Box 1. Fiscal projections and the macroeconomic forecast

In its capacity as a member of the European System of Central Banks (ESCB), the National Bank of Romania is required to prepare biannual projections and independent assessments of national fiscal policy by using the standard forecasting and analysis methodology developed within the ESCB's Public Finance Group, which draws on the experience of Member States and on that gained within the ECB's Fiscal Policies Division[73].

The NBR's fiscal projections are built to be consistent with the macroeconomic scenario resulting from the central bank's own forecasting and analysis model. The projections of relevant macroeconomic variables (GDP, deflators, consumption, employment, wages, interest rates, exchange rates, etc.) interact with the revenues and expenditures discretionary measures taken by competent authorities in order to project the general government budget (GGB) for the current year and the next two years. The considered revenues and expenditures of the GGB comply with ESA 95, which differs from the methodology underlying the drafting of the Annual Budget Law[74].

Fiscal balances result from both the fiscal authorities' decisions and the influence of factors beyond their direct control, of which the most important are fluctuations in economic activity. Adjustment of the GGB balance by the influence of cyclical factors facilitates the analysis of budget policies and therefore the projections of revenues, expenditures and implicit budget balances are also accompanied by the calculation of their structural component – according to the standard methodology of the ESCB. From an economic perspective, the cyclical adjustment seeks to determine the size of the GGB balance that would have prevailed if the economy was at its potential level. Identifying the structural fiscal position allows one to assess the manner in which fiscal policy acts as a macroeconomic stabiliser, which implies a looser stance in times of recession and a tighter stance during an economic boom. The forecasting process and the cyclical adjustment materialise in the components set out below:

- **Structural fiscal position (underlying fiscal position**) is a measure of the deficit that would have prevailed in the absence of business cycle effects. Below is an example[75] of the breakdown of the budget balance.

Actual fiscal position	=	Structural fiscal position	+	Cyclical component		
(-2% of GDP)		(-2.5% of GDP)		(0.5% of GDP)		
				↑		
				Cyclical component	= Excess Demand	x Sensitivity of the budget balance to excess demand[76]
				(0.5% of GDP)	(1% of GDP)	(0.50)

- Dynamically, the structural balance may be analysed from the perspective of **fiscal stance (orientation of fiscal policy)** that reflects the change in the structural balance. An alternative indicator is the **fiscal impulse**, which is equal to the fiscal position, but has an inverted algebraic sign. A positive fiscal impulse denotes a looser fiscal policy, which fuels inflation, even though the actual deficits may be on a downward path. If the positive fiscal impulse coexists with excess demand in the period under review, it can be asserted that the fiscal policy is **pro-cyclical**, namely that fiscal policy fails to act as a business cycle stabiliser and, moreover, it contributes to magnifying the amplitude of cyclical fluctuations and inflationary pressures induced by excess demand.
- The fiscal impulse to the economy is incorporated in the model which the NBR uses to prepare the projection as an element impacting aggregate demand. The consistency between the macroeconomic scenario and the fiscal projection is ensured by an iterative process in which the two elements interact until they converge.
- The cyclical adjustment of budget deficits is a standard procedure in macroeconomic analyses and is normally used by the European Commission, the OECD, the IMF, as well as the Romanian Ministry of Economy and Finance in the context of the annual update of the Convergence Programme.

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[73] The methodology used by the ESCB is presented in detail in the ECB Working Paper No. 77 and 579.

[74] ESA95 differs from the cash methodology mainly with respect to the treatment of revenues and expenditures (recorded on an accrual basis) and of EU funds (according to ESA95, the EU is a separate sector). For details, see "Government Finance Statistics Guide – January 2007", ECB, 2007.

[75] Figures given herein are purely hypothetical and used for illustrative purposes alone.

[76] The coefficient shows the shift in the (share-to-GDP) budget balance in relation to a one percentage point change in excess demand.