

**Romania: Request for Stand-By Arrangement—Staff Report; Staff Supplements; and Press Release on the Executive Board Discussion**

In the context of the request for a Stand-By Arrangement for Romania, the following documents have been released and are included in this package:

- The staff report for the Request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended March 25, 2009, with the officials of Romania on economic development and policies. Based on information available at the time of these discussions the staff report was completed on April 24, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of April 28, 2009, on the assessment of the risks to the Fund and the Fund's liquidity position.
- A staff supplement of April 30, 2009, updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its May 4, 2009, discussion of the staff report that completed the review.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19<sup>th</sup> Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

**International Monetary Fund**  
**Washington, D.C.**



INTERNATIONAL MONETARY FUND

ROMANIA

**Request for Stand-By Arrangement**

Prepared by the European Department  
(In Consultation with Other Departments)

Approved by Poul Thomsen and Philip Gerson

April 24, 2009

- **Stand-By Arrangement.** In the attached letter, the Romanian authorities request a 24-month, SDR 11.443 billion (€12.95 billion, US\$17.07 billion, 1110.77 percent of quota) Stand-By Arrangement under the exceptional access policy. An initial purchase of SDR 4.37 billion becomes available on approval of this request. In the letter, the authorities outline the rationale for adopting the economic program for which they seek Fund financial support and describe its economic policy objectives. To attain these objectives, the program seeks to: (i) strengthen fiscal policy further to reduce the government's financing needs and improve long-term fiscal sustainability; (ii) maintain adequate capitalization of banks and liquidity in domestic financial markets; (iii) sustainably reduce inflation; and (iv) secure adequate external financing and improve confidence. The authorities' plan incorporates reductions in government expenditure, the introduction of fiscal reforms to improve the budgeting process and reduce key expenditure pressures, financial sector reforms to better protect against banking difficulties, and steps to improve monetary policy.
- **Discussions.** After preliminary discussions in Washington, a mission was fielding to Bucharest (March 11–25, 2009), where the staff team met with the President Basescu, Prime Minister Boc, Finance Minister Pogea, Central Bank Governor Isarescu, Minister of Labor and Social Policy Sîrbu, and senior members of parliament from the three largest political parties. The mission also met with trade union leaders and with representatives of financial institutions.
- **Staff.** The staff team comprised Mr. Franks (head); Ms. Cebotari Ouanes, Mr. Fernández-Valdovinos, and Mr. Lybek (EUR); Mr. Hobdari (SPR); Mr. Hasanov (FAD); Ms. Rosenberg (LEG); and Mr. Frécaut, Mr. Roger, and Ms. Zanforlin (MCM). Mr. Fernández-Ansola (Senior Resident Representative) assisted the team. Representatives from the European Commission and the World Bank also joined the mission.

Contents	Page
I. Background and Recent Economic Challenges .....	4
II. The SBA-Supported Program .....	7
A. Overall Program Objectives.....	7
B. Macroeconomic Framework .....	8
C. Fiscal Policy Stance and Fiscal Framework .....	10
D. Financial Sector and Financial Markets.....	13
E. Monetary and Exchange Rate Policy .....	17
III. Program Modalities.....	20
A. Access .....	20
B. Capacity to Repay the Fund and Risks to the Program .....	20
C. Program Monitoring and Conditionality.....	23
IV. Staff Appraisal .....	24
 Tables	
1. Selected Economic and Social Indicators, 2005–11 .....	31
2. Balance of Payments, 2005–11 .....	32
3. Gross Financing Requirements, 2009–11 .....	33
4. General Government Operations, 2005–11 .....	34
5. Monetary Survey, 2005–11.....	35
6. Selected Financial Soundness Indicators, 2004–08 .....	36
7. Public Sector Debt Sustainability Framework, 2003–13 .....	37
8. External Debt Sustainability Framework, 2003–13 .....	38
9. Indicators of External Vulnerability, 2005–09 .....	39
10. Proposed Access, 2009–11 .....	40
11. Indicators of Fund Credit, 2009–16 .....	41
12. Schedule of Reviews and Purchases .....	42
 Figures	
1. Financial Markets.....	28
2. Public Debt Sustainability: Bound Tests .....	29
3. External Debt Sustainability: Bound Tests .....	30
 Boxes	
1. Romania and the Economic Slowdown in the Euro Area.....	10
2. Vienna Meetings on Financial Sector Coordination in Romania—March 26, 2009 .....	16
3. Real Effective Exchange Rate and External Competitiveness .....	19
4. Exceptional Access Criteria.....	22

5. Stand-By Arrangement .....25

Attachments

Attachment I. Romania: Letter of Intent.....43

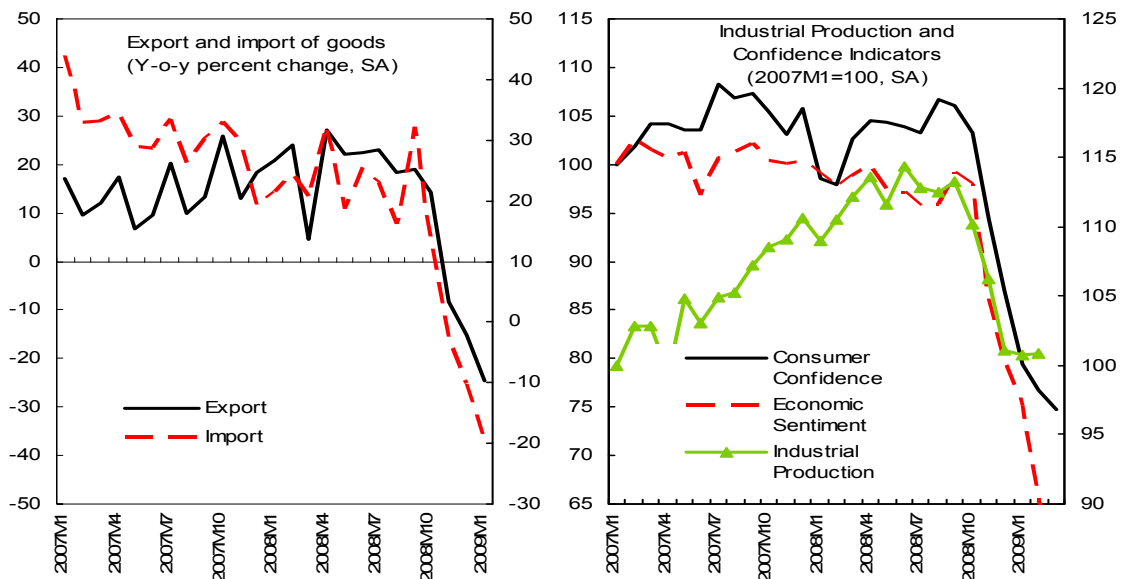
Attachment II. Romania: Technical Memorandum of Understanding (TMU).....54

## I. BACKGROUND AND RECENT ECONOMIC CHALLENGES

1. **Romania experienced an economic boom over the past five years that led to overheating and unsustainable imbalances.** GDP growth averaged over 6½ percent per year from 2003-08, as foreign direct investment and capital inflows (in part through subsidiaries of foreign banks in Romania) helped finance high consumption and investment growth. Robust export growth to EU countries reflected a process of increasing economic integration with western European economies. However, domestic demand growth was even faster, generating increasing current account deficits that reached 14 percent of GDP by 2007. The overheating economy and rapid capital inflows complicated monetary policy, resulting in the National Bank of Romania's (NBR's) inability to achieve its inflation target notwithstanding increases in interest rates and reserve requirements. The real effective exchange rate (REER) appreciated by about 50 percent between mid-2004 and mid-2007, driven by the strong capital inflows and expectations of economic convergence under EU membership. Fiscal policy played a strongly procyclical role, with the government deficit rising from under 1 percent of GDP in 2005 to near 5 percent of GDP by 2008.
2. **The rapid increase in borrowing that fueled the boom left Romania highly exposed to global financial difficulties and to exchange rate volatility.** The banking system's external borrowing drove rapid domestic credit growth, averaging 50 percent per year over the past four years. Banks' net foreign liabilities increased from -2 percent of GDP in 2003 to +19 percent in 2008. Corporate access to foreign credit also contributed to the boom, rising from a net of 4 percent of GDP in 2005 to nearly 11 percent in 2007. In addition, over half of the domestic private credit is in foreign currency, much of it is to unhedged households or corporates, creating substantial indirect foreign exchange risk exposure for banks even though banks' balance sheets themselves have little currency mismatch. The maturity structure of external debt also deteriorated in recent years, with the coverage of gross international reserves to short-term external debt declining to about 75 percent in February 2009 from over 170 percent in 2003.
3. **The NBR took a number of important measures to reduce inflation and contain credit expansion, especially in foreign currency lending.** Between 2004 and 2008, the central bank: (i) raised policy interest rates (to 10.25 percent) and minimum reserve requirements (to 18 percent on local currency liabilities and 40 percent on foreign currency liabilities); (ii) took measures to limit household debt exposures, especially with regard to mortgage debt; (iii) strengthened prudential regulations to limit lending to unhedged borrowers of foreign exchange and tightened restrictions on household debt service ceilings. These measures contributed to the subsequent deceleration in household credit growth, but pressure from expansionary fiscal policy and capital inflows caused the NBR to miss its inflation target in 2007 and 2008.
4. **Loose fiscal and incomes policies also contributed to the overheating of the economy and to its current vulnerabilities.** Excessive spending growth, especially on wages and pensions, was the main culprit and helped fuel domestic demand growth. As financial markets have deteriorated, deficit financing was increasingly concentrated at very

short maturities, exposing the government to roll-over and funding risks in an environment of intensifying deleveraging.

5. **Economic activity turned down sharply in late 2008 and has fallen further in early 2009, but inflation remains relatively high.** Real GDP growth slowed from an average of 9 percent (quarter-on-quarter, annualized) during the first three quarters of 2008 to a 13 percent decline in the fourth quarter — one of the sharpest turnarounds among emerging markets. The decline was spearheaded by a drop in domestic demand. For the first quarter of 2009, early indicators (confidence, industrial production, retail sales, tax revenues) all point to a continued sharp drop in GDP. Export growth has also turned sharply negative, but imports have dropped even more steeply, beginning a rapid correction in the current account deficit, which halved during January-February 2009 compared to the same period last year. Inflation has eased somewhat from its 9.1 percent peak in July 2008, but remains near 7 percent.

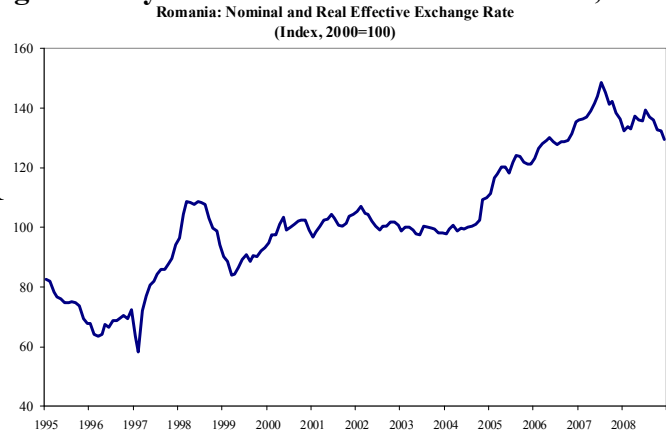


6. **Asset and financial markets have been severely affected by the economic downturn and the effects of the global crisis.** The Bucharest stock market, like markets elsewhere, has been hard hit, losing 65 percent of its value since the peak in August 2008. The interbank market was disrupted in October 2008 by liquidity problems at a commercial bank, with rates spiking to very high levels and remaining relatively high on lingering concerns about counterparty risk, high risk aversion, and market segmentation due to an uneven distribution of assets (T-bills) eligible for discount with the NBR. Balance of payment pressures drove a 15 percent depreciation of the leu against the Euro from October 2008, putting pressures on household, corporate and bank balance sheets. Despite the depreciation, financial conditions tightened significantly on increased sovereign credit default swap premium and monetary policy tightening. Romania's international credit rating was cut in late 2008 (to below investment grade in the case of Fitch) by a larger margin than those of other countries in the region, reflecting market concerns about the sustainability of Romania's large current account deficit, uncertainties surrounding the outlook for fiscal and

incomes policies, and the financial health of banks with subsidiaries or branches in Romania. This has translated into significantly higher external borrowing costs for Romanian banks and corporates.

**7. The exchange rate has weakened significantly since the onset of the downturn, starting to reverse the appreciation accumulated in recent years.**

By end-2008, the REER had depreciated by about 7 percent relative to its peak in July 2007. In January and February of 2009, the REER depreciated by another 7 percent following the nominal fall of the leu.



**8. Stresses are also building in the banking system.**

Access to external sources of funds is now limited and interbank market liquidity has also largely dried up, with activity limited to very short tenures. Although banks generally entered the crisis well capitalized, nonperforming loans have already begun to rise, especially those extended in foreign currencies, and the downturn will certainly accelerate the deterioration in asset quality. As a result, lending to the private sector began to shrink in fourth quarter of 2008, reflecting a combination of supply and demand factors.

**9. The authorities have begun to address Romania's economic vulnerabilities, but policy options are limited by the severity of the downturn and the fragility of financial conditions.** As the country enters recession, an easing of fiscal policy to cushion the downturn is unfortunately no longer possible, with spending already too high for medium-term sustainability and the government's ability to finance a large deficit limited. Rather, the authorities preferred to implement a restrictive 2009 budget to begin to bring the fiscal imbalance better under control. Monetary policy easing to cushion the crisis is also hindered by persistent inflation and balance of payment pressures. Significant additional weakening of the exchange rate due to looser monetary policy would likely generate severe balance sheet effects on the banking system. The NBR did take several steps to strengthen the banking sector, including increasing deposit insurance, enhancing monitoring and management of liquidity conditions, reintroducing repo operations to provide short-term liquidity additional to overnight Lombard lending, and conducting bilateral swaps against Euro. Supervisory efforts have also been stepped up, with capital increases already obtained from several banks and improved home-host coordination.

## II. THE SBA-SUPPORTED PROGRAM

### A. Overall Program Objectives

**10. The Fund-supported program is designed to cushion the effects of the sharp drop in capital inflows while addressing Romania's external and fiscal imbalances and**



**strengthening the financial sector.** Program objectives include: (i) reducing the fiscal imbalance to bring the deficit back under 3 percent of GDP by 2011; (ii) maintaining adequate capitalization of banks and liquidity in domestic financial markets, (iii) bringing inflation within the NBR's target range and maintaining it there; and (iv) securing adequate external financing and improving confidence. European Commission representatives worked jointly with Fund staff in program negotiations and the EU will support the SBA with €5 billion in financial support.

11. **The program combines strong, highly visible policy measures, coupled with sizeable financial support.** Together, these two pillars are expected to stabilize expectations in key markets, thus support rollover rates for maturing external debt, and lay the foundation for a return of investor confidence.

- ***Strong policy program:*** Key to restoring confidence is a reversal of the recent sharp increase in public spending, which caused a large deficit to accumulate even during a period of strong economic growth. Short-term budget cuts will be combined with fiscal policy reforms to place the public finances on a more sustainable medium-term path. Banking sector measures will help ensure that banks are sufficiently strong to weather the economic downturn and allow the authorities to deal effectively with banks in distress should the need arise. Continued exchange rate flexibility will further cushion the real effects of the downturn.
- ***Large external financing assistance*** is essential to minimize the risk of a run on Romania's debt and currency markets, given the large external debt stock. With the holders of Romanian debt being a broad and diversified group, official intervention in the form of an external financial buffer will help to shore up private investor confidence. Financing assistance will also avoid a destabilizing overshooting of the nominal exchange rate, with the attendant difficulties that would ensue for the banking system. At the same time, large private sector creditors—notably the foreign parent banks of the major banks—have been encouraged to maintain their exposures to Romania and have responded favorably (see below).

12. **The program will also help reduce regional vulnerabilities and spill-over effects that could result from a deeper downturn in Romania.** Banks from several European countries are active in Romania, and stabilizing economic and financial conditions there will avoid negative spill-over effects on other countries in emerging Europe through banking sector stresses. Greater stability in Romania will also avoid negative confidence effects on other countries in the region.

## **B. Macroeconomic Framework**

13. **The global downturn is expected to severely affect the Romanian economy.** Economic conditions in the country have already worsened sharply, and indicators consistently show continued deterioration in the first quarter of 2009 (Box 1). Staff projects that growth will remain negative throughout the year. Domestic demand is projected to plunge as private consumption and investment contract, reflecting worsening conditions in the corporate and household sectors. External demand is also projected to be weak as current projections indicate sharp contractions in Romania's main trading partners. The projected

import compression will, however, lead to a positive contribution of net exports to GDP growth.

**14. Given the global and domestic downturn, the authorities' program is based on cautious macroeconomic projections for 2009-10, and a gradual recovery over the medium term:**

- *Output* is expected to contract by about 4 percent in 2009. Foreign direct investment and capital inflows, which previously helped finance high consumption and investment growth, will drop sharply. Increased financial stress, tightening credit standards and limited access to external funding will inhibit lending to the private sector. Once confidence is restored and balance sheets readjust, domestic demand is expected to slowly rebound, with positive growth resuming by the second quarter of 2010. However, growth would remain near zero in 2010, before recovering to 5 percent in 2011.
- *Inflation* is expected to fall from 6.7 percent in March to within the official target band (3.5 percent, plus or minus 1 percent) by end-2009 and remain there through 2010. Easing demand pressures as well as declining global food and energy prices, combined with a conservative monetary policy, are expected to outweigh any upward pressures on inflation arising from the recent depreciation of the exchange rate.
- The *current account* deficit is projected to decline from 12½ percent of GDP in 2008 to 7½ percent in 2009 and further to 6½ percent in 2010, bringing it to a level that staff analysis suggests is sustainable over the medium term (including projected net EU capital transfers of about 1½-2 percent of GDP per year). This adjustment process will be driven in the near term by a sharp import decline arising from the drop in domestic demand and the depreciation in the real exchange rate, and over the medium term by renewed export growth and a recovery in worker remittances. The fall of the leu experienced in recent months, together with declining domestic inflation, should help produce a further depreciation of the REER in 2009, easing competitiveness concerns.
- The balance in the *capital and financial account* is expected to fall from a surplus of €18.8 billion in 2008 to a €2.7 billion deficit in 2009. FDI will decline considerably in 2009, and trade credit contracts will fall in line with import compression, consistent with developments in recent months. This account is projected to reach a €3.8 billion surplus in 2010, following a slight recovery in FDI and tamed capital outflows.
- Given the difficult international conditions, the program is based on conservative assumptions on *roll over rates* for maturing external debt. For the external obligations of non-financial corporates, the program assumes overall rollover rates of about 75 percent during 2009. The program assumes overall rollover rates for the maturing external obligations of Romania's banking sector of just over 80 percent in early 2009. Once the program takes effects, however, it is expected that foreign banks will largely maintain their exposure in the country, in line with commitments recently made by the owners of the top nine foreign banks operating in the country, with the rollover rate for the year as a whole rising to 90 percent.

**Romania: Macroeconomic Outlook**

	2006	2007	2008	2009	2010	2011
Real GDP growth	7.9	6.2	7.1	-4.1	0.0	5.0
CPI inflation, average	6.6	4.8	7.8	5.9	3.9	3.5
Fiscal balance (% of GDP, cash)	-1.4	-3.1	-4.9	-4.6	-3.6	-2.7
Saving-investment balance (% of GDP)	-10.4	-13.8	-12.4	-7.5	-6.5	-6.2
<i>o/w</i> : private	-9.0	-10.7	-7.5	-3.0	-2.9	-3.5
Trade Balance (% of GDP)	-12.0	-14.4	-13.5	-7.5	-6.6	-6.8
Gross international reserves (bn euros)	22.7	28.7	29.4	29.4	32.4	34.9

15. **The outlook is, however, subject to exceptional uncertainties and risks.** In the near term, output could be further compressed through balance-sheet effects arising from a further leu depreciation, especially if capital outflows are larger than anticipated. It would also be affected by a further worsening of global growth prospects. On the positive side, a rapid reestablishment of consumer and investor confidence could mitigate the drop in domestic demand, and measures to strengthen the financial sector could produce a more rapid recovery in credit availability. Risks to the baseline scenario are large and tilted to the downside, reflecting unpredictability on the speed with which financial markets will stabilize and the depth of the external economic slowdown.

**Box 1: Romania and the Economic Slowdown in the Euro Area**

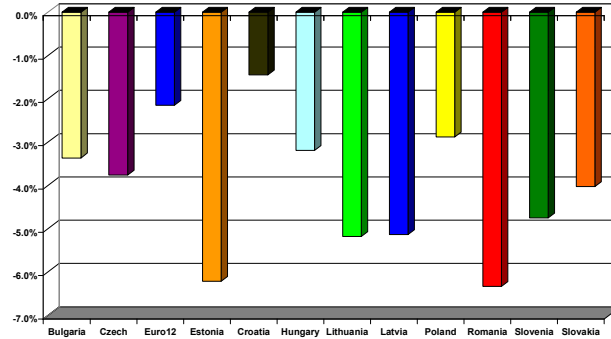
**Romania has been hit hard by the global economic meltdown.** The decline in GDP growth was among the largest in Eastern Europe. The industrial sector in particular, which accounts for 24 percent of total output, was severely disrupted. The (seasonally adjusted) industrial production index dropped 21 percent from May to December 2008.

**The current euro area slowdown will have broad cross-border consequences in Eastern Europe.** The economies in the

region are now closely integrated with the euro area, which constitutes one of the largest trade partners for the countries. As such, business cycle synchronization among both regions has become quite strong. Romania, in particular, presents a high degree of business cycle correlation with the euro area. The projected dwindling demand in major export markets will, therefore, severely hurt economy activity in Eastern Europe.

**As the euro area recession deepens in 2009, economic conditions in Romania will deteriorate further.** Historically, economic developments in the euro area have had significant spillover effects in the domestic economy. Moreover, an analysis of growth deceleration episodes in recent years indicates that declines in economic activities in the euro area were followed by even steeper drops in production in Romania.

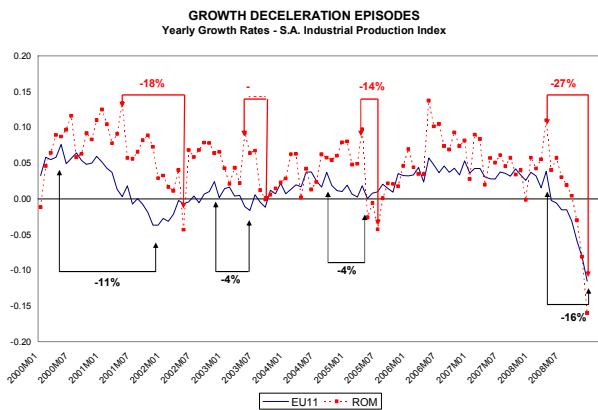
**Growth Deceleration in Eastern Europe**  
Changes in Annual Growth Rates  
2008Q4 vs. 2008Q3



**BUSINESS CYCLE SYNCHRONIZATION WITH EU12-ZONE**  
2004-08

	GDP 1/	IPI 2/
Bulgaria	0.62	0.18
Czech	0.78	0.55
Estonia	0.80	0.55
Croatia	n.a.	0.34
Hungary	0.68	0.48
Lithuania	0.77	0.27
Latvia	0.79	0.55
Poland	0.49	0.48
Romania	0.63	0.58
Slovenia	0.86	0.45
Slovakia	0.30	0.48

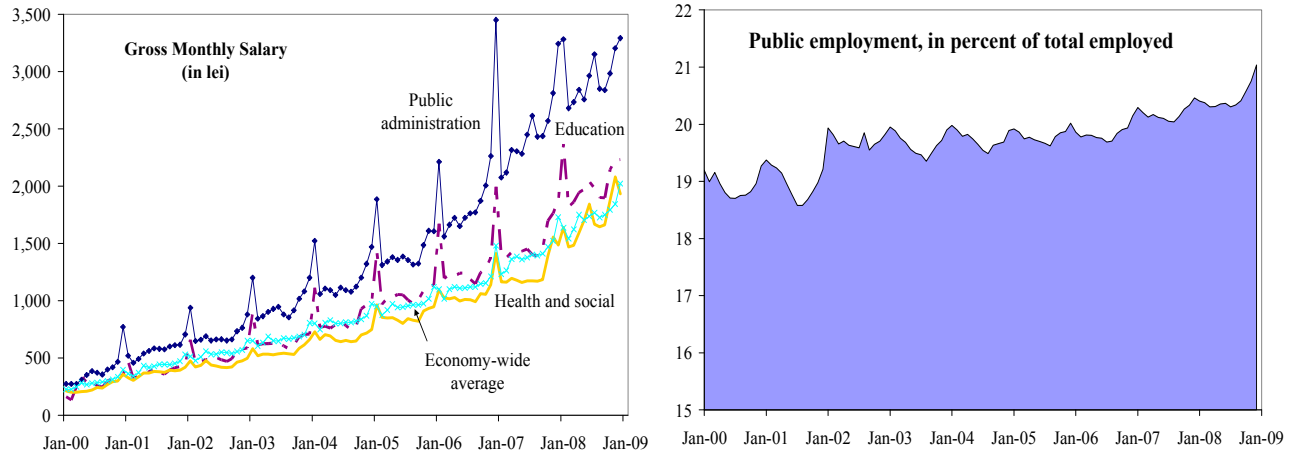
1/ Measured by correlation coefficients of quarterly growth rates in the (s.a.) GDP.  
2/ Measured by correlation coefficients of monthly growth rates in the (s.a.) Industrial Production Index.



**C. Fiscal Policy Stance and Fiscal Framework**

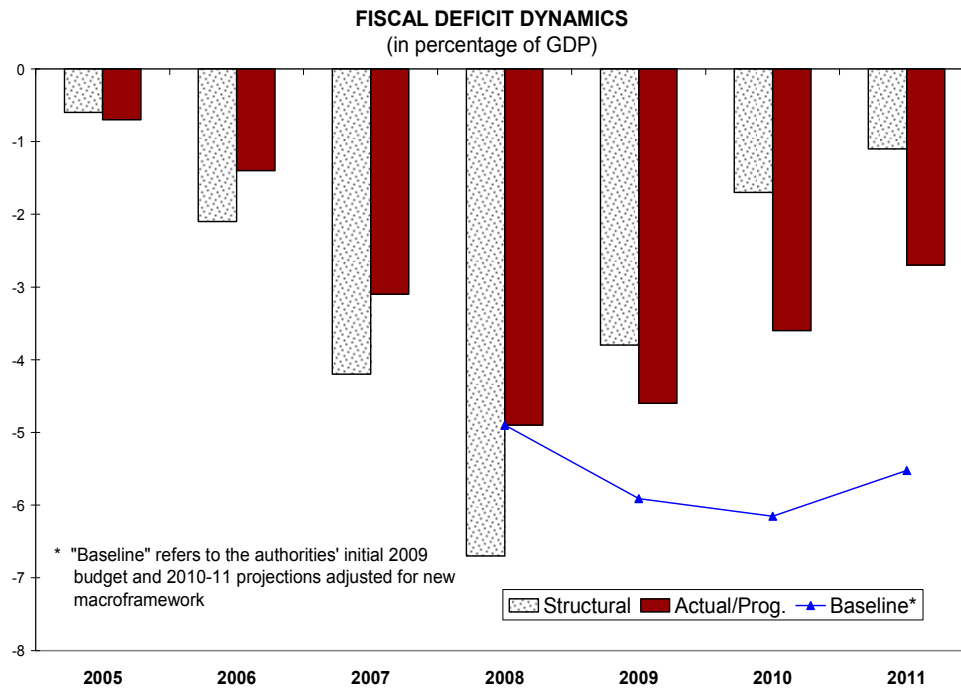
16. **Excessive public spending in recent years and the current tight financing environment do not leave room for counter-cyclical fiscal policies.** Between 2005 and 2008, government spending doubled in nominal terms, and the public share of economic

activity rose from 32 percent of GDP to 37 percent. The public sector wage bill also more than doubled because of both large wage hikes and additional government employment. Financing conditions have also worsened over the past several months due to the global financial crisis, leaving the government unable to finance a large deficit at reasonable cost. In the run-up to the elections at the end of 2008, large expenditure increases were financed on a short-term basis with up to 3-month maturities.



17. **The current government, which took office in late December, has already taken significant steps to consolidate the fiscal position.** Without a change in policy, the 2009 fiscal deficit was set to rise to nearly 9 percent of GDP. The authorities' 2009 budget would reduce the deficit by about 3 percentage points. Key budget measures included: (i) an increase of 3.3 percentage points in social contributions; (ii) a hike in excise taxes on alcohol and tobacco; (iii) an increase in property taxes due to revaluation; (iv) significant cuts in the public wage bill through reductions of bonuses and other benefits and the elimination of 137,000 vacancies (previously used to grant higher salaries to existing staff); and (v) substantial reductions in goods and services spending as well as in subsidies.

18. **The program envisages a further, front-loaded fiscal tightening to reduce the budget deficit.** Given strong expenditure pressures and still high vulnerabilities, additional fiscal adjustment is needed to restore fiscal viability in the medium term. Fiscal measures, concentrated on expenditure reductions and yielding 1.1 percent of GDP in 2009, are to be implemented as a prior action for the program (LOI ¶11). These measures are expected to lower the deficit to 4.6 percent of GDP in 2009, with the structural fiscal deficit declining by nearly 3 percentage points of GDP (from 6.7 percent to 3.8 percent of GDP). The authorities envisage additional adjustment efforts in 2010 to bring the deficit down to around 3 $\frac{2}{3}$  percent of GDP in that year, and to bring it to below 3 percent in 2011 to meet the Maastricht deficit criterion (LOI ¶13).



19. **To achieve sustainably lower budget deficits, the authorities have proposed a series of fiscal reforms to contain key expenditure pressures and improve the budgeting process.** A key component of these reforms will be the submission of a draft fiscal responsibility law (FRL) to parliament and development of an implementation plan (LOI ¶14). These legal and procedural reforms should allow the government to streamline the budget process, provide discipline in budget planning, and ensure fiscal sustainability over the medium term. Key features of these reforms will include: (i) a framework for improved multiyear budgeting; (ii) limits on intrayear budget revisions; (iii) fiscal rules on expenditures, public debt, and the primary deficit; (iv) the creation of an independent fiscal council; and (v) a framework for managing guarantees and other contingent liabilities.

20. **The program contemplates reforms in tax and expenditure policies, tax administration, and public enterprise oversight.** With technical assistance from the Fund, the World Bank, and the European Commission in 2009, the authorities plan to improve public financial management, tax administration, and the efficiency of public expenditures during 2010 (LOI ¶15). The authorities are also currently revising the tax code and the tax procedures code to bring them in line with the European Commission's procedures and regulations. Public enterprise oversight will be strengthened to better control expenditures and reduce subsidies.

21. **The program envisages a passage of public compensation legislation to create a fairer, simpler, more easily administered wage structure (LOI ¶16).** Currently, multiple bonuses comprise more than 50 percent of total compensation, and base wages for similar work vary greatly from ministry to ministry. The proposed legislation will establish a simplified pay scale and reform the bonus system, including by imposing ceilings on bonuses and reducing their number, and by standardizing base wages. To allow for a gradual restructuring and protect low paid workers, the phase-in period may be up to 3 years.

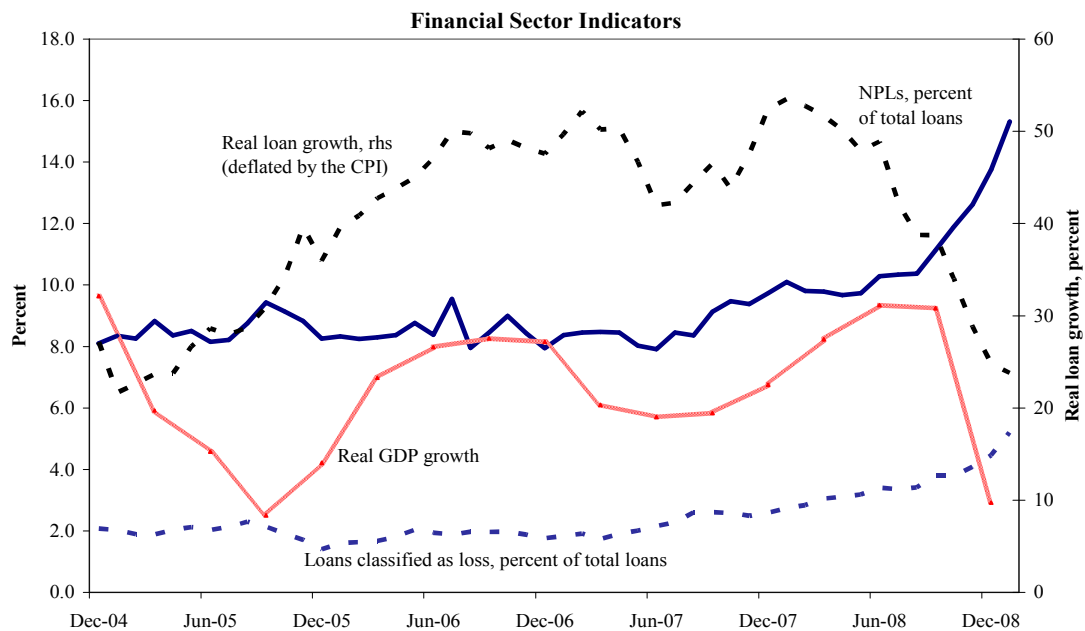
22. **One of the greatest risks to medium-term fiscal stability is the current pension system, which is expected to run large deficits in the coming years.** Current projections envisage a 2 percent of GDP pension deficit in 2011, rising to more than 6 percent of GDP by 2050. The program contemplates reforms in pension parameters to bring system costs better under control, significantly reducing this deficit (LOI ¶17). The current pension system indexes pensions to wages, allows for discretionary pension increases, has a low retirement age, and excludes certain groups of public employees from pension contributions. The proposed legislation will gradually move pension indexation to consumer prices; contributions will be phased-in for the excluded groups; and the gradual adjustment of the retirement age will continue beyond the current schedule to bring it more in line with advanced economies. The second pillar of the pension system will continue to be phased-in with scheduled increases in contributions.

23. **The government is committed to cushioning the effects of the fiscal adjustment and budget reforms by boosting social safety net spending and safeguarding capital spending.** An additional RON 250 million in social safety net spending was built into the program in 2009 and RON 500 million in 2010 to help protect the most vulnerable groups, in particular to expand the guaranteed minimum income scheme (LOI ¶11). In reforms planned for public wages and pensions, the government intends to take steps to protect the lowest wage employees and the poorest pensioners (LOI ¶16 and ¶17). The authorities are also placing priority on maintaining capital spending cofinanced by EU funds to provide for a stronger growth potential in the medium term.

#### **D. Financial Sector and Financial Markets**

24. **The NBR reacted promptly in October 2008 to significant liquidity pressures in the domestic interbank markets by broadening the range of accepted collateral and extending credit lines through its emergency liquidity assistance framework.** While currently liquidity pressures in the interbank markets have subsided, market liquidity is now limited to very short tenures—not much beyond 10 days. Access to domestic and external finance remains tight, as reflected in high borrowing costs for both leu and foreign exchange, as well as stagnation in bank lending. Foreign-owned banks generally report that lines of credit from abroad are—at best—not being increased in 2009, causing a sharp drop in new liquidity.

25. **The Romanian banking sector entered the period of financial turbulence with a strong solvency position, but stresses are building up and NPLs have been growing rapidly.** The average capital adequacy ratio reached 12.3 percent at the end of 2008, but pressures on the exchange rate will contribute to lower asset quality, as 55 percent of loans in Romania are denominated in foreign currency. Banks are already experiencing a deterioration in loan quality. Nonperforming loans (NPLs) have already begun to rise in the fourth quarter of 2008 (from 10 percent to 12 percent), with a rapid increase in provisioning needs. FSAP stress testing exercises conducted in November 2008 indicated that several banks are vulnerable to significant depletion of capital in the event of a sharp weakening of the economy and a more depreciated exchange rate.



Note: NPLs reflect unadjusted exposure of loans classified as "loss", "doubtful", and "substandard".

26. **Recent capital increases by a number of banks have helped address the deteriorating environment, but large vulnerabilities remain.** Banking supervisors at the NBR actively encouraged certain banks to boost capital in late 2008. Risks have been heightened by the significant worsening of the economic outlook just in the last couple of months. Most banks have indicated that they intend to continue with the past practice of adding the majority of 2008 profits to local capital, but further strengthening of capital positions is likely to be needed in several cases.

27. **The financial sector measures under the program include arrangements to ensure that banks in Romania remain adequately capitalized throughout the program (LOI ¶19).** The program envisages maintenance of strong capital buffers in commercial banks. To this end, the NBR has conducted stress tests on the balance sheets of banks accounting for over 90 percent of the assets of the banking system as a prior action under the program, building on the stress testing conducted during the recent FSAP update, and taking advantage of the high level of expertise developed at the NBR in this area. The stress tests



were based on two macroeconomic scenarios, one relying on the program macroeconomic assumptions, the other using more severe assumptions. The development of the analysis was carried out in close consultation with Fund staff.

28. **The stress test results will be used to assess precautionary increases in banks' capital.** Based on the outcome of the stress tests, the NBR is estimating the increase in funds that each bank will need to make so as to ensure that its capital adequacy ratio remains above 10 percent throughout the program period. Banks have been contacted and asked to strengthen their own funds in accordance with the stress testing results, by end-September 2009 (LOI ¶20), and as agreed in broad terms in the concluding statement of the financial sector coordination meeting held on March 26 (Box 2).

29. **Most banks are foreign owned and most of the parent banks are based in the Euro area, with access to liquidity through the ECB facilities.** The parents of the main banks operating in Romania have pledged any support necessary for their subsidiaries, committing to maintaining their global exposures to Romania over the program period, and to recapitalizing their subsidiaries as needed. The NBR, in conjunction with home country banking supervisors, will monitor this commitment closely.

**Romania: Distribution of Majority Foreign-Owned Banks, June 2008**

Country	Share of		
	Loans	Assets	Deposits
Austria	40.1	40.8	39.0
Greece	17.4	16.1	9.7
France	17.5	15.9	19.9
Italy	1.9	1.7	1.3
Netherlands	6.8	7.7	9.9
Hungary	2.5	2.3	1.5
United States	1.1	1.6	1.8
Germany	0.5	0.5	0.5
UK	0.4	0.3	0.2
Turkey	0.4	0.3	0.1
Israel	0.4	0.5	0.7
Egypt	0.1	0.1	0.1
Portugal	0.0	0.1	0.0
Other foreign or not identified	0.2	0.2	0.3
<b>Total majority foreign-owned banks</b>	<b>89.2</b>	<b>88.0</b>	<b>85.2</b>
Romanian banks	10.8	12.0	14.8
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Sources: *Romanian Financial Directory 2007-2008*, issued by the Finmedia.

## **Box 2. Meetings on Financial Sector Coordination in Romania—March 26, 2009**

Support from commercial banks operating in Romania is crucial to avert serious financial sector difficulties and to assure adequate balance of payments financing under the program. With nearly 90 percent of the Romanian banking system in foreign hands, involvement of parent banks and home country authorities need to play an important role in Romania's stabilization efforts. To secure this support, meetings were held in Vienna on March 26, 2009, with the main commercial banks active in Romania, and representatives of NBR, the home countries of these banks, and international organizations active in the country.

The meetings—the first attempt to seek a coordinated approach on financial sector issues for a country affected by the current crisis—was hosted by the Joint Vienna Institute (JVI) and jointly sponsored by the Fund and the EBRD with the support of other institutions, including the EU. Fund staff chaired the sessions. The meetings included the nine largest foreign-owned banks incorporated in Romania (with a total market share of 70 percent of assets), their parent banks, the European Commission (EC), the World Bank Group, the EBRD, the EIB, the NBR, representatives of the home country authorities (Austria, France, Greece and Italy), and an observer from the European Central Bank.

As a result of an open dialogue highlighting the common interests of all stakeholders, all nine parent banks signed a concluding statement (<http://www.imf.org/external/np/cm/2009/032609.htm>) that:

- Expressed their support for the program for Romania and awareness of the fact that its success will also be favorably enhanced by the continued involvement of the foreign-owned banks
- Confirmed their long-term approach to Romania as strategic investors, while acknowledging that in the current challenging economic environment a need for additional capital for some of their subsidiaries in Romania cannot be excluded
- Expressed their support to the ongoing stress-tests of the banks by the NBR
- Confirmed their willingness to make commitments, within the framework of the multilateral support programs, on a bilateral basis with the NBR to maintain their exposure to Romania and to recapitalize their subsidiaries as needed.

Follow-up meetings are scheduled in May to secure individual commitments from the banks to provide additional capital in advance of needs revealed by the stress tests results, and to maintain their overall exposure to Romania during the period the Fund-supported program remains in effect.

30. **Banks' commitment to maintain or increase exposures and to enhance capital as needed is a key element in improving financial stability and monetary conditions.** If monetary conditions evolve favorably, the NBR will be prepared to gradually ease reserve requirements, which in turn will promote bank stability. A temporary preferential regime will be established during the program period for banks committing to maintain exposures throughout the period of the program and increase the capital of their subsidiaries in Romania in line with the potential needs, as assessed under the stress-testing exercise (LOI ¶21). For these banks, any new subordinated debt subscribed either by the owners or by the IFIs would be exempt from the NBR's reserve requirements. This subordinated debt and similar instruments would be counted as tier 1 capital for the purposes of monitoring compliance,

while existing capital adequacy rules will still apply. In line with EU principles, it will be available to all banks established in Romania, regardless of the nationality of the owners.

31. **To add further confidence in the authorities' ability to deal with any potential banking difficulties, the program includes plans to amending banking and winding-up laws to be able to respond in a more timely and effective fashion in the event of bank distress** (LOI ¶22). A key objective of the amendments is to strengthen the special administrator's ability to deal with banks in weak financial positions (structural benchmark). The NBR's remedial powers will also be strengthened with provisions allowing it to request that significant shareholders increase their share capital and financially support the bank, and to prohibit or limit profit distributions (structural benchmark). The authorities are also aware of the need to streamline and strengthen the court-based winding-up proceedings for liquidation of banks and intend to pursue further work in this area at a future stage.

32. **Action will also be taken to further ensure confidence in the system of deposit insurance** (LOI ¶23). Romania, like several other European countries, acted to strengthen its deposit insurance system (RDGF) by raising the level of deposit coverage to €50,000 in 2008. To further strengthen the insurance fund, the authorities will supplement existing RDGF funding with access, should the need arise, to government privatization receipts held in the Treasury account in the NBR (currently RON 11.6 billion). Additionally, legal amendments will be enacted to broaden the grounds for the activation of deposit insurance and to accelerate payouts (structural benchmark).

33. **The NBR will continue to improve the banking supervisory and regulatory framework** (LOI ¶24). This will include more detailed reporting requirements on liquidity and, at an appropriate time, raising the minimum level of the capital adequacy ratio from 8 percent to 10 percent. The authorities are also committed to bringing Romanian financial accounting standards into line with international practice, as reflected in the International Financial Reporting Standards (IFRS). Adopting IFRS will reduce regulatory burdens on cross-border banks and corporations, and provide a more transparent framework for FDI.

#### **E. Monetary and Exchange Rate Policy**

34. **Monetary policy will aim at gradually bringing inflation within the official target range (3.5 percent  $\pm$  1 percent) by end-2009.** The authorities are firmly committed to retaining their inflation targeting framework for monetary policy under a floating exchange rate regime<sup>1</sup>. While the recent depreciation of the exchange rate will generate some additional inflationary pressures, the pass through into domestic prices is expected to be reduced due to the weakness of domestic demand. However, external financing constraints and strains in the banking system will also tightly constrain monetary policy. While under normal

---

<sup>1</sup> In August 2005, the National Bank of Romania shifted to an inflation-targeting regime, while maintaining a floating exchange rate with no pre-determined path for the exchange rate. Romania's exchange system is free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions that are maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No 144-(52/51).

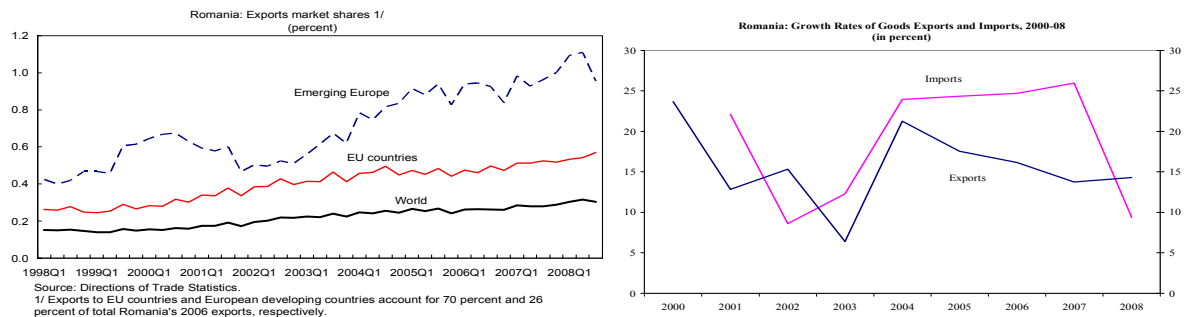
circumstances, the sharp slowing of economic activity and falling world prices might permit an easing of the monetary policy stance, the NBR will have to remain vigilant to the effects a more relaxed monetary policy could have on the exchange rate and on capital outflows. (See Box 3 for a discussion of the exchange rate and competitiveness.) Under the program, easing of interest rates and reserve requirements would be permitted, but only to the extent that exchange rate and the NFA target permit.

35. **The program will include an NFA target (including both NBR own reserves and bank's foreign exchange reserve requirements) that contemplates an increase in gross reserves of €3.0 billion over the program period (LOI ¶26).** This increase will constrain the NBR's ability to reduce reserve requirements (particularly on foreign exchange deposits) and will ensure that any easing of monetary policy cannot facilitate capital flight. They will also improve the reserve coverage of short-term external liabilities from 76 percent at end-February 2009 to about 100 percent by end-2010, significantly reducing external vulnerabilities and adding confidence to the economy.

### Box 3. Romania: Real Effective Exchange Rate and External Competitiveness

Romania's real effective exchange rate (REER) has been on a depreciating trend recently, following a sharp appreciation since the mid-1990s. At end-2008, the REER had depreciated by about 13 percent relative to its peak in July 2007. Prior to that, it had appreciated by about 50 percent between mid-2004 and mid-2007, due to large capital inflows.

Romania has more than doubled its trade share in both the EU and world markets since the late-1990s, despite the REER appreciation during this period. Its total goods exports grew at a rapid pace during this period, with the fastest growth coming from non-textile manufacturing. During 2000-08, while total exports grew by an average of nearly 16 percent per year, that of non-textile manufacturing grew by over 20 percent. However, despite such fast export growth, the current account deficit increased sharply in recent years, as imports grew at an even faster pace.



Staff analysis suggests that the average 2008 REER for Romania was moderately overvalued—in the range of 0-15 percent—based on the results of three CGER-type methods. Results from the equilibrium REER method looking at fundamentals believed to affect the equilibrium REER, suggest no exchange rate misalignment. According to this approach, the appreciation in recent years was driven primarily by better terms of trade, and by improvements in relative productivity. Results from the second method, the macroeconomic balance approach, yields a wide range of estimates, with an average overvaluation of about 13½ percent. Results from the third method, looking at external sustainability, indicates that to stabilize NFA would require an REER depreciation of about 16 percent relative to the 2008 average.

Romania: Estimated REER Misalignment	
Approach	Magnitude of Misalignment
Equilibrium REER	Broadly balanced
Macroeconomic Balance	Overvalued: 13½ percent
External Sustainability 1/	Overvalued: 16percent
<b>Overall assessment</b>	<b>Overvalued: 0-15 percent</b>

1/ Level of misalignment for keeping the NFA level at end-2008 level.

As of February 2009, the REER had depreciated by about 10 percent relative to the 2008 average, making up for some of the perceived overvaluation. With continued exchange rate flexibility, an expected decline in inflation, and further productivity gains, staff expects that competitiveness difficulties will continue to ease under the program. If competitiveness challenges do emerge, however, exchange rate adjustment could help Romania adapt quickly.

### III. PROGRAM MODALITIES

#### A. Access

36. **Romania faces considerable balance of payments financing needs over the next 24 months** (Table 3). Under staff rollover assumptions, gross financing needs of €44 billion in 2009 will produce a financing gap of approximately €11¾ billion. For 2010 and the first quarter of 2011, staff assumes that a strong adjustment program will reduce the financing gap to about €8¼ billion, bringing total financing gap under the program to €19.95 billion, as the current account will continue to adjust and rollover rates and FDI will improve due to higher confidence in economic policies and expected incipient recovery in the world economy.

37. **Disbursements by the Fund, the European Union, the World Bank, and other multilateral institutions will be needed to fill these gaps.** The program is based on €5 billion in support from the EU, €1 billion from the World Bank, and roughly €1 billion in incremental lending from the EBRD, EIB, and IFC. From the Fund, exceptional access of around €12.95 billion<sup>2</sup> (SDR 11.443 billion, 1110.77 percent of quota) will be needed. Of this, it is proposed that €5 billion be disbursed up front, with the remainder made available in quarterly tranches during a 24-month SBA. Staff assesses that Romania meets the four criteria for exceptional access (Box 4) and considers that a 24-month SBA is appropriate given the backdrop of uncertain global financial markets. Absent exceptional financing from the Fund and balance of payment support from other multilateral institutions as discussed above, gross reserves will decline to an unsustainably low level that risks triggering a disorderly balance of payments adjustment.

#### B. Capacity to Repay the Fund and Risks to the Program

38. **Romania's capacity to repay the Fund is expected to be strong.** By the end of the arrangement, Fund exposure to Romania is projected to be about 10 percent of GDP, nearly 40 percent of gross reserves, higher than the average for recent exceptional access cases. While this exposure is large, the associated risks to servicing such an exposure are mitigated by the relatively low level of public debt. Direct public indebtedness (outside borrowing from the Fund) is expected to remain low (under 26 percent of GDP), with public external debt peaking at around 10 percent of GDP at end-2010. Total external debt is projected to increase to about 68 percent of GDP at end-2010 from 53 percent at end-2008, but the declining current account deficit and a return to economic growth would gradually reduce it to manageable levels in the medium term. Romania's strong political commitment to the IMF-supported SBA program and its excellent track record servicing external obligations, also provide comfort that it will fulfill its financial obligations to the Fund in a timely manner.

39. **Notwithstanding these assurances, Romania's capacity to repay the Fund could be jeopardized by adverse political and economic developments at home and abroad.**

---

<sup>2</sup>Calculated using the exchange rate of April 16, 2009.

Romania's capacity to repay the Fund depends upon its commitment to the program and its success in rebalancing the economy. While the president, prime minister, and both parties in the coalition signed off on the Fund-supported program, October presidential elections could strain their alliance, and ultimately undermine an effective implementation of the program. If adjustment is incomplete, higher balance of payments and fiscal disequilibria could provoke capital flight and risks to Romania's ability to repay. There is also a risk that the global downturn will deepen further than currently foreseen, or that its recovery will be more protracted. Finally, it is possible that foreign banks will be unable to maintain their exposure to Romania despite their commitment to do so, given the regional dimensions of the financial sector crisis and of their operations. For these reasons, the balance of payment gap during 2009–10 could prove larger than projected under the program, or balance of payments pressures could extend beyond 2010, impairing Romania's ability to repay the Fund.

**40. The program is designed to mitigate risks on program implementation and on Romania's capacity to repay the Fund.** Application of key fiscal adjustment measures needed to bring the fiscal deficit down in 2009, and the conduct of stress tests by NBR of major banks (and selected smaller banks) to identify vulnerable institutions and assess needs for additional capital, were prior actions for the Board consideration of the request for the program. In addition, final parliamentary approval of the fiscal measures for 2009 will be obtained by the time of the first review under the SBA. To achieve sustained lower fiscal deficits, the program includes structural benchmarks on submission to parliament of a draft fiscal responsibility law, and reforming the public compensation and the pension systems by end-2009. Meetings with most of the foreign banks that have subsidiaries in Romania secured agreement to maintain exposures and recapitalize their subsidiaries as needed. Finally, close monitoring of the NBR's foreign assets and liabilities, along with a consultation clause on reserve losses, should help ensure that early policy discussions take place in case of emerging pressures under the program.

#### Box 4. Romania: Exceptional Access Criteria

The staff assesses that Romania meets the four exceptional access criteria. Proposed total access under the SBA would equal €12.95 billion (SDR11.443 billion, 1110.77 percent of quota). Since both the cumulative and annual access limits under the program exceed normal access limits, evaluation under the exceptional access framework is required. In staff's view, Romania meets these criteria:

- **Criterion 1: The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in the need for Fund financing that cannot be met within normal limits.** Romania is suffering from a severe reduction in capital inflows which, despite a significant contraction in the current account deficit, is producing a financing gap beyond what can be financed within normal limits. As noted above, the exchange rate has depreciated significantly in recent months, and central bank reserves have begun to fall. Absent exceptional financing from the Fund, gross reserves would fall to an unsustainably low level, risking to trigger in turn a disorderly balance of payments adjustment.
- **Criterion 2: A rigorous systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term.** Public debt is low (20 percent of GDP in 2008) and is not expected to pose a risk, despite rising somewhat during the program period (to 26 percent of GDP), as the fiscal deficit will be reduced and potential contingent liabilities on the government are limited, including those arising from private sector indebtedness. In addition, the financial sector is largely foreign owned, and most of the parent banks have access to liquidity through ECB facilities. The parents of the main banks operating in Romania have also pledged any support necessary for their subsidiaries, committing to maintaining their global exposures to Romania over the program period, and to recapitalizing their subsidiaries as needed.
- **Criterion 3: The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.** Romania's loss of access to capital markets is linked to the global financial crisis, though it has been exacerbated by unsustainable domestic policies. As an EU member with moderate external debt (53 percent of GDP at end-2008), strong long-term growth potential, excellent track record in servicing its external debt even in periods of balance of payments stress, and the prospect of eventual accession to the euro area, Romania's access to private financial markets should be restored as the global financial difficulties ease.
- **Criterion 4: The policy program provides reasonably strong prospect of success including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.** While Romania's past track record of adherence to Fund programs is mixed, the economic reforms supported by this stand-by arrangement from the Fund is supported at the highest political level and by both parties in a coalition that has an ample majority in parliament. Since taking office in December, the current government has already demonstrated willingness to take difficult adjustment measures. However, presidential elections in October 2009 may test the cohesiveness of the coalition. There are also macroeconomic uncertainties, but the program scenario is relatively conservative, reducing risks of things going quickly off track due to a worsening outlook. Fortunately, Romania approached the Fund before financing and banking sector problems became acute, improving the chance that the worst of these difficulties can be averted.



### C. Program Monitoring and Conditionality

41. **The SBA will run over 24 months from May 2009 to May 2011 (Box 5).** The size and timing of the disbursements should ensure that the program is able to support to Romania's economic policies during the current period of global deleveraging. Given the exceptional access level and high uncertainty surrounding projections under the proposed program, staff will consult with the authorities on evolving risks and agree on policy adjustments needed to achieve the goals of the program (LOI ¶4).

42. **Program performance will be monitored by quarterly reviews.** The first review under the program will be set for September 15, 2009, based on end-June 2009 targets. Given the need to respond quickly to rapid changes in financial markets, besides quarterly reviews, conditionality focuses on measures critical for addressing the problems faced by Romania. Limited structural conditionality is appropriate, given ongoing reform efforts in key fiscal and financial areas. The program includes five quantitative performance criteria: (i) a floor on the change in net foreign assets; (ii) a floor on the overall general government cash balance; (iii) a ceiling on general government guarantees; (iv) non-accumulation of external debt arrears (continuous); and (v) a ceiling on general government domestic arrears. There is also an indicative target (ceiling) on general government primary spending (excluding capital spending reimbursed by EU funds) and an inflation consultation clause. The program also includes two prior actions: (i) approval by emergency government ordinance of fiscal measures amounting to 1.1 percent of GDP (for Board consideration of the SBA request); and (ii) NBR completion of stress tests on banks with system assets greater than 1 percent, and selected smaller banks to assess the need for additional capital (for Board consideration of the SBA request). Finally, the program includes seven structural benchmarks for 2009: (i) final parliamentary approval of fiscal measures amounting to 1.1 percent of GDP will be obtained by the first review of the SBA; (ii) passage of amendments to the banking law to strengthen NBR's power to request bank shareholders an increase in their share capital and limit profit distribution (June 30, 2009); (iii) passage of amendments to deposit insurance legislation to broaden grounds for activation of deposit insurance, expedite payouts and provide RDGF access to privatization receipts (August 31, 2009); (iv) passage of revised public compensation legislation (October 31, 2009); (v) parliamentary submission of fiscal responsibility legislation and preparation of the associated implementation plan (November 30, 2009); (vi) passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF (November 30, 2009); and (vii) passage of revised pension legislation (December 31, 2009).

43. **Staff has initiated a safeguards assessment of the NBR, which will be completed no later than the first review under the SBA.** This assessment would update the assessment completed in June 2004, which concluded that the safeguards in place at the NBR appear generally adequate, but recommended measures to address certain weaknesses that were identified in the internal audit and controls system. Staff has requested the

documentation from the authorities necessary to complete the update assessment and will hold initial discussions with the central bank's external auditors.

#### IV. STAFF APPRAISAL

**44. Romania's macroeconomic policy stance has deteriorated sharply since 2007, particularly in the public finances.** While monetary policy attempted to cope with inflationary pressures from the boom in growth and the associated massive capital inflows, fiscal policy turned sharply procyclical. This policy mismatch contributed to missing the NBR's inflation targets and worsened the current account deficit, setting the stage for financing difficulties as capital inflows slowed sharply in recent months. Structural reform efforts also slowed in the post-accession period, leaving Romania far from attaining the objectives under its EU convergence program. The government that took office in December 2008 has moved quickly to address the fiscal imbalance, but their adjustment plans proved insufficient in the face of a rapidly worsening macroeconomic outlook and capital flight.

**45. Returning Romania to a position of fiscal and external sustainability will require both financing and a high degree of policy discipline.** Staff supports the authorities' objective of cushioning the country against the worst effects of the global economic and financial crisis while implementing policies to permit a speedy return to sustainable economic growth once the downturn passes. The multilateral financing package will boost confidence that short-term obligations can be met without resorting to unsustainable or damaging policies. Strong policies—both in the fiscal and financial sector—will ensure that the banking system is solid and that the public finances will remain under control over the medium term.

### Box 5. Romania: Stand-By Arrangement

**Access:** SDR 11.443 billion.

**Length:** 24 months.

**Phasing:** SDR 4.37 billion will be made available upon the Board's approval of the arrangement to address the large balance of payments need in the second quarter of 2009 and to replenish reserves. The seven subsequent quarterly tranches, starting from September 15, 2009 and ending on March 15, 2011, will equal SDR 7.07 billion.

#### Conditionality

- **Quantitative Performance Criteria**
  - A floor on the change in net foreign assets.
  - A ceiling on general government domestic arrears.
  - A floor on the overall general government cash balance.
  - A ceiling on general government guarantees.
  - Non-accumulation of external debt arrears.
- **Quantitative Indicative Target**
  - General government primary spending (excluding EU funds).
- **A consultation band around the 12-month rate of inflation of consumer prices.**
- **Prior Actions**
  - Approval by emergency government ordinance of fiscal measures amounting to 1.1 percent of GDP. *Prior action for Board consideration of SBA request.*
  - Conducting stress tests on banks with >1% of system assets and certain smaller banks to assess the need for additional capital. *Prior action for Board consideration of SBA request.*
- **Structural Benchmarks**
  - Parliamentary ratification of the fiscal measures amounting to 1.1 percent of GDP.
  - Passage of amendments to the banking law to strengthen NBR's power to request bank shareholders an increase in their share capital and limit profit distribution. *By June 30, 2009.*
  - Passage of amendments to deposit insurance legislation to broaden grounds for activation of deposit insurance, expedite payouts and provide for access to government privatization receipts. *By August 30, 2009.*
  - Passage of revised public compensation legislation. *By October 30, 2009.*
  - Presentation of fiscal responsibility legislation to parliament and preparation of an implementation plan. *By November 30, 2009.*
  - Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF. *By November 30, 2009.*
  - Passage of revised pension legislation. *By December 31, 2009.*

46. **The authorities' program delivers a strong policy anchor, but significant risks remain.** Under the program, the public finances will be firmly set on a path of fiscal adjustment, and measures are being undertaken to assure the banking system remains well-capitalized and liquid and that the safety net in case of financial sector difficulties is fortified.

Together, these measures address the areas of greatest vulnerability and should therefore go far in turning around market expectations. Yet risks to the program remain, including a more serious economic deterioration than underlying the macroeconomic framework projections, a slower recovery of global financial markets, and the possibility of flagging political support as presidential elections approach. To minimize these risks, continued and careful program monitoring and an ongoing policy dialogue with the Fund will be essential, along with the commitment to make policy adjustments that may become necessary.

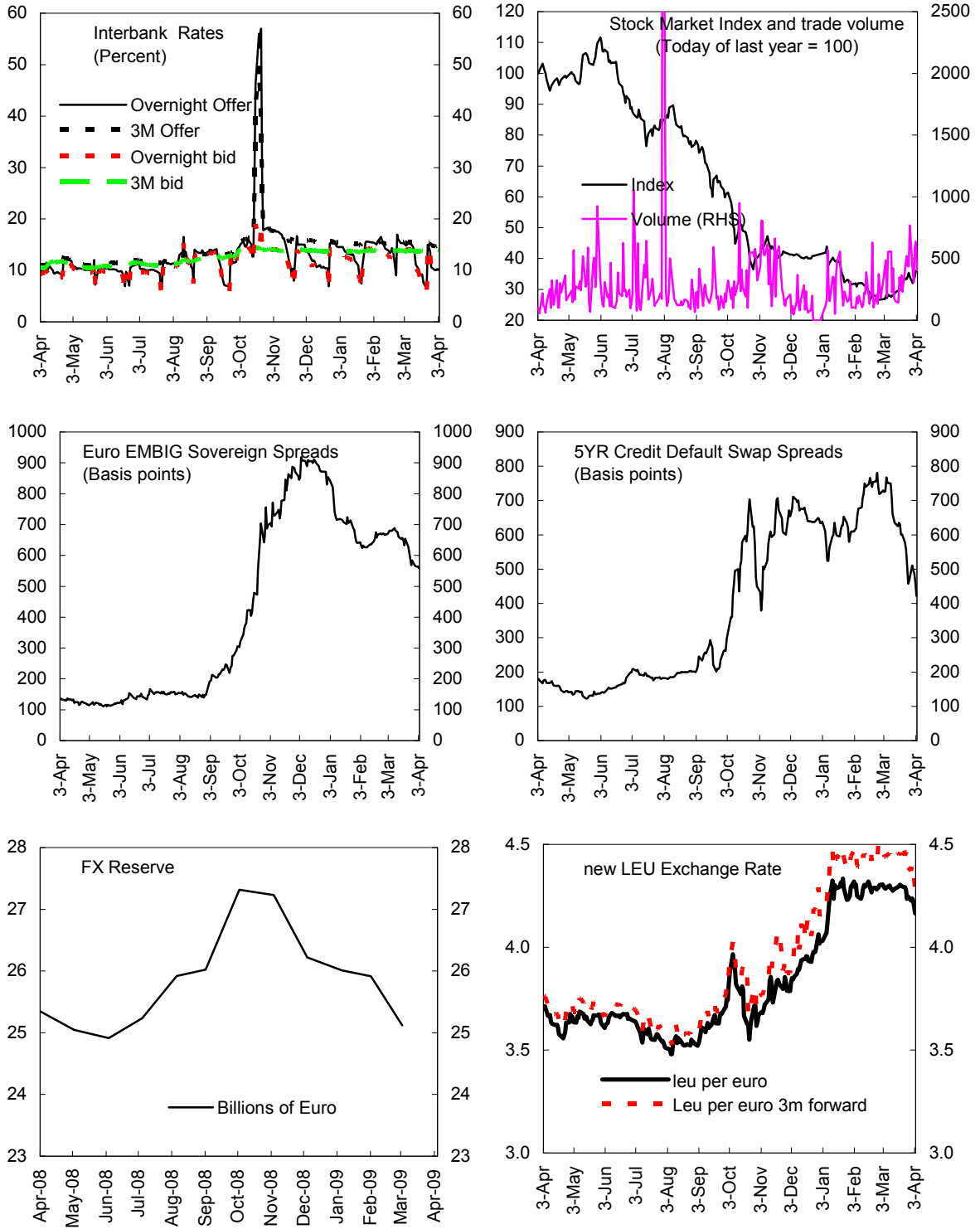
**47. The fiscal policy package aims for a balance between a needed short-term fiscal adjustment and longer-term reforms to make the public finances sustainable beyond the program period.** The initial adjustment is concentrated on reducing current expenditure to reverse the sharp, unsustainable increases in this area in recent years. Fiscal reforms in the public wage structure, pensions, and public enterprises will address the largest public spending pressure points to assure fiscal sustainability. These efforts will be combined with improvements in tax and expenditure efficiency to emerge out of technical assistance from the Fund, the World Bank, and the European Commission. While the initial effects of these measures are unavoidably painful, they will have important longer term benefits. It will be critical to engage social partners on these issues and build consensus on these critical measures.

**48. The financial sector measures should preserve the strong condition of the banking system and avoid the worst effects of the global crisis.** By securing commitments to maintain liquidity for the main foreign bank subsidiaries operating in Romania, the program helps reduce the external financing gap while anchoring the system. Steps to conduct stress tests and recapitalize banks in advance of the emergence of significant shortfalls should reinforce confidence and minimize the risk of bank failures. Finally, if difficulties occur, the measures to strengthen deposit insurance and the resolution framework should reduce the risk that problems in individual banks will lead to systemic difficulties. Supporting improvements in supervision and central bank liquidity management will also help to enhance the stability of the banking sector and support its continued access to global financial markets. In particular, the authorities should take action to boost access to liquidity for banks, including by expanding the range of assets that can be used as collateral for NBR lending to banks and removing constraints to providing temporary guarantees for interbank lending.

**49. Prudent management of monetary policy will also prove crucial to support the overall policy package.** Under the program, reducing inflation and keeping it within the NBR's target will be critical for the sustainability of the reform package. While retaining its primary focus on its inflation target, the NBR will have to carefully calibrate any policy easing to assure that it does not facilitate capital flight or induce undue pressure on the exchange rate. On the other hand, the NBR will also have to guard against an overly tight policy, which could worsen balance sheet difficulties in the banking sector.

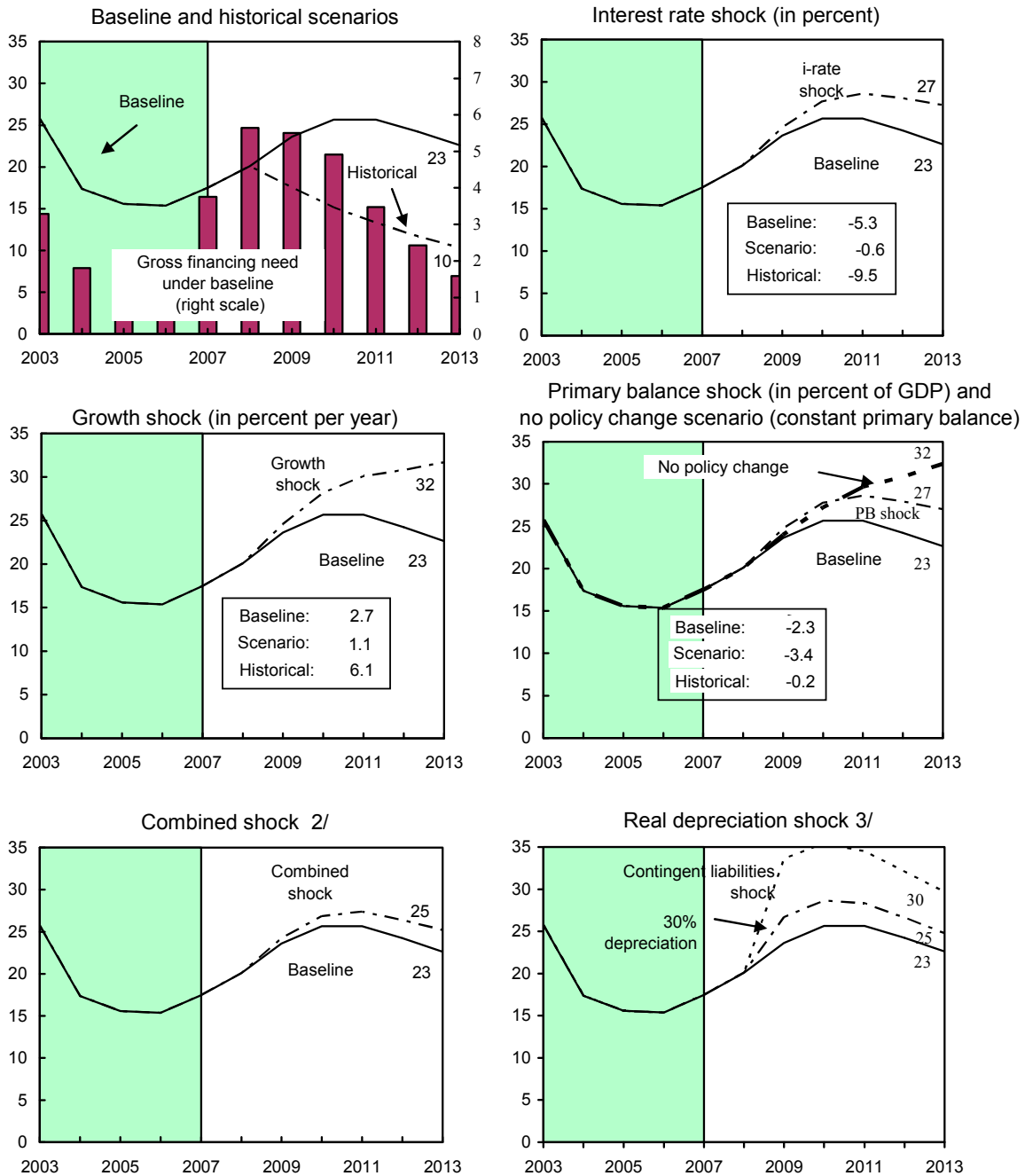
50. **With the consistent implementation of the program, staff expects that the Romanian economy will weather the current difficulties and could emerge stronger from the downturn.** Staff supports the authorities' request for a 24 month SBA arrangement.

Figure 1. Romania: Financial Markets



Source: Bloomberg, DataStream, IFS.

Figure 2. Romania: Public Debt Sustainability: Bound Tests 1/  
(Public debt in percent of GDP)



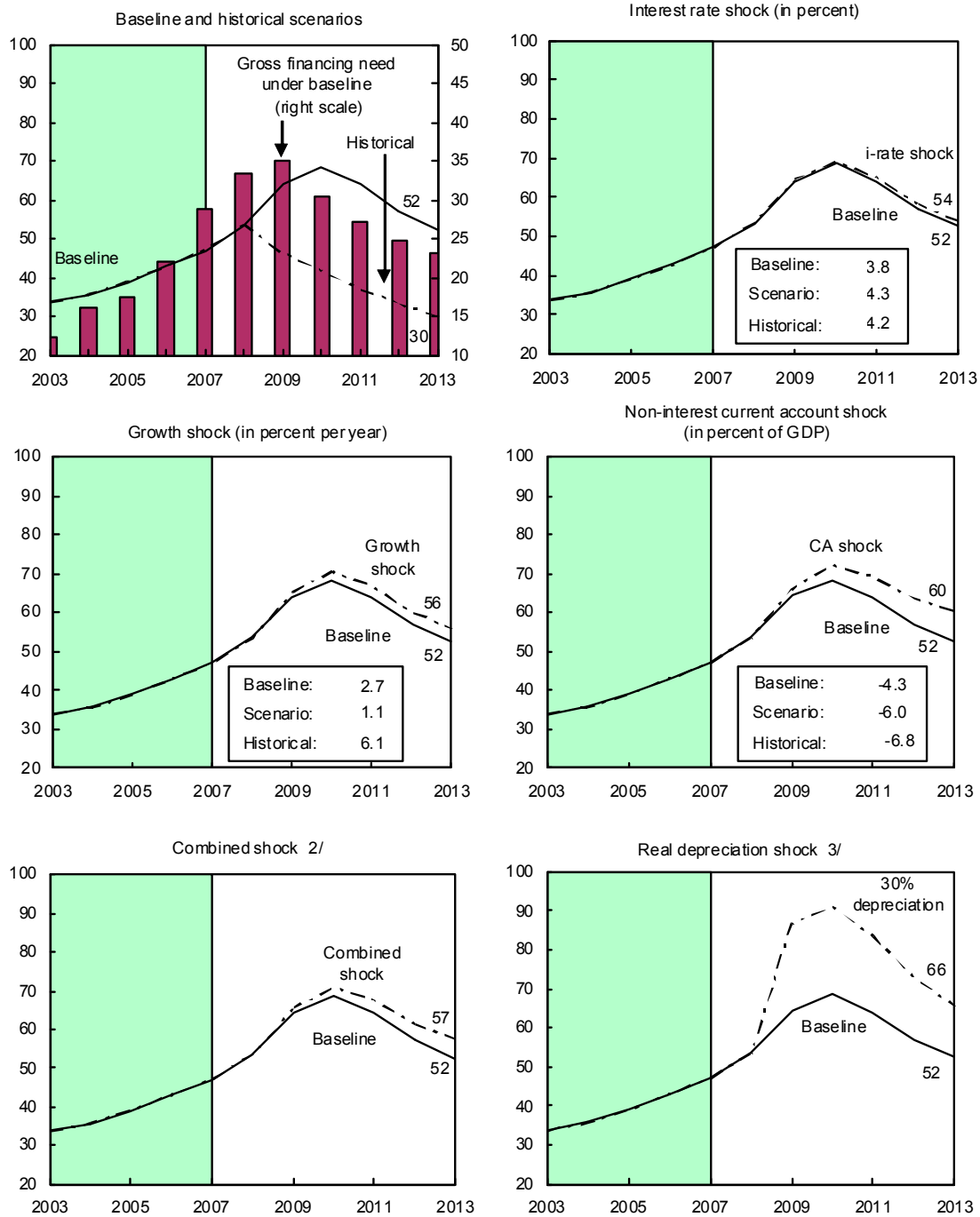
Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Seven-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 3. Romania: External Debt Sustainability: Bound Tests 1/  
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks to (i) interest rate and growth and (ii) non-interest current account are permanent one and one-half standard deviation shocks, respectively. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Seven-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2009.



Table 1. Romania: Selected Economic and Social Indicators, 2005–11

	2005	2006	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.
<b>Output and prices</b>							
	(Annual percentage change)						
Real GDP	4.1	7.9	6.2	7.1	-4.1	0.0	5.0
Domestic demand	8.3	12.8	14.3	8.9	-8.2	-2.7	5.7
Net exports (contribution)	-6.1	-10.2	-16.6	-6.3	7.8	3.9	-2.6
Consumer price index (CPI, average)	9.0	6.6	4.8	7.8	5.9	3.9	3.5
Consumer price index (CPI, end of period)	8.6	4.9	6.6	6.3	4.5	3.5	3.5
Unemployment rate	5.8	5.4	4.3	4.0	8.9	9.7	7.7
Nominal wages	17.0	18.9	22.6	23.6	5.9	3.8	5.2
Public sector wages	25.9	27.3	18.5	31.0	5.1	3.9	3.5
Private sector wages	14.7	16.5	23.2	21.2	6.2	3.8	5.7
<b>Saving and Investment</b>							
	(In percent of GDP)						
Gross domestic investment	23.3	26.5	31.1	31.4	30.8	29.9	31.9
Gross national savings	14.4	16.1	17.3	19.0	23.2	23.4	25.7
<b>General government finances</b>							
Revenue	31.4	32.3	32.5	32.6	33.0	33.4	33.1
Expenditure	32.1	33.7	35.6	37.5	37.5	37.0	35.8
Fiscal balance	-0.7	-1.4	-3.1	-4.9	-4.6	-3.6	-2.7
Privatization proceeds	1.3	0.4	0.1	0.1	0.0	0.0	0.0
External financing	0.5	0.2	0.1	0.5	2.8	1.1	0.2
Domestic financing	-1.1	0.7	2.9	4.4	1.8	2.4	2.5
Structural fiscal balance 1/	-0.6	-2.1	-4.2	-6.7	-3.8	-1.7	-1.2
Gross public debt (direct debt only)	15.6	15.4	17.5	20.1	23.6	25.7	25.7
<b>Money and credit</b>							
	(Annual percentage change)						
Broad money (M3)	36.5	28.1	33.7	17.6	6.6	6.5	11.5
Credit to private sector	-	54.5	60.4	33.7	16.4	4.8	3.3
<b>Interest rates, eop</b>							
	(In percent)						
Euribor, six-months	2.79	3.23	4.79	3.52	-	-	-
NBR policy rate	7.50	8.75	7.50	10.25	-	-	-
NBR lending rate (Lombard)	14.00	14.00	12.00	14.25	-	-	-
Interbank offer rate (1 week)	7.00	7.42	7.81	15.95	-	-	-
<b>Balance of payments</b>							
	(In percent of GDP)						
Current account balance	-8.9	-10.4	-13.8	-12.4	-7.5	-6.5	-6.2
Merchandise trade balance	-9.9	-12.0	-14.4	-13.3	-7.1	-6.3	-6.4
Capital and financial account balance	15.6	15.7	17.3	13.7	-2.3	3.2	7.4
Foreign direct investment balance	6.6	8.9	5.8	6.6	2.9	3.5	3.5
International investment position	-29.2	-35.3	-39.8	-52.9	-55.6	-54.6	-53.0
Gross official reserves	22.9	23.2	23.2	21.5	24.6	27.3	26.7
Gross external debt	39.0	42.9	47.1	53.4	64.2	68.5	64.0
<b>Exchange rates</b>							
Lei per euro (end of period)	3.7	3.4	3.5	4.0	-	-	-
Lei per euro (average)	3.6	3.5	3.3	3.7	-	-	-
Real effective exchange rate CPI based (depreciation -)	17.9	7.6	9.0	-4.2	-	-	-
<b>Memorandum Items:</b>							
Nominal GDP (in bn RON)	289.0	344.7	412.8	504.0	531.3	568.5	634.1
Nominal GDP (in bn euros)	79.7	97.8	123.6	136.8	119.7	118.8	130.7
<b>Social Indicators</b> (reference year in parentheses)							
<b>Per capita GNI</b> (Atlas method, 2005): US \$4445; <b>Income distribution</b> (GINI index, 2000): 30.3; <b>Poverty rate</b> (2005): 13 p.c.;							
<b>Primary education completion rate</b> (2004): 94 percent; <b>Gender pay gap</b> (2003): 18 percent;							
<b>Life expectancy at birth</b> (2004): 71.3; <b>Infant mortality per 1000 live births</b> (2004): 16.8.							

Sources: Romanian authorities; Fund staff estimates and projections; and World Development Indicators database.

1/ Actual fiscal balance adjusted for the automatic effects of the business cycle.

Table 2. Romania: Balance of Payments, 2005–2011  
(In billions of euros, unless otherwise indicated)

	2005	2006	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.
<b>Current account balance</b>	-7.1	-10.2	-17.1	-17.0	-9.0	-7.8	-8.2
Merchandise trade balance	-7.9	-11.8	-17.8	-18.2	-8.6	-7.5	-8.3
Exports (f.o.b.)	22.3	25.9	29.5	33.6	30.5	32.6	35.0
Imports (f.o.b.)	-30.2	-37.6	-47.4	-51.8	-39.1	-40.1	-43.3
Services balance	-0.4	0.0	0.2	0.8	1.6	1.7	2.0
Exports of non-factor services	3.9	5.5	7.6	9.1	8.6	9.2	10.4
Imports of non-factor services	-4.4	-5.5	-7.4	-8.4	-7.0	-7.5	-8.4
Income balance	-2.3	-3.2	-4.4	-5.4	-6.7	-7.0	-7.2
Receipts	1.2	1.7	2.4	2.3	2.0	2.0	2.2
Payments	-3.6	-5.0	-6.8	-7.8	-8.7	-9.0	-9.4
Current transfer balance	3.6	4.8	4.9	5.9	4.7	5.0	5.4
<b>Capital and financial account balance</b>	12.4	15.4	21.4	18.8	-2.7	3.8	9.6
Capital transfer balance	0.6	0.0	0.8	2.3	2.7	2.8	2.7
Foreign direct investment balance	5.2	8.7	7.2	9.1	3.5	4.2	4.6
Portfolio investment balance	0.8	-0.3	0.0	-1.2	-0.8	-0.6	0.0
Other investment balance	5.8	6.9	13.4	8.6	-8.1	-2.5	2.3
General government	0.4	-0.1	-0.1	0.6	-0.3	-0.9	0.7
Domestic banks	2.6	3.8	6.0	5.1	-1.1	0.0	0.0
Other private sector	2.8	3.3	7.5	2.8	-6.7	-1.7	1.6
Errors and omissions	0.3	0.1	0.3	-1.7	0.0	0.0	0.0
<b>Overall balance</b>	5.6	5.3	4.6	0.1	-11.8	-4.0	1.5
<b>Prospective financing</b>	...	...	...	...	3.3	3.6	0.2
European Commission	...	...	...	...	2.5	2.4	0.2
World Bank	...	...	...	...	0.5	0.5	0.0
EIB/EBRD	...	...	...	...	0.3	0.7	0.0
<b>Financing</b>	-5.6	-5.3	-4.6	-0.6	8.5	0.5	-1.5
Gross international reserves (increase: -)	-5.4	-5.2	-4.5	-0.6	0.0	-3.0	-2.5
Use of Fund credit, net	-0.1	-0.1	-0.1	0.0	8.5	3.5	1.0
Purchases	0.0	0.0	0.0	0.0	8.5	3.5	1.0
Repurchases	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Other liabilities, net	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>							
					(In percent of GDP)		
Current account balance	-8.9	-10.4	-13.8	-12.4	-7.5	-6.5	-6.2
Foreign direct investment balance	6.6	8.9	5.8	6.6	2.9	3.5	3.5
Merchandise trade balance	-9.9	-12.0	-14.4	-13.3	-7.1	-6.3	-6.4
Exports	27.9	26.4	23.9	24.6	25.5	27.4	26.8
Imports	-37.8	-38.4	-38.3	-37.9	-32.6	-33.7	-33.2
Gross external financing requirement	16.5	20.2	27.7	33.5	35.1	30.2	26.8
					(Annual percentage change)		
Terms of trade (merchandise)	2.8	6.4	5.3	-3.2	8.4	-3.4	-0.2
Merchandise export volume	6.1	6.8	8.7	10.4	-7.0	5.0	6.0
Merchandise import volume	15.0	22.3	26.1	3.1	-15.2	-2.3	6.6
Merchandise export prices	9.6	8.5	5.2	3.0	-2.4	1.7	1.3
Merchandise import prices	7.0	2.2	-0.1	6.1	-11.1	5.0	1.4
					(in billions of euros)		
Gross international reserves	18.1	22.7	28.7	29.4	29.4	32.4	34.9
GDP	79.7	97.8	123.6	136.8	119.7	118.8	130.7

Sources: Romanian authorities; and Fund staff estimates and projections.

Table 3. Romania: Gross Financing Requirements, 2009-11  
(in billion of Euro, unless otherwise indicated)

	2009					2010	2011	Total 2009-11
	Q1	Q2	Q3	Q4	Year			
<b>I. Total financing requirements</b>	<b>11.7</b>	<b>10.1</b>	<b>9.4</b>	<b>12.7</b>	<b>43.9</b>	<b>40.4</b>	<b>38.9</b>	<b>123.2</b>
I.A. Current account deficit	1.5	2.7	2.4	2.4	9.0	7.8	8.2	25.0
I.B. Short-term debt	8.4	4.3	4.5	5.3	22.5	18.6	18.6	59.7
Public sector	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.9
Banks	5.5	1.4	1.8	1.8	10.6	9.6	9.6	29.7
Corporates	2.9	2.7	2.6	3.4	11.6	8.7	8.7	29.0
I.C. Maturing medium- and long-term debt	1.3	2.0	1.6	4.4	9.3	11.7	12.2	33.2
Public sector	0.2	0.3	0.2	0.3	1.0	1.6	1.4	4.0
Banks	0.1	0.2	0.3	1.1	1.8	2.1	2.3	6.2
Corporates	1.0	1.6	1.0	3.0	6.5	7.9	8.5	23.0
I.D. Other capital outflows 1/	0.5	1.1	0.9	0.6	3.1	2.3	0.0	5.4
<b>II. Total financing sources</b>	<b>9.2</b>	<b>6.3</b>	<b>6.8</b>	<b>9.9</b>	<b>32.2</b>	<b>36.3</b>	<b>40.3</b>	<b>108.8</b>
II.A. Foreign direct investment, net	1.2	0.9	0.7	0.7	3.5	4.2	4.6	12.2
II.B. Capital account inflows (EU)	0.3	0.7	0.8	0.9	2.7	2.8	2.7	8.2
II.C. Short-term debt	6.8	3.2	3.9	4.6	18.6	18.6	18.6	55.8
Public sector	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.9
Banks	4.8	1.3	1.8	1.8	9.6	9.6	9.6	28.7
Corporates	2.0	1.9	2.1	2.8	8.7	8.7	8.7	26.2
II.D. Maturing medium- and long-term debt	0.9	1.5	1.4	3.7	7.4	10.8	14.4	32.6
Public sector	0.1	0.2	0.2	0.1	0.7	0.7	2.1	3.5
Banks	0.1	0.2	0.3	1.1	1.7	2.1	2.3	6.1
Corporates	0.7	1.1	0.8	2.4	5.0	7.9	10.1	23.0
<b>III. Increase in gross reserves</b>	<b>-3.0</b>	<b>1.1</b>	<b>0.9</b>	<b>1.0</b>	<b>0.0</b>	<b>3.0</b>	<b>2.5</b>	<b>5.5</b>
<b>IV. Financing gap</b>	<b>-0.5</b>	<b>5.0</b>	<b>3.5</b>	<b>3.8</b>	<b>11.8</b>	<b>7.0</b>	<b>1.1</b>	<b>19.9</b>
<b>V. Prospective financing</b>	<b>-0.5</b>	<b>5.0</b>	<b>3.5</b>	<b>3.8</b>	<b>11.8</b>	<b>7.0</b>	<b>1.1</b>	<b>19.95</b>
IMF	0.0	5.0	1.9	1.6	8.5	3.5	1.0	12.95
Others	0.0	0.0	1.6	1.7	3.3	3.6	0.2	7.0
European Commission	0.0	0.0	1.50	1.00	2.50	2.35	0.15	5.0
World Bank	0.0	0.0	0.0	0.5	0.5	0.5	0.0	1.0
EIB/EBRD	0.0	0.0	0.1	0.2	0.3	0.7	0.0	1.0
<i>Memorandum items:</i>								
Rollover rates for amortizing debt (in percent)								
Banks 2/	87	87	96	96	91	100	100	...
Corporates 3/	69	69	81	81	76	100	100	...
Gross international reserves	26.4	27.5	28.4	29.4	29.4	32.4	34.9	...
Coverage of gross international reserves								
- Months of imports of GFNS (next year)	...	...	...	...	7.4	7.5	7.2	...
- Share of short-term external debt (in percent)	83	87	89	93	93	107	114	...

Source: IMF staff estimates.

1/ Includes reduced trade credit exposures, as well as portfolio equity and deposit outflows, in line with the experience in recent r

2/ Once the Fund program takes effect in May, full rollover is assumed for foreign banks exposures to Romania.

For Romanian banks a rollover rate of 50 percent is assumed throughout 2009.

3/ Once the Fund program takes effect in May, full rollover is assumed for foreign banks lending to corporates in Romania (which lending by subsidiaries booked abroad), as banks are expected to commit to full rollover of their exposure to Romania as part of the program. For corporate external debt to their parents assumes a rollover rate of 50 percent throughout 2009.

Table 4. Romania: General Government Operations, 2005–11  
(In percent of GDP)

	2005	2006	2007	2008 Prel.	2009 1/		2010 Proj.	2011 Proj.
					Baseline	Proj.		
<b>Revenue</b>	31.4	32.3	32.5	32.6	32.7	33.0	33.4	33.1
<b>Taxes</b>	27.3	28.2	28.1	28.3	27.9	28.1	28.3	27.9
Taxes on profits	2.7	2.7	2.9	2.9	2.4	2.6	2.5	2.5
Taxes on income	2.4	2.8	3.5	3.6	3.5	3.5	3.5	3.4
Value-added taxes	7.8	8.1	7.6	8.1	7.4	7.4	7.5	7.6
Excises	3.1	3.1	3.0	2.7	2.9	2.9	3.3	3.1
Customs duties	0.8	0.8	0.2	0.2	0.1	0.1	0.1	0.1
Social security contributions	9.5	9.6	9.6	9.6	10.3	10.3	10.0	9.8
Other taxes	1.1	1.2	1.4	1.1	1.2	1.3	1.4	1.4
Nontax revenue	3.2	3.3	3.4	3.3	3.1	3.1	3.3	3.3
Capital revenue	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Grants, including EU disbursements	0.6	0.5	0.8	0.6	1.6	1.6	1.6	1.7
Financial operations and other	...	...	...	0.3	...	...	...	...
<b>Expenditure</b>	32.1	33.7	35.6	37.5	38.6	37.5	37.0	35.8
<b>Current expenditure</b>	29.1	29.4	30.9	33.0	35.0	34.1	33.3	31.8
Compensation of employees	7.4	8.0	8.2	8.6	8.1	7.8	7.2	6.7
Maintenance and operations	6.3	6.2	6.1	6.6	5.2	5.1	5.1	5.1
Interest	1.2	0.8	0.7	0.8	1.8	1.6	1.7	1.4
Subsidies	2.2	2.2	1.7	1.6	1.2	1.2	0.9	0.9
Transfers 2/	12.0	12.2	14.2	15.5	18.0	17.7	17.7	16.8
Pensions	5.8	5.4	5.5	6.6	7.4	7.4	7.3	7.0
Other social transfers	3.7	3.6	3.9	4.0	4.4	4.4	4.3	4.1
Other transfers 3/	2.1	2.5	4.1	3.7	5.5	5.2	5.4	5.2
ow contribution to EU budget	...	...	0.9	0.9	1.0	1.0	1.4	1.3
Other spending	0.4	0.8	0.7	1.2	0.7	0.7	0.6	0.6
Proj. with ext. credits	0.0	0.0	0.0	0.0	0.8	0.8	0.8	0.8
Capital expenditure 4/	3.0	4.3	4.8	4.6	3.5	3.5	3.7	4.0
Reserve fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
<b>Fiscal balance</b>	-0.7	-1.4	-3.1	-4.9	-5.9	-4.6	-3.6	-2.7
Primary balance	0.5	-0.6	-2.4	-4.1	-4.1	-3.0	-1.9	-1.3
<b>Financing</b>	0.7	1.4	3.1	4.9	5.9	4.6	3.6	2.7
Privatization proceeds	1.3	0.4	0.1	0.1	0.0	0.0	0.0	0.0
External	0.5	0.2	0.1	0.5	0.0	2.8	1.1	0.2
Domestic	-1.1	0.7	2.9	4.4	5.9	1.8	2.4	2.5
<b>Financial liabilities</b>								
Gross public debt 5/	20.3	18.4	19.8	21.8	26.6	25.3	27.2	27.1
Gross public debt excl. guarantees	15.6	15.4	17.5	20.1	25.0	23.6	25.7	25.7
External	10.6	7.9	7.1	7.0	6.6	9.4	9.9	9.1
Domestic	5.0	7.5	10.4	13.1	18.3	14.2	15.8	16.7
<b>Memorandum items:</b>								
Fiscal balance (ESA95 basis)	-1.4	-2.2	-2.5	-5.3	...	...	...	...
Output gap 6/	-0.4	2.2	3.2	5.4	-2.4	-2.4	-5.7	-4.6
Conventional structural fiscal balance	-0.6	-2.1	-4.2	-6.7	-5.1	-3.8	-1.7	-1.2
Nominal GDP (in billions of RON)	289.0	344.7	412.8	504.0	531.3	531.3	568.5	634.1

Sources: Ministry of Finance; Eurostat; and Fund staff projections.

1/ "Baseline" refers to authorities' 2009 budget adjusted for new macroframework.

"Proj" also includes agreed adjustment fiscal measures.

2/ Increase in 2009 mostly reflects higher EU-financed capital spending and budgeted rise in pensions.

3/ Includes co-financing of EU projects.

4/ Does not include all capital spending. Total investment increased from 6.0 percent of GDP in 2008 to 7.0 percent of GDP in the authorities' 2009 budget.

5/ Total public debt, including government debt, local government debt, and guarantees.

6/ Percentage deviation of actual from potential GDP.

Table 5. Romania: Monetary Survey, 2005-11  
(In millions of lei (RON), unless otherwise indicated; end of period)

	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11
I. Banking System							
<b>Net foreign assets</b>	<b>41,501</b>	<b>38,734</b>	<b>29,076</b>	<b>13,050</b>	<b>-28,834</b>	<b>-35,534</b>	<b>-26,713</b>
In million euros	11,286	11,454	8,225	3,300	-6,290	-7,165	-5,612
o/w commercial banks	-5,337	-9,984	-19,064	-24,580	-25,693	-25,693	-25,693
<b>Net domestic assets</b>	<b>45,025</b>	<b>72,087</b>	<b>119,039</b>	<b>161,085</b>	<b>213,826</b>	<b>232,476</b>	<b>246,382</b>
Public sector credit, net	3,297	3,546	9,571	17,268	27,152	41,093	56,756
Private sector credit	59,806	92,379	148,181	198,086	235,515	245,109	254,098
Other	-18,078	-23,837	-38,712	-54,269	-48,842	-53,726	-64,471
<b>Broad Money (M3)</b>	<b>86,526</b>	<b>110,821</b>	<b>148,116</b>	<b>174,136</b>	<b>184,992</b>	<b>196,942</b>	<b>219,669</b>
Intermediate money (M2)	86,230	110,442	148,044	173,737	184,568	196,491	219,166
Money market instruments	295	379	72	399	424	451	503
Narrow money (M1)	33,760	48,726	79,914	92,605	98,379	104,734	122,766
Currency in circulation	11,386	15,130	21,442	25,314	28,551	30,395	31,933
Overnight deposits	22,375	33,596	58,473	67,292	69,828	74,339	90,833
II. National Bank of Romania							
<b>Net foreign assets</b>	<b>61,125</b>	<b>72,498</b>	<b>96,466</b>	<b>110,240</b>	<b>87,637</b>	<b>91,876</b>	<b>95,593</b>
In million euros	16,623	21,438	27,289	27,880	19,402	18,527	20,081
<b>Net domestic assets</b>	<b>-38,913</b>	<b>-37,918</b>	<b>-47,593</b>	<b>-59,772</b>	<b>-30,716</b>	<b>-31,278</b>	<b>-31,928</b>
Public sector credit, net	-3,943	-9,562	-8,499	-5,449	-5,449	-5,449	-5,449
Credit to banks, net	-21,995	-12,104	-7,088	4,954	29,010	28,449	27,798
Other	-12,976	-16,252	-32,006	-59,277	-54,277	-54,277	-54,277
<b>Reserve money</b>	<b>22,212</b>	<b>34,580</b>	<b>48,873</b>	<b>50,468</b>	<b>56,921</b>	<b>60,598</b>	<b>63,665</b>
(Annual percentage change)							
Broad money (M3)	36.5	28.1	33.7	17.6	6.2	6.5	11.5
NFA contribution	9.7	-3.2	-8.7	-10.8	-24.1	-3.6	4.5
NDA contribution	26.8	31.3	42.4	28.4	30.3	10.1	7.1
Reserve money	62.1	55.7	41.3	3.3	12.8	6.5	5.1
NFA contribution	150.7	51.2	69.3	28.2	-44.8	7.4	6.1
NDA contribution	-88.6	4.5	-28.0	-24.9	57.6	-1.0	-1.1
Domestic credit, real	32.3	44.9	54.3	28.4	16.7	5.3	5.0
Private sector, at constant e/r	52.0	60.1	58.2	25.6	9.7	0.9	6.5
Public sector, real	5.2	2.6	153.3	69.7	50.5	46.2	33.5
Broad money (M3), at constant e/r	25.6	22.1	25.4	10.6	1.7	2.9	7.8
Private deposits, at constant e/r	35.0	32.5	31.7	13.1	1.1	4.7	13.7
<b>Memorandum items:</b>							
CPI inflation, eop	8.6	4.9	6.6	6.3	4.5	3.5	3.5
Inflation target	6.5 - 8.5	4 - 6	3 - 5	2.8 - 4.8	2.5 - 4.5	2.5 - 4.5	...
Interest rates (percent):							
Policy interest rate	7.50	8.75	7.50	10.25	...	...	...
Interbank offer rate, 1 week	7.00	7.42	7.81	15.95	...	...	...
Corporate loans 1/	13.69	12.10	11.62	19.50	...	...	...
Household deposits 1/	6.68	6.86	6.92	15.27	...	...	...
Share of foreign currency deposits in M3	29.9	28.1	28.0	30.2	...	...	...
Share of foreign currency private loans	54.7	47.3	54.3	55.5	...	...	...
M2 velocity	3.34	3.12	2.79	2.90	2.80	2.80	2.80
Money multiplier (M3/reserve money)	3.90	3.20	3.03	3.45	3.25	3.25	3.45

Sources: National Bank of Romania; and Fund staff estimates.

1/ Rates for new local currency denominated transactions.

Table 6. Romania: Selected Financial Soundness Indicators, 2004–08

	2004	2005	2006	2007	2008
(in percent, unless otherwise indicated)					
<b>Capital buffers:</b>					
Capital adequacy ratio 1/	20.6	21.1	18.1	13.8	12.3
Own capital ratio 1/	8.9	9.2	8.6	7.3	7.0
<b>Credit risk:</b>					
Assets, in percent of GDP	37.1	45.2	50.9	63.1	66.2
Domestic credit, in percent of GDP	17.8	21.9	27.8	38.2	42.7
Private sector credit, in percent of GDP	16.6	20.8	26.8	35.9	39.3
Credit to households, in percent of GDP	4.8	7.4	11.4	17.3	19.7
Lending for real estate purchase, in percent of GDP 2/ 3/	1.9	2.7	3.9	3.2	4.1
Medium and long term credits, in percent of non-gov. credit	58.4	63.9	68.4	76.0	76.9
Non-performing loans, in percent of loans 4/	8.1	8.3	8.0	9.7	13.8
Specific provisions, in percent of non-performing loans 4/	16.1	14.4	18.2	25.7	28.7
Off-balance activities, in percent of assets	14.8	15.0	17.1	16.6	16.5
<b>Foreign exchange risk:</b>					
Net open position in foreign exchange, in percent of capital	-2.0	-0.6	0.6	0.3	0.9
Lending in foreign exchange, in percent of non-gov. credit	61.8	54.7	47.3	54.3	57.8
Foreign currency liabilities, in percent of total liabilities 5/	46.8	44.3	44.1	42.5	39.0
Deposits in foreign exchange, in percent of non-gov. dom. deposits	41.2	34.6	32.3	32.1	34.8
<b>Liquidity risk:</b>					
Liquidity ratio 6/	2.3	2.6	2.3	2.1	2.6
Liquid assets, in percent of total assets 5/	63.6	61.8	54.4	48.3	47.2
Liquid assets, in percent of short term liabilities 5/	193.9	245.7	207.2	171.7	233.8
Loan to deposit ratio, in percent 7/	72.1	80.0	95.8	114.8	130.8
Net foreign assets of credit institutions, in percent of GDP 5/	-2.1	-6.8	-9.8	-16.3	-19.3
<b>Profitability and concentration:</b>					
Return on average assets	2.5	1.9	1.7	1.3	1.7
Return on average equity	19.3	15.4	13.6	11.5	18.1
Market share (assets) of five largest banks	59.2	58.8	60.3	56.3	54.4
<b>Memorandum items:</b>					
Stock market capitalization, in percent of GDP 8/	17.1	22.3	24.4	26.7	11.3

Sources: National Bank of Romania, Romanian National Institute of Statistics, and Fund staff estimates.

Note: On January 1, 2007, the NBR introduced the ESCB's statistical methodology. Only some time series have been recalculated back to December 2004.

- 1/ The NBR amended the capital adequacy requirements effective January 1, 2007 to be consistent with EU minimum requirements and Basel II. The former 12 percent capital adequacy ratio and 8 percent Tier I ratio were substituted by a new 8 percent solvency ratio.
- 2/ Refers to loans and commitments to a single debtor above RON 20,000 according to the Central Credit Register, which covers about 82 percent of total loans and commitments granted.
- 3/ During 2007, the share of credit to households for house purchase has remained relatively constant around 19–20 percent.
- 4/ Non-performing loans reflect unadjusted exposure to non-performing loans classified as "loss", "doubtful", and "substandard", according to the NBR's loan classification regulations, as percent of total loans using the balance sheet approach, which may differ from the data published in the NBR's Monthly Bulletin.
- 5/ 2008 data as of September.
- 6/ Effective liquidity over required liquidity, the mandatory ratio is thus one.
- 7/ Loan-to-deposit ratio of domestic credit to resident deposits, including government.
- 8/ Covers the regulated market at Bucharest Stock Exchange, including SIFs, and RASDAQ. Derivatives, traded at SIBEX, are excluded.

Table 7. Romania: Public Sector Debt Sustainability Framework, 2003-2013  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	
<b>Baseline: Public sector debt 1/</b>	25.8	17.4	15.6	15.4	17.5	20.1	23.6	25.7	25.7	24.2	22.6	
o/w foreign-currency denominated	13.2	10.1	8.8	7.2	6.5	6.7	6.9	6.3	5.7	5.2	4.8	-2.2
Change in public sector debt	-2.7	-8.4	-1.8	-0.2	2.1	2.6	3.5	2.0	0.0	-1.4	-1.6	
Identified debt-creating flows (4+7+12)	-4.8	-6.1	-2.5	-2.8	0.1	1.7	3.5	2.0	0.0	-1.4	-1.6	
Primary deficit	0.2	-0.2	-0.4	0.6	2.5	4.5	4.1	3.1	2.2	1.3	0.7	
Revenue and grants	28.7	29.9	31.4	32.3	32.5	32.6	33.0	33.4	33.1	32.9	32.7	
Primary (noninterest) expenditure	28.9	29.7	31.0	32.9	35.0	37.1	37.1	36.5	35.3	34.2	33.3	
Automatic debt dynamics 2/	-4.8	-5.3	-0.9	-3.0	-2.3	-2.7	-0.6	-1.1	-2.2	-2.8	-2.3	
Contribution from interest rate/growth differential 3/	-4.6	-3.9	-1.5	-1.7	-1.9	-2.7	-0.6	-1.1	-2.2	-2.8	-2.3	
Of which contribution from real interest rate	-3.3	-2.2	-0.8	-0.7	-1.1	-1.7	-1.3	-1.1	-1.1	-1.1	-1.1	
Of which contribution from real GDP growth	-1.3	-1.7	-0.6	-1.0	-0.8	-1.0	0.8	0.0	-1.1	-1.6	-1.2	
Contribution from exchange rate depreciation 4/	-0.2	-1.4	0.6	-1.3	-0.4	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	-0.6	-1.3	-0.4	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.2	-0.6	-1.3	-0.4	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.1	-2.2	0.7	2.7	2.1	0.9	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	89.8	58.0	49.6	47.6	53.8	61.6	71.7	76.9	77.6	73.8	69.3	
<b>Gross financing need 6/</b>	3.3	1.8	1.6	1.8	3.8	5.6	5.5	4.9	3.5	2.4	1.6	
in billions of U.S. dollars	2.0	1.4	1.6	2.2	6.4	11.3	8.6	7.6	5.9	4.9	3.7	
<b>Scenario with key variables at their historical averages 7/</b>						20.1	17.5	15.2	13.3	11.7	10.3	-1.5
<b>Scenario with no policy change (constant primary balance) in 2008-2013</b>						20.1	24.0	27.2	29.6	30.8	32.3	-3.2
<b>Key Macroeconomic and Fiscal Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	5.8	8.5	4.1	7.9	6.2	7.1	-4.1	0.0	5.0	7.2	5.4	
Average nominal interest rate on public debt (in percent) 8/	9.3	6.2	7.0	6.0	5.2	3.0	2.5	2.1	1.8	1.6	1.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-13.9	-9.3	-5.2	-4.5	-7.6	-11.0	-7.4	-4.9	-4.4	-4.6	-4.9	
Nominal appreciation (increase in US dollar value of local currency, in percent)	1.9	14.2	-6.2	19.4	6.5	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	23.2	15.5	12.2	10.5	12.8	14.0	10.0	7.0	6.2	6.2	6.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.4	11.6	8.7	14.4	13.0	13.5	-4.2	-1.5	1.6	3.8	2.7	
Primary deficit	0.2	-0.2	-0.4	0.6	2.5	4.5	4.1	3.1	2.2	1.3	0.7	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)] / (1+g+\pi+g\pi)$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\varepsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\varepsilon(1+r)$ .

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 8. Romania: External Debt Sustainability Framework, 2003-2013  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -8.3
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	
<b>Baseline: External debt</b>	33.7	35.6	39.0	42.9	47.1	53.4	64.2	68.5	64.0	57.1	52.5	
Change in external debt	0.5	1.9	3.4	3.9	4.2	6.4	10.7	4.3	-4.4	-7.0	-4.6	
Identified external debt-creating flows (4+8+9)	-1.3	-4.7	-7.0	-5.5	-0.9	3.6	7.8	3.6	-0.4	-1.4	-0.2	
Current account deficit, excluding interest payments	4.5	7.1	7.7	9.3	12.7	10.2	5.1	4.1	3.9	4.0	4.1	
Deficit in balance of goods and services	7.4	9.1	10.5	12.0	14.2	12.7	5.8	4.9	4.9	5.3	5.6	
Exports	34.8	35.8	32.9	32.1	30.1	31.3	32.7	35.2	34.7	32.9	31.7	
Imports	42.2	44.8	43.3	44.1	44.3	44.0	38.5	40.1	39.6	38.2	37.2	
Net non-debt creating capital inflows (negative)	-4.6	-8.4	-7.5	-8.6	-5.8	-5.8	-2.2	-3.0	-3.5	-3.5	-3.5	
Automatic debt dynamics 1/	-1.1	-3.4	-7.2	-6.1	-7.8	-0.8	5.0	2.5	-0.8	-1.9	-0.8	
Contribution from nominal interest rate	1.3	1.3	1.2	1.1	1.2	2.2	2.4	2.4	2.3	2.1	1.9	
Contribution from real GDP growth	-1.6	-2.5	-1.1	-2.5	-2.1	-3.0	2.5	0.0	-3.1	-3.9	-2.7	
Contribution from price and exchange rate changes 2/	-0.9	-2.2	-7.2	-4.7	-6.9	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.8	6.7	10.4	9.4	5.1	2.8	2.9	0.7	-4.1	-5.5	-4.4	
External debt-to-exports ratio (in percent)	97.0	99.7	118.7	133.9	156.6	170.9	196.4	194.5	184.5	173.5	165.7	
<b>Gross external financing need (in billions of euros) 4/</b>	6.5	9.8	14.0	21.6	35.8	45.8	42.0	36.3	35.4	37.9	40.4	
in percent of GDP	12.4	16.1	17.5	22.1	28.9	33.5	35.1	30.5	27.1	24.7	23.1	
<b>Scenario with key variables at their historical averages 5/</b>						53.4	46.3	41.8	37.1	33.4	30.1	-9.6
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	5.3	8.5	4.1	7.9	6.2	7.1	-4.1	0.0	5.0	7.2	5.4	
GDP deflator in euros (change in percent)	2.7	7.0	25.4	13.7	19.0	3.3	-8.7	-0.7	4.8	9.3	8.3	
Nominal external interest rate (in percent)	4.4	4.4	4.2	3.5	3.5	5.2	4.0	3.8	3.7	3.8	3.8	
Growth of exports (euros terms, in percent)	6.7	19.4	19.9	19.8	18.5	15.0	-8.5	6.9	8.5	11.1	9.8	
Growth of imports (euros terms, in percent)	11.5	23.4	26.1	24.9	27.0	9.9	-23.4	3.2	8.7	13.0	11.3	
Current account balance, excluding interest payments	-4.5	-7.1	-7.7	-9.3	-12.7	-10.2	-5.1	-4.1	-3.9	-4.0	-4.1	
Net non-debt creating capital inflows	4.6	8.4	7.5	8.6	5.8	5.8	2.2	3.0	3.5	3.5	3.5	

1/ Derived as  $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $\rho$  = change in domestic GDP deflator in euro terms,  $g$  = real GDP growth rate,  $\varepsilon$  = nominal appreciation (increase in euro value of domestic currency), and  $\alpha$  = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as  $[-\rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$  times previous period debt stock.  $\rho$  increases with an appreciating domestic currency ( $\varepsilon > 0$ ) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; euro deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.



Table 9. Romania: Indicators of External Vulnerability, 2005-09

	2005	2006	2007	2008	2009 Latest
<b>Financial Indicators</b>					
M3, end-of-period, percent change	36.5	28.1	33.7	17.6	19.4
Private sector credit, percentage change	45.8	54.5	60.4	33.7	33.8
Share of foreign currency deposits in private deposits	34.6	32.3	32.1	34.8	37.9
Share of foreign currency loans in total loans, <i>o/w to</i> :	54.7	47.3	54.3	57.8	59.4
Corporates (private and public)	58.8	52.0	55.3	56.7	58.1
Households	44.1	41.2	53.1	58.7	60.6
Non-performing loans to gross loans 1/	8.3	8.0	9.7	13.8	...
<b>External Indicators</b>					
Exports of goods and services, annual percentage change	19.9	19.8	18.5	15.0	...
Imports of goods and services, annual percentage change	26.1	24.9	27.0	9.9	...
Real effective exchange rate, percentage change (+ = appreciation)	17.9	7.6	9.0	-4.2	...
Current account balance, in percent of GDP	-8.9	-10.4	-13.8	-12.4	...
Capital and financial account, in percent of GDP	15.6	15.7	17.3	13.7	...
Financial account, in percent of GDP	14.8	15.7	16.6	12.0	...
Net foreign direct investment, in percent of GDP	6.6	8.9	5.8	6.6	...
Gross official reserves, in billions of euros 2/	18.1	22.7	28.7	29.4	26.5
In months of next year GNFS imports	5.0	5.0	5.7	7.7	6.9
In percent of short-term debt at remaining maturity	189.8	133.2	99.4	89.2	80.4
Total external debt, in billions of euros	31.1	42.0	58.2	73.1	...
In percent of GDP	39.0	42.9	47.1	53.4	...
Short-term debt at remaining maturity, in billions of euros	9.5	17.0	28.9	33.0	...
In percent of GDP	12.0	17.4	23.3	24.1	...
In percent of total external debt	30.7	40.6	49.6	45.2	...
<b>Financial Market Indicators</b>					
Stock market index, eop 3/	6,586	8,050	9,825	2,901	2,367
CDS spread, 5-year, eop 4/	36	20	87	635	385

Source: Romanian authorities; and staff estimates.

1/ Non-performing loans reflect unadjusted exposure to loans classified as "loss", "doubtful", and "substandard", according to the NBR's loan classification regulations.

2/ 2009 data as of February 23, 2009.

3/ 2009 data as of end-March.

4/ 2009 data as of April 6.

Table 10. Romania: Proposed Access, 2009-11

	Proposed Arrangement	Normal Access Cases					High-Access Cases 1/				
		Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile	Average	Median	Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile	Average	Median
<b>Access</b>											
In millions of SDRs	11,443	100	35	412	428	128	72.2	1,645	12,686	7,872	6,901
Average annual access	555	100	21	52	43	35	88	137	471	293	248
<b>Total access in percent of: 3/</b>											
Actual quota	1,111	100	30	75	70	49	86	302	901	642	505
Calculated quota	1,590	100	26	100	81	50	97	262	1,018	625	545
Gross domestic product	10.8	100	0.7	2.8	1.8	1.3	85	2.9	9.4	8.6	5.6
Gross international reserves	44	81	5	43	41	13	37	27	90	85	51
Exports of goods and nonfactor services	33	100	1.9	7.2	5.7	3.9	69	11.1	39.2	31.8	24.6
Imports of goods and nonfactor services	28	100	1.7	6.5	4.9	3.6	63	12.4	49.3	31.3	22.1
Total debt stock											
<i>Of which:</i> Public	49	...	...	...	...	...	88	7	33	23	12
External	123	100	2	6	5	3	100	6	17	16	12
Short-term	101	...	...	...	...	...	79	20	101	100	33
M2	32	95	1	12	100	4	86	7	29	27	14

Source: Executive Board documents, MONA database, and Fund staff estimates.

High access cases include available data at approval and on augmentation for all the requests to the Board since 1997 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.

Based on scenario analysis (Scenario I) from Review of the Adequacy of and Options for Supplementing Fund Resources.

The data used to calculate ratios is the actual value for the year prior to approval for public and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables.

Table 11. Romania: Indicators of Fund Credit, 2009-16 1/  
(In millions of SDR)

	2009	2010	2011	2012	2013	2014	2015	2016
<b>Existing Fund Credit</b>								
Stock 2/	0	0	0	0	0	0	0	0
Obligations	0	0	0	0	0	0	0	0
<b>Proposed Stand-By Arrangement</b>								
Disbursement	7,497	3,072	874	0	0	0	0	0
Stock 1/	7,497	10,569	11,443	10,136	5,812	1,507	109	0
Obligations 3/	120	302	362	1,662	4,590	4,408	1,415	110
Repurchase	0	0	0	1,307	4,324	4,305	1,398	109
Charges	120	302	362	355	266	103	17	1
<b>Stock of existing and prospective Fund credit</b>								
In percent of quota	728	1,026	1,111	984	564	146	11	0.0
In percent of GDP	7.1	10.0	9.8	7.4	3.7	0.9	0.1	0.0
In percent of exports of goods and services	21.7	28.4	28.3	22.6	11.8	2.8	0.2	0.0
In percent of gross reserves	28.8	36.7	36.8	30.4	16.4	4.0	0.3	0.0
<b>Obligations to the Fund from existing and prospective Fund arrangements</b>								
In percent of quota	11.7	29.3	35.1	161.3	445.5	427.9	137.4	10.7
In percent of GDP	0.1	0.3	0.3	1.2	3.0	2.5	0.7	0.0
In percent of exports of goods and services	0.3	0.8	0.9	3.7	9.3	8.1	2.4	0.2
In percent of gross reserves	0.5	1.0	1.2	5.0	12.9	11.7	3.5	0.3

Source: IMF staff estimates.

1/ Using SDR interest rate as well as exchange rate of SDR/US\$ and US\$/€ of April 16, 2009.

2/ End of period.

3/ Repayment schedule based on repurchase obligations.

Table 12. Romania: Schedule of Reviews and Purchases

Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
May 6, 2009	4,370	424.22	Approval of arrangement
September 15, 2009	1,718	166.76	First review and end-June 2009 performance criteria
December 15, 2009	1,409	136.77	Second review and end-September 2009 performance criteria
March 15, 2010	766	74.40	Third review and end-December 2009 performance criteria
June 15, 2010	768	74.54	Fourth review and end-March 2010 performance criteria
September 15, 2010	769	74.62	Fifth review and end-June 2010 performance criteria
December 15, 2010	769	74.63	Sixth review and end-September 2010 performance criteria
March 15, 2011	874	84.82	Seventh and end-December 2010 performance criteria
<b>Total</b>	<b>11,443</b>	<b>1110.77</b>	

Source: IMF staff estimates.

**ATTACHMENT I. ROMANIA: LETTER OF INTENT**

Bucharest, April 24, 2009

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Dear Mr. Strauss-Kahn:

51. Economic conditions in the region have worsened sharply in recent months as a result of the global financial crisis. These events were aggravated by underlying imbalances in our economy, and have resulted in sharply deteriorating prospects for Romania. In response, the government and the National Bank of Romania (NBR) have developed a comprehensive strategy to firmly anchor macroeconomic policies and reduce financial market stress. We request that the Fund support our program through a Stand-By Arrangement (SBA) for a period of 24 months in the amount equivalent to SDR11.443 billion (€12.95 billion). In conjunction with support of €5 billion under the EU's balance of payment financing facility and other multilateral commitments of some €2 billion, this arrangement will signal the international community's support for our policies. We view this package as essential to protect the Romanian economy from the worst effects of the worldwide crisis, and to put us in a position for a strong return to growth once the current difficulties ease.

52. We have discussed with IMF staff our economic program, which is outlined below. The program aims to cushion the effects of the sharp drop in private capital inflows while implementing policy measures to address the external and fiscal imbalances and to strengthen the financial sector. The immediate objective is to facilitate an orderly adjustment of the external deficit, thus easing excessive pressures on the exchange rate which could otherwise cause severe balance sheet effects on the corporate and household sectors, resulting in a sharper recession and strains in the banking sector. To attain this objective, our program intends to: (i) strengthen fiscal policy further to reduce the government's financing needs and improve long-term fiscal sustainability, thus preparing Romania for eventual entry into the euro zone; (ii) maintain adequate capitalization of banks and liquidity in domestic financial markets, (iii) bring inflation within the NBR's target range and maintain it there; and (iv) secure adequate external financing and improve confidence.

53. The government has already made important efforts to bring about the needed adjustment to stabilize the economy. We approved a 2009 budget with important spending cuts and revenue increases yielding around 3 percent of GDP. As prior actions under the program, another 1.1 percent of GDP in fiscal consolidation measures will be implemented.

An anti-crisis plan has been launched, including efforts to reorient public spending toward investment and to encourage private investment. Social measures to protect vulnerable groups are also being undertaken. The NBR has expanded its liquidity support to bank and several banks have boosted their capital adequacy while others are in the process of doing so.

54. The program will be monitored through quantitative performance criteria and indicative targets, structural benchmarks and consultation clauses, during quarterly reviews. Table 1 below sets out specific quarterly targets that are to be observed under the SBA for the overall general government balance, the change in arrears for the general government, CPI inflation, and net foreign assets, as well as for the issuance of new government contingent liabilities on behalf of the nonfinancial private sector and public enterprises. In addition, there will be indicative targets on the primary expenditure of the general government, net of disbursements of pre- and post-accession EU structural funds. We will have approved by emergency ordinance and sent to the parliament for ratification a package of fiscal measures designed to yield 1.1 percent of GDP RON 5.9 billion before consideration of our program by the IMF's Executive Board. Final approval of these measures will be required for the first review. The NBR will complete by April 30 (as a prior action) stress testing of all banks with more than 1 percent share (by assets) in the Romanian market, plus selected smaller banks, according to risk parameters agreed with IMF staff. The first review of the program will take place by September 15, 2009 and the second review by December 15, 2009. We believe that the policies set forth in this letter are adequate to achieve the objectives of our economic program, but the Government stands ready to take additional measures as appropriate to ensure the achievement of its objectives. Romania will consult with the IMF on the adoption of these measures and in advance of revisions to the policies contained in this letter in accordance with the IMF's policies on such consultations.

### **Recent economic performance and macroeconomic framework for 2009–10**

55. Romania experienced an economic boom from 2003-08 that led to overheating and unsustainable imbalances. GDP growth averaged over 6½ percent per year, as foreign direct investment and capital inflows helped finance high consumption and investment growth. Robust export growth to EU countries reflected a process of increasing economic integration with western European economies. However, import growth was even faster, generating increasing current account deficits that peaked at 13½ percent of GDP in 2007. The overheating economy and rapid capital inflows complicated monetary policy, resulting in credit growth averaging 50 percent per year in 2006-7, and impairing NBR's ability to achieve its inflation target notwithstanding increases in interest rates and reserve requirements together with other measures to slow credit growth. Fiscal policy was strongly procyclical, with the government deficit rising from under 1 percent of GDP in 2005 to near 5 percent of GDP by 2008.

56. In recent months financial stress has increased, reflecting external factors and the downturn in the economy. The extreme shift in investors' risk preferences, which spilled

over from difficulties in global financial markets, has negatively affected the exchange rate, equity prices, and the government securities market. Capital inflows have slowed sharply, and NBR reserves have begun to decline. The effects in Romania have not been especially pronounced compared with elsewhere in the region, but due to the weak fiscal position and high current account deficit, the vulnerability to a sudden drop in capital flows is higher.

57. The economy turned sharply down in the fourth quarter of 2008, and prospects for 2009 are negative. GDP fell by 3.9 percent (q-on-q seasonally adjusted) in the last quarter, and indicators suggest the decline is continuing in early 2009. At this time, the outlook is particularly uncertain, as it depends on global events and on restoring consumer and investor confidence. We anticipate a sharp drop in GDP this year, but are hopeful that the measures proposed in this program will limit the fall. A recovery is expected to begin in 2010, but growth is likely to remain near zero due to the lingering effects of the global downturn on Romania. The risks to the baseline scenario are mostly on the downside, reflecting uncertainty about the speed with which financial markets will stabilize and the depth of the global economic slowdown. Inflationary pressures are expected to abate as the economy turns downward, and we anticipate that CPI inflation will move to within the NBR target band by late 2009 and remain there throughout 2010.

58. A current account correction appears well underway, but receding capital inflows are opening a significant external financing gap. Gross external financing needs will decline in 2009, due to the smaller current account deficit, and will be partly covered by pre- and post-accession EU structural funds (a stable source of inflows) and already committed foreign direct investment inflows. We cautiously assume net outflows from the non-financial private sector. Our IMF- and EU-supported program will strike a balance between balance of payments adjustment and financing support. Once the program takes effect, we expect foreign banks to largely maintain their exposure, stemming the decline experienced early in the year. At the same time, we aim to gradually increase the NBR's foreign reserves as a precaution against unexpected outflows. The resulting external financing need of some €20 billion over the period 2009-2011 can be covered by drawing on resources from the IMF, support under the EU's balance of payment facility, and from other official creditors.

### **Fiscal Policy**

59. Government spending doubled between 2005 and 2008 in nominal terms, pushing the public share of economic activity from 32 percent of GDP to 37 percent. The public sector wage bill also more than doubled these three years due to high wage increases combined with a large increase in government employment. The fiscal deficit rose in 2008 to about 5 percent of GDP. In the final months of 2008, further expenditure increases in the run-up to the elections were financed on a very short-term basis, as the government found itself unable to borrow on longer maturities at reasonable cost. As the economy enters recession in 2009, an easing of fiscal policy to cushion the downturn is unfortunately no longer possible. Spending

has become too high and financing conditions leave the government unable to finance a large deficit.

60. The current government, which took office in late December, has already taken significant steps to reverse the fiscal imbalance. The fiscal policies of 2008 would have produced a deficit of nearly 9 percent of GDP in 2009, but measures already approved in the 2009 budget will reduce the deficit by about 3 percentage points of GDP. These budget measures include: (i) an increase of 3.3 percentage points in social contributions; (ii) adjusted property taxes due to an increase in appraisals; (iii) significant cuts in the public wage bill through reductions of bonuses and other benefits, and the elimination of 137,000 vacancies (previously used to grant higher salaries to existing staff); and (iv) substantial reductions in goods and services spending, as well as in subsidies.

61. Under the proposed IMF-supported program, the government will undertake additional fiscal adjustment efforts as a prior action, designed to bring the deficit down another 1.1 percent of GDP to 4.6 percent of GDP in 2009. Primary government expenditure (which excludes interest payments) will be reduced by an additional 0.85 percentage point of GDP compared to the 2009 budget. This will be achieved by (i) foregoing public sector wage increases (totaling 5 percent) scheduled for 2009 or equivalent further cuts in employment; (ii) reducing public employment, including by replacing only 1 of 7 departing employees; (iii) reductions in capital spending on items like vehicles and office equipment, plus a more realistic timetable for EU supported investment projects; (iv) additional cuts in spending on goods and services; and (v) further reductions in subsidies to public entities. Parliamentary ratification of these measures will be completed by the first review of the program (structural benchmark) Within the government's expenditure envelope, we will give priority to investment projects cofinanced by EU funds. We will also allocate an additional RON 250 million in spending to improving social protection for the most vulnerable groups during the economic downturn. On the revenue side, measures to eliminate certain tax deductions and allowances (in particular on company cars, and depreciation of revalued assets) are expected to generate an additional 0.25 percent of GDP.

62. The program will be primarily monitored through the cash balance of the general government (as defined in the accompanying technical memorandum, TMU) (a quarterly performance criterion). In the event that nongrant revenues exceed those foreseen under the program, the deficit target will be adjusted downward by one half the surplus, allowing for additional capital spending while reducing the deficit further. We will consult IMF staff on adjustments to the target and on eventual corrective measures in the event of a shortfall in government financing. A performance criterion will be established on the change in domestic payments arrears (as defined in the TMU) that will contemplate a full repayment of 2008 arrears under the program. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. An indicative target will also be established on the primary expenditure of the general government, net of reimbursements



from pre- and post-accession EU structural funds, which will be subject to the same adjustor as applied to the deficit target.

**63.** The government is committed to maintaining fiscal discipline in the long-term, recognizing that this is a key element in reducing the external imbalance and in retaining investor confidence. We therefore intend to continue budget consolidation in 2010. We envisage a further reduction in the general government deficit to around 3½ percent of GDP. Fiscal efforts will continue to be concentrated on the expenditure side. Specific quarterly targets for 2010 will be set at the time of the second program review (to be concluded by December 15, 2009). For 2011, we plan to move the general government deficit below 3 percent of GDP (under both national and ESA 95 definitions). Passage of a 2011 budget designed to achieve this objective will be a structural benchmark for the sixth review of the program (scheduled by December 15, 2010).

**64.** Sustainable achievement of lower budget deficits will require important changes in the budget process, as well as reforms in revenue and expenditure policies. A key component of our medium-term strategy will be a new fiscal responsibility law that will, among other things: (i) set up, in coordination with the IMF and the World Bank, procedures for improved multiyear budgeting; (ii) establish limits on budget revisions during the course of the year; (iii) lay out fiscal rules on expenditures, public debt and the primary deficit; (iv) create a fiscal council to provide independent and expert scrutiny; and (v) set up a framework for the issuance and management of guarantees and other contingent liabilities. We plan to submit this law to parliament and prepare an implementation plan by end-November 2009 (a structural benchmark).

**65.** We have requested technical assistance from the IMF, the World Bank, and the European Commission in 2009 to assist in improving public financial management, tax administration, and the efficiency of public expenditures. Implementation of recommendations from this assistance will be undertaken in 2009 and 2010, including comprehensive reviews of the fiscal code and the fiscal procedures code in line with European Commission deadlines and procedures. We will implement an improved system of financial monitoring of decentralized fiscal entities (including public enterprises) and will move to increase the net revenue from these entities through tighter control on their expenditures and reduced subsidies. In 2010, once the enhanced monitoring is in place, an indicative target on the financial balance of the largest public enterprises will be included in program conditionality. Public enterprises will not be allowed to accumulate new arrears, but they will have to restructure to reduce existing arrears. During the program period, public enterprises making losses will not be allowed to raise compensation; those earning profits will only be allowed to increase compensation in line with inflation and productivity growth. We will step up efforts to improve the absorption of EU funds, while ensuring they target the right growth priorities. Improving the efficiency and effectiveness of the public administration will be instrumental to this goal.

66. We currently face major problems in the public sector wage system. Bonuses comprise too much of total compensation, there is no unified wage scale, and there is a large numbers of laws regulating wages in different parts of the system. To permanently eliminate these problems, we will approve during 2009 legislation to restructure the public compensation (structural benchmark). Under this legislation, we will establish a unified, simplified pay scale, and reform the current system of bonuses. A ceiling of under 30 percent will be phased-in on the share of all non-wage personnel expenditures as a share of total public compensation. Creation of non-monetary bonuses will be prohibited. Monetary bonuses will be consolidated—eliminating the large majority of bonuses or rolling them into the base wage. For any given public servant, total bonuses would be legally capped. All bonuses will continue to be fully taxable. The law could provide for a phasing-in period of the reforms of up to 3 years, and efforts will be made to safeguard the real incomes of the lowest paid workers during this process. Further attributes of this legislation will be coordinated with the Fund and the World Bank.

67. A significant source of fiscal pressure over the medium term is the cost of future pension obligations. To address this, we will reform key parameters of the pension system, in coordination with the World Bank (structural benchmark). Changes will include moving toward indexing public pensions to consumer prices rather than to wages and limiting the scope for discretionary pension increases. Groups of public employees currently excluded from pension contributions will have such contributions phased-in. We will also continue gradual adjustment of the retirement age beyond the currently agreed schedule (particularly for women) taking into account the evolution of life expectancies, to allow for greater financial stability of the system, as well as to ensure that retirement parameters are more in line with EU practices. To protect vulnerable pensioners, we will make efforts to boost targeted poverty support programs that would improve their living standards. We will continue to phase in the second pillar of the pension system, with regularly scheduled increases in contributions as originally envisaged. Together, we hope that the pillars of the pension system will allow us to eventually attain our objective of a 45 percent replacement ratio for retirees on average.

## **Financial Sector**

68. The Romanian banking system entered the period of global financial turbulence with a strong solvency position. All 32 banks are in compliance with the capital adequacy requirement of 8 percent, and the average capital adequacy ratio was 12.3 percent at the end of 2008. Most banks are foreign owned (with 87 percent of assets), and most of the parent banks are based in the Euro area, with access to liquidity through the ECB facilities. The parents of the main banks operating in Romania have pledged any support necessary for their subsidiaries, committing to maintaining their global exposures to Romania over the program period, and to recapitalizing their subsidiaries as needed. This was reaffirmed in their joint statement issued in Vienna on March 26, 2009. The NBR, in conjunction with home country banking supervisors, will monitor this commitment closely.

69. While the banking system as a whole is currently well-capitalized, it now faces more difficult macroeconomic and global financial circumstances than in recent years and exceptionally uncertain prospects. In these circumstances it is prudent for banks to maintain strong capital buffers. To this end, the program will take advantage of the high standards of stress testing capability developed by the NBR. Stress tests of individual bank balance sheets and lending portfolios under different scenarios will be used to assess the potential increases in own funds needed to ensure that solvency ratios remain above 10 percent throughout the program period (prior action).

70. Once stress tests are completed, banks will be required to secure, by the end of September 2009, sufficient resources to cover any potential shortfalls revealed by the stress tests. These resources could be provided either in the form of increases in share capital or through subordinated long-term (at least 5-year) loans and similar instruments, qualifying as tier 2 capital and convertible into ordinary share capital at the holders' discretion or at the request of the NBR. These resources should in the first place come from the owners of the banks, but we will encourage bank owners to actively explore opportunities for cofinancing the increase in stable funding offered by the IFIs in the framework of their February 2009 Joint Action Plan in support of banking systems in the CEE region.

71. A temporary preferential regime will be established for banks whose majority owner signs a commitment to (i) maintain overall exposure to Romania throughout the period of the program; and (ii) increase the capital of its bank in Romania in line with the potential needs, as assessed under the stress-testing exercise. For these banks, any new subordinated debt subscribed either by the owners or by the IFIs would be exempt from the NBR's reserve requirements. For the purposes of monitoring compliance with (ii), this subordinated debt and similar instruments would be counted as tier 1 capital, while existing capital adequacy rules will still apply. This preferential regime will expire at the end of the program period. In line with EU principles, it will be available to all banks established in Romania, regardless of the nationality of the owners. Banks' commitment to maintain or increase exposures and to enhance capital as needed is a key element in improving financial stability and monetary conditions. If monetary conditions evolve favorably, the NBR will be prepared to gradually ease reserve requirements, which in turn will promote bank stability.

72. Although the banking system is currently stable and sound, we will amend our banking and winding-up laws, in consultation with the IMF, to be able to respond in a timely and effective fashion in the event of bank distress. A key objective of the amendments will be to strengthen the special administrator's ability to deal with banks in weak financial positions (end-November 2009 structural benchmark). Beyond bank resolution, the NBR's remedial powers will be strengthened with provisions allowing it as part of its assessment of suitability to request that significant shareholders increase their share capital and financially support the bank, and to prohibit or limit profit distributions (end June 2009 structural benchmark). We are cognizant of the need to streamline and strengthen our court-based

proceedings for winding-up of banks and intend to pursue further work in this area at a future stage.

73. A further crucial ingredient in ensuring confidence in the banking system is the system of deposit insurance. In 2008, governments across Europe, including Romania, acted to strengthen their deposit insurance systems by raising the level of deposit coverage to at least €50,000. To further strengthen the RDGF, and to bring it more closely into alignment with international best practice and prospective requirements under EU directives, the RDGF will supplement its existing funding with access to government privatization receipts held in the Treasury account in the NBR (currently RON 11.6 billion). Additionally, procedures for the activation of deposit insurance will be modified to simplify and accelerate payouts. Under modified legislation, deposit insurance will be paid within the 20 working day period authorized in the EU directive on deposit guarantee schemes (structural benchmark).

74. The NBR will continue to improve the banking supervisory and regulatory framework, and will consult with Fund staff prior to the introduction of any new or revised prudential regulations for banks. This will include more detailed reporting requirements on liquidity and, at an appropriate time, raising the minimum level of the capital adequacy ratio from 8 percent to 10 percent. We are also committed to bringing Romanian financial accounting standards into line with international practice, as reflected in the International Financial Reporting Standards (IFRS). Adopting IFRS will reduce regulatory burdens on cross-border banks and corporations, and provide a more transparent framework for FDI. In the current circumstances, however, a rapid transition could be disruptive, particularly in the financial sector. In view of this, the adoption of IFRS will take place on a timetable to be determined by the NBR.

75. We will seek an agreement with commercial banks to facilitate the restructuring of household debt contracted in foreign currency by adjusting the maturity and repayment schedule of the debt, including offering the option to voluntarily convert it in domestic currency. Banks will also be allowed to continue to rely on their own in-house expertise for the collection of their claims

### **Monetary and Exchange Rate Policy**

76. The NBR is determined to gradually bring inflation down to the official target of 3.5 percent (plus or minus 1 percent). Under the program, progress towards this goal will be monitored using an inflation consultation clause (see TMU). Monetary policy was tightened in 2007 and the first half of 2008 in response to a rise in underlying inflationary pressures. Looking forward, the economic slowdown in Romania and the rest of the world will likely put downward pressure on inflation, but any further depreciation of the exchange rate could boost inflation. Therefore, monetary policy will remain vigilant, with any easing of reserve requirements or of the policy interest rate calibrated to assure attainment of the inflation

objective by end-2009, and with due consideration of the possible effects on capital flows and the exchange rate.

77. Under the program, we plan for an increase in Gross International Reserves of 0 in 2009 (implying a recovery of all reserves lost in the months before the program takes effect), and of €3.0 billion in 2010. This will provide improved confidence in the economy and allow for greater reserve coverage of short-term liabilities. A performance criterion will be established on Net Foreign Assets that is consistent with gross reserves accumulation objective. Within the inflation targeting framework, the NBR's intervention policy will be applied consistently with the target for net foreign assets under the program. Reserve losses exceeding €2 billion in any 30-day period during the program will trigger consultation with IMF staff. The NBR will widen the range of assets acceptable as collateral for its facilities. The NBR stands ready to further expand its toolkit as needed.

78. During the period of the Stand-by arrangement we will not, without Fund approval, introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement. Moreover, we will not introduce or intensify import restrictions for balance of payments reasons.

79. We recognize the importance of completing a safeguards assessment by the first review under the Stand-By Arrangement. The National Bank of Romania will provide the information required to complete the assessment by the first review and will receive as safeguards mission from the IMF as necessary.

\\s\  
Gheorghe Pogea  
Minister of Finance

\\s\  
Mugur Isarescu  
Governor of the BNR

Attachments

**Table 1. Romania: Quantitative Program Targets**

	2008	2009				2010
	Dec Actual	March Proj.	June Prog	Sept Prog	Dec Proj	Dec Proj
<b>I. Quantitative Performance Criteria</b>						
1. Cumulative change in net foreign assets (mln euros) 1/	25,532	-3,500	-7,600	-8,720	-9,000	-500
2. Cumulative floor on general government overall balance (mln lei) 2/	-24,655	-8,300	-14,508	-18,612	-24,363	-20,583
3. Cumulative change in general government arrears (bn lei) 1/	0.3	...	0.0	0.0	-0.15	-0.15
4. Ceiling on general government guarantees issued during the year (face value, bn lei)	0.0	...	6.0	6.0	6.0	...
<b>II. Continuous Performance Criterion</b>						
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0
<b>III. Inflation Consultation</b>						
6. 12-month rate of inflation in consumer prices						
Outer band (upper limit)	8.3	8.7	8.4	7.7	6.5	4.5
Inner band (upper limit)	7.3	7.7	7.4	6.7	5.5	3.5
Center point	6.3	6.7	6.4	5.7	4.5	2.5
Outer band (lower limit)	5.3	5.7	5.4	4.7	3.5	1.5
Inner band (lower limit)	4.3	4.7	4.4	3.7	2.5	0.5
<b>IV. Indicative Target</b>						
7. General government primary spending (excluding EU funds; mln lei) 2/	182,411	44,120	87,505	132,356	182,723	191,468

1/ The December 2008 figure is a stock.

2/ The December 2008 figure is for the whole year.

**Table 2. Romania: Proposed Structural Conditionality Under the Program in 2009**

Measure	Conditionality 1/	Timing
<b>Fiscal policy</b>		
1. Passage of 1.1 percent of GDP in fiscal measures to ensure achievement of fiscal targets (¶4, 11)	Prior Action	
2. Ratification by parliament of fiscal measures equivalent to 1.1 percent of GDP (¶4, 11)	SB	August 31, 2009
3. Passage of revised public compensation legislation (¶16)	SB	October 30, 2009
4. Presentation of fiscal responsibility legislation and implementation plan to parliament (¶14)	SB	November 30, 2009
5. Passage of revised pension legislation (¶17)	SB	December 31, 2009
<b>Financial Sector</b>		
6. Conducting stress-tests on banks with >1% of system assets and certain smaller banks to assess the need for additional capital (¶19)	Prior Action	
7. Passage of amendments to the banking law to strengthen NBR's power to request bank shareholders an increase in their share capital and limit profit distribution (¶22)	SB	June 30, 2009
8. Passage of amendments to deposit insurance legislation to broaden grounds for activation of deposit insurance, expedite payouts and provide a line of credit from the government (¶23)	SB	August 30, 2009
9. Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF (¶22)	SB	November 30, 2009

1/ SB = structural benchmark.

**ATTACHMENT II. ROMANIA: TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)**

April 1, 2009

1. This Technical Memorandum of Understanding: (i) defines the variables subject to the quantitative targets specified in the Letter of Intent (LOI); (ii) describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets (Section I); and (iii) provides clarifications for some of the structural conditionality under the program (Section II). As is standard under all Fund arrangements, we will consult with the Fund before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.
2. For the purposes of the program, *the exchange rates* of the Romanian Leu (RON) to the euro is set at  $\text{RON } 3.9852 = \text{€}1$ , to the U.S. dollar at  $\text{RON } 2.8342 = \text{\$}1$ , to the Japanese yen at  $\text{RON } 3.1419 = \text{¥}100$ , and to the pound sterling at  $\text{RON } 4.1169 = \text{£}1$ , the rates as shown on the National Bank of Romania's (NBR's) website as of December 31, 2008. The exchange rates to other currencies, where applicable, will also be the ones shown on the NBR's website as of December 31, 2008.
3. For the purposes of the program, the *general government* includes the entities as defined in the 2009 budget. These are: the central government (state budget, treasury, self-financed state entities included in the budget, etc.), local governments, social security funds (pension, health, and unemployment), road fund company, and administration of the property fund. This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform IMF staff of the creation of any such new funds or programs immediately.

**I. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILING, AND CONTINUOUS PERFORMANCE CRITERIA****A. Floor on the Net Foreign Assets of the NBR**

4. **Net Foreign Assets (NFA)** of the National Bank of Romania (NBR) are defined as the euro value of gross foreign assets of the NBR (including reserve requirements of the commercial banking system held at the NBR) minus gross foreign liabilities; and will be measured on the basis of the NBR's operational rather than accounting definitions. Non-euro denominated foreign assets and liabilities will be converted into euro at the program exchange rates.
5. **Gross foreign assets** are defined to include the NBR's holdings of SDRs, the country's reserve position at the Fund, holdings of cash, securities and deposits abroad in



convertible foreign currencies. Excluded from reserve assets are: (i) gold and other precious metals; (ii) assets in nonconvertible currencies; (iii) illiquid assets; (iv) any assets that are pledged, collateralized, or otherwise encumbered; (v) claims on residents; and (vi) claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

6. **Gross foreign liabilities** are defined as all foreign exchange liabilities to residents and nonresidents, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options), and all credit outstanding from the Fund, but excluding (i) banks' foreign currency deposits against reserve requirements; and (ii) government foreign currency deposits at the NBR. This definition is meant to bring the concept of foreign liabilities closer to the balance of payment definition, on which the targets are based.

**Floor on cumulative change in NFA from the beginning of the year** (in mln. euros) 1/

	2008	2009				2010
	December	March	June	September	December	December
	(stock)	(est)	PC	PC	IT	IT
Cumulative change in NFA	25,532	-3,500	-7,600	-8,720	-9,000	-500
<i>Memorandum Item:</i>						
Gross Foreign Assets	26,220	-3,500	-2,300	-1,200	0	3,000

1/ PC=performance criterion; IT=indicative target. Data for end-month.

7. NFA targets will be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as external disbursements from official creditors (World Bank and the EC) that are usable for the financing of the overall central government budget. The NFA targets will also be adjusted upward by the increase in commercial bank reserve requirements held with the NBR relative to end-December, 2008 (€13,038 million), measured at program exchange rates.

**External Program Disbursements – Baseline Projections** (in mln. euros)

	2009				2010
	March	June	September	December	December
Cumulative flows from end-December 2008	0	0	1,500	3,000	2,350

### B. Consultation Mechanism on the 12-month Rate of Inflation

8. The quarterly consultation bands for the 12-month rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the Romanian Statistical Institute), are specified below. Should the observed year-on-year rate of CPI inflation fall outside the outer bands specified above, the authorities will complete a consultation with the Fund on their proposed policy response before requesting further purchases under the program. In addition, the NBR will conduct discussions with the Fund staff should the observed year-on-year rate of CPI inflation fall outside the inner bands specified for the end of each quarter in the table above.

	2008	2009				2010
	December	March	June	September	December	December
Outer band (upper limit)	8.3	8.7	8.4	7.7	6.5	4.5
Inner band (upper limit)	7.3	7.7	7.4	6.7	5.5	3.5
<i>Center point</i>	6.3	6.7	6.4	5.7	4.5	2.5
Outer band (lower limit)	5.3	5.7	5.4	4.7	3.5	1.5
Inner band (lower limit)	4.3	4.7	4.4	3.7	2.5	0.5

### C. Performance Criterion on General Government Balance

9. The budget deficit will be monitored quarterly through the cash balance of the general government. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing.

#### Cumulative floor on general government balance

	(In millions of lei)
December 31, 2008 (actual)	-24,655
End-March 2009 (actual)	-8,300
End-June 2009 (performance criterion)	-14,508
End-September 2009 (performance criterion)	-18,612
End-December 2009 (indicative target)	-24,363

10. The budget deficit will be measured from above the line using the budget execution data. The Ministry of Public Finance (MPF) will also provide monthly data to measure the deficit from below the line. The balance of the general government measured from below the line will include:

- + (i) net external financing, excluding valuation gains and losses;
- + (ii) change in net domestic credit from the financial system, excluding valuation gains and losses from deposits denominated in foreign currency and including adjustments for;

- (a) received EU funds not yet spent (advance payments);
- + (b) claims of the government on EU funds;
- + (c) property fund obligations not yet paid;
- + (iii) change in the stock of issued government securities, net of valuation changes;
- + (iv) net changes in other financing.

11. If the difference between the general government deficit measured from above the line and from below the line is larger than lei 200 million each quarter during 2009, and to be determined for 2010 during the second review, the Ministry of Public Finance will consult with IMF staff.

12. In the event that non-grant revenues exceed those projected under the program, the deficit target will be adjusted downward by one half of the surplus to allow for additional capital spending while reducing the deficit further. The following table shows the accumulated projected non-grant revenue for 2009, to which the actual non-grant revenue will be compared.

<b>Cumulative projected revenue of general government, net of EU funds</b>	(In millions of lei)
December 31, 2008 (actual)	161,650
End-March 2009 (actual)	36,951
End-June 2009 (forecast)	77,351
End-September 2009 (forecast)	120,145
End-December 2009 (forecast)	166,722

#### **D. Performance Criterion Limiting the Issuance of Government Guarantees to the Non-Financial Private Sector and Public Enterprises**

13. The issuance of general government guarantees to the non-financial private sector and public enterprises will be limited during the program period.

	(In billions of lei)
Ceiling on new general government guarantees issued from end-2008 until:	
End-March 2009 (actual)	...
End-June 2009 (performance criterion)	6.0
End-September 2009 (performance criterion)	6.0
End-December 2009 (indicative target)	6.0

### **E. Performance Criterion on Non-Accumulation of Domestic Arrears by the General Government**

14. The performance criterion established on the change in domestic payments arrears of the general government contemplates no accumulation of new arrears and their elimination during the program period. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. For the purpose of the program, arrears mean accounts payable past due date by 90 days (in line with ESA95 definitions for expenditures).

<b>Cumulative change in general government arrears</b>	<b>(In billions of lei)</b>
December 31, 2008 (stock, actual)	0.3
End-March 2009 (projected)	0.0
End-June 2009 (performance criterion)	0.0
End-September 2009 (performance criterion)	0.0
End-December 2009 (indicative target)	-0.15
End-December 2010 (indicative target)	-0.15

### **F. Continuous Performance Criteria on Non-Accumulation of External Debt Payments Arrears by the General Government**

15. The general government will not accumulate external debt arrears during the program period. For the purposes of this performance criterion, an external debt payment arrear will be defined as a payment by the general government, which has not been made within seven days after falling due. The performance criterion will apply on a continuous basis.

### **G. Indicative Target on General Government Primary Spending**

16. The indicative target on primary expenditure of the general government, i.e. overall spending excluding interest payments, net of disbursements of pre-accession and post-accession EU funds, will be subject to the same adjustor as applied to the deficit target.

<b>Cumulative change in general government primary expenditures, net of EU funds</b>	(In millions of lei)
December 31, 2008 (actual)	182,411
End-March 2009 (actual)	44,120
End-June 2009 (indicative target)	87,505
End-September 2009 (indicative target)	132,356
End-December 2009 (indicative target)	182,723

### **H. Monitoring of Public Enterprises**

17. The Ministry of Public Finance, the Ministry of Labor and Social Protection, and other pertinent institutions will provide information to document that a monitoring system of public enterprises is in place by the time of the first review. During the program period, information will be provided to document that sanctions—decline in remuneration and dismissal of management according to Ordinances 37/2008 and 79/2008—are imposed if the budgets and company targets for restructuring are not observed.

18. During the second review, after the monitoring system of the Ministry of Public Finance has been refined, quarterly indicative targets for 2010 will be established on the operating balance (earnings before interest and tax), net of subsidies, of the 30 largest enterprises by total expenditures (as of 2009).

### **I. Reporting Requirements**

19. Performance under the program will be monitored from data supplied to the IMF by the NBR and the Ministry of Finance as outlined in Table 1. The authorities will transmit promptly to the IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

**Table 1. Romania: Data Provision to the IMF**

Item	Periodicity
<b>To be provided by the Ministry of Finance</b>	
Preliminary monthly data on general government accounts	Monthly, on the 25 <sup>th</sup> day of the following month
Quarterly final data on general government accounts	Quarterly cash data, on the 35 <sup>th</sup> day past the test date. Quarterly accrual data, on the 55 <sup>th</sup> day past test date.
The budget deficit of the general government using ESA95 definition	Quarterly, with a lag of three months
Preliminary data on below-the-line financing for the general government	Monthly, with a lag of no more than 35 days past the test date
Final quarterly data on below-the-line financing for the general government	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government	Quarterly, within 55 days
Total accounts payable and arrears of the central government and social security funds	Monthly, within the next month
Stock of the central government external arrears	Daily, with a lag of not more than seven days
Public debt and new guarantees issued by the general government	Monthly, within one month
Preliminary monthly data on general government primary spending, net of EU disbursements	Preliminary monthly data will be reported to the IMF staff within 25 days
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
From 2010, the operating balance, profits, arrears, and personnel expenditures of 30 largest public enterprises by total expenditures	Quarterly, within three months of the test date
Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month
<b>To be provided by the National Bank of Romania</b>	
NFA data, by components, in both program and actual exchange rates	Weekly, each Monday succeeding the reporting week and with a 3 working day lag in the case of end-

	quarter data
Monetary survey data in the format agreed with IMF staff	Monthly, within 30 days of the end of the month
The schedule of contractual external payments of the <i>banking sector</i> falling due in the next four quarters, interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The schedule of contractual external payments of the <i>corporate sector</i> falling due in the next four quarters interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The stock of short-term external debt of banks and corporates	Monthly, 45 days after the end of each month
Balance of payments in the IMF format currently used to report	Monthly, 45 days after the end of each month
Exposure (deposits, loans, subordinated loans) of (i) foreign parent banks to their subsidiaries in Romania; (ii) IFI and (iii) other creditors to banks in Romania (by national and foreign currency).	Monthly, 20 days after the end of each month

## II. STRUCTURAL CONDITIONALITY: SPECIFICATIONS

### A. Capital adequacy and stress testing

20. The stress tests involved in the assessment of capital adequacy of banks will include the following features:

- The tests will be applied to all banks with assets greater than 1 percent of total bank assets plus a number of smaller banks selected on basis of the quality and vulnerability of loan portfolios; the evolution of non-performing loans over the past year; and the current level of bank solvency;
- Two macroeconomic scenarios will be developed, including a baseline scenario consistent with the main features of the program assumptions, and a more severe scenario reflecting the potential for an even sharper weakening of growth and the external value of the leu. The NBR macroeconomic forecasting model will be used to generate internally consistent scenarios for the evolution of all key macroeconomic variables;
- The stress tests will be conducted by the NBR, using stress testing methods employed in the context of the IMF FSAP update in 2008. The tests will employ the results of the macroeconomic scenarios, together with the most recently available data on bank

and corporate balance sheets, to project the evolution of bank balance sheets over the program period under the two scenarios;

- The results of the analyses will be used to assess the level of additional own funds required at the outset to ensure that each bank's solvency ratio would remain above 10 percent throughout the program period.
- The stress tests and assessment of prudential increases in own funds on a bank-by-bank basis will be completed by end-April. The intention is to share with banks the general approach to the stress testing analysis by late March. It is expected that the detailed assessment of needed increases in own funds would be able to be communicated to banks by end-April.
- The stress testing analysis and assessment of prudential capital needs will be carried out in consultation with IMF staff. In particular, IMF staff will be consulted on the final selection of banks included in the analysis and the assessment of appropriate increases in own funds. Additionally, the NBR staff will provide a note detailing the design of the stress testing exercise, including the macroeconomic scenarios, key assumptions, data employed, and key findings.

### **B. Bank Resolution**

21. The legal amendments enacted by Parliament to the banking and winding-up laws will include the following elements:
- a. The law will specify a clear trigger for the early and mandatory appointment of a special administrator based on a regulatory threshold.
  - b. Supplementing its existing authority, the special administrator will be granted new authority to implement promptly a broad range of restructuring measures, which shall include purchase and assumptions, sales of assets, transfer of deposits, and write downs of capital to absorb losses.
  - c. The law will provide authority for the appointment of the special administrator with the powers of all of the banks' decision-making bodies, including the bank's general assembly of shareholders
  - d. The law will carve out the application of burdensome provisions, including under the general companies law, to the extent that they are inconsistent with the prompt implementation of restructuring measures (i.e., in particular, the prompt implementation of the transfer of substantial assets and of the reduction of capital to absorb all existing losses)
  - e. The law will provide legal protection for the special administrator's good faith actions in the performance of his duties.
  - f. The law will provide greater legal certainty for bank resolution measures during special administration so that these measures may not be suspended or reversed by



litigation (i.e., such as by means of avoidance powers under the winding-up or insolvency proceedings). It will also clarify that restructuring measures are not subject to creditors' consent.

- g. Initiation of winding up proceedings under the winding-up law and of liquidation proceedings under the companies law will require the NBR's prior approval.
- h. The law will provide seniority in insolvency to depositors' claims and the same priority ranking to the Deposit Guarantee Fund.

### **C. Deposit insurance**

22. Legislation will be modified by Parliament to extend the existing grounds for activation of the deposit insurance, which shall also be activated upon the NBR's determination that a credit institution, due to its financial circumstances, appears unable to repay a deposit and to have no current prospect of being able to do so. The conversion of foreign currency denominated deposits into lei will be determined as of the date of the activation of the deposit insurance.

23. The time limit for beginning payouts will be cut from the current 3 months, which can be extended to 9 months, to 20 working days consistent with the March 2009 amendments to the EU directive on deposit guarantee schemes.

INTERNATIONAL MONETARY FUND

**Romania—Assessment of the Risks to the Fund and the Fund’s Liquidity Position**

Prepared by the Finance and Strategy, Policy, and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Philip Gerson

April 28, 2009

1. **This note assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for Romania and its effects on the Fund’s liquidity, in accordance with the policy on exceptional access.** The authorities are requesting a 24-month SBA with access of SDR 11,443 million (1,114 percent of quota). The arrangement would be front-loaded with a first purchase of SDR 4,370 million (424.2 percent of quota) available upon approval, followed by seven purchases as shown in Table 1. Access during the first year of the arrangement would reach just over 800 percent of quota and the last purchase under the arrangement would be available in March 2011.

**Table 1. Romania: Proposed SBA—Access and Phasing**

Availability	Date 1/	SDR mn	Percent of quota	
			Purchase	Cumulative
2009	May (approval)	4,370	424.2	424.2
	September	1,718	166.8	591.0
	December	1,409	136.8	727.7
2010	March	766	74.4	802.1
	June	768	74.5	876.6
	September	769	74.6	951.3
	December	769	74.6	1,025.9
2011	March	874	84.8	1,110.8
	Total	11,443	1,110.8	1,110.8

Source: Finance Department.

1/ Starting in September 2009, purchases will depend on the completion of a review.

**I. BACKGROUND**

2. **Romania has had several Fund arrangements, but has not drawn on Fund resources since 2003 (Table 2).** In total, eight SBAs were approved between June 1981 and

July 2004, with the most recent SBA treated as precautionary. The largest arrangement, by far, was the 1981 SBA with total access of SDR 1.1 billion. The program supported by the most recent Fund arrangement aimed at strengthening the external current account balance, further reducing inflation, sustaining rapid GDP growth, and preparing the economy for EU accession. The first review was completed in September 2004. In June 2005, staff had reached understandings on the completion of the next SBA review, but political turmoil derailed implementation of key policies agreed with staff. No other reviews were completed and the arrangement expired in July 2006. No Fund credit has been outstanding to Romania since late 2007 (Figure 1) and all obligations to the Fund have been met in a timely manner.

**Table 2. Romania: IMF Financial Arrangements, 1981–2016**  
(In millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Arrangement as a Percent of Quota	Amount Drawn	Purchases	Repurchases	Fund Exposure 1/
1973		01-May-73		47.5	25.0	47.5	47.5		47.5
1974									47.5
1975	SBA	03-Oct-75	02-Oct-76	95.0	50.0	95.0	40.0		87.5
1976	CFF	01-Apr-76		95.0	50.0	95.0	150.0		237.5
1977	SBA	07-Sep-77	08-Sep-78	64.1	33.8	64.1	72.5	40.0	270.0
1978							39.1	47.5	255.6
1979							41.3	50.0	246.8
1980							121.3	80.0	257.4
1981	SBA	15-Jun-81	31-Jan-84	1,102.5	217.6	817.5	309.5	60.3	506.7
1982							310.0	35.1	781.6
1983							183.9	60.9	904.7
1984							183.6	132.5	955.7
1985								172.9	782.9
1986								199.3	583.5
1987								226.0	357.6
1988								250.6	106.9
1989								106.9	
1990									
1991	SBA	11-Apr-91	10-Apr-92	380.5	67.2	318.1	565.8		565.8
1992	SBA	29-May-92	28-Mar-93	314.0	41.8	261.7	338.5	153.4	750.9
1993									750.9
1994	SBA	11-May-94	22-Apr-97	320.5	35.4	94.3	245.1	89.6	906.4
1995							37.7	245.8	698.3
1996								245.4	453.0
1997	SBA	22-Apr-97	21-May-98	301.5	63.5	120.6	120.6	98.4	475.2
1998								92.3	382.8
1999	SBA	05-Aug-99	28-Feb-01	400.0	119.8	139.8	53.0	102.0	333.8
2000							86.8	72.9	347.7
2001	SBA	31-Oct-01	15-Oct-03	300.0	97.4	300.0	52.0	91.7	308.0
2002							82.7	75.7	314.9
2003							165.3	79.6	400.6
2004	SBA	07-Jul-04	06-Jul-06	250.0	87.6	0.0		115.3	285.4
...									
2009 2/	SBA	06-May-09	15-Mar-2011	11,443.0	1,110.8		7497.0		7497.0
2010 2/							3072.0		10569.0
2011 2/							874.0		11443.0
2012 2/								1307.3	10135.8
2013 2/								4323.9	5811.9
2014 2/								4305.0	1506.9
2015 2/								1397.6	109.3
2016 2/								109.3	

Source: Finance Department.

1/ As of end-December.

2/ Figures under the proposed program in italics. Assumes repurchases on an obligations basis.

3. **Romania's external debt is higher than many recent exceptional access cases, with private sector debt accounting for the largest share.** At end-2008, Romania's total external debt stood at 53.4 percent of GDP, of which over 85 percent was owed by the private sector (Table 3). Private sector debt stood at about 46 percent of GDP in 2008 and is mainly owed to non-monetary institutions. Short-term debt has more than doubled over the last few years to about 40 percent of private external debt. Public sector external debt has declined by several percentage points of GDP to 7.5 percent in 2008, and is owed mainly to multilateral institutions (Figure 2). Romania's total external debt as a ratio of GDP is higher

**Figure 1. Romania: IMF Credit Outstanding, 1980–2008**  
(In millions of SDRs)



Source: Finance Department.

**Table 3. Romania: Total External Debt, 2005–2009 1/**

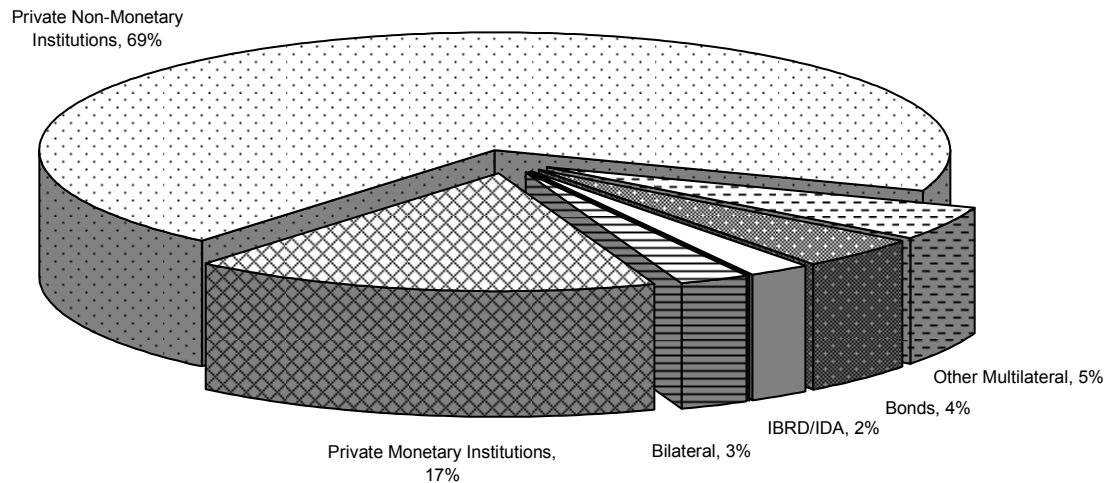
	2005	2006	2007	2008	2009 2/
	(In Millions of U.S. Dollars)				
Total External Debt	38,735	52,722	79,768	107,547	100,681
<i>of which:</i>					
Public	14,091	13,819	14,629	15,083	27,938
Loans	8,201	8,265	8,816	10,550	24,534
Multilateral	5,870	5,934	6,291	7,849	22,130
Bilateral	2,331	2,331	2,525	2,700	2,404
Bonds	5,890	5,554	5,813	4,533	3,404
Private	24,643	38,903	65,140	92,465	72,743
Short-term	8,017	16,854	27,054	34,746	21,363
Long-term	16,627	22,048	38,085	57,718	51,380
	(In Percent of GDP)				
Total External Debt	39.0	42.9	47.1	53.4	64.2
<i>of which:</i>					
Public	14.2	11.3	8.6	7.5	17.8
Loans	8.3	6.7	5.2	5.2	15.6
Multilateral	5.9	4.8	3.7	3.9	14.1
Bilateral	2.3	1.9	1.5	1.3	1.5
Bonds	5.9	4.5	3.4	2.3	2.2
Private	24.8	31.7	38.4	45.9	46.4
Short-term	8.1	13.7	16.0	17.3	13.6
Long-term	16.7	18.0	22.5	28.7	32.8

Source: Romanian authorities and IMF staff estimates.

1/ End of year unless otherwise indicated.

2/ Staff projections for end-2009.

**Figure 2. Romania: Composition of Total External Debt, end-2008**  
(In percent)



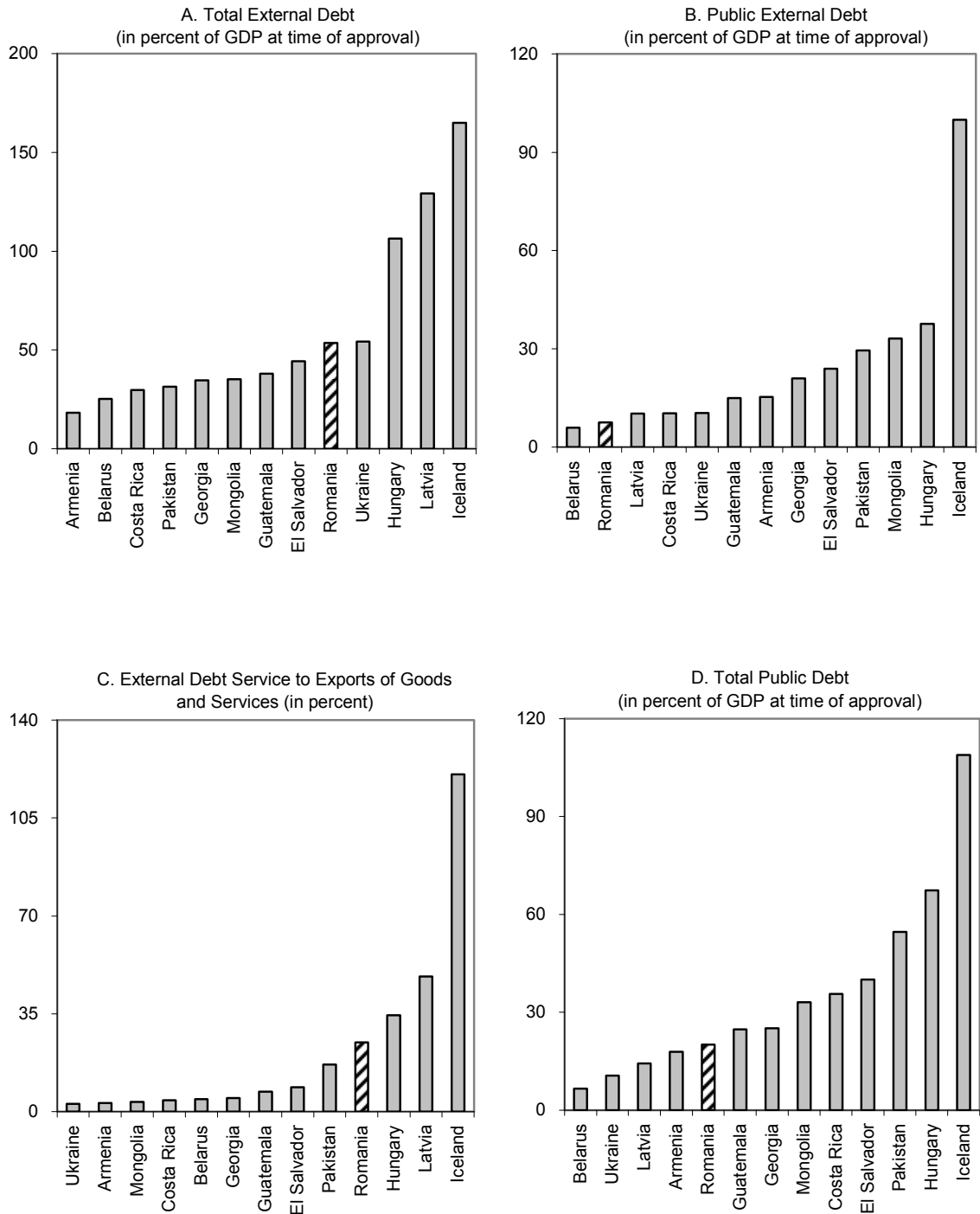
Source: Romanian authorities and IMF staff estimates.

than in most recent exceptional access cases, although its public sector component compares favorably among them (Figure 3, Panels A and B).<sup>1</sup> Reflecting the country's relatively high debt stock, Romania's external medium and long-term debt service ratio of about 25 percent of exports of goods and services is high vis-à-vis most recent exceptional access cases (Figure 3, Panel C).

4. **Public debt is relatively low and about one third is owed to external creditors.** Total public debt has been stable in the 15–17 percent of GDP range over the past four years, and is estimated at about 20 percent of GDP at end-2008, below the corresponding ratios for most of the recent exceptional access cases (Figure 3, Panel D).

<sup>1</sup> The exceptional access cases used as comparators in this paper are the recent SBAs approved since September 2008.

**Figure 3. Debt Ratios for Recent Exceptional Access Arrangements 1/**



Source: Romanian authorities and IMF staff estimates, and World Economic Outlook.

1/ For arrangements approved since September 2008, estimates as reported in each staff report on the request of the Stand-By Arrangement. Ratios generated using end-2008 data, except for Guatemala for which projected end-2009 data were used.

## II. THE NEW STAND-BY ARRANGEMENT—RISKS AND IMPACT ON FUND’S FINANCES

### A. Risks to the Fund

5. **Access under the proposed arrangement would exceed by far that in previous arrangements for Romania and would surpass both the annual and cumulative access limits.<sup>2</sup>**

- If all purchases were to be made as scheduled, Romania’s outstanding use of GRA resources would rise to 424 percent of quota upon approval, to just over 800 percent of quota during the first year of the arrangement, and then peak at over 1,100 percent of quota in March 2011. In terms of quota, this projected peak exposure would be the third highest after Latvia (Figure 4).
- If the SBA is fully disbursed, GRA credit outstanding to Romania would be equivalent to just over 10 percent of GDP by end-2011 and almost 40 percent of gross international reserves (Table 4). Outstanding use of GRA resources would represent about 16 percent of total external debt, and about 48 percent of public external debt. Peak Fund exposure ratios, particularly with regard to GDP, would be higher than in most recent exceptional access SBAs (Figure 5).
- In terms of SDRs, the projected peak GRA exposure of SDR 11,443 million would be about ten times higher than Romania’s previous peaks in Fund credit outstanding reached in 1984 and 1994. It would also be the highest among recent exceptional access cases (Figure 6, Panel A).

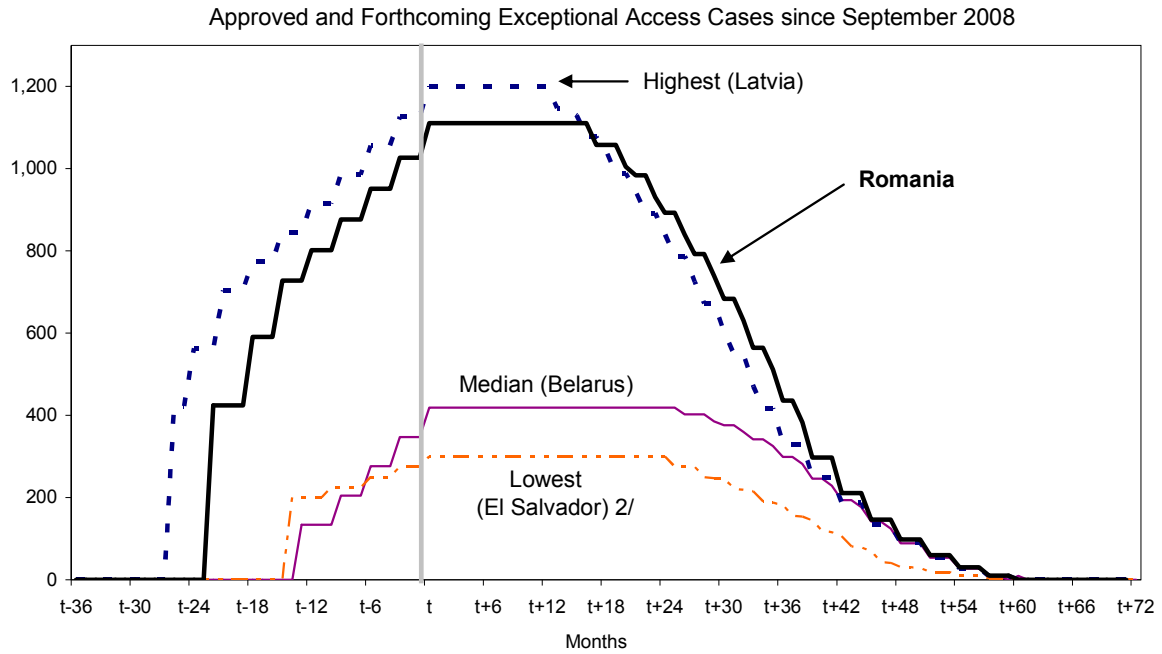
6. **If all purchases under the proposed SBA were to take place as scheduled, Romania’s external debt service to the Fund would be relatively large.** Romania’s projected debt service to the Fund would peak at about SDR 4,580 million in 2013. Peak debt service to the Fund as a share of exports of good and services, at just over 9 percent, would be the second highest among recent exceptional access cases (see Figure 5).<sup>3</sup> Peak total external debt service in percent of exports of goods and services, at just over 34 percent, would be relatively large.

---

<sup>2</sup> The proposed access during the first year of the arrangement is just over 800 percent of quota.

<sup>3</sup> Debt service to the Fund is calculated assuming that all repurchases are made as scheduled, i.e., each purchase is repurchased in eight quarterly installments, beginning in 3¼ years after each purchase and ending after 5 years. As for level-based surcharges, they are calculated according to the current schedule: 100 basis points for credit outstanding over 200 percent of quota and 200 basis points for credit outstanding above 300 percent of quota. The new system of surcharges, which applies to credit outstanding above 300 percent of quota, will go into effect on August 1, 2009, subject to grandfathering at the member’s request.

**Figure 4. Fund Credit Outstanding in the GRA around Peak Borrowing 1/**  
(In percent of quota)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.



**Table 4. Romania—Capacity to Repay Indicators 1/**

	May-09	2009	2010	2011	2012	2013	2014	2015
<b>Exposure and Repayments (In SDR millions)</b>								
GRA credit to Romania 2/ (In percent of quota)	4,370.0 (424.2)	7,497.0 (727.7)	10,569.0 (1,025.9)	11,443.0 (1,110.8)	10,135.8 (983.9)	5,811.9 (564.2)	1,506.9 (146.3)	109.3 (10.6)
Charges due on GRA credit 3/ Debt service due on GRA credit 3/		94.3 94.3	248.5 248.5	335.6 335.6	341.2 1,648.5	255.9 4,579.8	98.7 4,403.7	16.1 1,413.7
<b>Debt and Debt Service Ratios 4/</b>								
In percent of GDP								
Total external debt	53.4	64.2	68.5	64.0	57.1	52.5	48.2	44.3
External debt, public	7.5	17.8	23.1	21.5	18.8	17.0	14.8	12.9
GRA credit to Romania	3.3	7.3	10.4	10.3	7.8	3.9	0.9	0.1
Total external debt service	7.8	10.0	12.4	11.6	11.5	11.5	10.2	9.1
Public external debt service	1.6	2.7	3.9	3.3	3.8	5.1	4.5	4.0
Debt service due on GRA credit		0.1	0.2	0.3	1.3	3.1	2.6	0.8
In percent of Gross International Reserves								
Total external debt	248.2	261.1	250.8	239.6	233.2	230.0	224.5	219.0
External debt, public	34.8	72.4	84.6	80.4	76.9	74.5	69.0	63.7
GRA credit to Romania	15.3	29.6	38.1	38.4	31.7	17.2	4.2	0.3
In percent of Exports of Goods and Services								
Total external debt service	24.9	29.0	33.2	31.5	32.9	34.2	33.0	31.9
Public external debt service	4.9	7.7	10.4	9.1	11.0	15.2	14.6	14.0
Debt service due on GRA credit		0.3	0.7	0.8	3.6	9.1	8.5	2.6
In percent of Total External Debt								
GRA credit to Romania	6.2	11.3	15.2	16.0	13.6	7.5	1.9	0.1
In percent of Total External Debt Service								
Debt service due on GRA credit		0.9	2.0	2.6	11.0	26.7	25.7	8.2
In percent of Total Public External Debt								
GRA credit to Romania	44.1	40.8	45.0	47.7	41.3	23.0	6.1	0.5
In percent of Total Public External Debt Service								
Debt service due on GRA credit		3.4	6.3	9.0	32.8	60.2	58.3	18.8

Sources: Romanian authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

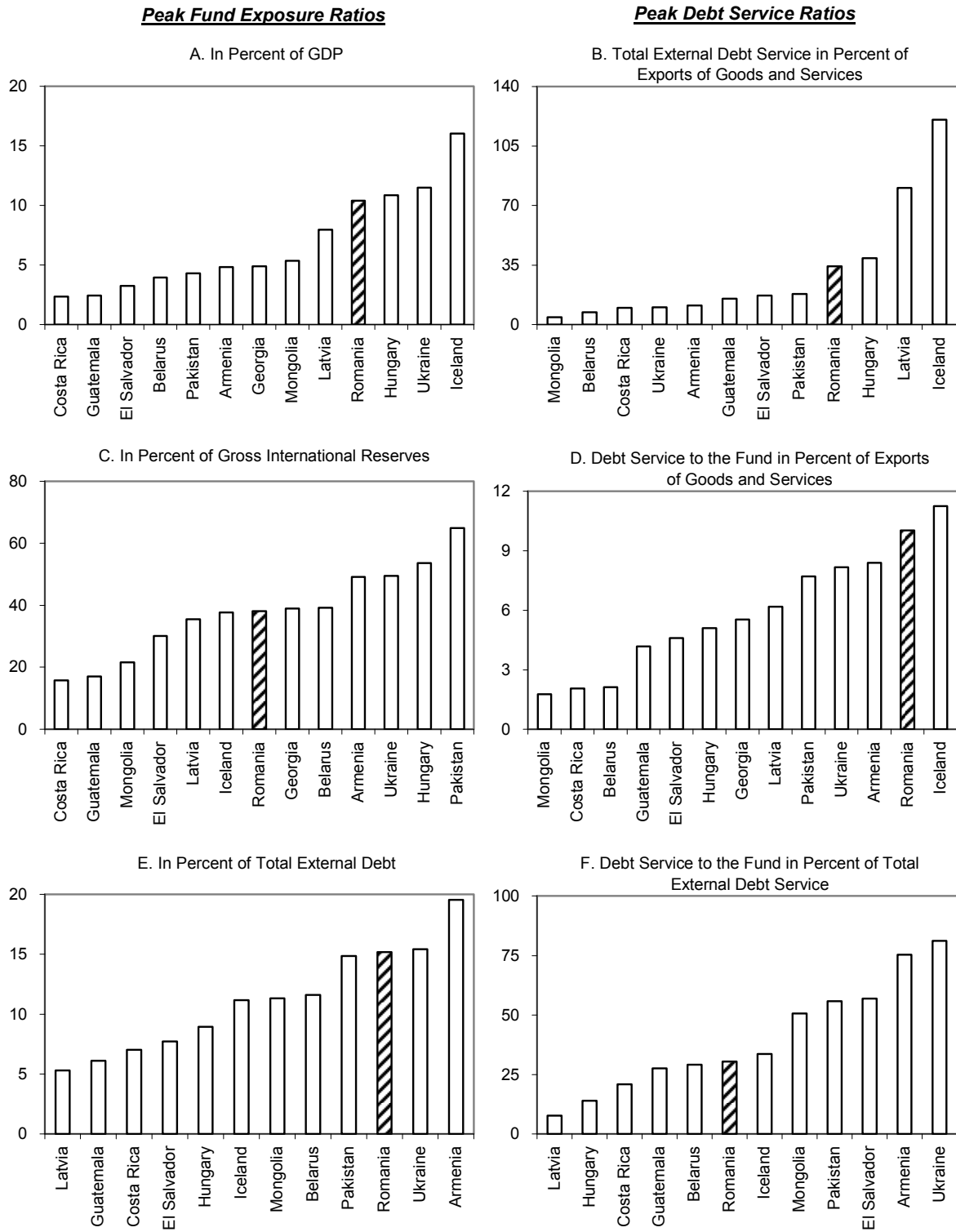
1/ Assumes full drawings.

2/ Repurchases follow the obligations schedule.

3/ Includes surcharges and service fees.

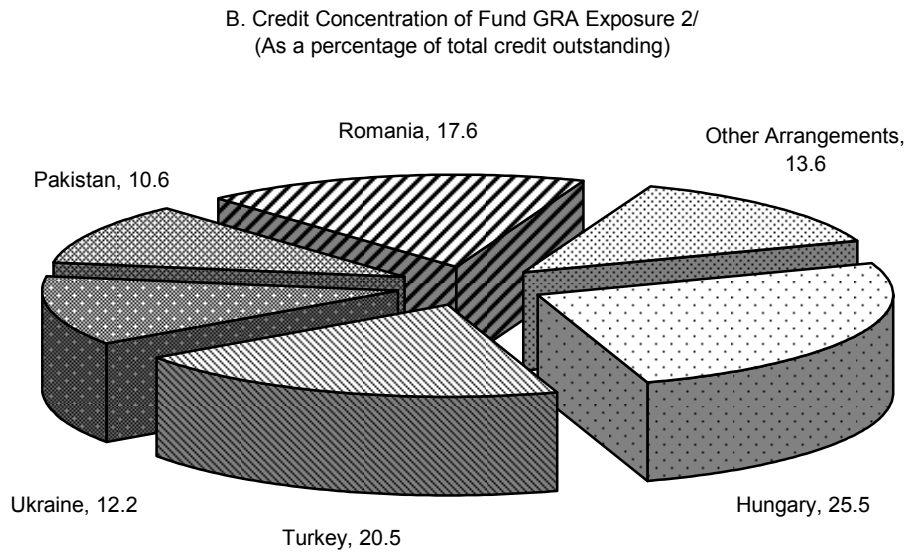
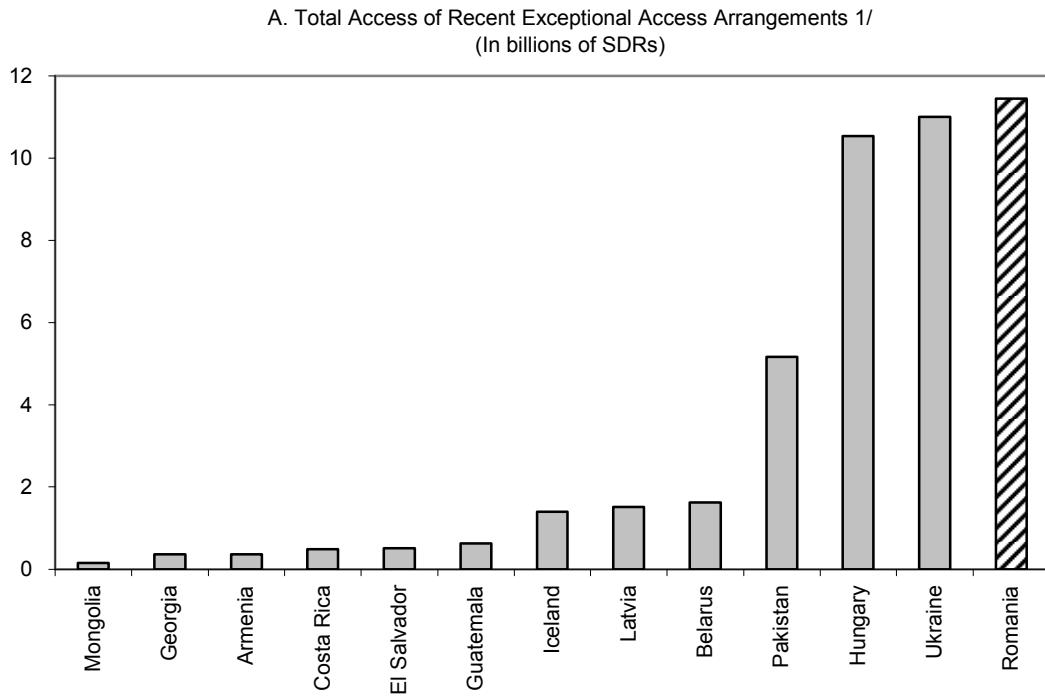
4/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA. For May 2009, projections for external debt, GDP, gross international reserves, and exports of goods and services are as of end-December 2008.

**Figure 5. Peak Fund Exposure and Debt Service Ratios for Recent Exceptional Access Cases**



Source: Romanian authorities and IMF staff estimates, and World Economic Outlook.

**Figure 6. Exceptional Access Levels and Credit Concentration**



Source: Finance Department.

1/ Does not include FCL arrangements.

2/ Credit outstanding as of April 23, 2009 plus the first purchase under the proposed arrangement with Romania.

## B. Impact on the Fund's Liquidity Position and Risk Exposure

7. **Given the high access under the arrangement, the impact on the Fund's liquidity and credit risk exposure is relatively large.**

- **The proposed arrangement would reduce Fund liquidity by more than 15 percent (Table 5).** Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC), which currently stands at SDR 66.7 billion, by about SDR 11.4 billion.<sup>4 5</sup>
- **If the first purchase is made, Fund credit to Romania would represent 17.6 percent of total GRA Fund credit (Figure 5, Panel B),** making Romania the third largest user of Fund resources. The share of the top five users of Fund resources of total outstanding credit would increase slightly to about 86 percent (see Table 5).<sup>6</sup>
- **In the event Romania were to fully draw on resources available under the proposed SBA, and to incur arrears on the charges accruing to its GRA obligations, the capacity of the Fund's burden sharing mechanism would be exceeded.**<sup>7</sup> Charges on the GRA obligations would equal about SDR 94 million in 2009, almost 5 times the current estimated residual burden-sharing capacity (see Table 5).<sup>8</sup> Nonetheless, the impact on the Fund's burden sharing capacity of potential arrears from this arrangement would be expected to decline to the extent the demand for Fund resources continues to expand.
- **Potential GRA exposure to Romania would be large in relation to the current level of the Fund's precautionary balances.** After the first purchase, Fund credit to

---

<sup>4</sup> The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months.

<sup>5</sup> This FCC is determined on the basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and US\$100 billion under the borrowing agreement with Japan.

<sup>6</sup> Given the possibility of new financing operations, including some that will involve exceptional access, the concentration of the Fund's lending portfolio is likely to change in coming months.

<sup>7</sup> Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to compensate the Fund for a loss in income when debtors do not pay charges. The Executive Board has set a floor for remuneration at 85 percent of the SDR interest rate. No corresponding ceiling applies to the rate of charge.

<sup>8</sup> Burden sharing capacity has declined recently, despite the increase in credit outstanding, reflecting the steep decline in the SDR interest rate.

Romania would be about 63 percent of the Fund's current precautionary balances (see Table 5), and the total access amounts to more than one-and-a-half times current precautionary balances.

**Table 5. Romania—Impact on GRA Finances**

	as of 04/23/2009
<b>Liquidity measures</b>	
One-year Forward Commitment Capacity (FCC) (in millions of SDRs) 1/	66,704.8
Japan borrowing agreement, available resources (in millions of SDRs)	67,324.7
Romania's impact on FCC 2/	(11,443.0)
<b>Prudential measures</b>	
Fund GRA credit outstanding to Romania (percent of current precautionary balances) 3/	63.0
Romania's annual GRA charges (percent of Fund's residual burden sharing capacity)	471.4
Fund GRA credit outstanding to Romania (percent of total GRA credit outstanding) 4/	17.6
<b>Memorandum items</b>	
Fund's precautionary balances (in millions of SDRs) 3/	6,938.6
Fund's residual burden sharing capacity (in millions of SDRs) 5/	20.0
Fund GRA credit outstanding to five largest debtors (percent of total GRA credit outstanding) 4/	86.4

Sources: Romanian authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ The Forward Commitment Capacity is a measure of the resources available for new financial commitments in the coming year, equal to usable resources minus undrawn balances under existing arrangements plus repurchases one-year forward minus a prudential balance. The FCC is determined on basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and \$US100 billion under the borrowing arrangement with Japan.

2/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.

3/ As of end-April 2008.

4/ Reflects total Fund credit outstanding plus the first purchase by Romania.

5/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

### III. ASSESSMENT

8. **Romania's Fund-supported program aims to support confidence during a period of large external adjustment.** The proposed access, and the substantial and front-loaded financing under the program, aim to strengthen confidence in Romania's ability to address the effects of global deleveraging. It also provides breathing space for implementing the needed economic adjustment, with the Fund-supported program aimed at reducing external and fiscal imbalances, while ensuring financial stability by maintaining adequate capitalization and liquidity in the financial sector, with a view to bringing Romania back to a path of strong and balanced growth over the medium term.

9. **There are significant risks to the outlook which could undermine Romania's expected strong capacity to repay the Fund.** The October presidential election could

undermine implementation of the program. The pressures in the external accounts would be exacerbated if the global downturn is deeper or more protracted than currently foreseen. In such circumstances, there would also be a risk that foreign banks will be unable to maintain their exposure to Romania despite their commitment to do so, along with a risk of capital flight.

10. **Overall, there are significant financial risks associated with the proposed arrangement for Romania.** Potential Fund exposure to Romania will be the highest among recent SBA-supported programs. In terms of relevant metrics such as economic size, stock of reserves, exports of goods and services, and total debt and debt service, Fund exposure and debt service to the Fund will peak at higher levels than those reached in most recent exceptional access cases, although the relatively low level of public debt is a mitigating factor. Hence, the authorities' readiness to take additional measures as appropriate to ensure the achievement of program objectives is essential to mitigate risks to Romania's capacity to repay and safeguard Fund resources. In this regard, Romania's excellent track record servicing external obligations provides comfort that financial obligations to the Fund will be met in a timely manner.

INTERNATIONAL MONETARY FUND

ROMANIA

**Request for Stand-By Arrangement  
Supplementary Information**

Prepared by the Staff Representatives

Approved by Poul Thomsen and Michele Shannon

April 30, 2009

This supplement reports on economic and policy developments since the staff report was issued on April 24. The information does not alter the thrust of the staff appraisal.

- 1. Pressures in the financial markets have eased, but economic activity remains weak.** The leu has appreciated somewhat in April amid calm regional markets, recovering some of the value lost earlier in the year. Banks' cost of funding has eased in the domestic and external markets: interbank market rates have converged towards monetary policy rates and the CDS premium has declined some 300 basis points from its early-March peak, helping ease bank lending and deposits rates. Nevertheless, lending to the private sector declined sharply in March, by 2.6 percent in real terms relative to February, with foreign currency and corporate credit declining faster than leu and household credit, respectively.
- 2. The fiscal position was weaker than expected in the first quarter.** On preliminary data, the overall fiscal deficit widened to 1½ percent of estimated 2009 GDP, compared to near zero in 2008 and 1⅓ percent anticipated by staff. Lower revenues account for the entire shortfall: revenues declined by 12 percent in real terms relative to the same quarter of last year, which may reflect a sharper-than-expected deterioration in economic activity. The government is preparing contingency plans should the shortfall persist.
- 3. The authorities adopted the agreed fiscal measures, and secured their parliamentary approval significantly ahead of schedule.** On April 14, the government adopted an emergency ordinance amending the budget and introducing the agreed fiscal adjustment measures of 1.1 percent of GDP, thereby meeting the related prior action. The emergency ordinance was ratified by parliament at end-April in fulfillment of an end-August structural benchmark, highlighting the authorities' commitment to fiscal discipline and to the program's targets. To complement the budget amendment ordinance, a separate emergency ordinance was issued to cap public sector bonuses before the full-fledged wage reform legislation is adopted later this year.

4. **The NBR eased foreign currency reserve requirements on long-term liabilities.**

Effective May 2009, minimum reserve requirements on foreign currency liabilities with remaining maturity over 2 years will be reduced from 40 percent to zero. Reserve requirements on the remaining liabilities have remained unchanged.

5. **Stress tests have identified the need for further capital increases in the banking system.**

The national bank has completed stress tests to determine the resiliency of the banking system to future shocks and the need for capital increases under the program's macroeconomic scenario (as well as under a more severe scenario), thereby meeting the related prior action. The stress tests revealed that additional capital of about €1 billion (0.8 percent of GDP) would be needed to maintain all banks' solvency ratios above 10 percent throughout the program period, in spite of the expected strong increase in non-performing loans. On the basis of these stress tests, the authorities have already initiated discussions with the banks about preemptive capital increases, and full capital injections are expected by end-September 2009. Even under the adverse scenario, recapitalization needs for the banking system were seen to be manageable, particularly given the capital cushion foreseen under the program.





Press Release No. 09/148  
FOR IMMEDIATE RELEASE  
May 4, 2009

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Approves €12.9 Billion Stand-By Arrangement for Romania**

The Executive Board of the International Monetary Fund (IMF) today approved a 24-month SDR 11.4 billion (about €12.9 billion or US\$17.1 billion) Stand-By Arrangement for Romania to support an economic program designed by the Romanian authorities and intended to cushion the effects of the sharp drop in capital inflows while addressing the country's external and fiscal imbalances and strengthening the financial sector. The approval makes SDR 4.37 billion (about €4.9 billion or US\$6.6 billion) immediately available and the remainder will be available in installments subject to quarterly reviews. The Stand-By Arrangement entails exceptional access to IMF resources, amounting to 1,111 percent of Romania's quota.

The Stand-By Arrangement will be combined with other multilateral financial support to fill the country's 2009-2010 financing gap. The total international financial support package will amount to €19.9 billion (about US\$26.4 billion), with the European Union providing €5 billion (or about US\$6.6 billion), the World Bank €1 billion (or about US\$1.3 billion), and the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the International Finance Corporation (IFC) a combined €1 billion (or about US\$1.3 billion).

Following the Executive Board discussion on Romania, Mr. John Lipsky, First Deputy Managing Director and acting Chairman, said:

“The Romanian authorities are to be commended for seeking early international support to assist them with an orderly correction of the large external imbalances and vulnerabilities built up during recent boom years, and leaving the country highly exposed to global financial turmoil and exchange rate volatility. Excessive public spending in recent years also produced sizeable fiscal deficits which, in the current tight financing environment, are destabilizing. With the global downturn increasingly spilling over to Romania, a rebalancing of the economy is unavoidable.

“The Romanian authorities have launched a comprehensive program to respond to the current challenges. The program aims at reversing the deteriorating fiscal path with significant expenditure cuts and additional revenues. Planned fiscal reforms are designed to contain future expenditures pressures, improve the budgeting process, and enhance the efficiency of tax collections and government operations over the medium-term. An action plan is being implemented to maintain confidence in the banking system, including by preemptive bank recapitalization, agreements to maintain foreign banks’ exposure in the country, and efforts to strengthen bank supervision and resolution. This program, combined with significant external financial support, should ease short-term funding pressures and enhance medium-term economic prospects.

“The joint financial assistance being provided by the IMF, the European Union, and the World Bank will help cushion the economic downturn and will provide reassurance to markets that Romania’s external obligations will be met. It sends a strong signal of the international community’s confidence that, with the consistent implementation of the program, Romania will weather the current difficulties and emerge with a better-balanced and more flexible economy,” Mr. Lipsky said.

## **Recent Economic Developments**

Romania experienced an economic boom over the past five years that led to overheating and unsustainable imbalances. GDP growth averaged over 6½ percent per year from 2003-08, as foreign direct investment and capital inflows, in part through subsidiaries of foreign banks in Romania helped finance high consumption and investment growth. The rapid increase in borrowing that fueled the boom left Romania highly exposed to global financial difficulties and to exchange rate volatility. Loose fiscal and incomes policies also contributed to the overheating of the economy and to its current vulnerabilities, with excessive spending, especially on wages and pensions, as the main culprit.

Economic activity turned down sharply in late 2008 and has fallen further in 2009. Growth is projected at about 4 percent in 2009 on account of a sharp contraction in domestic demand, which in turn will set off a correction in the current account deficit from 12½ percent of GDP in 2008 to 7½ percent in 2009. Foreign direct investment and capital inflows will drop sharply. Increased financial stress, tightening credit standards and limited access to external funding will inhibit lending to the private sector. Once confidence is restored, domestic demand is expected to slowly rebound, but growth will remain near zero in 2010, before recovering to 5 percent in 2011. Inflation is expected to fall in 2009 to within the official target (3.5 percent, plus or minus 1 percent) and remain there in 2010.

## **Program Summary**

The IMF-supported program combines strong policy measures with sizable financial support. Key to restoring confidence is a reversal of the sharp increase in public spending, which caused a large deficit to accumulate even during a period of strong economic growth. Short-term budget cuts will be combined with fiscal policy reforms to place the public finances on a more sustainable path. The effects of the fiscal adjustment and budget reforms will be cushioned by boosting social safety net spending and safeguarding capital spending. Banking sector measures will also be implemented to ensure that banks remain sufficiently strong to weather the economic downturn.

Specific program objectives include:

- Reduce the fiscal imbalance to bring the deficit back under 3 percent of GDP by 2011.
- Maintain adequate capitalization of banks and liquidity in domestic financial markets.
- Bring inflation within the target range of the National Bank of Romania (NBR) by end-2009 and maintain it there.

- Secure adequate external financing and improve confidence.

Romania joined the IMF on December 15, 1972, and its quota is SDR 1.03 billion (about €1.16 billion or US\$1.54 billion). Its latest arrangement with the IMF was a Stand-By Arrangement that expired on July 6, 2006.

