

NATIONAL  
BANK OF  
ROMANIA

# Inflation Report

## February 2025

Year XXI, No. 79

# Inflation Report

## February 2025

## **NOTES**

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.

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# 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 most recent 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 14 February 2025 and the cut-off date for the data underlying the macroeconomic projection was 6 February 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

At end-2024, the annual CPI inflation rate went up to 5.14 percent, i.e. 0.52 percentage points above the level seen at the end of the previous quarter. Behind the upward path stood solely the exogenous components of the consumer basket, namely energy prices, especially fuel prices, amid the strengthening of the US dollar and the episodic increase in the oil price in October. Conversely, volatile food prices, which posted notable rises during Q3, partly offset, over the last three months of 2024, the adverse impact exerted by energy prices. At the same time, the annual adjusted CORE2 inflation rate remained flat at around 5.6 percent during Q4, as a result of the combined influence of several factors that acted in both directions. The average annual inflation rate continued to decline, with the indicator calculated based on the national methodology (CPI) falling to 5.6 percent and the indicator calculated in accordance with the harmonised structure (HICP) going down to 5.8 percent at end-2024. Thus, during Q4 the correction was approximately 0.5 percentage points for each indicator. Under the circumstances, the differential with the EU average narrowed to 3.2 percentage points in December, 0.4 percentage points lower than at the end of Q3, reflecting further a slightly slower disinflation in Romania.

After the marginal drop (of merely 0.1 percentage points) in Q3, the annual adjusted CORE2 inflation rate remained flat at 5.6 percent in Q4. During this period, the dynamics of this indicator were influenced by both supply- and demand-side factors that acted in opposite directions. Thus, on the one hand, the increase in agri-food commodity prices, which has steepened recently, started to reflect in the steady advance in the annual growth rate of domestic industrial producer prices for food items. On the other hand, the dynamics of non-food and market services prices remained on a downward path. Both segments were further affected by increasingly less favourable demand conditions. Nevertheless, the pace of disinflation posted by the two sub-components is relatively sluggish and even slower in the case of non-food prices, after losing the support of import prices. In the services segment, disinflation is slowed down by the persistence of labour cost pressures, as this segment is among the most labour intensive across the economy. Moreover, short-term expectations on price developments adjusted slightly upwards in Q4, with trade posting a higher increase in the balance of answers, in correlation with the upward trajectory in the volume of sales.

The annual dynamics of unit labour costs economy-wide remained elevated in 2024 Q3, in spite of a certain moderation. The faster increase in compensation per employee (19.1 percent, +2.8 percentage points) was somewhat counterbalanced by labour productivity growth rate returning to positive territory, yet the gap between the two indicators continues to be significant. The breakdown shows that professional activities and administrative services made a larger contribution to the slight improvement

in productivity. In industry, the annual growth rate of unit wage costs moderated to 12.2 percent October through November 2024, after a pick-up to 18.5 percent in Q3; in October-November, domestic production made a comeback after a period of contraction, being accompanied by a slowdown in the wage dynamics.

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

In its meeting of 8 November 2024, 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 fell to 4.62 percent in September from 5.10 percent in August 2024. The decrease was mainly driven by lower fuel and energy prices, especially amid the drop in crude oil prices, which outweighed the impact of the new increases seen this month in food and tobacco product prices. In turn, the annual adjusted CORE2 inflation rate slowed its downward trend in 2024 Q3 as a whole, also compared with the forecast, reaching 5.6 percent in September from 5.7 percent in June. The deceleration was further driven by the disinflationary base effects in non-food sub-components and by the decrease in import price dynamics. The influence of these factors was substantially mitigated over this period by the unfavourable statistical effect in the processed food segment and by the hike in some agri-food commodity prices, as well as by 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.

Significant uncertainties and risks stemmed from the future fiscal and income policy stance, given the fiscal-budgetary measures that might have been implemented as of 2025 for budget consolidation purposes. Labour market conditions and wage dynamics in the economy also remained a source of uncertainties and risks. At the same time, significant uncertainties were further associated with developments in energy and food prices, as well as with the future path of crude oil prices amid geopolitical tensions. Heightened uncertainties and risks to the outlook for economic activity, implicitly the medium-term inflation developments, continued to arise from the war in Ukraine and the Middle East conflict, as well as from the economic performance in Europe and globally, in the context of escalating geopolitical tensions. 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. 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 rose higher than expected over the past three months of 2024, up to 5.14 percent in December, from 4.62 percent in September. The advance versus end-Q3 was driven mainly by higher fuel prices – primarily as a result of the significant appreciation of the US dollar on the international financial market –, and to a small extent by the new increases in food prices, amid the severe drought in the summer of 2024 and the hike in some commodity prices. At the same time,

the annual adjusted CORE2 inflation rate saw a halt in its downward trend in 2024 Q4, remaining flat at 5.6 percent until December, i.e. a level similar to that at end-Q3. This was ascribable to the opposite influences coming over this 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. In turn, economic activity stalled in 2024 Q3, after increasing by 0.1 percent in the previous three months (quarterly change), which made it likely for excess aggregate demand to have further narrowed over this period too. Annual GDP growth stepped up to 1.2 percent in 2024 Q3 from 0.9 percent in the previous quarter. The annual rate of increase of household consumption remained fast-paced over this period, albeit it slowed down compared to Q2, while the annual dynamics of gross fixed capital formation continued to see a relatively steep decline, reaching a nine-quarter low. Net exports exerted, however, a considerably lower contractionary impact in 2024 Q3 amid a somewhat faster decrease in the annual change in the import volume of goods and services, which nevertheless remained in positive territory. Consequently, the trade deficit and current account deficit posted significantly slower annual growth rates compared to the previous quarter.

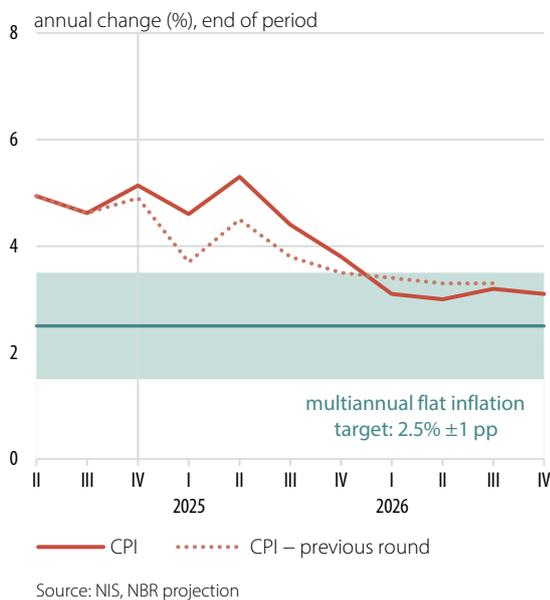
At the time of the NBR Board meeting of 15 January 2025, the latest assessments reconfirmed the prospects for the annual inflation rate to decline in the first three months of 2025, yet on a higher-than-previously-anticipated path. The decrease would result primarily from sizeable base effects and the deceleration in import price growth, yet amid the persistence of opposite effects exerted on food and energy price dynamics by the 2024 unfavourable weather conditions and by the increase in some commodity prices, as well as by the higher energy consumption over the winter months. The previously identified risk and uncertainty factors remained relevant.

Based on the data and assessments available at that time, as well as in light of the elevated uncertainty, the NBR Board decided in the meeting of 15 January 2025 to keep the monetary policy rate at 6.50 percent per annum. Moreover, it decided to leave unchanged the lending (Lombard) facility rate at 7.50 percent per annum and the deposit facility rate at 5.50 percent per annum.

## **Inflation outlook**

Global economic activity remained fairly resilient in the face of multiple supply-side shocks in recent years, although the developments across the region are still divergent somewhat. Specifically, while the US economy continues to expand at a relatively sustained pace, the growth outlook for the euro area economy was revised downwards in the context of geopolitical tensions and a more sluggish manufacturing sector. At the same time, global disinflation carried on, but in some economies inflation is further elevated and rather persistent, amid a budding slowdown in wage dynamics and a gradual normalisation of labour markets. In the euro area, the ECB's latest projections point to a gradual convergence of inflation towards the target over the medium term, albeit at differentiated rates across its main components.

### Inflation forecast



Thus, goods price inflation has already neared the 2 percent threshold, while services inflation is persistently high.

According to the updated baseline scenario of the projection, after standing at 5.14 percent in December 2024, the annual CPI inflation rate in Romania will embark on a mostly downward course in 2025, yet it is expected to stabilise in the course of next year. At the same time, until 2025 Q3, the path of CPI inflation will be marked by two-way swings, chiefly triggered by base effects. Specifically, inflation is expected to fall to 4.6 percent in March 2025, partly underpinned by the exit from the calculation base of the impact of the VAT and excise duty hikes in January 2024. Subsequently, the indicator will rise temporarily and reach 5.3 percent in June 2025, amid the fading-out of the impact of significant cuts in electricity and natural gas prices made in the same

year-ago period. Starting with 2025 Q3, inflation will return below 5 percent and will decline to 3.8 percent at end-2025. From 2026 Q1, it will re-enter the variation band of the target and come in at 3.1 percent in both March and December 2026.

Although the path of the annual headline inflation rate during 2025 remains broadly similar to that anticipated in the previous *Report*, the updated projection reveals upward revisions. They are driven, on the one hand, by the mild increase in the projection for the adjusted CORE2 index, due to persistent pressures in the food commodity segment and still strong wage dynamics, which will continue to feed through to goods and services prices, especially in labour-intensive sectors. On the other hand, a number of unanticipated price hikes have been recorded or announced recently for some exogenous subcomponents of the CPI basket, such as cigarettes, water, sewerage and sanitation, as well as fuels. Although these rises refer strictly to a few particular items, they will influence the annual CPI inflation rate over 12 months, thus leading also to an upward revision of the end-2025 inflation projection (by 0.3 percentage points as against the latest *Report*).

The forecast for the annual adjusted CORE2 inflation rate was adjusted marginally upwards for the end of this year, to 3.7 percent from 3.5 percent in the previous *Inflation Report*, yet over the medium term the indicator is revised downwards and the pace of disinflation is quicker. Thus, the indicator is seen falling to 3.4 percent in March 2026 and thereafter to 2.9 percent in December 2026. The ongoing downward trajectory of the annual core inflation rate will be driven by the gradual adjustment of inflation expectations, the easing of pressures from import prices, as well as by the effects of the authorities' recent fiscal consolidation measures. Against this backdrop, the emergence early this year of an aggregate demand deficit (negative output gap) in the economy will be a key factor in the correction of the adjusted CORE2 inflation, with broader cumulative effects especially in the course of next year.

In Romania, after the slowdown in economic activity in 2023, when the average annual growth rate slipped to 2.4 percent, GDP dynamics further lost momentum in 2024, with the latest official data pinpointing a contraction in the annual rate to 1.2 percent in Q3. Sectoral developments between October and December 2024 hint at positive annual GDP dynamics in Q4 as well. For 2024 as a whole, GDP growth is estimated to stand in the vicinity of 1 percent, implying a new deceleration compared to 2023. This development is driven, *inter alia*, by a slower economic activity of EU trading partners over several quarters, with a significant contagion effect on Romania as well. Against this background, the positive output gap continued to narrow during 2024, reaching at the end of the year a marginally positive level of 0.2 percent, similar to that estimated in the November 2024 *Inflation Report*. By contrast, the budgetary and fiscal measures taken late last year (GEO No. 156/2024), effective 1 January 2025, are envisaged to have a significant impact on aggregate demand components. On the one hand, they will reduce markedly households' financial resources available for consumption and, on the other hand, they will affect firms' investment decisions both directly and indirectly. Against this backdrop, the dynamics of domestic demand are expected to lose considerable momentum, causing *inter alia* the output gap to fall into negative territory as early as the beginning of this year.

Under the circumstances, the growth rate of household consumption is expected to slow during 2025 compared to the swift dynamics in 2024, underpinned by the authorities' extremely loose income policy and by the wage pressures stemming from labour shortages in certain sectors. Conversely, after the assessed relative standstill in gross fixed capital formation in 2024, mainly influenced by the underperformance in construction, industry and services to enterprises, investment is seen rebounding strongly starting this year. The projection is based on several favourable factors: (i) the gradual recovery of trading partners' economic activity, although growth forecasts have been revised slightly downwards versus the previous *Report*, (ii) the faster absorption rate of EU funds under the Multiannual Financial Framework 2021-2027, upon entering the fifth year of the programme implementation, (iii) the likely release of new funds from the Recovery and Resilience Facility, also via additional payment requests submitted by the Romanian authorities, and (iv) the continued large volumes of foreign direct investment (FDI), which, by further flowing mainly into sectors such as industry, will help *inter alia* stimulate exports of Romanian products.

In light of the aforementioned factors, the forecast envisages, on one hand, a return of Romania's exports to positive annual dynamics starting in 2025 and, on the other hand, an abatement of pressures on imports of goods and services, induced by the impact of fiscal measures on available financial resources in the economy. Hence, the current account deficit is estimated to see a correction over the course of 2025, after the opposite influences that marked its path in 2024. Moreover, these developments hint also at a more balanced economic growth pattern, reflected by the more sustainable dynamics of household consumption, the renewed positive contribution from investment and, equally, a rebalancing of net export contribution to the GDP advance towards more favourable levels. Over the medium term, however, the further correction of the current account deficit is of the essence, alongside the adjustment of the excessive budget deficit. This is all the more necessary given *inter alia* the significant contraction, in 2024, of external deficit financing sources, particularly non-debt-creating ones.

In addition, amid the persistent geopolitical tensions worldwide, the likelihood of future significant improvements in these categories of financial flows remains rather low.

The NBR's recent monetary policy stance aimed to bring the annual inflation rate back in line with the 2.5 percent  $\pm 1$  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.

Since the past *Inflation Report*, some of the identified risk factors have materialised, in particular those associated with the launch of fiscal consolidation measures by the authorities. Specifically, they released budget coordinates aimed at meeting a 7 percent of GDP deficit target in 2025. On the external front, the geopolitical conflict in the Middle East deescalated slightly, contrary to expectations of its stronger persistence. Even in these circumstances, the assessed balance of risks suggests possible upside deviations of inflation from its path in the baseline scenario, particularly should new adverse supply-side shocks emerge.

The implementation of the fiscal consolidation measures laid down in Government Emergency Ordinance No. 156/2024 significantly reduces the uncertainties about the fiscal and budget policy stance in the baseline scenario of the projection. Nevertheless, over the seven-year horizon covered by the plan that the authorities have committed themselves to, new adjustments are possible, with potential implications that may be both inflationary, for instance if indirect taxes are raised, and disinflationary, if direct taxes are increased or budget expenditure is cut. The start of the multiannual fiscal correction notwithstanding, significant deficit slippages from the path undertaken by the authorities could influence the perception of investors in domestic assets. These developments might put pressure on the exchange rate, with knock-on effects on inflation as well. For instance, the social tensions generated by the measures taken at the turn of the year, which impacted directly the financial resources of significant segments of households, could entail, over time, initiatives of an expansionary nature, such as additional support schemes for vulnerable categories. In the absence of significant budget resources that should have been put aside prior to enforcing such measures, the fulfilment of the fiscal deficit targets could be jeopardised, implicitly calling for new compensatory measures.

One of the risks becoming increasingly obvious is that of the failure to absorb EU funds in the amounts and by the deadlines set. Fund absorption under the Multiannual Financial Framework 2014-2020 ended, while in the current exercise, spanning 2021-2027, after four years of implementation, only about 10 percent of total allocations have been accessed (including amounts from pre-funding and agriculture subsidies). Moreover, under the NRRP, no tranche was accessed in 2024, which significantly reduces the window of opportunity in implementing this programme, given that the allocated funds must be absorbed by end-2026. In this context, any additional delays will limit the total volume of EU-funded investment, diminishing its positive impact on the economy and impairing its capacity to counterbalance the contractionary effects of the fiscal consolidation process already underway. This would also affect the financing of external deficits, which are still high, while replacing EU funds with alternative sources of finance, such as portfolio investment, could trigger additional

volatilities. Furthermore, an incomplete take-up of EU funds might put a brake on progress in structural reforms, especially in areas where accessing the amounts is conditional on the fulfilment of specific milestones and targets.

In spite of recent easing signs of labour market tensions, the related risks remain a source of concern. Uncertainties linger with regard to wage dynamics, particularly in the private sector, where the removal of some tax breaks since the beginning of this year could generate more sizeable wage adjustments than those anticipated in the baseline scenario. Moreover, bringing the minimum wage to the level set forth in the EU directive might lead to new price increases, with the stronger wage pressures feeding through to production costs as well. In the public sector, the strict enforcement of the provisions of Government Emergency Ordinance No. 156/2024 has mitigated the risk of broad-based wage pressures across the economy, including via demonstration effects onto private sector wages. Conversely, over the medium term, certain sectors might see a rise in the persistent structural deficiencies, such as the skills mismatch, which could imply new sources of inflationary shocks.

On the external front, uncertainties have increased, especially amid the possible protectionist measures announced by the United States, which might have divergent effects on economic activity and inflation respectively, generating the risk of stagflation. The impact of these measures would depend on each economy's direct trade exposure to the US, but also on possible indirect productivity losses among local firms and those in the economies of Romania's main trading partners. Besides, an increase in global risk aversion could prompt companies to postpone some investment decisions. Furthermore, a rise in customs tariffs might compound inflationary pressures via costlier imported goods, including commodities and intermediate goods. These increases in costs could reflect in new hikes along the production chain, thus putting stronger pressure on final prices.

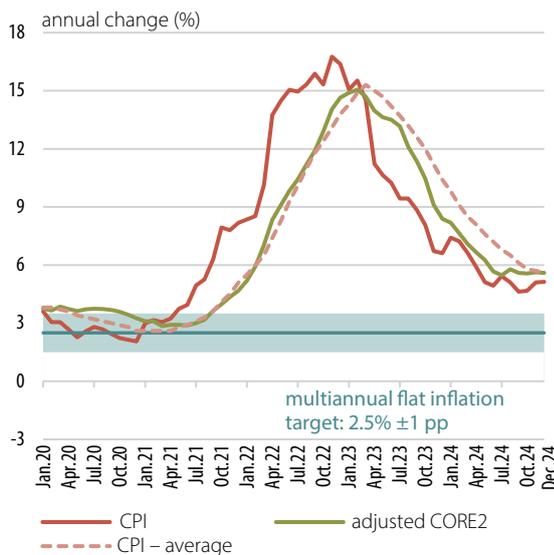
## Monetary policy decision

Given the prospects for the annual inflation rate to stay at higher values than previously anticipated and above the variation band of the target during the current year, also amid a markedly fluctuating path in 2025 H1, and considering the associated risks and uncertainties, the NBR Board decided in its meeting of 14 February 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 keep 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 climbed to 5.14 percent at end-2024, up 0.52 percentage points from the level posted at the end of the previous quarter. The upward trend was almost solely driven by energy prices, particularly fuel prices, amid the appreciation of the US dollar, the short-lived hike in oil prices in October, but also the onset of the cold season. The annual adjusted CORE2 inflation rate stayed at around 5.6 percent in the period under review, the effects of the further decline in excess aggregate demand in the economy being offset by the influence of the poor agricultural year and the pressures from labour costs (Chart 1.1).

Chart 1.1. Inflation developments



Source: NIS, NBR

The pick-up in CPI inflation in 2024 Q4 is ascribable almost exclusively to energy prices, especially fuel prices, whose monthly growth rates returned to positive territory in this period. As far as motor fuels are concerned, a significant impact came from the strengthening of the US dollar by about 6 percent in December versus end-Q3, amid the measures announced by the winner of the US presidential elections. The Brent oil price surged in early October, against the background of the hostilities between Israel and Iran, but witnessed a correction subsequently, fluctuating in a range of USD 70-75/barrel until the end of December. In 2024 Q4, the firewood price also recorded a seasonal increase linked to the start of winter<sup>1</sup> (Chart 1.2).

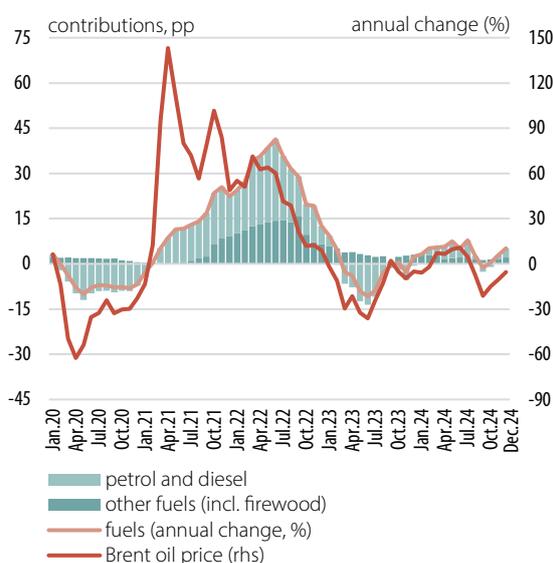
At the same time, the larger demand for energy during the cold season led some electricity final consumers to migrate to the upper consumption bracket

(associated with a higher price ceiling). This triggered a hike in the average electricity price, yet with a merely 0.1 percentage point inflationary contribution, significantly lower than that of fuels, which was assessed at 0.6 percentage points. The slight decreases in natural gas prices, *inter alia* as a result of the market share competition among the main suppliers, acted in the opposite direction.

As regards exogenous factors, the developments in the annual inflation rates for volatile food and administered prices partly offset the inflationary impact of energy prices. In the former case, this was due to the slowdown in vegetable price dynamics, after

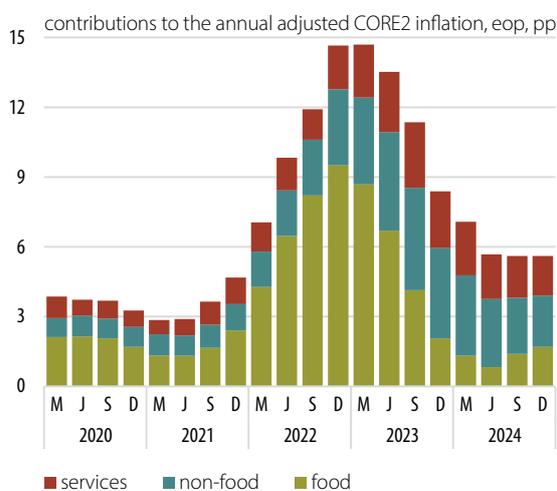
<sup>1</sup> Unlike the behaviour in most of the previous years, in 2023 this price rise was concentrated in Q3, amid the large hike in the Brent oil price, motor fuels and firewood being substitutable goods to a certain extent.

Chart 1.2. Crude oil and fuel prices



Source: NIS, Bloomberg, NBR calculations

Chart 1.3. Adjusted CORE2 inflation components



Note: Contributions include VAT rate changes.

Source: NIS, NBR calculations

the steep increases in 2024 Q3, when the annual VFE inflation rate reached 10 percent, against the backdrop of the shorter supply. Turning to goods and services with administered prices, the deceleration in their annual pace of growth was chiefly driven by a base effect related to water, sewerage, sanitation services.

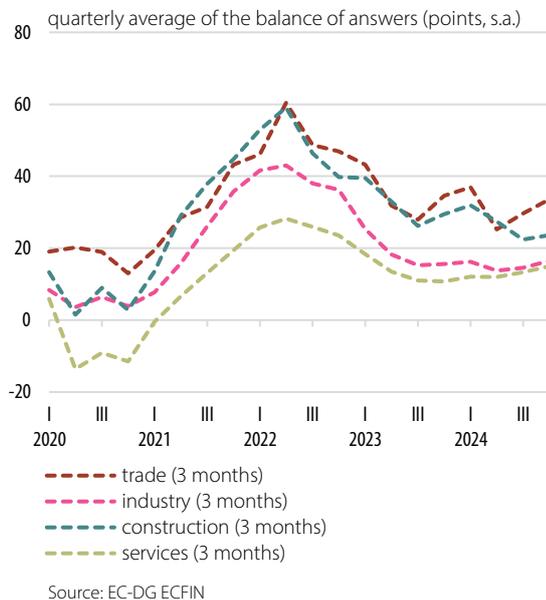
In the period under review, the annual adjusted CORE2 inflation rate remained at 5.6 percent, a level around which it has been fluctuating as of June 2024, given the mixed developments by component (Chart 1.3). Thus, the annual growth rate of processed food prices further followed the upward trend it had embarked upon in 2024 Q3 (rising to 4.2 percent). While in the previous quarter the context of the poor agricultural year at regional level influenced consumer prices mainly via the expectations channel, subsequently the hike in agri-food commodity costs started to be reflected in the steady pick-up in the annual dynamics of domestic industrial producer prices for food items (from 0.4 percent in July to 2.2 percent in November). Vegetable oil prices witnessed the strongest step-ups, the sunflower harvest being the most affected by the severe summer drought, yet dairy and meat prices also posted robust monthly dynamics. In addition, the annual inflation rate at end-2024 no longer includes the negative monthly change of November 2023, when the measure to cap the mark-ups on some basic food products was extended.

Prices of non-food items and market services continued on a disinflationary path in 2024 Q4 (to 6.4 percent and 6.7 percent respectively), mitigating the influence of developments in food prices. Nevertheless, in the case of non-food items, the pace of disinflation has slowed down, losing some of the support provided

by imports. Specifically, the annual dynamics of euro area HICP inflation excluding energy (a proxy for imported inflation) reverted to 2.7 percent<sup>2</sup> in October and remained at this level until end-2024, whereas the annual rate of change of the UVIs of some categories of imported goods (3-month moving average) such as cosmetics, sports goods or games and toys followed an upward trend, re-entering positive territory in some cases. Looking at prices of market services, although in 2024 Q4 their annual

<sup>2</sup> After having declined by 0.1 percentage points at end-Q3, to 2.6 percent

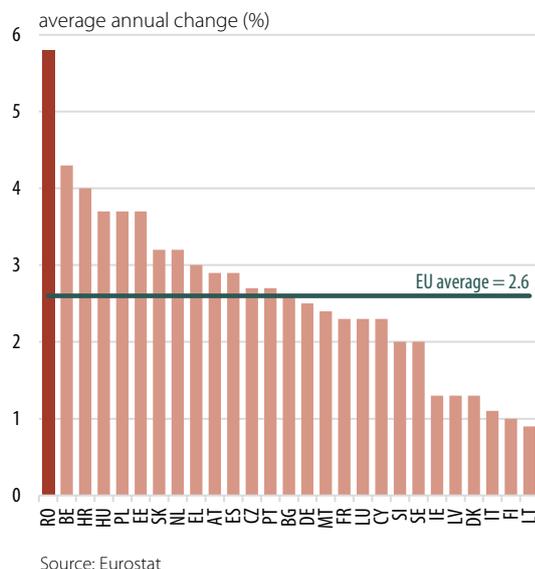
Chart 1.4. Expectations on price developments



growth decelerated at a pace similar to that in the previous quarter, the progress has been slow, being affected by the persistent pressures from labour costs, as this sector ranks among the most labour-intensive sectors in the economy. Moreover, demand conditions in both segments were further favourable, even though they weakened somewhat.

In 2024 Q4, economic agents in all sectors adjusted their short-term expectations on price developments slightly upwards, retailers reporting a larger increase in the balance of answers, likely correlated with the uptrend in the volume of sales (Chart 1.4). In a similar vein, financial analysts revised upwards their expectations on the annual inflation rate over the one-year horizon, but left unchanged the two-year ahead indicator at the same value recorded at end-Q3 (right below the upper bound of the variation band of the inflation target).

Chart 1.5. Average annual HICP in the EU – Dec. 2024



The average annual rate of change of consumer prices further declined, at end-2024 reaching 5.6 percent for the indicator calculated based on the national methodology and 5.8 percent for that calculated in accordance with the HICP structure (-0.5 percentage points and -0.6 percentage points respectively compared to end-Q3). Even though the gap to the EU average narrowed to 3.2 percentage points in December (down 0.4 percentage points from September), Romania continued to record the highest average annual HICP inflation rate among the EU Member States (Chart 1.5).

At end-2024, the actual outcome for the annual CPI inflation rate stood 0.3 percentage points above the projection in the November 2024 *Inflation Report*, as core inflation did not resume its downward path, as previously anticipated. In addition, fuel prices rose

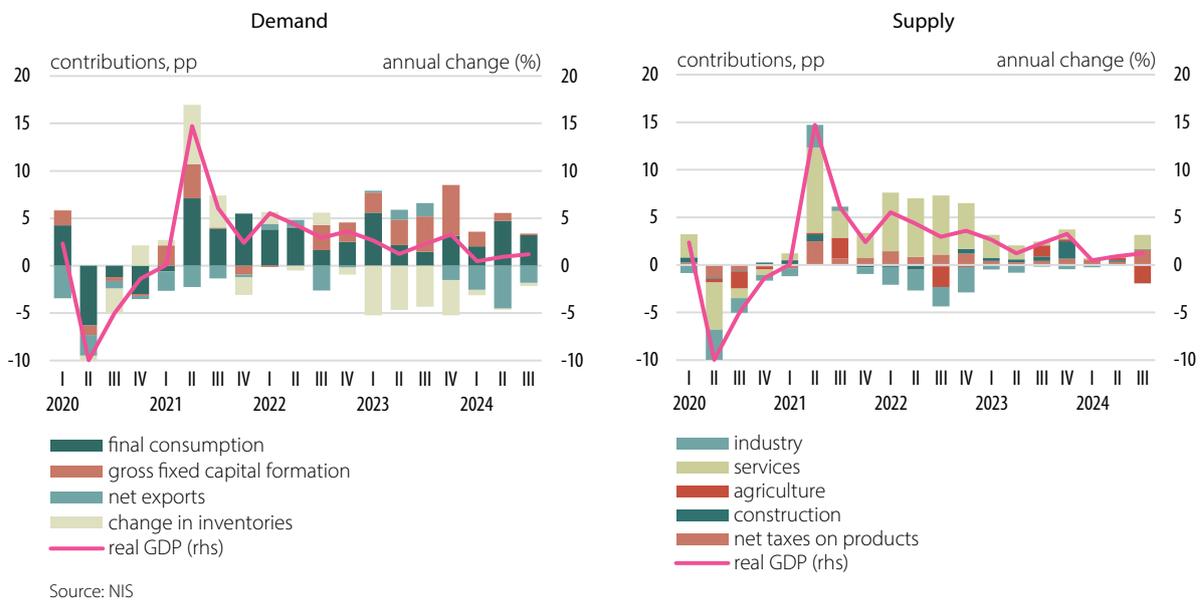
above expectations, given that both the hike in the firewood price and the appreciation of the US dollar were stronger than envisaged.

## 2. Economic developments

### 1. Demand and supply

In 2024 Q3, real GDP continued to rise at a subdued pace in annual terms (+1.2 percent<sup>3</sup>), amid a slowdown in both components of domestic absorption; in counterpart, imports lost momentum, which reflected in a waning drag of net external demand on real GDP growth (Chart 2.1).

Chart 2.1. Contributions to economic growth



On the supply side, gross value added in the economy decreased by 0.4 percent, as the sluggish industrial activity, the protracted decline in the construction of buildings, and the downward or flat paths of many service activities were accompanied by a sharp fall in agricultural output, under the impact of a year of drought. However, some sub-sectors reported positive dynamics, most notably civil engineering works, design services, retail trade, and related services (wholesale of consumer goods, storage, and courier services), Chart 2.2.

Household consumption saw its annual growth rate decelerate to 5.1 percent, mainly on the back of self-consumption, in correlation with the poor maize and sunflower crops. Conversely, purchases of goods further rose at a fast pace (over 7 percent, annual change), particularly on account of non-durables, which recorded increases across all groups of goods, the most dynamic being wearing apparel, footwear, cosmetic and pharmaceutical products, which continued to post a double-digit annual advance.

<sup>3</sup> In this section, the analysis of the annual GDP dynamics relies on the volume series expressed in the prices of the corresponding quarter of the previous year.

In the case of durables, sales picked up at a more moderate pace, with automotive purchases recording one of the lowest growth rates (+1.1 percent), due to weaker demand for new motor vehicles<sup>4</sup>.

Chart 2.2. Main economic activities

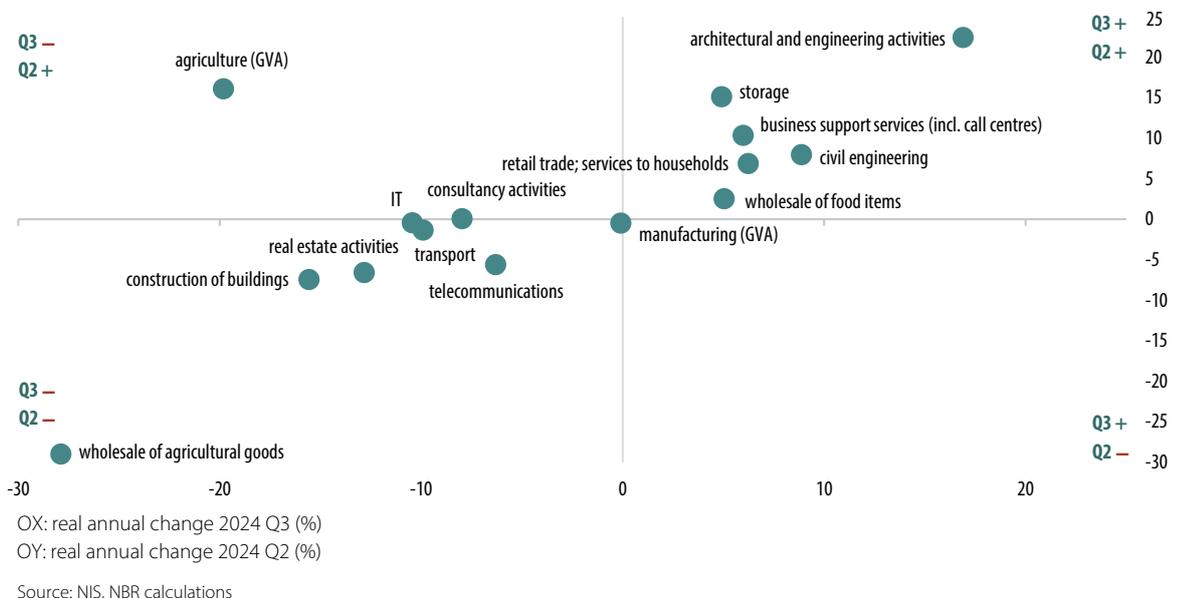
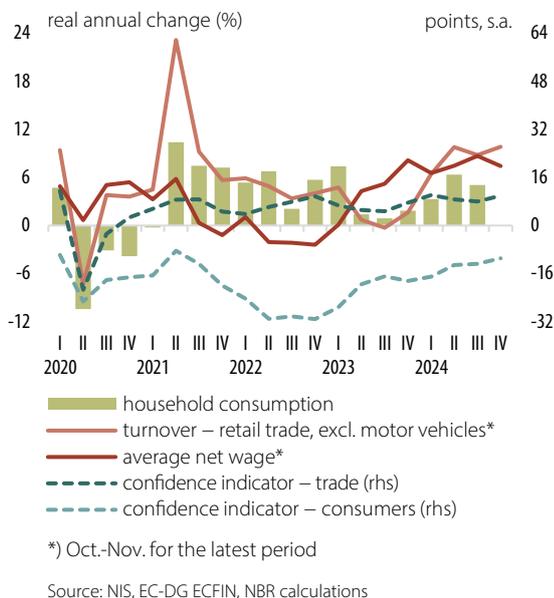


Chart 2.3. Household consumption



The upward trend in private consumption may continue over the near term, with the strong rise in household real income during 2024, supplemented by the sizeable increase in new consumer credit, reflecting in the improvement in confidence indicators by about 2 points for households and retailers, respectively, in 2024 Q4 versus the Q3 average (Chart 2.3). The outlook is confirmed by developments in retail trade turnover October through November, whose volume picked up by 9.8 percent in annual terms. Trade in non-durables maintained the strong growth momentum seen since the beginning of the year, with market signals also pointing to some favourable supply-side influences, such as the adjustment of selling strategies towards more frequent promotional campaigns<sup>5</sup>. Online trade was another segment with a notable performance, increasing by over 15 percent in

<sup>4</sup> In this category, the annual change of the number of new registrations returned to negative territory in 2024 Q3 (-13.7 percent).

<sup>5</sup> According to data provided by YouGov Romania, given that price cuts usually target well-known goods, the intensification of promotional campaigns has increased competition from this product category against own-brand products, leading implicitly to a decline in the latter's market share.

October-November, in line with the trend observed throughout 2024. Specifically, the share of individuals using digital channels to purchase goods and services neared 60 percent in 2024 (relative to the total number of internet users over the last 12 months), up from the previous year (yet, according to Eurostat, it remained significantly below the EU average of 76.7 percent). The uptrend in household income also contributed to the recovery of recreational services, with their volume of receipts returning to positive annual dynamics in October-November (1.7 percent), after two consecutive quarters of contraction.

In 2024 Q3, the general government budget execution witnessed a new pronounced deterioration as compared with the same year-earlier period, leading to a deficit of lei 32.6 billion (1.8 percent of GDP), well above that in 2023 Q3 (lei 19.2 billion, i.e. 1.2 percent of GDP). The general government deficit was thus significantly larger than that recorded in Q2, the same as in 2023<sup>6</sup>, given that total budget revenues decreased somewhat from the previous three-month period<sup>7</sup>, under the impact of the decline in receipts from corporate income tax<sup>8</sup>, non-tax revenues<sup>9</sup> and personal income taxes<sup>10</sup>, which was only partly offset by the increase in receipts from taxes and duties on goods and services<sup>11</sup>. At the same time, total budget expenditure further rose slightly<sup>12</sup>, primarily on account of the sharp advance in capital expenditure and social security spending<sup>13</sup>, whereas opposite influences came from the decrease in other current expenditure items<sup>14</sup>.

In 2024 Q4, the general government deficit posted a considerably stronger increase than in the previous year, reaching lei 56.5 billion (3.2 percent of GDP), from lei 33.6 billion (2.1 percent of GDP) in 2023 Q4. Under the circumstances, 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 deficit of lei 90.1 billion, i.e. 5.6 percent of GDP.

Gross fixed capital formation continued to decelerate, its annual rate of change reaching 0.4 percent, as 2024 was marked by a contraction in the main financing channels. Nevertheless, the step-up in transport infrastructure works towards

<sup>6</sup> In 2024 Q2, the general government deficit came in at lei 27.8 billion (1.6 percent of GDP), which was, in turn, well above that posted in the same year-ago period (lei 14.5 billion, i.e. 0.9 percent of GDP).

<sup>7</sup> Nonetheless, total budget revenues further increased in real annual terms, namely by 6.7 percent against 5.9 percent in Q2.

<sup>8</sup> Largely reflecting, however, the base effect associated with the collection in Q2 of the receipts from corporate income tax for the previous fiscal year. In fact, their positive real annual dynamics stepped up as compared with the preceding quarter, climbing to a two-digit level.

<sup>9</sup> Nevertheless, these continued to grow in real annual terms, yet at a slower pace than in Q2.

<sup>10</sup> While further increasing at a fast real annual rate.

<sup>11</sup> The rise in this type of revenues was driven mainly by the developments in other taxes and duties on goods and services and in VAT, while receipts from excise duties exerted an additional, yet smaller impact.

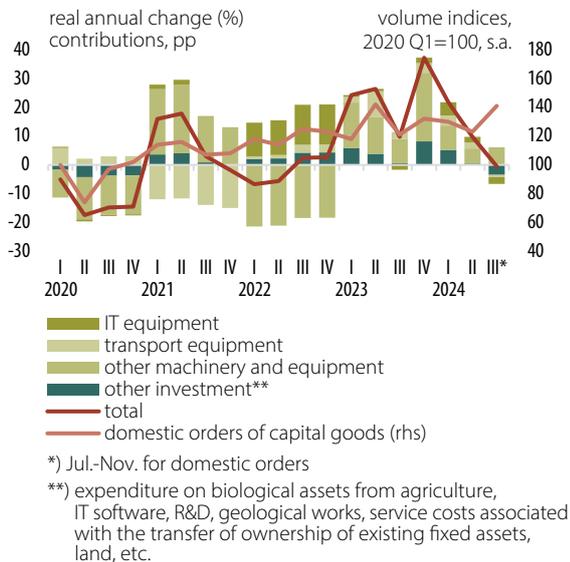
<sup>12</sup> The real annual pace of increase of total budget expenditure picked up from 13.6 percent in Q2 to 14.0 percent.

<sup>13</sup> The real annual growth rates of both categories of expenditure almost doubled versus the previous quarter, in the case of social security spending this rise reflecting also the impact of the measure to recalculate pensions as of September 2024. In addition, the further increase in spending for projects financed from the lending component of the NRRP made a somewhat smaller contribution to the advance in total budget expenditure.

<sup>14</sup> Chiefly in spending on goods and services – in a context in which they were capped in September-December 2024 (according to Government Emergency Ordinance No. 107/2024), earlier than in the prior year –, as well as in other expenditure, interest expenses and subsidies. The real annual dynamics of these expenses (except for spending on subsidies, which declined in annual terms) remained nevertheless at a two-digit level, but decelerated as compared with the preceding quarter. Spending on projects financed from non-repayable external funds also decreased – at a slightly swifter real annual pace –, yet without exerting a significant influence on the budget balance, given the relatively similar decline in disbursements from the EU.

year-end and the rebound in the portfolio of domestic orders to capital goods manufacturing sub-sectors between July and November could underpin a modest short-term recovery of investment. Regarding financing, 2024 Q3 followed a similar

Chart 2.4. Investment, excluding construction

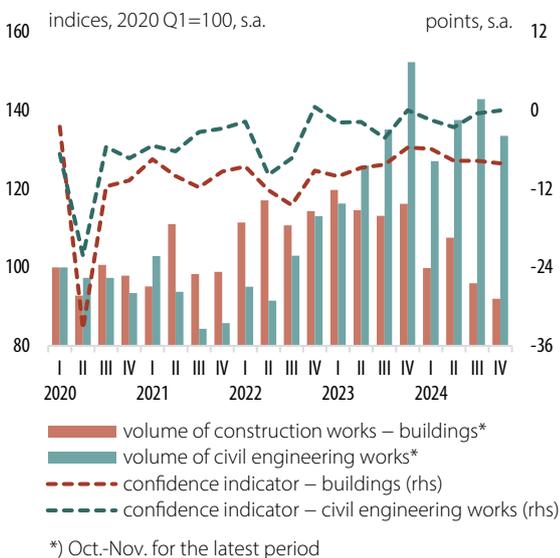


Source: Eurostat, NIS, NBR calculations

pattern to H1, with the low level of own funds of the corporate sector (driven by the unfavourable developments of numerous sub-sectors) accompanied by a 26 percent decline in FDI inflows in the form of equity (including reinvestment of earnings) over January-November. At the same time, the slow absorption of EU funds<sup>15</sup> and the weak administrative capacity to manage the funds raised continued to hamper capital investment.

In this context, the slowdown in gross fixed capital formation was chiefly ascribable to lower investment in transport equipment bought by companies and public institutions, hardware and software, as well as in biological assets in agriculture (plantations, livestock), Chart 2.4. An opposite trend was visible in the component excluding the aforementioned categories of machinery and equipment, which recorded an 18 percent annual increase, driven by purchases of technologies for investment projects scheduled for completion in the final months of the year, particularly in the automotive industry<sup>16</sup>.

Chart 2.5. Construction



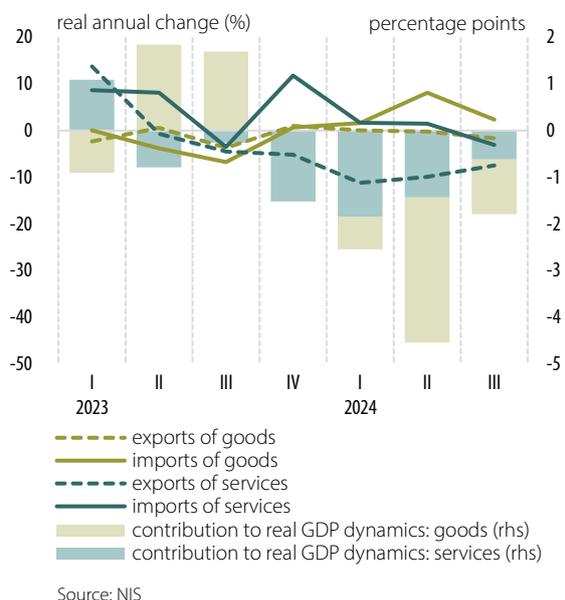
Source: NIS, Eurostat, EC-DG ECFIN

Investment in construction saw a slight rebound, but the advance was weak (annual rate of change of 0.9 percent), given that the step-up in the growth rate of civil engineering works to about 9 percent was largely offset by the doubling of the pace of decline of construction of buildings (to -15.6 percent). These developments are likely to remain divergent in the near future as well (Chart 2.5). Specifically, works on the road transport network, including motorway and express road projects, accelerated in 2024 Q4. Conversely, expectations for the construction of buildings remained negative, as reflected by the continued worsening, since the beginning of 2024, of the confidence indicator for construction firms (from -5.7 points in 2023 Q4 to -8.1 points in 2024 Q4).

<sup>15</sup> As for the EU structural and cohesion funds, only 53 percent of the amounts estimated under the two multiannual financial frameworks and less than 8 percent of the NRRP grants were raised in 2024 (according to the MF).

<sup>16</sup> The inauguration of a battery assembly line at the Ford Otosan Craiova plant in October, intended for equipping the three electric car models that entered production in late 2024.

Chart 2.6. Foreign trade



Net external demand continued to erode the annual dynamics of real GDP, yet the magnitude of the effect decreased as compared with Q2 (to -1.8 percentage points), mainly due to a slowdown in the growth rate of imports of goods (Chart 2.6).

According to national accounts data, the volume of goods exports witnessed a new contraction (down 1.6 percent in annual terms), driven mainly by weather conditions and the weak external demand, particularly from the EU. In the former case, the persistent drought and high temperatures in 2024 affected exports of agri-food commodities, whose volume fell by approximately 16 percent. In the latter case, the sluggish economic activity in the euro area, especially in Germany, weighed on exports of manufactured goods – final goods (particularly consumer goods<sup>17</sup>, whose exports increased by slightly more than 1 percent) or intermediate goods

manufactured by industries integrated in global value chains (for example, electrical equipment, electronic components).

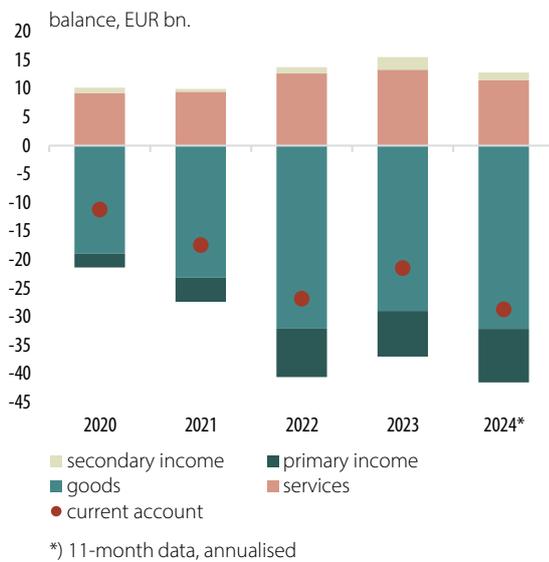
Although the price competitiveness of local products is not among the main factors behind the erosion of the external trade position in 2024, as indicated by the relatively modest average appreciation of around 2 percent in the real effective exchange rate based on the industrial producer price index, the ongoing pressures from labour costs cannot be overlooked. The persistent two-digit growth rate of nominal unit labour costs (ULC) in manufacturing is likely to raise concerns during periods of weakening demand, especially in labour-intensive sub-sectors (such as the light industry, the manufacture of electronic products, or machinery and equipment). Apart from this challenge that has been manifest over the past three years, the domestic industry has faced competitive pressures from recent international developments. This is the case for metallurgy, where exports are hit by the plentiful and relatively cheap supply from China and Türkiye, as well as for the automotive industry, where Chinese-made electric vehicles will pose strong competition to domestic models of this type, which entered production at the end of 2024.

Behind the deterioration of the external component of GDP in 2024 Q3 stood also the energy trade deficit, as drought conditions weighed on hydropower output, prompting consumption peaks to be met through imports and leading to a decline in exports. Furthermore, natural gas exports fell, given that the gradual recovery of industrial consumption took up a larger share of domestic resources. However, in 2024 as a whole, the increase in local production helped eliminate the economy's import dependency. Trade in oil and petroleum products was broadly balanced in 2024 Q3, with the shift to a surplus in the petroleum products trade balance prompting additional crude oil imports.

<sup>17</sup> E.g. food items, cosmetics, household appliances

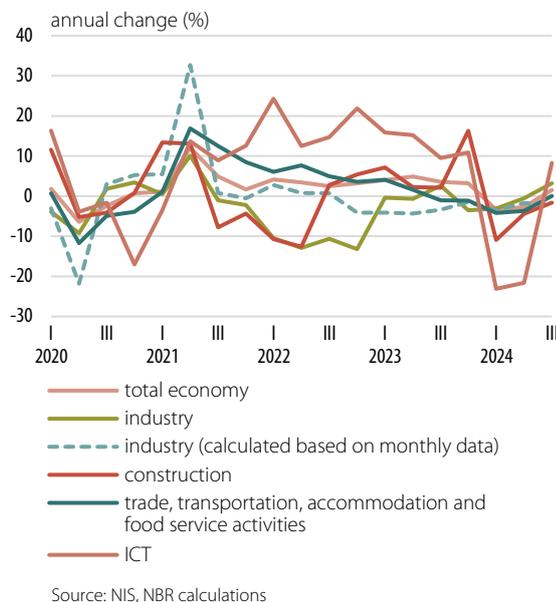
The slowdown in domestic absorption and the downward path of exports had an impact on the annual dynamics of imports of goods, their deceleration (to +2.4 percent) being mostly linked to intermediate goods, while imports of consumer goods continued to grow at a swift pace (around 7 percent).

Chart 2.7. Current account



Source: NBR

Chart 2.8. Labour productivity economy-wide



Source: NIS, NBR calculations

In the period January-October 2024, the negative differential between the annual change in exports of goods and that in imports thereof, in terms of volume, was only marginally counterbalanced by the favourable evolution of the price component (with the UVI of exports rising somewhat more sharply than that of imports)<sup>18</sup>. Therefore, in the first 11 months of 2024, the goods trade deficit (BOP data) widened by 14.9 percent versus the same year-earlier period. This affected the current account deficit (+33 percent), alongside the narrowing services surplus – attributed to the larger shortfall of travel, and to the decline in net receipts from freight transport (in line with the sluggish economic activity in Romania and, more generally, across the EU). The primary income account made an additional contribution, as a result of higher interest payments on government securities issued in the international market and lower inflows of workers’ remittances from abroad; the negative impact of these developments was mitigated by a decline in outflows in the form of earnings reinvested by FDI enterprises, as well as by a certain improvement in the secondary income surplus (Chart 2.7).

### Labour productivity

In 2024 Q3, the rate of change of labour productivity economy-wide returned to positive territory (1.5 percent versus -2.7 percent previously), due to the significant contribution coming from services, in particular trade and related activities, supported by consumer demand, as well as ICT, where the restructuring process is ongoing (Chart 2.8). Labour productivity in industry also seems to have recorded positive developments (determined based on gross value added), which, however, diverge from those indicated by the monthly series on production and the number of employees. Based on the latter method of calculation,

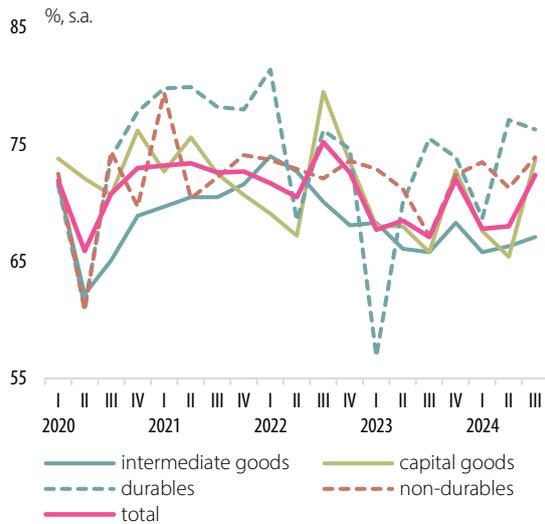
labour productivity shrank in annual terms for the eighth consecutive quarter, its dynamics further declining to -2.1 percent.

<sup>18</sup> Calculations based on international trade data – standard international trade classification by broad economic categories (BEC) (Source: Eurostat)

The picture displayed by industrial activity remains broadly similar to that prevailing throughout 2024. On the demand side, there is still support from the domestic market (in Q3, new orders increased by over 7 percent year on year and at a double-digit pace in October), while external orders fell by around 1 percent July through October. As for sub-sectors, many of the primarily export-oriented activities saw marked

declines in productivity indicators: double-digit contractions in rubber and plastics industry, metallurgy, IT equipment and electronic products, and machinery and equipment. These developments are occurring in a broader context where the loss of competitiveness of the EU industry, especially the automotive one, continues to erode the interest in European goods, favouring those produced in China or the US. Against this backdrop, a wave of restructurings and even bankruptcies is already affecting several major car factories in Europe, and, subsequently, manufacturers in related industries. This impacts the local economy at a fast pace, given the high degree of integration: about 40 percent of the value added in the local industry is exported, and for half of it the euro area is the final destination. The outlook for external environment developments remains rather pessimistic, with a high likelihood of new tariffs imposed by the US after the inauguration of the new administration, which might further fragment global value chains.

**Chart 2.9. Capacity utilisation rate in manufacturing**



Source: EC-DG ECFIN

**Chart 2.10. Labour market tightness**



Note: The labour market tightness indicator is calculated as the ratio of the job vacancy rate to the ILO unemployment rate (monthly data).

Labour shortage refers to the share of answers of companies citing the difficulty of finding workforce as a factor that constrains their economic activity.

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

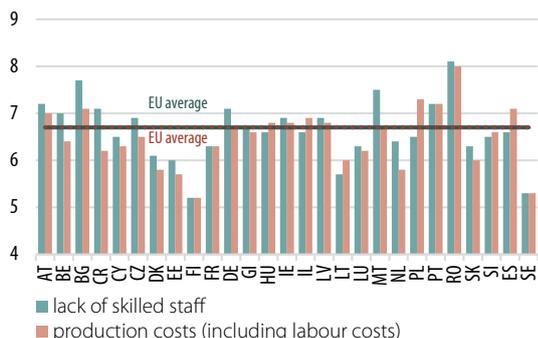
The latest data show some improvement in the capacity utilisation rate of Romanian plants, along with a temporary boost in confidence indicators October through November, owing mainly to the roll out of new car models, including electric vehicles (Chart 2.9). In fact, car production recorded an all-time high in October and throughout 2024, in terms of the number of units assembled in the two factories. However, the end of the year saw a correction in confidence indicators, and given the lack of a rebound in European manufacturing, it is hard to envision a recovery in the local industrial activity, which is currently close to the 2016 level.

**Labour market developments**

Between July and November, labour market conditions underwent some changes, with an easing trend that became more noticeable (Chart 2.10). Labour demand continued to be subdued, the unemployment rate increased, and wages resumed their downward path after the sharp rise in July, which was linked to the

hike in the gross minimum wage economy-wide. Although recent developments have sparked some positive signals regarding the number of employees and the unemployment rate, in line with the slightly positive dynamics of economic activity, the outlook remains cautious.

Chart 2.11. Main problems faced by companies in their activity

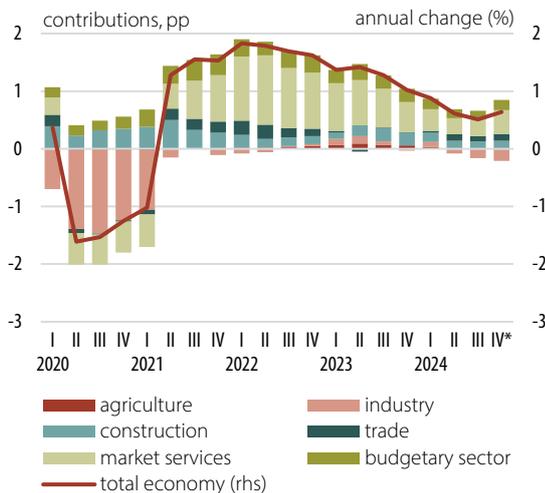


Note: In the survey, firms respond to the question "How important have the following problems been for your enterprise in the current and previous quarters?". The responses refer to the difficulties encountered between April and September 2024 (the period for collecting data is September-October 2024 and belongs to the 2024 Q3 wave) and are provided on a scale from 1 to 10, in descending order of importance.

Source: ECB, EC-DG IMIESMEs, Survey on the Access to Finance for Enterprises (SAFE)

The job vacancy rate was 0.7 percent in 2024 Q3, unchanged since 2023 Q4 (compared to 0.8-0.9 percent in 2021-2023 Q4). At the same time, labour supply increased, with the ILO unemployment rate rising to 5.6 percent in Q3 and 5.4 percent in October-November (provisional data), after staying relatively stable at approximately 5.2 percent in 2024 H1. The further easing of the labour market may have helped alleviate the skilled labour shortage in Q4, with the relevant indicator from the December 2024 DG ECFIN survey dropping to 8.3 percent, after hovering around 10 percent for roughly three years. Nonetheless, the labour shortage remains a steady feature of the Romanian economy (Chart 2.11), given the long-lasting effects of structural factors such as high emigration levels, population ageing, a low labour force participation rate and the skill mismatch.

Chart 2.12. Number of employees economy-wide



\*) Oct.-Nov.

Source: NIS, NBR calculations

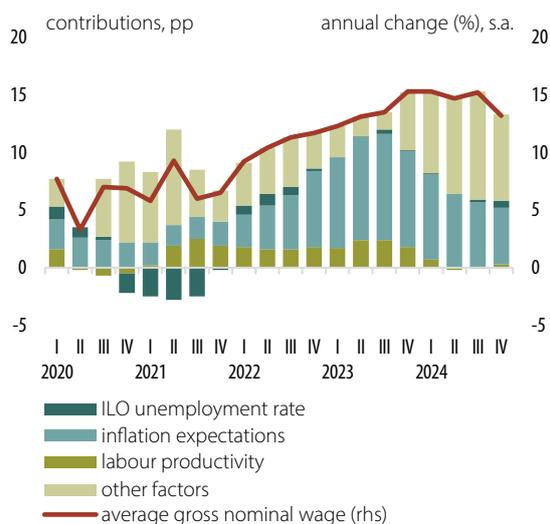
The annual growth rate of the number of employees economy-wide continued on a downtrend in Q3, reaching 0.5 percent (Chart 2.12). This deceleration was mainly driven by manufacturing. On the one hand, the struggles of the European automotive sector are strongly impacting the local industry, with estimates indicating that every job cut in the German car industry leads to the loss of seven to ten jobs along the supply chain in the automotive component industry<sup>19</sup>. On the other hand, restructuring persists in the sub-sectors more severely affected by the increase in the minimum wage, such as those in the light industry. The annual change in staff further displays a contraction in the ICT sub-sector as well, with uncertain prospects shaped by a weakening external demand, by the challenges stemming from the rapid paradigm shifts in the field, and also by the limited progress of digitalisation at national level.

However, October through November witnessed a slight improvement in the aggregate indicator, with the annual change in the number of employees economy-wide picking up to 0.6 percent, mainly on the back of services

<sup>19</sup> According to an analysis by the recruitment company Prohuman.

(primarily accommodation and food services, the transport and storage area, administrative and recreational activities). As far as the budgetary sector is concerned, the annual rate of change of the number of employees remained at 0.8 percent July through November.

Chart 2.13. 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:

$$\Delta \text{average gross wage}_t = \beta_1 \Delta \text{average gross wage}_{t-1} + \beta_2 \Delta \text{labour productivity}_t + \beta_3 \Delta \text{CPI}_{t-2} + \beta_4 \Delta \text{ILO unemployment rate}_{t-2} + \text{other factors}$$

Changes are approximated by logarithmic differences.

Source: NIS, Eurostat, NBR estimates and forecasts

In Q3, the annual dynamics of the average gross wage economy-wide halted their downward trend and rose to 16.7 percent (+0.8 percentage points from Q2), before slowing down again to 14.2 percent from October to November overall. This trend was driven by the private sector and can be largely attributed to minimum wage changes. On the one hand, the wage increase at the beginning of July 2024 pushed the annual growth rate of the private sector wages up to 16.3 percent in 2024 Q3 (+1.6 percentage points); on the other hand, the rises in 2023 Q4 created a base effect in October-November 2024, bringing the indicator down to 13.2 percent (Chart 2.13).

The budgetary sector followed a downward path, falling to 17.7 percent in July-November (-2.1 percentage points versus Q2). A statistical effect was observed in this case as well, as a result of the significant wage hike in the education sector starting 1 June 2023. In public administration and healthcare, the annual paces of increase stepped up in the period under review, climbing from about 15 percent in Q2 to almost 18 percent in July-October.

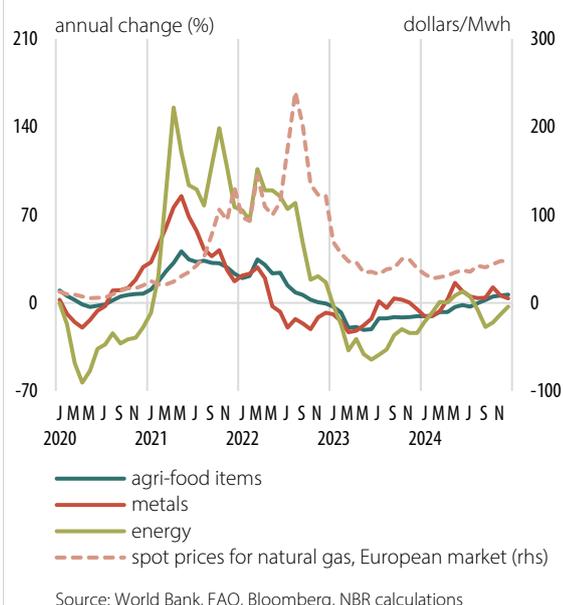
## 2. Import prices and producer prices on the domestic market

In 2024 Q3, import prices, as well as industrial and agricultural producer prices on the domestic market recorded faster annual rates of change to positive values, under the impact of extreme temperatures that favoured surges not only in electricity prices, but also in agri-food prices, by affecting spring crops. However, in October-November, the annual dynamics of industrial producer prices on the domestic market re-entered negative territory, driven primarily by adjustments in some natural gas prices. Although still high, pressures from labour costs in industry have recently faded somewhat, as a result of restructuring in the past year.

### 2.1. Import prices

The subdued outlook for global activity contributed to international commodity prices further posting negative annual dynamics in 2024 H2, the aggregate index published by the World Bank falling by 4 percent in Q3 and 4.4 percent in Q4 (Chart 2.14).

Chart 2.14. International commodity prices



This trend was visible in the case of energy prices, which recorded annual decreases, while other prices maintained their moderate annual increases. Specifically, crude oil prices – after a rise in early July amid lower stocks and fears about escalating geopolitical tensions – resumed a downward path in August, stabilising at around USD 73/barrel in 2024 Q4. Concerns about a global economic slowdown and the greater supply from the US offset the opposite influences from the geopolitical tensions in the Middle East and Eastern Europe and the improved estimates of higher demand following the Fed’s interest rate cut. Conversely, given the geopolitical situation, the European natural gas market remained tight in 2024 H2. Thus, the upward trajectory of prices was interrupted only temporarily in September (due to significant shocks), while resuming later amid the increase in demand for residential heating above the seasonal average, due

to the colder weather in some parts of Europe (at end-December 2024, natural gas storage levels reached only 72 percent across the EU compared to 86 percent at end-2023). Additional pressures were exerted by the expiry of the gas transit agreement between Ukraine and Russia at end-2024.

The annual dynamics of industrial metal prices (including mineral product prices) lost momentum, sliding to 4.4 percent in July-September (with the price of iron ore dropping sharply in annual terms), fostered by the slowdown in China’s economy, particularly in the real estate sector. Subsequently, the anticipated economic growth in the US and the rebound of Chinese industry, once government incentives were announced, led to a significant rise in prices at the beginning of Q4; these declined gradually in November-December, as the impact of China’s stimulus measures on the increase in demand proved to have been overestimated by the markets.

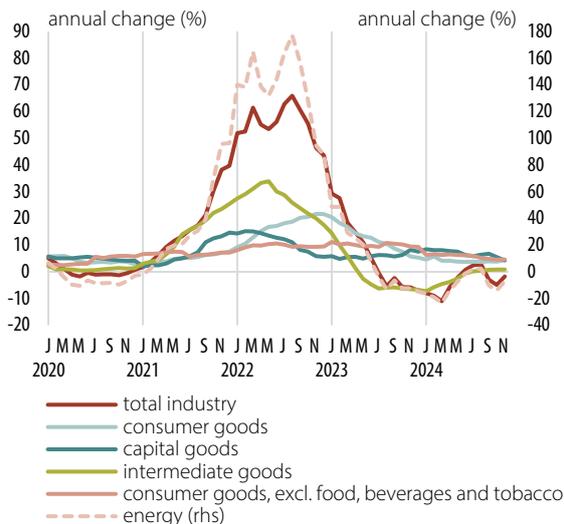
The FAO index followed an upward path, its annual growth rate re-entering positive territory in Q4 (5.9 percent), with significant hikes being visible in the case of oleaginous plants (given the poor crops in the Black Sea region) and dairy products, amid weaker milk production, as an effect of erratic weather conditions.

In 2024 Q3, the annual unit value index (UVI) of imports returned to values above one (101.5 percent versus 97.8 percent in the previous quarter), as the unfavourable impact on domestic prices was mitigated by the appreciation of the leu against the US dollar. The breakdown shows that most categories of goods posted increases in UVIs. These advances compared to the previous quarters were faster for energy prices (with the annual change of UVI entering positive territory after an 8.4 percentage point hike correlated with higher prices at the beginning of the period) and food prices, which were marked by the poor agricultural year (mainly on the fruit, fats, and meat segments).

## 2.2. Producer prices on the domestic market

In October-November 2024, the annual rate of change of industrial producer prices on the domestic market fell into negative territory to -3.3 percent (-3.9 percentage points

Chart 2.15. Industrial producer prices on the domestic market



Source: NIS, Eurostat

versus 2024 Q3), owing solely to energy prices, following the price adjustments by the main natural gas suppliers (Chart 2.15). Excluding this, the annual growth of prices is estimated to have stood around 3 percent in the period under review, similarly to Q3 and up by approximately 1.5 percentage points from 2024 H1. In the absence of significant pressures from non-energy commodity prices, these dynamics most likely reflect the influence of wage costs, which remains high in spite of dissipating somewhat over the last period as a result of restructuring and a modest temporary recovery in activity. An additional hint in this respect comes from the rise in the balance of answers for producer prices in the DG ECFIN survey of December 2024 (up to 18.6 percent compared to 15.4 percent in the first two months of Q4), especially in the case of economic agents operating in the capital and consumer goods manufacturing sub-sectors, with the highest exposure to labour.

The annual contraction of energy prices widened in October-November by 8.2 percentage points to -10.4 percent. Behind this stood the developments in crude oil processing, in correlation with the trajectory of oil prices, but mostly those in electricity, gas, steam and air conditioning supply, where producer prices decreased by 10.1 percent in annual terms in October-November from -0.8 percent in Q3. In the latter case, apart from a base effect, this evolution reflected the renewal of contracts with large industrial consumers at more advantageous prices and the competition for market share among the main suppliers.

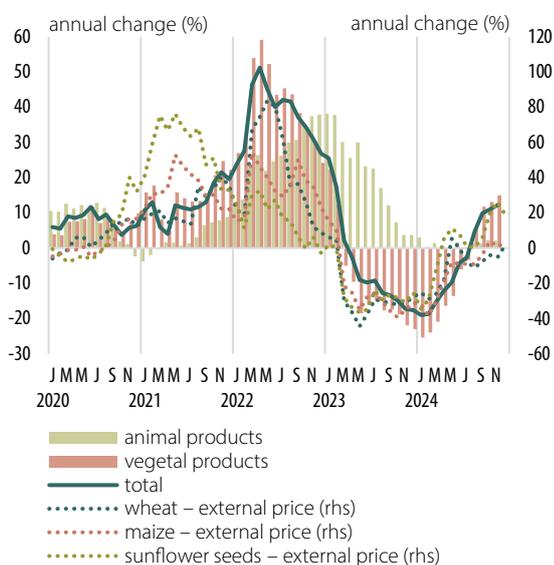
The electricity segment also had a modest contribution, as the correction in spot prices<sup>20</sup> in October was largely offset by the developments in November. Specifically, amid stronger supply, benefiting from favourable weather conditions for electricity output from renewable sources, especially hydropower (the Danube flow rates stood well above their multi-annual average), prices declined significantly in October. However, this trend subsequently reversed, as they recorded a significant leap, the reduction in domestic electricity production (*inter alia* as a result of overhauls carried out by some companies in the field) being accompanied by an increase in consumption, amid temperatures below the seasonal average in this period. The sector is further affected by the slow implementation pace of investments, yet a boost may come from the entry into force of the Contracts for Difference scheme (which states that the producer is guaranteed a minimum selling price); nevertheless, its success remains conditional on investments to improve the obsolete distribution and transmission network.

<sup>20</sup> Following the price surges in July-August, amid the severe imbalance between higher consumption (extremely high temperatures) and lower production (drought, overhauls)

The annual dynamics of producer prices for capital goods remained high (4.9 percent), well above the industrial sector’s average, continuing to partly mirror wage cost pressures. There was however a slowdown in October-November (-1.4 percentage points), driven by the automotive industry (from 5.7 percent in Q3 to 2.6 percent), as the closure of some auto parts plants and the related redundancies helped moderate this influence over the entire segment by limiting wage growth in the remaining companies.

The annual change in producer prices for consumer goods picked up slightly to 4.1 percent. In the food industry, pressures started to emerge from some agri-food commodity costs, especially oleaginous plants and milk, whose prices soared in the second half of 2024. Additionally, wage cost pressures persist, the consumer goods industries being more vulnerable to the increase in the minimum wage.

Chart 2.16. Agricultural producer prices



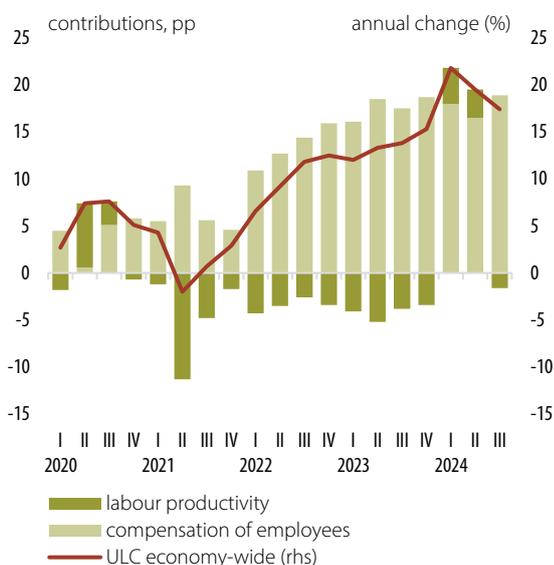
Source: NIS, Bloomberg, NBR calculations

Despite a slight step-up from the previous period, the annual dynamics of producer prices for intermediate goods remained low (0.9 percent), given the further negative annual change in metallurgy, amid competition from inexpensive imports from Türkiye, likely favoured by the use of commodities from Russia.

In October-November 2024, agricultural producer prices rose at a faster annual pace (+7.8 percentage points versus Q3), to 11.6 percent, with both segments gaining momentum (Chart 2.16). The annual dynamics of vegetal products climbed to 14 percent, reflecting the poor harvest (both at European level and domestically). The dynamics of sunflower seed prices increased significantly (to 27.4 percent), the crop output being estimated at half of the last five-year average. The annual growth rate of prices for animal products witnessed similar developments, albeit of a low magnitude – 2.2 percent, 1.3 percentage points above the Q3 average, fodder costs resuming an upward trend.

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Chart 2.17. Unit labour costs



Source: NIS, NBR calculations

**Unit labour costs**

The annual dynamics of unit labour costs economy-wide remained high (17.4 percent), despite declining somewhat in 2024 Q3 from the previous period (-2.1 percentage points), Chart 2.17. The swifter pace of increase of compensation per employee (19.1 percent, +2.8 percentage points) was only marginally offset by the labour productivity growth rate re-entering positive territory (1.5 percent, up 4.2 percentage points from the prior three months), hence the gap between the two indicators is still

considerable. The breakdown shows that professional activities and administrative services had a larger contribution to the slight improvement in productivity.

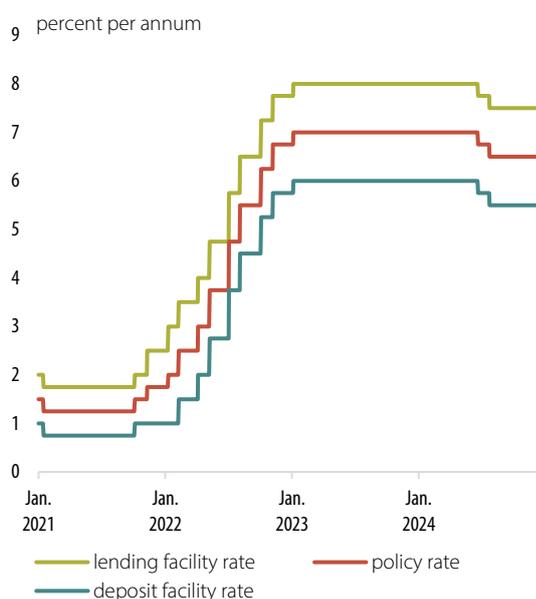
In industry, the annual growth rate of unit wage costs slowed down to 12.2 percent in October-November, after rising to 18.5 percent in Q3; in the first two months of Q4, local production recovered from a period of contraction in activity, being accompanied by a deceleration in the wage growth rate. Specifically, most sub-sectors witnessed slacker ULC dynamics, the annual changes standing roughly between 10 percent and 20 percent (higher levels, exceeding 30 percent, were reported only by mining of metal ores and related services, manufacture of beverages, and repair and installation of machinery).

### 3. Monetary policy and financial developments

#### 1. Monetary policy

In November 2024 and January 2025, the NBR kept the monetary policy rate at 6.50 percent and left unchanged the lending facility rate at 7.50 percent and the deposit facility rate at 5.50 percent (Chart 3.1). In addition, the minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions were kept at the existing levels, i.e. 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  $\pm 1$  percentage point flat target, in a manner conducive to achieving sustainable economic growth.

Chart 3.1. NBR rates



The NBR Board decisions in November were warranted by the worsening of the inflation developments and outlook compared to the previous medium-term projection, especially in the short run, and by the high uncertainties surrounding forecasts over the longer time horizon.

Specifically, the annual inflation rate continued to decline in 2024 Q3 as a whole, albeit more slowly than in the previous three months and compared to forecasts. It fell to 4.62 percent in September from 4.94 percent in June, as the sharp decreases in the dynamics of administered prices and fuel prices<sup>21</sup> were largely counterbalanced, in terms of impact, by the hike in food prices and to a lower extent by the higher electricity prices, primarily amid the severe drought in 2024. In turn, the annual adjusted CORE2 inflation rate posted a slower downtrend in Q3, also compared with the forecast, reaching

5.6 percent in September from 5.7 percent in June<sup>22</sup>, amid the re-acceleration in the growth rate of processed food prices and the slower decline in the fast dynamics of

<sup>21</sup> Due to base effects and the unexpected drop in crude oil prices

<sup>22</sup> The deceleration of core inflation was further driven mainly by the disinflationary base effects in non-food sub-components and by the decrease in import price dynamics. The influence of these factors was substantially mitigated in Q3 by the unfavourable statistical effect in the processed food segment and by the hike in some agri-food commodity prices, as well as by 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.

services prices, but also against the background of the decrease at a relatively swift pace, similar to that seen in Q2, in the dynamics of non-food prices, which remained however elevated.

At the same time, the updated medium-term projection indicated a worsening of the inflation outlook compared to the previous forecasts, especially over the short term. Specifically, the annual inflation rate was expected to pick up slightly in the closing months of 2024 and to see a marked fluctuation in 2025 H1, thus staying above the variation band of the target and at significantly higher values than anticipated in August 2024. Moreover, the indicator was then seen resuming its decline on a higher path than in the prior projection, dropping no sooner than the onset of 2026 below the upper bound of the variation band of the target and remaining in its vicinity until the end of the forecast horizon. Thus, the annual inflation rate was envisaged to go up to 4.9 percent at end-2024, before decreasing to 3.5 percent in December 2025 and to 3.3 percent at the end of the forecast horizon<sup>23</sup>.

The fluctuations and the higher levels of the annual inflation rate in the following three quarters were primarily attributable to two-way base effects – associated *inter alia* with the legislative changes in the energy field applied in April 2024 –, but also to the severe drought of 2024 and the uptrend in some commodity prices, further affecting food and energy price dynamics. The overall action of supply-side factors was, however, expected to become disinflationary again afterwards, mainly under the impact of base effects that would materialise in the non-food sub-components of core inflation, as well as in the growth rates of administered prices and tobacco product prices<sup>24</sup>. The movements in energy and food prices remained, nevertheless, a major source of inflationary risks, given the applicable legislation and the protracted drought of 2024, as well as the path of crude oil and other commodity prices in view of escalating geopolitical tensions.

Underlying inflationary pressures were, nevertheless, expected to be more moderate and easing more swiftly than in the prior forecast, as the positive output gap was seen narrowing progressively in the following six quarters, until almost closing, implicitly to significantly lower values than envisaged in the previous forecast<sup>25</sup>. Yet, over the short horizon, pressures would remain sizeable, also amid the markedly faster growth of private consumption in 2024 H1 and probably during the year overall, as well as following the high and above-expectations level recently reached by the annual dynamics of unit labour costs in the private sector.

Significant uncertainties and risks came from the future fiscal and income policy stance, given the fiscal and budgetary measures that might be implemented as of 2025 with a view to placing the budget deficit onto a sustainable downward path in line

<sup>23</sup> Compared to 4.0 percent, 3.4 percent and 3.2 percent respectively, as indicated by the prior projection for the same reference periods

<sup>24</sup> At the same time, fuel price dynamics were anticipated to stay in the short run below the previously-forecasted levels, amid the recent and anticipated developments in crude oil prices.

<sup>25</sup> Economic growth was anticipated to see a markedly slower pace in 2024 and then recover moderately in 2025, reflecting the revival of external demand, as well as amid the use of European funds under the Next Generation EU instrument, albeit in a lower volume than envisaged previously.

with the new EU economic governance framework. Moreover, heightened uncertainties and risks to the outlook for economic activity, implicitly the medium-term inflation developments, stemmed from the war in Ukraine and the Middle East conflict, as well as from the economic performance in Europe and globally, also in the context of escalating geopolitical tensions, but also from the absorption and efficient use of EU funds, especially those under the Next Generation EU programme.

According to subsequently-released statistical data, the annual inflation rate saw a higher-than-expected rise in the last three months of 2024 to reach 5.14 percent in December, mainly under the impact of higher fuel prices<sup>26</sup>, but also following the new increases in food prices, amid the severe drought in the summer of 2024 and the hike in some commodity prices.

At the same time, the annual adjusted CORE2 inflation rate saw a halt in its downward trend, remaining flat at 5.6 percent until December, i.e. a level similar to that at end-Q3. This occurred as the further acceleration of the annual growth in processed food prices was accompanied by the markedly slower disinflation in the non-food segment and by the steady pace of disinflation in services prices. The behaviour of core inflation reflected 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.

Economic activity stalled in 2024 Q3, after having increased by 0.1 percent in the previous three months (quarterly changes) so that excess aggregate demand is likely to have further narrowed over this period, relatively in line with forecasts. Annual GDP growth stepped up to 1.2 percent from 0.9 percent in 2024 Q2, although the fast rate of increase of household consumption slowed down and the annual dynamics of gross fixed capital formation continued to see a steep decline<sup>27</sup>. Their impact on the annual GDP growth rate was more than offset by the substantial decline in the negative contribution of net exports, amid the visibly swifter decrease in the annual change in the import volume of goods and services than in that of the export volume. The narrowing differential between the latter two also triggered a significant deceleration in 2024 Q3 in the annual growth rates of trade and current account deficits, compared to the previous quarter.

On the labour market, the number of employees economy-wide resumed its monthly increase in September 2024 and continued to grow at a relatively fast pace in October 2024, while the ILO unemployment rate fell in October and November, after having risen in the previous quarter. Furthermore, employment intentions slowed their decline in quarterly terms, whereas the labour shortage reported by companies shrank more visibly in 2024 Q4 as a whole. The two-digit annual growth rate of

<sup>26</sup> Primarily as a result of the significant appreciation of the US dollar on the international financial market

<sup>27</sup> Falling to a slightly positive level, i.e. a nine-quarter low

the nominal gross wage and especially that of unit labour costs in industry decreased in October, yet remained elevated, after the increases seen in 2024 Q3 to 16.7 percent and 18.6 percent respectively.

On the financial market, the main interbank money market rates witnessed sizeable increases in the second part of November and then remained relatively unchanged. At the same time, long-term yields on government securities steepened and extended their upward course until the closing 10-day period of December 2024. This occurred in the context of the high volatility of the global risk appetite, but also amid the uncertainty associated with the electoral events in November and early December, conducive to a temporary rise in financial investor concerns about the fiscal and external positions of the economy. The EUR/RON exchange rate remained broadly stable in November and December, at the higher values it had returned to in mid-Q3. In relation to the US dollar, the leu continued to depreciate markedly over this period, as the former strengthened visibly on international financial markets.

The annual growth rate of credit to the private sector continued to pick up during the first two months of 2024 Q4 overall, on the back of household credit, given the further step-up in the dynamics of the leu-denominated component. The share of the domestic currency component in credit to the private sector thus widened to 70.2 percent in November from 69.8 percent at the end of 2024 Q3.

The updated assessments in this context reconfirmed the prospects for the annual inflation rate to decline in the first three months of 2025, yet on a higher path than that shown in the November 2024 medium-term forecast. The decrease would be largely driven by supply-side factors, primarily by base effects in the non-food sub-components of core inflation and in the fuels segment. The disinflationary action of these factors would, however, be weaker than previously anticipated, given the recent developments in fuel and crude oil prices, but also the persistent opposite effects exerted on food and energy price dynamics by the 2024 unfavourable weather conditions and by the increase in some commodity prices, as well as by the higher energy consumption over the winter months.

At the same time, significant uncertainties were further associated with the anticipated developments in food and energy prices, given the applicable legislation and the price movements in wholesale markets, as well as the future path of crude oil and other commodity prices in view of geopolitical and trade tensions.

Underlying inflationary pressures were expected to ease in line with previous assessments, as the new forecasts, like the previous ones, pointed to moderate quarterly increases in economic activity in 2024 Q4 and 2025 Q1 – implying the decrease of excess aggregate demand to very low values over this period –, yet amid the still robust consumer demand and the swift growth of unit labour costs in the private sector, although decelerating versus the rates seen in the first three quarters of 2024<sup>28</sup>.

<sup>28</sup> More obvious 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.

Significant uncertainties and risks to the forecasts came from the future fiscal and income policy stance, given the recently approved package of fiscal and budgetary measures implemented at the onset of 2025 for budget consolidation purposes 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 inflation developments, stemmed from the war in Ukraine and the Middle East conflict, as well as from the economic performance in Europe and globally and international trade developments, in the context of escalating geopolitical tensions, and of the economic policy measures taken by advanced countries. A major source of uncertainties remained also the absorption of EU funds, especially those under the Next Generation EU programme.

The analysed context overall warranted a policy rate status-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 15 January 2025, the NBR Board decided to keep the monetary policy rate at 6.50 percent and to leave unchanged the lending facility rate at 7.50 percent and the deposit facility rate at 5.50 percent. Furthermore, the NBR Board kept the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions.

## 2. Financial markets and monetary developments

The daily average interest rate on interbank transactions<sup>29</sup> increased frequently in the second part of 2024 Q4, while the longer-term rates rose significantly in the closing 10-day period of November and then stabilised at the new levels. The EUR/RON exchange rate tended to remain at the higher values it had returned to in mid-Q3. The annual growth rate of liquidity across the economy went up October through November 2024 overall, while that of credit to the private sector continued on an upward trend.

### 2.1. Interest rates

The daily average interest rate on interbank money market transactions remained at the lower bound of the interest rate corridor in the first half of 2024 Q4 too, before witnessing frequent increases, although of a moderate magnitude. The quarterly average of the indicator<sup>30</sup> decreased more slowly than in Q3, dropping by 0.06 percentage points to 5.60 percent.

<sup>29</sup> The average interest rate on transactions in deposits on the interbank money market, weighted by the volume of transactions

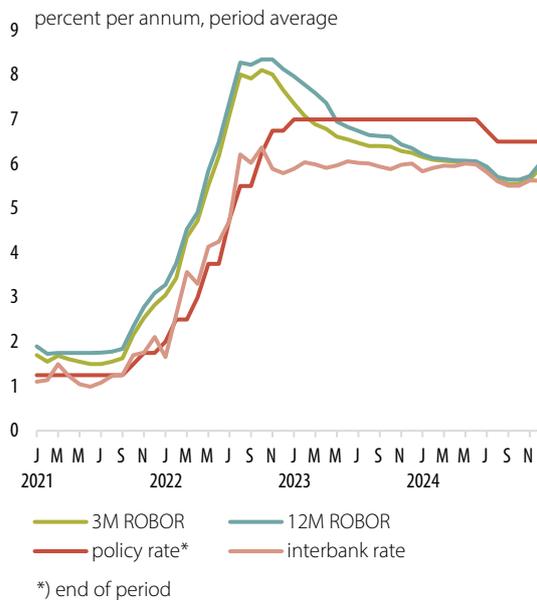
<sup>30</sup> Average weighted by the volume of transactions

The main drivers of this behaviour were the status-quo of the NBR's key rates and the steep narrowing of liquidity surplus on the money market, starting particularly from the mid-quarter<sup>31</sup>, in the context of the high volatility of the global risk appetite<sup>32</sup>, but

also amid the uncertainty associated with the electoral events in November and early December<sup>33</sup>, conducive to a temporary rise in financial investor concerns about the fiscal and external positions of the economy<sup>34</sup>.

In turn, 3M-12M ROBOR rates remained unchanged until mid-Q4<sup>35</sup>, then witnessed sizeable increases in the second half of November before stabilising at the new levels. In the period from November to December as a whole, the monthly averages of ROBOR rates thus rose in a range between 0.36 and 0.37 percentage points, to 5.91 percent for the 3M rate and to 5.97 percent and 6.02 percent for 6M and 12M rates respectively. The quarterly averages of ROBOR rates thus halted their decrease, advancing marginally as compared to those recorded July through September 2024, i.e. to 5.70 percent for the 3M rate and to 5.74 percent and 5.79 percent respectively for 6M and 12M rates (Chart 3.2).

Chart 3.2. Policy rate and ROBOR rates



In the same context, medium- and long-term reference rates on the secondary market for government securities<sup>36</sup> steepened their upward path at mid-November<sup>37</sup> and, after a visible decline in the first part of December, resumed their abrupt rise, reaching 21-month highs<sup>38</sup> at the end of the second 10-day period. Their evolution thus diverged temporarily from that of similar yields in advanced economies and in the region<sup>39</sup>.

In turn, rates on 6- and 12-month securities rose at a faster pace at mid-Q4, while also

<sup>31</sup> The liquidity surplus remained relatively large from a historical perspective and was further mopped up by the central bank via the deposit facility. The average daily stock of these deposits shrank to lei 21.2 billion in 2024 Q4, from lei 40.9 billion in the previous quarter.

<sup>32</sup> Largely driven by the uncertainty surrounding the result of the US presidential elections and the expectations on the economic policies of the future administration – likely to lead to a new revision of investor expectations on the pace/size of interest rate cuts by the Fed and to a stronger appreciation trend of the US dollar –, as well as the escalation of the Russia-Ukraine conflict

<sup>33</sup> The first round of the presidential elections was held on 24 November and the parliamentary elections took place on 1 December 2024. On 6 December, the Constitutional Court decided that the entire process of presidential elections was annulled and that it would be resumed in full, based on a subsequently agreed calendar.

<sup>34</sup> Further fuelled by the weaker-than-expected economic performance in 2024 Q3, as shown by the statistical data released in this period

<sup>35</sup> Close to the levels recorded immediately after the NBR's policy rate cut in August 2024

<sup>36</sup> Bid-ask averages

<sup>37</sup> They resumed and stayed on an upward path in October, relatively in line with developments in advanced economies and in the region, due to investors reconsidering the outlook for the Fed's interest rate, with an impact on the global risk appetite as well.

<sup>38</sup> On 17 December, Fitch revised the outlook on Romania's sovereign rating (BBB-) to "negative" from "stable", the rationale being the increase of political uncertainty to high levels and its potential implications for fiscal consolidation.

<sup>39</sup> Long-term (10-year) government security yields in the US extended their upward course in the first part of November, before witnessing a decline, and then they surged again, reaching a 7-month high, after the Fed's monetary policy decision of December. In turn, long-term government security yields in the euro area and countries in the region followed a relatively similar path, but did not exceed in December the levels recorded in the first part of the previous month.

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

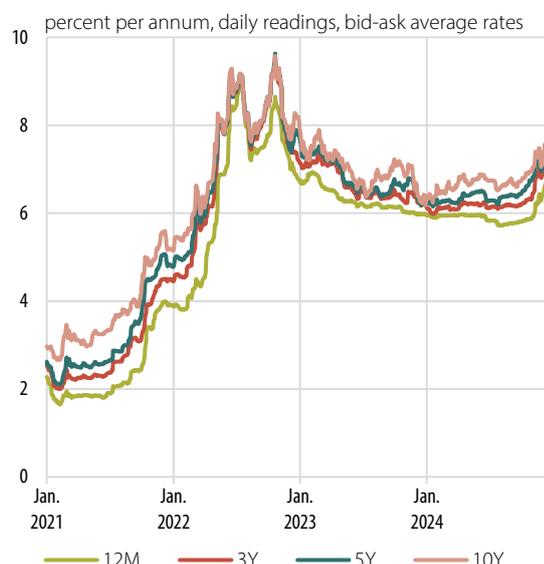
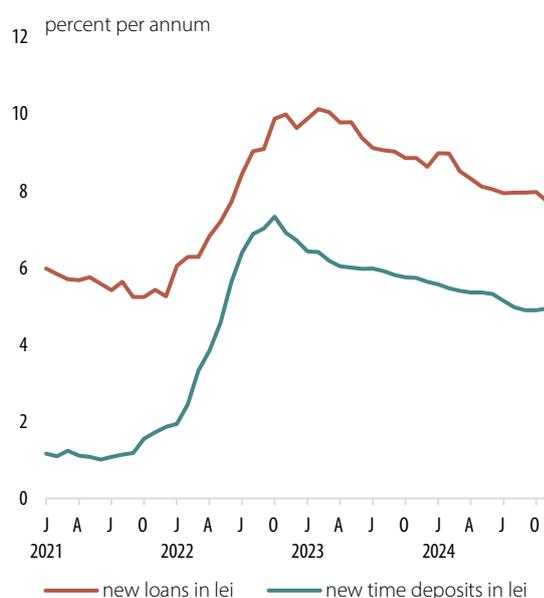


Chart 3.4. Bank rates



posting larger fluctuations in the latter part of the period (Chart 3.3). As a result of these developments, the monthly averages of these rates picked up by 0.60-0.80 percentage points in December as compared to those seen in September, relatively more strongly in the median segment of the yield curve – up to 6.37 percent and 6.46 percent for 6M-12M Treasury certificates and 7.00 percent, 7.15 percent and 7.31 percent for 3-, 5- and 10-year bonds. The positive slope of the yield curve declined slightly.

Average rates in the primary market of government securities<sup>40</sup> posted sizeable increases too. Specifically, they went up in December versus September in a range between 0.70 and 0.82 percentage points to 6.49 percent for the 1-year securities and to 7.04 percent and 7.48 percent for the 3- and 10-year maturities. At the same time, the volume of issues contracted by lei 6.2 billion in 2024 Q4 versus Q3 (to lei 20.1 billion), while that of net issues plummeted by approximately lei 20 billion to lei 4.5 billion, on the back of the notable rise in this period in the volume of maturing securities (lei 15.5 billion). The considerable weakening of investors’ appetite for this type of investments is also reflected by the reduction in the ratio of the amounts of bids submitted by primary dealers to the announced volume at auctions (to 1.64, from 2.16 in Q3), as well as in the ratio of the volume of issues to the announced volume (to 1.06, from 1.47)<sup>41</sup>.

Credit institutions’ average interest rates applicable to non-bank clients recorded a slower decrease in October-November as a whole compared to Q3, for both new loans (-0.10 percentage points to an average value of 7.85 percent) and new time deposits (-0.08 percentage points to 4.92 percent) (Chart 3.4).

<sup>40</sup> During 2024 Q4, the “Tezaur” programme saw the monthly issuance of government securities with 1-, 3- and 5-year maturities, at rates of: (i) 5.80 percent, 6.60 percent and 7.00 percent respectively in October, (ii) 5.85 percent, 6.60 percent and 7.00 percent respectively in November and (iii) 5.95 percent, 6.70 percent and 7.10 percent in December. Additionally, the MF issued government securities for households under the “Fidelis” programme in October (both in domestic currency, with 1- and 5-year maturities, at rates of 5.85 percent and 7.00 percent, worth around lei 1.5 billion, and in euro, with 1- and 5-year maturities, at rates of 3.95 percent and 5.00 percent, totalling about EUR 388 million) and in December (both in domestic currency, with 1-, 3- and 5-year maturities, at rates of 6.45 percent, 7.60 percent and 7.90 percent, worth around lei 1.4 billion, and in euro, with 2- and 7-year maturities, at rates of 3.75 percent and 5.75 percent, amounting to about EUR 225 million). Moreover, in December 2024, the MF issued on the domestic market EUR-denominated government securities with 12-month and 2-year maturities and average rates of 3.19 percent and 3.50 percent respectively, totalling EUR 350 million. For the first time, the MF issued on the external market JPY-denominated green Samurai bonds with 3-, 5- and 7-year maturities and rates of 2.10 percent, 2.63 percent and 3.14 percent respectively, totalling approximately JPY 33 billion (the equivalent of EUR 200 million).

<sup>41</sup> Given that the MF fully rejected in November the primary dealers’ bids submitted at two 4-year securities auctions.

From a sectoral perspective, average interest rates displayed mixed changes in the case of new loans, yet moved in the same direction for new time deposits. Specifically, the average interest rate on new loans to households saw a slightly faster drop as against Q3 (-0.21 percentage points to 7.75 percent), but mainly as a result of the larger share in total of new housing loans, whose volume reached a new all-time high in this period (Chart 3.5). However, the average interest rate on these loans posted a significantly slower decline (-0.11 percentage points to 6.17 percent), while that on new consumer credit fell marginally (-0.05 percentage points to 9.57 percent), after the modest upward adjustment in Q3.

Chart 3.5. Interest rates for households\*

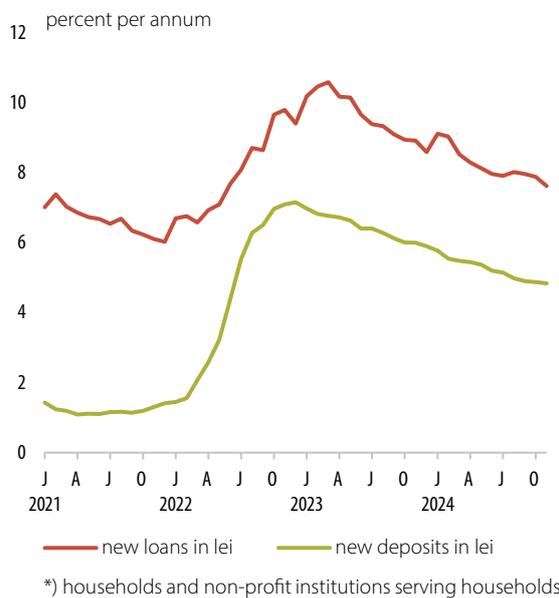
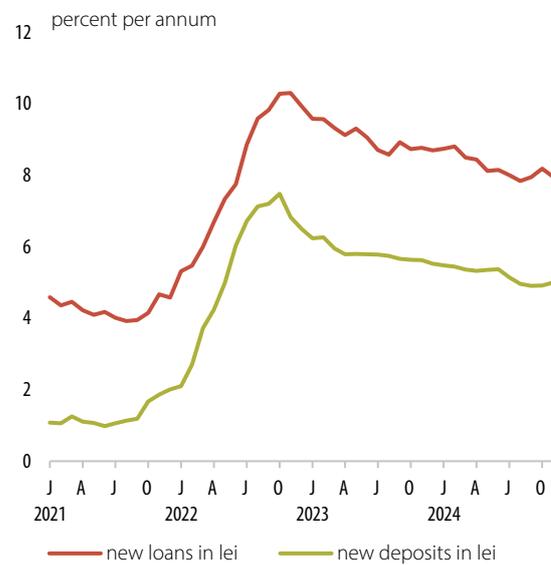


Chart 3.6. Interest rates for non-financial corporations



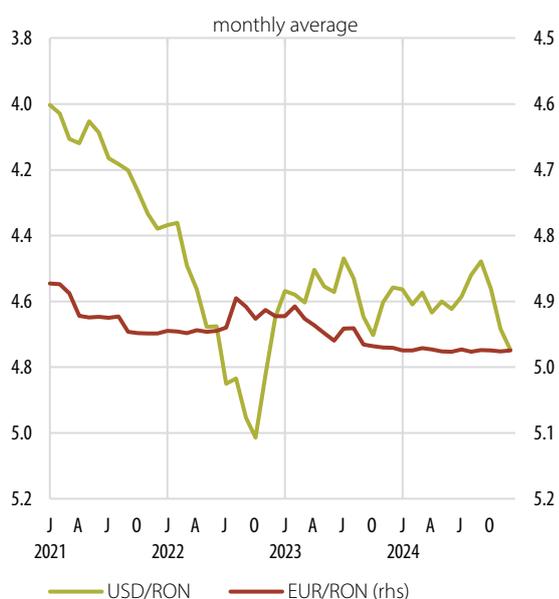
By contrast, the average lending rate on new business to non-financial corporations increased slightly in the period overall, to 8.07 percent (+0.14 percentage points versus Q3), thus discontinuing its downward trend over the past seven quarters (Chart 3.6). Nevertheless, developments were uneven across the major types of loans, given that the average interest rate on high-value loans (above EUR 1 million equivalent) saw a relatively strong advance (+0.46 percentage points as against Q3 to 7.62 percent), whereas that on low-value loans (below EUR 1 million equivalent) rose marginally (+0.05 percentage points to 8.43 percent).

Looking at new time deposits, the average remuneration recorded a significantly slower contraction compared to the previous quarter in the case of households (-0.16 percentage points to an average of 4.85 percent in the October-November period), while that for non-financial corporations almost halted its decline, decreasing only marginally to 4.96 percent.

## 2.2. Exchange rate and capital flows

The EUR/RON exchange rate tended to stick in the last three months of 2024 to the higher values to which it had returned to in mid-Q3 (Chart 3.7).

Chart 3.7. Nominal exchange rate



In October, the exchange rates of the main currencies in Central and Eastern Europe were faced with increased pressure, amid the decline in global risk appetite, mainly under the impact of investors reconsidering the outlook for the Fed's interest rate<sup>42,43</sup>, but also amid investor concerns about the worsening of some economic developments in the euro area, which also prompted the EUR/USD exchange rate to shift to a steeply downward path. The EUR/RON exchange rate remained relatively stable at the higher values to which it had returned to in mid-Q3, also in the context of the NBR's monetary policy decision taken in October, while the exchange rates of currencies in the region re-embarked and stayed on a strong uptrend<sup>44</sup>.

Global financial market sentiment was further volatile in November, while the investor risk perception of some emerging economies deemed

more vulnerable continued to worsen, amid the uncertainty surrounding the outcome of the presidential election in the US and the expectations on the economic policies of the new administration, likely to lead to an additional revision of the expectations on the pace and size of interest rate cuts by the Fed<sup>45</sup>, as well as to a steeper appreciation trend of the US dollar<sup>46</sup>. At the same time, financial investor concerns about the fiscal and external positions of the economy have been temporarily amplified since mid-Q4 by the weaker-than-expected economic growth in 2024 Q3<sup>47</sup>, but especially by the uncertainty associated with the electoral events that took place in the closing 10-day period of November and at the beginning of December<sup>48</sup> (Table 3.1). The EUR/RON exchange rate remained relatively stable, *inter alia* amid the contraction, in this context, in the liquidity surplus across the banking system and the rise in longer-term interest rates in the money market (Chart 3.8).

<sup>42</sup> Given the above-expectations performance of labour market and inflation in the US, as shown by the new statistical data

<sup>43</sup> Additional effects came from the uncertainty surrounding the outcome of the upcoming presidential election in the United States, alongside its economic and geopolitical implications, as well as from the escalating tensions in the Middle East.

<sup>44</sup> During October as a whole, the Czech koruna depreciated versus the euro by 0.8 percent, the zloty by 0.9 percent, and the forint by 1.8 percent.

<sup>45</sup> Investors revised their expectations in favour of a slower and less sizeable cut in Fed's policy rate. These expectations were partly adjusted in the closing 10-day period of the month.

<sup>46</sup> On 22 November, the EUR/USD exchange rate fell to an approximately 2-year low.

<sup>47</sup> According to the flash estimates released on 14 November, the economic activity contracted by 0.1 percent in 2024 Q3 (quarterly change), whereas the subsequently revised data indicated a stagnation.

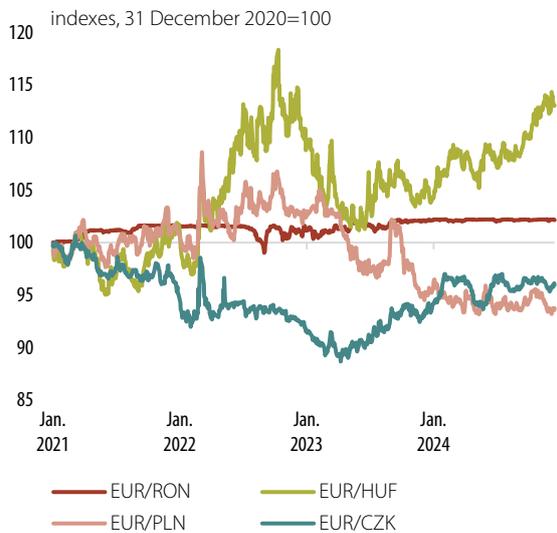
<sup>48</sup> The first round of presidential elections took place on 24 November 2024, while the parliamentary elections were organised on 1 December 2024.

Table 3.1. Key financial account items

	EUR million					
	11 mos. 2023			11 mos. 2024		
	Net acquisition of financial assets*	Net incurrence of liabilities*	Net	Net acquisition of financial assets*	Net incurrence of liabilities*	Net
Financial account	17,212	28,126	-10,914	5,127	25,479	-20,352
Direct investment	1,469	7,729	-6,259	1,018	6,875	-5,857
Portfolio investment	0	14,127	-14,127	1,718	13,668	-11,950
Financial derivatives	184	0	184	57	0	57
Other investment	2,757	6,270	-3,513	2,439	4,936	-2,497
– currency and deposits	306	-461	767	1,143	-466	1,609
– loans	-175	1,269	-1,444	96	1,856	-1,760
– other	2,626	5,462	-2,837	1,200	3,547	-2,347
NBR's reserve assets, net	12,801	0	12,801	-104	0	-104

\*) "+" increase/"-" decrease

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



Source: ECB, NBR

However, the exchange rates of major currencies in the region versus the euro witnessed mixed developments in November, reflecting particularly the influences of some domestic factors<sup>49</sup>.

The EUR/RON exchange rate saw a notable decrease after the Constitutional Court's ruling to annul the process of the presidential elections<sup>50</sup>, but reverted and then tended to remain at the values prevailing before, amid investor concerns about budget consolidation prospects<sup>51</sup>, but also due to the fluctuating global risk appetite. The latter improved in the first half of the month, but then deteriorated again, as a result of the Fed's monetary policy decision of 17-18 December and the associated statement, implying the upward revision of investor expectations for the path of the Fed's policy rate<sup>52</sup>, which also entailed a further decline in the EUR/USD exchange rate.

Amid the visible strengthening of the US dollar on international financial markets during Q4, the leu depreciated markedly in relation to the US dollar in the closing three months of 2024.

In 2024 Q4 overall, the interbank forex market turnover rose significantly, whereas the negative balance of transactions reached a very high level.

In this period, the leu remained unchanged versus the euro<sup>53,54</sup> and continued to appreciate in real terms (by 0.3 percent). In relation to the US dollar, the national currency depreciated considerably, in both nominal and real terms, i.e. by 5.7 percent and 5.4 percent respectively. Looking at the annual change in the quarterly averages of the exchange rate, the leu saw its depreciation against the euro slow down, but weakened also vis-à-vis the US dollar, after the slight appreciation in the previous quarter.

<sup>49</sup> In November overall, the forint continued to weaken significantly versus the euro, the Polish zloty saw a more modest depreciation, while the Czech koruna remained relatively unchanged versus the euro.

<sup>50</sup> Issued on 6 December 2024

<sup>51</sup> On 17 December 2024, Fitch revised the outlook on Romania's sovereign rating (BBB-) to "negative" from "stable", the rationale being the increase of political uncertainty to high levels and its potential implications for fiscal consolidation.

<sup>52</sup> The updated projections of participants in the FOMC meeting on the median of the midpoint of the target range for the federal funds rate were revised upwards more than anticipated.

<sup>53</sup> Based on December and September 2024 averages of the EUR/RON exchange rate

<sup>54</sup> At the same time, the forint weakened by 4.2 percent against the single currency, the Czech koruna by 0.1 percent, whereas the zloty appreciated by 0.1 percent.

## 2.3. Money and credit

### Money

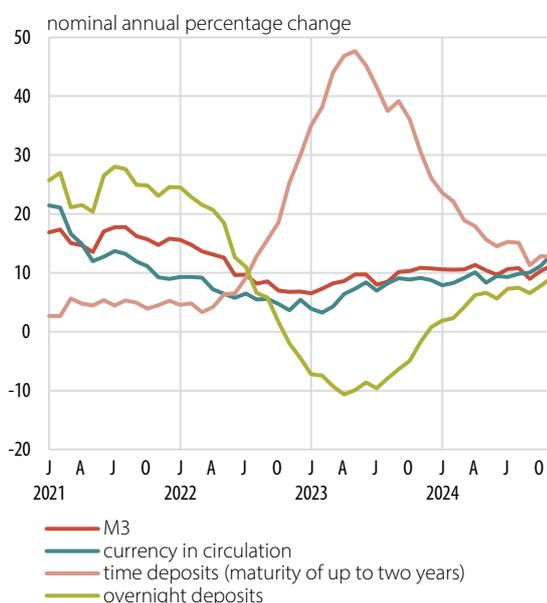
The annual dynamics of broad money (M3) stepped up to 10.8 percent<sup>55</sup> in October-November 2024, after decelerating to 10.1 percent in Q3, in correlation with the characteristics of budget execution and the continued uptrend in the annual growth rate of credit to the private sector (Table 3.2).

Table 3.2. Annual growth rates of M3 and its components

	nominal percentage change						
	2023	2024				Oct.	Nov.
	IV	I	II	III			
	quarterly average growth						
M3	10.6	10.6	10.5	10.1	10.3	11.2	
M1	0.8	4.3	7.0	7.8	8.7	10.3	
Currency in circulation	8.9	8.4	9.3	9.7	11.2	13.1	
Overnight deposits	-2.0	2.8	6.2	7.1	7.8	9.2	
Time deposits (maturity of up to two years)	30.9	21.6	16.0	13.9	12.8	12.7	

The stronger momentum of M3 was driven, during this period as well, mainly by narrow money (M1), whose annual rate of change picked up more visibly, prompted by the markedly slower decline in households' foreign currency-denominated overnight deposits and the re-acceleration of the annual growth rate of currency in circulation<sup>56</sup>, also amid the uncertainty associated with the electoral events in the closing 10-day period of November and early December. Nevertheless, the annual dynamics of leu-denominated overnight deposits remained unchanged, at a two-digit level, given the divergent influences that continued to be exerted by the faster increase in households' deposits, on the one hand, and the loss of momentum in corporate and non-MFI deposits, on the other hand (Chart 3.9).

Chart 3.9. Main broad money components



At the same time, the annual pace of increase of time deposits with a maturity of up to two years slowed its downward path markedly, amid the re-acceleration in the growth of non-financial corporations' deposits – primarily on account of the annual rate of change of the foreign currency-denominated component<sup>57</sup> –, but also following the milder deceleration in the dynamics of households' time deposits, with the major contribution of foreign currency-denominated deposits as well. Nevertheless, the share of M1 in M3 narrowed slightly from the level posted at end-Q3, namely to 60.3 percent in November 2024 from 60.5 percent.

The breakdown by holder shows that the advance in M3 growth was driven by non-financial corporations' deposits, whose annual dynamics re-accelerated,

<sup>55</sup> In real terms, the annual pace of increase of M3 re-embarked on an upward path, climbing to 5.6 percent October through November 2024 from 4.8 percent in Q3.

<sup>56</sup> The annual growth rate of currency in circulation reached a 13-quarter high in October-November 2024.

<sup>57</sup> In turn, the annual dynamics of non-financial corporations' leu-denominated deposits stepped up somewhat, for the first time in the past seven quarters.

in correlation with the faster paces of increase of the turnover volumes of retail trade<sup>58</sup> and market services to households in October-November, as well as of government spending on goods and services, accompanied however by similar developments in payments of taxes and charges<sup>59</sup>. Conversely, the annual rate of change of households' deposits continued to decline somewhat, amid the relatively more pronounced

pick-up in the dynamics of purchases of goods and services and of this sector's holdings of government securities than the acceleration in the annual growth rate of real disposable income during this period.

From the perspective of M3 counterparts, expansionary influences were exerted in this period by the new step-ups in the growth rates of net credit to the central government and credit to the private sector, while opposite effects stemmed from the further deceleration in the pace of increase of net foreign assets of the banking system.

#### Credit to the private sector

The annual dynamics of credit to the private sector remained on an upward trend in October-November 2024, rising to an average of 8.9 percent over this period from 7.6 percent in Q3, primarily due to the continued acceleration of the growth rate of the leu-denominated component, but also with the modest contribution of foreign currency credit (Chart 3.10). Thus, the share of leu-denominated loans in total private sector credit widened to 70.2 percent in November from 69.8 percent in September.

The step-up in the dynamics of credit to the private sector was driven by both major sectors (Chart 3.11). Specifically, the annual rate of change of loans to households continued to rise relatively fast, solely on account of the leu-denominated component, whose two-digit annual growth accelerated, equal contributions being made by housing loans – amid the historical high reached by their flow<sup>60</sup> – and consumer credit and other loans. Conversely, the stock of foreign currency credit to households (expressed in euro) further recorded a particularly sizeable contraction against the same year-earlier period.

Chart 3.10. Credit to the private sector by currency

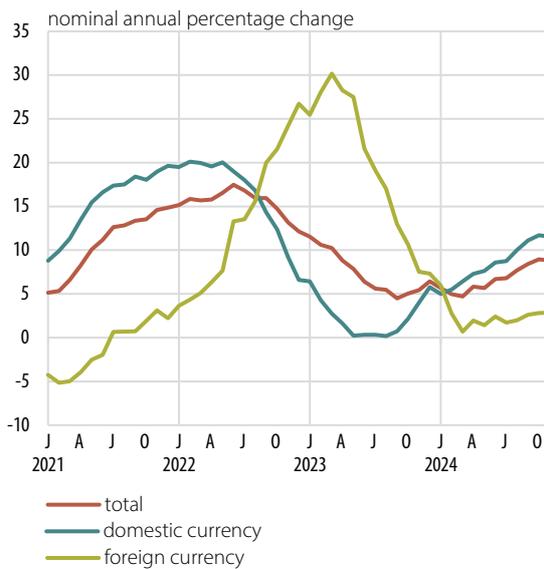
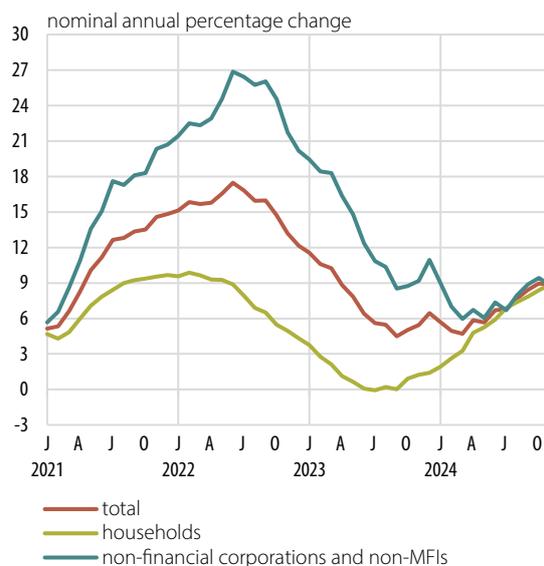


Chart 3.11. Credit to the private sector by institutional sector



<sup>58</sup> Motor vehicle and motorcycle trade included

<sup>59</sup> According to general government budget execution data

<sup>60</sup> Excluding renegotiated loans

In turn, the annual pace of increase of loans to non-financial corporations stuck to an upward path, chiefly following the new pick-up in the dynamics of leu-denominated loans, even amid the lower contribution of government programmes (“IMM Invest Plus”) as compared with the same year-ago period. The main factor behind this development was the rate of change of short-term loans, modest influences being however exerted by medium- and long-term loans<sup>61</sup> as well. At the same time, the annual growth rate of the foreign currency-denominated component regained slight momentum, as a result of the rebound in short-term loans, whose impact was only partly offset by the slower-paced increase in medium- and long-term loans.

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<sup>61</sup> Amid their annual growth rate re-entering positive territory for the first time in the past four quarters

## 4. Inflation outlook

The baseline scenario of the macroeconomic projection anticipates further fluctuations in the annual inflation rate for the first part of 2025. Subsequently, the indicator is seen declining and re-entering the variation band of the target in 2026 Q1, before remaining relatively stable in its upper half throughout the year. The breakdown shows that the trajectory of CPI inflation is shaped by the continuous, albeit gradual, decline in core inflation, while the exogenous components of the consumer basket overall will drive the volatile pattern of headline CPI during the first part of the forecast interval, mainly owing to some base effects. Under the circumstances, the annual CPI inflation rate is forecasted to reach 3.8 percent in December 2025 and 3.1 percent in December 2026. Compared to the trajectory published in the November 2024 *Inflation Report*, CPI inflation will run at higher levels until end-2025 (more visibly in the first quarters of the year) and at lower levels in 2026. The revision for December 2025 is +0.3 percentage points, primarily ascribable to the price hikes at the beginning of the year (tobacco products and administered prices), as well as to the more persistent core inflation dynamics, partly offset by slightly more optimistic prospects for the VFE group. Conversely, at the horizon of the preceding forecast (2026 Q3), the annual CPI growth rate is 0.1 percentage points lower, particularly as a result of the downward revision of core inflation. The balance of risks is assessed to remain tilted to the upside compared to the inflation path in the baseline scenario. At the current juncture, the risk of a step-up in trade protectionism has risen. Domestically, the future configuration of the electricity and natural gas price capping scheme is clouded by uncertainty.

### 1. Baseline scenario

#### 1.1. External assumptions

Compared to the previous *Report*, the dynamics of the external trading partners' economic activity, as proxied by the EU effective GDP, were revised downwards to 1.2 percent in 2025, and marginally upwards to 1.6 percent in 2026 (Table 4.1). In the short run, economic growth reflects primarily the high degree of uncertainty facing economic agents. Specifically, external economic activity is expected to increase at a moderate pace in quarterly terms in 2024 Q4 and 2025 Q1, and to gain slight momentum thereafter. Over the medium term, economic activity is foreseen to be boosted by developments in consumption, along with a recovery in extra-EU foreign demand<sup>62</sup> and an easing of the restrictive effect of the ECB's monetary policy.

<sup>62</sup> Given the possibility of trade protectionism being tightened through the introduction of tariff barriers, uncertainties stemming from the external environment have gained increased significance.

**Table 4.1. Expected developments in external variables**

	annual averages	
	2025	2026
EU effective GDP growth (%)	1.2	1.6
Euro area annual inflation (%)	2.1	1.9
Euro area annual inflation excluding energy (%)	2.4	2.1
Annual CPI inflation rate in the USA (%)	2.5	2.4
3M EURIBOR (% p.a.)	2.1	1.9
USD/EUR exchange rate	1.03	1.05
Brent oil price (USD/barrel)	74.6	71.1

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

Against this background, the effective external output gap was revised downwards and is envisaged to remain in negative territory over the entire forecast interval, whereas in the prior projection it was expected to post negative values only until 2025 Q2.

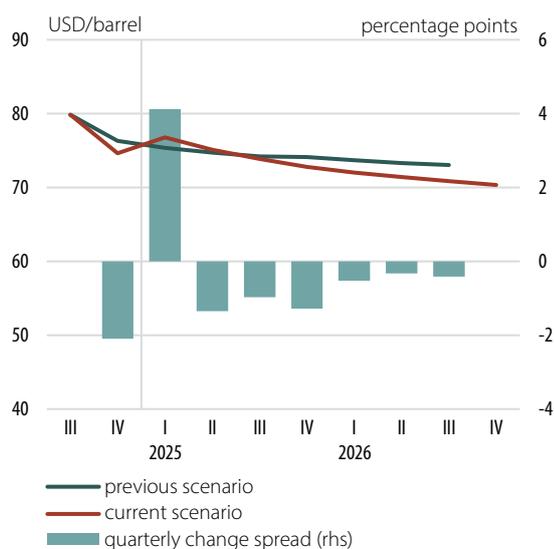
The average annual inflation rate for the euro area was assessed at a slightly lower level compared to the prior *Report* (2.1 percent in 2025 and 1.9 percent in 2026), mainly on account of the energy sub-component. The annual inflation rate is forecasted to reach the ECB's 2 percent benchmark in 2025 Q4, as envisaged in the previous *Inflation Report*, and to

subsequently stay mildly below this level over the remainder of the projection interval.

The forecast of the euro area HICP inflation excluding energy<sup>63</sup> was kept at 2.4 percent for 2025 and at 2.1 percent for 2026. Looking by quarter, the indicator follows a steadily downward track, at a swifter pace than headline inflation over both the short and medium term. This path is anticipated amid the gradual moderation of pay rises, while corporate profit margins are assessed to further act as a partial buffer, especially in the short term, against the pass-through of labour costs to final prices of goods and services. At the projection horizon, i.e. 2026 Q4, the HICP inflation rate excluding energy is forecasted to run slightly above headline inflation (2 percent versus 1.9 percent).

The nominal 3M EURIBOR hit a high of 4 percent for the current cycle in 2023 Q4 and is seen remaining on a gradually declining path and reaching 1.8 percent in 2025 Q4, before stabilising around this value over the remainder of the forecast interval. 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 euro area economy. This effect is expected to fade out until 2025 Q2, assuming further cuts in the ECB's nominal policy rate. Subsequently, the real 3M EURIBOR rate is projected to remain at close to neutral levels until the forecast horizon.

**Chart 4.1. Brent oil price scenario**



Source: U.S. Energy Information Administration, NBR assumptions based on Bloomberg data

The path of the EUR/USD exchange rate points to a strengthening of the US dollar in the short term, followed by a slight and gradual recovery of the euro over the projection interval. This path takes shape against the background of expectations for the monetary policies pursued by the ECB and the

<sup>63</sup> A proxy for imported inflation in the case of Romania.

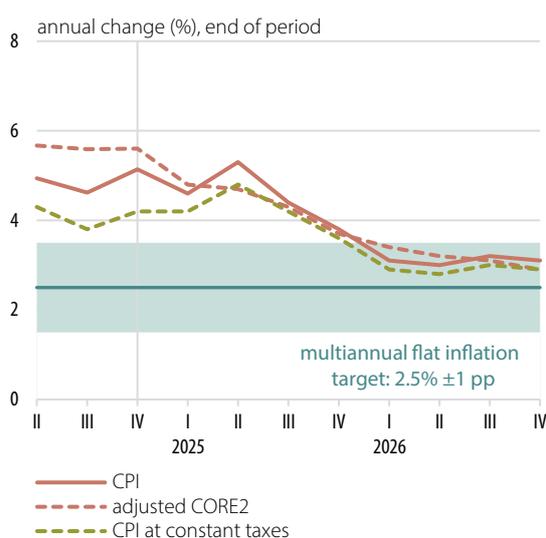
Fed, in a general context where the European economy is showing signs of weakness. Moreover, a major factor influencing the exchange rate is international trade, including the potential increase in US tariffs on EU goods. Under the circumstances, the forecasted movements in the exchange rate of the euro against the US dollar are surrounded by a high degree of uncertainty.

The scenario for the Brent oil price is based on futures prices and foresees a downswing, given the prospective slowdown in global economic activity. Specifically, at the forecast horizon, the Brent oil price is projected at around USD 70/barrel (Chart 4.1). However, this outlook is subject to multiple risk factors, in particular of a geopolitical nature, such as the anticipated increase in US tariffs on certain countries or regions. On the demand side, concerns about the weakening global growth prevail over the short and medium term, weighing also on oil demand. On the supply side, the new US presidential administration is making visible efforts to lower commodity prices, on the one hand by accelerating the approval of several energy infrastructure projects and, on the other hand, by taking steps to encourage OPEC members<sup>64</sup> to lower oil prices. As far as the Middle East conflict is concerned, the ceasefire between Israel and Hamas supports the trend indicated by futures prices.

## 1.2. Inflation outlook

During 2024 Q4, the annual CPI inflation rate went up at a faster-than-anticipated pace, reaching 5.14 percent in December (+0.3 percentage points above the projected

Chart 4.2. CPI and adjusted CORE2 inflation forecasts



Source: NIS, NBR projection

level in the November 2024 *Inflation Report*)<sup>65</sup>. It will continue to fluctuate under the impact of statistical base effects throughout the following three quarters, before being expected to decrease gradually.

The inflation rate will re-enter the variation band of the target in 2026 Q1, coming in at 3.1 percent, and will remain close to this value throughout the next year (Chart 4.2). The breakdown shows that the trajectory of CPI inflation is shaped by the continuous, albeit gradual decline in core inflation, while the exogenous components of the consumer basket overall will drive the volatile pattern of headline CPI during the first part of the forecast interval.

In the short run, the annual inflation rate will go down in 2025 Q1. This is ascribable to some favourable base effects that will offset the price increases envisaged at the beginning of the year for tobacco products, fuels, water, sewerage and waste

<sup>64</sup> At the 2025 World Economic Forum meeting in Davos, the US president stated that he would exert pressure on OPEC members to lower oil prices.

<sup>65</sup> The Box assesses the accuracy of NBR projections for the annual CPI inflation rate at end-2024.

**Table 4.2. CPI and adjusted CORE2 inflation in the baseline scenario**

	annual change (%), end of period							
	2025				2026			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Target (mid-point)	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
CPI projection	4.6	5.3	4.4	3.8	3.1	3.0	3.2	3.1
CPI projection*	4.2	4.8	4.2	3.6	2.9	2.8	3.0	2.9
Adjusted CORE2 projection	4.8	4.7	4.3	3.7	3.4	3.2	3.1	2.9

\*) calculated at constant taxes

disposal services, as well as for products included in the adjusted CORE2 index. Subsequently, headline inflation will increase in 2025 Q2, when it will capture unfavourable statistical influences associated with the decreases in natural gas, electricity and VFE prices that occurred one year earlier. In the second half of 2025, the updated baseline scenario foresees the annual inflation rate declining gradually to reach 3.8 percent in December 2025. After a new slowdown in the beginning of next year, *inter alia* on the back of some base effects, the indicator will stabilise and is expected to reach 3.1 percent at the projection horizon (Table 4.2). The inflation forecast strongly

depends on the working assumptions regarding price developments for the two previously mentioned categories of energy goods, given that the price capping scheme in its current version expires on 31 March 2025. The baseline scenario is built on the principle that fiscal measures are included only if they have been enacted or at least if they are well into the enactment process. Under the circumstances, in the absence of information that is certain about future measures of competent authorities, the baseline scenario envisages only limited price adjustments over the remainder of the forecast period, under the assumption of a normal functioning of the relevant markets.

Compared to the trajectory published in the November 2024 *Inflation Report*, the annual CPI inflation rate will run at higher levels until end-2025 (more visibly in the first quarters of the year) and at lower levels in 2026 (Chart 4.2). The revision for December 2025 is +0.3 percentage points. This was primarily ascribable to the previously mentioned price hikes at the beginning of the year (especially tobacco products and administered prices), as well as to the more unfavourable evolution of core inflation, partly offset by the slightly more optimistic prospects for the VFE group. At the horizon of the preceding forecast (2026 Q3), the annual CPI growth rate is 0.1 percentage points lower, particularly as a result of the downward revision of core inflation over the medium term.

The annual adjusted CORE2 inflation rate stood still in 2024 Q4, i.e. at 5.6 percent, before starting to decline again at the beginning of this year, yet the variable will have an only moderately descending pattern over the medium term. Therefore, the annual core inflation rate is projected at 3.7 percent at end-2025 and 2.9 percent in December 2026 (Chart 4.2).

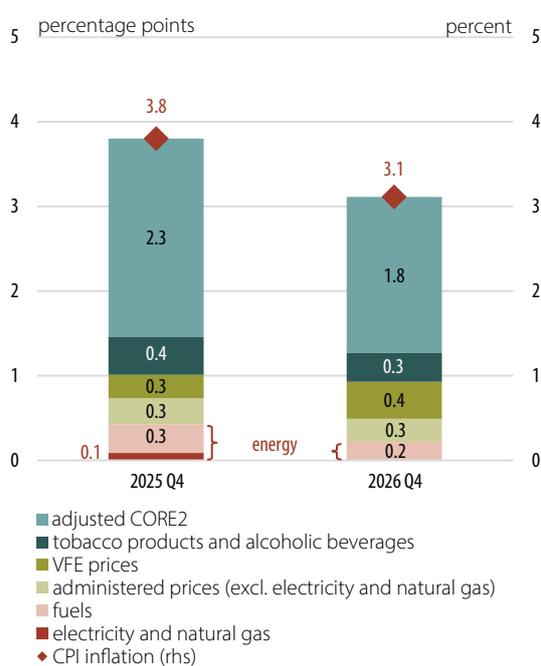
The breakdown by sub-component shows that the forecasted trajectory reflects the gradual deceleration in the annual dynamics of prices for non-food items and services, which are still high (6.4 percent and 6.7 percent respectively at end-2024). The monthly dynamics of these sub-components returned to values more favourable for disinflation in December 2024, with corroborative evidence also visible from industrial producer prices. However, market services prices further capture the persistent inflationary pressures from labour costs, whose dynamics, though on a decline, are still high. Looking at processed food items, the increase in agri-food commodity costs, amid the poor crops at regional level, and the fading out of the impact of the measures to cap the mark-ups led to a step-up in the annual price dynamics in the recent period. This trend

is expected to persist, albeit at a slower pace, the annual inflation rate of the sub-component being foreseen to remain at lower values than those of the aggregate index.

From the perspective of the determinants modelled under the Phillips curve framework, the declining trajectory of adjusted CORE2 inflation reflects the negative contributions from the output gap. The latter is envisaged in negative territory, widening throughout the current year and narrowing subsequently<sup>66</sup>. Over the projection interval, inflation expectations will also contribute to disinflation, as they are anticipated to follow a steadily downward course, staying above the variation band of the target, except at the forecast horizon. The annual growth rate of import prices is expected to be relatively stable in 2025 and slow down slightly in the following year, in line with the euro area annual HICP inflation rate excluding energy<sup>67</sup>.

Compared to the previous forecast, the annual core inflation rate was revised upwards for the first part of the projection interval and marginally downwards for the second part. Specifically, the forecast for end-2025 is higher by 0.2 percentage points. At the horizon of the preceding projection, i.e. 2026 Q3, the updated projection is 0.1 percentage points lower. The revision in the first part of the forecast interval reflects

Chart 4.3. Components' contribution to annual inflation rate\*



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

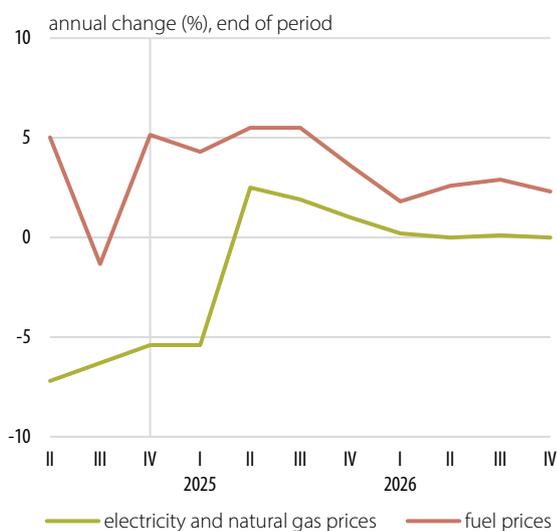
Source: NIS, NBR projection

the recent pressures in the food segment, as well as the underestimation of the persistent pressures from the services sub-group. In the latter part of the interval, the adjustment is based on the reconfiguration of the output gap at negative values, especially due to the reassessment of the fiscal impulse, amid the new fiscal consolidation measures being incorporated in the forecast.

The cumulative contribution of the exogenous components of the consumer basket to the annual CPI inflation rate is projected at 1.5 percentage points at end-2025 (revised upwards by +0.3 percentage points compared to the November 2024 *Inflation Report*) and at 1.3 percentage points at the forecast horizon, i.e. December 2026 (Chart 4.3). Behind the upward revision in December 2025 stood primarily more unfavourable developments in the case of tobacco product and alcoholic beverage prices, fuel prices, administered prices, as well as natural gas prices; these were partly offset by downward corrections of volatile food prices. The value for 2026 Q3 (the preceding forecast horizon) is relatively similar to that projected in the previous *Report*.

<sup>66</sup> For further details, see Section 1.3. Demand pressures in the current period and over the projection interval

<sup>67</sup> According to the December 2024 *Eurosystem staff macroeconomic projections for the euro area*, the average annual growth rate of the indicator will fall to 2.5 percent in 2025 and 2 percent in 2026.

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


Source: NIS, NBR projection

**Table 4.3. Inflation of CPI exogenous components**

	annual change (%), end of period		
	Dec. 2024	Dec. 2025	Dec. 2026
Energy prices	0.0	2.4	1.2
Fuel prices	5.1	3.6	2.3
Electricity and natural gas prices	-5.4	1.0	0.0
VFE prices	8.8	4.7	7.4
Administered prices (excl. electricity and natural gas)	4.8	5.0	4.6
Tobacco products and alcoholic beverages prices	9.9	6.0	4.6

Source: NIS, NBR projection

After gaining momentum during 2024 Q4, the annual growth rate of fuel prices is anticipated to run above the central target throughout most of 2025 (Chart 4.4, Table 4.3). The foreseen performance of the component can be attributed to some unfavourable base effects, as well as to the higher-than-expected seasonal change in the firewood price and to the depreciation of the leu against the US dollar. Specifically, the path of fuel prices was revised significantly upwards for 2025. For the remainder of the projection interval, the annual dynamics of fuel prices are seen declining to values inside the variation band of the target, mainly owing to the substantial corrections in oil futures prices<sup>68</sup>. For 2026 Q3, the annual growth rate of fuel prices also witnessed an upward, albeit marginal, revision.

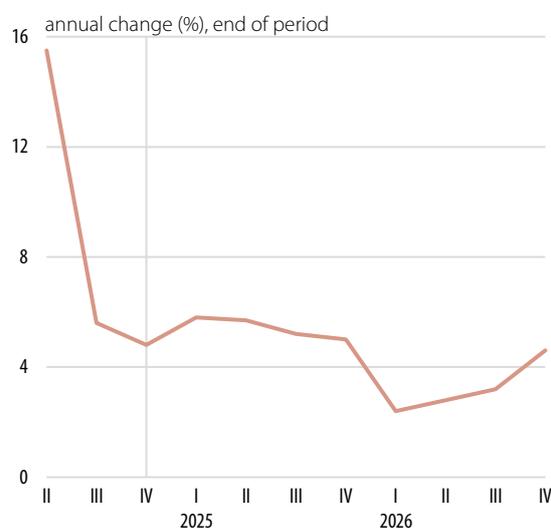
The annual dynamics of electricity and natural gas prices<sup>69</sup> are forecasted to stay in negative territory in 2025 Q1 as well (Chart 4.4, Table 4.3). These will re-enter positive territory in 2025 Q2, amid some unfavourable base effects, and are envisaged to stay at benign levels over the remainder of the projection horizon, implying limited price adjustments, under the assumption of a normal functioning of the relevant markets. Compared to the November 2024 *Inflation Report*, the value for end-2025 was revised upwards, primarily on account of the recent uptrend in natural gas prices on the wholesale markets. This is expected to reflect over the short term in end-user prices, which are currently below the caps established by the authorities.

The exogenous scenario for the annual dynamics of administered prices other than electricity and natural gas, which is built chiefly on historical data, foresees values above the variation band of the target for most of the projection interval (Chart 4.5, Table 4.3). Compared to the prior *Inflation Report*, only the values in the first half of the projection interval were adjusted more notably upwards, mainly due to unanticipated increases in prices for water, sewerage, and sanitation services, and for heating in the recent period. Over the remainder of the projection interval, however, 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.

<sup>68</sup> For further details, see Section 1.1. External assumptions

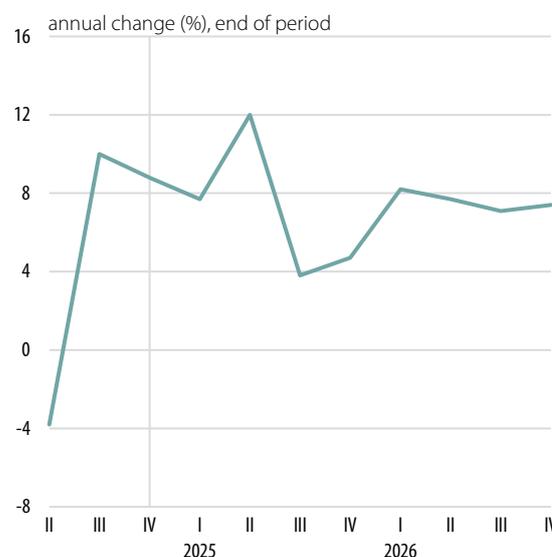
<sup>69</sup> According to NIS Press Release No. 37/14 February 2023, electricity and natural gas were re-included in the group of administered price items of the CPI basket, following the changes made to the energy price capping and compensation schemes as of 1 January 2023.

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



Source: NIS, NBR projection

**Chart 4.6. VFE price inflation**



Source: NIS, NBR projection

In spite of recent developments that proved more favourable than previously anticipated, the annual dynamics of volatile food prices are expected to stay above the variation band of the target throughout the projection interval (Chart 4.6, Table 4.3).

The end-2025 value was revised downwards, while subsequently the expected levels are seen as relatively similar to those previously projected, reflecting the assumption of normal agricultural years.

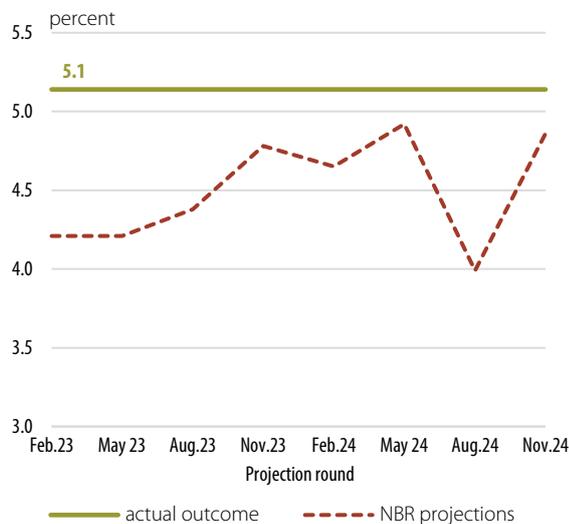
The path of the annual growth rate of tobacco product and alcoholic beverage prices is shaped primarily by higher excise duties provided for in the legislation, but also by the behaviour of companies in the field as regards the final price adjustment. The annual dynamics of the group are forecasted to decelerate until 2026 Q2 (Table 4.3) and to accelerate afterwards. The trajectory for 2025 was revised upwards, amid recent, previously unforeseen increases in tobacco product prices that are not warranted by changes in the excise duty regime.

#### **Box. Assessment of the accuracy of macroeconomic forecasts on the December 2024 annual CPI inflation rate**

This Box is part of the annual exercise designed to assess the accuracy of NBR projections on the annual CPI inflation rate at the end of the prior year.

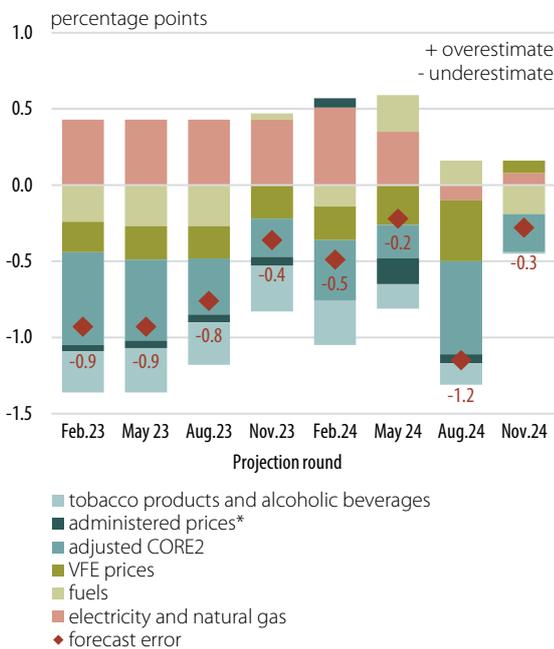
The December 2024 annual inflation rate was subject to successive forecasting rounds between February 2023 and November 2024. The actual outcome (5.14 percent) was underestimated in the eight forecasting rounds (Chart A), with forecast errors ranging between 0.22 percentage points and 1.15 percentage points. Atypically, the highest level of forecast errors was related to the August 2024 round, although this one benefited from a theoretically broader set of data as compared to the previous six rounds. This highlights the significant influence that weather conditions exert on the developments in the consumer price index (CPI) in Romania, given the large

Chart A. The December 2024 annual CPI inflation rate: forecasts vs. actual outcome



Source: NIS, NBR projections

Chart B. Breakdown of forecast errors for the December 2024 annual CPI inflation rate by CPI components



\*) electricity and natural gas prices excluded

Source: NIS, NBR projections and calculations

share held by the food component in its composition (28.6 percent against the 15.2 percent EU average<sup>70</sup>). Specifically, the NBR forecast for the August 2024 round was made amid the favourable weather conditions in the first part of the year, followed by a prolonged drought during the summer months, the effects of which were not fully anticipated at the time of the projection.

The breakdown of forecast errors by CPI components (Chart B) shows that the underestimation tendency characterised both the adjusted CORE2 index and the exogenous components of the consumer basket overall, although the dynamics of some of these components were also overestimated.

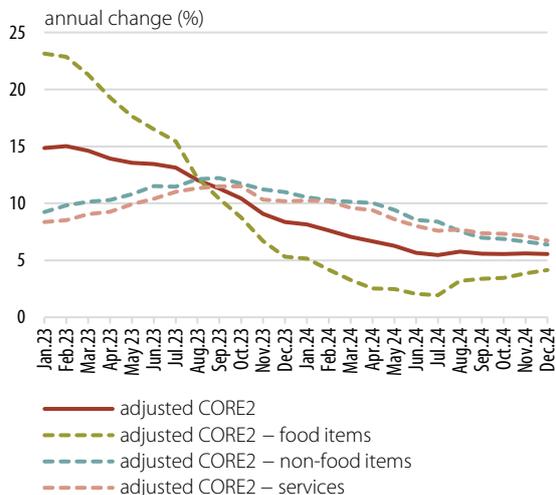
The annual adjusted CORE2 inflation rate witnessed a sharp decline throughout 2023 (Chart C), mainly due to the significant corrections in food prices (influenced by the relatively large crops domestically and internationally) and to the successive administrative measures to cap the mark-ups on certain categories of food items. Subsequently, disinflation slowed down markedly, and even stalled in 2024 H2, amid the hikes in taxes and charges implemented at the beginning of the year, the persistent inflationary pressures from labour costs, and the fading-out of favourable influences from food prices affected *inter alia* by the weather conditions in the summer months, namely the prolonged drought. These developments, which were difficult to anticipate, including in terms of magnitude, explained the underestimation of the December 2024 actual outcome of core inflation (5.6 percent) in all eight forecasting rounds under review.

As previously mentioned, the underestimation tendency also characterised the exogenous components of the consumer basket, with the exception of electricity, natural gas and fuel prices. Similarly to the food component of the adjusted CORE2 indicator, the path of volatile food (VFE)

prices was also marked by the climate factors acting in 2024 (such as the transition from the favourable weather conditions in the first part of the year to the prolonged

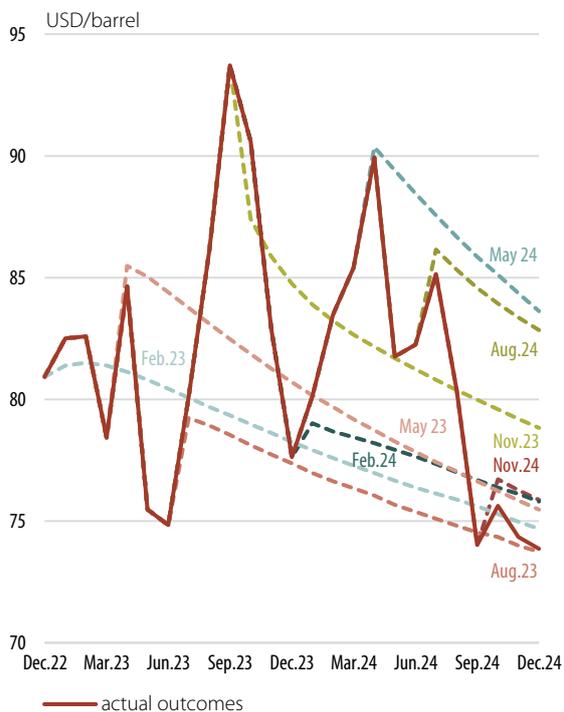
<sup>70</sup> For comparability with the European Union average, the shares shall refer to the consumer basket corresponding to the Harmonised Index of Consumer Prices (HICP).

**Chart C. Historical developments in the annual adjusted CORE2 inflation rate and its subcomponents**



Source: NIS

**Chart D. Brent oil price: historical developments and futures prices (successive forecast rounds)**



Source: Bloomberg

drought in the summer months), their annual dynamics standing relatively high at the end of the year (8.8 percent). At the same horizon, tobacco product prices also posted significant dynamics (10.5 percent, a 14-year high), against the backdrop of multiple increases throughout the year that were not justified by the tax regime, but by the decisions of tobacco companies.

The forecasts regarding fuel price dynamics were conditional on Brent oil futures prices, their successive adjustments (Chart D) largely reflecting the impact of multiple geopolitical tensions. Moreover, the annual growth rate of fuel prices in 2024 was marked by the significant increase in the specific excise duty in two steps (January and July 2024, totalling 34 percent), a piece of information that has been incorporated into the NBR forecasts starting with the November 2023 round.

Over the past year, the support scheme capping final electricity and natural gas prices remained in effect. However, it has been subject to reconfigurations as of April 2024, which paved the way for lower electricity and natural gas prices for households, amid benign developments in the domestic and European wholesale prices at that time. Moreover, successive reconfigurations of the trajectory of end-user prices also occurred in the context of consumer migration between consumption brackets during winter months (data provided by ANRE, the Romanian Energy Regulatory Authority). These developments were incorporated into the NBR forecasts only when their realisation became certain, in line with the standard practice for making projections. Against this background, the dynamics of electricity and natural gas prices were overestimated in the projection rounds in 2023 and the first part of 2024, partially offsetting the impact of the price change underestimation for the other consumer basket components, excluding fuels.

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

#### The output gap

Real GDP stagnated in 2024 Q3<sup>71</sup>, remaining on the fragile path of prior quarters. The performance was below the expectations in the November 2024 *Inflation Report*, with almost all components recording mostly unanticipated declines. The positive contribution of net exports to economic growth in this quarter (driven by the particularly strong import compression) was only partly offset by the slightly negative contribution from domestic absorption. Thus, the zero dynamics of real GDP translated into a significant negative contribution from the residual component (statistical discrepancy and change in inventories), with an extremely low economic content.

For 2024 Q4, near-term forecasts point to a modest pick-up in real GDP, prompted by a certain rebound in domestic absorption. Household disposable income is projected to gather momentum in quarterly terms, given the broad-based increase in pensions seen already in September 2024 and the ongoing robust growth of gross wage earnings. In addition, unemployment rate declined moderately<sup>72</sup> and consumer credit posted a solid advance in 2024 Q4. The assessments of fourth-quarter household consumption are supported also by the positive dynamics of the related turnovers (retail trade and services to households) and the specific confidence indicators in the DG ECFIN surveys (related to consumers, services and trade). On the investment side, favourable developments are anticipated to come mostly from civil engineering works, given the multiple road infrastructure projects completed in the last months of the previous year. By contrast, industrial output, despite a certain rebounding trend in October and November 2024 as a whole, may have contracted in the final month of the quarter. This is suggested by the marked worsening of confidence indicators (DG ECFIN and the PMI), also reflecting the still subdued path of external demand. Other growth-inhibiting factors are: more sluggish disinflation, further restrictive real broad monetary conditions, slower take-up of EU funds, and the uncertainties affecting economic activity following the electoral events at the end of November/beginning of December.

For 2025 Q1, real GDP dynamics are also projected to be only subdued, possibly even lower than those estimated for 2024 Q4. Adding to the above-mentioned dampening factors, with persistent effects, are the fiscal consolidation measures effective 1 January 2025 (GEO No. 156/2024), having a direct impact on the income of public sector employees and the transfers to large categories of households. In fact, in January, the economic sentiment indicator (ESI) plummeted (from a five-year high in 2024 Q4 to its lowest level since June 2023 and, at the same time, below the long-term average), due mainly to the worsening of the consumer confidence indicator. Uncertainties are also assessed on the rise internationally, amid the recent spike in geopolitical and economic tensions between the United States and their trading partners. The uncertain economic environment is likely to put a damper on growth via a lower propensity to consume and firms' delayed investment decisions.

<sup>71</sup> NIS Press Release No. 7 of 10 January 2025 regarding second provisional data on GDP

<sup>72</sup> Calculations based on monthly series

In 2024 as a whole, economic growth is expected to decelerate markedly compared to the prior year<sup>73</sup>, amid, *inter alia*, sluggish industrial activity both domestically and in Europe's largest economies, directly affecting Romania's exports. For 2025 and 2026, real GDP is expected to moderately gather momentum, depending also on the medium-term recovery of external demand. In the baseline scenario, a favourable contribution to economic growth is envisaged to come from turning EU funds from multiple sources<sup>74</sup> to good account, although delays have been recorded in the absorption and actual use of these amounts for investment projects.

On the expenditure side, the economic slowdown in 2024 is attributable to a hefty negative contribution of net exports (after the slightly positive one in 2023), while the contribution of domestic demand is assessed to have remained robust, primarily on the back of final consumption, whose growth was, however, very little accommodated by domestic production. For this year and the next, the path of real GDP is projected to be further shaped by domestic demand. Its components reflect the measures set out<sup>75</sup> in the fiscal consolidation package under Government Emergency Ordinance No. 156/2024, with a contractionary bearing on economic activity, this year in particular. Nevertheless, final consumption is expected to remain the key driver of economic growth (with its sizeable share of GDP prevailing over the expected slower rise of this component than in the preceding year). Over the projection interval, the contribution of gross fixed capital formation to growth is anticipated to be positive, yet lower than that of consumption. However, over the medium term, the contribution of gross fixed capital formation is foreseen to expand gradually, under the assumption of further take-up of EU funds, as well as foreign direct investment inflows. The contribution of net exports appears set to stay negative, albeit of a very low magnitude, amid the forecasted average annual growth rate of exports of goods and services close to that of imports.

The average annual growth rate of potential GDP is estimated to remain solid over the projection period, but this is largely contingent on the continued and even swifter absorption of EU funds. Compared to the previous *Report*, the path of the indicator was reshaped slightly downwards over the medium term. The revision reflects the recent abatement in net investment in the economy, which is expected to weigh on total factor productivity (TFP) over the short term, mainly by delaying technology modernisation, and to cap growth by reducing the capital stock over the long term.

Although fixed capital formation is assessed to have stayed flat in 2024 overall, the remarkable performance of investment in previous years continues to have capital stock as the chief driver of potential GDP growth. The prospects for a gradual recovery of gross fixed capital formation envisage a more moderate path compared to past

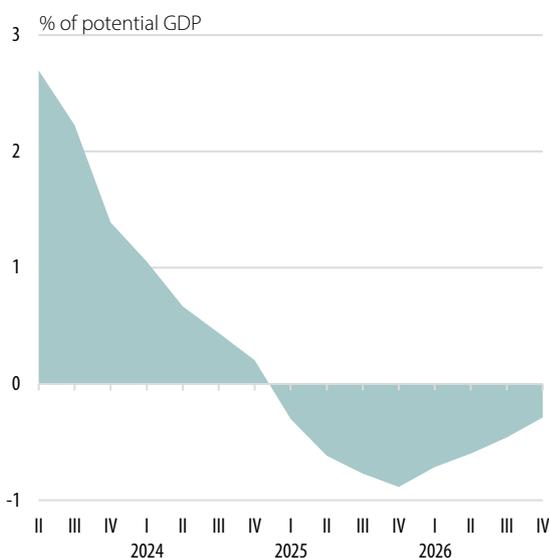
<sup>73</sup> In 2023, the annual GDP growth averaged at 2.4 percent. The contribution of the change in inventories, a component with limited economic content, was negative and large, hinting at uncertainties surrounding the final composition of GDP growth (after the NIS makes, in time, all revisions of statistical data, the final data for 2023 are due for October 2025).

<sup>74</sup> The Multiannual Financial Framework 2021-2027 and the Next Generation EU programme (2021-2026)

<sup>75</sup> Among the measures that entered into force on 1 January 2025 pursuant to Government Emergency Ordinance No. 156/2024, with an impact on domestic demand components, are: (i) the freezing of wages and pensions at the level of that recorded in November 2024, (ii) the increase in the dividend tax rate from 8 percent to 10 percent, (iii) the removal of tax breaks for workers in agriculture, food industry, construction and IT, and (iv) the lowering of the tax ceiling for micro-enterprises from EUR 500,000 to EUR 250,000 and, subsequently, EUR 100,000 as of 1 January 2026.

developments, also amid the authorities' measures taken pursuant to GEO No. 156/2024 on changes to the corporate tax regime. Against this backdrop, key funding sources are foreseen to be allocated via inflows of foreign direct investment and EU funds, particularly under the Next Generation EU programme. The contribution of the TFP trend is affected by companies' relatively lacklustre performance in identifying innovative solutions, also in terms of integrating digitalisation into their activity<sup>76</sup>. Over a longer horizon, the contribution of this component is set to recover somewhat, mirroring firms' efforts to align with the revamping and energy efficiency trends, also supported by financing provided via European Commission programmes such as the Just Transition Fund, InvestEU or the Recovery and Resilience Facility (RRF). Accessing these resources could expedite the modernisation and digitalisation of production, thereby enhancing economic competitiveness over the long term. The contribution of labour is projected to remain only moderately positive, gradually shrinking over the longer term, as a result of persistently unfavourable demographic developments in Romania, such as ageing population and labour migration, amplified also by long-standing structural labour market issues (low labour force participation, skills shortage in certain key sectors, high inactivity rate among young people). Looking ahead, the adverse effects of elevated uncertainty both domestically and internationally remain relevant to the path of potential GDP, amid geopolitical tensions and possible renewed bottlenecks in global supply chains.

Chart 4.7. Output gap



Source: NBR assessments based on data provided by the NIS

Given the economic slowdown over the past two years, the output gap is assessed on a steadily downward path to a slightly positive value in 2024 Q4, similar to that in the previous *Report*. In 2025 Q1, however, the output gap is projected to turn negative (versus slightly positive in the previous assessment), on the back of a large restrictive impact from the fiscal impulse (versus a quasi-neutral one in the prior *Report*), an indicator that captures the assessed effects of the fiscal consolidation measures recently implemented by the authorities. This revision influences the path of the indicator in the periods ahead as well, given that the fiscal impulse is expected to further have restrictive effects in 2026, albeit significantly softer, causing the output gap to take lower values than estimated in the previous round. Specifically, the output gap is anticipated to remain negative (as opposed to persistently positive, yet moderate, over the medium term in the previous

forecast). The demand deficit is assessed on the rise this year and subsequently on the wane, conditional also on the assumptions regarding the budget deficit configuration (Chart 4.7)<sup>77</sup>.

<sup>76</sup> 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.

<sup>77</sup> From the perspective of aggregate demand components, the output gap path is shaped by those of domestic demand (with household individual consumption and gross fixed capital formation displaying positive gaps), whereas the aggregate gap of net exports is foreseen to be negative (with relatively small changes).

From the perspective of output gap fundamentals, apart from the influence of the fiscal impulse, an additional restrictive effect also comes from the external output gap. Although narrowing, the latter is anticipated to stay in negative territory throughout the forecast interval, unlike the previous assessment, which indicated negative values only until 2025 Q2. 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 final consumption is projected to lose momentum in the course of 2025 following the substantial pace of increase seen in the prior year. The path of this component also reflects the slowdown in households' real disposable income in the context of implementing the fiscal and budgetary measures laid down in GEO No. 156/2024, with an impact on broad categories of consumers. For next year, the rebound in final consumption benefits from favourable effects induced by the ongoing gradual downturn in inflation.

Gross fixed capital formation, which is assessed to have stalled in 2024, is envisaged to gradually return during the projection interval to rather robust average annual rates, albeit more moderate compared to historical developments in the post-pandemic period. Its projected path is strictly conditional on investor confidence given the foreign investors' worsening outlook on investments/placements in Romania over macroeconomic imbalances and political uncertainty<sup>78</sup>. Moreover, a key role plays the authorities' conduct in carrying out investment projects funded from both own and borrowed sources, as well as those financed from non-repayable external funds. On the one hand, favourable effects on gross fixed capital formation are anticipated to materialise amid the planned allocation of significant amounts for public investment in 2025<sup>79</sup>. On the other hand, as for EU funds, especially those financed through the Next Generation EU programme, any further delays could reduce the window of opportunity for implementing this programme, given that the allocated amounts must be taken up by end-2026 at the latest. At the same time, the already-taken fiscal consolidation measures, in particular those regarding tax regime changes, could entail sizeable reassessments of corporate investment plans.

The contribution of net exports is projected to remain in negative territory over the projection interval, albeit of a considerably lower magnitude than in 2024, reflecting for the current year the projected slowdown in imports and a slight pick-up in exports of goods and services. After having contracted in the course of 2024, exports of goods and services are set to bounce back gradually over the medium term, underpinned by a favourable yet still moderate outlook for external demand, which was revised downwards against the previous projection. The trajectory of the component continues to be affected mainly by the economic performance of foreign trading partners, Germany in particular, over uncertainties surrounding both geopolitical tensions and

<sup>78</sup> In this vein, noteworthy are the recent decisions made by Fitch Ratings and Standard & Poor's to revise the outlook on Romania's sovereign credit rating – which currently is the lowest level of investment grade – from stable to negative.

<sup>79</sup> According to the Report on the macroeconomic situation in 2025 and its projection for 2026-2028 published by the Ministry of Finance in January 2025, public investment spending included in the general government budget is expected to post, in the current year, an increase both in nominal terms and as a share of GDP compared to 2024.

global trade frictions. 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. The path of imports of goods and services is set to further display relatively robust rates close to those of exports, tightly correlated with the dynamics in the main components of domestic demand.

The year 2024 is assessed to have ended on a wider current account deficit than in 2023 (6.6 percent of GDP). The trade deficit made the largest contribution to this development, on the back of almost broad-based deteriorations in the main groups of goods. Against this backdrop, the current account deficit is envisaged to undergo a correction in the course of 2025. This is also fostered by the resumption of fiscal consolidation process after the opposite influences that marked its path in 2024, such as pension recalculation and public sector pay rises. Similarly to the previous rounds, the external deficit staying on a downward course is conditional on the absence of new bottlenecks in global value chains and on the rebound in main trading partners' economic activity. Nevertheless, these developments could be vulnerable to adverse factors, including a possible increase in customs tariffs, which could hurt trade flows and export competitiveness in the future.

In 2024, the overlapping of the wider current account deficit and the compression of capital transfers and foreign direct investment, i.e. equity including reinvestment of earnings, is estimated to have led to a modest financing of the current account deficit from non-debt-creating sources. Over the medium term, the projection envisages a gradual improvement in the external deficit covered by such sources. However, this is conditional on the assumption of significant EU funds being attracted via NRRP allocations, as well as on larger inflows from the Multiannual Financial Framework 2021-2027, thereby countering, in the medium term, the end of funds absorption under the MFF 2014-2020 once this exercise was completed at end-2024. At the same time, foreign direct investment is expected to further exceed its pre-pandemic levels in absolute terms, even though the latest data point, in this case as well, to less favourable developments than those in preceding years, while a mild recovery is anticipated over the medium term.

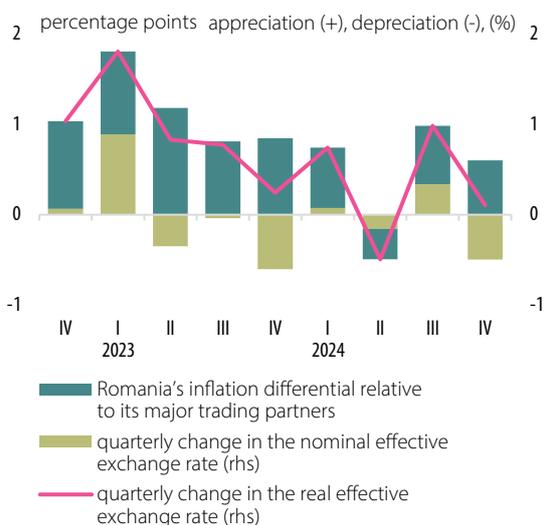
### **Broad monetary conditions**

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.

The baseline scenario of the projection envisages that real broad monetary conditions will continue to be restrictive over the entire forecast interval. This will occur amid a further pass-through into the economy of the NBR Board's monetary policy decisions, which aim 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.

**Chart 4.8. Quarterly change in the effective exchange rate**



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

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. 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 reflect 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, mirroring political uncertainty in recent periods mostly and the persistence of twin deficits in the economy. The dynamics of the leu's real effective exchange rate gap are seen to exert a quasi-neutral impact via the wealth and balance sheet effect.

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



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

## 2. Risks associated with the projection

The balance of risks to the annual inflation rate (Chart 4.9) is assessed to remain tilted to the upside compared to its projected path in the baseline scenario. At the current juncture, the risk of a step-up in trade protectionism has risen, while the economic impact of geopolitical tensions has diminished slightly, amid renewed tentative actions to cool down the conflicts. These developments are underpinned, on one hand, by the first signs of de-escalation of the Middle East conflict and, on the other hand, by a shorter time horizon for a possible solution to end the armed conflict in Ukraine. Domestically, the upcoming expiry of the current electricity and natural gas price capping scheme raises questions about the possible future setup of support schemes

after 1 April 2025. To these add the uncertainties surrounding the future behaviour of economic agents in the energy field, as upward price adjustments cannot be ruled out. Conversely, risks associated with the fiscal and income policy stance abated somewhat after the introduction of the fiscal consolidation package via Government Emergency Ordinance No. 156/2024.

With the increased likelihood of a rise in trade protectionism, via the extended introduction of tariff barriers, external environment-related uncertainties became more prominent. In this context, the US trade policy decisions and the retaliatory measures taken by the respective partners could trigger divergent developments in inflation and in economic activity dynamics, heightening the risk of stagflation. These effects might propagate both directly, via the impact on the flows of goods and services, and indirectly, through the worsening of the economic growth outlook, affecting Romania's economy as well. Aside from the direct effects, possible productivity losses at firm level would compound the negative impact, affecting both local companies and especially firms in the economies of Romania's main trading partners. In this environment marked by fresh challenges to trade and investment flows, the future coordination of economic policies remains of the essence. Specifically, the calibration of the monetary policy decisions by major central banks and those in the region, as well as the effective implementation of the *National Medium-Term Fiscal-Structural Plans* in the EU economies will be of particular importance.

Economic policy decisions might, however, be hampered by new shocks in the energy market. In the case of Romania, for December 2024, actual data confirmed a higher inflation rate than that envisaged in the previous *Report*, with costlier fuels making a significant contribution to the forecast error. Although having partly materialised, risks from this source are assessed to persist. For example, the recent sanctions on Russia, as well as their prospective tightening, could entail additional inflationary pressures in relation to the oil price. Moreover, new upside risks are also associated with the halt in Russian gas transit via Ukraine, especially if the situation were to be compounded by difficulties in tapping alternative sources of such products or regarding the purchase price thereof. Additional pressures on energy prices might also stem from the prevalence of low temperatures, conducive to higher demand. Besides, there is also the risk of a scant supply of such goods in the event of unfavourable weather conditions.

The latter have the potential to exert adverse effects on other commodity prices as well. Extreme events, such as new episodes of protracted drought or devastating floods would also affect agricultural crops, entailing new inflationary pressures. In the medium run, the implications of climate change adaptation policies are further relevant.

The incorporation into the baseline scenario of the measures in the fiscal consolidation package laid down in Government Emergency Ordinance No. 156/2024 has contributed to the reduction of risks identified in previous rounds with regard to the future fiscal and budget policy stance. Nonetheless, in the medium run, in case of slippages from the objectives set in the *National Medium-Term Fiscal-Structural Plan*, the adoption of new fiscal consolidation measures cannot be ruled out. Their impact on the annual inflation rate might be bidirectional, depending on their specifics (raises of indirect taxes versus increases of direct taxes or public expenditure restructuring).

Over the short term, uncertainties surround possible new expansionary measures, such as those meant to support low-income households, with the potential to push inflation higher.

At the same time, further deficit slippages from the path undertaken by the authorities could deteriorate creditors' perception and might entail sanctions from the European Commission, *inter alia* by restricting access to non-repayable EU funds. This risk is all the more relevant as Romania is already facing difficulties in absorbing and implementing NRRP funds, which could limit the capacity to finance strategic projects and affect long-term economic growth. In addition, failure to absorb EU funds, including those under the standard multiannual financial exercise, in the amounts and by the deadlines set, would also impair their capacity to counterbalance the contractionary effects of the fiscal consolidation process already underway.

Risks associated with the labour market are still important, despite some signs of progress towards easing tensions. In the private sector, wage dynamics might be influenced by employers' efforts to preserve employees' net income level, after the removal of the tax breaks in certain sectors. Moreover, the uncertainty about firms' future behaviour is compounded by bringing the minimum wage to the level set forth in the EU directive, as the pass-through of wage costs into final prices of goods and services cannot be ruled out. Furthermore, inflationary pressures might be heightened by a rise in labour market structural deficiencies, such as the skills mismatch. By contrast, a moderation of the public sector wage bill over the medium term cannot be ruled out, as part of the efforts to bring the budget deficit in line with the path set under the *National Medium-Term Fiscal-Structural Plan*.

# 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
FOMC	Federal Open Market Committee
GDP	gross domestic product
GVA	gross value added
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Office
IPPI	Industrial Producer Price Index
IRCC	benchmark index for loans to consumers
MF	Ministry of Finance
MFF	Multiannual Financial Framework
MFI	monetary financial institution
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
USDA	United States Department of Agriculture
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

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