parts plants and the related redundancies contributed to easing wage cost pressures across the remaining companies.

The annual rate of change of agricultural producer prices on the domestic market slowed down to 8.9 percent in January-February 2025 (-2 percentage points from Q4), on account of both components (Chart 2.14). Specifically, in the case of vegetal products, the development was mainly driven by

Chart 2.14. Agricultural producer prices
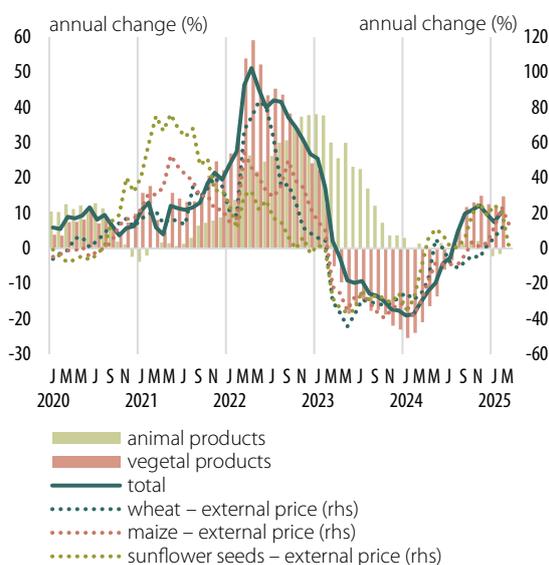
Source: NIS, Bloomberg, NBR calculations

vegetables, amid an adequate supply at European level. Potatoes were an exception, as this segment faced limited supply, with output reaching a seven-year low due to a sharp reduction in the cultivated area.
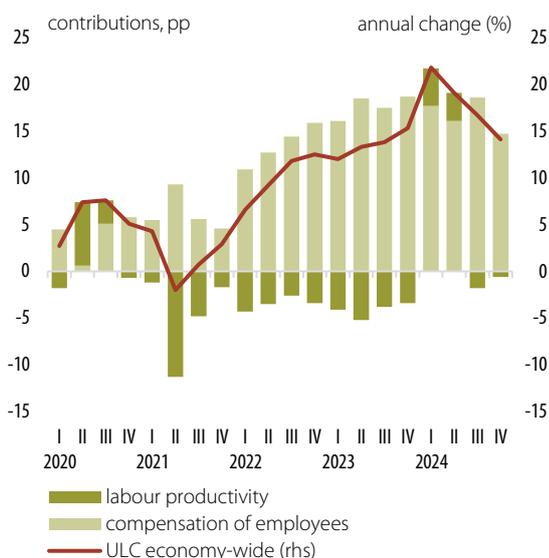
As regards animal products, the rate of change of prices for pork meat lost significant momentum, against the backdrop of increased supply following the import bans imposed by several countries on German products after the outbreak of foot-and-mouth disease.

Unit labour costs

The annual growth rate of unit labour costs economy-wide slowed down in 2024 Q4, reaching 14.1 percent (-2.6 percentage points versus the previous quarter), as the gap between the ratio indicators narrowed somewhat. Specifically, in late 2024, the annual rate of change of compensation per employee decreased by 4 percentage points from the previous quarter to 14.7 percent, while the annual pace of labour productivity growth decelerated less sharply (-1.2 percentage points compared to Q3) (Chart 2.15).

In industry, the annual growth rate of unit wage costs fell to 10.5 percent in 2024 Q4, standing 8 percentage points below the previous quarter's average. Wage earnings saw a considerable slowdown in their annual dynamics (12.1 percent, -4 percentage points), while the growth rate of labour productivity climbed to 1.5 percent in Q4 (3.5 percentage points higher than in Q3). However, the measures adopted by the authorities at the beginning of 2025 (the hike in the minimum wage and the fiscal changes provided for by Government Emergency Ordinance No. 156/2024) prevented a clearer downward trend from emerging, with the annual dynamics of unit wage costs reaccelerating to 16.4 percent January through February.

Chart 2.15. Unit labour costs

labour productivity
compensation of employees
ULC economy-wide (rhs)

Source: NIS, NBR calculations

3. Monetary policy and financial developments

1. Monetary policy

In February and April 2025, the NBR kept the monetary policy rate at 6.50 percent and left unchanged the lending and deposit facility rates at 7.50 percent and 5.50 percent respectively (Chart 3.1). Moreover, the central bank kept the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions at 8 percent and 5 percent respectively. The decisions aimed to ensure and maintain price stability over the medium term, in line with the 2.5 percent ±1 percentage point flat target, in a manner conducive to achieving sustainable economic growth.

Chart 3.1. NBR rates

percent per annum

lending facility rate — policy rate
deposit facility rate
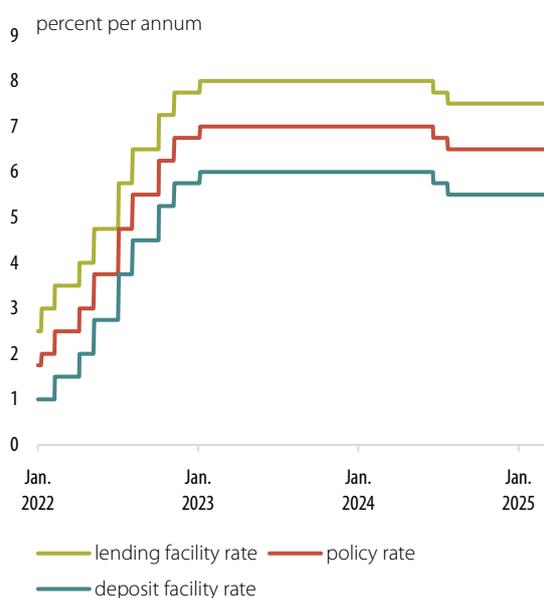
The NBR Board decisions in February 2025 were warranted by a new worsening of inflation developments and short-term outlook compared to the previous medium-term projection and by the high uncertainties surrounding forecasts over the longer time horizon.

Specifically, the annual inflation rate witnessed increases in the final three months of 2024, rising higher than expected during Q4 overall – to 5.14 percent in December from 4.62 percent in September –, mainly as a result of the pick-up in the prices of fuels[22], but also following new hikes in food prices amid the severe drought in the summer of 2024 and the rise in some commodity prices. In turn, the annual adjusted CORE2 inflation rate saw a halt in its downward trend, remaining flat at 5.6 percent until December 2024, i.e. a level similar to that at end-Q3, reflecting the further acceleration of the growth in processed food prices and the markedly slower disinflation in the non-food segment, but also the steady pace of disinflation in services prices[23].

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[22] Primarily under the impact of the significant appreciation of the US dollar on the international financial market

[23] The behaviour of core inflation mirrored the relatively equal opposite influences coming over this period, on the one hand, from the base effects in non-food sub-components and from the decline in import price dynamics and, on the other hand, from the hike in some agri-food commodity prices, as well as from higher wage costs passed through, at least in part, into some consumer prices, *inter alia* amid still high short-term inflation expectations and a robust demand for goods.

At the same time, the updated medium-term forecast indicated a new worsening of the short-term inflation outlook compared to the previous forecasts. Specifically, the annual inflation rate was expected to see a marked fluctuation in 2025 H1, before declining in H2 on a higher path than in the prior projection, staying above the variation band of the target until end-2025. Moreover, after a sizeable drop witnessed probably in the early months of 2026, primarily amid base effects, the annual inflation rate was seen falling, but also staying afterwards, slightly below the upper bound of the target band, at levels only marginally lower than previously projected. Thus, the annual inflation rate was seen going down to 3.8 percent in December 2025 and to 3.1 percent in December 2026, at the end of the forecast horizon, compared to 3.5 percent and 3.3 percent respectively, as indicated by the prior projection for the same reference periods.

The generally downward trend of the annual inflation rate in the first five quarters of the projection horizon, but also its subsequent halt, were largely attributable to supply-side factors. The latter were anticipated to have a further disinflationary action in the short run, mainly under the impact of base effects manifest in the non-food sub-components of core inflation, as well as in the growth rates of tobacco product, fuel and VFE prices. The overall disinflationary action of supply-side factors was, however, envisaged to be weaker than previously anticipated and to temporarily fade in 2025 Q2, owing to the opposite influences stemming over this horizon from unfavourable base effects – associated *inter alia* with legislative changes in the energy field implemented in April 2024 –, as well as from the persistent effects exerted on food and energy price dynamics by the severe drought in 2024, by the increase in some commodity prices, and by the higher energy consumption over the winter months. Moreover, the future developments in these categories of prices remained a source of inflationary risks, given the applicable legislation and the price movements in wholesale markets, while notable risks came, at the new juncture, from the expansion trend of trade protectionism, potentially impacting the prices of some intermediate and final goods.

At the same time, underlying price pressures were expected to gradually turn from modestly inflationary currently to mildly disinflationary, in the context of the lagged disinflationary effects from the negative output gap anticipated to open and to widen moderately during the current year, but to narrow progressively thereafter[24], as well as amid the markedly faster growth of household consumption in 2024 and the double-digit dynamics of wage costs in the private sector, probably also in the near future.

Uncertainties and risks continued to stem from the future fiscal policy stance, given the corrective fiscal and budgetary measures already adopted and the budget programme approved for 2025, but also the budget consolidation requirement according to the *National Medium-Term Fiscal-Structural Plan* agreed with the European Commission and under the excessive deficit procedure. Moreover, heightened uncertainties and risks to the outlook for economic activity, implicitly the medium-term

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[24] According to the new data and assessments, economic growth saw a stronger-than-expected slowdown in 2024 and would probably witness during 2025-2026 a less visible recovery than previously anticipated, yet at a gradually faster pace, reflecting the moderation in inflation, the revival of external demand and the larger use of European funds under the Next Generation EU instrument.

inflation developments, came from the war in Ukraine and the situation in the Middle East, but especially from developments in the global/euro area economy and in international trade amid geopolitical tensions and the trade policy measures of the US administration. Furthermore, a significant source of such risks and uncertainties remained the absorption and efficient use of EU funds, especially those under the Next Generation EU programme.

The subsequently released statistical data showed that the annual inflation rate had fluctuated in the first two months of 2025, decreasing less than anticipated to 5.02 percent in February, given the significantly faster growth rates of energy prices and administered prices that had largely offset the declines in the dynamics of food, tobacco product and fuel prices during the period overall.

The annual adjusted CORE2 inflation rate resumed its decrease at a visibly faster pace, as forecasted, falling to 5.0 percent in February 2025, given that the mild decline posted by the dynamics of processed food prices, after two quarters of growth, was accompanied by the significantly swifter disinflation in non-food and services segments, whose annual dynamics continued to be high. The drop in the annual core inflation rate was driven mainly by disinflationary base effects, especially across non-food sub-components and, to some extent, by the slower dynamics of import prices. At the same time, moderate opposite influences continued to come from the hike in some agri-food commodity prices, as well as from the gradual pass-through of higher wage costs into some consumer prices, *inter alia* amid high short-term inflation expectations.

Economic activity posted a faster-than-expected increase in 2024 Q4, to 0.8 percent from 0.1 percent in the previous three months, so that excess aggregate demand narrowed at a probably slower pace over this period compared with the forecasts. At the same time, the annual growth rate of household consumption remained robust, decelerating only slightly versus Q3, while gross fixed capital formation recorded a large contraction compared with the same year-earlier period, contributing decisively to the decline in the annual GDP dynamics to 0.7 percent in the last quarter of 2024, from 1.2 percent in the previous three months. Moreover, the contractionary impact of net exports grew stronger, as the annual dynamics of the import volume of goods and services saw a renewed pick-up and those of the export volume continued to fall deeper into negative territory. The trade deficit further reported, however, slower annual growth – amid the significantly improved terms of trade –, whereas the current account deficit posted a markedly faster annual pace of increase, owing to the severe deterioration of the income balance, *inter alia* on account of inflows of EU funds to the current account.

Looking at the labour market, the latest data and surveys confirmed the halt in the easing of market conditions in 2024 Q4 – given also the steady job vacancy rate –, indicating also a reversal of this trend, probably temporary, in the first months of 2025 and in the near future. Specifically, the number of employees economy-wide saw a swifter monthly pick-up in December 2024 and January 2025, while the ILO unemployment rate fell slightly in the first two months of the year as a whole[25].

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[25]   After rising to and remaining at an average of 5.7 percent in 2024 H2

In turn, employment intentions over the very short horizon stepped up in 2025 Q1 overall, after declining for two quarters in a row, while the marked contraction in labour shortage reported by companies in the last quarter of 2024 reversed entirely during the same period. The annual dynamics of nominal gross wage continued to decline in January 2025, remaining however in the two-digit range – *inter alia* amid the hike in the economy-wide gross minimum wage and the partial compensation by employers of the impact exerted by the removal of some tax breaks –, while those of unit labour costs in industry increased again at the beginning of the year[26], after having declined considerably in 2024 Q4.

On the financial market, the main interbank money market rates further held relatively steady in February and March 2025 at the high levels reached in the previous quarter. Long-term yields on government securities fully corrected in February the abrupt increase seen in the first part of January, before remaining almost unchanged, amid the lowering of financial investor concerns about budget consolidation prospects after the completion and adoption of the draft budget for 2025, but also reflecting the fluctuations in global risk appetite. Under the circumstances, the EUR/RON exchange rate shifted in mid-Q1 and then stuck to higher readings, while in relation to the US dollar, the leu strengthened significantly in February-March, recovering to a large extent the ground lost in the prior quarter, given the former's sharp depreciation in international financial markets during this period.

The annual growth rate of credit to the private sector stepped up further during the first two months of 2025 Q1 overall, reaching 9.4 percent in February[27], as the pace of increase of loans to non-financial corporations accelerated, while that of household credit lost significant momentum, primarily due to the very swift dynamics of leu denominated consumer loans embarking on a downward path. The share of the domestic currency component in credit to the private sector narrowed marginally, to 69.9 percent in February 2025 from 70.0 percent in December 2024.

The updated assessments in this context indicated that the annual inflation rate would fluctuate further in 2025 H1, continuing to decline in March on a higher path than in the February 2025 medium-term forecast, before rising moderately in Q2, relatively in line with previous projections. The pick-up in Q2 would be driven by the base effects associated with the sizeable drop in the prices of energy[28] and of some food items[29] in the same year-earlier period[30].

Moreover, the balance of risks to the inflation forecast induced by supply-side factors became significantly more tilted to the upside, given the heightened uncertainties and risks stemming from the future developments in energy and food prices, particularly

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[26] To 15.3 percent

[27] From 8.8 percent in December 2024

[28] Especially prices of natural gas, under the influence of legislative changes implemented as of April 2024

[29] Mainly those belonging to the VFE category

[30] Their impact would heftily outweigh the one anticipated to be exerted by the opposite base effects further manifest in the non-food sub-components of core inflation and in the tobacco products segment, as well as temporarily in the case of fuels.

in 2025 H2, also amid the regulations in the field, but also from the expansion of trade protectionism, with a potential impact on the international prices of some intermediate and final goods.

At the same time, underlying inflationary pressures were expected to be still sizeable over the near-term horizon, and easing only slightly, amid prospects for the negative output gap to open and to widen in 2025 H1 to more modest values than previously envisaged and the time lag required for the disinflationary effects thus generated to become manifest, as well as the annual dynamics of wage costs in the private sector probably further recording a double-digit level, although on a decline[31].

High uncertainties and risks continued to stem from the future fiscal and income policy stance, considering the corrective fiscal and budgetary measures already implemented or adopted and the budget execution in the first months of the year, but also the budget consolidation requirement according to the *National Medium-Term Fiscal-Structural Plan* agreed with the European Commission, as well as to the excessive deficit procedure.

At the same time, heightened uncertainties and risks to the outlook for economic activity, implicitly the medium-term inflation developments, stemmed from the external environment, given the protracted war in Ukraine and situation in the Middle East, but especially amid the trade policy of the US administration and the retaliatory measures taken by other countries, affecting the global economy and international trade. Moreover, a major source of uncertainties remained the absorption of EU funds, especially those under the Next Generation EU programme.

The analysed context overall warranted a policy rate statu-quo, with a view to ensuring and maintaining price stability over the medium term, in a manner conducive to achieving sustainable economic growth.

Under the circumstances, in its meeting of 7 April 2025, the NBR Board decided to keep the monetary policy rate at 6.50 percent and to leave unchanged the lending and deposit facility rates at 7.50 percent and 5.50 percent respectively. At the same time, the NBR Board kept the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions.

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[31] However, notable disinflationary effects were expected over this time horizon from the slacker dynamics of import prices, as well as from the downward adjustment of short-term inflation expectations, albeit slower and from higher levels than previously anticipated.

2. Financial markets and monetary developments

> In 2025 Q1, the daily average interest rate on interbank transactions[32] moderated its fluctuations somewhat, while longer-term rates remained relatively stable. The EUR/RON exchange rate shifted in mid-quarter and then stuck to higher readings. The annual growth rate of liquidity across the economy contracted January through February 2025 overall, while that of credit to the private sector advanced further, yet significantly more slowly than in prior quarters.

2.1. Interest rates

In 2025 Q1, the daily average interest rate on interbank transactions continued to fluctuate above the central bank's deposit facility rate, yet more moderately and at lower readings than in the second part of 2024 Q4. The quarterly average of the indicator[33] edged down 0.05 percentage points from the previous three months to 5.55 percent.

Chart 3.2. Policy rate and ROBOR rates

percent per annum, period average

3M ROBOR
12M ROBOR
policy rate*
interbank rate

*) end of period
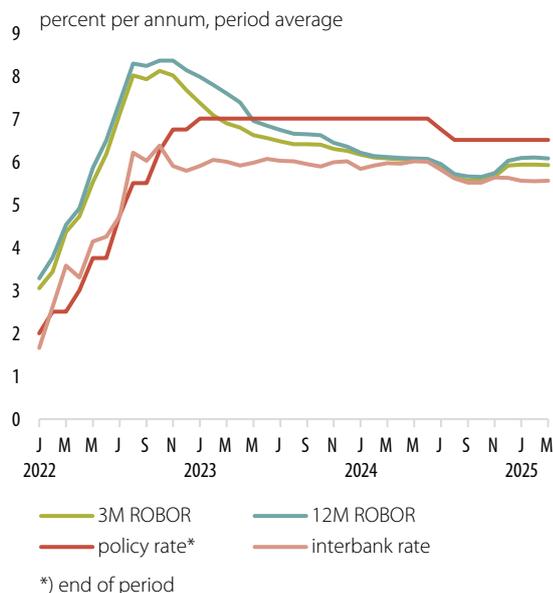
This evolution reflected primarily the behaviour of very short-term rates, given the status-quo of NBR rates, but also the re-widening of the liquidity surplus on the money market[34], which the central bank continued to mop up via the deposit facility[35].

The 3M-12M ROBOR rates tended to stay during 2025 Q1 at the significantly higher levels reached in the closing part of November 2024[36]. Their quarterly averages thus increased visibly more steeply in this period than in the prior quarter (by up to 0.30 percentage points), reaching 5.93 percent for the 3M rate and 5.99 percent and 6.08 percent for the 6- and 12-month maturities respectively[37] (Chart 3.2).

Looking at the government securities market, medium- and long-term reference rates on the

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[32] The average interest rate on transactions in deposits on the interbank money market, weighted by the volume of transactions

[33] Average weighted by the volume of transactions

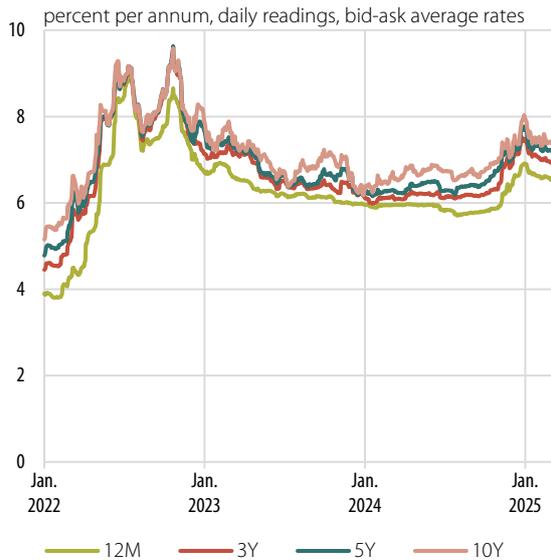[34] Under the impact of liquidity injections generated by Treasury operations

[35] The average daily stock of these deposits rose January through March 2025 overall to lei 29.0 billion from lei 21.2 billion in the previous quarter.

[36] They recorded mild increases in the second half of January 2025, which were slowly corrected over the following months.

[37] The monthly averages of ROBOR rates went up further in January 2025, yet much more modestly than in December 2024, adding 0.02 percentage points for the 3- and 6-month maturities and 0.06 percentage points for the 12M rate, before remaining practically unchanged in the following months, at 5.92 percent (3M), 5.99 percent (6M) and 6.07 percent (12M).

secondary market[38] remained on a steep upward path in the first part of January[39], before embarking in the closing 10-day period on a sharply downward course, reverting towards end-February and then tending to stick to the values recorded at the beginning of the year. These developments reflected the alleviation of financial investor concerns about fiscal consolidation prospects after the completion and adoption of the 2025 draft budget[40], but also the fluctuations in global risk appetite[41]. The near-term segment of the yield curve witnessed a relatively similar evolution, albeit more moderate in terms of magnitude (Chart 3.3). As a result, the monthly averages of the rates edged up only slightly in March versus those in the closing month of 2024 Q4 for the 1-, 5- and 10-year maturities (by around 0.1 percentage points to 6.57 percent, 7.23 percent and 7.41 percent respectively) and shrank for the 3-year maturity (by 0.04 percentage points, to 6.96 percent), as well as for the 6-month one (by 0.13 percentage points, to 6.24 percent). Hence, the positive slope of the yield curve moderated slightly compared to December 2024.

Chart 3.3. Reference rates on the secondary market for government securities

percent per annum, daily readings, bid-ask average rates

Developments in the average accepted rates on the primary market[42] also reflected, however, the influence exerted by the timing of auctions, amid the wide fluctuations of rates. Specifically, when compared to the December 2024 levels, the rates at the last auctions in March rose in a range between 0.15 and 0.29 percentage points for the 1-, 3-, 5- and 10-year maturities (to 6.64 percent, 7.07 percent, 7.38 percent and 7.47 percent respectively) and stayed flat for the 6-month Treasury certificates (at 6.40 percent).

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[38] Bid-ask averages

[39] Hitting two-year highs

[40] The draft budget was approved by the government on the last day of January and was adopted by Parliament on 5 February.

[41] The global risk appetite continued to fluctuate in this period, amid the economic policies and evolutions in developed countries, with potential implications also for the major central banks' monetary policy decisions. Against this background, 10-year government security yields in the US extended their upward course in the first half of January, reaching a 15-month high, but then embarked on a generally downward path, which steepened markedly in the closing 10-day period of February – owing to expectations for a deterioration of economic activity, under the impact of the US administration's economic policies –, before remaining relatively stable in March. Long-term government security yields in the euro area followed a relatively similar trajectory in the first half of Q1, before witnessing an abrupt leap in the first 10-day period of March, in response to the announcement on the future massive increase in defence and infrastructure spending in Germany, conducive to bolstering economic activity in the upcoming period and raising the public sector's financing needs over the longer term.

[42] During 2025 Q1, the MF's "Tezaur" programme saw the monthly issuance of government securities with 1-, 3- and 5-year maturities, at rates of: (i) 6.45 percent, 7.20 percent and 7.60 percent respectively in January, (ii) 7.00 percent, 7.50 percent and 7.80 percent respectively in February, and (iii) 6.95 percent, 7.65 percent and 7.95 percent in March. Moreover, under the "Fidelis" programme, the MF issued in February government securities for households both in domestic currency, with 1-, 3- and 5-year maturities, at rates of 6.95 percent, 7.65 percent and 7.95 percent respectively, worth around lei 2.3 billion, and in euro, with 2- and 7-year maturities, at rates of 4.00 percent and 6.25 percent respectively, totalling EUR 390 million. March saw the issuance of securities in domestic currency, with 1-, 3- and 5-year maturities, at rates of 6.80 percent, 7.50 percent and 7.80 percent respectively, worth lei 1.4 billion, and in euro, with 2- and 7-year maturities, at rates of 3.75 percent and 6.00 percent respectively, totalling EUR 168 million. Furthermore, the MF issued in February both EUR-denominated Eurobonds, with maturities of 5 and 9 years, at rates of 5.29 percent and 6.34 percent respectively (amounting to EUR 2.8 billion), and USD-denominated Eurobonds, with a 12-year maturity and a rate of 7.55 percent (worth USD 1.25 billion). Towards end-March, the MF issued on the external market EUR-denominated Eurobonds with maturities of 7 and 14 years, totalling EUR 2.75 billion, at rates of 5.92 percent and 6.79 percent respectively.

During 2025 Q1 overall, the value of securities issued went up by approximately lei 10 billion against the previous three months, to lei 30.1 billion, mainly on the back of medium- and long-term securities, but also with a contribution from those at the shorter end of the maturity spectrum[43]. The value of net issues also rose to lei 9.3 billion (from lei 4.5 billion in the previous quarter), even amid a large volume of securities maturing in this period. Investors' rekindled appetite for this type of investments is also reflected by the increase in the ratio of the amounts of bids submitted by primary dealers to the announced volume at auctions (up to 2.30, after a drop to 1.64 in 2024 Q4), as well as in the ratio of the volume of issues to the announced volume (to 1.36, after a decline to 1.06 in the previous three months).

The average interest rates applicable to non-bank clients' new loans and new time deposits halted their downtrend at the onset of 2025 Q1, recording mild increases January through February overall, i.e. +0.07 percentage points, to 7.88 percent, and +0.09 percentage points, to 5.03 percent respectively (Chart 3.4).
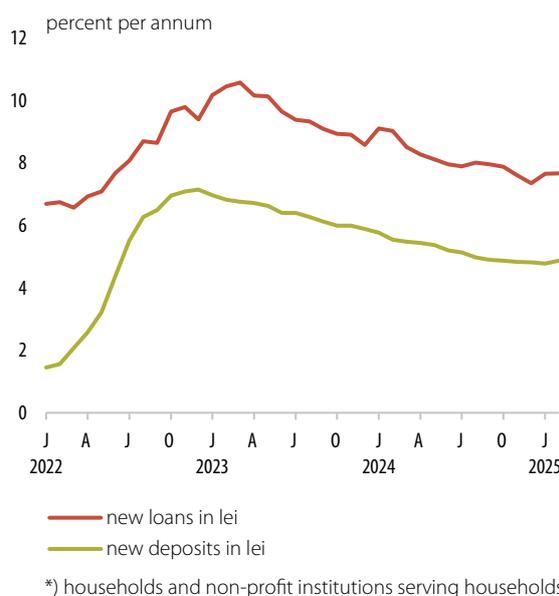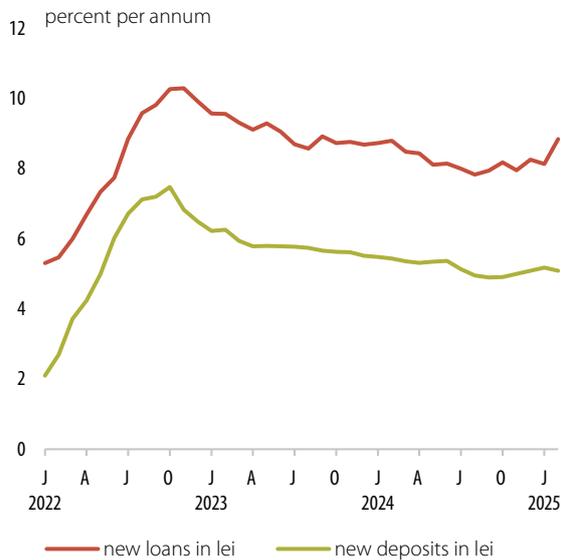
Chart 3.4. Bank rates

percent per annum

new loans in lei
new time deposits in lei
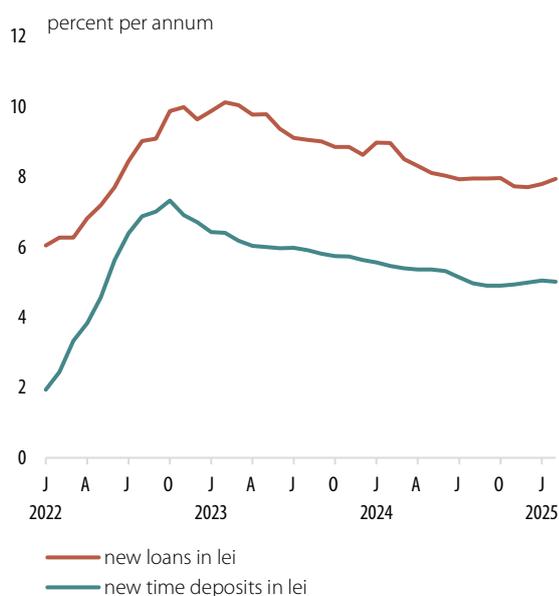
Chart 3.5. Interest rates for households*

percent per annum

new loans in lei
new deposits in lei

*) households and non-profit institutions serving households

From a sectoral perspective, most rates moved in the same direction. Specifically, after three quarters of decline, the lending rate on new business to households went up during the two months overall, to an average of 7.67 percent (+0.05 percentage points versus the 2024 Q4 reading) (Chart 3.5). Behind this stood the faster growth of the average interest rate on new consumer credit (up 0.16 percentage points, to 9.80 percent) and the larger share of these loans in the total flow of household credit, both factors being only partly offset in terms of impact by a new, albeit more moderate decline in the average interest rate on new housing loans (down 0.09 percentage points, to 6.03 percent).

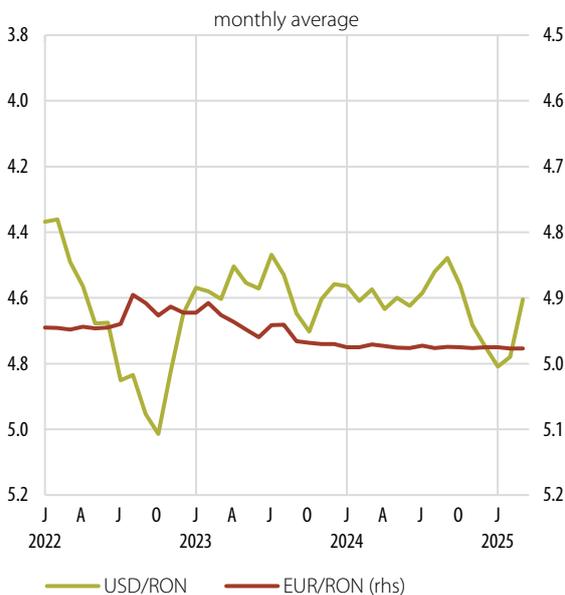[43] The MF issued at an auction in March securities with a 1.3-year maturity worth lei 2.2 billion.

Chart 3.6. Interest rates for non-financial corporations

percent per annum

new loans in lei new deposits in lei

Chart 3.7. Nominal exchange rate

monthly average

USD/RON EUR/RON (rhs)

At the same time, the average lending rate on new business to non-financial corporations steepened its uptrend during the first two months of Q1 overall (+0.36 percentage points against 2024 Q4, to 8.50 percent) (Chart 3.6). This was ascribable to the hefty increase in the average interest rate on low-value loans (below EUR 1 million equivalent), which added 0.48 percentage points versus 2024 Q4, to 8.94 percent, whereas the average interest rate on high-value loans (above EUR 1 million equivalent) moderated its upward course, advancing 0.18 percentage points from 2024 Q4, to 7.92 percent.

The average remuneration of new time deposits from households practically halted its decline January through February 2025 overall, falling only marginally against 2024 Q4 to an average of 4.82 percent[44], while that on similar deposits from non-financial corporations saw a renewed pick-up (+0.14 percentage points to 5.14 percent).

2.2. Exchange rate and capital flows

The EUR/RON exchange rate shifted in mid-Q1 and then stuck to higher readings (Chart 3.7).

The currency pair tended to stay, during January 2025 as well, in the vicinity of the values prevailing in 2024, before climbing in the first 10-day period of February and then staying until the end of the month at higher levels. Behind the developments in the EUR/RON stood the fluctuation of the international financial market sentiment[45] – affecting the behaviour of the EUR/USD exchange rate also[46] –, but also the steep worsening trend of the trade balance, as well as financial investor concerns about fiscal consolidation prospects, which were however visibly alleviated after the completion and adoption of the 2025 draft budget[47] (Table 3.1).

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[44] This masked a slight advance in February, for the first time in two years, solely due to the higher remuneration of deposits with a 3 to 6-month maturity, promoted in this period by some credit institutions, possibly also in response to households' keener appetite for investing in government securities.

[45] The global risk appetite improved in the second half of January, but deteriorated again in the closing 10-day period of February, following the trade policy measures announced by the US administration, conducive to a reconsideration by investors of the outlook for the monetary policy stance of the Fed/major central banks.

[46] The pair went down further in the first part of January 2025, before witnessing a trend reversal.

[47] The draft budget was approved by the government on the last day of January and was adopted by Parliament on 5 February 2025.

Table 3.1. Key financial account items

EUR million

	2 mos. 2024			2 mos. 2025		
	Net acquisition of financial assets*	Net incurrence of liabilities*	Net	Net acquisition of financial assets*	Net incurrence of liabilities*	Net
Financial account	6,489	10,273	-3,784	520	4,463	-3,943
Direct investment	577	2,242	-1,666	172	1,198	-1,026
Portfolio investment	-56	6,695	-6,751	-112	3,169	-3,281
Financial derivatives	36	0	36	-21	0	-21
Other investment	2,586	1,336	1,249	336	96	239
– currency and deposits	2,091	-518	2,609	-70	-606	536
– loans	-32	875	-907	246	541	-295
– other	526	979	-453	160	161	-1
NBR's reserve assets, net	3,347	0	3,347	145	0	145

*) "+" increase/"-" decrease

Chart 3.8. Exchange rate developments on emerging markets in the region

indexes, 31 December 2021=100

Source: ECB, NBR
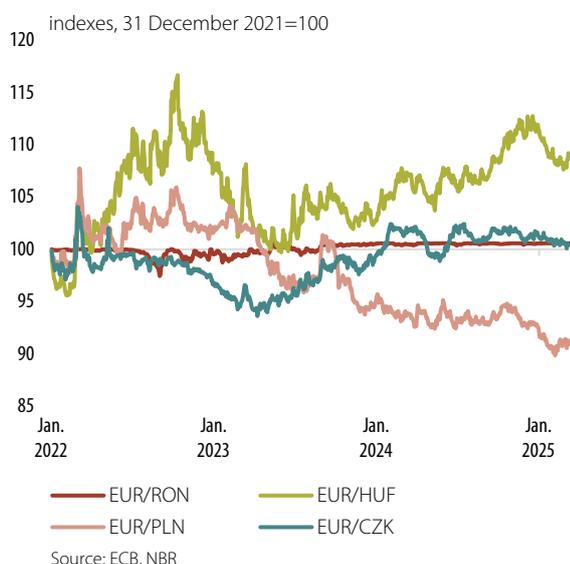
The exchange rates of major currencies in the region re-embarked, nevertheless, in mid-January and then stayed in February on a generally downward course, mainly under the influence of domestic factors[48].

The EUR/RON exchange rate stuck to the new levels until towards end-March, in the context of increased fluctuations, reflecting the very high uncertainties triggered worldwide and on the international financial market by the US administration's trade policy measures, but also amid the start of negotiations on ending the war in Ukraine and the adoption of a massive package of defence and infrastructure spending in Germany, conducive to an improvement in investor perception on the outlook for European economies and to a steeper advance of the EUR/USD exchange rate.

Developments on the financial markets in the region were however heterogeneous in the closing month of the quarter. Specifically, the exchange rate of the Czech koruna went down further[49], whereas that of the forint re-entered an upward path in mid-March. At the same time, the exchange rate of the zloty rose in the first part of the month, before remaining relatively stable[50] (Chart 3.8).

In relation to the US dollar, the leu reversed in mid-January its relatively swift depreciation trend and strengthened significantly February through March, largely recovering the ground lost in the previous quarter, due to the former's marked weakening on international financial markets during this period.

The interbank forex market turnover declined slightly in 2025 Q1, while the negative balance of transactions contracted significantly versus the prior quarter, on account of non-residents' operations.

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[48] The central bank of Poland and that of Hungary kept key rates unchanged in February and further conveyed signals of prudence in terms of future monetary policy stance, *inter alia* amid the higher-than-expected annual inflation rate in January in both countries. The Czech central bank resumed the prudent cut of the key rate, while maintaining the restrictiveness of the monetary policy stance.

[49] Also as the Czech central bank left the monetary policy rate unchanged in March and the related communication pointed out the heightened inflationary risks and the need to maintain a tight monetary policy stance.

[50] Given also the above-expectations drop in the annual inflation rate in February, which prompted investors to revise downwards the anticipated path of the Polish central bank's monetary policy rate.

During the period overall, the leu depreciated marginally against the euro in nominal terms[51,52], but continued to appreciate in real terms, at a mildly slower pace than in the previous quarter (by 0.2 percent). In relation to the US dollar, the domestic currency strengthened considerably, in both nominal and real terms, i.e. by 3.1 percent and 3.4 percent respectively. Looking at the annual change in the quarterly averages of the exchange rate, the leu continued to weaken slightly versus the euro, at a similar pace to that recorded a quarter earlier, but saw a faster depreciation vis-à-vis the US dollar.

Table 3.2. Annual growth rates of M3 and its components

					nominal percentage change	
	2024				2023	
	I	II	III	IV	Jan.	Feb.
	quarterly average growth					
M3	10.6	10.5	10.1	10.9	10.1	9.0
M1	4.3	7.0	7.8	9.5	9.3	9.6
Currency in circulation	8.4	9.3	9.7	12.8	14.9	14.5
Overnight deposits	2.8	6.2	7.1	8.3	7.3	7.7
Time deposits (maturity of up to two years)	21.6	16.0	13.9	13.0	11.2	8.0

Chart 3.9. Main broad money components

nominal annual percentage change

- M3
- currency in circulation
- time deposits (maturity of up to two years)
- overnight deposits

2.3. Money and credit

Money

During the first two months of 2025, the annual dynamics of broad money (M3) posted a strong decline, atypical for the seasonal pattern, reaching an average of 9.5 percent[53] from 10.9 percent in 2024 Q4 (Table 3.2). This was correlated with the characteristics of budget execution, with the worsening of the trade balance, as well as with the pick-up in portfolio shifts to alternative financial instruments (government securities).

Looking at M3 components, the turning point in the growth rate of broad money was almost entirely driven by the annual dynamics of time deposits with a maturity of up to two years. These witnessed a stronger decline compared to the previous quarter's average[54], given that the rate of change of leu-denominated deposits saw a faster decrease in this period, primarily on the back of household deposits[55], whereas the impact thus generated was offset only to a small extent by the further pick-up in the dynamics of the foreign currency component (expressed in EUR), also with the major contribution of individuals' deposits (Chart 3.9).

The annual rate of increase of narrow money (M1) remained, however, at the level reached in the previous quarter[56], thus stopping its upward movement, given the relatively equal diverging influences of M1 components. These stemmed,

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[51] Based on the March 2025 and December 2024 averages of the EUR/RON exchange rate

[52] In the same period, the Czech koruna strengthened versus the euro by 0.5 percent, the zloty 2.1 percent, and the forint by 3.0 percent.

[53] In real terms, the annual growth rate of M3 also decelerated January through February 2025, i.e. to 4.3 percent from 5.6 percent in 2024 Q4.

[54] Reaching an 11-quarter low

[55] But also with a significant contribution from similar deposits from non-financial corporations

[56] To an 11-quarter high

on the one hand, from the further deceleration in the growth rate of leu-denominated overnight deposits – especially as a result of developments in the non-financial corporations segment – and, on the other hand, from the new step-up in the dynamics of forex overnight deposits[57] (expressed in EUR), on the back of household deposits, as well as in the growth rate of currency in circulation[58]. Nevertheless, the share of M1 in M3 remained on the slightly downward path it had embarked on in mid-2024, narrowing in February to 60.2 percent from 60.4 percent at end-2024 Q4.

The breakdown by holder shows that the loss of momentum of M3 was mainly driven by the significant decrease in the growth of corporate deposits[59], in correlation with the decline recorded by the rate of change of some disbursements from the government budget[60] and by the amounts cashed in from EU funds, as well as with the slower growth of retail trade and with the marked worsening of the trade balance, but also with the probable increase in dividend payments[61]. The dynamics of household deposits moderated only slightly, given that the decline in the real annual change of income from wages and social benefits in the first two months of the year as a whole was associated with a more visible slowdown in the purchases of goods, while the swifter pace of growth of households' holdings of government securities in this period was probably also supported by higher revenues from dividends.

From the perspective of M3 counterparts, the contractionary influences stemmed from a new significant decline posted in this period by the change in net foreign assets of the banking system[62], whose impact was largely offset, however, by the further brisker increase in net credit to the central government.

Credit to the private sector

The annual growth rate of loans to the private sector continued to advance during January-February 2025, albeit significantly more slowly than in previous quarters, reaching an average of 9.1 percent[63] from 8.9 percent in 2024 Q4, given that the leu-denominated component witnessed

Chart 3.10. Credit to the private sector by currency

nominal annual percentage change

total
domestic currency
foreign currency

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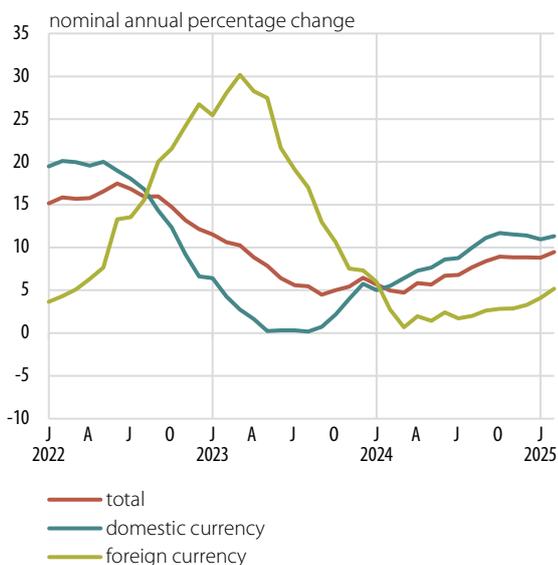
[57] Returning to positive territory for the first time in nine quarters

[58] Thus, its dynamics reached a four-year high (assessment based on quarterly averages).

[59] Their dynamics fell to an almost 12-year low (assessment based on quarterly averages).

[60] According to general government budget execution data
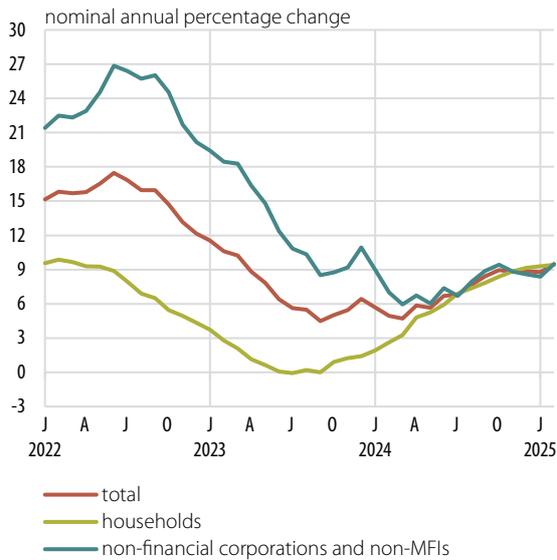
[61] According to general government budget execution data

[62] *Inter alia* due to a base effect associated with the high volume of Eurobond issues by the Ministry of Finance January through February 2024 (the equivalent of EUR 7.7 billion). In February 2025, the MF issued Eurobonds worth approximately EUR 4.0 billion.

[63] In turn, the real annual growth of credit to the private sector further stepped up, reaching 3.9 percent on average January through February, from 3.7 percent in 2024 Q4.

a mild reduction in its two-digit change[64], whereas foreign currency-denominated credit (expressed in EUR) rose at a faster pace (Chart 3.10). However, the share of the domestic currency component in credit to the private sector narrowed only marginally, to 69.9 percent in February 2025 from 70.0 percent in December 2024.

Chart 3.11. Credit to the private sector by institutional sector

nominal annual percentage change

- total
- households
- non-financial corporations and non-MFIs

Similarly to the previous quarter, both major institutional sectors contributed to the slight pick-up in the growth of credit to the private sector (Chart 3.11). Specifically, the annual dynamics of household loans further followed an upward trend, albeit at a considerably slower pace, and solely on the back of leu-denominated housing loans, whose flow contracted only marginally compared to the historical peak reached in December 2024[65], whereas the very high annual rate of change of domestic currency consumer credit and other loans virtually halted its rise in this period. At the same time, the stock of foreign currency credit to households (expressed in EUR) maintained its particularly sizeable contraction against the same year-earlier period.

The annual dynamics of loans to non-financial corporations slowed down somewhat more visibly their increase in January-February compared to 2024 Q4, as a result of the decline in the average change of leu-denominated loans, after six quarters of acceleration, *inter alia* amid the uptrend in related interest rates over the past months and the relative tightening of credit standards in this segment[66], as well as given the lower contribution from government programmes ("IMM Invest Plus") as compared with the same year-ago period. Nevertheless, the pace of increase of the foreign currency component (expressed in EUR) witnessed a sharper upward trend, almost entirely on the back of the faster rise in medium- and long-term loans.

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[64] After rising continuously for five quarters

[65] Assessment based on the flows adjusted for the value of renegotiated loans

[66] According to the *Bank Lending Survey*

4. Inflation outlook

According to the updated forecast, the annual CPI inflation rate is expected to fluctuate mildly over the short term, with a marginal rise in Q2 to 5.1 percent in June 2025, a level anticipated for September as well. The indicator will resume its downward path as from Q4, reaching 4.6 percent in December 2025 and will return inside the variation band of the target in 2026 Q3. Subsequently, the annual inflation rate is projected to remain relatively stable, moving inside the upper half of the variation band of the target. The value forecasted for end-2026 is 3.4 percent. Given the expiry of the electricity price capping scheme on 30 June 2025, the forecast includes the assumption of a 15 percent hike in electricity prices in July, which is, however, subject to upside risks.

Compared to the projection published in the February 2025 *Inflation Report*, the annual CPI inflation rate will run at higher levels throughout the projection interval, except 2025 Q2. The revisions are +0.8 percentage points for end-2025 and +0.3 percentage points for end-2026. Higher contributions are projected for core inflation over the entire projection interval and electricity prices in 2025 H2 and 2026 H1, partly offset this year by a lower fuel inflation. Despite these upward revisions, the balance of risks to the inflation projection is assessed to remain tilted to the upside compared to the values foreseen in the baseline scenario.

1. Baseline scenario

1.1. External assumptions

Compared to the previous *Report*, the dynamics of trading partners' economic activity, as proxied by the EU effective GDP, were revised downwards for both 2025 and 2026, i.e. 1.1 percent and 1.5 percent (Table 4.1). Over the short term, EU growth is dampened by the negative impact of the uncertainty about the US administration's announced hike in tariffs. Specifically, external economic activity is seen growing at a moderate quarterly pace in 2025 Q1 and Q2, and gaining some momentum thereafter. Over the medium term, economic activity is foreseen to be spurred by the upturn in consumption, a rebound in investment, a recovery in foreign demand and by the common monetary policy in the euro area becoming less restrictive. However, the balance of risks surrounding the outlook for the EU economic activity remains tilted to the downside.

Against this background, the effective external output gap was also revised downwards, especially over the medium term. It is expected to stay in negative territory throughout

Table 4.1. Expected developments
in external variables

	annual averages	
	2025	2026
EU effective GDP growth (%)	1.1	1.5
Euro area annual inflation (%)	2.3	1.9
Euro area annual inflation excluding energy (%)	2.4	2.2
Annual CPI inflation rate in the USA (%)	2.8	2.4
3M EURIBOR (% p.a.)	2.2	1.8
USD/EUR exchange rate	1.08	1.09
Brent oil price (USD/barrel)	68.7	65.1

Source: NBR assumptions based on data provided by the
European Commission, Consensus Economics and Bloomberg

the projection interval, similarly to the previous assessment, but at more contractionary values in terms of the impact on Romania's exports dynamics.

The average annual inflation rate for the euro area was assessed at a slightly higher level than in the prior *Inflation Report* for this year (2.3 percent), mainly on account of the energy sub-component. For 2026, the forecast was kept at 1.9 percent. The annual inflation rate is forecasted to reach the ECB's 2 percent benchmark in 2026 Q1, a quarter later compared to the assumption in the previous *Inflation Report*, and to subsequently stay mildly below or even at this level over the remainder of the projection interval. Based on information available at this moment, in the absence of any retaliatory response from the EU, global trade tensions could put moderately disinflationary pressure on the euro area inflation rate by dampening external demand, affecting the investment outlook and, at least until the completion of the baseline scenario, by the appreciation trend of the euro against the US dollar, which favours lower prices of imported goods. Against this background, based strictly on this information, not implying a tit-for-tat scenario, the balance of risks associated with the path of inflation appears to be tilted rather downwards.

The forecast of the euro area HICP inflation excluding energy[67] was maintained at 2.4 percent for 2025 and revised slightly upwards at 2.2 percent for 2026. Looking by quarter, it will follow a downward track, nearing, albeit slightly above, the path of headline inflation rate. This path is anticipated on the back of the gradual decline in the services component, amid the gradual slowdown in pay rises, while profit margins are foreseen to resume growth. At the projection horizon, i.e. 2027 Q1, the HICP inflation rate excluding energy is envisaged to run slightly above headline inflation, at 2.1 percent versus 2.0 percent.

The nominal 3M EURIBOR stayed on a downtrend, after hitting a high of 4 percent for the current cycle in 2023 Q4, and is seen declining to 1.8 percent in 2026 Q1. Over the longer term, this rate is projected to revert slightly towards 2 percent, reaching this level in 2027 Q1. Similarly to the previous *Report*, the real 3M EURIBOR rate is assessed to have run below its trend as early as 2023 Q3, reflecting the restrictive effect of the ECB's monetary policy on the economic activity in the euro area. This effect is expected to fade out until 2025 Q2, considering also the nominal policy rate cut decided by the ECB's Governing Council at its April meeting. Subsequently, the real 3M EURIBOR rate is projected to remain at close-to-neutral levels until the forecast horizon. How trade rows will unfold is a key factor in the future calibration of the monetary policy stance pursued by the ECB, whose decisions could envisage possible further rate adjustments compared to the path in the baseline scenario.

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[67] A proxy for imported inflation in the case of Romania

The US dollar appreciated in 2025 Q1 as a whole, yet on a monthly basis it reversed the appreciation trend and embarked on a strong depreciation path starting in March. Specifically, over the near term, the US dollar is expected to soften significantly on a quarter-on-quarter basis, in correlation with the reassessed US economic outlook and the heightening of volatility and uncertainty in view of the US trade protectionism.

Chart 4.1. Brent oil price scenario

Source: U.S. Energy Information Administration,
NBR assumptions based on Bloomberg data
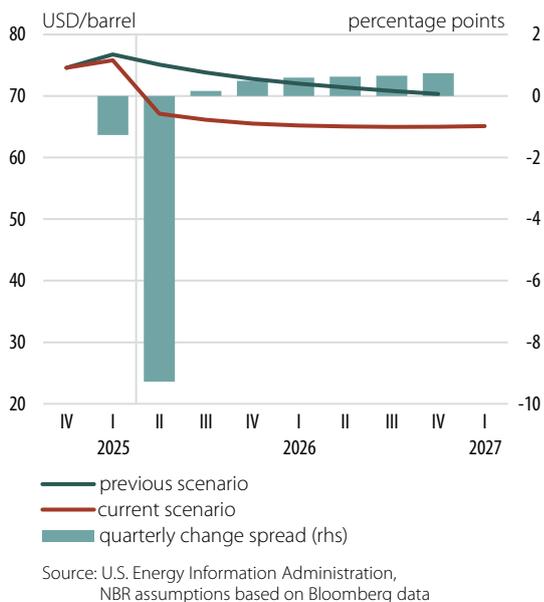
At the same time, the outlook for the euro area economy is underpinned by the EU's commitments to step up defence spending and the expected easing of fiscal rules in Germany, with potential stimulative effects on private sector investment, which are likely to materialise over the medium term in particular. The EUR/USD exchange rate is envisaged to stabilise somewhat over the projection interval, but its future dynamics are marked by elevated uncertainty.

The scenario for the Brent oil price is based on futures prices and foresees a downward course over the medium term amid the potential negative impact of trade rows on global economic activity. Specifically, at the forecast horizon, the Brent oil price is projected at around USD 65/barrel (Chart 4.1). Nevertheless, a possible resumption of US-China trade talks could bolster oil prices. On the demand side, concerns about the weakening global growth prevail over the short and medium term, thus depressing oil demand as well. On the supply side, the higher-than-expected output increase from OPEC+ members puts more downward pressure on oil prices. However, stiffer sanctions on Iran's oil exports could provide an underpinning to oil prices through the projection interval.

1.2. Inflation outlook

In March 2025, the annual CPI inflation rate stood at 4.86 percent, down slightly from 5.14 percent in December 2024. Over the short term, the indicator will post minor fluctuations, yet it is expected to come in at 5.1 percent in both June and September. In the current quarter, the annual inflation rate will reflect unfavourable statistical influences associated with the decreases in natural gas, electricity and VFE prices recorded in 2024 Q2. Going forward, the inflation forecast depends decisively on the working assumptions concerning developments in electricity prices, given that the price capping scheme expires on 30 June 2025. The baseline scenario includes a 15 percent rise in July, reflecting the assumption that market prices will align with the most advantageous offer currently available. The price quotations for the coming months, as collected from the market at the time of completing the projection, indicate considerable upside risks to this assumption.

Following the impact of this shock and amid the easing of recent inflationary pressures, the annual CPI inflation rate will resume its downward path as from 2025 Q4, reaching

4.6 percent at end-2025. Disinflation is expected to gain momentum in 2026, with the indicator projected to re-enter the variation band of the target in 2026 Q3 and to decline to 3.4 percent in December 2026 and to 3.3 percent at the forecast horizon, i.e. 2027 Q1 (Chart 4.2). The path of the indicator will be influenced by significant base effects during the first three quarters of next year, when both-way fluctuations are expected. The breakdown shows that the decline in the annual CPI inflation rate over the medium term will be driven by core inflation, which is anticipated to fall continuously starting in 2025 Q3, as well as by the exogenous components of the consumer basket overall, which will shape the volatile pattern of the aggregate indicator in 2026.

Chart 4.2. CPI and adjusted CORE2 inflation forecasts

annual change (%), end of period

multiannual flat inflation target: 2.5% ±1 pp

— CPI
--- adjusted CORE2
--- CPI at constant taxes

Source: NIS, NBR projection
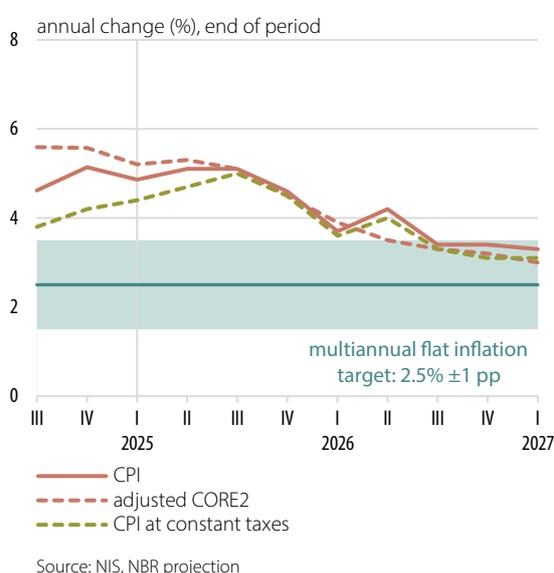
Table 4.2. CPI and adjusted CORE2 inflation in the baseline scenario

annual change (%), end of period

	2025			2026				2027
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Target (mid-point)	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
CPI projection	5.1	5.1	4.6	3.7	4.2	3.4	3.4	3.3
CPI projection*	4.7	5.0	4.5	3.6	4.0	3.3	3.1	3.1
Adjusted CORE2 projection	5.3	5.1	4.5	3.9	3.5	3.3	3.2	3.0

*) calculated at constant taxes

Compared to the February forecast, the updated path of the annual CPI inflation rate was revised upwards throughout the projection interval, except 2025 Q2 (Chart 4.2). The revisions are +0.8 percentage points for end-2025 and +0.3 percentage points for end-2026. Higher contributions are anticipated to come from core inflation over the entire projection interval and from electricity prices in 2025 H2 and 2026 H1. These are partly offset by the slower dynamics of fuel prices until 2026 Q1.

The annual adjusted CORE2 inflation rate decelerated at the beginning of 2025, from 5.6 percent in December 2024 to 5.2 percent in March 2025, and is forecasted to continue on a downward path throughout the projection interval, except 2025 Q2. Nonetheless, the pace of disinflation is anticipated to be relatively sluggish, with the indicator being expected to touch the upper bound of the variation band of the target no sooner than 2026 Q2 and to stay in its upper half until the forecast horizon. Specifically, the annual core inflation rate is projected at 4.5 percent for end-2025, 3.2 percent for December 2026 and 3.0 percent for March 2027 (Table 4.2).

The breakdown shows that the downward path of core inflation is supported by the decline in the annual growth rate of non-food prices, favoured by the moderation in imported inflation and by the gradual weakening of consumer demand. By contrast, a slower pace of disinflation is envisaged in the services sector, given the persistence of wage pressures. Processed food prices, which have recently reflected upward pressures from the costs of some agri-food commodities (e.g. dairy products, oleaginous plants, coffee), as well as from wage costs, are expected to contribute to disinflation over the medium term, once these shocks subside and amid more subdued demand.

From the perspective of the fundamentals modelled under the Phillips curve framework, the forecasted path of core inflation reflects slightly negative contributions from the output gap, which is anticipated to remain in negative territory over the entire forecast interval, an only gradual decline in inflation expectations, which are envisaged to stay above the variation band of the target until 2026 Q4, as well as the relatively stable dynamics of import prices, in line with the projected movements in the euro area annual HICP inflation excluding energy[68].

Compared to the previous forecast, the trajectory of the annual core inflation rate is revised upwards for the entire projection period (by 0.8 percentage points at end-2025 and 0.3 percentage points at end-2026). This revision reflects recent, stronger and more persistent pressures from services, which are foreseen to gradually dissipate over the medium term, and from food items, given the still high dynamics of wage costs and the unfavourable developments in some agri-food commodity prices. Adding to these is the impact of upward adjustments, albeit of low magnitude, of inflation expectations and import prices, as well as a slight revision of the output gap contribution (upwards in the first part of the projection interval and downwards in the latter part).

Chart 4.3. Components' contribution to annual inflation rate*

percentage points   percent
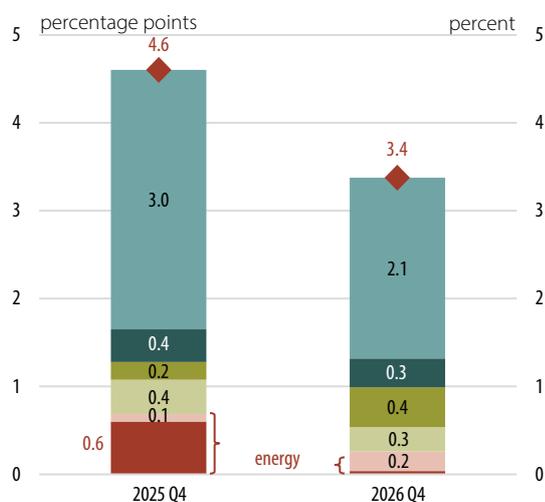
- adjusted CORE2
- tobacco products and alcoholic beverages
- VFE prices
- administered prices (excl. electricity and natural gas)
- fuels
- electricity and natural gas
- ◆ CPI inflation (rhs)

*) end of period; values have been rounded off to one decimal place

Source: NIS, NBR projection

The cumulative contribution of the exogenous components of the consumer basket to the annual CPI inflation rate is estimated at 1.7 percentage points at end-2025 (up by 0.2 percentage points compared to the February 2025 *Inflation Report*), before declining to 1.3 percentage points in December 2026 (the same level as previously anticipated) and standing at 1.4 percentage points at the forecast horizon, i.e. March 2027 (Chart 4.3). The upward revision for end-2025 was mainly ascribable to a more unfavourable outlook for electricity and administered prices, partly offset by downward corrections in fuel prices, tobacco product prices and volatile food (VFE) prices.

Under the impact of the recent declines in oil prices[69], the annual inflation rate for fuels is projected to run below the central target until 2026 Q1, before stabilising close to the target (Chart 4.4, Table 4.3); the variable's path was revised significantly downwards in the first part of the forecast compared to the previous *Inflation Report*. Over the remainder of the projection interval, values were revised upwards, as oil prices are expected to decline at a slower pace at this horizon.

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[68] According to the March 2025 *ECB staff macroeconomic projections for the euro area*, the average annual growth rate of the indicator will stand at 2.4 percent in 2025, 2.2 percent in 2026, and 2 percent in 2027.

[69] For further details, see Section 1.1 External assumptions.

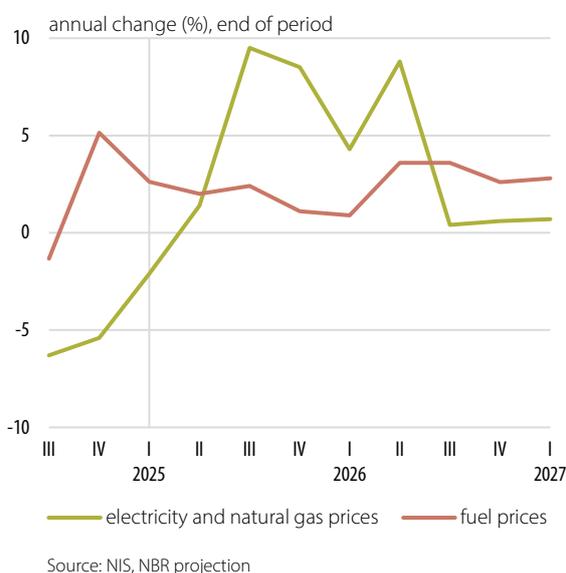## Chart 4.4. Inflation of fuel prices and of electricity and natural gas prices

annual change (%), end of period

electricity and natural gas prices — fuel prices

Source: NIS, NBR projection

Table 4.3. Inflation of CPI exogenous components

annual change (%), end of period

	Dec. 2025	Dec. 2026	Mar. 2027
Energy prices	4.4	1.7	1.8
Fuel prices	1.1	2.6	2.8
Electricity and natural gas prices	8.5	0.6	0.7
VFE prices	3.3	7.4	7.6
Administered prices (excl. electricity and natural gas)	6.4	4.6	4.6
Tobacco products and alcoholic beverages prices	5.2	4.6	4.6

Source: NIS, NBR projection

Electricity and natural gas prices[70] in 2025 H1 will be influenced by the staggered expiry of price capping schemes for household consumers: the scheme for electricity prices was extended until 30 June 2025, while that for natural gas prices remains in place until 31 March 2026 (Chart 4.4, Table 4.3). Specifically, by 2025 Q2, the annual growth rate for this group will run below the central target, being expected, however, to exceed the upper bound of the variation band of the target as of 2025 H2 and in 2026 H1. The working assumption envisages a 15 percent rise[71] in electricity prices in July 2025, having an inflationary impact for four quarters. The group is afterwards foreseen to witness only moderate increases, under the assumption of a normal functioning of the relevant markets. Compared to the February 2025 *Inflation Report*, the group's trajectory was revised downwards only for 2025 Q2, as a result of the updated technical assumptions on the electricity component[72]. Over the remainder of the forecast interval, the new values are higher – more visibly until June 2026 – than those previously projected, reflecting the hike in electricity prices.

Administered prices (excluding energy) are expected to post annual dynamics above the target in 2025, following significant upward revisions compared to the previous round, due to higher prices at the beginning of the year (for heating, water and sewerage services, and underground transport) (Chart 4.5, Table 4.3). Over the remainder of the projection interval, the annual growth rate of administered prices is relatively similar to that previously envisaged, being based on the historical pattern of changes to the prices of the main items in this group.

Against the background of more favourable recent developments, the annual growth rate of volatile food prices is expected to stay close to the central target in 2025 H2, the indicator being revised downwards for this year (Chart 4.6, Table 4.3). Over the remainder

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[70] According to NIS Press Release No. 37/14 February 2023, electricity and natural gas were re-included in the group of administered price items of the CPI basket, following the changes made to the energy price capping and compensation schemes as of 1 January 2023.

[71] At this horizon, a 15 percent increase in electricity prices was assumed, with an estimated impact of 0.6 percentage points on the CPI inflation rate. The value reflects the assumption that market prices will align with the most advantageous offers currently available.

[72] The aggregate price level calculated by the NIS is influenced by the distribution of households' shares by consumption bracket, which are variable over the year.

of the forecast interval, their annual dynamics are anticipated to run above the upper bound of the variation band of the target, broadly in line with previous projections and consistent with the historical price patterns of this component.

Chart 4.5. Administered price inflation (excl. electricity and natural gas)

annual change (%), end of period
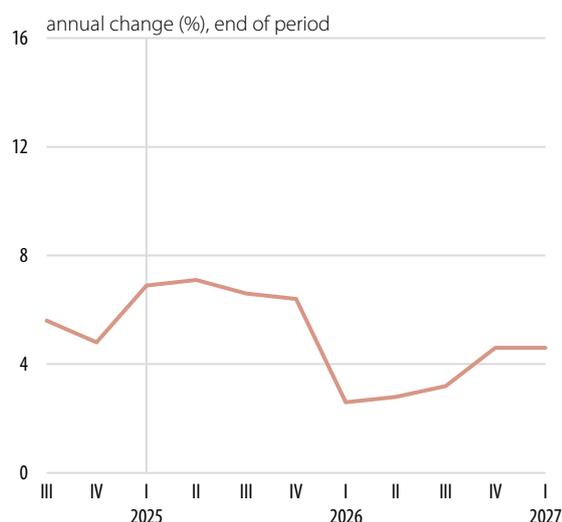
Source: NIS, NBR projection

Chart 4.6. VFE price inflation

annual change (%), end of period
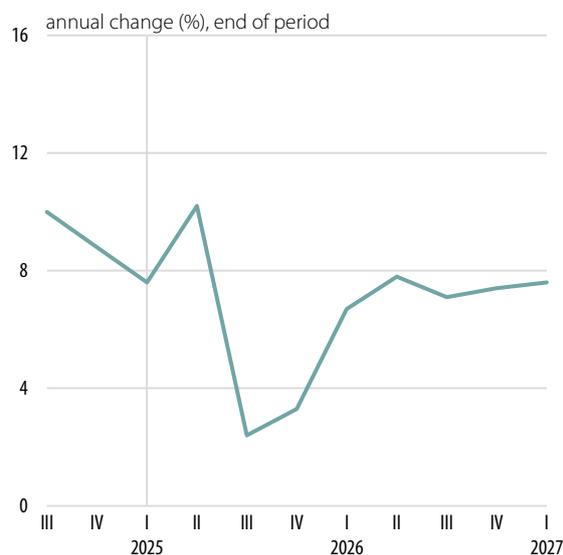
Source: NIS, NBR projection

The path of the annual growth rate of tobacco product and alcoholic beverage prices is shaped primarily by higher excise duties provided for in the legislation, but also by the price-setting behaviour of companies in this field. The annual dynamics of the group are projected to exceed the upper bound of the variation band of the target throughout the projection interval, except 2026 Q1 (Table 4.3). The trajectory for this year was revised downwards, supported by a recent, previously unforeseen decline in the price of a specific cigarette item.

1.3. Demand pressures in the current period and over the projection interval

The output gap

In 2024 Q4, real GDP saw a faster increase in quarterly terms (0.6 percent[73]), slightly above the expectations in the previous *Report*. However, looking at the demand side, the cumulative contribution from domestic absorption and net exports was strongly negative, i.e. -3.2 percentage points. Although household actual consumption rose swifter than forecasted, gross fixed capital formation recorded a surprising broad contraction, whereas net exports made a larger-than-expected negative contribution due to the compression of exports and the advance of imports. Thus, the positive quarterly dynamics of real GDP primarily reflected the approximately 3.8 percentage point contribution from the residual component (statistical discrepancy and change

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[73]   NIS Press Release No. 88 of 10 April 2025 regarding second provisional data on GDP

in inventories), with a low economic content. Throughout 2024, real GDP growth decelerated markedly compared to the previous year[74], reaching 0.8 percent, i.e. close to the forecast in the prior *Report*. The slowdown in economic growth occurred amid a robust consumption driven by imports and a significant drop in investments, while the sluggish industrial activity both domestically and in Europe's largest economies dampened the dynamics of Romania's exports.

For 2025 Q1, real GDP is expected to post a modest performance in quarterly terms. Trade and services are envisaged to have been affected by the declining disposable income, against the backdrop of the contractionary fiscal consolidation measures that entered into force as of 1 January 2025 (GEO No. 156/2024), despite the increase in the minimum wage economy-wide. In this respect, the following are relevant: (i) the turnover decline in retail trade and market services to households during the first two months of the year versus the 2024 Q4 average, (ii) the deterioration of confidence indicators in the DG ECFIN surveys (related to consumers, services and trade) and (iii) the slowdown in the growth rate of consumer loans. These developments can also be attributed, to some extent, to the higher uncertainty stemming from the extension of the electoral calendar into 2025 Q2, as shown by the notable rise in the sovereign risk premium[75]. The worsening economic situation in 2025 Q1 is reflected, *inter alia*, by the deceleration of housing loans and the standstill of credit to non-financial corporations. In this context, the first two months of the year saw a fragile path of construction works[76] and industrial activity, the latter being negatively impacted also by the further subdued growth in external demand.

For 2025 Q2, quarterly real GDP growth is expected to be moderate, picking up slightly compared to January-March 2025, amid the anticipated resumption of the upward trend in disposable income after its discontinuation in Q1. The main deterrent to economic growth is a renewed sharp increase in regional and global uncertainty, driven primarily by the trade policy measures adopted by the US administration in March and April. This was also signalled by the exceptional volatility of several financial indicators[77]. In fact, after a gradual rebound of Romania's ESI (Economic Sentiment Indicator) during 2025 Q1 (according to the DG ECFIN survey), April saw a decrease in this index driven by declines across nearly all its components. A worsening of confidence indicators was also noticeable across the EU/euro area, with the latter also witnessing a particularly sharp drop in the Sentix index. The uncertain economic environment is likely to put a damper on growth via a lower propensity to consume and firms' postponement of investment decisions.

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[74] In 2023, the annual GDP growth averaged at 2.4 percent. The contribution of the change in inventories, a component with limited economic content, was negative and large, hinting at uncertainties surrounding the final composition of GDP growth (after the NIS makes, in time, all revisions of statistical data, the final data for 2023 are due for October 2025).

[75] In this vein, noteworthy are the recent decisions made by Fitch Ratings, Moody's and Standard & Poor's to revise the outlook on Romania's sovereign credit rating from "stable" to "negative", the current ranking representing the lowest level of investment grade. Against this background, the sovereign risk premium proxied by Credit Default Swap (CDS) quotes rose from around 143 basis points in 2024 Q3 to approximately 164 basis points in 2024 Q4 and to approximately 201 basis points in 2025 Q1.

[76] Despite the stepped-up expansion of the road transport network at the beginning of the current year

[77] These include the following: the sovereign risk premium proxied by Credit Default Swaps (CDS), the BET index, the VIX (volatility index), the indices reflecting global commodity prices (S&P GSCI) and maritime transport costs (Baltic Dry Index), the price of the reserve asset – gold – and the STOXX Europe 600 stock index.

Looking at the annual rates, economic growth is expected to gradually recover in 2025 and 2026. This reflects, on the one hand, the relatively robust annual dynamics of potential GDP and the assumed favourable and increasing contribution of EU funds from multiple sources[78]. On the other hand, the following will act in the opposite direction: (i) the large restrictive fiscal impulse, (ii) the effective external demand deficit that will shrink only gradually over the next eight quarters and (iii) the restrictiveness of real broad monetary conditions. On the expenditure side, the medium-term economic growth is foreseen to further be driven by domestic demand, primarily on the back of final consumption, whose contribution is however anticipated to decrease, also as a result of fiscal consolidation measures. Gross fixed capital formation is forecasted to make a positive contribution only in 2026 (the negative contribution in 2025, despite the sequential recovery of this component, is solely attributable to a statistical carry-over effect stemming from its unusual decline in 2024 Q4). The contribution from net exports is projected to remain negative, given the expected modest performance of external demand and the rise in imports driven by domestic demand, albeit significantly softer compared to the previous year. Forecasts are marked by high uncertainty, with partial roots in the external environment, amid the protracted war in Ukraine and situation in the Middle East, and especially fuelled in the context of the trade policy measures of the US administration and the retaliatory measures adopted by other countries, which will affect global economy and international trade.

Compared to the previous *Report*, the average annual dynamics of potential GDP were revised slightly downwards for 2024 and over the projection interval. This reassessment reflects the persistent effects of the recent worsening in net investments in the economy, as well as the assumption of a slightly lower impact from investments financed via the Next Generation EU programme. However, the average annual growth rate of the indicator is estimated to post relatively high values over the projection period, but this is largely contingent on the progress to be made in attracting and managing European funds.

The key driver of potential GDP dynamics will continue to be capital accumulation, supported by the remarkable performance of investment particularly in 2023, even though in 2024 gross fixed capital formation slowed down. Over the medium term, the seemingly favourable outlook is strictly conditional on the absorption and efficient use of inflows of foreign direct investment and EU funds, in particular those under the Next Generation EU programme. This component's developments are affected by the government measures taken via GEO No. 156/2024 on changes to the corporate tax regime. Nevertheless, capital stock accumulation could benefit from the initiatives recently announced by the European Commission to expand the capacity of the European Union's defence industry, although tangible effects are expected to be seen mainly from 2026 onwards. The materialisation of these initiatives could also generate favourable effects on the allocation efficiency of production factors, by spreading productivity gains horizontally across the economy. The contribution of the TFP trend is however affected by companies' relatively lacklustre performance in identifying

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[78] The Multiannual Financial Framework 2021-2027 and the Next Generation EU programme (2021-2026)

innovative solutions, also in terms of integrating digitalisation into their activity[79]. Over the medium term, this component is set to somewhat recover, mirroring the firms' efforts to capitalise on innovation opportunities[80] and to align with the technology integration and energy efficiency[81] trends. In this context, enhancing the access to financing sources supported by European Commission programmes, such as the Just Transition Fund, InvestEU or the Recovery and Resilience Facility (RRF), could expedite the modernisation and digitalisation of production, with beneficial effects on the competitiveness of the Romanian economy. The contribution of labour is anticipated to remain only moderately positive, gradually shrinking over the longer term due to the persistently unfavourable demographic developments in Romania, in particular the decline in the working-age population aged 15 to 74, as well as to social ones, e.g. the low youth employment rate[82]. An analysis based on a microeconomic approach of the impact that total factor productivity dynamics have on the labour market is presented in Box 2.

Box 2. The impact of total factor productivity dynamics on the labour market. A microeconomic approach

The impact of technological innovation and, more recently, of digitalisation on the labour market is a topic of major importance, being intensely debated as early as the First Industrial Revolution. In Romania's case, digitalisation is a key pillar of the National Recovery and Resilience Plan (NRRP), benefiting from substantial EU funds allocations, also under the Next Generation EU programme. Moreover, it is a strategic priority for key companies in Romania, which aim at restructuring and increasing their operational efficiency[83].

Given the limitations of direct data on the degree of digitalisation at firm level, the analysis presented in this box builds on an indirect approach. It uses total factor productivity (TFP) as a proxy to capture these changes and to estimate their potential effects on the dynamics of employment, on the share of wage earnings in gross value added (labour share) and on the average wage.

Even though economic theory tends to consider TFP a measure of technological progress and efficiency, the indicator estimated in this analysis is a residual that includes everything that is not gauged – not only innovation, but also, for instance, management quality, the allocation efficiency of production factors, learning

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[79] According to the European Innovation Scoreboard 2024, Romania is still an Emerging Innovator, coming in last EU-wide. At the same time, among its peers, a poorer performance versus 2023 is recorded only in the case of Romania.

[80] In March 2025, the European Institute of Innovation and Technology (EIT) launched the EIT Community Hub in Romania, part of a network containing 17 European hubs aimed at supporting the development of local ecosystems and facilitating access to funding, partnerships, and international expertise, in order to narrow regional innovation gaps.

[81] Government Decision No. 1491/2024 (on Romania's Energy Strategy for 2025-2035, with a perspective towards 2050) aims to develop the energy sector under conditions of security, low carbon emissions, energy efficiency, competitiveness, development of smart grids and cybersecurity.

[82] The share of young people aged 16-29 neither in employment, nor in education and training (NEET) posted one of the highest values across the EU in 2024 (19.4 percent, compared to the 11 percent EU average).

[83] See, for instance, the voluntary separation programme of Dacia car plant: https://economedia.ro/uzina-dacia-a-lansat-un-program-de-plecari-voluntare-prime-cuprinse-intre-16-000-lei-si-130-000-lei-net-pentru-angajatii-care-pleaca-singuri-din-fabrica-sunt-vizati-angajati-din-zona-de-digitalizar.html

effects or even data measurement errors. In this vein, Autor and Salomons (2018) clearly state that TFP may increase also for non-technological reasons: better human capital, market access, industrial reorganisation, institutions, etc., factors that are hard to measure distinctly.

Chart A. Dynamics of TFP and of some labour market indicators
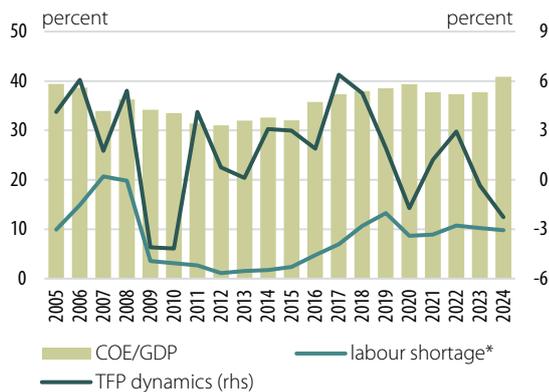
*) series calculated based on data from DG ECFIN surveys representing the share of answers of companies economy-wide (manufacturing, construction, services) citing labour shortage as a factor that constrains their economic activity.

Note: COE/GDP is the share of compensation of employees in GDP.

Source: Eurostat, AMECO, DG ECFIN, NBR calculations

The indicators shown in Chart A highlight a number of phenomena relevant to this analysis. Despite being naturally synchronised with the business cycle, TFP dynamics (according to AMECO data of the European Commission) saw significant fluctuations in the period under review, being partly correlated with labour shortage indicators, even though the relationship is not linear. Thus, following the Great Recession, during 2011-2015 TFP grew at robust rates – albeit lower than those in 2005-2008[84] –, while labour shortage remained relatively low, amid the structural adjustments in the economy, also through a decline in the share of compensation of employees (COE) in GDP (COE/GDP).

In view of the fiscal easing of 2015-2016, TFP dynamics stepped up again, in parallel with an increase in labour shortage and a sustained rise in wages, mirrored by the higher COE/GDP ratio.

The post-pandemic period (2021-2022) witnessed a fast recovery of total factor productivity, followed however by a deceleration in its pace of growth and the stabilisation of labour shortage at slightly lower levels than those prevailing before the pandemic. Overall, the relationship between TFP and compensation of employees is not clearly defined, being influenced by multiple demand- and supply-side shocks (e.g. demand shocks associated with the Great Recession and post-pandemic supply shocks linked to energy prices and disruptions in global supply chains), as well as by persistent structural factors (emigration, population ageing, poor infrastructure). This context warrants the examination of microeconomic relations for a better understanding of the underlying mechanisms.

The analysis uses data from the balance sheets of non-financial corporations in Romania for the period between 2008 and 2023. The goal is to estimate the relationship between TFP dynamics and the changes in several key labour market indicators at firm level: number of jobs, labour share and the average wage[85]. TFP was estimated at firm level as a residual of a Cobb-Douglas production function[86], using sectoral estimates (NACE division) of the elasticities of production factors (labour and capital).

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[84] This might owe to lower technology diffusion from foreign companies to domestic firms via the latter's integration in global value chains (GVC) (Chiacchio, Gradeva and Lopez-Garcia, 2018).

[85] Calculated, at firm level, by dividing labour costs by the number of employees

[86] TFP was calculated as a residual (TFP = GVA – α*L – β*K) at firm level, where L and K stand for labour and capital stock, respectively, and α and β for the related elasticities of the two production factors. In addition, a Cobb-Douglas production function with constant returns to scale ($\alpha+\beta=1$) was assumed. In fact, some economic sectors might have increasing returns (for instance, "network" effects) or decreasing returns, yet, even in this case, residual TFP might include these scale effects as well.

In order to estimate TFP and the production function, the methodology proposed by Levinsohn and Petrin (2003) was employed. This uses the rate of change of costs of raw materials and materials as a proxy to solve the simultaneity problem between inputs and output, the latter measured as GVA in this case. In this vein, the methodology allows for obtaining more reliable estimators, avoiding a statistical bias (distorted coefficients), given that more productive companies tend to use more capital and labour, which would implicitly result in a correlation between inputs and the unobserved productivity shock (TFP)[87].

Table A. Estimation results

	No. of employees dynamics	Labour share dynamics	Average wage dynamics
TFP dynamics	-0.138*** (0.003)	-0.541*** (0.012)	0.111*** (0.006)
Turnover dynamics	0.398*** (0.003)		
Turnover dynamics > 20%	0.03*** (0.002)	0.062*** (0.002)	
GVA dynamics		-0.176*** (0.012)	
Average wage (t-1)			-0.234*** (0.004)
No. of employees (t-1)			0.06*** (0.005)
R^2	0.237	0.557	0.27

( ) standard deviations, heteroscedasticity robust

* $p<0.10$, ** $p<0.05$, *** $p<0.01$

Notă: Observations weighted by the number of employees of the company in a given year. All regressions include control variables for firm age and size, NACE division and observation year. Variables are expressed in logarithmic form, except for binary variables and the dynamics of number of employees. The latter dynamics are calculated relative to the average between the observation in the said year and that in the preceding year. The variable "turnover dynamics>20%" takes the binary form, referring to a company whose turnover dynamics exceed 20 percent in a given year.

Source: MF, Eurostat, NBR estimates

The econometric analysis covering non-financial corporations in Romania over the period 2008-2023 (Table A) shows a slightly negative average impact of TFP growth on the dynamics of the number of employees (column 1)[88], even though the magnitude of this effect depends on the specification of the model and the control variables employed. In addition, an increase in TFP is associated with a lower labour share (column 2)[89], similarly to the finding of Autor and Salomons (2018) for 2007-2015. These results remain robust to alternative specifications[90]. At the same time, estimations (column 3) suggest a positive, albeit moderate[91], relationship between TFP growth and wage dynamics, pointing to a partial sharing of productivity gains with employees.

These findings are in line with a literature with heterogeneous conclusions on the impact of automation and technological progress on the labour market. Some historical studies or with a focus on certain technologies (e.g. industrial robots) highlight positive effects on productivity, wages and even on overall employment or of high-skilled workers (Alexopoulos and Cohen, 2016; Graetz and Michaels, 2015). However, other research papers underline the negative influence on

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[87] The Levinsohn and Petrin method addresses the simultaneity problem, yet it does not automatically adjust also for firm selection, i.e. the fact that certain inefficient companies may exit the market. For this reason, reducing the sample to a balanced panel may introduce a slight bias in the TFP distribution, the average TFP of still operating firms being higher. Nevertheless, in this analysis, the said effect is not assumed to qualitatively alter the results.

[88] A 1 percentage point increase in TFP dynamics is associated with an approximately 0.1 percentage point decrease in the dynamics of the number of employees.

[89] Thus, a 1 percentage point step-up in TFP growth is linked to an around 0.5 percentage point slowdown in the rate of change of labour share.

[90] Which imply, for instance, various combinations of fixed effects or substituting some control variables for similar ones, etc.
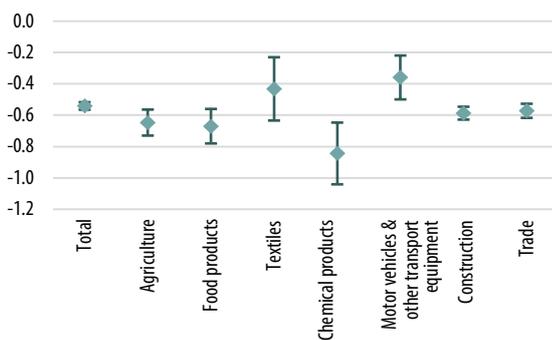
[91] A 1 percentage point acceleration in TFP dynamics is associated with an about 0.1 percentage point faster growth of average wages at firm level.

employment of medium-skilled workers (Gregory, Salomons and Zierahn, 2016) or the critical part played by technology in the decrease of labour share in GDP by replacing routine tasks (Dao *et al.*, 2017; Autor and Dorn, 2013) or even declines in employment and wages in areas more exposed to automation (Acemoglu and Restrepo, 2020). Recent studies that use TFP as a proxy for technological progress (Autor and Salomons, 2018; Stehrer, 2022), similarly to this analysis, tend to confirm a negative impact on labour share, as well as an inconclusive or even slightly positive effect on overall employment, possibly owing to competitiveness gains.

Sectoral results show a certain heterogeneity regarding the impact of TFP dynamics on labour share (Chart B). The effect seems to be stronger in sectors such as agriculture, the food industry, and the chemical industry. By contrast, in the labour-intensive textile industry[92] or in the manufacture of motor vehicles and other transport equipment (undergoing worldwide restructuring), the estimated impact is slightly weaker compared to the sample average. However, it should be mentioned that a lower estimated coefficient (in absolute terms) for certain sectors does not necessarily imply a low level of automation; in the period under review (2008-2023) the existence of some labour shortages in these sectors[93] may have offset, on average, the downtrend of labour share driven by TFP growth.

In conclusion, the econometric analysis suggests that the impact of the increase in total factor productivity (TFP) on the labour market in Romania is complex. Estimations indicate a negative effect on the labour share and a slightly negative impact on the dynamics of the number of employees. By contrast, TFP growth is correlated, on average, with mildly positive wage dynamics. This may suggest that productive firms have a strategy to manage labour market constraints (such as labour shortage[94], although recently on a decline) by increasing efficiency, namely allowing for activity to continue or expand without a proportional increase in employment.

Chart B. The impact of TFP dynamics on the labour share in GVA (sectoral perspective)

Note: The chart shows the coefficients related to the impact of TFP dynamics on the dynamics of the labour share in GVA (column 2, Chart A) for several sectors of the economy. The points represent the values of the estimated coefficients, whereas the segments show the associated confidence intervals (95 percent). "Agriculture" includes NACE Rev. 2 divisions 1-3, "Manufacture of food products", divisions 10-11, "Manufacture of textiles", divisions 13-15, and "Manufacture of motor vehicles and other transport equipment", divisions 29-30.

Source: MF, Eurostat, NBR estimates

In terms of practical implications, the results support the idea that public policies can drive productivity growth (via digitalisation and innovation) in response to structural labour market challenges, including demographic ones. Nevertheless, given the estimated negative effect of TFP on labour share, it is essential that

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[92]   For a sectoral analysis on the textile industry, see Box 5 entitled "Long-term growth drivers in the textile industry in Romania", published in the NBR's 2020 *Annual Report*.

[93]   See the conclusions of the study conducted by the Automobile Manufacturers' Association of Romania (ACAROM, 2021), available at: https://acarom.ro/studiu-acarom-72-dintre-manageri-gasesc-cu-greu-angajati-specializati-in-industrie/

[94]   For an analysis on the effect of labour shortage on wages, number of employees, and inflation, see the Box entitled "The effect of labour shortages on wage growth and number of employees" in the August 2024 *Inflation Report* and Box 1 entitled "The inflationary impact of labour shortage" in the November 2024 *Inflation Report*.

these productivity-boosting policies be accompanied by complementary measures to address the potential distributional implications and to mitigate the risk of increasing income inequality.

However, for a better understanding of TFP effects on the labour market, future research is necessary to overcome current data limitations. It would be useful to differentiate the impact of TFP depending on employees' skill level, in order to capture the redistributive effects of technological progress. Moreover, analysing the diffusion of innovation among firms along the value chains may offer additional insights on the way in which productivity gains pass through into the economy.

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The path of potential GDP remains subject to significant downside risks stemming from the high level of both domestic and external uncertainty. These uncertainties are fuelled by the persistence of geopolitical tensions and, more recently, by the intensification of protectionist measures in international trade, which may lead to renewed disruptions in global supply chains.

The output gap trajectory was revised compared to the previous round, mainly due to the significantly higher budget deficit recorded in 2024. The associated stronger fiscal impulse resulted in an upward revision of the output gap during 2024 H2 and the first

three quarters of 2025. Subsequently, however, starting in 2026 the projection points to a more negative output gap than previously expected. Similarly to the assessment in the prior *Report*, the indicator is estimated to fall below zero as of 2025 Q1 and to deepen further, hitting lows between 2025 Q4 and 2026 Q2. Thereafter, it will gradually narrow until the end of the forecast horizon, i.e. 2027 Q1. These envisaged developments of the output gap reflect predominantly the fiscal policy stance and the considerable restrictive impact exerted by the fiscal impulse, which dampens the projected GDP dynamics (Chart 4.7)[95].

Chart 4.7. Output gap

% of potential GDP
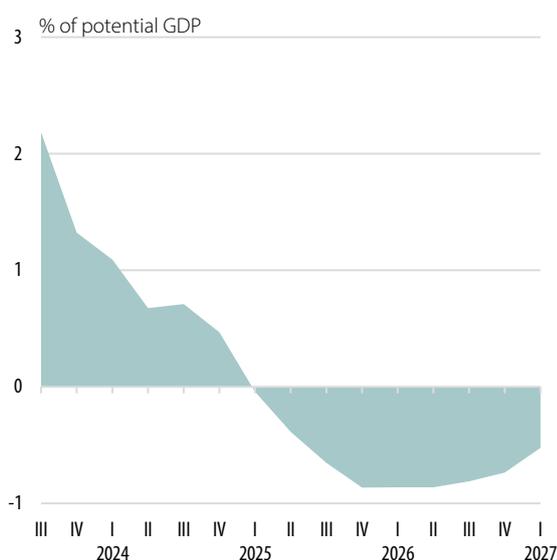
Source: NBR assessments based on data provided by the NIS

In terms of fundamentals, the output gap path reflects: (i) primarily the fiscal impulse, which is assessed to exert a large restrictive impact (given the entry into force, as of 1 January, of the fiscal consolidation package under GEO No. 156/2024); this effect is only partly mitigated by favourable factors such as the anticipated, though slightly slower absorption of Next Generation EU funds, and (ii) the short term deepening, and subsequent persistence of the negative external demand gap. Moreover, real broad monetary conditions are assessed to preserve their restrictive nature throughout the projection interval.

Aggregate demand components

The average annual growth rate of household final consumption is projected to slow down both this year and the next. These expected developments in consumption mainly reflect the slowdown in the dynamics of households' real disposable income. This is due both to the impact of the extensive fiscal measures set out in GEO No. 156/2024, which entered into force on 1 January 2025 and affects a broad range of consumers, and to the anticipated hike in the electricity price in July 2025, following the expiry of the current capping scheme. In addition, a moderating consumption trend cannot be ruled out, amid elevated uncertainty surrounding the effects of the protectionist trade measures imposed by the U.S. administration, particularly in the event of their escalation. However, the further gradual disinflation is likely to provide support for consumption dynamics over the medium and long term.

After an exceptional quarterly decline in gross fixed capital formation at the end of the previous year, which contributed to a contraction in this component for 2024 as a whole, its average annual dynamics are expected to be adversely affected throughout 2025 by notable carry-over effects. Over the medium term, investment dynamics are forecasted to return to robust growth rates. The projected path of investments (gross fixed capital formation) is strictly dependent on investor confidence, given that

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[95] In terms of components, the output gap path mirrors: (i) the swift narrowing, and even the turning negative as of 2026 Q2 of the gap of households' actual individual consumption, concurrently with (ii) the short-term widening of the strongly negative GFCF gap and its further persistence in negative territory for most of the projection interval, albeit on the wane, and (iii) the export gap remaining in negative territory, although narrowing as well.

the outlook for investment in Romania is affected by the existing macroeconomic imbalances and the persistence of political uncertainty. Moreover, a key role is attached to the authorities' conduct in carrying out investment projects financed from both own and borrowed sources, as well as from non-repayable external funds. With respect to EU funds, particular attention is paid to the implementation of the Next Generation EU programme. Considering Romania's limited progress in absorbing these funds over the past years, any further delays risk to significantly narrow the window of opportunity for the full use of the allocated amounts, given the strict deadline for the completion of the programme, i.e. the end of 2026. At the same time, companies' investment plans could be significantly reassessed in the event of additional fiscal consolidation measures being adopted, especially if these include tax regime changes.

After the 2024 contraction, exports of goods and services are envisaged to remain almost flat in 2025. Thus, a recovery in this component is expected to take place mainly in the following year, in the context of a still subdued outlook for external demand developments in the short term and even revised downwards since the previous round. The component's trajectory continues to be affected over the medium term by the uncertainty surrounding global geopolitical tensions and the trade related ones stemming from the protectionist measures adopted by the US. The persistence or even heightening of these trade tensions could lead to renewed bottlenecks in global supply chains and to disruptions in international trade flows. The real effective exchange rate (deflated by the CPI growth rates in Romania and its trading partners) is envisaged to remain overvalued until the forecast horizon, and thus to further exert, *ceteris paribus*, restrictive effects on the price competitiveness of Romanian products, albeit gradually on the wane. Imports of goods and services are expected to post robust dynamics, reflecting the developments in domestic demand components. Under these circumstances, the contribution of net exports to economic growth is projected to remain negative throughout the forecast horizon, improving, however, against the previous year.

The year 2024 ended with a current account deficit of 8.4 percent of GDP. Over the medium term, it is anticipated to continue to post high values, following only a slightly downward path that reflects the ongoing fiscal consolidation process, albeit marked by multiple uncertainties. Further steps to accelerate the budget deficit correction could in turn trigger a more pronounced downward adjustment of the current account deficit. By contrast, upside risks to the external balance are generated by a potential escalation of tariffs, which could lead to a more severe worsening of export dynamics compared to the assumptions in the baseline scenario, as well as to an increase in the nominal value of imports, especially under the assumption that the European Union adopts retaliatory measures.
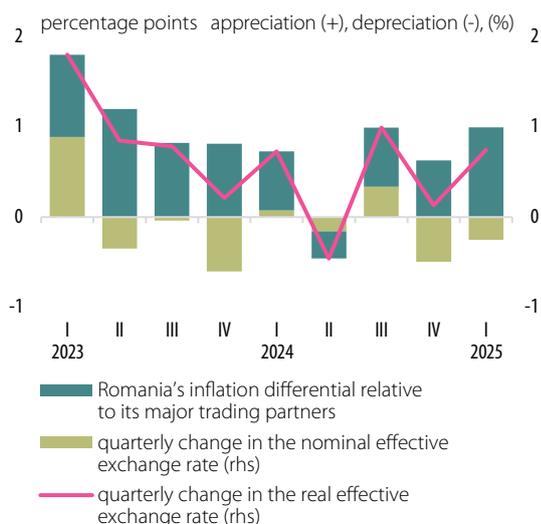
The low degree of current account deficit coverage by stable (non-debt-creating) sources in 2024 mirrored the correlation between the widening external imbalance and the declining capital inflows in the form of transfers and foreign direct investment (equity and reinvestment of earnings). Over the medium term, the projection assumes a gradual improvement in the ratio of external deficit financed by such sources. However, this is conditional on the assumption of significant EU funds being attracted through NRRP and MFF 2021-2027, thereby countering the end of funds absorption

under the 2014-2020 financial framework. At the same time, foreign direct investment is expected to further exceed its pre-pandemic levels in absolute terms, although its outlook remains subject to heightened uncertainty. The new trade protectionism measures may impact companies' investment plans, while the slow pace of fiscal consolidation and the modest progress in implementing reforms and absorbing NRRP funds could be additional obstacles to attracting FDI and improving foreign investor sentiment.

Broad monetary conditions

According to the transmission mechanism, broad monetary conditions capture the cumulative impact exerted on future developments in aggregate demand by the real interest rates applied by credit institutions on leu- and foreign currency-denominated loans and deposits of non-bank clients, and by the real effective exchange rate of the leu. The exchange rate exerts its influence via the net export channel, as well as via companies' wealth and balance sheet effect.

Chart 4.8. Quarterly change in the effective exchange rate

percentage points   appreciation (+), depreciation (-), (%)

■ Romania's inflation differential relative to its major trading partners
■ quarterly change in the nominal effective exchange rate (rhs)
— quarterly change in the real effective exchange rate (rhs)

Source: Eurostat, U.S. Bureau of Labor Statistics, NBR, NBR calculations

The baseline scenario of the projection envisages that real broad monetary conditions will continue to be restrictive over the entire forecast interval. These developments mirror the gradual pass-through into the economy of the NBR Board's previous monetary policy decisions, which are calibrated to ensure and maintain price stability over the medium term, in a manner conducive to achieving sustainable economic growth.

Looking by component, the real effective exchange rate (Chart 4.8) will continue to exert, *ceteris paribus*, restrictive effects on the price competitiveness of Romanian products, which are seen gradually waning, yet with a still significant impact via the net export channel. The contribution of the real effective exchange rate is further estimated in the context of the past appreciation of the domestic currency in real terms, determined by the prevailing effect of the higher domestic inflation rate compared to those of Romania's trading partners and by the strengthening in nominal terms against the US dollar. Conversely, real interest rates on both new loans and new time deposits in lei are anticipated to have rather neutral influences throughout the forecast interval. This is projected to take place as monetary policy decisions pass through to nominal interest rates, along with a downward trend of inflation expectations.

The wealth and balance sheet effect is foreseen to further post restrictive values, albeit gradually on the wane throughout the projection interval. The breakdown shows that its dynamics mainly mirror the downward path of the real foreign interest rate (3M EURIBOR), given the gradual decline of the nominal rate, the effect of which is partly offset by the falling inflation expectations in the euro area. Moreover, the sovereign risk premium for Romania is projected to exert a restrictive impact, reflecting

the imbalances associated with the twin deficits in the economy, as well as the high uncertainty surrounding the evolution of trade disputes. The dynamics of the leu's real effective exchange rate gap are seen to exert a quasi-neutral effect via the wealth and balance sheet effect.

2. Risks associated with the projection

The current assessment continues to point to a balance of risks to the annual inflation rate projection tilted to the upside (Chart 4.9), despite some risks that have already materialised since the previous *Report* being factored into the baseline scenario. Thus, the baseline scenario already incorporates some effects of increased trade protectionism, but the uncertainty surrounding this channel remains elevated. On the domestic front, significant sources of risk are associated with the evolution of electricity and natural gas prices amid the ending of the related price capping schemes, as well as with the future stages of fiscal consolidation. Moreover, in the electoral context prevailing upon the completion of the analysis in this *Report*, additional uncertainties were emerging about both the possible short-term reactions of financial markets – including on the dynamics of the leu's exchange rate, yields on government securities and interbank rates, the sovereign risk premium or asset volatility – and the possible implications, over the medium and long term, on the design and continuity of fiscal and structural policies.

Chart 4.9. Uncertainty interval associated with inflation projection in the baseline scenario

%, end of period

multiannual flat inflation target: 2.5% ±1 pp

III IV I II III IV I II III IV I
2025   2026   2027

uncertainty interval
annual inflation rate
variation band

Note: The uncertainty interval was calculated based on the annual CPI inflation forecast errors in the NBR projections during 2005-2024. The magnitude of forecast errors is positively correlated with the time horizon they refer to.

Source: NIS, NBR calculations and projections

The fiscal consolidation process and the compliance with the budget deficit adjustment path committed to by the authorities under the *National Medium-Term Fiscal-Structural Plan* play a decisive role in charting the inflation trajectory. This may require further corrective measures, apart from those already taken, whose impact on the inflation rate would depend on their nature, namely upwards in the event of indirect tax rate increases (mainly VAT), or downwards amid contained budget expenditures or the hike in direct tax rates.

Possible deviations from the officially announced fiscal consolidation path could trigger reactions from the European Commission, without ruling out the possibility of sanctions that could include the partial suspension of access to EU funds. Independent of this risk, uncertainties continue to cloud the domestic administrative capacity to effectively absorb available funds. Moreover, the delay in the correction of the excessive budget deficit could lead to difficulties in its orderly financing, amid the already deteriorating outlook on Romania's sovereign risk rating, the recent hike in the risk premium and potential pressures on the leu's exchange rate, possibly stemming from multiple sources. In such a context, a further depreciation of the domestic currency could act as an adjustment mechanism for external imbalances,

insofar as they are not corrected by structural measures adopted by the authorities, but could also enhance inflationary pressures, through the import price channel.

The external environment also remains highly volatile. The US administration's trade policy has recently generated significant turmoil in international markets, amplifying the uncertainty about the level and applicability of customs tariffs, as well as about the possible exemptions that could be considered. On the other hand, retaliatory measures from the European Union cannot be ruled out; these could put additional inflationary pressures by raising the prices of imported goods. At the same time, a possible fragmentation of international trade – including by reshaping bilateral relations – could have disinflationary effects, for example by prompting Asia to redirect exports to the European market.

A possible stagnation or deceleration of global economic activity would also act in the same direction. The impact of increased protectionism would depend on the degree of trade exposure of each economy to the United States, but the effects would also be passed on indirectly – via exports of intermediate goods to third-party trading partners and through productivity losses at firm level, as a result of heightened uncertainty and postponed investment decisions. In the case of Romania, while direct effects are assessed to be limited, indirect effects could be significantly larger.

The macroeconomic outlook continues to be negatively impacted by the persistent geopolitical tensions, which have recently led, *inter alia*, to increased military procurement efforts by Member States. At European level, additional uncertainties are associated with the implementation of the *Readiness 2030* plan, which could involve additional fiscal measures. At the same time, on the domestic front, there is further an urgent need for fiscal consolidation and for ensuring the sustainability of public debt.

A possible further slowdown in the global economy could trigger downward corrections in international oil and other commodity prices, with a disinflationary potential. By contrast, domestically, after the expiry of capping schemes, the risks associated with final energy prices have a rather inflationary potential. In the case of electricity, the current mechanism is set to expire at the end of June and available market offers suggest significant inflationary pressures. Depending on the magnitude of these price increases, the direct impact could be enhanced by indirect effects via production costs, as well as by second-round effects via inflation expectations.

In the case of agri-food items, prices could be adversely impacted by unfavourable weather conditions, including extreme events, the frequency of which has been increasing in recent years. In addition, there are uncertainties about the emergence of new outbreaks of African swine fever and, at regional level, of possible outbreaks of foot-and-mouth disease. In the medium term, further inflationary pressures could stem from the implementation of climate transition policies, in particular those aimed at decarbonising the economy, although their effects are less likely over the eight-quarter horizon envisaged in the projection.

As in the previous rounds, labour market developments remain relevant. In the public sector, risks are attributed to a moderation in the wage bill over the medium term in

order to meet the fiscal targets committed to. In the private sector, possible changes in the wage tax regime could lead to wage adjustments necessary to preserve the employees' net income level, likely to be partly passed on in the final prices of goods and services. Over the medium term, additional inflationary pressures may stem from wider structural imbalances in the labour market, especially the skills mismatch.

Abbreviations

CPI	consumer price index
DG ECFIN	Directorate General for Economic and Financial Affairs
EC	European Commission
ECB	European Central Bank
EU	European Union
Eurostat	Statistical Office of the European Union
FAO	Food and Agricultural Organization of the United Nations
FDI	Foreign Direct Investment
GDP	gross domestic product
GVA	gross value added
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Office
MF	Ministry of Finance
MFF	Multiannual Financial Framework
NBR	National Bank of Romania
NIS	National Institute of Statistics
NRRP	National Recovery and Resilience Plan
OPEC	Organisation of the Petroleum Exporting Countries
ROBOR	Romanian Interbank Offer Rate
TFP	total factor productivity
UVI	unit value index
VAT	value added tax
VFE	vegetables, fruit, eggs
WB	World Bank
3M	3 months
12M	12 months
3Y	3 years
5Y	5 years
10Y	10 years

Tables

Charts