

BNR report: 2021 expected to mark the beginning of fiscal consolidation

This year is expected to mark the beginning of fiscal consolidation after the budget deficit has widened in 2020, including against the background of adverse developments associated with the pandemic crisis, reveals the National Bank of Romania's (BNR) quarterly Inflation Report released on Tuesday.

"On the domestic front, an important change is expected in the future stance on the fiscal and revenue policy, as the risks associated with this segment have become significantly less relevant given that the authorities have recently approved a budget plan outlining the start of a medium-term fiscal correction in 2021, from the high levels of last year's government deficit. Thus, after the fiscal deficit has widened in 2020, including amid adverse developments associated with the pandemic crisis, the fiscal year 2021 is expected to mark the beginning of fiscal consolidation. However, its future stages are marked by uncertainty, including as regards the medium-term measures intended to bring the budget deficit below the reference level of 3 percent of GDP provided for in the Stability and Growth Pact and of the impact thereof on the economic activity and, implicitly, on the annual inflation rate. However, upside risks are not completely ruled out, particularly in the event of a resurgence of the public health crisis, which would entail additional costs - with a view to supporting the economic agents directly hit by social distancing measures -, as well as possible losses of budget revenues stemming from the contraction of economic activity," the report states.

As regards the labor market developments, the BNR notes that the risks are expected to slightly increase once the incentives from the government support measures run out, amid potential adjustments in labor demand. Risks also arise on the labor supply side. In the event of a prolongation of the pandemic crisis, readjustments are not excluded against the background of a possible increase of the inactive population, simultaneously with maintaining a high unemployment rate among the youth.

As for the factors with a direct impact on the trajectory of the annual inflation rate, a large part of the risks associated with the liberalization of the electricity market starting with January 1, 2021 have already materialized. Uncertainties still persist regarding a possible intensification of competition in the competitive market, thus inducing disinflationary pressures.

The speed of the economic recovery - the report notes - could be supported by the rapid implementation of projects financed by the "Next Generation EU" temporary economic recovery instrument, both locally and internationally, with potential persistent knock-on effects. Yet the gradual access to such funding is marked by high uncertainties, especially until the approval by the European officials of the National Recovery and Resilience Plans and the start of the subsequent steps specific to this financing facility.