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ROMANIA

EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2011 STAND-BY ARRANGEMENT

March 2014

This Ex Post Evaluation of Exceptional Access Under the 2011 Stand-By Arrangement on Romania was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on March 4, 2014.

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EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2011 STAND-BY ARRANGEMENT

Authorized for distribution by
The European Department and the Strategy, Policy, and Review Department

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INTRODUCTION

1. **In March 2011, Romania requested a successor Stand-By Arrangement (SDR 3.1 billion, 300 percent of quota) to continue the economic adjustment initiated under the 2009 SBA.** Under the 2009 SBA, Romania's economy had stabilized, external and structural fiscal imbalances had been substantially reduced, and initial signs of growth had emerged. However, an uncertain external environment combined with the need for further fiscal adjustment and deep structural reforms still posed significant risks to the country's financial stability and economic recovery, at a time when initial repayments to the Fund were coming due.

2. **The primary objectives of the new program, jointly supported by the European Union, were to provide precautionary support against external shocks and to advance economic adjustment.** Building on the achievements of the previous SBA, the program included further fiscal consolidation, an agenda of structural reforms to boost growth, and financial support against possible external shocks. The authorities considered the program as a device to foster confidence by signaling their commitment to reforms and announced their intention to treat the arrangement as precautionary. This was the first precautionary arrangement jointly supported by the IMF and the European Union (EU), following the 2008-09 global financial crisis.

3. **The program was successful in preserving macroeconomic stability and advancing economic adjustment, although progress on the structural reform agenda was uneven.** Despite a complex political situation and a more challenging external environment than initially envisaged, sustained fiscal consolidation efforts allowed Romania to exit the EU Excessive Deficit Procedure (EDP) in 2013. Macroeconomic stability and policy credibility led to an upgrade of Romania's sovereign rating to investment grade and continued market access. On average, banks remained well capitalized and liquid, however non-performing loans increased and funding risks remained high and partially materialized towards the end of the program. On the structural agenda, the energy sector regulatory framework was reformed, electricity and gas tariff liberalization was initiated, and arrears of state-owned enterprises (SOE) were reduced. However, progress in reforming the SOE sector to foster more private sector participation and improve its governance was limited, with the program design underestimating opposition to specific reform measures, which subsequently impacted program implementation. Political instability also weighed negatively on the implementation of the structural agenda.

4. **This ex-post evaluation report assesses the design and performance of the 2011 SBA.**[1] The remainder of the report focuses on the following four questions: why did Romania request a

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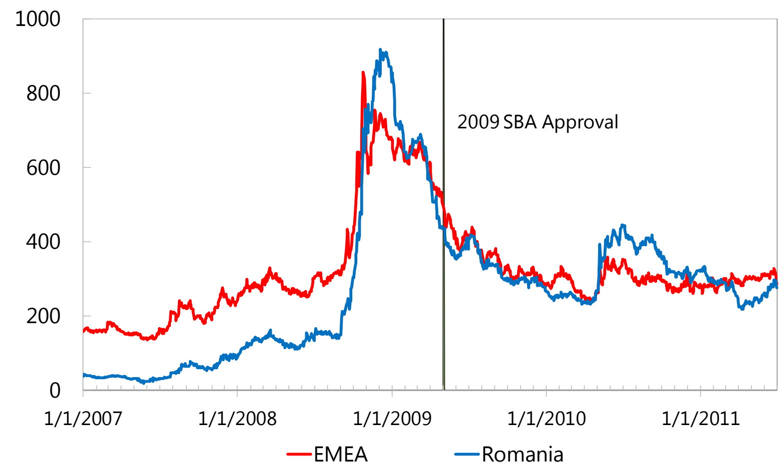
[1] Fund policy requires the Fund to perform an ex post evaluation (EPE) of GRA-supported programs with exceptional access within a year after the end of the arrangement. See BUFF/03/28, Ex-Post Evaluations of Exceptional Access Arrangements, Revised Guidance Note, SM/10/44 (http://www.imf.org/external/np/pp/eng/2010/022510.pdf).

successor Fund arrangement? was program design appropriate? did the program achieve its objectives? and, what are the key lessons from the experience with the 2011 SBA.[2]

WHY DID ROMANIA REQUEST A SUCCESSOR FUND ARRANGEMENT?

5. **In 2011, Romania successfully completed the SBA approved in 2009 with stabilized market conditions and reduced macroeconomic imbalances**. By the end of 2010, the economy had started to recover, with real GDP growth expected to reach about 1½ percent in 2011 and to accelerate to above 4 percent in 2012. The current account deficit had more than halved to just over 4 percent of GDP and the structural fiscal deficit had declined. Pressures on the exchange rate had subsided and international reserves had stabilized. Financial markets had responded by reducing pressures on sovereign spreads, which by end-2010 had fallen nearly 600 basis points from their crisis peak. Against this positive environment, Romania's authorities successfully returned to the market placing, over the program period, a €1 billion Eurobond internationally and €2.4 billion of euro-denominated instruments domestically. At the same time, throughout the global crisis, banks remained well capitalized and foreign parent banks continued to support their Romanian subsidiaries. In view of the improving economic and funding situation, the authorities decided to treat the last tranche under the SBA as precautionary.

Romania: Sovereign Spread
(Basis points)



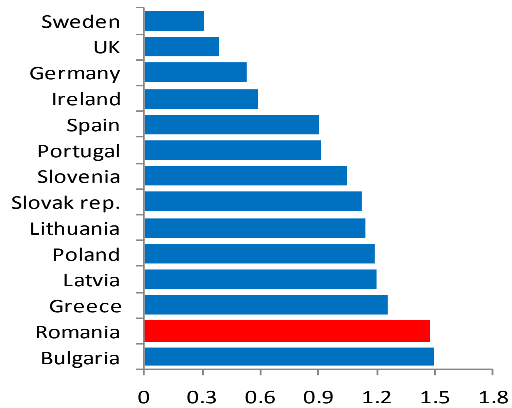
Sources: EMBI

[2] In accordance with procedures, this report was prepared at headquarters by an interdepartmental staff team, primarily on the basis of documents and data available at the time it was completed. The team is grateful for conversations with the Romanian authorities, staff from the European Commission and the World Bank, and current and former Fund mission chiefs and other Fund staff involved in the 2011 SBA. The key findings of the EPE were discussed with the authorities during a staff visit on November 20-21, 2013 and their general reactions are presented in the Annex.

6. **Nevertheless, the unfinished structural reform agenda and an uncertain external environment continued to pose significant risks to the economy**.

- **Structural reforms and growth**. As highlighted in the 2012 Article IV staff report, Romania exited the 2008-09 crisis with one of the lowest levels of per capita income in the region and a notably slow pace of convergence compared to its peers. With foreign direct investment (FDI) expected to remain well below pre-crisis levels, the authorities had turned their attention to implement structural reforms to boost potential growth. In particular, the low efficiency of the main network industries (primarily energy and transportation) and, more generally, of the sizable SOE sector were, together with poor governance, the most clearly understood issues hindering Romania's growth prospects. According to a recent study, institutional reforms could boost long-term potential growth in Romania up to 1-1½ percent a year.[3] While critical for longer-term growth, these reforms were less urgent for shorter-term stabilization purposes, in light of the competitiveness buffers offered by Romania's flexible exchange rate.

Average Impact of Broad Institutional Reforms
(GDP growth, p.a.)



Source: Cheptea & Velculescu (2013)

- **External shocks and vulnerabilities**. Given its high degree of financial and trade openness, Romania remained highly vulnerable to external shocks, in particular from the Euro area. Despite stable funding from Euro area parent banks, the banking sector was exposed to significant liquidity risks from possible parent banks' deleveraging (with a significant part of bank funding coming from parent banks in the Euro area, including Greece).[4] The sector also faced substantial exchange rate risks (with about 60 percent of bank lending denominated in foreign currency). These risks were also noted in the 2009 Financial System Stability Assessment. At the same time, while the economy had gradually started to recover, growth remained sensitive to external demand conditions particularly from Euro area trading partners, notably Germany and Italy.

7. **The need to advance Romania's reform agenda and shield the economy against external shocks motivated the authorities' request for a successor arrangement.** The

[3] Cheptea, C., & D.Velculescu, "Growth-Enhancing Structural Reforms in Europe: Where to Start?," in Schindler and others (Eds.) Getting Back on Track: Growth, Employment, and Rebalancing in Europe (IMF: forthcoming).

[4] The first European Banking Coordination Initiative (EBCI) expired in 2011 with the cancellation of the 2009 SBA. Under the EBCI, the main foreign parent banks operating in Romania committed to maintain exposure to the country at the March 2009 level and recapitalize their subsidiaries as needed.

authorities also intended to continue the fiscal adjustment initiated under the 2009 SBA. On March 25, 2011, the authorities successfully completed the final review of the 2009 SBA and a new 24-month SBA for 300 percent of quota was approved. As with the final disbursement of the 2009 SBA, the authorities indicated that they would treat the new arrangement as precautionary. The authorities saw the new program as a tool to protect the economy from possible balance of payment pressures and as a valuable policy anchor to catalyze consensus around politically difficult structural reforms not addressed under the previous program. They also relied on the new arrangement to continue the fiscal adjustment initiated under the previous program and exit the EU EDP. A key consideration underlying the new program was to provide a framework for continuous policy engagement following the 2009 SBA. In this context, Romania's request was the first among successor Fund arrangements, following the first wave of crisis programs, that focused on supporting deeper and long-term structural reforms.[5]

WAS PROGRAM DESIGN APPROPRIATE?

A. Program Objectives and Design

8. **The 2011 successor program aimed to assist Romania in continuing its economic adjustment and provide precautionary support against external shocks.** Building on the achievements of the previous SBA, the key objectives of the program were to:

i. Continue the fiscal adjustment process while attacking problems of revenue and expenditure efficiency and arrears;

ii. Boost growth potential through structural reforms and improved flexibility of the economy;

iii. Continue fostering confidence, facilitating private capital flows, by improving policy stability and the business climate.[6]

9. **To pursue these objectives, the arrangement had an initial duration of 24 months, although it was subsequently extended.** While the duration was appropriate given the extent of the reform agenda, political tensions ahead of a parliamentary election in December 2012 and delays in implementing the structural agenda resulted in a request for a three-month extension of the program, which was granted on a "lapse of time" basis (i.e., no Board discussion was necessary) on March 15, 2013. As a result, the combined seventh and eighth (and final) review took place in June 2013—three months after the initial arrangement expiration date. The extension aimed to give

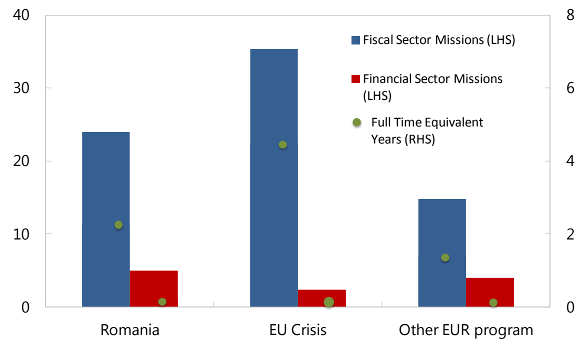
[5] Through December 2013, about half of Wave 1 crisis program countries (identified in Crisis Program Review, IMF, July 2012) had requested follow-on programs.

[6] Romania—Seventh Review under the Stand-by Arrangement, Cancellation of the Current Stand-Arrangement, and Request for a New Stand-by Arrangement, Country Report 11/80.

the new authorities additional time to implement delayed policies and bring the reform agenda back on track. It also served to rebuild reform momentum and create a basis for a successor program, as the new authorities had already signaled their interest in a new arrangement to continue supporting the implementation of their reform agenda.

10. **The program was the first precautionary arrangement jointly supported by the Fund and the EU, in collaboration with the World Bank.** As with the predecessor arrangement, the 2011 SBA required extensive coordination with the European Commission (EC) and the World Bank to develop a consistent policy position. Quarterly program reviews were conducted jointly with the EC, and the reform agenda in key sectors (e.g., energy, health, transport) was guided by the expertise of the World Bank and the EC. Program design also reflected extensive Fund technical assistance provided before and during the 2011 SBA, particularly in the fiscal area. The EC and the World Bank also assisted the authorities in strengthening their debt management capacity.

Fiscal and Financial Sectors Technical Assistance, 2011-13
(Number of missions)



Sources: Staff estimates covering IMF fiscal years 2011-13.

11. **From the outset, political uncertainty was identified as a potential risk to program implementation.** In view of the narrow government majority, the 2011 SBA request noted the risk that domestic political tensions could lead to policy reversals and undermine program performance. In the event, political risks did emerge, with three changes of government in 2012, including a change in the political majority supporting the government, and a parliamentary vote to impeach the president. While successive governments re-affirmed their commitment to the Fund-supported program, political turmoil and local and parliamentary elections held in the second half of 2012 complicated the implementation of the reform agenda.

B. Was The Financing Package Adequate?

12. **In March 2011, the IMF's Executive Board approved a new 24-month SBA with access equal to SDR 3,090.6 million (€3.6 billion) or 300 percent of Romania's quota**.[7] The program was part of a financing package totaling €5.4 billion that also included co-financing from the EU (€1.4 billion) and the World Bank (€0.4 billion).[8] Access was appropriately lowered compared to

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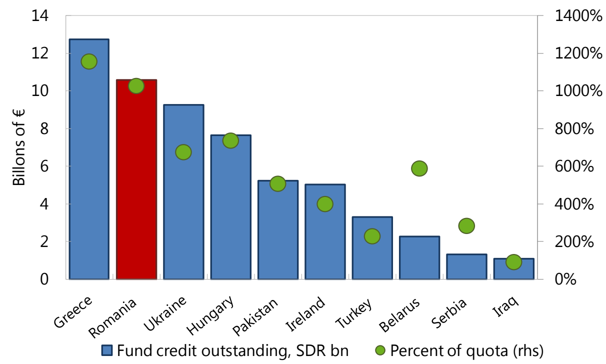
[7] With the exception of the first and last scheduled disbursements, disbursements were evenly phased and allowed access equal to 131 percent of quota in 2011, and 169 percent of quota over 2012-13.

[8] The World Bank's contribution was subsequently increased to €1 billion.

the previous arrangement, given reduced balance of payment pressures. However, it remained somewhat above the average access level of recent post-crisis arrangements treated on a precautionary basis. Importantly, the new program came against the background of a large Fund exposure. As of end-March 2011, Romania was the Fund's second largest borrower, after Greece, with total purchases outstanding of SDR10.6 billion or about 15 percent of the Fund's total lending exposure. If all purchases under the 2011 program had been made, Romania's peak debt service burden to the Fund would have been above the median level of most recent exceptional access cases, although comparable to the burden under the 2009 SBA. However, as noted in the program request and in the Assessment of Risks to the Fund, Romania's low public debt level at 33 percent of GDP, sound performance under the 2009 SBA, and excellent track record in serving its external obligations mitigated risks to the Fund.

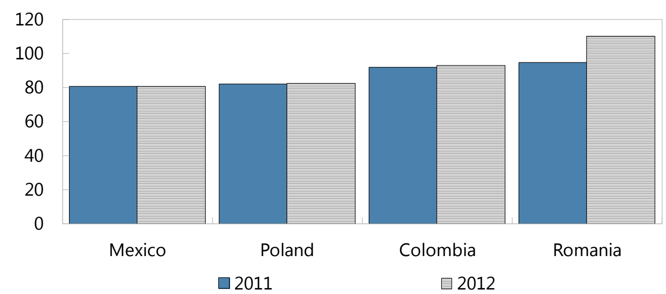
Fund Credit Outstanding
as of March 31, 2011



Sources: Financial data (IMF)

13. **Consistent with the authorities' intention to treat the program as precautionary, access was justified on the basis of a potential balance of payments need**. Under staff's baseline scenario, Romania's external financing needs, including Fund repurchases, were fully covered by private and non-program official sources. Under an adverse scenario, renewed external pressures would reduce FDI and lower rollover rates on private sector external liabilities to below 100 percent, as foreign banks repatriated resources and corporations faced reduced access to external financing. However, rollover rates assumed in the adverse scenario were less conservative than those assumed under contemporary precautionary arrangements, including FCL cases, suggesting that assumptions were relatively benign (and subsequently proved to be optimistic). The envisaged access level was expected to cover any external financing gap arising under the adverse scenario, without requiring additional adjustment, while maintaining gross international reserve (GIR) coverage of short-term external debt just above 90 percent.

Private Rollover Rates Under Adverse Scenarios: Contemporany Precautionary Arrangements 1/
(Percent)

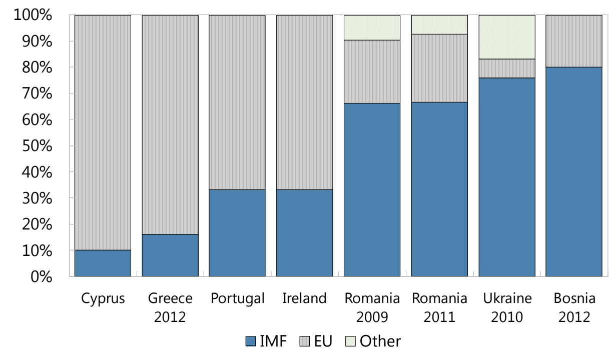


1/ Contemporary arrangements are those precautionary arrangements approved +/- 3 months from the approval date of the 2011 SBA with Romania. Macedonia has been excluded as rollover rates for private and public sector debt were not available in program documents.

Sources: IMF Country Report No. 11/11, 11/24, 11/162 and EBS/11/37

14. **Burden sharing under the 2011 program was kept in line with the 2009 SBA, with the EU providing, for the first time, balance of payments assistance on a precautionary basis**. Consistent with the 2009 program, the Fund provided roughly two-thirds of the total official financing under the program, with the EU and the World Bank providing the remaining part. While there was no extensive discussion of burden sharing, the degree of sharing with other official creditors was broadly in line with other non-Euro area joint programs with the EU. For the EU, the 2011 Romania's program marked the first arrangement provided under its Balance of Payments Assistance Facility on a precautionary basis and subsequently prompted an EC proposal to amend existing EU rules to explicitly cover the possibility of precautionary assistance for non-Euro area countries.[9]

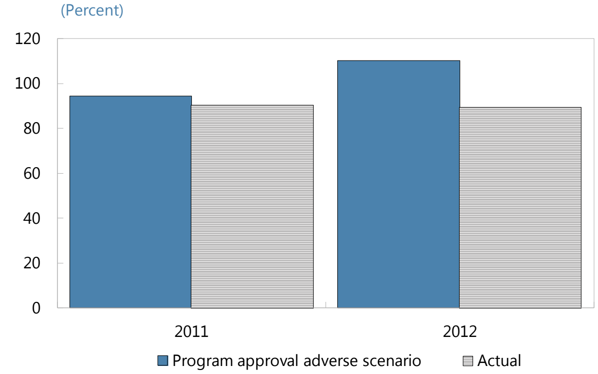
Burden Sharing Under Select Fund-EU Arrangements



Sources: IMF

15. **Despite the unfolding Euro area crisis and renewed external pressures, the authorities were able to continue treating the program as precautionary**. As external pressures intensified, rollover assumptions used under the adverse scenario turned out to be too optimistic, as reflected in weaker than projected financial flows. Moreover, toward the end of the program, deleveraging pressures from Euro area parent banks further reduced the private sector's rollover rates, while, at the same time, FDI was lower than projected. These shortfalls were partially offset by a lower than expected current account deficit and higher portfolio inflows, mainly toward government bonds. As a result, non-program resources remained sufficient to meet the country's financing needs throughout the program, although gross international reserves at the end of the program were lower than projected, reflecting the optimistic assumptions on overall financial flows under the program. Nonetheless, by the time the program expired in June 2013, outstanding resources from the Fund had fallen from over 1,000 percent to 725 percent of quota, in line with the initial repayment schedule and the precautionary nature of the program.

Rollover Rates, Corporates and Banks
(Percent)



Sources: EBS/11/37, EBS/12/121, and EBS/13/120

[9] See "Proposal for a Council Regulation Establishing a Facility for Providing Financial Assistance for Member States Whose Currency Is Not The Euro", COM (2012) 336, June 2012.

C. Were The Exceptional Access Criteria Met?

16. **Given the level of outstanding purchases from the Fund, Romania's program request was subject to the Fund's exceptional access policy**. While access under the 2011 SBA was below the threshold for exceptional access (200 percent of quota annually and 600 percent of quota cumulative), Romania's stock of outstanding purchases from the Fund at the time of program approval stood at more than 1,000 percent of quota, well above the cumulative threshold, making the new program request subject to the Fund's Exceptional Access policy.

17. **The four exceptional access criteria were met**:[10]

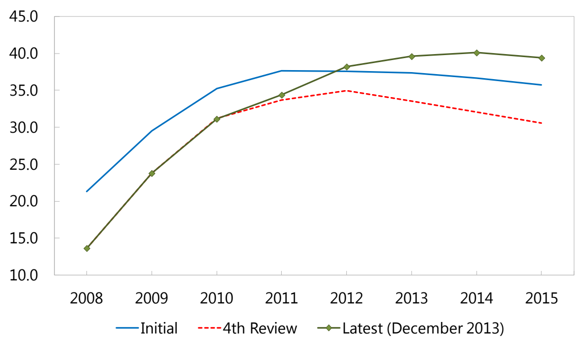
- **Criterion 1**: *Member is experiencing or has the potential to experience exceptional balance of payments pressures, resulting in a need for Fund financing that cannot be met within the normal limits.* While the program request presented a baseline scenario that did not demonstrate exceptional balance of payments pressures, the country was exposed to risks of economic and financial disruptions in Europe which, if realized as presented by staff under an adverse scenario, could give rise to financing needs and imply cumulative access above normal access limits. Therefore, the criterion was met.

- **Criterion 2**: *High probability that public debt is sustainable in the medium term.* Romania's public debt sustainability was not a major program concern and this criterion was satisfactorily met. At the time of program approval, Romania's public debt (including guarantees) was characterized as low at around 35 percent of GDP (subsequently revised downward to about 31 percent of GDP) and was not expected to pose a risk under the program nor over the medium term.[11] Continued fiscal adjustment was expected to set the public debt ratio on a downward path ensuring debt sustainability with high probability, despite remaining particularly sensitive to GDP growth shocks. By the end of the program, public debt had increased by around 8½ percent of GDP since program approval (6½ percent of GDP more than originally projected) in part driven up by a build-up in cash deposits (reflected in stock flow adjustments) and lower nominal GDP than initially projected.

[10] For a detailed description of the exceptional access policy and the four exceptional access criteria see Selected Decision 14064-(08/18) as amended (available at http://www.imf.org/external/pubs/ft/sd/index.asp?decision=14064-(08/18).

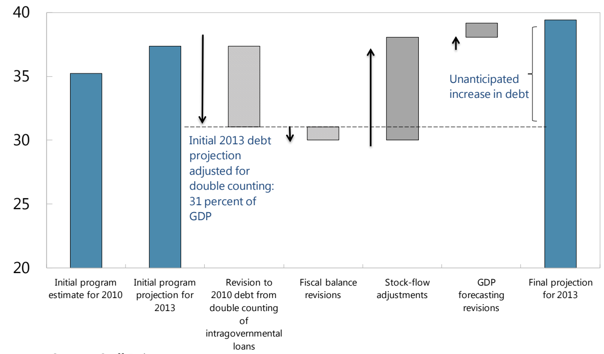
[11] For a discussion on debt thresholds for market access countries, see Staff Guidance Note, Public Debt Sustainability Analysis in Market Access Countries, IMF, May 2013.

Public Debt Dynamics
(Percent of GDP)



Sources: WEO

Change in 2013 Public Debt Projection
(Percent of GDP)



Sources: Staff Estimates

- **Criterion 3**: *Prospects of gaining or regaining access to private markets within the timeframe when Fund resources are outstanding.* Romania had regained access to private capital markets before the end of the 2009 SBA and was expected to retain access for the duration of the new program and beyond. During the program period, the authorities launched a medium-term note (MTN) program, which successfully raised €5.8 billion, in addition to a separate Euro bond issuance, which raised €750 million.

- **Criterion 4**. *Reasonably strong prospect of the program's success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.* The program had good prospects for success and performance under the predecessor program lent confidence to Romania's institutional and political capacity to continue implementing sound policies. Nevertheless, as noted in the program request, program performance was exposed to political risks, given the narrow government majority. Political risks materialized towards the end of the program, delaying progress with the policy agenda and eventually leading to the postponement of the seventh review and a request for a program extension.

18. **There was an appropriate level of Board consultation in the lead up to the SBA request.** As required under the Fund exceptional access policy, staff briefed the Executive Board on developments in Romania in an informal restricted session in January 2011. The briefing and associated staff note described the current economic situation and provided a preliminary evaluation of the need for exceptional access and the likely timetable for discussions on a successor arrangement. A report on Assessing Risks to the Fund and the Fund's Liquidity Position was also provided in conjunction with the staff report containing the request for the new arrangement, in accordance with the Fund's policy on exceptional access.

D. Was Program Conditionality Correctly Focused?

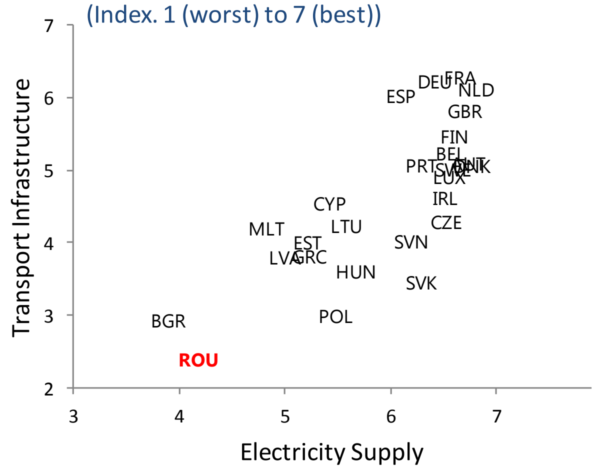
19. **Program conditionality appropriately aimed at continuing economic adjustment, deepening structural reforms and preserving macroeconomic stability.** Accordingly, conditionality focused on: (i) achieving further fiscal adjustment and implementing a set of structural

fiscal reforms to achieve a sustainable medium term adjustment, (ii) improving the functioning of key network industries (energy and transportation) and launching a comprehensive reform of the SOE sector, as well as (iii) preserving central bank credibility and financial sector stability.

- **Fiscal conditionality.** Fiscal policy was anchored on the authorities' commitment to reduce the accrual deficit (ESA terms) to below 3 percent of GDP by 2012 and exit the EU Excessive Deficit Procedure. This objective implied a sizeable structural adjustment (originally projected at about 3.4 percent of GDP) that was frontloaded, reflecting the carryover of measures already taken in 2010. A quantitative performance criterion (PC) on the general government cash balance was set to monitor fiscal performance. An additional PC was established to ensure the elimination over time of domestic arrears at the central government level, and indicative targets (ITs) were set to eliminate the stock of local government arrears and reduce to a more manageable level the large stock of SOE arrears.[12] While the use of a cash target allowed a timely monitoring of the government's financing needs, it was not directly linked to the government's accrual deficit objective. However, the PC and ITs on arrears helped in part to address this limitation and better link the cash and accrual deficit targets. The program also focused on continuing and, in some cases, expanding the fiscal structural reforms started under the previous SBA to anchor medium-term fiscal sustainability. Structural conditionality to support these reforms included measures to reduce arrears in the health sector, improve the efficiency of the revenue administration and the public investment budget, strengthen accounting and treasury reporting systems, as well as increase the absorption capacity of EU structural and cohesion funds.

- **Structural reforms.** The program approached structural reforms with a two-pronged strategy: (i) reform the regulatory and pricing structure of Romania's key network sectors (energy and transportation), and (ii) re-launch a comprehensive reform of the SOE sector. The focus on the energy and transportation sector was well justified by the poor quality of national infrastructure. The SOE reforms focused on improving the SOE governance framework and increasing private sector participation through the sale of (mostly) minority stakes. It was hoped that these reforms would strengthen accountability and transparency, provide much needed private sector capital and expertise, and

EU-27. Infrastructure Quality Indicators: 2011
(Index. 1 (worst) to 7 (best))



Source: World Economic Forum, 2012

[12] To better measure the chronic arrears problem that had plagued the previous program, the new program narrowed the coverage of the arrears PC from the general government to the central government, and introduced two indicative targets on key SOE and local government arrears.

improve the overall financial and operating performance of SOEs. Structural conditionality supported improvements in the regulatory and tariff structures of the gas and electricity sectors, and in the governance of the SOE sector. It also included measures to support partial and outright privatizations. In parallel, quantitative IT on the operating balance and the stock of arrears of about twenty key SOEs were set to monitor the sector's performance.

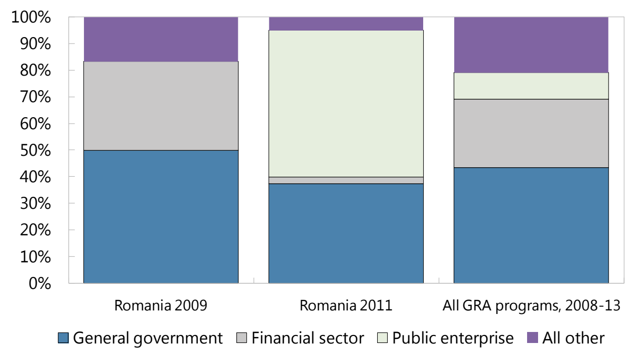
- **Monetary policy conditionality.** The program supported the inflation targeting framework of the central bank (NBR). In line with the previous SBA, the new program included a quarterly inflation consultation mechanism to bring inflation within the NBR's inflation band. The program inflation band was adjusted in 2012 to accommodate a spike in volatile food prices. Program design also included a floor on the change in net foreign assets (NFA) targeting a gradual increase in reserves. The combination of an inflation consultation clause and an NFA floor aimed to strike a balance between maintaining a firm stance against inflation while supporting economic recovery and increasing financial buffers. The NFA target carried over from the previous program and was subsequently flagged in the EPE of the 2009 SBA (completed in March 2012) as potentially creating scope for "window dressing" to meet the target around program test dates. However, to mitigate in part this risk, as with the 2009 SBA, the new program adjusted the NFA targets upward by any increase in commercial bank reserve requirements above the level prevailing before program approval. The program did not include any conditionality to improve the operation of the central bank's inflation targeting framework.

- **Financial sector conditionality.** As the financial sector had withstood the crisis well, the program strategy focused on completing delayed reforms initiated under the 2009 SBA. These reforms included completing the new resolution framework and strengthening the regulatory framework. In contrast to the previous program, conditionality in the financial sector was limited (consisting of just one structural benchmark over the program period). The program foresaw an initial increase in non-performing loans (NPLs), and was cognizant of the risks posed by possible deleveraging by foreign parent banks (given the expiration in 2011 of the first EBCI agreement) and by the sizable share of banks' loans in foreign currency to unhedged borrowers. However, program conditionality did not focus on reducing these risks and on the possible negative impact of large and mounting NPLs, even if well provisioned, on credit and GDP growth.[13]

[13] The program envisaged a discussion with foreign parent banks on the extension of the EBCI agreement, which did not materialize.

20. **Overall, program conditionality was less streamlined than in previous programs and increased over time, notably in the area of structural reforms.** The quantitative performance criteria reflected continuity with the 2009 program and their number was in line with the average of previous crisis programs (Review of Conditionality, IMF 2012). However, on average, five structural benchmarks and prior actions were set per review compared to an average of four under other GRA programs during the period 2009-2011. In line with program priorities, structural conditionality focused on fiscal and structural issues and, compared to most other programs, was limited in the financial sector area. Over time, the program increasingly relied on prior actions, in particular to complete the sixth and the combined seventh and eight reviews, largely reflecting delays in implementing the structural reform agenda (Table 1). More generally, as implementation of the structural agenda faltered, prior actions and structural benchmarks were increasingly used to promote intermediate steps towards the authorities' end goals that, nonetheless, were not always achieved.

Program Conditionality
(Percent of total)



Sources: MONA database

DID THE PROGRAM ACHIEVE ITS OBJECTIVES?

21. **Despite a complex political situation, program performance was satisfactory compared to other Fund-supported programs, but faced challenges toward the end of the program period.** Through the sixth review, the implementation rate of quantitative performance criteria stood at 93 percent, above the 90 percent average of other Fund-supported programs (Review of Conditionality, IMF 2012). However, in the run up to the December 2012 elections, the overall implementation rate declined to 86 percent, reflecting the weaker performance in the combined seventh and eighth reviews, where waivers were sought for three out of five PCs (Table 2).[14] The indicative targets on key SOEs' and local governments' arrears had similarly mixed results, with an overall implementation rate at the end of the program of only 64 percent across the two targets. Inflation remained around the central point of the program's inflation band, but breached the upper limit in the fall of 2012 due to food prices and administrative prices hikes, triggering discussions with staff under the consultation mechanism. Implementation of structural measures followed a similar pattern as performance criteria. Several measures were delayed, and over time the program increasingly relied on prior actions, which ultimately comprised about half of all structural

[14] Implementation rate refers to the number of PCs met as a percent of total PCs in the program. "Met" PCs include targets that have been modified since program approval. The benchmark includes GRA programs during 2002-11.

conditionality. In addition, four structural benchmarks still remained unmet when the program expired and have become part of the new program conditionality.[15]

Romania, 2011 SBA: Performance Criteria and Indicative Targets

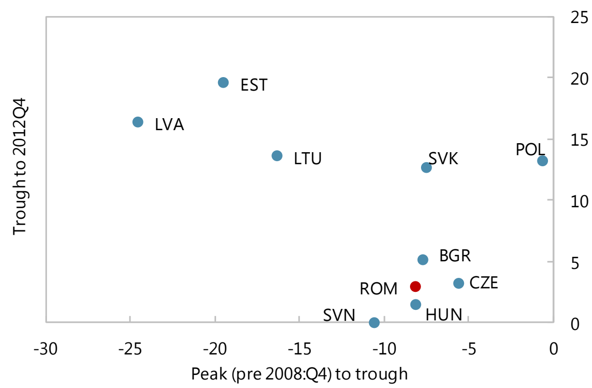
	Performance criteria					Consultation	Indicative targets				
	NFA	GG deficit	CG arrears	Guarantees	Ext arrears	Inflation	Current spending	SOE balance	SOE arrears	Local arrears	PNDI
Program											
1st review	met	met	met	met	met	met	met	met	met	met	
2nd review	met	met	met	met	met	missed inner band	met	met	not met	met	
3rd review	met	met	met	met	met	met	met	met	met	met	
4th review	met	met	met	met	met	met	met	met	met	met	
5th review	met	met	not met	met	met	met	met	met	met	not met	met
6th review	met	met	not met	met	met	met	met	met	met	not met	met
7th and 8th review	not met	not met	not met	met	met	met	not met	met	not met	not met	met

Source: IMF Documents

A. Macroeconomic Developments

22. **Romania's economic growth during the post-crisis period lagged behind that of many European emerging economies.**[16] Romania's relatively weak post-crisis growth performance in part reflects slower domestic demand growth. Over the program period, domestic demand in peer emerging economies grew by about 4.6 percent on average compared to only 2 percent in Romania. In turn, the relatively weaker performance of Romania's domestic demand was in part due to the large fiscal adjustment under the program (Figure 2) and the impact of political uncertainty that undermined investor and consumer confidence.

Crisis Growth Performance



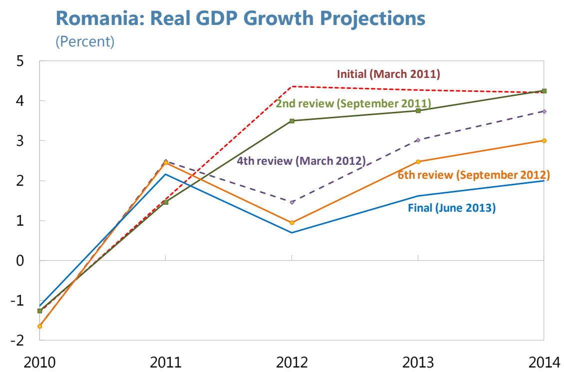
Source: WEO; and IMF staff calculations.

23. **The initial growth projections substantially overestimated the speed of the recovery due to optimistic domestic and external demand assumptions.** While a positive harvest in 2011 boosted real GDP to 2.2 percent, above the initial projection, growth decelerated substantially in 2012. As the Euro area crisis deepened and risks of political tensions, identified upon program approval, materialized, GDP growth in 2012 slowed to 0.7 percent, well below the initial projection of

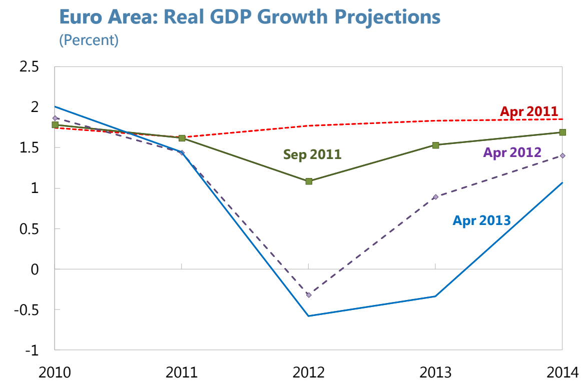
[15] The unmet measures included to: i) update the investment database to identify priority local government projects funded through budgetary and EU funds, and publish a list of low priority projects to be discontinued; ii) finalize a detailed definition of the structural architecture of the accounting and treasury reporting system; iii) hold IPOs of government shares in Romgaz and Hidroelectrica; and iv) sign a contract with legal and transaction advisors for the majority privatization of Oltenia.

[16] Peer countries include Albania, Belarus, Bosnia & Herzegovina, Bulgaria, Croatia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Republic of Montenegro, Poland, Russian Federation, Republic of Serbia, Turkey, and Ukraine.

around 4 percent, driven by weak domestic and external demand and a poor harvest. While the speed of the recovery turned out to be highly overestimated, initial growth projections were broadly in line with consensus forecast and the WEO's external demand assumptions, pointing to a generalized underestimation of the risks in the Euro area. Over the same period, growth overestimation was common in other European peer countries, although it was slightly larger in Romania (see WEO, April 2011 and WEO April 2013). The program adjusted its projections gradually, reflecting the pace of adjustment in the Euro area growth projections (Table 3).



Sources: WEO; Romanian authorities; staff projections



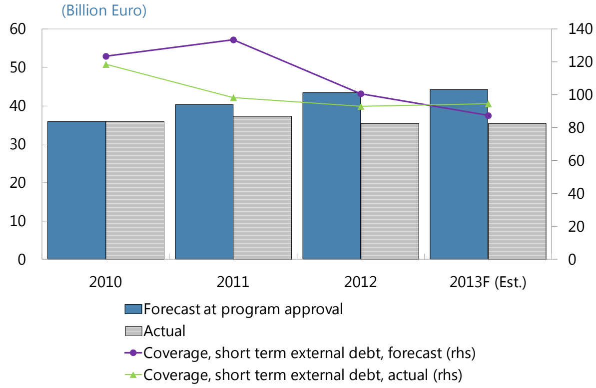
Source: WEO

24. **The slower domestic recovery prompted a larger external adjustment than initially envisaged**. At program approval, economic recovery in Romania and across Europe was expected to boost both exports and imports, with the current account deficit in Romania initially deteriorating to about 5 percent of GDP and stabilizing at roughly this level over the medium term. As the Euro crisis evolved, the deep contraction in domestic demand led to a sharper adjustment in imports. As a result, the current account deficit contracted more than expected and is estimated to have reached about 1 percent of GDP at end-2013, stabilizing just around 2 percent of GDP over the medium-term.

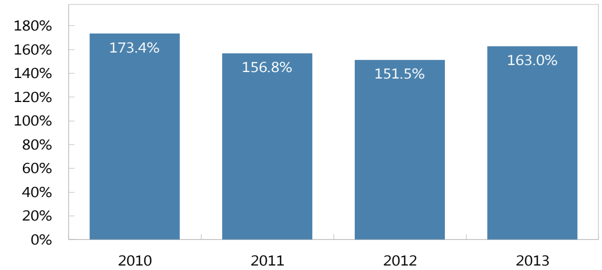
25. **Despite the larger external adjustment, weaker financial flows resulted in lower than projected reserves over the program period.** Program projections assumed that sustained investor confidence under the program would bring renewed FDI and banking inflows, the latter more than offsetting possible parent banks' deleveraging. In the event, overall capital inflows, notably FDI and other investment flows (including banking flows), were less than projected and were only partially offset by buoyant portfolio inflows (mainly in government bonds) that featured across many emerging market economies at the time, given low global interest rates. Overall, the improved current account only partially offset the weaker than expected capital flows, leading to a decline in gross international reserves, which reached €35.4 billion at end-2013, compared to an initial baseline projection at program approval of about €44 billion (Figure 1). However, despite the lower reserves, reserve coverage held up rather well. While it fell to less than 100 percent of short-term external

liabilities, it remained well within the "adequate" range under the Funds' reserve adequacy metric as, contrary to the initial program projections, lower deposit and other financial sector outflows offset the drop in reserves.[17] In addition, external debt remained broadly stable over the program period at about 75 percent of GDP, and is expected to decline in 2013.

Romania: Gross International Reserves
(Billion Euro)



Reserves as Percent of Metric



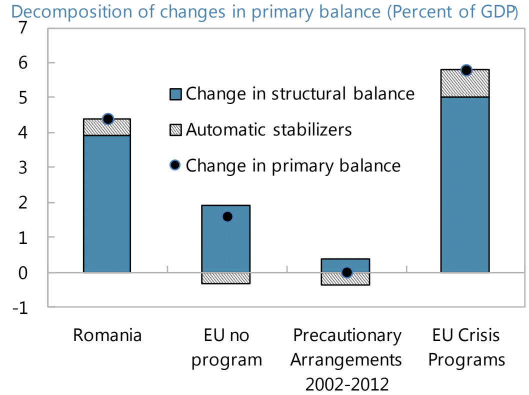
Note: Float Exchange Rate ARA Metric = 5% × Exports + 5% × Broad Money + 30% × Short-term Debt + 10% × Other Liabilities. As a rule of thumb, reserves within 100-150 percent of the new ARA metric are considered adequate.
Sources: IMF

26. **As the growth slowdown proved more protracted and structural in nature, staff revised downwards its potential growth projections.** The initial program projections assumed that the output loss during the crisis was mainly cyclical in nature. As weak growth persisted, staff re-estimated potential output (using a multivariate approach) and concluded that the crisis had left lasting scars in the economy and that potential growth would only recover slowly. These revisions provided further urgency to staff's view that higher rates of potential growth required the rapid implementation of the program's ambitious structural reform agenda and stepped up absorption of EU funds. However, the quantitative link between structural reforms and the program estimates of potential growth was admittedly more qualitative than empirical.

B. Fiscal Policy

27. **The authorities delivered on the program objective of bringing the fiscal deficit below 3 percent of GDP by 2012, allowing Romania to successfully exit the EDP.** (Figure 2) This required a significant structural fiscal adjustment effort of about 4 percent of GDP over the program period, in addition to the 2¼ percent of GDP already achieved under the 2009 SBA. This was one of the largest adjustments among EU countries (excluding Euro

Automatic Stabilizers and Change in Fiscal Stance (2010-12)
Decomposition of changes in primary balance (Percent of GDP)



[17] See Assessing Reserve Adequacy, ARA (SM/11/31). As a rule of thumb, reserves within 100-150 percent of the ARA metric are considered adequate. As of December 2012, Romania's gross reserves were equal to 152 percent of the ARA metric (down from 173 percent as of December 2010).

area programs) and above the average adjustment in past programs treated on a precautionary basis. The large adjustment succeeded in slowing the accumulation of public debt, expected to stabilize at around 40 percent of GDP in 2013-14, although debt dynamics remain sensitive to growth shocks.

28. **The emphasis placed on meeting the 3 percent of GDP deficit target translated, however, into limited flexibility to adapt to slowing real GDP growth**. Despite a large negative output gap, real time downward revisions to 2012 GDP growth (from 4.4 percent to less than one percent by fall 2012) led to only a slight relaxation of the cash targets, consistent with keeping the 3 percent of GDP accrual (ESA95) deficit target unchanged.[18] Given Romania's low public debt level and relatively low deficit, IMF staff considered the possibility of relaxing the fiscal target in line with macroeconomic developments. However, the authorities, supported by the EC, remained strongly committed to meeting the 3 percent EDP target by 2012, mainly for credibility reasons. Overall, this resulted in a sharper pro-cyclical structural adjustment in 2012 than initially envisaged and a larger drag on GDP growth.[19]

29. **In meeting the fiscal objectives, the program mainly relied on expenditure measures, although some revenue increases could have been considered.** The emphasis on spending measures rightly sought to rectify pre-crisis excesses. Most of the measures were of a long-term nature, (e.g., reductions in public wages and subsidies), although the adjustment also relied on some transitory measures (e.g., a temporary pension freeze) and crisis initiatives that were not sustainable over the longer term (e.g., an almost complete hiring freeze). Revenue measures made up a larger part of the adjustment only with the 2013 budget, which incorporated some of the recommendations of a Fund technical assistance that advised to increase some tax rates (e.g., property taxation), broaden the tax base and simplify the tax system. With the benefit of hindsight, the program could have pursed more forcefully the original program objective of simplifying the tax system and, in this context, placed more emphasis on revenue increases, to replace temporary and crisis measures that are unviable over the longer term.

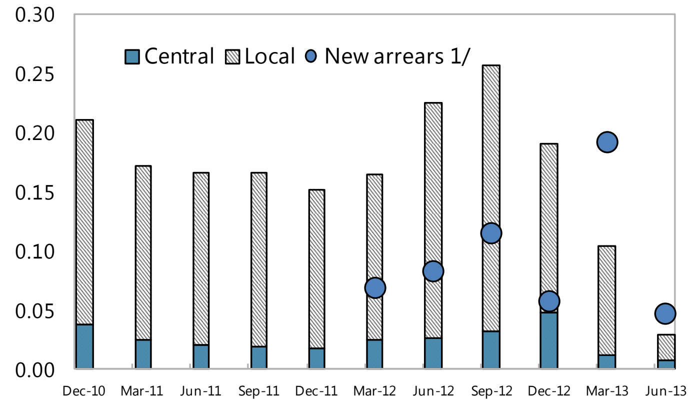
30. **The program also focused on structural fiscal reforms to place public finances on a sustainable footing, although progress was uneven**. Reforms focused on further efforts to reduce and eventually eliminate government arrears (an issue carried over from the previous program), improving revenue administration and the tax system, and increasing the efficiency of health spending and public investment, including by enhancing the absorption of EU funds.

[18] The cash target was relaxed in part to abide to a Constitutional court rule that required the government to roll back a portion of the 25 percent public sector wage reduction and to compensate pensioners for a healthcare contribution increase implemented during the 2009 SBA.

[19] Using a fiscal multiplier of 0.5 over a cumulative three-year period, the drag on growth would be as large as 1 percent, although this was somewhat mitigated by reducing inefficient domestic capital spending.

- ***Arrears.*** The program was successful in reducing the stock of government arrears, but did not prevent the continued accumulation of new arrears. Initially, the authorities completed a stocktaking exercise (prior action) of arrears and unpaid bills in the general government (and SOEs) and began reducing the stock of government arrears primarily through dedicated new revenue streams (e.g., clawback mechanisms in the health sector). Later in the program, they began the lengthy process of introducing a commitment control system to prevent the accumulation of new arrears. The stock of arrears was reduced in 2011, but began to increase in 2012 as insufficient financing and spending inefficiencies led to the accumulation of new arrears in the health sector, and as previously unrecorded local government arrears were registered, breaching program targets. One of the factors compromising the achievement of program goals was that the program initially focused on reducing the stock of arrears, and only later in the program on preventing the accumulation of new arrears. Hence, as old arrears were cleared new arrears continued to be generated at a rate of about 0.1 percent of GDP a quarter during 2012. The introduction of commitment control systems earlier in the process could have helped to better control the accumulation of new arrears, as planned under the 2013 SBA.[20] Nonetheless, due to further arrears clearance measures in early 2013, the outstanding stock of arrears of the central and local governments at the end of the program was low at less than 0.1 percent of GDP.

Central and Local Government Arrears
(Percent of GDP)



1/ Data only for 2012 and 2013

- ***Revenue administration and tax policy.*** Revenue administration reforms have not yet delivered the desired increase in revenue and collection efficiency. During the program, progress was made to restructure the tax administration, increase the focus on large taxpayers, introduce a high wealth individuals unit, and develop indirect audit methods. The number of small VAT

Collection Efficiency: Revenue Productivity 1/

	2008	2009	2010	2011	2012
Value Added Tax	0.42	0.36	0.35	0.36	0.36
Company Income Tax	0.18	0.18	0.17	0.13	0.12
Personal Income Tax	0.22	0.22	0.24	0.22	0.21

Source: USAID, WEO, Staff estimates
1/ Tax receipts as percent of GDP divided by the standard tax rate

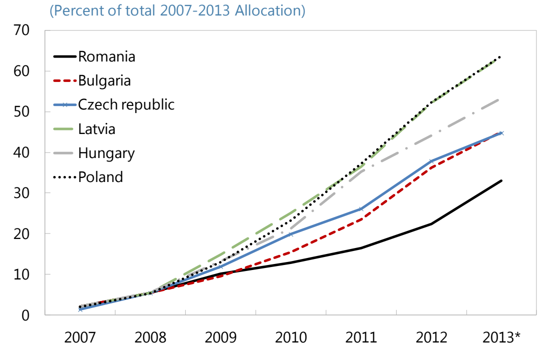
[20] In September 2013, the IMF Board approved a successor precautionary SBA.

taxpayers was also reduced, although initial plans to simplify VAT collection ran into strong political opposition and were abandoned. However, the collection efficiency of the main taxes has remained unchanged and in some cases declined. The weak revenue and collection efficiency response to-date is indicative that revenue administration reforms take time to deliver results. As organizational and operational reforms proceeded, where appropriate, the program could have gradually shifted away from institutional reforms and placed more emphasis on monitoring outputs (e.g., collection of tax debt, number of audits) more directly linked to collection and administrative performance, an approach applied in other European programs.

- ***Healthcare system.*** Healthcare reforms were identified as critical for putting the fiscal finances on a sustainable path, but proved to be a difficult area to tackle and progress was limited. The initial focus was on reducing the mismatch between entitlements and resources. Efforts focused on increasing revenue (e.g., introducing a claw back tax and copayments), reducing entitlement costs (e.g., expanding the use of generics, introducing e-prescription, reducing the number of independent hospitals and beds) and improving controls on hospital budgets. However, these measures encountered strong opposition and their effectiveness was significantly reduced, failing to generate the anticipated results. A comprehensive reform package was also planned, but was eventually withdrawn after public protests. As a result, progress over the course of the program was limited and reforms achieved much less than initially envisaged.

- ***EU Funds absorption and public investment planning.*** The program had only limited success in improving the efficiency of public domestic investment and increasing the absorption rate of EU funds. The program focused on prioritizing existing projects, cancelling low priority projects, incentivizing local governments to use EU-financed projects, and improving institutional capacities. A new Ministry of European Affairs was created to coordinate the use of EU funds, and the monitoring of existing projects strengthened. While the absorption rate did increase somewhat and domestically funded capital expenditure were reduced, in 2012 the use of EU funds was still 0.8 percent of GDP lower than originally anticipated, and short of absorption targets included in the EU program.[21] Romania's absorption rate

Absorption Rate of EU Funds
(Percent of total 2007-2013 Allocation)



Source: EC
*As of October 3, 2013

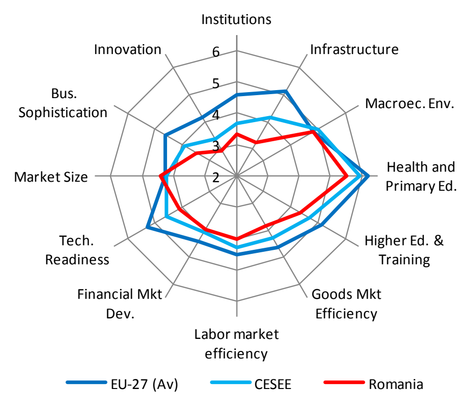
[21] In the same year, governance problems also resulted in delays in reimbursements. The authorities replaced delayed EU funds with domestic financing, contributing to miss the cash deficit target in the last program review.

remains one of the lowest in Europe with the potential to lose about 10 percent of GDP in unused funds by end-2013. Capacity constraints, organizational issues and governance problems associated with the investment budget turned out to be deeply ingrained and difficult to address within the program time span. Improving budgetary planning, project prioritization and the governance of the overall framework around the use of domestic and EU funds remain key priorities to address.

C. Structural Reforms

31. **The implementation of the ambitious structural reform agenda under the program proved more challenging than initially envisaged.** Since its transition from central planning, Romania's long history of structural reforms has often benefitted from external support. In this regard, the program's focus on key network industries and SOE reform represented the revival of an agenda that had largely stalled following Romania's accession to the European Union. This focus was appropriate, given the burden imposed on the competitiveness of the broader economy by poor infrastructure (particularly in the transport and energy sectors) and weak institutions. But it nonetheless posed a daunting challenge. Enterprise reform was not at the core of the Fund's areas of expertise, and while the program could rely on the EU and World Bank expertise in this area, in the Romanian context, enterprise reform confronted significant resistance from a diverse and well-connected set of vested interests.

Eu-27. Global Competitiveness Indexes: 2011



Source: World Economic Forum, 2012

32. **The program largely achieved the objective of reforming the price and regulatory frameworks of the energy sector, although tariff liberalization encountered repeated delays.** The legislation transposing the EU Third Energy Package was largely put in place in mid-2012, and legislation on the independence of the energy regulator entered into force in the fall of the same year.[22] The process of liberalizing energy prices, on the other hand, proved more challenging. Electricity and gas roadmaps for price liberalization were approved later than planned as prior actions, and *ad hoc* price increases, to offset these delays, were also the subject of prior actions. Moreover, the roadmaps were less ambitious than originally intended, with full price liberalization scheduled at end-2017 for electricity, and end-2018 for gas (respectively, two and three years later

[22] The EU Third Energy Package consists of a series of EC directives and regulations aimed at creating an effective single EU market for gas and electricity, while protecting vulnerable consumers.

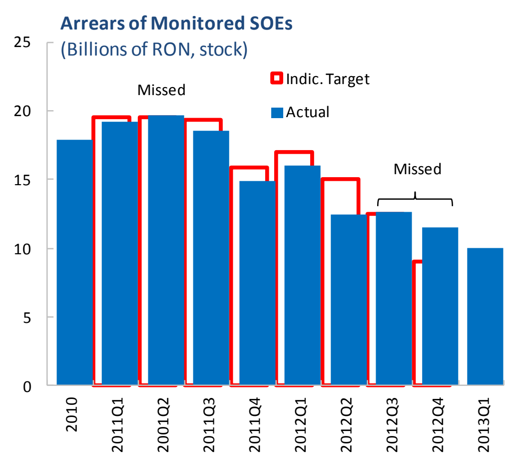
than originally planned). Later in the program, the authorities also began revamping the social safety net to protect the most vulnerable consumers from energy price increases. Overall, the program was largely successful in this area.

33. **However, the program made only limited progress in reforming the SOE sector.** The reform process faced strong political resistance and, with ongoing political turmoil throughout 2012, encountered repeated postponements and reversals. Progress on improving SOE governance and on advancing SOE privatization plans was limited, with some success only in reducing SOE arrears.

- **Governance.** After a significant delay, in December 2011 the authorities adopted an emergency ordinance on SOE governance. The ordinance relied on OECD principles and required, among other things, the hiring of professional managers and Board members. However, the appointment of managers and Board members was, in several cases, subject to political interference and remained incomplete. In some instances, professional managers were appointed and, shortly after, removed. In other cases, there were doubts as to whether the final appointments were based on purely professional criteria.

- **Privatization.** The privatization agenda stalled. Despite an original commitment to sell stakes in 13 companies, the authorities sold minority stakes in only two companies already listed on the stock exchange. In addition, toward the end of the program, the authorities liquidated two companies, placed an additional two into insolvency, and initiated the sale-purchase agreement of a large rail freight company (although, the sale failed after the program ended).

- **Arrears.** Although, the indicative targets on SOE arrears were missed on two occasions, the stock of arrears of key SOEs significantly declined from 3.4 percent of GDP in 2011 to around 1.6 percent in early 2013. Nonetheless, reducing arrears on a permanent basis proved challenging. One of the main factors that prevented further arrears reduction was the indirect approach taken under the program (through encouraging SOE restructuring) to address the risk of new arrears accumulating. Hence, as past arrears were cleared in some companies, a few other companies (mainly in the railway sector) continued to accumulate new arrears. The program could have focused more concretely on reforms to reduce the operating losses and monitoring and controlling the accumulation of new arrears in the main railways companies.



Sources: Romanian authorities; and IMF staff estimates.

34. **As the SOE reform process faltered, program conditions became more detailed and focused on incremental gains**. Detailed conditionality may be unavoidable when dealing with complex structural reforms, as the experience in some Euro area programs has recently shown.

However, in the case of Romania, the root cause of the repeated delays and policy reversals can be traced back to limited ownership of the reform agenda, and institutional resistance to surrendering political control of key SOEs. In addition, political instability throughout 2012 and a change in the political majority supporting the government created an unfavorable environment to implement a wide-ranging program of structural reform. As the reform agenda stalled, program conditionality became more detailed and focused on intermediate steps. While detailed conditionality can be an effective tool to maintain reform momentum, it also raises a number of questions about how to identify the best sequence of intermediate steps to achieve the authorities' ultimate goals, while ensuring that detailed conditionality does not further undermine ownership. Striking the right balance is difficult. In Romania, output-oriented conditionality was relatively successful in the liberalization of energy prices where ownership was bolstered by the existing EU directives. However, the more gradual approach and process-oriented conditionality associated with the SOE reform agenda, where ownership was weaker, delivered limited results. In this latter area, program's conditionality became perhaps too detailed, and in the process, the link between some individual short-term measures and the main objective of long-term growth became somewhat tenuous.[23]

35. **Looking forward, ensuring strong ownership and using well focused conditionality remain key elements for the success of the structural reform agenda.** The key goal is not only to encourage short-term incremental gains, but also to promote the internal capacity and consensus needed to implement difficult reforms over the longer term. In this context, conditionality should emphasize targeted macro-critical actions that clearly signal from the outset the authorities' commitment to implement key elements of the reform agenda. Similarly, despite subsequent governments in Romania reiterated their formal commitment to the program, in the event of a change in government, a reassessment of the authorities' reform priorities and, if needed, a readjustment of reform sequencing and conditionality could help to strengthen ownership.

D. Financial Sector

36. **During the program, the authorities focused on completing reforms initiated under the previous program to strengthen the resolution framework and improve transparency.** At the outset of the program, banks were well capitalized and liquid, economic recovery was expected to accelerate, credit to continue to grow, NPLs to stabilize and banks' profitability to improve. Against this background, and in line with program commitments, the authorities focused on strengthening the bank resolution framework and the financial safety net. They introduced bridge-bank powers and the possibility for purchase-and-assumption transactions, improved data exchange

[23] The Fund's guidelines require that program conditionality be parsimonious and well matched to tightly specified program objectives. Program-related conditions, including structural benchmarks or prior actions need to be either critical to the achievement of program goals or to monitoring implementation—"critical" in this sense meaning that, if a measure were not implemented, it is expected that the program's goals would not be achieved or that program monitoring would not be possible (SM/10/22).

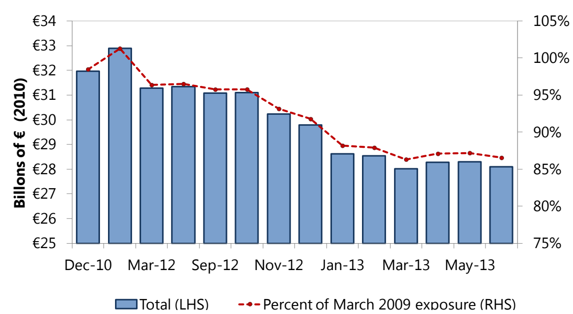
between the central bank and the deposit guarantee fund, and developed further contingency plans to address possible financial pressures, including from the Euro area periphery. To improve transparency and align to standards used in other European countries, in early 2012 they adopted the International Financial Reporting Standards (IFRS) for the banking sector.

37. **The authorities also maintained enhanced supervision.** They secured adequate NPL provisioning and required capital injections to cover the shortfalls that emerged under mandated collateral audits. Moreover, they restricted foreign currency lending to un-hedged households, and later in the program to corporations, and kept prudential filters in place after the introduction of IFRS to ensure prudent loan provisioning. The authorities also strengthened liquidity monitoring of parent exposures and introduced weekly reporting of deposits. These actions and the stronger financial safety net helped contain the impact on the Romanian banking system of the Greek crisis and later the collapse of the Cypriot financial system, preserving depositor confidence.[24] On average, banks remained well capitalized and liquid, and NPLs were well provisioned throughout the program (with total provisions at around 90-100 percent of NPL), although profitability declined as the continued growth of NPLs required additional provisioning. Relatively little emphasis was placed on the impact of possible deleveraging and high NPLs on banks' ability to lend and support economic growth.

38. **However, as the Euro crisis unfolded and domestic recovery weakened, it became evident that the financial sector faced greater challenges than initially envisaged.** In the context of widespread funding pressures in the Euro are periphery, notably Greece, and lower domestic demand, deleveraging by parent banks accelerated and NPLs rapidly increased.

- **Foreign banks deleveraging.** While parent banks' exposures had remained stable during the global crisis, foreign bank deleveraging accelerated in the second half of 2012. In early 2012, short-term foreign borrowing, mainly from parent banks, represented an important part of total bank borrowing, and further deleveraging could have been expected. Indeed, by mid-2013 parent banks funding had declined by 20 percent compared to the level prevailing in 2011. At the same time, as the crisis in Greece and Cyprus deepened, the fragmentation of the interbank markets led to further deterioration of liquidity for some banks.

Bank System Parent Funding

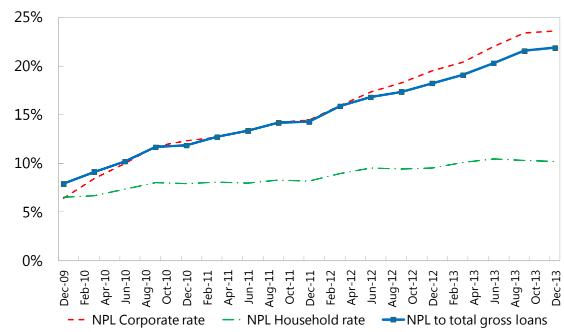


Sources: Romania Central Credit Register

[24] In early 2011, Greek banks accounted for 14 percent of the Romania's banking system assets. Cypriot banks had a much smaller presence with a small branch and a subsidiary, accounting for less than 1.5 percent of banking system assets.

- **Non-performing loans.** As domestic and external demand was revised downwards, banks' asset quality deteriorated further. Contrary to the program's initial projections, NPLs rapidly rose in 2012 driven by the difficult operating environment, particularly for small and medium size enterprises, and difficulties in writing off NPLs. By mid-2013, NPLs had reached about 20 percent of total loans up from about 12 percent at end-2010, despite some positive, although limited, loan growth. This was one of the highest and fastest growing levels of NPLs in the region. Given the need to provision for increasing NPLs, and relatively high operating costs, by end-2012, bank profitability had turned negative and credit started to decline. Supply side constraints, in addition to weak demand, were later identified by staff as key factors explaining negative credit growth and the inability of banks to support economic recovery, one of the main objectives of the program. At the same time, banks remained exposed to significant exchange rate risks with foreign currency lending still above 60 percent of total lending at end-2012, largely unchanged since 2010. Some of these risks were flagged at the outset of the program that, however, included limited actions to address them directly.

Non-Performing Loans
(90 days past due loans as percent of total loans)



Sources: Romania Central Credit Register

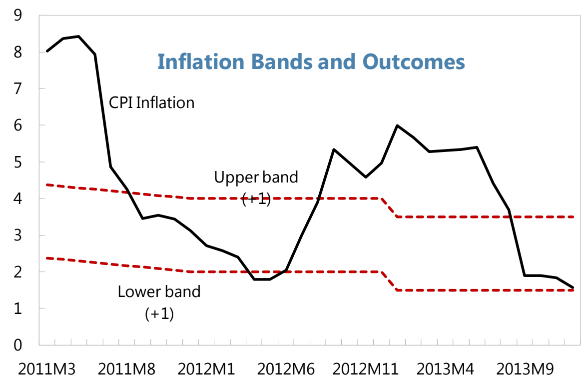
39. **While the 2011 program quickly adapted to the new liquidity and asset quality challenges, it is with the 2013 program that financial vulnerabilities have taken center stage.** To address problems with the distribution of liquidity across banks, during the program, the central bank expanded the range of eligible collateral for the overdraft facility and provided liquidity support in foreign currency via swap arrangements. To facilitate the removal of fully provisioned NPLs from banks' balance sheets, the authorities modified the tax code to ensure a tax neutral treatment for the sale of bank receivables and clarified the accounting rules (under IFRS) applicable to the write-off of impaired loans, although this latter intervention proved to be ineffective. Later in the program, as NPLs continued to increase, the authorities planned to remove impediments to insolvency and foreclosure procedures and facilitate NPLs resolution, although specific actions were only taken after the program expired. With the benefit of hindsight, the program could have better anticipated the extent of parent bank deleveraging and placed more emphasis on the risks from the significant reliance on external funding, as well as the banks' sizable NPL debt overhang.

E. Monetary And Exchange Rate Policy

40. **Falling inflation and the still sizable output gap allowed a gradual easing of monetary policy during the early part of the program.** The NBR reduced its key policy rate by one percentage point by early 2012. Domestic and foreign reserve requirements were left unchanged against a background of abundant liquidity and concerns with financial sector stability. However, overall, monetary conditions loosened substantially as abundant liquidity kept the interbank rate significantly below the policy rate for extended periods of time. This in part reflected the central

bank's concerns with its own profitability and an implicit reluctance to use repos operations to mop up excess liquidity.

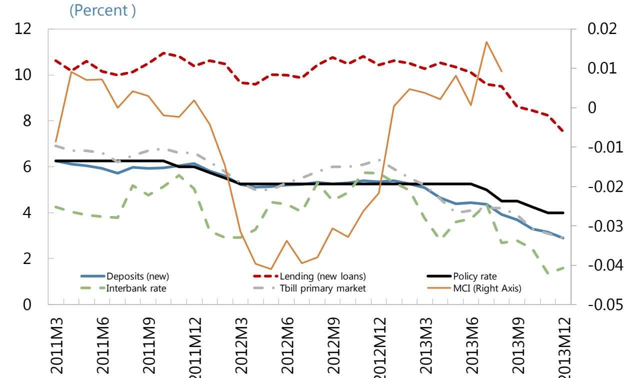
41. **Tensions arose toward the end of the program as inflation pressures emerged**. In the fall of 2012, a spike in food prices, administrative price increases, and the weakening exchange rate pushed headline inflation outside the program's inflation consultation band, triggering discussions with staff. The authorities agreed with the need for a prudent monetary stance in order to contain capital outflows and exchange rate depreciation, given the sizable foreign currency exposure of the economy, as well as to anchor inflation expectations. In the end, the central bank tightened liquidity and kept the policy rate unchanged. To stem pressures on the exchange rate, the central bank stepped up market interventions, lowering reserves and missing the end-December 2012 NFA target. The exchange rate eventually stabilized, but inflation only returned to within the central bank's inflation band in September 2013. Following further depreciation during the program, staff assessed that the real exchange rate was broadly in line with fundamentals.



Sources: Haver; and IMF staff estimates

42. **During the program, the central bank improved the operation of its inflation targeting framework.** Substantial foreign currency denominated lending and a wide interest corridor of +/- 400 basis points around the policy rate (between the NBR's deposit facility and credit facility rates) weakened monetary policy transmission and allowed for greater decoupling of the money market and the policy rate. Later in the program, the central bank tightened the interest rate corridor to +/-300 basis points. While the divergence between the interbank rate and the policy rate was the subject of program discussions, the program could have encouraged specific measures to reduce this divergence through a more active use of open market operations to manage market liquidity. Looking forward, as the interbank market deepens, measures could also include a tighter corridor around the policy rate.

Interest Rates and Monetary Conditions (MCI)
(Percent)



Sources: Haver; and NBR

43. **The program's floor on net foreign assets pursued multiple objectives and could have been simplified.** The floor included the NBR's international reserves and commercial banks' foreign currency reserves held at the central bank. The inclusion of commercial banks' reserves was intended to constrain changes in foreign currency reserve requirements, thus serving prudential purposes. However, this approach increased the risk of missing the NFA target in case of deposit outflows and

insufficient net international reserve (NIR) accumulation.[25] Moreover, this design created scope for potential "window dressing" as the NFA target could be met around the program dates by increasing excess reserves. At the same time, the NFA design did not allow for additional external issuances to build buffers.[26] Eventually, during the second part of the program, there were indications of increased intra-month movements in foreign currency reserves, supporting the level of NFA, around program dates. In addition, the heightened political uncertainty in the second half of 2012 led the NBR to intervene frequently to stem pressure on the exchange rate, contributing to the authorities' failure to meet the end-December 2012 NFA target. In these circumstances, a more standard NIR target could have better served the program objective of maintaining adequate reserve buffers.

THE NEW STAND-BY ARRANGEMENT

44. **In September 2013, the authorities requested a new successor arrangement.** The new 24-month SBA aims to maintain macro and financial sector stability, provide a reserve buffer against possible external shocks, and continue growth-enhancing structural reforms. In particular, the new program seeks to: (i) safeguard sound public finances, (ii) continue monetary and financial sector policies that preserve buffers and increase the resilience against external shocks, and (iii) reduce bottlenecks to potential growth through structural reforms. The authorities regard the new SBA as an important policy anchor to keep fiscal policy and structural reform on course, and plan once again to treat the arrangement as precautionary.

45. **The new arrangement builds on the lessons from the previous SBA.** Under the 2011 SBA, structural reforms were often delayed and the financial sector remained vulnerable to external shocks. The new SBA narrows the focus to macro critical reforms in the energy and transportation sectors and relied on upfront actions to create reform momentum and underpin the authorities' commitment to undertake long delayed reforms of SOEs. While banks remain well capitalized, the new program seeks to accelerate banks' balance sheet repair and address banks' sizable stock of non-performing loans. It also seeks to develop new long-term funding instruments to replace external funding and reduce incentives for new foreign currency-denominated lending. Under the new SBA, the authorities plan to reach the medium-term structural balance agreed under the Stability and Growth Pact by 2015 and continue to strengthen fiscal institutions. The design of international reserve targets and the arrears strategy of the new program also reflect lesson from previous SBAs.

[25] The NFA target under the program was revised on at least four occasions to account for deviations from timing and/or amount of market issuances relative to the baseline.

[26] The new program included an adjustor to account for any deviation from the forecast, both in term of amounts and timing, due to external bond placements by the Ministry of Public Finance and external disbursements from other official sector. De facto, this adjustor constrained the authorities' ability to meet the target through higher external issuances.

CONCLUSIONS AND LESSONS

46. **The program was successful in achieving its goals of fostering macroeconomic stability and advancing economic adjustment, but vulnerabilities remain.** While the Euro area crisis unfolded and domestic recovery was slower than initially envisaged, external and fiscal adjustment continued. Macroeconomic stability and reduced macroeconomic imbalances led to an upgrade in Romania's sovereign rating to investment grade and continued market access. As the current account improved, however, weaker financial flows resulted in lower than projected reserves by the end of the program, in part reflecting optimistic projections about FDI and other investment flows, including from parent banks. Fiscal consolidation continued, allowing Romania to exit the EU EDP in 2013 and stabilize the debt to GDP ratio, although structural issues with the effectiveness of revenue administration and the absorption of EU funds remained. Finally, the program was instrumental in strengthening further the banking resolution framework and preserving financial stability through enhanced supervision. However, risks to financial stability and credit growth arising from parent banks deleveraging and relatively high NPLs were not fully reflected in the initial program design.

47. **The program supported an ambitious reform agenda, although progress was uneven and a number of reforms remain incomplete.** The program largely achieved the objective of reforming the regulatory and price frameworks of the gas and electricity sectors. However, progress in the SOE privatization agenda and on improving the SOE governance framework was limited, mainly because of inadequate ownership. As implementation problems arose, the program increasingly relied on detailed conditionality focused on intermediate steps at the cost of weakening the link between specific short-term measures and the main macroeconomic objective of improved long-term growth. To address this problem, the program could have relied more on targeted macro-critical conditionality to confirm, at the outset of the program, the authorities' commitment to implement key elements of the ambitious reform agenda. As governments changed, a reassessment of the authorities' reform priorities and, if needed, a readjustment of reform sequencing and conditionality could have helped strengthen program ownership.

48. **The experience with the Romania's successor arrangement provides some broad lessons:**

- ***Program ownership and structural reforms.*** Strong ownership is critical to implement complex structural reforms and cannot be replaced by detailed conditionality. Difficult measures were taken to regulate the energy sector and liberalize gas and electricity tariffs. In the areas where ownership lacked (e.g., the privatization agenda), however, progress was limited and greater reliance on more detailed structural conditionality was not effective to reestablish reform momentum and meeting the program's broad objectives.

- ***Cross-border financial linkages and vulnerabilities***. Cross-border banking exposures remain central to assess financial sector vulnerability even in a post-crisis environment. One of the lessons from the Romanian experience after the 2008-09 global financial crisis is the need to pay special attention to the risks arising from cross-border banking linkages and foreign currency exposure of the banking, and more in general, of the overall financial sector, even outside a full crisis environment. Addressing these risks in a post-crisis world requires stronger coordination between home and host supervisors, appropriate design of macro-prudential policies, as well as enhanced transparency and data disclosures.

- ***EU-Fund cooperation***. The program was a successful case of joint collaboration with the EU on a precautionary arrangement focused on long-term structural reforms, setting the precedent for future joint support of programs. The need to coordinate consistent policy positions required intensive engagement with other creditors. The reform agenda in key sectors (e.g., energy, transportation and health) was guided by the EC and World Bank expertise and, as in other programs, the authorities' commitment to adhere to EU targets under the EDP framework helped anchor the fiscal consolidation plan. However, the larger than projected pro-cyclical impact of fiscal adjustment is a reminder of the need for constant flexibility in adjusting program targets and conditionality to the country's evolving circumstances.

Table 1. Romania: Structural Conditionality and Prior Actions Under the 2011 SBA

Structural Benchmarks	Time of Proposal
Fiscal	
Completion of a stocktaking of arrears and unpaid bills as of end-December 2010 for the entire general government and SOEs	Initial SBA
Introduction of a simplified taxation system for smaller taxpayers under the threshold with help from the IMF and EC, while requesting a shift in the VAT mandatory threshold from the EU Council of Ministers to €50,000	Initial SBA
Eliminate by government ordinance the legal basis of stimulente funds, effective January 1, 2012	Initial SBA
Completion of a comprehensive review of the existing investment portfolio, which will prioritize and evaluate existing projects to focus on those where funding can be fully secured, examine the viability of old projects, with low priority and unviable ones discontinued, and production of a final report and action plan	Initial SBA
Impose a revised clawback tax on the pharmaceuticals based on the growth in their costs or above a pre-determined threshold	2nd Review
Prepare comprehensive amendments to the health care legislation to address the persistent budgetary shortfalls and to ensure high quality health care services	2nd Review
Design measures to reduce registration of small VAT payers by 20 percent by end-September 2012 (compared to end-September 2011)	3rd Review
Launch tender for providing software to integrate the accounting reporting system with the Treasury payment system	5th Review
Update the investment database to identify priority local government projects funded through budgetary and EU funds, and publish a list of low priority projects which will be discontinued	6th Review
Publish up-to-date financial statements of all public hospitals on a webpage of the Ministry of Health	6th Review
Finalize a detailed definition of the structural architecture of the accounting and treasury reporting system	6th Review
Financial	
Amend legislation to allow the use of the deposit guarantee fund resources to facilitate bank restructuring, including purchase and assumption transactions	Initial SBA
Structural	
Preparation of strategic action plans for key SOEs (as specified in TMU)	Initial SBA
Undertake SOE reforms, including (i) appointment of legal advisors for privatization of CFR Marfa, TAROM, Transelectrica, Transgaz, and Romgaz; (ii) Preparation of action plans for the remaining SOEs of the central government; (iii) Design mechanisms to facilitate restructuring and securitizing SOE arrears	1st Review
Approve legislation to improve governance of SOEs	1st Review
Selection of advisors for SOE reform: (i) select transaction advisors for group 1 and (ii) legal advisors for group 2	2nd Review
Appoint transaction advisor for group 2 and legal advisor for group 3 as specified in MEFP	3rd Review
An increase of 5 percent in the electricity price for both residential and nonresidential consumers	4th Review
Hold IPOs of government shares in Romgaz and Hidroelectrica	5th Review
Sign a contract with legal and transaction advisor for the majority privatization of Oltenia	6th Review
Prior Actions	
Fiscal	
The government decision on indirect audit methods will be passed	Initial SBA
Completion of a stocktaking of arrears and unpaid bills as of end-December 2010 for the entire general government and SOEs	1st Review
Pass the government decision on ANAF restructuring	1st Review
Enact the copayment law and the revised clawback tax law	3rd Review
The government will approve a memorandum for the cancellation of penalties on railroad company arrears to Electrica and an emergency ordinance to grant a bridge loan to clear CFR rail infrastructure arrears to private energy providers	5th Review
Approve government ordinance to allow that: (i) resources available to local governments, currently limited to co-financing investment, can be used for paying arrears; and (ii) the central government can directly pay off arrears of local governments from shared taxes	6th Review
Reduce central government arrears to RON 0.02 billion	7th Review
Reduce local government arrears to RON 0.3 billion	7th Review
Structural	
Approval of a government ordinance separating the CUG prices between households and non-residential customers and allowing ANRE full autonomy to adjust the CUG price to non-residential customers	1st Review
Increase the gas price for non-residential customers, in order to further align with CUG formula, by 8 percent	2nd Review
Appoint legal advisor for Hidroelectrica, transaction advisor for Oltchim, Transelectrica, and publish tender for transaction advisor for Romgaz, Tarom and Transgaz	3rd Review
Increase gas price for non-resident consumers, in order to further align with CUG formula, by 5 percent	3rd Review
Approve a roadmap for the deregulation of electricity prices as specified in the MEFP	4th Review
Approve a roadmap for the deregulation of gas prices as specified in the MEFP	5th review
Increase gas prices for non-residential consumers by 10 percent and for households by 5 percent	6th Review
Launch the tender for a secondary public offering of 15 percent of Transgaz shares	6th Review
Launch the tender for the majority privatization of Oltchim	6th Review
Initial a sale-purchase agreement with the winning strategic investor for the sale of the majority stake in the capital of CFR Marfa	7th Review
Launch the tender for a secondary public offering of 15 percent of the government shares in Transgaz	7th Review
Sign a contract with a transaction advisor for an initial public offering of 15 percent of the share capital of Oltenia	7th Review

Table 2. Romania: Quantitative Program Targets Under the 2011 SBA

	2010	1st Review		2nd Review		3rd Review		4th Review		5th Review		6th review		7th & 8th review			
	Dec	Mar-11		Jun-11		Sep-11		Dec-11		Mar-12		Jun-12		Sep-12		Dec-12	
	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Prelim.
I. Quantitative Performance Criteria																	
1. Floor on the change in net foreign assets (mln euros) 1/ 2/	20,026	-50	119	250	1896	-150	293	-500	-457	533	1696	-557	-457	-267	-243	633	-317
2. Floor on general government overall balance (mln lei) 3/	-33,621	-7,289	-5,254	-13,280	-11,260	-17,500	-13,685	-23,953	-23,837	-4,550	-3,421	-7,769	-7631	-10,470	-8,257	-14,770	-17,430
3. Ceiling on stock of central government and social security arrears (bn lei)	0.19	0.20	0.15	0.20	0.11	0.15	0.10	0.10	0.09	0.08	0.14	0.06	0.15	0.04	0.18	0.02	0.03
4. Ceiling on general government guarantees issued since end-2008 (face value, bn lei)	7.6	14.0	8.1	14.0	6.0	14.0	5.8	14.0	6.5	14.0	7.0	14.0	7.7	14.0	8.3	14.0	9.8
II. Continuous Performance Criterion																	
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
III. Inflation Consultation																	
6. 12-month rate of inflation in consumer prices																	
Outer band (upper limit)	...	9.0	...	8.8	...	6.2	...	5.7	... ..	4.1	...	4.4	...	5.9	...	5.6	...
Inner band (upper limit)	...	8.0	...	7.8	...	5.2	...	4.7	... ..	3.1	...	3.4	...	4.9	...	4.6	...
Actual/*Center point*	8.0	*7.0*	8.0	*6.8*	7.9	*4.2*	3.5	*3.7*	3.1	*2.1*	2.4	*2.4*	2.0	*3.9*	5.3	3.6	5.0
Inner band (lower limit)	...	6.0	...	5.8	...	3.2	...	2.7	... ..	1.1	...	1.4	...	2.9	...	2.6	...
Outer band (lower limit)	...	5.0	...	4.8	...	2.2	...	1.7	... ..	0.1	...	0.4	...	1.9	...	1.6	...
IV. Indicative Target																	
7. Ceiling on general government current primary spending (excl. EU funds and social assistance,	131,938	32,000	30,670	64,000	62,578	96,350	94,133	130,700	128,317	32,000	30,921	64,800	63,968	99,000	96,595	133,700	134,330
8. Floor on operating balance (earnings before interest and tax, net of subsidies) of key SOEs (as defined in TMU (bn. lei)) 4/	-6.8	-1.7	-0.7	-2.7	-1.8	-3.6	-2.4	-3.9	-2.0	-1.5	-0.4	-2.2	1.4	-2.7	-2.3	-3.2	-2.2
9. Ceiling on stock of arrears of key SOEs (as defined in TMU (bn lei)) 4/	17.9	19.5	19.2	19.5	19.7	19.2	18.5	15.9	14.9	17.0	16.2	15.0	12.4	12.4	12.7	8.9	11.5
10. Ceiling on stock of local government arrears (bn lei)	0.91	0.95	0.82	0.90	0.81	0.85	0.82	0.80	0.75	0.70	0.82	0.50	1.17	0.75	1.32	0.30	0.84
11. Ceiling on the execution of the PNDI program (mln lei) 5/	...		...	...	...	...	...	...	...	200	66	400	67	700	67	1,000	210

1/ The end-December 2010 figure is a stock.

2/ Cumulative figure during calendar year. For March 2011 target, an adjuster for WB disbursement of 300 million euros is applied to the target of 250 million euros. 2011 September target is adjusted down from 250 million to -150 million due to the delayed disbursement of 400 million from World Bank. 2011 December target is adjusted down from 500 million to -500 million reflecting the delayed Eurobond issurance. March 2012 target is adjusted up by 533 million Euros to reflect larger than projected Eurobond placement. The June 2012 target is adjusted downward by 817 million Euros to reflect lower than projected Eurobond placement, and the target is adjusted upward by 10 million Euros to reflect higher than projected commercial bank reserve requirement held with the NBR. The September 2012 target is adjusted downward by 67 million Euros to reflect lower than projected Eurobond placement, and the target is adjusted upward by 50 million Euros to reflect higher than projected commercial bank reserve requirement held with the NBR. The December 2012 target is adjusted upward by 1,433 million Euros to reflect higher than projected Eurobond placement.

3/ Cumulative figure during calendar year (e.g. September 2011 figure is cumulative from January 1, 2011). The target for March 2011 is adjusted from -6300 to -7289 reflecting higher capital spending (6798) than defined in TMU (5740) and extra revenue. March 2012 target is adjusted by RON 1450 million to RON 4550 for capital spending. June 2012 target is adjusted by RON 769 million to 7769 million for the loan to CFR Infrastructura. The September 2012 deficit target is adjusted by RON 770 million to RON 10,470 million for the loan to CFR Infrastructura. Actual data is adjusted for PNDI (67.5 mill. RON), the loan to CFR Infratsructura (770 mill. RON) and the EU cash accrual gap (239 mill. RON) for end-September 2012. For end-December 2012, actual data includes PNDI (210 million RON) and EU cash accrual gap (2447 million RON).

4/ Adjusted indicative targets for end-September and end-December in 2011, reflecting the merger of SOEs under monitoring.

5/ Cumulative figure during calendar year (e.g. March 2012 figure is cumulative from January 1, 2012).

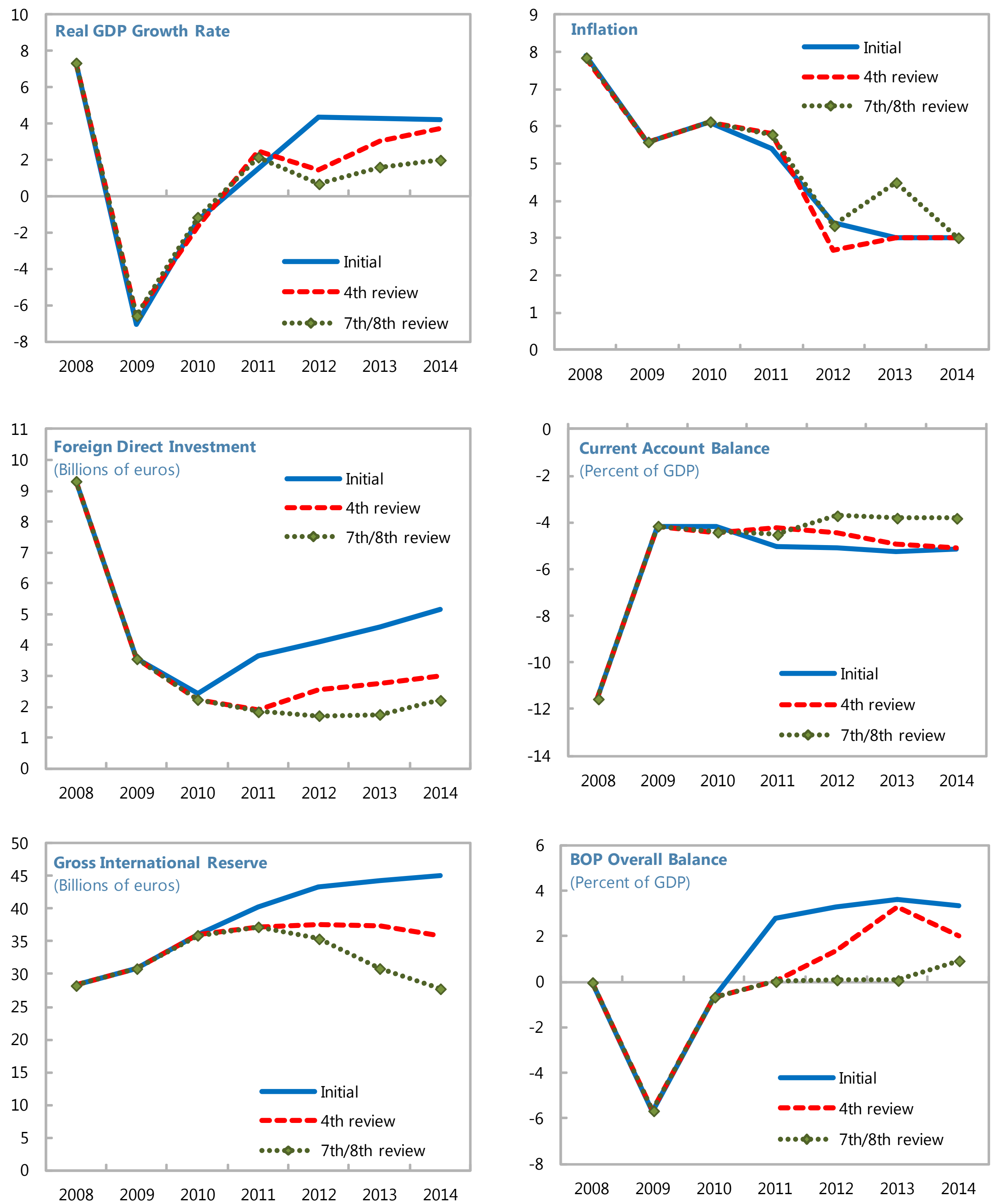
Table 3. Romania: Selected Economic Indicators, 2009-13

	2009	2010	2011		2012		2013
			Prog.	Actual	Prog.	Actual	Proj.
Output and prices			(Annual percentage change)				
Real GDP	-6.6	-1.1	1.5	2.2	4.4	0.7	3.5
Domestic demand	-13.2	-1.2	1.2	2.5	4.3	1.5	-0.6
Net exports (contribution)	7.0	0.0	0.2	-0.5	-0.1	-0.8	4.1
Consumer price index (CPI, average)	5.6	6.1	5.4	5.8	3.4	3.3	4.0
Consumer price index (CPI, end of period)	4.8	8.0	3.7	3.1	3.0	5.0	1.6
Unemployment rate (average)	6.9	7.3	6.6	7.4	5.8	7.0	7.3
Nominal wages	8.4	2.5	4.7	4.9	6.7	5.0	5.0
Saving and Investment			(In percent of GDP)				
Gross domestic investment	25.4	25.6	24.6	26.8	25.2	26.0	23.2
Gross national savings	21.2	21.2	19.5	22.3	20.1	21.6	22.1
General government finances							
Revenue	31.2	32.2	33.3	32.6	33.7	32.9	31.7
Expenditure	38.5	38.6	37.7	36.8	36.7	35.4	34.2
Fiscal balance	-7.3	-6.4	-4.4	-4.3	-3.0	-2.5	-2.5
Privatization proceeds	0.0	0.1	0.0	0.0	0.0	0.0	0.0
External financing	2.6	2.8	2.8	2.7	0.7	3.3	2.1
Domestic financing	4.6	3.6	1.6	1.5	2.3	-0.8	1.4
Structural fiscal balance 1/	-7.9	-5.9	-2.4	-3.6	-1.6	-1.9	-1.8
Gross public debt (direct debt only)	21.7	28.1	36.1	32.2	36.2	35.8	36.9
Gross public debt (including guarantees)	23.8	31.1	37.7	34.3	37.6	38.2	39.3
Money and credit			(Annual percentage change)				
Broad money (M3)	9.0	6.9	10.3	6.6	14.1	2.7	8.8
Credit to private sector	0.9	4.7	7.7	6.6	8.7	1.3	-3.3
Interest rates, eop			(In percent)				
Euribor, six-months	4.52	1.2	-	1.6	-	0.3	0.4
NBR policy rate	8.00	6.3	-	6.0	-	5.3	4.0
NBR lending rate (Lombard)	12.00	10.3	-	10.0	-	9.3	7.0
Interbank offer rate (1 week)	10.69	3.6	-	6.0	-	5.8	1.5
Balance of payments			(In percent of GDP)				
Current account balance	-4.2	-4.4	-5.0	-4.5	-5.1	-4.4	-1.1
Merchandise trade balance	-5.8	-6.1	-5.1	-5.6	-4.7	-5.6	-2.4
Capital and financial account balance	-2.5	1.0	5.3	1.6	8.4	3.2	4.5
Foreign direct investment balance	3.0	1.8	2.9	1.4	2.9	1.7	1.8
International investment position	-62.4	-62.6	-75.3	-64.2	-72.6	-68.0	-61.4
Gross official reserves	26.1	28.9	31.7	28.3	30.9	26.9	24.8
Gross external debt	68.7	74.3	78.9	75.1	75.4	75.7	67.5
Exchange rates							
Lei per euro (end of period)	4.3	4.3	-	4.3	-	4.4	4.5
Lei per euro (average)	4.2	4.2	-	4.2	-	4.5	4.4
Real effective exchange rate							
CPI based (percentage change)	-7.5	1.6	-	2.8	-	-6.1	-
GDP deflator based (percentage change)	-8.7	1.9	-	2.6	-	-5.0	5.4
Memorandum Items:							
Nominal GDP (in bn RON)	498.0	523.7	542.0	557.3	590.2	586.7	631.1

Sources: Romanian authorities and Fund staff estimates and projections.

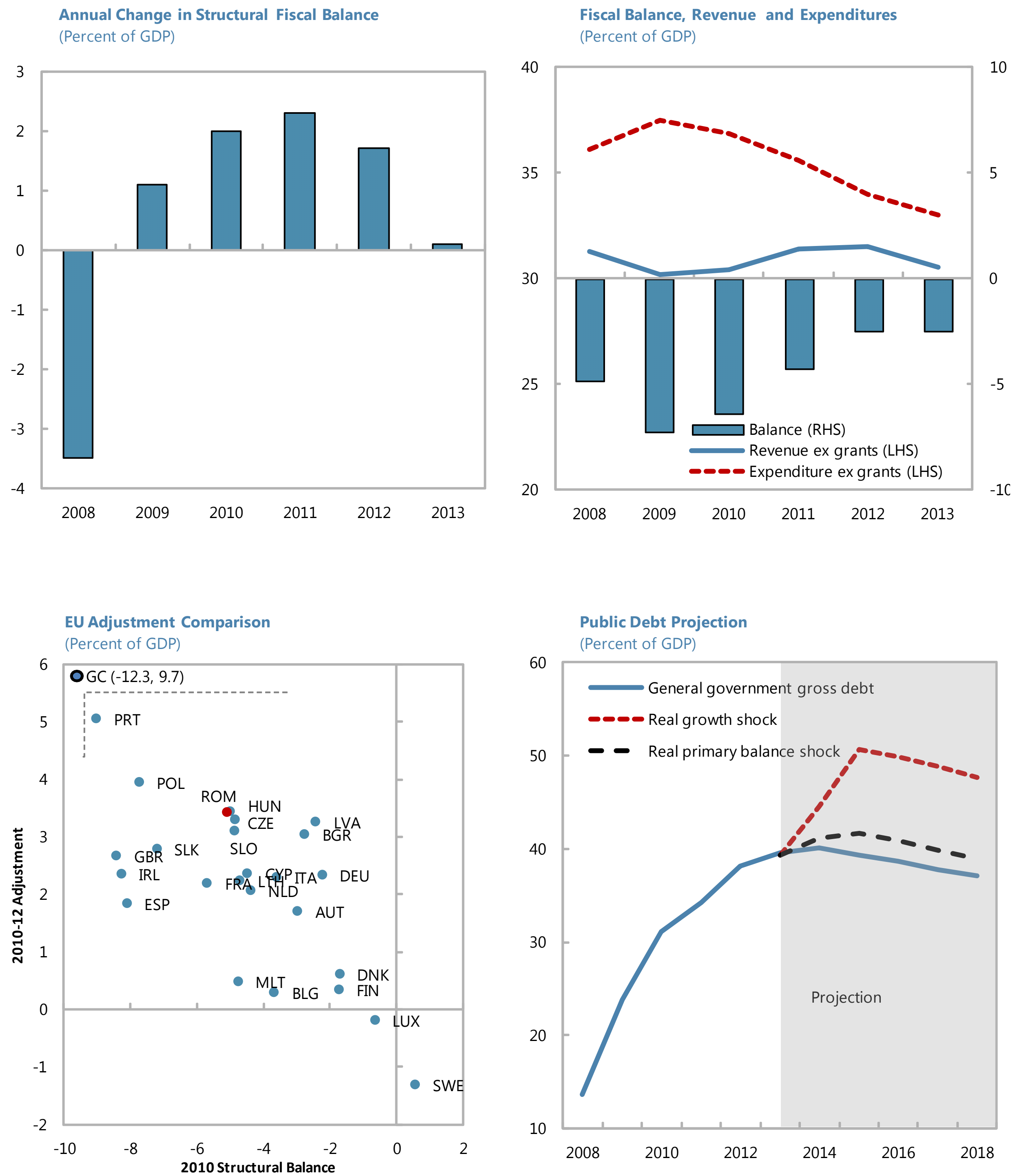
1/ Actual fiscal balance adjusted for the automatic effects of the business cycle.

Figure 1. Romania: 2011 SBA Program Projections



Sources: Romanian authorities; and IMF staff estimates.

Figure 2. Romania: Fiscal Adjustment During the Program



Source: IMF WEO, IMF Staff estimates.

Annex. Views of the Romanian Authorities[27]

The authorities agree with the main conclusions of the Ex-Post Evaluation report. They concur with the view that the program was well-conceived, and correctly focused on continuing fiscal adjustment, boosting potential growth through structural reforms, and fostering confidence, particularly providing adequate financial support and helping to strengthen financial sector stability. During discussions, the authorities emphasized that the program was successful and an important tool to signal their reform commitment and keep policy implementation on course. While fiscal adjustment was significant, they noted that structural issues remain with revenue collection, health sector efficiency, absorption of EU funds, and fiscal discipline at local government level. They agreed that progress on the structural reform agenda was uneven, and shortcomings emerged in implementing SOE reforms. They agreed that the banking resolution framework was strengthened, although risks from parent banks deleveraging and rising NPLs were not fully reflected in the initial program design.

The authorities have the following observations on specific program issues:

- *Implementation of the SOE reform agenda.* During discussions, the authorities agreed that the implementation of the SOE reform agenda, particularly privatization plans, did not meet the original program objectives. However, they noted that objectives were too ambitious and, in some cases, did not fully account for unfavorable market conditions and the difficulty of identifying qualified buyers. They noted that further progress was achieved in broadening the coverage of the SOEs' monitoring system.

- *Investment prioritization and absorption of EU funds.* The authorities noted that improving investment prioritization and increasing the absorption of EU funds proved more difficult than initially envisaged. However, they emphasized that the steps taken during the program are now yielding results, allowing a reduction in the number of investment projects and better project prioritization.

- *Parent banks deleveraging and rising non-performing loans (NPLs)*. The authorities agreed that the initial program design could have better incorporated the risk of possible parent banks deleveraging, although they noted that deleveraging has so far been broadly in line with the experience in peer countries. They also concurred that addressing the NPLs debt overhang is now a policy priority. However, they also noted that it would have been difficult to project, early in the program, the large NPL increase observed during the program.

[27] The views of the Romanian authorities on program design and outcome were sought during a visit to Bucharest on November 20-21, 2013. This Annex summarizes views heard during the visit.

- *Banking system liquidity management*. The authorities noted that during most of the program the central bank acted from a net creditor position vis-à-vis the banking system, providing liquidity via repo operations conducted in the form of full-allotment tenders. These operations were consistent with the pursuit of liquidity management adequate to: (i) the specific functioning conditions of the financial market, stemming from the temporary asymmetry of liquidity distribution across the banking system and from the influence exerted by exposure limits among credit institutions on the interbank market; (ii) the weak lending activity (reflecting both demand and supply factors) and the large persistent negative values of the current and expected output gap. At the same time, longer term rates (3 and 6 months) did not deviate substantially from the policy rate, while interest rates on new loans were broadly steady. Nevertheless, in the second half of 2012, against the background of rising volatility of capital flows, and of the exchange rate, the NBR tightened the liquidity in the banking system.

- *NFA target*. The authorities noted that the deviation from the NFA target toward the end of the program was short-lived. The deviation was mainly driven by lower than projected levels of rollover rates of private sector financing and FDI, as well as by the inability of the authorities to meet the NFA target through external issuances due to the program adjustor on the Ministry of Finance's bond issuances. However, the deviation from the NFA target was subsequently more than offset as market sentiments improved and the attractiveness of Romanian assets among international investors increased. Throughout the program, international reserves remained adequate as a ratio of short-term external liabilities, as well as in terms of the IMF reserve adequacy metrics.