INTERNATIONAL MONETARY FUND

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ROMANIA

August 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ROMANIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Romania, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its August 28, 2019 consideration of the staff report that concluded the Article IV consultation with Romania.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 28, 2019, following discussions that ended on June 7, 2019, with the officials of Romania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 23, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Romania.

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August 30, 2019

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IMF Executive Board Concludes Article IV Consultation with Romania

On August 28, 2019 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Romania.

Economic growth in Romania was strong in 2018, reflecting pro-cyclical fiscal policy and rapid wage increases. Unemployment reached record lows and financial sector is stable. Fiscal and current account deficits have been widening in the past few years, reaching respectively 2.8 and 4.5 percent of GDP in 2018. Although the National Bank of Romania's (NBR) inflation target was met in 2018, inflation is gathering pace, with headline inflation exceeding the target band since February 2019. Structural reform agenda remains stalled and investment growth lagged the broader economic activity.

Growth in 2019 is expected to stay above potential at 4 percent, led by continued fiscal stimulus and strong wage growth, and be accompanied by further widening of current account and fiscal deficits. Inflation in 2019 is expected to stay above the NBR's target band. Growth is expected to moderate to 3 percent in the medium term as the transitory effects of the fiscal stimulus fade. Lack of progress on structural reforms and subdued investment will constrain potential growth over the medium term.

With macroeconomic imbalances becoming increasingly evident, eroding buffers and undermining Romania's capacity to withstand adverse shocks, there is a risk that the income convergence with the EU could suffer a setback. The key domestic risk is an increase in vulnerability caused by policy shocks, including further fiscal stimulus or regresses on structural reforms. Externally, the key risk stems from a sharper-than-expected external slowdown, which would widen the current account deficit, magnifying financing pressures. While Romania's moderate public debt and reserves can provide a temporary cushion, these buffers can prove insufficient under an adverse event.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the strong economic growth and low unemployment, but raised concerns about widening current account and fiscal deficits and renewed inflation, as well as lagging structural reforms and investment. To address the growing imbalances, Directors called for shifting from procyclical to countercyclical fiscal policy, complemented by a tighter monetary policy stance and greater exchange rate flexibility. They further supported strengthening policy predictability and renewing structural reform initiatives to sustain convergence to average EU income levels.

Directors called for a durable fiscal consolidation to help curb the twin deficits and reduce the burden on monetary policy. They encouraged sustained fiscal reforms to achieve consolidation over the medium term and improve budget composition. Directors supported meeting this year's budget target with quality measures, including shifting expenditures away from rigid spending–such as wages and pensions–towards investment, reversing the trend of declining public investment in recent years. They cautioned that the new pension law could undermine fiscal sustainability and should be subjected to a comprehensive review, balancing social, equity and investment needs in line with available fiscal space. Directors also encouraged modernizing revenue administration by upgrading IT systems and improving compliance risk management, and improving expenditure efficiency and transparency through stronger expenditure reviews and the procurement process.

Directors supported further monetary policy tightening, given continuing inflation pressures. They encouraged further action beyond tight liquidity management to rein in inflation, which would support the credibility and independence of the central bank.

While welcoming the strong banking sector performance, Directors noted that efforts to strengthen financial stability should continue, including sustaining the good progress on implementing the 2018 FSAP recommendations. They called for measures to increase resilience to risks stemming from high bank exposure to the Romanian state and encouraged close monitoring of the new tax on bank assets due to its potential impact on monetary policy transmission and credit allocation. Directors also noted that the new AML/CFT legislation should be followed by a robust implementation.

Directors emphasized the need to re-energize the structural reform agenda to improve Romania's medium-term growth prospects. They noted that public investment should be increased by focusing on public infrastructure and achieving a more efficient absorption of EU funds. Directors called for moving ahead with the state-owned enterprise reform agenda

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

to improve the quality of public goods and services. They recommended moderating minimum wage hikes and linking changes to a set of objective criteria that reflect productivity. Directors further highlighted that Romania's fight against corruption should be renewed, noting that these reforms could alleviate constraints on growth, enhance competitiveness and facilitate investment.

Romania: Selected Economic Indicators, 2017–20

Population: 19.6 million (2018)
Quota: 1,811 million SDRs (0.4% of total)

Per capita GDP: US$12,301 (2018)
Literacy rate: 99%
People at risk of poverty: 35.7% (2017)

Key export markets: European Union (Germany, Italy, France)
Main products and exports: Machinery and transport equipment, manufactured goods

	2017	2018	2019	2020
			Proj.	
Output				
Real GDP growth (%)	7.0	4.1	4.0	3.5
Output gap (%)	1.8	2.1	2.4	2.1
Employment				
Unemployment (%)	4.9	4.2	4.3	4.6
Prices				
CPI inflation (%, period average)	1.3	4.6	4.2	3.3
General government finances (% GDP)				
Revenue	28.0	29.4	29.8	30.5
Expenditure	30.8	32.2	33.5	34.0
Fiscal balance	-2.8	-2.8	-3.7	-3.5
Primary balance	-1.7	-1.5	-2.3	-2.1
Structural fiscal balance 1/	-3.5	-3.6	-4.1	-4.0
Public debt (including guarantees)	36.9	36.7	37.4	38.6
Money and credit				
Broad money (% change)	11.5	8.8	12.0	9.0
Credit to the private sector (% change)	5.7	8.0	8.1	6.5
Policy rate (%)	1.75	2.5	…	…
Balance of payments				
Current account (% GDP)	-3.2	-4.5	-5.5	-5.2
FDI (% GDP)	-2.6	-2.5	-2.5	-2.4
Reserves (months imports)	4.9	4.3	3.9	3.7
External debt (% GDP)	49.8	48.1	47.3	46.5
Exchange rate				
REER (% change)	2.0	4.4	…	…

Sources: Romanian authorities, World Bank, Eurostat and IMF staff calculations.
1/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.

INTERNATIONAL MONETARY FUND

ROMANIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

July 23, 2019

KEY ISSUES

Background and Risks

Economic growth has remained strong, raising people's incomes towards those in advanced EU countries. However, macroeconomic imbalances have become increasingly evident: the current account and fiscal deficits have been widening and inflation pressures are building. Economic growth is expected to stay above potential in 2019 on the back of continued fiscal stimulus, but slow down over the medium term due to faltering investment and reforms. The growing imbalances are eroding policy room for maneuver and increasing the risk that the convergence with EU could suffer a setback, triggered by domestic policy excesses or swings in global investor sentiment.

Policy Recommendations

- **Fiscal Policy.** Take advantage of strong growth and start durable fiscal consolidation underpinned by high-quality measures to rein in the twin deficits and improve the macroeconomic policy mix. The more fiscal policy tightens, the less monetary tightening is needed. Modernize revenue administration and improve expenditure efficiency. Reassess the new pension law to balance social needs and fiscal sustainability.

- **Monetary Policy.** Tighten the policy stance to address inflation pressures and anchor inflation expectations, while allowing for greater exchange rate flexibility to absorb external shocks. Uphold the independence of the central bank.

- **Financial Sector.** Maintain prudent financial regulation to safeguard the banking sector's resilience. Reassess the new bank tax and interbank transactions-based reference rate in light of their potential to distort the market and adversely affect financial development and stability.

- **Structural Reforms.** Strengthen public investment management institutions and governance of state-owned enterprises (SOEs) to better absorb EU funds and provide high-quality infrastructure. Set wage policies in line with productivity gains. Renew the fight against corruption.

Approved By
Jörg Decressin and Kevin Fletcher

Discussions were held in Bucharest during May 27-June 7, 2019. The staff team was led by J. Lee and comprised R. Bems, O. Luca, S.G. Toh (EUR), D. Ostojic (SPR), A. Hajdenberg (Resident Representative), and G. Babici (local economist). The mission met with Prime Minister Dăncilă, Minister of Public Finance Teodorovici, Governor Isărescu, members of Parliament, other senior officials, representatives of political parties, labor and business organizations, civil society, and financial institutions.

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CONTEXT

1. **Expansionary policies have accelerated real income growth but also expanded macroeconomic imbalances** (Figure 1). Economic policies turned expansionary in 2016, adding procyclical stimulus to an economy that was already expanding at a brisk pace. As a result, Romania's per capita GDP growth has been one of the fastest amongst new EU member states (NMS) since 2016, accompanied by strong employment. In parallel, the twin deficits deepened: the fiscal deficit approached 3 percent of GDP and the current account deficit reached 4.5 percent of GDP in 2018. The external deficit was propelled by strong consumption and eroding competitiveness on the import side, while the global slowdown in 2018 weighed down on exports. Deepening imbalances and vulnerability pushed up spreads, which rose by 40 bps over April 2018-June 2019. Imbalances deepened also in the composition of spending, as the shares of investment in government and aggregate spending fell to multi-decade lows, to the detriment of sustainable long-term growth.

2. **Political developments can add to vulnerability in the coming years.** Back-to-back election years will likely weaken the political incentive for fiscal moderation or the structural and governance reforms that the Fund has been advocating (Annex IV).[1] Already, the 2019 budget was delayed till March, coming in more expansionary than initially proposed. Since June, the results of the recent European Parliament (EP) election and the anti-corruption referendum seem to have halted the political momentum for further changes to the justice laws and criminal codes, which would reduce the tension with the EC and help improve market sentiment.[2] The ensuing political realignments, however, will likely have limited impacts on economic policies, as the national election cycle is coming in sight. The busy election cycle could also add to the unpredictability of policy announcements, a key source of business and market uncertainty in recent years.

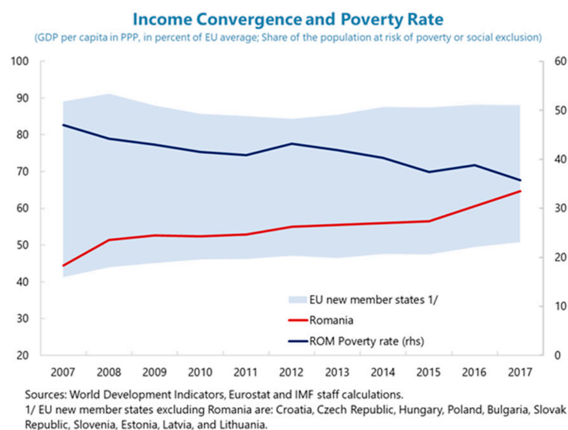
3. **The focus of discussions was on actions required to curb the widening imbalances and to re-orient the economy towards investment and sustainable income convergence.** Durable fiscal consolidation and a shift in the expenditure composition towards investment would help reduce the growing imbalances and improve the fiscal-monetary policy mix. Further monetary tightening is needed to address rising inflation pressures. Greater exchange rate flexibility would help preserve buffers and absorb external shocks. These policies should be complemented by further progress on structural reforms and a more predictable policy environment.

[1] Three elections are coming: in 2019, presidential (end-year); and in 2020, local government (mid-year) and parliamentary (end-year).

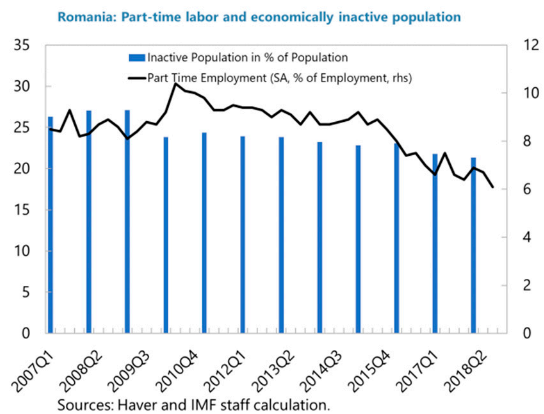
[2] The recent overhaul of the judicial system laws and initiatives to amend the criminal codes were reflected in a cautionary Cooperation and Verification Mechanism report by the EC in November 2018. According to the report, key problematic provisions of the new judicial system laws included the establishment of a special prosecution section for investigating offences committed by magistrates, new provisions on material liability of magistrates for their decisions, and a new early retirement scheme. The report also noted that proposed amendments of the criminal codes would entail profound changes in the procedural aspects of the criminal investigations and trial, and also reduce the scope of corruption as an offense.

Figure 1. Romania: Consumption-Led Growth and Imbalances

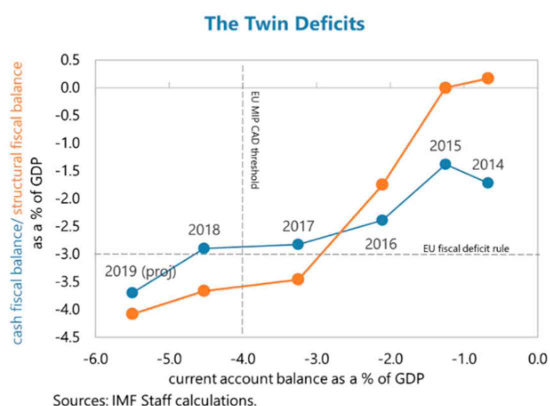
Romania's income has risen faster towards average EU income levels …



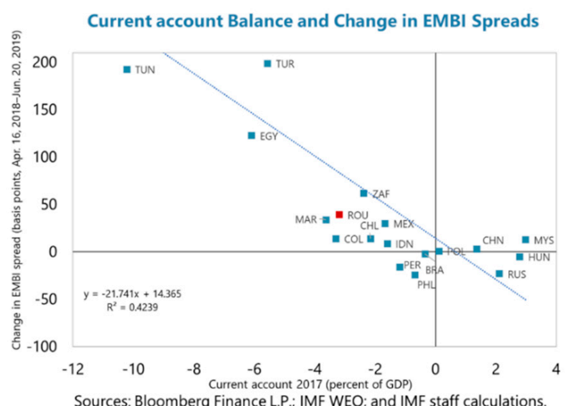
…which has partly helped reduce inactive population and raised permanent employment.



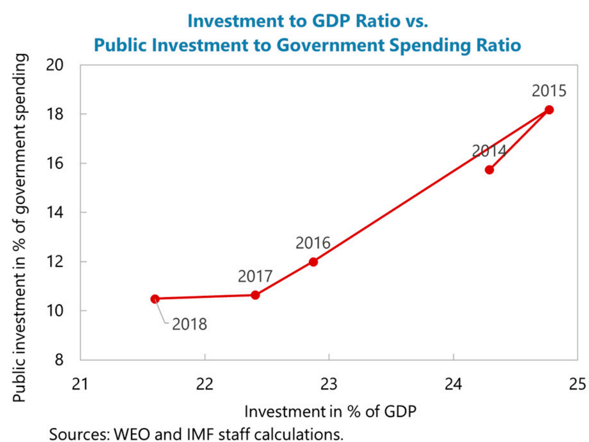
However, macroeconomic imbalances have expanded …



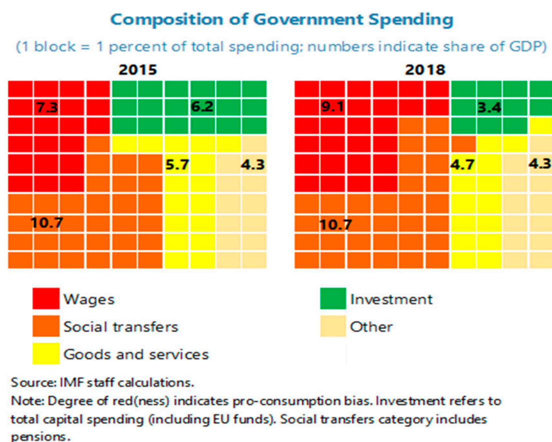
…pushing up sovereign spreads….



…and investment shares have fallen sharply.

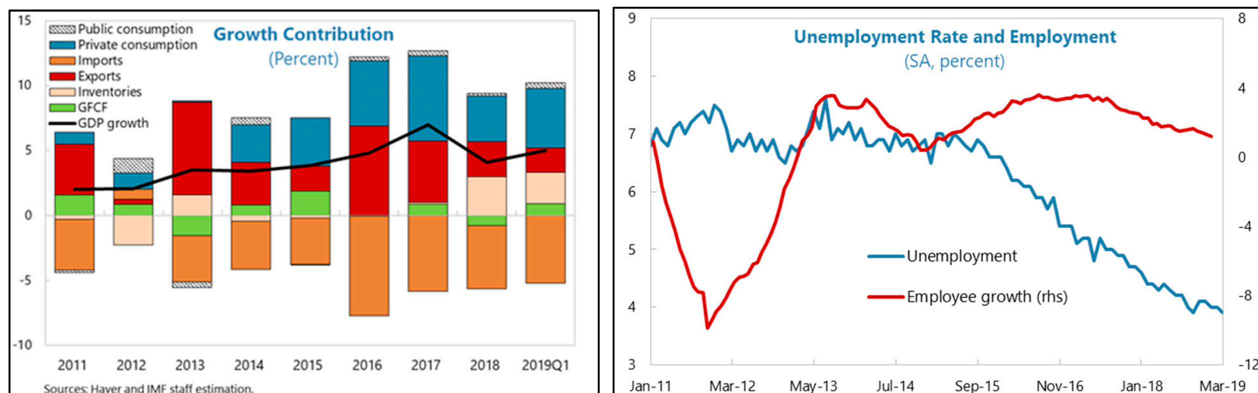


Beyond the headline deficit, substantial pro-consumption bias in budget composition since 2015.

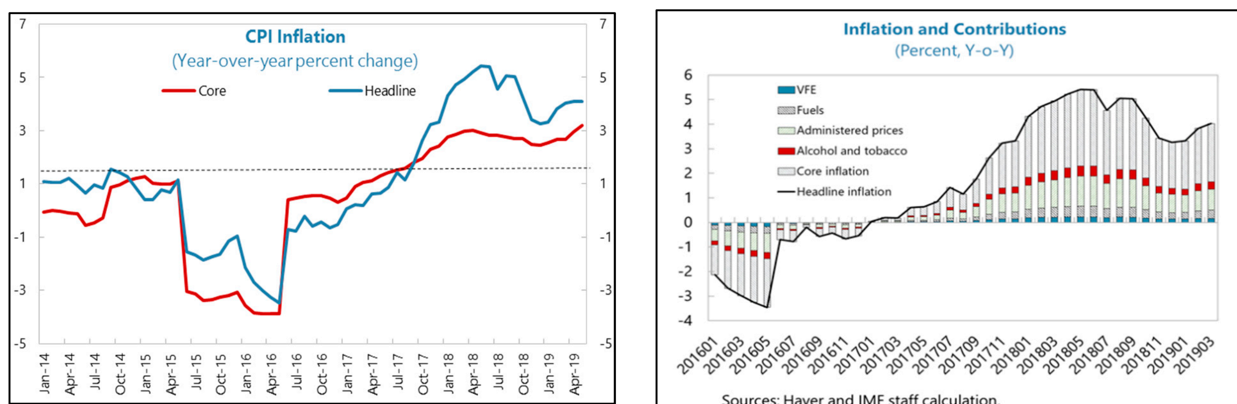


RECENT ECONOMIC DEVELOPMENTS

4. Growth remains strong. Albeit lower than the 7 percent recorded in 2017, GDP growth reached 4.1 percent in 2018 and accelerated to 5 percent year-on-year (y/y) in Q1 2019, led by consumption and inventory accumulation.[3] The output gap remained substantially positive in 2018, as policy-driven strong domestic demand more than offset the decline in net exports and in gross fixed capital formation. Labor market remains tight and wage growth has been strong, with net wages rising by 16 percent y/y in January–April 2019.



5. Inflation is rising again after a lull in late 2018. Headline inflation came within the target band (2.5 ± 1 percent) by end-2018. Since the beginning of 2019, however, elevated domestic demand and currency depreciation, combined with sectoral pricing disruptions associated with the General Emergency Ordinance 114/2018 (GEO 114, paragraph 10 and Annex I) have significantly increased inflation pressures and kept headline inflation above the target band since February. Core inflation has also edged up and exceeded 3 percent since April.

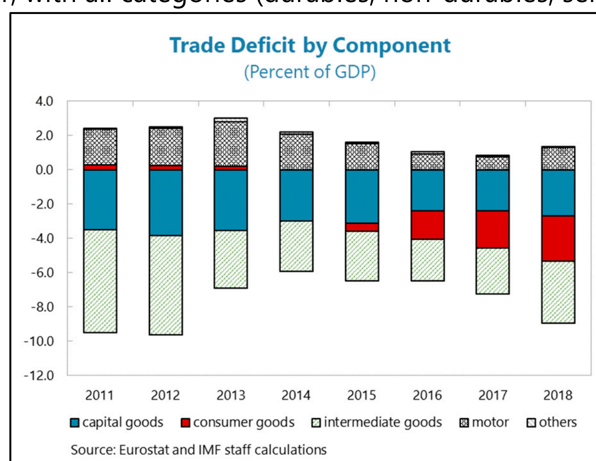


6. The 2018 headline fiscal deficit remained below 3 percent of GDP, albeit relying on late-year measures. The headline cash deficit recorded 2.8 percent of GDP, while having further

[3] Large inventory contribution and a sizable discrepancy term, adding about 2.5 percent of GDP in 2018 and continuing into Q1 2019, raise statistical issues (discussed in Statistical Annex) and increase uncertainty about the pace of GDP growth.

widened in cyclically-adjusted terms to 3.5 percent of GDP. The deficit was contained by low-quality or one-off measures at year-end, amounting to 0.6 percent of GDP, including utilization of EU funds to retrospectively finance domestic investment projects and extraordinary SOE dividends. The 2018 accrual-based deficit was calculated by the authorities at 3.0 percent of GDP, which is the EU's Excessive Deficit Procedure ceiling.[4] The expenditure composition further deteriorated, with a rising share of rigid spending (wages and social assistance) relative to tax revenue and a falling share of investment in government spending.

7. **The current account deficit has expanded, on the back of strong import growth.** The current account deficit rose to 4.5 percent of GDP in 2018, the highest ratio in the EU. The key driver was the continued deterioration of merchandise trade balance on the back of import-intensive growth and slower growth of exports of goods and services (Box 1). These reflected eroding competitiveness of Romanian producers in domestic and export markets as well as the euro area slowdown. A surge in the trade deficit for consumer goods—as opposed to capital goods or intermediate inputs—was the chief contributor, with all categories (durables, non-durables, semi-durables and food) exhibiting deteriorating balances. Reflecting the fiscal deficit and rapid wage increase in recent years, the savings-investment balance turned negative for both government and private sectors. Capital account inflows remained at around 1.2 percent of GDP in 2018, reflecting still low absorption of EU funds. Net FDI (mostly reinvested earnings) was around 2.4 percent of GDP during 2018, financing about a half of the current account deficit.

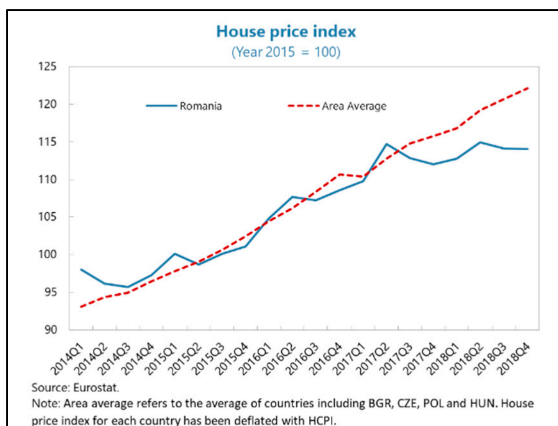


8. **Staff's external sector assessment suggests that Romania's external position in 2018 was weaker than implied by underlying fundamentals and desirable policies** (Annex VI). The EBA-lite models imply a current account gap in the range of -1.5 to -3.5 percent of GDP, subject to substantial model and statistical uncertainty. The current account gap is partly attributed to identified policy gaps and partly to structural policies and distortions that are not captured by the model. Reserve coverage remains broadly adequate.

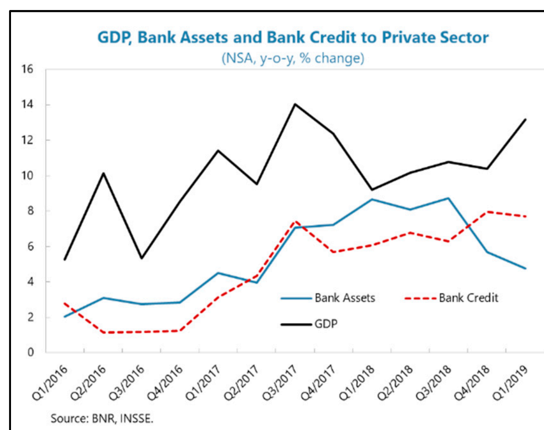
9. **Growth of bank credit has strengthened but continues to lag the broader expansion in economic activity.** The robust labor market and the government's Prima Casa guarantee program helped sustain growth in household loans, supporting higher bank profitability. However, bank credit growth rates have remained below those of GDP. The stock of bank credit to the private sector, at 26 percent of GDP, remains one of the lowest in the region. House prices are growing at a more subdued rate than in comparator countries. The share of FX credit (currently at 34 percent) has

[4] This estimate, provisionally cleared by the EC, will be finalized later in the year.

been on a prolonged decline. The NPL ratio fell to 5 percent at end-2018 (relative to 22 percent in 2013) and is now close to the EU average (3.2 percent).



Source: Eurostat.
Note: Area average refers to the average of countries including BGR, CZE, POL and HUN. House price index for each country has been deflated with HCPI.



Source: BNR, INSSE.

10. The surprise adoption of GEO 114 in December 2018 brought about significant economic dislocations. The ordinance contained sizable and distortionary sectoral measures and tax changes, which triggered a strong response from the affected parties and a negative market reaction, including a depreciation of the leu and a sharp correction in the stock market (Annexes I and II). The ordinance has since been revised, reducing the economic impact of some of the initial sectoral measures. Nevertheless, there remain measures that can be expected to hinder domestic financial market development and critically needed investment, ultimately limiting potential growth.

OUTLOOK AND RISKS

11. Growth is projected to remain at around 4 percent in 2019 and to slow to 3 percent over the medium term. Economic activity would continue to be led by consumption, accompanied by elevated inflation and a current account deficit exceeding 5 percent of GDP in 2019-2020. Growth is projected to decline as productive investment has weakened amid regresses on structural reforms, while the fiscal impulse fades over time. Demographic trends, including emigration, weigh on long-term growth prospects as well.[5] Without policy corrections, vulnerability will keep rising, with the twin deficits staying elevated and risks for a sudden correction in activity. However, the medium-term projections currently assume that fiscal stimulus will be limited after the elections in 2019–2020, while weakening growth will somewhat rein in external deficits.

Romania: Macroeconomic Outlook
(Percent)

	2015	2016	2017	2018	2019	2020
Real GDP (yoy)	3.9	4.8	7.0	4.1	4.0	3.5
Output gap	-2.5	-1.3	1.8	2.1	2.4	2.1
CPI inflation (yoy, eop)	-0.9	-0.5	3.3	3.3	4.5	3.5
Unemployment rate (average)	6.8	5.9	4.9	4.2	4.3	4.6
(In Percent of GDP)						
Current account balance	-1.2	-2.1	-3.2	-4.5	-5.5	-5.2
Fiscal balance (cash)	-1.4	-2.4	-2.8	-2.8	-3.7	-3.5
Gross general government debt (direct debt only)	37.1	36.6	34.8	34.8	35.6	36.9
Gross external debt	57.4	54.5	49.8	48.1	47.3	46.5

Sources: Eurostat; Romanian authorities; IMF staff projections.

[5] IMF Departmental Paper 19/12 "Demographic Headwinds in Central and Eastern Europe."

12. Risks are tilted to the downside and sizable. The key domestic risk is a further increase in vulnerability caused by policy shocks (Annexes II and III). Given the electoral cycle over the next two years, there are risks of further fiscal stimulus or backtracking on structural policies that could further reduce Romania's competitiveness. Currently, the new pension law poses a significant (medium-term) risk to fiscal sustainability (paragraph 17 and Annex V). The key external downside risk is a sharper-than-expected external slowdown, which would further deteriorate an already large current account deficit and magnify financing pressures. A sharp tightening in global financial conditions could lead to capital outflows and higher borrowing costs in Romania, especially if matched with domestic policy shocks. Romania's reserves and moderate government debt could provide a temporary cushion, but these buffers could prove insufficient under an adverse event as the imbalances continue to grow.

Authorities' Views

13. The authorities had a more optimistic outlook. They project GDP growth to be stronger this year at 5.5 percent and exceed 5 percent in the medium term, consistent with Romania's history of high growth and their higher estimates of potential growth. They highlighted the measures implemented under GEO 114 that aimed to alleviate construction workforce shortages (Annex I) and thus stimulate the construction sector, which in the past had been a bottleneck to raising fixed investment. While concurring that rebuilding buffers was useful, the authorities expected a mild impact of an external downturn on the economy, including from the eurozone. Romania's exports had a niche in value-driven product segments notably in automotive, IT services and agribusiness sectors. The authorities reaffirmed commitment to the EU fiscal framework and to ensuring the consistency between their policy objectives and sound public finances. They pointed to several revisions of the GEO 114 that reflected business concerns. On the external sector assessment, the authorities expressed reservations about the EBA-lite model's fit, noting that the EBA-lite CA model likely underestimated the contribution of cyclical and structural factors to the current account deficit in 2018. Moreover, central bank's analysis suggested that the leu was broadly in line with fundamentals.

POLICY DISCUSSIONS

Rising vulnerability calls for a balanced macroeconomic policy mix built on durable fiscal consolidation. High-quality fiscal consolidation would reduce the burden on monetary policy for macroeconomic stabilization, mitigate external pressure by containing the current account deterioration, and bolster growth potential by improving the balance between consumption and investment (CR/18/148 Box 3). Greater exchange rate flexibility combined with a tighter monetary policy stance is also critical for absorbing shocks amid the weak external outlook, while reining in inflation pressure. Structural and governance reforms should be resumed in order to boost Romania's growth potential.

A. Lower Fiscal Deficit, Better Budget Composition, and Quality Measures

14. The 2019 budget targets a deficit of 2.8 percent of GDP, but staff projects the outturn at 3.7 percent of GDP without additional measures. Continuing the trend since 2016, the 2019 budget increases public wages and pensions significantly, matched with strong revenue growth for value-added tax and social security contributions. The budget also includes tax exemptions to the construction sector, partly offset by revenues from new taxes on the energy and telecom sectors (Annex I). Staff views revenues overestimated by about 0.9 percent of GDP, due to optimistic assumptions on improvement in tax collection and growth in the private sector wage bill. Relative to the 2018 outcome (deficit of 2.8 percent of GDP), staff's baseline for 2019 projects an increase in fiscal deficit by 0.9 percent of GDP, which would amount to a significant positive fiscal impulse for an economy operating above potential.

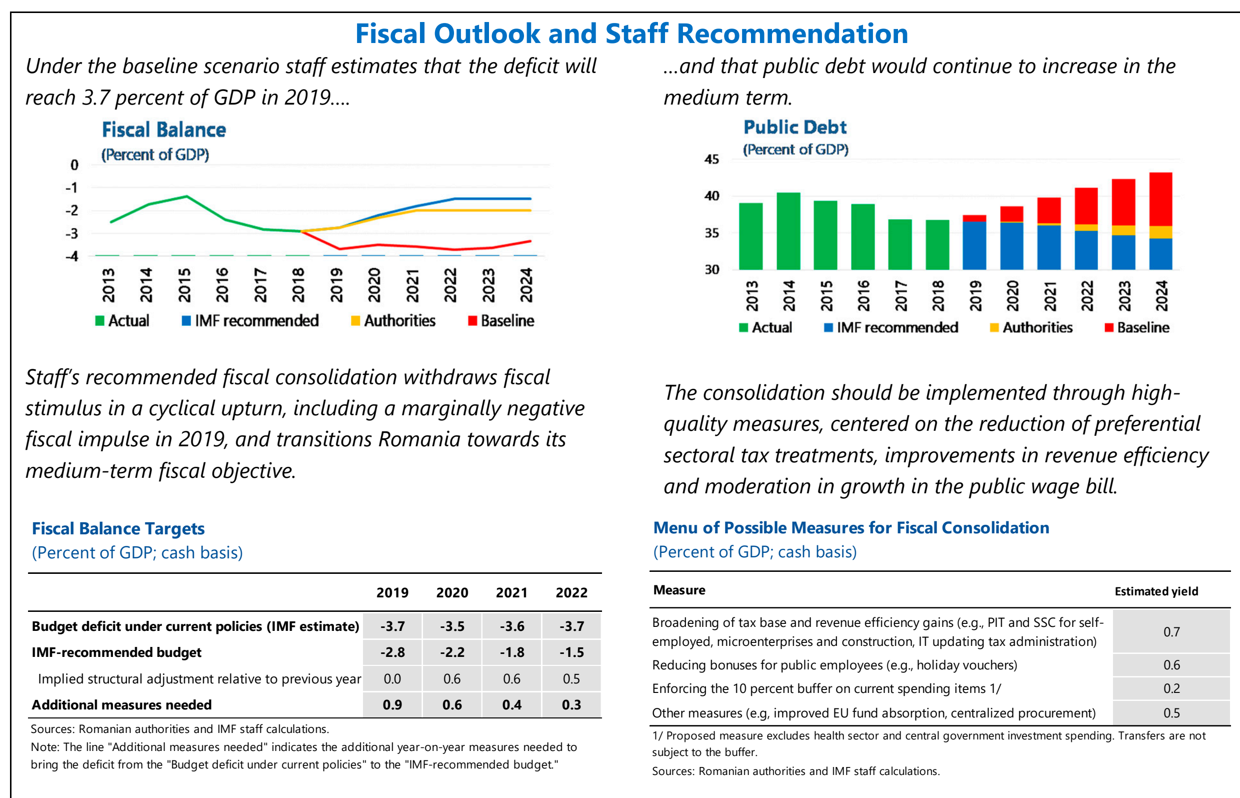
15. Given the cyclical strength and rising vulnerabilities, durable fiscal consolidation supported by quality measures is necessary. Achieving the authorities' target deficit of 2.8 percent of GDP in 2019 would be a start, entailing a marginally negative fiscal impulse relative to 2018, which would help curb the twin deficits and improve the macroeconomic policy mix. This should be combined with a credible commitment to reduce the deficit further to 1.5 percent of GDP by 2022, transitioning toward Romania's medium-term objective (MTO) of 1 percent of GDP. By staff estimate (paragraph 14), quality measures equivalent to about 1 percent of GDP are needed to achieve the 2019 deficit target. Drawing on a list of quality measures, the consolidation in 2019 and the future should aim at protecting the revenue envelope while shielding the poor and vulnerable groups and improving the budget structure by moderating growth in wages and pensions (see the table on targets and measures). The consolidation would strengthen confidence in the budget framework and help build fiscal buffers.

16. Re-energizing fiscal reforms would help facilitate and sustain fiscal consolidation over the medium term. There is significant scope to strengthen both revenue and expenditure efficiency.

- **Revenues.** Tax efficiency in Romania is among the lowest in the EU, with sizable potential revenue gains from closing efficiency gaps relative to regional peers (estimated at 2½ percent of GDP, CR/18/149). Strengthening the revenue administration (ANAF) is urgent, including by modernizing the IT infrastructure, adopting modern compliance risk management systems and improving the administration of large tax payer office. ANAF should move towards a more transparent and service-oriented model of revenue administration and improve its organizational structure to facilitate the implementation of recommended reforms. Envisaged restructuring plans, including reorganization and the split of customs and tax administration, should guard against disrupting revenue collections. Given numerous changes in the tax code in recent years, a comprehensive review of the tax system to identify distortions and areas for revenue gains is also recommended.

- **Expenditures**. Bolstering expenditure efficiency and transparency (CR/18/148) will help manage spending better and reduce corruption vulnerability. Rebalancing the budget structure to reduce the share of rigid spending—the wage bill and pensions—would

increase the flexibility while making room for investment. Improvements can also be achieved by strengthening expenditure reviews and the procurement process.



Fiscal Balance Targets
(Percent of GDP; cash basis)

	2019	2020	2021	2022
Budget deficit under current policies (IMF estimate)	-3.7	-3.5	-3.6	-3.7
IMF-recommended budget	-2.8	-2.2	-1.8	-1.5
Implied structural adjustment relative to previous year	0.0	0.6	0.6	0.5
Additional measures needed	0.9	0.6	0.4	0.3

Sources: Romanian authorities and IMF staff calculations.
Note: The line "Additional measures needed" indicates the additional year-on-year measures needed to bring the deficit from the "Budget deficit under current policies" to the "IMF-recommended budget."

Menu of Possible Measures for Fiscal Consolidation
(Percent of GDP; cash basis)

Measure	Estimated yield
Broadening of tax base and revenue efficiency gains (e.g., PIT and SSC for self-employed, microenterprises and construction, IT updating tax administration)	0.7
Reducing bonuses for public employees (e.g., holiday vouchers)	0.6
Enforcing the 10 percent buffer on current spending items 1/	0.2
Other measures (e.g, improved EU fund absorption, centralized procurement)	0.5

1/ Proposed measure excludes health sector and central government investment spending. Transfers are not subject to the buffer.
Sources: Romanian authorities and IMF staff calculations.

17. **The new pension law calls for a reassessment**. The parliament passed in June 2019 a new pension law, which entails doubling pillar I pension benefits by 2022. Implemented as is (with no offsetting measures), the new law would increase pension spending in several steps and add 3.2 percent of GDP to the total government expenditure in 2022 (text table). Debt sustainability analysis (DSA) shows that this could increase public debt in the medium term by 20 percentage points of GDP and nearly double gross financing needs to 14.4 percent of GDP by 2024 (Annex V and Box 2). Higher pension spending would further worsen the budget structure and constrain resources available for public investment and other social spending. It is critical to reconsider the pace of implementation of the law (in accordance with the clause subjecting the benefit increases to fiscal space) and conduct a comprehensive review of the pension system, which had the last major reform in 2010. Such a review should reflect available fiscal space and reassess the balance among social needs, equitable distribution and competing budgetary priorities (including the spending on youth, current workers, and future productive investment). Based on the staff's baseline scenario, Romania is assessed to have fiscal space at risk[6], while demographic challenges add to the need to build long-term fiscal buffers.

[6] The key drivers of this assessment are (i) the concern over the continued increase in public debt levels in the medium term in the staff's baseline projection scenario and (ii) Romania's persistently elevated sovereign interest rate spreads relative to regional peers.

Fiscal Impact of the New Pension Law	2020	2021	2022	2023	2024
Change in pension point value	40%	24%	7%	7%	8%
Spending on pensions (percent of GDP)					
New Pension Law	8.0	10.0	11.0	11.1	11.3
Baseline	7.3	7.6	7.8	7.9	7.9
Difference (percent of GDP)	**0.7**	**2.4**	**3.2**	**3.3**	**3.3**

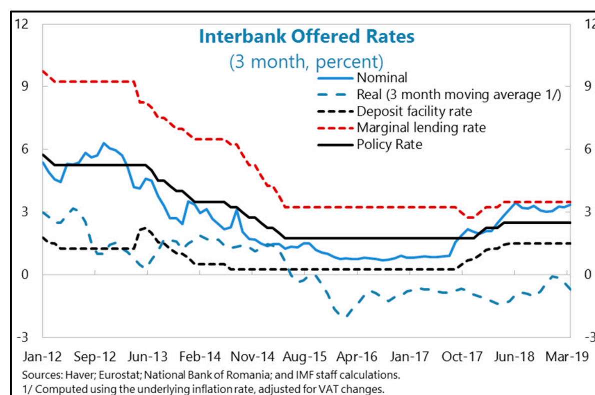
18. Greater medium-term orientation of policies would increase predictability and generate positive dividends for the economy. Regarding fiscal policies, the credibility of Romania's medium-term objectives would be enhanced by greater predictability. In recent years, the fiscal deficit target has been met by deploying ad-hoc measures that undermined the predictability of fiscal policy. Initiatives for tax amnesty and tax debt restructuring can damage taxpayers' discipline. They should only be considered as part of a comprehensive and carefully calibrated strategy to strengthen enforcement. Going beyond fiscal issues, adequate impact assessment, prior consultations with stakeholders and a more measured implementation would strengthen the predictability and effectiveness of economic policies.

Authorities' Views

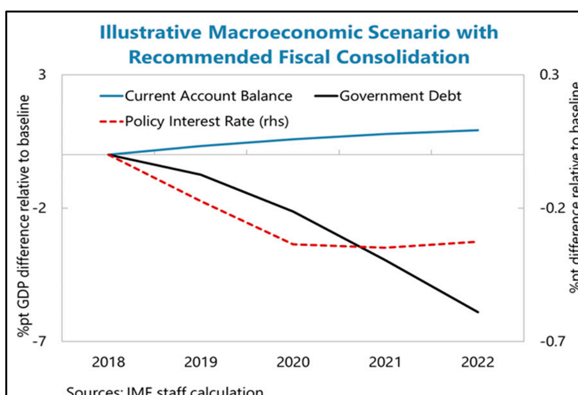
19. The authorities emphasized their commitment to the 2.8 percent-of-GDP fiscal deficit target set in the 2019 budget law. While acknowledging slightly underperforming fiscal outturns for the first trimester of 2019, they attributed it to temporary factors and expressed confidence in stronger revenue collections for the rest of 2019. Available buffers will be used according to the public finance law, if fiscal outturns continue to underperform. Agreeing on the urgency of improving revenue collection, the authorities noted that the newly appointed ANAF head would implement sweeping ANAF reforms, which could include IMF TA. Acknowledging that the new pension law poses risks to public finances, they stated that its implementation should go hand in hand with strong fiscal-structural reforms to stay within available fiscal space.

B. Tighter Monetary Stance and More Flexible Exchange Rate

20. Monetary policy needs further tightening. Inflation pressure is expected to remain elevated, in light of the still sizable positive output gap, strong wage increases, fiscal stimulus, and nominal exchange rate depreciation thus far. Staff projects inflation to stay above the NBR's inflation target band by end-2019 and return to the target band in 2020, assuming significant monetary



Sources: Haver; Eurostat; National Bank of Romania; and IMF staff calculations.
1/ Computed using the underlying inflation rate, adjusted for VAT changes.



Sources: IMF staff calculation.

tightening (involving policy rate hikes) in the near term. Fiscal consolidation would reduce the size of needed tightening (CR/18/148 Box 3). Tight liquidity management, which complemented policy rate hikes in 2018, would continue to help monetary management and mitigate FX pressures. In light of the weakening external position, greater exchange rate flexibility and limited interventions to smooth excessive volatility of the leu would help preserve buffers and absorb shocks.

21. **The independence and credibility of the central bank is an important asset for policy makers.** Monetary policy credibility, through well-anchored inflation expectations, provides a valuable buffer for emerging markets, increases resilience to external shocks, and reduces exchange rate pass-through to domestic prices (Fall 2018 WEO). The Consumer Credit Reference Index (IRCC), the new benchmark reference rate based on interbank transactions that was introduced in March (GEO 19), has several shortcomings that can weaken monetary policy transmission and its suitability for pricing household loans. These include its backward-looking calculation, high volatility (driven by liquidity), and potential confusion arising from the parallel use of IRCC for new loans and ROBOR for existing loans.

Authorities' Views

22. **The authorities agreed on the desirable direction of policy adjustments.** The NBR stressed its commitment to rein in inflation and continue strict liquidity management. They shared concerns about the growing external imbalance, including limited prospects for FDI needed to finance it. They agreed with the need for a somewhat greater exchange rate flexibility and underscored the need to balance the trade-off between greater exchange rate flexibility and financial sector stability. The IRCC, noted the NBR, will likely complicate the conduct of monetary policy, although it is too early to assess the full consequence. They likened the introduction of IRCC to the international efforts to replace LIBOR-based mechanisms to address their flaws.

C. More Resilient Financial Sector

23. **Banking sector performance is strong, while facing the new bank tax.** After several profitable years, banks have strong capital and liquidity positions, and non-performing loans have approached the EU average level. The banking system is overall stable, but the tax on bank assets (Annex I) creates some uncertainty. The tax could negatively affect the cost of bank credit to the private sector, and linking the tax to performance targets could lead to distortions in the allocation of credit and resources. The policy uncertainty surrounding implementation of the tax as well as the recently introduced IRCC could hinder financial sector development.

24. **Good progress has been made to improve resilience, consistent with the 2018 FSAP recommendations.** A majority of FSAP recommendations, including debt-service-to-income ratios and currency-differentiated liquidity requirements, have been fully or partially implemented (Annex VII). Areas that lack progress include the scaling back of the Prima Casa program, for which an expansion was recently announced.

25. **Additional progress in some areas, in line with FSAP recommendations, would further support financial stability.** One such area is the introduction of a carefully calibrated systemic risk buffer, which would increase the banking sector's resilience under a high sovereign exposure. While

the exposure of banks to the Romanian state approached 20 percent of assets in 2018, one of the highest in the EU, the exemption of government bond holdings from the new bank tax could incentivize banks to further increase the exposure. The authorities are also encouraged to continue strengthening the AML/CFT framework in compliance with the FATF standards (e.g., comprehensive assessment of ML/TF risks, customer due diligence requirements for politically exposed persons, enhancing entity transparency) and the asset declaration framework for senior officials.

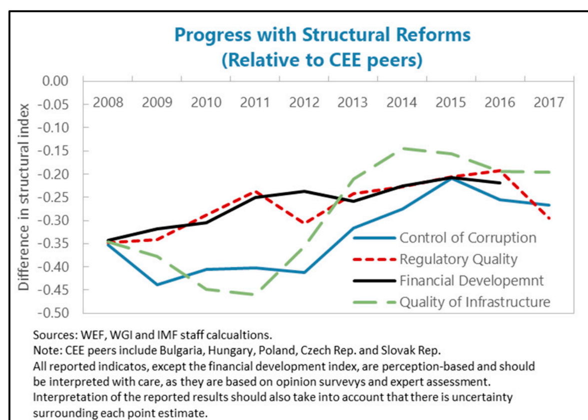
Authorities' Views

26. The authorities broadly agreed with the staff's financial sector assessment. The NBR stressed the good progress made on many FSAP recommendations (Annex VII). They shared staff's concerns over the sovereign-bank nexus and have been discussing internally an introduction of a systemic risk buffer. The authorities are strengthening the AML/CFT framework and have enacted a new law in July 2019.

D. Reforms to Stimulate Investment and Growth

27. Progress with the structural reform agenda has stalled or been reversed in some cases. Consequently, gaps in Romania's structural performance indicators relative to regional peers appear to have stopped narrowing since 2015 or so, particularly in the quality of infrastructure and control of corruption. The decline in the share of public investment in government spending over the recent years has been a contributing factor to the lack of progress in narrowing infrastructure gaps (relative to peers, especially in transport and utilities sectors). These structural gaps negatively affect Romania's competitiveness, FDI and growth potential.

Progress with Structural Reforms
(Relative to CEE peers)



Sources: WEF, WGI and IMF staff calcualtions.
Note: CEE peers include Bulgaria, Hungary, Poland, Czech Rep. and Slovak Rep.
All reported indicatos, except the financial development index, are perception-based and should be interpreted with care, as they are based on opinion survevys and expert assessment. Interpretation of the reported results should also take into account that there is uncertainty surrounding each point estimate.

28. Structural reform initiatives require a re-start. The aim should be to remove the most binding constraints to investment and long-term growth prospects.

- **Infrastructure.** With the quality of Romania's infrastructure remaining below its regional peers, strengthening the public investment management institutions is a priority. Effective absorption of EU funds will improve infrastructure quality with growth dividends (CR/17/134). Private-public partnerships (PPPs) should be accompanied by careful value-for-money analysis and strengthened administrative capacity for evaluating fiscal risks. Moreover, the desirability of PPPs should be assessed relative to other funding arrangements, such as EU funds. There should be a renewed focus on strengthening the governance of SOEs to raise the quality of public goods and services, which would benefit Romania's competitiveness.

- **Governance and anti-corruption.** Effective and sound institutions are critical for inclusive and sustained growth. Reducing corruption would help improve government revenue, enhance spending efficiency, and strengthen competitiveness. Strong governance has also been found to help reduce emigration, especially of the high-skilled (SDN/16/07). Whereas Romania's past progress in the fight against corruption was recognized internationally, recent amendments to the justice laws and initiatives to amend the criminal codes have been criticized as potentially weakening Romania's capacity to fight corruption. Unabated anti-corruption efforts need to resume.

- **Minimum wages and labor market.** Continued wage growth exceeding productivity bodes ill for competitiveness, and minimum wage hikes could decrease labor market flexibility. The minimum wage in Romania has tripled over the last 7 years to more than 40 percent of the average wage. It should be set by a transparent and objective mechanism that reflects gains in labor productivity (SM/16/94).

Authorities' Views

29. The authorities and staff agreed on the eventual goals. The authorities agreed that improving Romania's infrastructure remains a key priority and acknowledged bottlenecks in implementation, including the capacity of the construction sector. They argued that the construction activity was stimulated by GEO 114 and that PPPs provided an alternative funding means for bridging the infrastructure gaps. The authorities noted that the minimum wage determination, as guided by the governing program, takes productivity into account in a discretionary manner, and did not commit to a more systematic mechanism for linking the minimum wage to productivity developments. The sovereign wealth fund was no longer being pursued, eliminating a source of uncertainty on the governance of SOEs. The authorities indicated that the government will not pursue further initiatives related to the judicial system and will continue efforts to exit the EU's Cooperation and Verification Mechanism.

STAFF APPRAISAL

30. Romania is among the fastest growing countries in the EU, but imbalances have widened. Strong growth performance in recent years has supported convergence toward average EU income levels. However, its sustainability is increasingly at risk, as the twin deficits (current account and fiscal deficits) and inflationary pressures grow and room for macroeconomic policy maneuver is being eroded. Romania's external position in 2018 was assessed to be weaker than implied by underlying fundamentals and desirable policies. The consumption-led boom, fueled by rapidly increasing wages, continued in the first quarter of 2019 and was accompanied by a further deterioration in the trade balance.

31. A correction in the course of policies is needed to sustain convergence and reduce the likelihood of a setback. A durable fiscal consolidation—toward the authorities' medium-term objectives—would help improve the fiscal-monetary policy mix by alleviating domestic inflation pressures and reducing the extent of required monetary tightening. While consolidating the deficit, there is still room with revenue and other reforms to improve the fiscal space to meet social and

public investment needs. The fiscal consolidation should be accompanied by monetary tightening to rein in inflation, greater exchange rate flexibility as a shock absorber, and renewed structural reforms to facilitate investment. Across a broad spectrum of policies, adequate impact assessment, prior consultations with stakeholders and a more measured implementation would strengthen the policy predictability and effectiveness. In unison, these policies will reduce macroeconomic imbalances, strengthen buffers, and sustain inclusive convergence.

32. Fiscal consolidation should start with meeting this year's deficit target with quality measures. Staff has estimated that additional revenue and expenditure measures of almost 1 percent of GDP would be needed to bring this year's fiscal deficit to the budget law's target. Such measures should aim to shift fiscal expenditures away from rigid spending (e.g. the surging wage bill). Supported with suitable revenue measures, the recent trend of declining public investment should also be reversed.

33. Sustained revenue and expenditure reforms are needed to achieve consolidation over the medium term. With tax collection efficiency among the lowest in the EU, revenue administration should be modernized, by upgrading IT systems and improving compliance risk management. Expenditure efficiency and transparency should also be improved, to better manage spending and reduce corruption vulnerabilities, by strengthening expenditure reviews and the procurement process. The new pension law, if implemented as is, would undermine medium-term fiscal sustainability. It should be subjected to a comprehensive review, balancing social and equity needs and fiscal costs.

34. Monetary policy should be tightened further, given sizable inflation pressures. Inflation for 2019 is projected to stay above the target band, driven by the cyclical strength of the economy and fiscal stimulus. Tight liquidity management alone is not sufficient to rein in inflation, and further monetary tightening to anchor inflation in the medium-term is warranted. Such actions will also bolster the credibility and independence of the central bank.

35. Banking sector performance is strong, while progress with financial regulation should continue. The financial sector is stable, mainly reflecting several years of strong bank performance. Good progress has been made on implementing 2018 FSAP recommendations, improving the sector's resilience. Bank exposure to the Romanian state remains a concern and requires continued monitoring and appropriate regulatory responses. The new AML/CFT legislation should be followed by a robust implementation.

36. Improving medium-term growth prospects requires a re-energized structural reform agenda. The public investment rate should be increased from the current multi-decade low by focusing on public infrastructure and achieving a more efficient absorption of EU funds. SOE reforms require a re-start, to improve the quality of public goods and services. Minimum wage hikes should be moderated and linked to a set of objective criteria that reflect productivity developments. Romania's fight against corruption should be renewed. These reforms would alleviate constraints on growth, enhance Romania's competitiveness and facilitate investment.

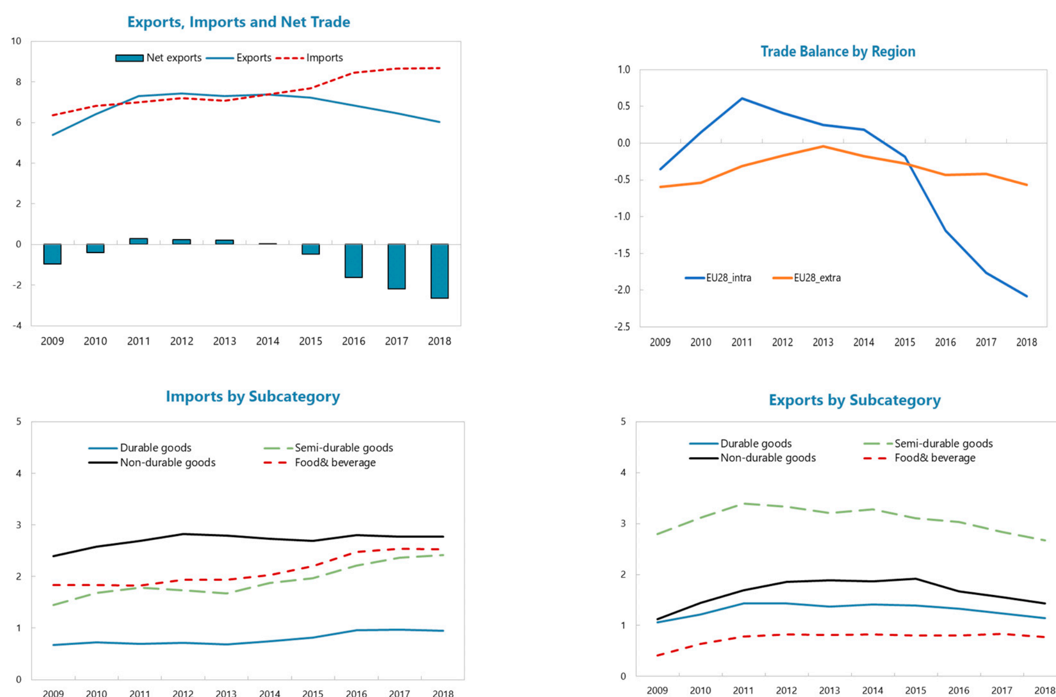
37. It is recommended to hold the next Article IV consultation on the standard 12-month cycle.

Box 1. The Current Account Deterioration

The current account balance in Romania has deteriorated significantly in recent years. From almost a balanced position in 2014, Romania's current account deficit has widened in recent years and reached 4.5 percent of GDP in 2018. The deterioration is expected to continue, as staff projects the deficit to increase by 1.0 percent of GDP in 2019. This Box examines the current account from the perspectives of consumer goods imports (which has been the main driver of the deterioration) and of Romania's internal saving-investment balance.

The rise in the trade deficit for consumer goods has been broad-based and driven mostly by imports, reflecting strong domestic demand. Consistent with Romania's cyclical strength, imports of consumer goods—as a share of GDP—have increased in all sub-categories since 2014, partly reflecting the eroding competitiveness of domestic producers in the face of wage-driven cost pressures. While the share of Romania's exports in world exports has continued to rise despite cost pressures (Annex VI), the share of exports in (Romania's) GDP declined and contributed to the rising trade deficit—this was due to Romania's strong GDP growth that exceeded the GDP growth in main trading partners (including EU). Geographically, the trade deficit has increased vis-à-vis both EU and non-EU trade partners, also indicating the domestic origin of the imbalance. The relatively larger increase in the trade deficit vis-à-vis EU trade partners reflects the increasing regional integration of trade.

Trade in Consumption Goods: 2009-18 1/
(Percent of GDP)



Source: Eurostat and IMF staff calculations.
1/ Consumption goods: raw and processed foods and beverages for household consumption and consumer goods.

Box 1. The Current Account Deterioration (concluded)

Saving-investment balances also look consistent with the strong imports of consumer goods. Both private and public sectors have contributed to the imbalance. This is in contrast to the previous external imbalance episode prior to 2007, when the private sector was the sole driver. Booming economic activity coincided with declining rates of both investment and savings, in a clear indication of the role of consumption in the current expansion. Savings declined faster than investment and widened the current account deficit, in another contrast with the pre-2007 episode, when investment increased faster than savings and widened the current account deficit.

Changes in Current Account by Components (in percent of GDP)

	2004-2007	2014-2018
ΔCA	**-6.0**	**-3.8**
Decompositions:		
1. $\Delta CA = \Delta CA^{Gov.} - \Delta CA^{Private}$		
$\Delta CA^{Gov.}$	0.3	-1.2
$\Delta CA^{Private}$	-6.3	-2.7
2. ΔCA =ΔS-ΔI		
ΔS	1.1	-4.4
ΔI	7.1	-0.6

Source: Eurostat and IMF staff calculations

Note: ΔCA denotes respectively CA_{2018}-CA_{2014} and CA_{2007}-CA_{2004}. The same notation applies to ΔS and ΔI.

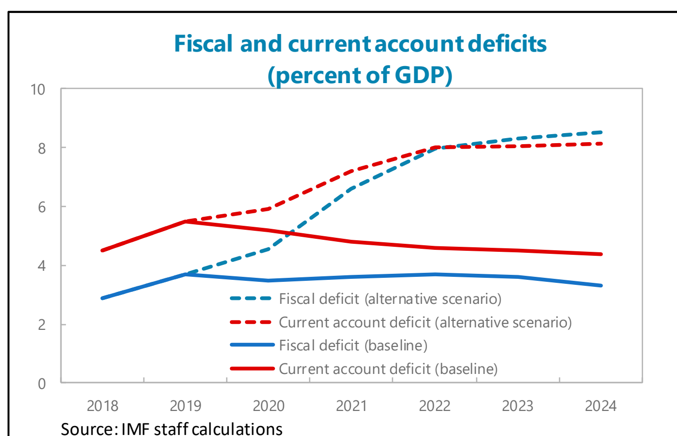
Box 2. Potential Consequences of the New Pension Law

If implemented as is without offsetting policy measures, the new law could double Romania's already sizable fiscal deficit, substantially increase current account deficits and raise external financing needs to excessive levels.

The government has enacted a new law that will double the pillar I pension benefits by 2022, without yet spelling out the budgetary implication of its implementation. As discussed in paragraph 17, pensions will rise in several stages, bringing about the additional fiscal expenditures of 3.2 percent of GDP by 2022 (compared to those that would have taken place under the previous law). As a result, the replacement ratio[1] is estimated to increase substantially from 42 percent in 2018 to 64 percent by 2022. This should help narrow the poverty risk gap[2] for elderly population in Romania, which is the highest in the EU (based on estimates for 2017), but will have no effect on the even higher poverty risk gap for population aged 18-64. The government has yet to explain how the budget will accommodate the additional expenditures, despite a clause in the law that emphasizes the importance of fiscal space.

An illustrative scenario fleshes out the possible implications of the new law for the fiscal and external accounts. This illustrative medium-term scenario elaborates on an alternative DSA scenario (Annex V) and assumes that no offsetting policy measures are adopted (while some would likely be announced in the 2020 budget law). The added pension expenditures would provide a boost to aggregate demand, but would also worsen the economic sentiment, as Romania's macroeconomic imbalances deteriorate. Worsening sentiment and rapidly increasing external financing needs are assumed to increase financing costs by 300 basis points. There are two important caveats. First, this scenario does not incorporate any restraint on the deficits that the EU's Excessive Deficit Procedure would impose, were the fiscal deficit to exceed 3 percent of GDP. Second, while tracing out the first round of macroeconomic consequences of the legislated additional fiscal expenditures, the scenario does not consider the possibility of more adverse market reactions (possibly induced by sovereign credit rating downgrade) and deeper economic dislocations that could follow.

The scenario reveals potentially devastating medium-term consequences. Romania's fiscal and current account deficits would both reach 8 percent of GDP by 2022. Public debt would increase by 20 percentage points of GDP (Annex V). External debt would also increase significantly, as the sizable additional expenditures would predominantly need to be financed in external markets (given already high domestic bank exposures; Annex II), tripling public sector's external financing needs by 2022. The rising financing needs could bring out more adverse market reactions than the 300 basis-point increase in the financing costs. Increasing reliance on external financing would raise the foreign currency share of public debt and heighten the exposure to the exchange rate risk.



Source: IMF staff calculations

Box 2. Potential Consequences of the New Pension Law (concluded)

The authorities need to reassess the implementation of the new pension law to ensure fiscal and external sustainability. Without additional fiscal measures, the new law endangers medium-term fiscal sustainability and prolongs policy uncertainty with adverse effects on economic activity and investment. The implementation of the new law can be paced to limit its negative impact on medium-term fiscal and external imbalances. Turning to the overall budget, redoubling fiscal reform efforts along the lines of staff recommendations would help provide fiscal space. In particular, a comprehensive reform of revenue administration and a review of the tax system could significantly raise fiscal revenues over the medium term (CR/18/149). More targeted social policies could help to alleviate poverty risks for the elderly and the rest of the population.

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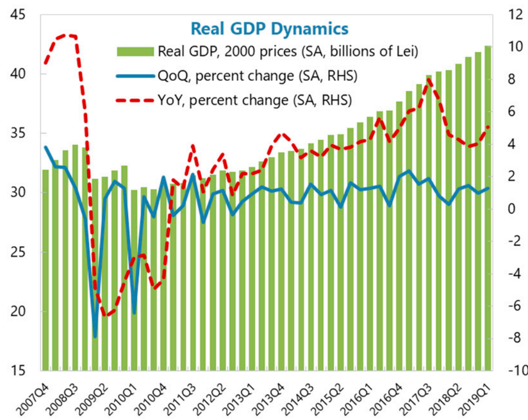
[1] Defined as the ratio between the net average pension and net average wage, as reported by the National Institute of Statistics.

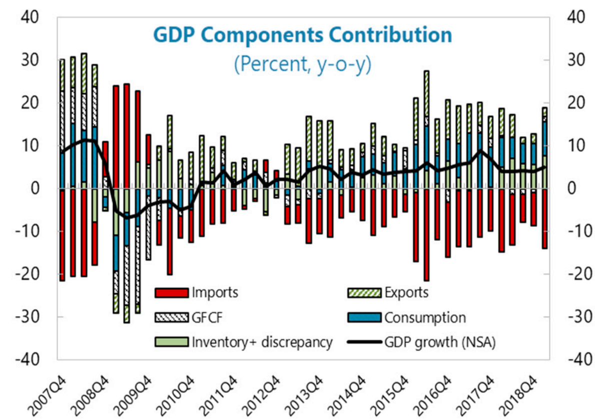
[2] Defined as the difference between the median equivalised total net income of persons below the at-risk-of-poverty threshold and the at-risk-of-poverty threshold.

Figure 2. Romania: Real Sector, 2007–19

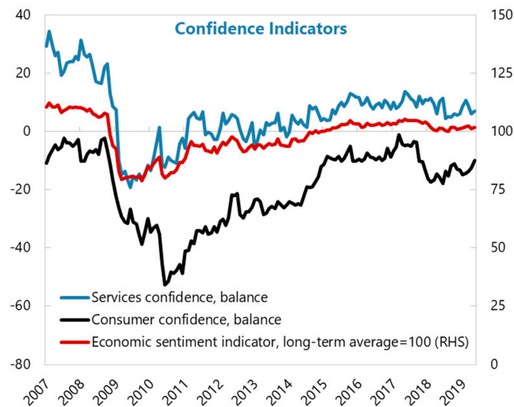
The economy slowed in 2018, but growth remained at a decent pace…



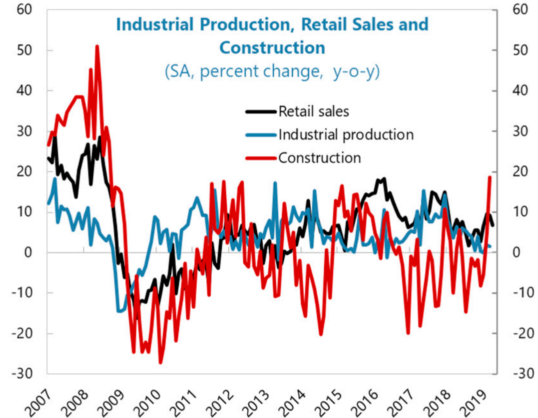
… mainly driven by consumption and inventory buildup. Imports growth continued as exports slowed.



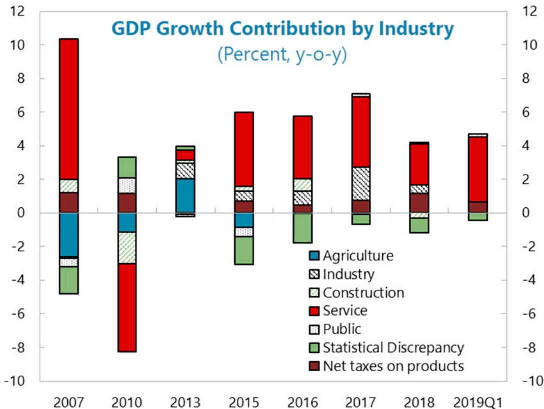
Economic sentiment and services confidence indicators remain firm, but consumer confidence has turned down recently.



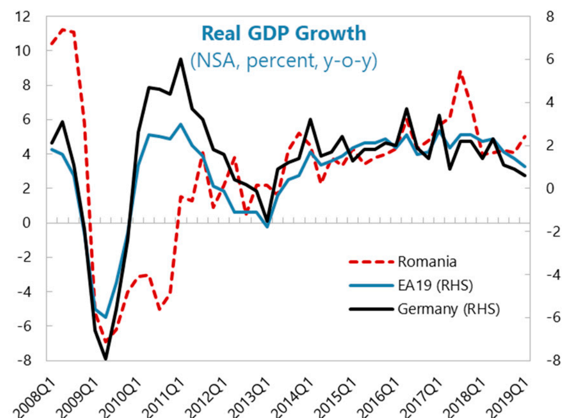
Retail sales continues growing, but industrial production has weakened on the external downturn, while construction works remained dragged down by lower public investment.



Consumption-related services and agriculture increased in recent years, the latter from bumper harvests in 2017-18



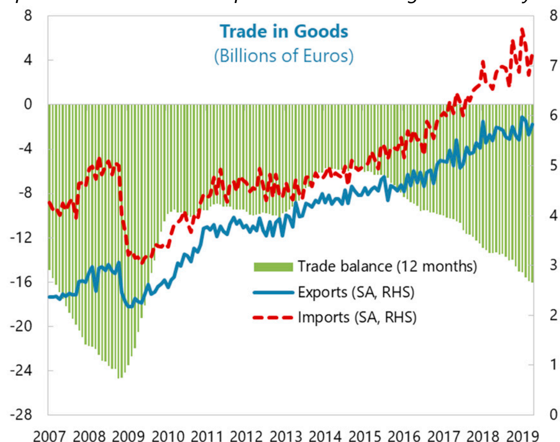
Romania remains broadly synchronized with the Euro Area, reflecting close integration.



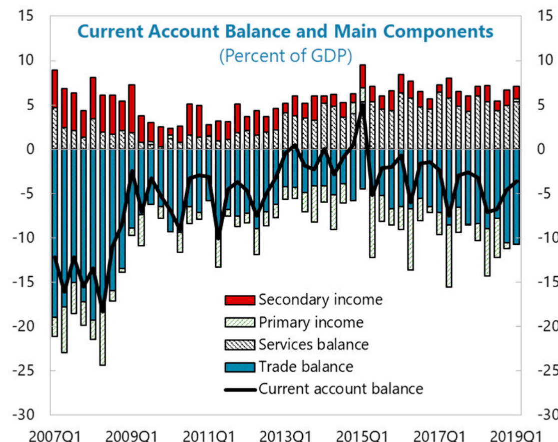
Sources: Haver Analytics; and IMF staff calculations.

Figure 3. Romania: External Sector, 2007–19

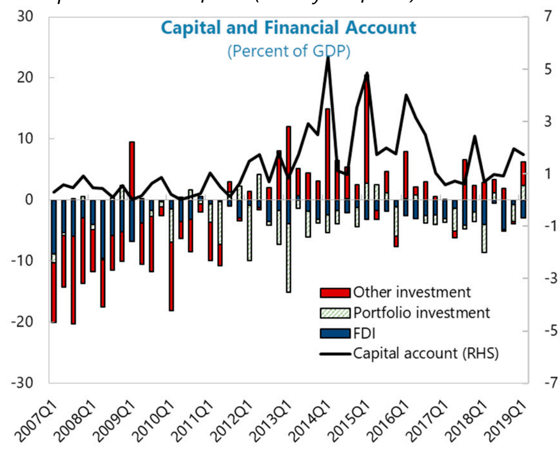
The trade balance in goods deteriorated further in 2018 as exports slowed even as imports continued to grow robustly…



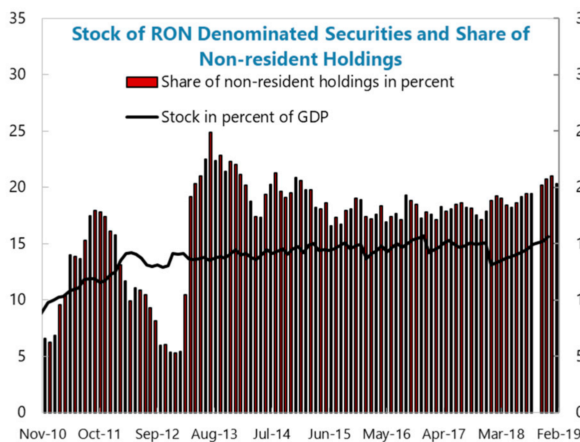
…and contributed to a widening current account deficit.



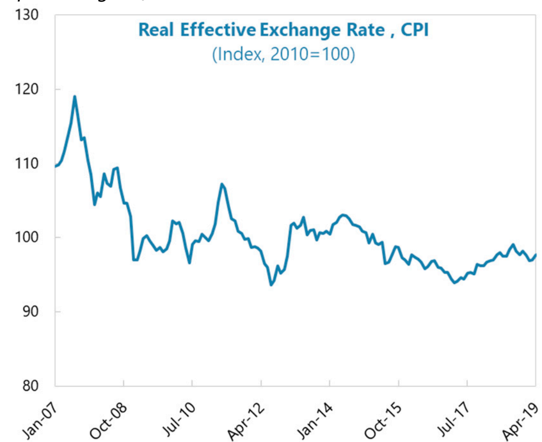
Net FDI flows were sustained due to reinvestment of earnings, and capital account inflows (mainly EU funds) continued.



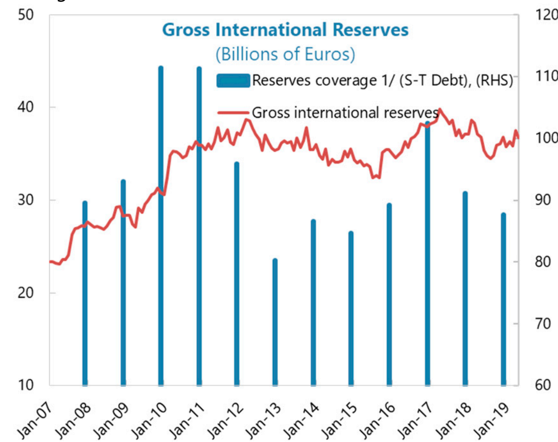
Non-resident holdings of government debt rose in H2 2018.



The real exchange rate broadly appreciated in 2018, before depreciating so far in 2019.



Foreign reserve coverage remains broadly adequate, but coverage has deteriorated relative to 2017.

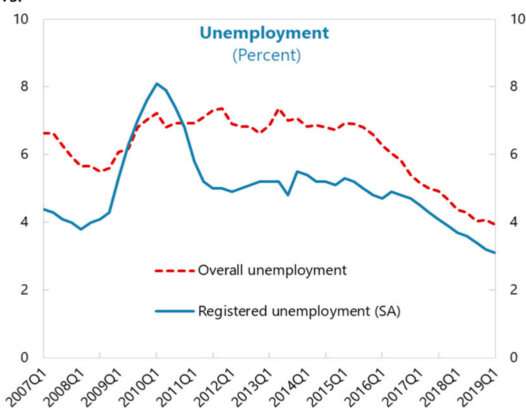


Sources: Haver Analytics; National Bank of Romania, IMF Information Notice System (INS); and IMF staff calculations.

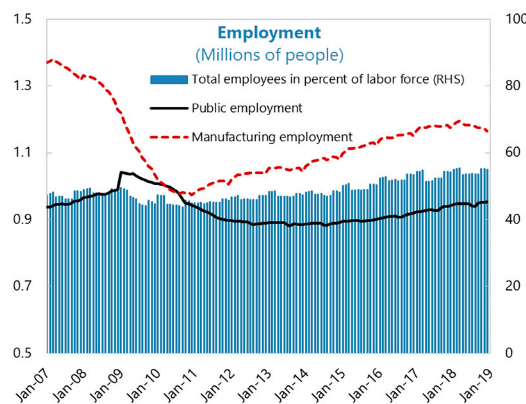
1/ Reserves coverage is based on end-of-year data.

Figure 4. Romania: Labor Market, 2007–19 1/

The unemployment rate has continued to fall to new record lows.

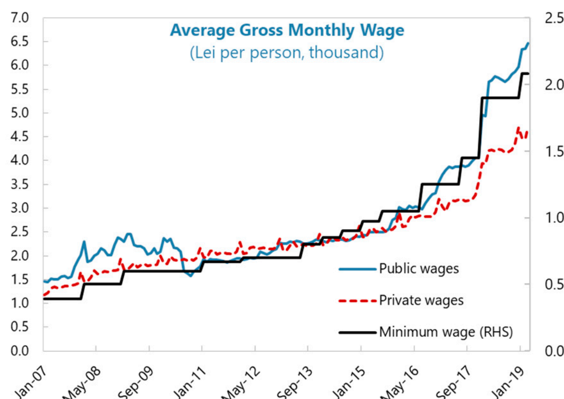


The number of employees has exceeded pre-crisis levels.

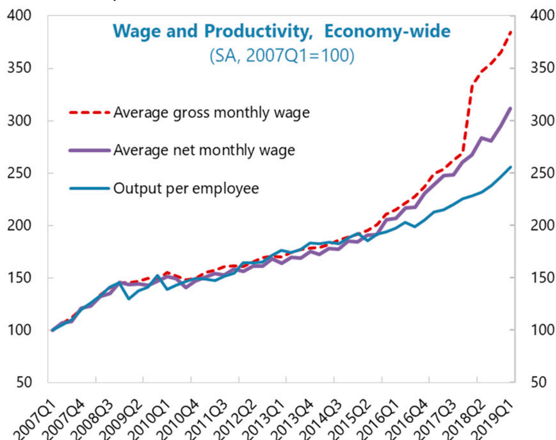


Real wage growth remains strong in 2019, after being dampened by the shift in social security contributions and higher inflation in 2018 …

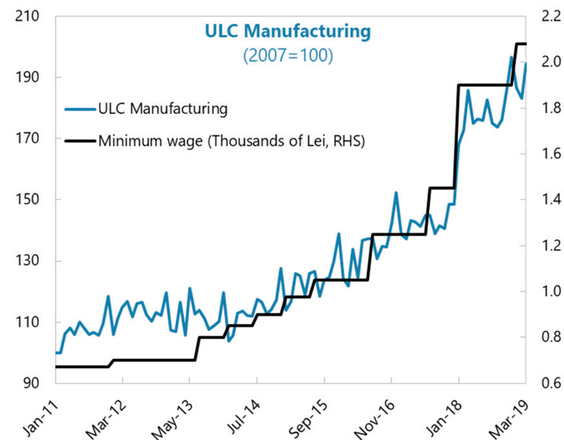
… owing to continuing public sector and minimum wages hikes.



Recent wage increases have exceeded the economy-wide productivity gains (netting out the 2018 shift in social security contributions).



Unit labor costs in the manufacturing sector have been on an accelerating upward trend.

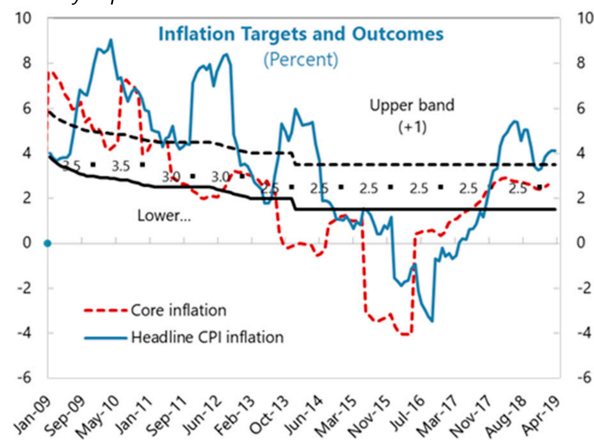


Sources: Eurostat, Haver Analytics; and IMF staff calculations.

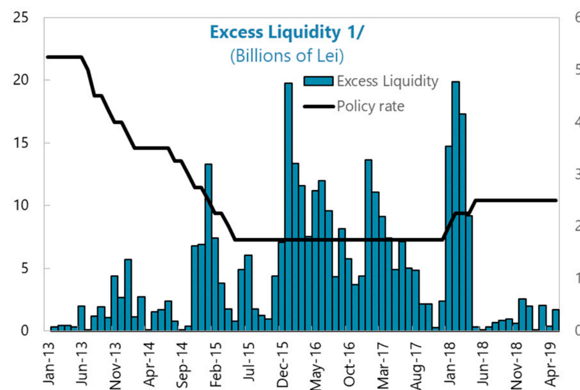
1/ Year 2018 reflects the upward adjustment of gross wages, including gross minimum wages, due to the implementation of the shift in social security contributions from employers to employees, which kept net wages and costs to employers unaffected.

Figure 5. Romania: Monetary Sector, 2007–19

After declining below the upper end of the band at end 2018, headline inflation has risen back above, in part due to recent currency depreciation…

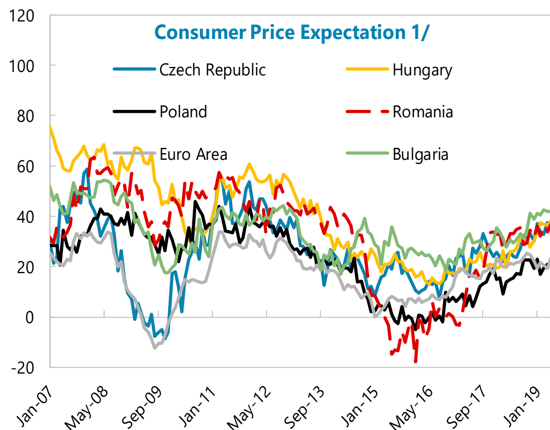


… while liquidity conditions have tightened as the monetary policy stance has firmed compared to the recent years.



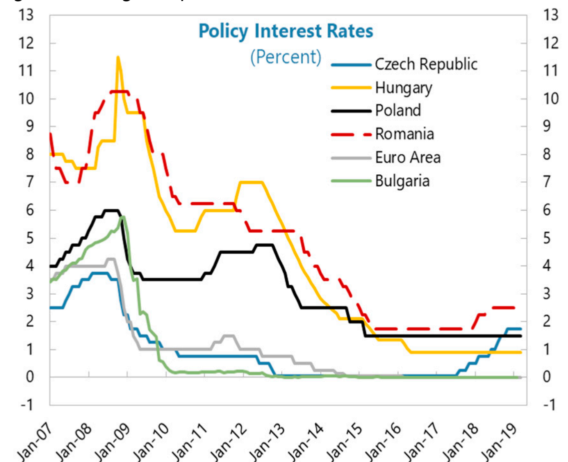
Source: NBR monthly bulletin.
1/ Stock of deposit in the NBR deposit facility (monthly average).

Inflation expectations across the region have risen.

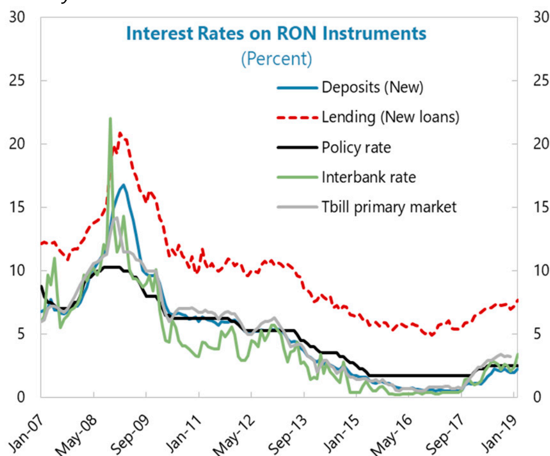


1/ Equals to the percentage of favorable answers minus the percentage of unfavorable answers in the survey on price trends over the next 12-month.

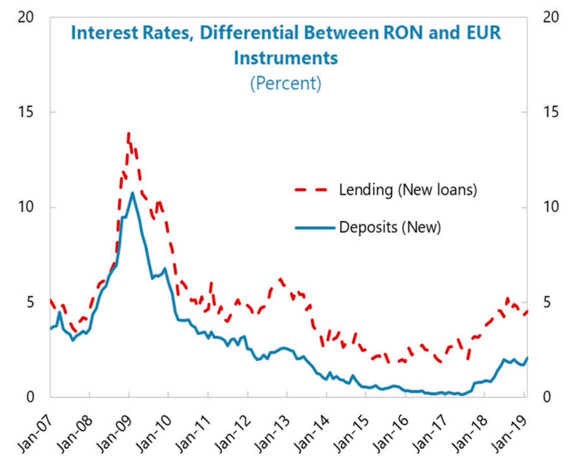
The policy rate was last raised in May 2018, and remains the highest among CEE peers



… and interest rates for domestic currency instruments remain relatively elevated …



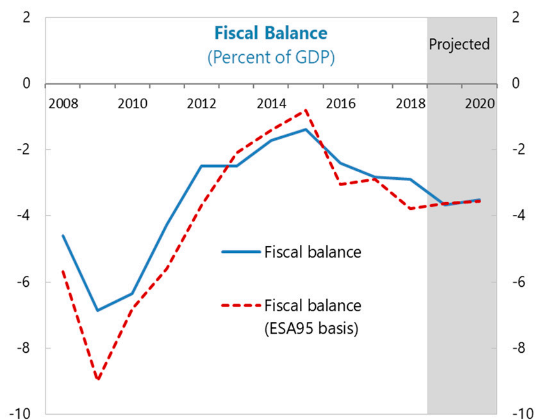
… keeping wide the differential with the rates on Euro-denominated instruments.



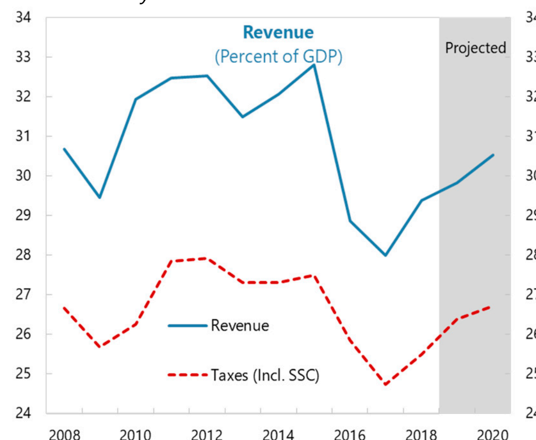
Sources: Haver Analytics; National Bank of Romania; Eurostat; Consensus Forecast; and IMF staff estimates.

Figure 6. Romania: Fiscal Operations, 2008–20

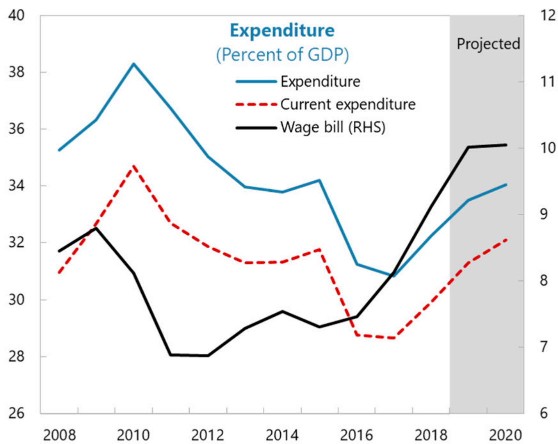
The fiscal deficit deteriorated further in 2018...



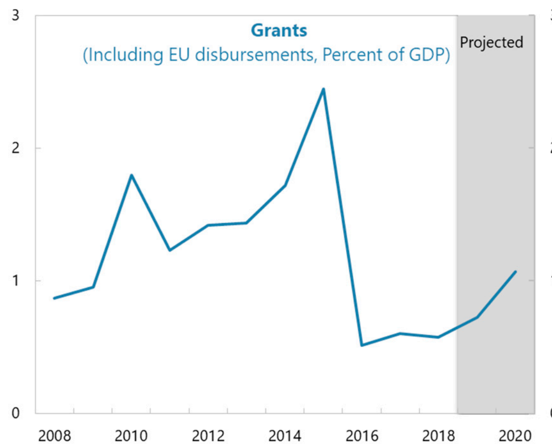
...despite higher revenues due to robust wage growth and economic activity...



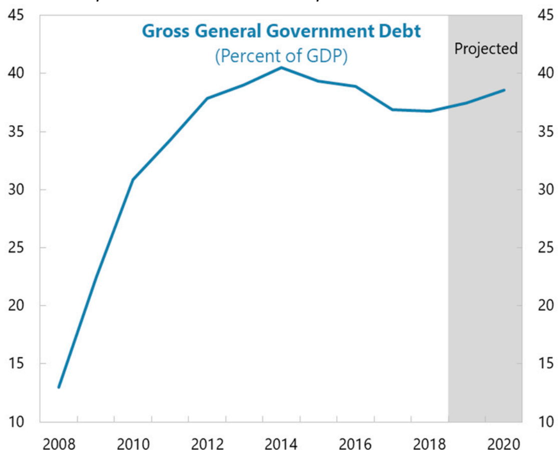
...led mainly by sharply higher public wages.



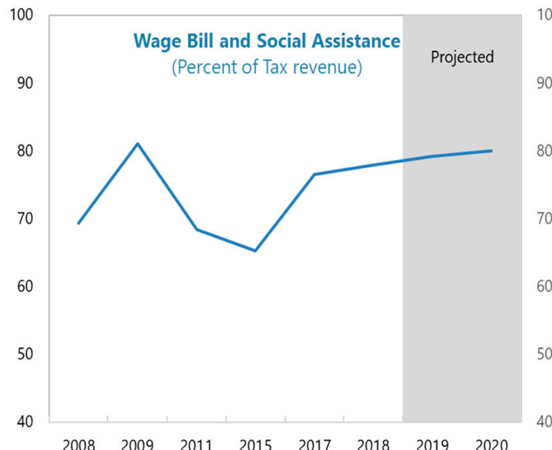
Absorption of EU funds remained weak in 2018.



Government debt ratios have been moderating on a high nominal GDP growth, but a slowdown and higher spending ahead is expected to reverse the improvement.



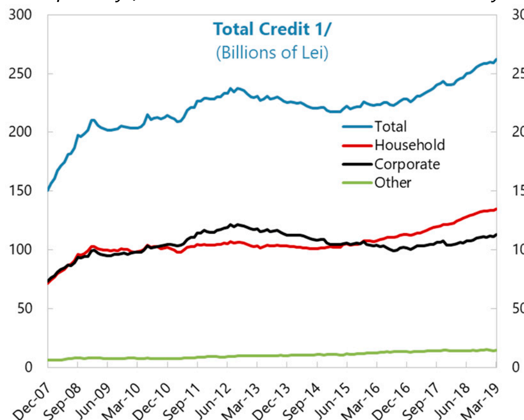
Meanwhile, rigidities in the budget structure continue to increase.



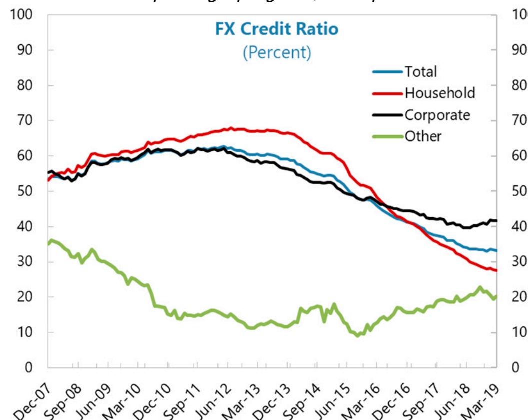
Sources: Romanian authorities; and IMF staff estimates and projections.

Figure 7. Romania: Financial Sector, 2007–18

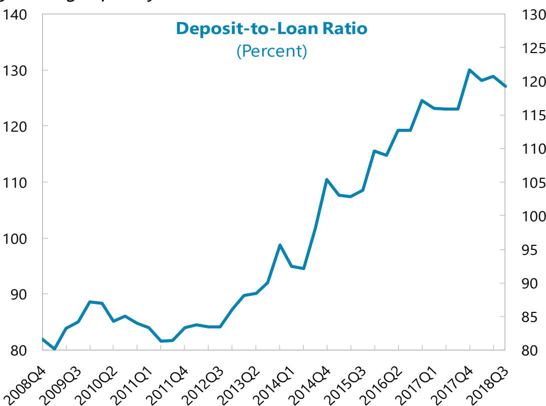
Local currency lending has been picking up over the past few years especially for households, but stalled since January…



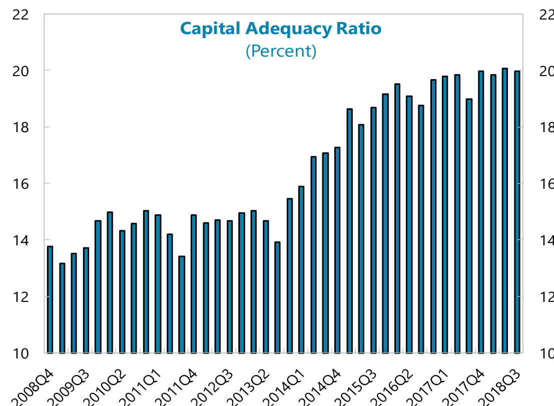
… while share of FX loans in total credit has declined over the period but started picking up again for corporate loans.



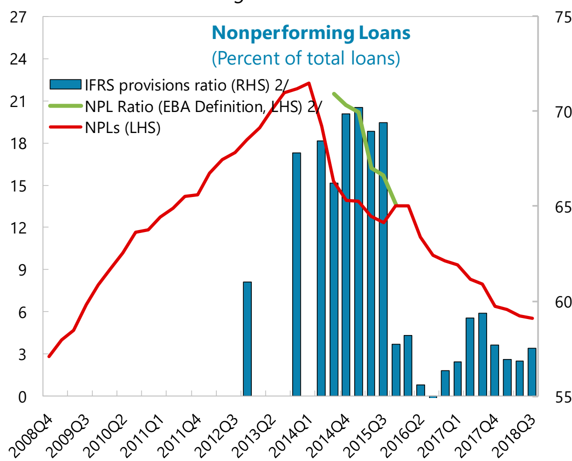
The deposit-to-loan ratio has been on an uptrend in the past few years, but has started to turn down, reflecting some tightening liquidity.



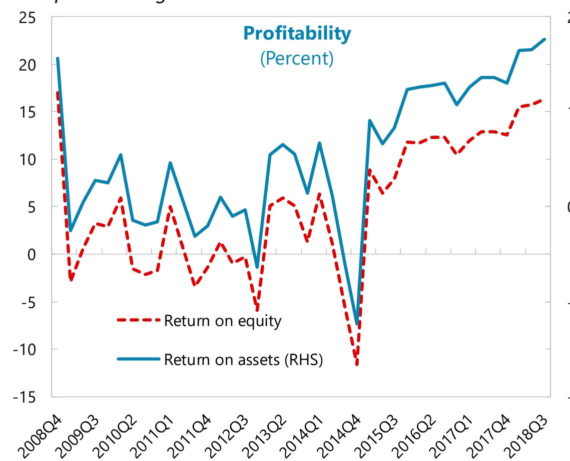
Capital buffers are substantial.



Progress in strengthening balance sheets continued, and NPLs are now around EU averages…



…while profitability has risen further, in part as past excess loan provisioning has been unwound.



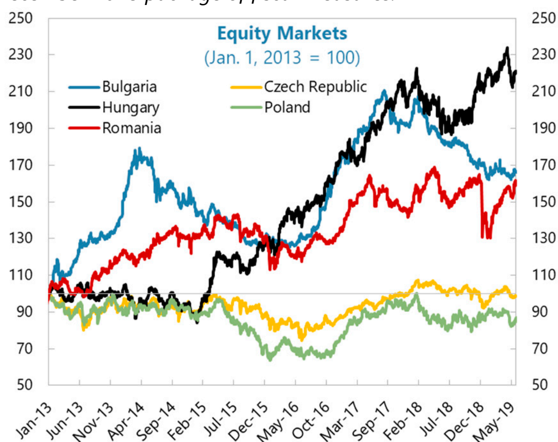
Sources: Dxtime; and National Bank of Romania.

1/ Excludes credit to central government.

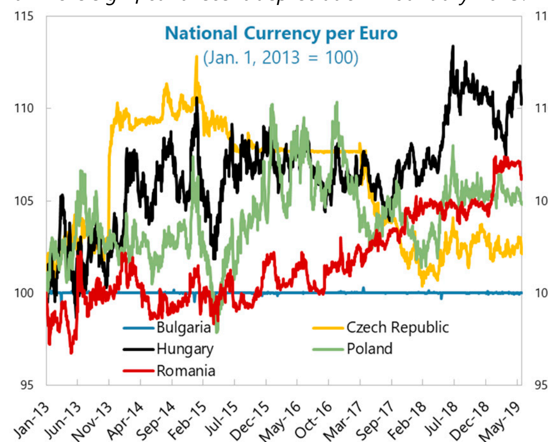
2/ In December 2015, the NBR moved from a national definition to an EBA methodology-based definition of NPL's.

Figure 8. Romania: Financial Developments, 2013–19

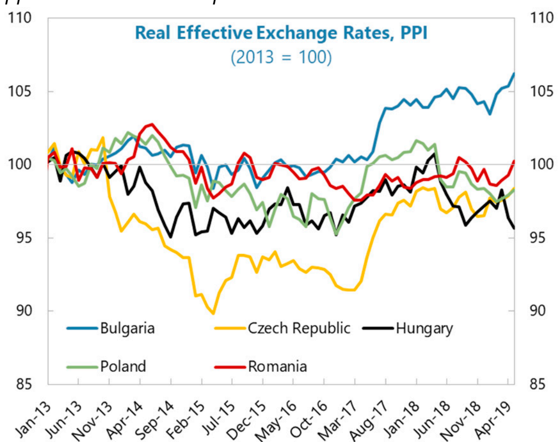
Romania's stock market index has been affected by the December 2018 package of fiscal measures.



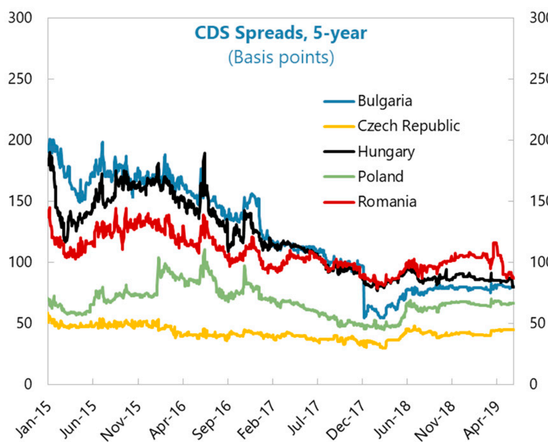
The leu has depreciated in general vis-a-vis Euro since 2016, with more significant recent depreciation in January 2019.



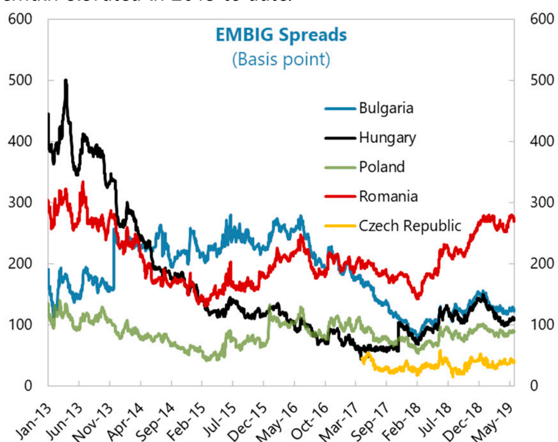
...and also depreciating in real terms recently after some appreciation relative to peers in 2018.



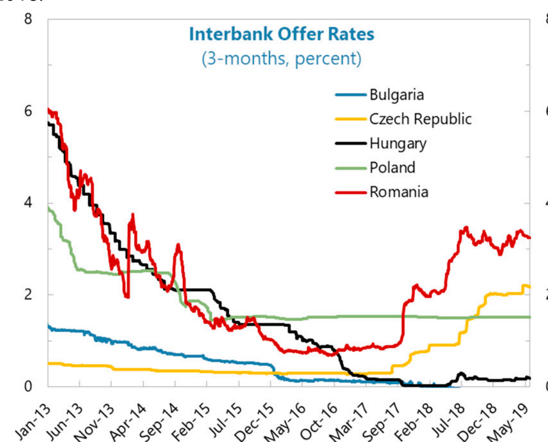
Romania's CDS spread is elevated relative to peers...



...while Romania's EMBIG spreads have risen in 2018 and remain elevated in 2019 to date.



Interbank rates also remain relatively higher after the rise in 2018.



Sources: Bloomberg; and Haver Analytics.

Table 1. Romania: Selected Economic and Social Indicators, 2013–20

	2013	2014	2015	2016	2017	2018 Prel.	2019 Proj.	2020 Proj.
Output and prices 1/			(Annual percentage change)					
Real GDP	3.5	3.4	3.9	4.8	7.0	4.1	4.0	3.5
Domestic demand 2/	-0.3	3.7	5.3	5.1	7.6	5.7	7.0	3.6
Contributions to GDP growth								
Domestic demand 2/	-0.3	3.8	5.3	5.1	7.6	5.8	6.1	3.9
Private consumption	0.1	2.9	3.7	5.0	6.3	3.3	4.6	3.2
Public spending	-0.5	0.5	0.0	0.3	0.4	0.2	0.4	0.4
Net exports	3.8	-0.4	-1.4	-0.3	-0.7	-1.7	-2.1	-0.4
Consumer price index (CPI, average)	4.0	1.1	-0.6	-1.6	1.3	4.6	4.2	3.3
Consumer price index (CPI, end of period)	1.6	0.8	-0.9	-0.5	3.3	3.3	4.5	3.5
Core price index (CPI, end of period)	-0.1	1.2	-3.1	0.3	2.4	2.5	3.3	3.5
Producer price index (average)	2.1	-0.1	-2.2	-1.8	3.5	5.0	...	...
Unemployment rate (average)	7.1	6.8	6.8	5.9	4.9	4.2	4.3	4.6
Nominal wages, gross 3/	5.0	5.3	8.5	12.8	14.8	35.4	15.3	7.2
Saving and Investment			(In percent of GDP)					
Gross domestic investment 2/	25.6	24.7	25.1	23.3	23.4	24.2	23.6	21.9
Gross national savings	24.5	24.0	23.9	21.2	20.2	19.6	18.1	16.7
General government finances 4/								
Revenue	31.5	32.1	32.8	28.9	28.0	29.4	29.8	30.5
Expenditure	34.0	33.8	34.2	31.3	30.8	32.2	33.5	34.0
Fiscal balance	-2.5	-1.7	-1.4	-2.4	-2.8	-2.8	-3.7	-3.5
External financing (net)	2.1	1.9	-0.5	0.7	0.8	0.6	1.3	1.4
Domestic financing (net)	1.4	1.2	1.0	2.2	2.4	2.5	2.4	2.1
Primary balance	-0.8	-0.2	-0.1	-1.1	-1.7	-1.5	-2.3	-2.1
Structural fiscal balance 5/	-1.2	0.2	0.0	-1.7	-3.5	-3.6	-4.1	-4.0
Gross public debt (including guarantees)	39.0	40.5	39.4	38.9	36.9	36.7	37.4	38.6
Money and credit			(Annual percentage change)					
Broad money (M3)	8.8	8.4	9.3	9.7	11.5	8.8	12.0	9.0
Credit to private sector	-3.3	-3.3	3.0	1.2	5.7	8.0	8.1	6.5
Interest rates, eop			(In percent)					
NBR policy rate	4.0	2.50	1.75	1.75	1.75	2.5	...	...
NBR lending rate (Lombard)	7.0	4.75	4.25	3.25	2.75	3.5	...	...
Interbank offer rate (1 week)	1.8	0.7	0.6	0.6	1.5	2.4	...	...
Balance of payments			(In percent of GDP)					
Current account balance	-1.1	-0.7	-1.2	-2.1	-3.2	-4.5	-5.5	-5.2
Merchandise trade balance	-4.0	-4.3	-4.9	-5.5	-6.5	-7.3	-8.1	-7.4
Exports (goods)	30.5	31.1	30.6	30.6	30.5	30.5	31.3	31.2
Imports (goods)	-34.6	-35.5	-35.5	-36.1	-37.0	-37.8	-39.4	-38.7
Capital account balance	2.1	2.6	2.4	2.5	1.2	1.2	1.1	1.6
Financial account balance	-3.1	0.1	0.4	-0.7	-1.9	-2.5	-4.1	-4.0
Foreign direct investment balance	-2.0	-1.8	-1.8	-2.6	-2.6	-2.5	-2.5	-2.4
International investment position	-61.9	-56.8	-53.7	-48.5	-46.9	-44.5	-46.6	-47.4
Gross official reserves	24.6	23.6	22.1	22.2	19.8	18.1	16.2	15.2
Gross external debt	68.2	63.0	57.4	54.5	49.8	48.1	47.3	46.5
Exchange rates								
Lei per euro (end of period)	4.48	4.48	4.52	4.54	4.66	4.66	…	…
Lei per euro (average)	4.42	4.44	4.44	4.49	4.57	4.65	…	…
Real effective exchange rate								
CPI based (percentage change)	4.7	0.7	-3.4	-1.8	-1.5	2.8	…	…
GDP deflator based (percentage change)	4.1	1.4	-0.3	2.2	2.0	4.4	…	…
Memorandum Items:								
Nominal GDP (in bn RON)	635.5	668.6	712.6	765.1	856.7	944.2	1027.5	1096.7
Potential output growth	2.9	3.2	3.3	3.5	3.7	3.7	3.7	3.7

Social and Other Indicators

GDP per capita: US$12,301 (2018); **GDP per capita, PPP:** current international $26595.4 (2017)

People at risk of poverty or social exclusion: 35.7% (2017)

Sources: Romanian authorities; IMF staff estimates and projections; World Development Indicators database, Eurostat.

1/ Staff's inflation projections assume monetary tightening.

2/ Including potential statistical uncertainty related to large inventory contribution in 2018.

3/ Year 2018 reflects the upward adjustment of gross wages due to the implementation of the shift in social security contributions from employers to employees, which kept net wages and costs to employers unaffected (see Box 1 in the 2018 Article IV staff report).

4/ General government finances refer to cash data.

5/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.

Table 2. Romania: Medium-Term Macroeconomic Framework, Current Policies, 2015–24

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
			Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
GDP and prices (annual percent change)										
Real GDP	3.9	4.8	7.0	4.1	4.0	3.5	3.0	3.0	3.0	3.0
Agriculture 1/	-10.3	1.5	11.2	9.4	...	...	...	...	...	...
Non-Agriculture 1/	6.2	6.3	6.9	3.6	...	...	...	...	...	...
Real domestic demand	5.3	5.1	7.6	5.7	7.0	3.6	3.1	3.3	3.3	3.2
Consumption 2/	4.8	6.8	8.6	4.5	6.4	4.4	3.8	3.5	3.3	3.5
Investment 2/	7.5	-0.2	3.5	-3.2	2.7	2.7	2.7	2.7	2.5	2.5
Exports	4.6	16.0	10.0	5.4	4.4	6.5	5.6	5.4	5.1	5.3
Imports	8.0	16.5	11.3	9.1	7.7	6.3	5.5	5.5	5.3	5.3
Consumer price index (CPI, average) 3/	-0.6	-1.6	1.3	4.6	4.2	3.3	2.9	2.5	2.5	2.5
Consumer price index (CPI, end of period) 3/	-0.9	-0.5	3.3	3.3	4.5	3.5	2.5	2.5	2.5	2.5
Saving and investment (in percent of GDP)										
Gross national saving	23.9	21.2	20.2	19.6	18.1	16.7	16.5	16.5	16.5	16.3
Gross domestic investment 2/	25.1	23.3	23.4	24.2	23.6	21.9	21.3	21.1	21.0	20.7
Government	6.2	3.8	3.3	3.4	3.5	3.6	3.7	3.9	4.0	3.5
Private 2/	18.9	19.6	20.1	20.8	20.2	18.3	17.6	17.2	17.1	17.2
General government (in percent of GDP)										
Revenue	32.8	28.9	28.0	29.4	29.8	30.5	30.7	30.8	30.6	30.3
Expenditure	34.2	31.3	30.8	32.2	33.5	34.0	34.3	34.5	34.3	33.6
Fiscal balance	-1.4	-2.4	-2.8	-2.8	-3.7	-3.5	-3.6	-3.7	-3.6	-3.3
Structural fiscal balance 4/	0.0	-1.7	-3.5	-3.6	-4.1	-4.0	-3.9	-3.8	-3.6	-3.2
Gross general government debt (direct debt only)	37.1	36.6	34.8	34.8	35.6	36.9	38.2	39.6	40.8	41.8
Gross general government debt (including guarantees)	39.4	38.9	36.9	36.7	37.4	38.6	39.8	41.1	42.2	43.1
Monetary aggregates (annual percent change)										
Broad money (M3)	9.3	9.7	11.5	8.8	12.0	9.0	8.0	7.5	7.5	7.5
Credit to private sector	3.0	1.2	5.7	8.0	8.1	6.5	6.3	6.0	6.1	6.0
Balance of payments (in percent of GDP)										
Current account	-1.2	-2.1	-3.2	-4.5	-5.5	-5.2	-4.8	-4.6	-4.5	-4.4
Trade balance	-4.9	-5.5	-6.5	-7.3	-8.1	-7.4	-6.8	-6.2	-5.7	-5.2
Services balance	4.2	4.5	4.4	4.1	3.6	3.2	2.9	2.6	2.3	2.0
Income balance	-2.4	-2.6	-2.5	-2.5	-2.5	-2.6	-2.4	-2.5	-2.5	-2.6
Transfers balance	1.7	1.5	1.4	1.2	1.5	1.5	1.5	1.5	1.5	1.4
Capital account balance	2.4	2.5	1.2	1.2	1.1	1.6	1.9	1.8	1.7	1.0
Financial account balance	0.4	-0.7	-1.9	-2.5	-4.1	-4.0	-4.4	-4.8	-4.8	-4.9
Foreign direct investment, balance	-1.8	-2.6	-2.6	-2.5	-2.5	-2.4	-2.4	-2.4	-2.2	-2.1
Memorandum items:										
Gross international reserves (in billions of euros)	35.5	37.9	37.1	36.8	35.1	35.1	37.0	39.2	40.5	40.3
Gross international reserves (in months of next year's imports)	5.9	5.6	4.9	4.3	3.9	3.7	3.7	3.7	3.6	3.6
International investment position (in percent of GDP)	-53.7	-48.5	-46.9	-44.5	-46.6	-47.4	-47.6	-47.9	-48.2	-49.1
External debt (in percent of GDP)	57.4	54.5	49.8	48.1	47.3	46.5	46.2	45.9	45.9	46.1
Short-term external debt (in percent of GDP)	12.9	13.7	13.4	13.2	13.1	13.0	13.0	13.0	13.0	13.0
Terms of trade (merchandise, percent change)	1.0	-1.7	-1.3	1.0	0.5	0.7	0.6	0.5	0.5	0.5
Nominal GDP (in billions of lei)	712.6	765.1	856.7	944.2	1,027.5	1,096.7	1,167.3	1,243.0	1,322.2	1,402.2
Nominal GDP (in millions of Euros)	160,313	170,380	187,546	202,906	216,352	230,879	245,751	261,692	278,354	295,196
Output gap (percent of potential GDP)	-2.5	-1.3	1.8	2.1	2.4	2.1	1.5	0.9	0.4	0.1
Potential GDP (percent change)	3.3	3.5	3.7	3.7	3.7	3.7	3.6	3.6	3.5	3.3

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

1/ Based on gross value added data from the National Institute of Statistics (NIS) in Romania. Note that there is a small discrepancy between the supply side GDP data from the NIS and the demand side data from Eurostat.

2/ Domestic demand components potentially distorted by statistical issues related to large inventory contribution (about 3 percent of GDP) in 2018, which from past experience are subsequently revised to reallocate to consumption and investment components.

3/ Staff's inflation projections assume monetary tightening.

4/ Actual fiscal balance adjusted for the automatic effects related to the business cycle and one-off effects.

Table 3. Romania: Balance of Payments, 2015–24
(In billions of euros, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-2.0	-3.6	-6.0	-9.2	-12.0	-12.0	-11.7	-12.1	-12.6	-13.0
Merchandise trade balance	-7.8	-9.3	-12.2	-14.8	-17.5	-17.1	-16.6	-16.4	-16.0	-15.4
Exports (f.o.b.)	49.1	52.2	57.2	61.8	67.8	72.1	76.5	81.1	85.9	91.2
Imports (f.o.b.)	56.9	61.5	69.4	76.7	85.3	89.3	93.2	97.4	101.8	106.5
Services balance	6.8	7.7	8.2	8.3	7.7	7.5	7.2	6.8	6.4	5.9
Exports of non-factor services	16.6	18.0	20.7	22.6	24.8	26.4	28.0	29.7	31.4	33.4
Imports of non-factor services	9.8	10.3	12.5	14.3	17.1	18.9	20.8	22.9	25.1	27.5
Primary income, net	-3.8	-4.5	-4.6	-5.0	-5.5	-5.9	-6.0	-6.5	-7.1	-7.6
Receipts	2.3	2.8	3.2	3.4	3.6	3.7	4.2	4.4	4.5	4.7
Payments	6.1	7.3	7.9	8.4	9.0	9.6	10.2	10.9	11.6	12.3
Secondary income, net	2.8	2.5	2.6	2.4	3.3	3.5	3.7	4.0	4.1	4.1
Capital account balance	3.9	4.3	2.2	2.4	2.4	3.4	4.2	3.8	3.6	2.2
Financial account balance	0.6	-1.2	-3.6	-5.0	-8.9	-8.6	-9.5	-10.4	-10.3	-10.6
Foreign direct investment balance	-3.0	-4.5	-4.9	-5.0	-5.3	-5.6	-5.9	-6.2	-6.2	-6.3
Portfolio investment balance	0.0	-0.9	-3.1	-3.0	-4.0	-3.3	-4.0	-4.6	-5.0	-6.0
Other investment balance	3.6	4.3	4.3	2.9	0.4	0.3	0.3	0.4	1.0	1.7
General government	0.4	0.8	2.1	1.0	0.1	0.0	0.0	0.0	0.0	0.0
Domestic banks	2.4	4.1	1.3	0.8	2.4	2.6	2.8	3.0	3.5	4.1
Other private sector	0.8	-0.7	-0.4	-0.1	-2.1	-2.3	-2.4	-2.6	-2.5	-2.4
Errors and omissions	0.4	0.8	0.6	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.9	2.7	0.4	-0.8	-0.7	-0.1	2.0	2.1	1.3	-0.1
Financing	-0.9	-2.7	-0.4	0.8	0.7	0.1	-2.0	-2.1	-1.3	0.1
Gross international reserves ("-": increase)	0.6	-2.3	-0.4	0.8	1.7	0.1	-2.0	-2.1	-1.3	0.1
Use of IMF credit, net	-1.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	-1.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Multilateral financing	-0.8	0.0	-0.7	-1.4	-1.0	0.0	...	...	...	...
European Commission	-1.5	0.0	-1.2	-1.4	-1.0	...	...	...	...	...
World Bank	0.8	0.0	0.5	0.0	0.0	...	...	...	...	...
EIB/EBRD/IFC	...	...	...	...	...	...	...	...	...	...
Memorandum items:			(In percent of GDP)							
Current account balance	-1.2	-2.1	-3.2	-4.5	-5.5	-5.2	-4.8	-4.6	-4.5	-4.4
Foreign direct investment balance	-1.8	-2.6	-2.6	-2.5	-2.5	-2.4	-2.4	-2.4	-2.2	-2.1
Merchandise trade balance	-4.9	-5.5	-6.5	-7.3	-8.1	-7.4	-6.8	-6.2	-5.7	-5.2
Exports	30.6	30.6	30.5	30.5	31.3	31.2	31.1	31.0	30.9	30.9
Imports	35.5	36.1	37.0	37.8	39.4	38.7	37.9	37.2	36.6	36.1
Gross external financing requirement	27.4	25.4	22.9	24.6	24.9	23.8	22.1	22.4	21.3	20.8
			(Annual percent change)							
Terms of trade (merchandise)	1.0	-1.7	-1.3	1.0	0.5	0.7	0.6	0.5	0.5	0.5
Export volume	4.6	16.0	10.0	6.7	4.4	6.5	5.6	5.4	5.1	5.3
Import volume	8.0	16.5	11.3	11.6	7.7	6.3	5.5	5.5	5.3	5.3
Export prices	-0.3	-9.8	1.6	0.8	5.0	0.1	0.4	0.6	0.7	0.8
Import prices	-1.3	-8.2	2.9	0.7	4.5	-0.6	-0.1	0.0	0.2	0.3
			(In billions of euros)							
Gross international reserves	35.5	37.9	37.1	36.8	35.1	35.1	37.0	39.2	40.5	40.3
Excluding IMF credit	35.4	37.9	37.1	36.8	35.1	35.1	37.0	39.2	40.5	40.3
of which: Excluding banks' required reserves										
GDP	160.3	170.4	187.5	202.9	216.3	230.9	245.7	261.7	278.3	295.2

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

Table 4. Romania: Gross External Financing Requirements, 2015–20

(In billions of euros, unless otherwise indicated)

	2015	2016	2017	2018	2019 Proj.	2020 Proj.
Total financing requirements 1/	**35.1**	**44.1**	**44.3**	**48.1**	**50.5**	**52.14**
Current account deficit	2.0	3.6	6.0	9.2	12.0	12.0
Short-term debt	19.9	30.3	26.4	28.7	29.1	30.8
Public sector	8.5	9.0	6.8	7.0	6.8	6.8
Banks	7.7	8.8	6.3	7.4	6.5	6.7
Corporates	3.7	12.5	13.3	14.3	15.7	17.3
Maturing medium- and long-term debt	12.3	8.2	8.3	7.7	8.2	8.6
Public sector	2.4	1.3	0.8	1.0	2.2	2.639
Banks	6.1	2.5	3.5	2.9	1.9	1.500
Corporates	3.8	4.4	3.9	3.8	4.1	4.5
Other net capital outflows 2/	0.9	2.1	3.6	2.5	1.3	0.7
Total financing sources	**36.4**	**45.7**	**44.9**	**47.7**	**49.9**	**52.08**
Foreign direct investment, net	3.0	4.5	4.9	5.0	5.3	5.6
Capital account inflows	3.9	4.3	2.2	2.4	2.4	3.4
Short-term debt	21.6	29.9	27.6	30.3	30.5	31.4
Public sector	8.3	9.1	6.8	6.8	7.0	6.8
Banks	9.0	7.5	6.8	7.7	6.3	6.7
Corporates	4.3	13.3	14.0	15.8	17.3	17.9
Medium- and long-term debt	8.0	7.0	10.2	10.0	11.6	11.7
Public sector	2.2	2.2	3.7	4.3	6.0	5.760
Banks	3.0	0.7	2.0	1.8	1.0	1.000
Corporates	2.9	4.1	4.5	3.9	4.6	4.9
Errors and omissions	0.4	0.8	0.6	0.9	0.0	0.0
Increase in gross international reserves	-0.6	2.3	0.4	-0.8	-1.7	-0.1
Financing gap	**-2.3**	**-0.1**	**-0.7**	**-1.4**	**-1.0**	**0.0**
Multilateral financing	**-2.3**	**-0.1**	**-0.7**	**-1.4**	**-1.0**	**0.0**
IMF 3/	-1.5	-0.1	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	-1.5	-0.1	0.0	0.0	0.0	0.0
European Commission	-1.5	0.0	-1.2	-1.4	-1.0	0.0
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0
Principal repayments	-1.5	0.0	-1.2	-1.4	1.0	0.0
Others	0.8	0.0	0.5	0.0	0.0	0.0
World Bank	0.8	0.0	0.5	0.0	0.0	0.0
EIB/EBRD/IFC	...	...	...	...	...	...
Memorandum items:						
Gross external financing needs (in percent of GDP	21.9	25.9	23.6	23.7	23.4	22.6
Rollover rates for amortizing debt ST (in percent)						
Public sector	99	101	100	98	102	100
Banks	117	85	107	103	96	100
Corporates	114	106	105	111	110	104
Rollover rates for amortizing debt MLT (in percent)						
Public sector	90	169	456	429	268	218
Banks	48	29	56	61	52	67
Corporates	75	93	114	103	114	109
Rollover rates for total amortizing debt (in percent)						
Public sector	97	110	138	140	143	133
Banks	87	72	89	91	86	94
Corporates	94	103	107	109	111	105
Gross international reserves 4/	35.5	37.9	37.1	36.8	35.1	35.1
Coverage of gross international reserves						
Months of imports of GFNS (next year)	5.9	5.6	4.9	4.3	3.9	3.7
Short-term external debt (in percent)	89.2	102.4	91.1	87.7	81.8	82.2

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

1/ The sharp increase in financing requirements in 2016 is partly due to the changes in the methodology of collecting data for short term debt for corporates.

2/ Includes portfolio equity, financial derivatives and other investments.

3/ SDR interest rate as well as exchange rate of SDR/US$ and US$/€ of January 15, 2015.

4/ Operational definition.

Table 5a. Romania: General Government Operations, 2015–2024 1/
(In percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Revenue	32.8	28.9	28.0	29.4	29.8	30.5	30.7	30.8	30.6	30.3
Taxes	27.5	25.8	24.7	25.5	26.4	26.7	26.6	26.5	26.5	26.5
Corporate income tax	2.1	2.1	1.9	1.9	2.0	1.9	1.9	1.9	1.9	1.9
Personal income tax	3.8	3.7	3.6	2.5	2.4	2.4	2.4	2.4	2.4	2.4
VAT	8.0	6.8	6.2	6.3	6.5	6.6	6.6	6.6	6.7	6.7
Excises	3.7	3.5	3.1	3.0	2.9	2.9	2.8	2.7	2.6	2.5
Customs duties	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social security contributions	8.1	8.0	8.4	10.4	11.1	11.3	11.3	11.3	11.3	11.3
Other taxes	1.7	1.6	1.4	1.3	1.4	1.5	1.5	1.5	1.5	1.5
Nontax revenue	2.7	2.4	2.6	2.9	2.7	2.7	2.7	2.7	2.7	2.7
Capital revenue	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grants, including EU disbursements 2/	2.4	0.5	0.6	0.6	0.7	1.1	1.3	1.5	1.4	1.1
Expenditure	34.2	31.3	30.8	32.2	33.5	34.0	34.3	34.5	34.3	33.6
Current expenditure	31.8	28.8	28.7	29.9	31.3	32.1	32.5	32.7	32.5	31.9
Compensation of employees	7.3	7.5	8.1	9.1	10.0	10.0	10.1	10.0	9.9	9.8
Goods and services	5.7	5.3	4.7	4.7	4.7	4.7	4.6	4.6	4.5	4.5
Interest	1.3	1.3	1.2	1.4	1.4	1.4	1.5	1.5	1.6	1.6
Subsidies	0.9	0.9	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6
Transfers	16.5	13.7	13.9	14.0	14.4	15.2	15.6	15.9	15.9	15.4
Pensions	7.2	6.8	6.7	6.7	6.8	7.3	7.6	7.8	7.9	7.9
Other social transfers	3.4	3.9	4.1	4.1	4.1	4.0	3.9	3.8	3.6	3.5
Other transfers 3/	5.3	2.5	2.5	2.5	2.7	3.1	3.4	3.6	3.7	3.2
Other spending	0.6	0.5	0.6	0.7	0.9	0.8	0.8	0.8	0.7	0.7
Projects with external credits	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 4/	2.5	2.5	2.3	2.5	2.3	2.1	1.9	1.9	1.9	1.9
Reserve fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending and expense refunds	-0.1	0.0	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Fiscal balance	-1.4	-2.4	-2.8	-2.8	-3.7	-3.5	-3.6	-3.7	-3.6	-3.3
Primary balance	-0.1	-1.1	-1.7	-1.5	-2.3	-2.1	-2.1	-2.2	-2.1	-1.8
Financing	1.4	2.4	2.8	2.8	3.7	3.5	3.6	3.7	3.6	3.3
External borrowing (net)	-0.5	0.7	0.8	0.6	1.3	1.4	1.6	1.6	1.6	1.5
Domestic borrowing (net)	1.0	2.2	2.4	2.5	2.4	2.1	2.0	2.1	2.0	1.9
Use of deposits	0.9	-0.6	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities										
Gross general-government debt 5/	39.4	38.9	36.9	36.7	37.4	38.6	39.8	41.1	42.2	43.1
Gross general-government debt excl. guarantees	37.1	36.6	34.8	34.8	35.6	36.9	38.2	39.6	40.8	41.8
External	18.6	18.1	17.0	16.2	16.2	16.5	17.1	17.7	18.2	18.6
Domestic	18.5	18.5	17.8	18.6	19.5	20.4	21.1	21.9	22.6	23.2
Memorandum items:										
Total capital spending	6.2	3.8	3.3	3.4	3.5	3.6	3.7	3.9	4.0	3.5
Fiscal balance (ESA2010 basis)	-0.8	-3.0	-2.9	-3.0	...	...	...	...	...	...
Output gap 6/	-2.5	-1.3	1.8	2.1	2.4	2.1	1.5	0.9	0.4	0.1
Cyclically adjusted balance 7/	-0.5	-2.0	-3.4	-3.5	-4.5	-4.2	-4.1	-4.0	-3.7	-3.3
CAPB 7/	0.7	-0.7	-2.2	-2.1	-3.0	-2.8	-2.6	-2.5	-2.2	-1.8
Structural fiscal balance 7/	0.0	-1.7	-3.5	-3.6	-4.1	-4.0	-3.9	-3.8	-3.6	-3.2
Gross general government debt (authorities definition) 8/	44.3	44.3	43.0	42.4	...	...	...	...	...	...
Nominal GDP (in billions of lei)	712.6	765.1	856.7	944.2	1,027.5	1,096.7	1,167.3	1,243.0	1,322.2	1,402.2

1/ Unless otherwise noted, the table is on a cash basis following GFSM 86. The general government is composed of the central government, local governments, social security funds, and the road fund company.

2/ For data comparability, does not include the EU agricultural subsidies reflected in authorities' budget reports starting 2016.

3/ Includes EU-financed capital projects. For data comparability, does not include the EU agricultural subsidies reflected in authorities' budget reports starting 2016.

4/ Does not include all capital spending.

5/ Total consolidated general-government debt, including state government debt, local government debt, and guarantees.

6/ Percentage deviation of actual from potential GDP.

7/ Expressed in percentage of potential GDP.

8/ Includes guarantees and intra-governmental debt.

Table 5b. Romania: General Government Operations, 2015–2024

(In millions of lei)

	2015	2016	2017	2018	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Revenue	233,795	220,966	239,867	277,452	306,471	334,904	358,526	382,470	405,244	424,866
Taxes	195,918	197,676	211,947	240,611	271,006	292,878	310,978	329,909	350,018	371,318
Corporate income tax	14,803	16,398	16,149	17,875	20,479	20,761	22,098	23,532	25,030	26,544
Personal income tax	27,288	28,384	30,751	23,631	24,448	26,486	28,175	29,973	31,881	33,896
VAT	57,132	51,675	53,544	59,609	66,527	72,391	77,493	82,604	88,102	94,049
Excises	26,018	26,957	26,604	28,518	30,252	31,311	32,251	33,218	34,215	35,241
Customs duties	816	883	933	1,050	1,206	1,274	1,342	1,417	1,495	1,579
Social security contributions	57,616	61,270	71,706	98,101	114,154	123,964	131,854	140,247	149,173	158,668
Other taxes	12,245	12,110	12,260	11,827	13,938	16,691	17,766	18,918	20,123	21,340
Nontax revenue	19,538	18,042	21,874	27,189	27,237	29,560	31,612	33,537	35,408	37,219
Interest Revenue	744	354	399	127	484	516	549	585	622	660
Capital revenue	918	768	830	849	883	914	942	970	999	1,029
Grants 1/	17,449	4,007	5,186	5,511	7,344	11,552	14,994	18,054	18,819	15,300
Financial operations and other	-29	473	29	3,291	0	0	0	0	0	0
Expenditure	243,426.0	239,270	264,161	304,302	344,136	373,237	400,052	428,324	453,201	471,433
Current expenditure	226,424	220,173	245,814	282,516	321,445	351,871	379,643	406,591	430,085	446,918
Compensation of employees	52,070	57,068	69,611	86,138	102,835	110,169	117,503	124,837	131,079	137,633
Goods and services	40,458	40,911	40,685	44,612	48,459	51,240	54,015	56,900	59,890	62,904
Interest	9,573	10,014	10,125	12,944	14,712	15,718	17,644	18,952	21,025	22,443
Subsidies	6,275	6,605	6,201	6,670	6,947	7,175	7,382	7,570	7,763	7,961
Transfers	117,591	105,178	118,914	131,765	148,068	167,118	182,619	197,821	209,785	215,400
Pensions	51,532	51,707	57,081	62,885	69,473	80,049	88,468	96,976	103,959	111,245
Other social transfers	24,430	30,111	35,490	38,479	42,483	44,230	45,509	46,669	47,859	49,079
Other transfers 2/	37,632	19,380	21,112	23,368	27,277	33,764	39,348	44,684	48,271	44,672
Other spending	3,998	3,980	5,232	7,032	8,835	9,075	9,294	9,492	9,696	10,404
Projects with external credits	456	396	277	388	422	450	479	511	543	576
Capital expenditure 3/	18,039	19,098	19,559	23,585	23,778	22,527	21,643	23,047	24,515	25,998
Reserve fund	0	0	0	0	0	0	0	0	0	0
Net lending and expense refunds	-1,037	0	-1,212	-1,799	-1,087	-1,160	-1,235	-1,315	-1,399	-1,483
Fiscal balance	-9,631	-18,304	-24,295	-26,851	-37,665	-38,333	-41,526	-45,853	-47,958	-46,566
Primary balance	-802	-8,644	-14,569	-14,034	-23,436	-23,131	-24,431	-27,486	-27,555	-24,783
Financing	9,631	18,304	24,295	26,851	37,665	38,333	41,526	45,853	47,958	46,566
External borrowing (net)	-3,809	4,983	6,508	6,103	12,873	14,830	18,353	20,265	21,195	20,580
Domestic borrowing (net)	7,227	16,770	20,321	24,039	24,792	23,503	23,173	25,588	26,762	25,986
Use of deposits	6,435	-4,428	-2,158	-1,954	0	0	0	0	0	1
Privatization proceeds	0	0	0	0	0	0	0	0	0	0
Financial liabilities										
Gross general-government debt 4/	280,415	297,449	315,801	346,929	384,595	422,928	464,453	510,307	558,264	604,831
Gross general-government debt excl. guarantees	264,274	280,407	298,334	328,356	366,021	404,354	445,880	491,733	539,691	586,257
External	132,701	138,579	145,884	153,115	165,988	180,818	199,171	219,436	240,632	261,212
Domestic	131,573	141,828	152,450	175,241	200,033	223,536	246,709	272,297	299,059	325,045
Memorandum item:										
Total capital spending	44,299	30,831	28,065	31,684	35,461	39,551	43,163	48,736	52,571	49,227
Gross general government debt (authorities definition) 5/	315,934	339,080	368,236	400,776	…	…	…	…	…	…

1/ For data comparability, does not include the EU agricultural subsidies reflected in authorities' budget reports starting 2016.

2/ Includes EU-financed capital projects. For data comparability, does not include the EU agricultural subsidies reflected in authorities' budget reports starting 2016.

3/ Does not include all capital spending.

4/ Total consolidated general-government debt, including state government debt, local government debt, and guarantees.

5/ Includes guarantees and intra-governmental debt.

Table 5c. Romania: Consolidated General Government Balance Sheet, 2012-2017

(In millions of lei, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017
Net worth and its changes:	**491,452**	**512,173**	**521,974**	**558,900**	**591,740**	**615,198**
Nonfinancial assets	**597,894**	**643,361**	**665,701**	**706,420**	**757,194**	**796,236**
Fixed assets	583,573	628,600	648,789	687,028	737,410	775,136
Buildings and structures	....	....	....	....	....	
Machinery and equipment	....	....	....	....	....	
Other fixed assets	....	....	....	....	....	
Inventories	14,321	14,761	16,912	19,392	19,784	21,100
Valuables	....	....	....	....		
Nonproduced assets	....	....	....	....		
Financial assets	**171,254**	**170,679**	**186,827**	**190,758**	**204,804**	**207,499**
by instrument						
Monetary gold and SDRs	-	-	-	-		
Currency and deposits	31,956	38,464	49,973	46,751	62,155	58,116
Securities other than shares	187	187	197	100	104	247
Loans	6,666	6,603	6,610	6,718	7,050	7,545
Shares and other equity	82,983	74,215	74,762	72,799	72,328	77,247
Insurance technical reserves	-	18	23	123	52	55
Financial derivatives	-	-	-	-		
Other accounts receivable	49,463	51,192	55,262	64,268	63,115	64,289
by debtor						
Domestic	154,013	152,498	166,962	165,285	179,850	182,713
Foreign	17,241	18,181	19,865	25,473	24,954	24,786
Liabilities	**277,696**	**301,867**	**330,554**	**338,279**	**370,258**	**388,537**
by instrument						
Special Drawing Rights (SDRs)	-	-	-	-	-	-
Currency and deposits	4,987	4,222	6,755	8,754	8,409	7,412
Securities other than shares	143,517	165,716	199,583	210,816	228,992	249,911
Loans	80,374	79,601	75,256	69,395	66,106	59,924
Shares and other equity	2	-	-	-		
Insurance technical reserves	128	164	202	259	303	358
Financial derivatives	-	-	-	-		
Other accounts payable	48,687	52,163	48,759	49,055	66,448	70,932
by debtor						
Domestic	151,746	157,658	173,693	182,944	197,613	204,203
Foreign	125,950	144,209	156,859	155,335	172,645	184,334
Memorandum items						
Net financial worth	(106,441)	(131,188)	(143,727)	(147,520)	(165,454)	(181,038)
Maastricht debt	219,762	238,882	262,195	269,151	285,553	301,158
Memorandum:						
Nominal GDP (Lei - billions)	593.7	635.5	668.6	712.6	765.1	856.7

Sources: Romanian authorities; Eurostat; and IMF staff calculations.

Table 6. Romania: Monetary Survey, 2014–20

(In millions of lei, unless otherwise indicated; end of period)

	2014	2015	2016	2017	2018 Prel.	2019 Proj.	2020 Proj.
			I. Banking System				
Net foreign assets	**94,282**	**108,650**	**144,983**	**158,989**	**166,578**	**173,376**	**185,513**
In millions of euros	21,035	24,014	31,927	34,120	35,717	36,500	39,055
o/w commercial banks	-11,778	-9,799	-5,781	-1,691	-1,210	1,229	3,842
Net domestic assets	**167,549**	**177,605**	**169,151**	**191,123**	**214,498**	**253,525**	**279,809**
General government credit, net	39,194	46,676	36,415	46,132	56,699	78,263	89,988
Private sector credit	211,164	217,399	220,101	232,603	251,100	271,459	289,017
Other	-82,809	-86,470	-87,365	-87,613	-93,301	-96,196	-99,196
Broad Money (M3)	**261,831**	**286,256**	**314,135**	**350,112**	**381,075**	**426,901**	**465,322**
Money market instruments	258	129	109	107	0	0	0
Intermediate money (M2)	261,573	286,126	314,026	350,005	381,075	426,901	465,322
Narrow money (M1)	118,582	149,550	179,980	210,636	235,126	246,481	266,044
Currency in circulation	39,890	46,482	54,672	63,273	67,704	71,047	76,685
Overnight deposits	78,691	103,069	125,308	147,364	167,422	175,435	189,358
			II. National Bank of Romania				
Net foreign assets	**147,071**	**152,988**	**171,235**	**166,868**	**172,318**	**167,540**	**167,262**
In millions of euros	32,813	33,813	37,708	35,811	36,947	35,272	35,213
Net domestic assets	**-78,694**	**-78,998**	**-85,769**	**-69,018**	**-71,968**	**-62,392**	**-53,768**
General government credit, net	-41,757	-37,675	-47,449	-41,079	-37,424	-31,424	-25,424
Credit to banks, net	-24,064	-27,465	-22,897	-13,396	-17,746	-17,246	-17,246
Other	-12,873	-13,857	-15,423	-14,543	-16,798	-13,721	-11,098
Reserve money	**68,377**	**73,990**	**85,466**	**97,850**	**100,350**	**105,148**	**113,493**
			(Annual percent change)				
Broad money (M3)	8.4	9.3	9.7	11.5	8.8	12.0	9.0
NFA contribution	13.9	5.5	12.7	4.5	2.2	1.8	2.8
NDA contribution	-5.5	3.8	-3.0	7.0	6.7	10.2	6.2
Reserve money	-0.4	8.2	15.5	14.5	2.6	4.8	7.9
NFA contribution	21.7	8.7	24.7	-5.1	5.6	-4.8	-0.3
NDA contribution	-22.1	-0.4	-9.2	19.6	-3.0	9.5	8.2
Domestic credit, real	-5.7	6.5	-2.3	5.2	6.5	3.6	5.4
Private sector, real	-4.1	3.9	1.8	2.3	2.3	1.3	1.1
Public sector, real	-13.2	20.2	-21.6	22.6	35.2	17.9	34.9
Broad money (M3), in real terms	7.5	10.4	10.3	7.9	7.9	8.0	6.4
Private credit, nominal	-3.3	3.0	1.2	5.7	8.0	8.1	6.5
Memorandum items:							
CPI inflation, eop	0.8	-0.9	-0.5	3.3	3.3	4.5	3.5
NBR inflation target band	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5
Interest rates (percent)							
Policy interest rate	2.75	1.75	1.75	1.75	2.50	…	…
Interbank offer rate, 1 week	0.7	0.6	0.6	1.5	2.4		
Corporate loans 1/	5.9	4.4	3.7	4.9	5.8	…	…
Household time deposits 1/	2.8	1.5	0.9	0.8	1.8	…	…
Share of foreign currency private deposits	33.9	33.3	32.3	32.8	34.2	…	…
Share of foreign currency private loans	56.4	49.3	42.8	37.2	34.0	…	…

Sources: National Bank of Romania; and IMF staff estimates and projections.

1/ Rates for new local currency denominated transactions.

Table 7. Romania: Financial Soundness Indicators, 2010–18

(In percent)

	2010 Dec.	2011 Dec.	2012 Dec.	2013 Dec.	2014 Dec.	2015 Dec.	2016 Dec.	2017 Dec.	2018 Dec.
Core indicators									
Capital adequacy									
Capital to risk-weighted assets	15.0	14.9	14.9	15.5	17.6	19.2	19.7	20.0	20.7
Tier 1 capital to risk-weighted assets 1/	14.2	13.9	13.8	14.1	14.6	16.7	17.5	18.0	18.6
Asset quality									
Nonperforming loans to total gross loans 2/	11.9	14.3	18.2	21.9	20.7	13.5	9.6	6.4	5.0
IFRS Provisions for NPLs / NPLs	...	...	76.7	67.8	56.6	57.7	56.3	57.7	58.5
Earnings and profitability									
Return on assets	-0.2	-0.2	-0.6	0.0	-1.3	1.2	1.1	1.3	1.6
Return on equity 3/	-1.7	-2.6	-5.9	0.1	-12.5	11.8	10.4	12.5	14.6
Net interest income to operating income	60.6	62.0	62.3	58.8	58.6	58.5	56.3	58.8	65.4
Noninterest expense to operating income (cost to income)	64.9	67.8	58.7	56.5	55.5	58.4	53.0	55.1	53.2
Personnel expense to operating income	21.0	21.9	26.0	25.5	24.9	26.6	24.7	26.1	25.6
Liquidity									
Liquid assets 4/ to total assets	60.0	58.7	57.6	56.2	57.4	54.1	53.4	53.4	52.6
Liquid assets 4/ to short-term liabilities 5/	142.2	139.0	147.7	156.3	158.9	163.4	156.3	145.6	171.0
Foreign exchange risk									
Net open position in foreign exchange, in percent of capital	-1.4	-4.7	1.3	2.5	-2.0	0.7	0.5	0.8	0.7
Foreign-currency-denominated loans to total loans	63.0	63.4	62.5	60.9	56.2	49.3	42.8	37.2	34.0
Foreign currency liabilities, in percent of total liabilities	37.3	36.8	37.5	35.9	34.9	33.8	31.1	30.3	30.9
Encouraged indicators									
Deposit-taking institutions									
Leverage ratio 6/	8.9	8.1	8.0	7.9	7.4	8.2	8.9	8.9	9.3
Personnel expenses to noninterest expenses	32.3	32.2	44.3	44.9	45.0	46.1	46.6	47.4	48.2
Customer deposits to total (non-interbank) loans	84.8	84.0	87.3	98.7	109.5	115.6	124.6	130.0	127.1
Loan-to-Deposit (LTD) Ratio	117.9	119.1	117.4	104.6	91.3	85.4	79.1	74.7	73.6
Structural indicators (December 2018)									
Number of banks: 34; Number of foreign-owned subsidiaries/branches: 21/7;									

Source: National Bank of Romania.

1/ For 2010, market and operational risk are not used in compiling risk weighted assets.

2/ In December 2015, the NBR moved from a national definition to an EBA methodology-based definition of NPL's.

3/ Return on equity is calculated as net profit/loss to average own capital.

4/ Liquid assets = balance sheet assets and off balance sheets items with residual maturity of up to 3 months.

5/ Short term liabilities = balance sheet liabilities and off balance sheet items with residual maturity of up to 3 months.

6/ Tier 1 capital to average assets.

Annex I. Summary and Evolution of December 2018 GEO 114 Policy Measures

In December 2018, the government announced policy measures under emergency ordinance (GEO 114/2018) and caught the market by surprise due to several drastic clauses contained in the original announcement and the uncertainty on the final format to be implemented. The announced measures were modified upon adoption, with extensive additional modifications in March 2019 (GEO 19/2019) and again in May 2019. Further modifications look possible.

While the package can generate some additional fiscal revenue, it is likely to have significant negative impact, especially when the broader impact of the surprise announcement on the predictability of business environment and legislative stability are considered. The package still contains many measures that distort markets, including through differentiated sectoral treatments without a clear economic rationale. Some of them potentially violate EU competition rules.

Measures adopted in December 2018 (GEO 114/2018)	Revisions announced in March 2019 (GEO 19/2019)	Subsequently announced revisions (as of June 2019)
1. Sectoral **tax on bank assets** increasing with the level of ROBOR - 0% for ROBOR up to 2% - 0.1% per quarter for 2-2.5% ROBOR - 0.2% per quarter for 2.5-3% ROBOR - 0.3% per quarter for 3-3.5% ROBOR - 0.4% per quarter for 3.5-4% ROBOR - 0.5% per quarter for ROBOR above 4%	Substantially **revised**: - de-link from ROBOR - 0.4% of assets per year for banks with market share of 1% or more - 0.2% of assets per year for banks with market share of less than 1% -tax rate is reduced depending on the credit growth rate, relative to a preset target. 2019 target for credit growth is 8% - tax rate is reduced if interest margin is reduced relative to a benchmark margin. 2019 target for cut in interest margin is 8% from a benchmark interest margin of 4 percentage points - loss making banks are not subject to the tax - the tax is effectively applied only to the credit to the private non-financial sector (government debt securities, loans to credit institutions and several other asset types are exempt)	Additional revisions announced in May 2, 2019: - For new loans ROBOR replaced with interbank transactions-based index (IRCC), based on average inter-banking transaction rates two quarters earlier. - existing loans not affected
2. Sectoral **turnover tax on energy and telecommunications** - Increased from 0.4 to 3% for telecoms - Increased from 0.1 to 2% for energy	One substantial modification: - Coal-fired electricity producers exempted from the 2% tax	

Measures adopted in December 2018 (GEO 114/2018)	March 2019 package of revisions (GEO 19/2019)	Subsequently announced revisions (as of June 2019)
3. Temporary **energy price caps** - Duration of 3 years - For gas, at the level of 68 lei/MWh, below the market price of 90 lei/MWh at the time of announcement - For electricity, caps to be determined by energy regulator	Substantially **revised and postponed**: - Non-residential consumers excluded from the price caps - Implementation postponed from April 1st to May 1st because earlier implementation judged not technically feasible	
4. Changes to the **2nd pension pillar** - Participants can opt out of the 2nd pillar contributions after a minimum of 5-year participation. - Very sizable (more than 10-fold) increase in minimum capital requirements for pension fund administrators - A reduction in management fees from 2.5% to 1% of contributions	Implementation **postponed** until June 2019	Substantially **revised** on May 31, 2019: - the increase in minimum capital requirements reduced from a 10-fold increase to a 10-15 percent increase. - implementation postponed to end-June 2019
5. Sectoral **tax exemptions for construction** activities - applied to firms with more than 80% of total activities pertaining to construction - reduction or exemption from PIT and parts of employer/employee SSC, with the latter limited to 2019-2028 - minimum wage hike in construction to 3000 RON/month (more than 40 percent higher than the statutory minimum wage)	**No change**	The definition of activities benefitting from the exemptions clarified and expanded.
6. **Amendments to procurement framework** - reduced and de-centralized external control (including for EU-funded contracts)	**No change**	

Annex II. Potential Macroeconomic Vulnerabilities

The relatively narrow financing base and higher vulnerabilities accumulated due to procyclical policies since 2015 raise risks of a hard landing in the event of an adverse external financing shock. Market developments in the months after December 2018 were a short-lived stress episode.

A. Indicators for Vulnerability in a Romanian Context

1. At first glance, and relative to other EU countries, Romania's indicators do not appear concerning (table)**.** Public debt ratios are relatively low, current account and fiscal deficits higher but not extraordinarily large for a fast-growing emerging market economy, reserve coverage comfortable by most Fund metrics for floating regimes, and banking liquidity ample. Buffers also exist on several other fronts.[1] The indicators are better on the whole than the levels in 2008 just before the last major crisis, although showing some deterioration compared to 2015.

Romania: Selected Indicators, 2018 vs. 2015 and 2008

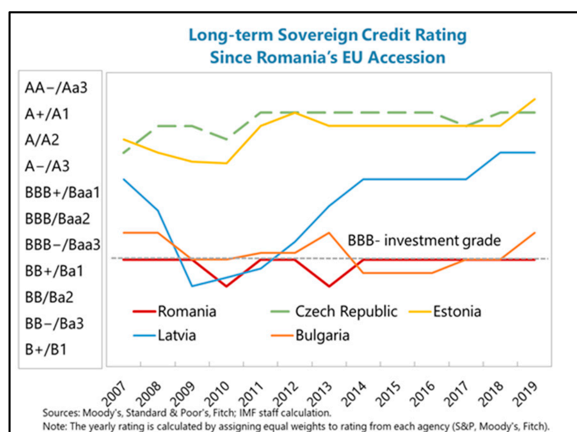
	2018	2015	2008
Current account balance, % of GDP	-4.5	-1.2	-11.6
Fiscal balance (cash), % of GDP	-2.8	-1.4	-4.6
- structural fiscal balance, % of GDP	*-3.6*	*-0.0*	*-8.5*
Gross public debt, direct debt only, % of GDP	38.9	37.1	11.3
External debt, % of GDP	48.1	57.4	51.8
Private credit (%, yoy)	8.0	3.0	33.7
Gross international reserves, billion euros 1/	36.8	35.5	28.3
- months of next year GNFS imports	*4.3*	*5.9*	*7.8*
- share of short-term external debt (in percent) 2/	*87.7*	*89.2*	*89.2*
Gross external financing requirement, billion euro 2/	48.1	35.1	34.4
Gross fiscal financing requirement, % of GDP	7.7	8.6	6.3
- in euro billion equivalent	*15.5*	*13.7*	*9.3*
Government debt held by non-official creditors, % of GDP	36.5	34.2	14.8
of which: Eurobonds	*11.8*	*10.5*	*1.6*
Non-residents holdings share of domestic government securities, % of total	20.2	*17.6*	*6.8 3/*
Private loans as percent of deposits (%, end period)	80.1	90.7	133.5

1/ Since 2011, includes fiscal buffer in FX built up towards four months of financing needs.
2/ Partly reflects methodological changes that increased short-term corporate external debt beginning 2016.
3/ Earliest reported share for December 31, 2009.

2. However, a detailed analysis of indicators reveals potential sources of concern. The concern will be heightened in the event of a large adverse shock, especially amidst a weakening outlook for the eurozone that dominates Romania's external trade and financial exposures:

- Romania's relatively low **public debt ratio** hides some potential vulnerabilities. Before the GFC shock, the public debt ratio was significantly lower than its current value.[2] While public debt maturity profile has been lengthened over recent years, the absolute size (nominal value) of market borrowing, both in domestic currency bonds and Eurobonds, has increased markedly (see table). Furthermore, despite the low public debt ratio, Romania's sovereign credit rating has

Long-term Sovereign Credit Rating Since Romania's EU Accession



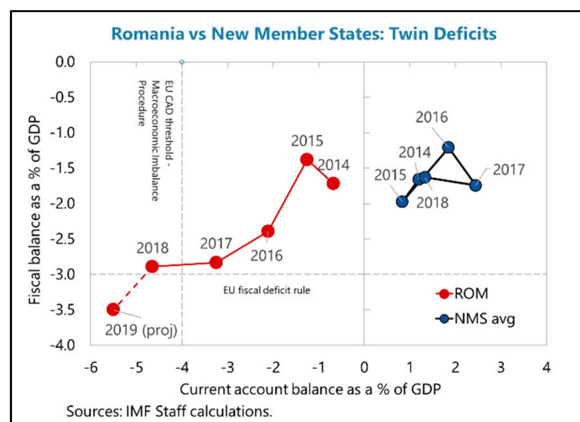
Sources: Moody's, Standard & Poor's, Fitch; IMF staff calculation.
Note: The yearly rating is calculated by assigning equal weights to rating from each agency (S&P, Moody's, Fitch).

[1] EU structural funds should provide ample FX inflows to finance productive public investments, as long as they are efficiently absorbed. Furthermore, a fiscal FX financing buffer has been built up, which was intended to cover several months of gross fiscal financing needs.

[2] Romania began a series of three programs from 2009. In a nutshell, external and fiscal financing gaps at program outset were caused by the GFC financing shock amidst severe FX and term mismatches, with the financing requirements having surged following highly procyclical fiscal policies in the run-up to the 2008 elections.

not risen above the borderline-investment grade in a decade after the EU accession.

- In contrast to its EU new member state peers, the **current account deficit** widened rapidly from being close to balance in 2014 and exceeded 4 percent of GDP in 2018, which is the indicative EU's macroeconomic imbalance procedure threshold. This deficit has mostly been financed with FDI and EU funds, which have in recent years together amounted to about 4 percent of GDP. A deficit above the 4 percent level would likely require additional market financing, increasing Romania's sensitivity to global financial market conditions.



Sources: IMF Staff calculations.

- After having reached its Medium Term Objective (a fiscal deficit of 1 percent of GDP) in 2015, the structural **fiscal deficit** (cyclically adjusted, excluding one-off measures) has substantially deteriorated in recent years, reaching 3.6 percent of GDP in 2018.
- **Reserve coverage** is declining as imports have surged in recent years, while external public debt service requirements are sizable (Table 4: Gross External Financing Requirements).
- As a broad indicator of available **banking liquidity**, headline loan-to-deposit ratios appear comfortable. However, in a small financial sector with a high domestic sovereign exposure (at 20 percent of bank assets, the highest in EU as noted in the 2018 FSAP), there may be limited room to further increase exposure to the sovereign.

B. Market Developments Following GEO 114

3. **Following the launch of the fiscal policy package (GEO 114, Annex I) in mid-December 2018, market pressures surged in January 2019 (panel figure).** The initial design of the policy package (revised subsequently) appeared to potentially affect Romania's external and fiscal financing bases, having been aimed at banks and pillar II pension managers (together holding about 65 percent of the government's lei securities). It also appeared to be targeted at important FDI sectors (energy and telecoms).

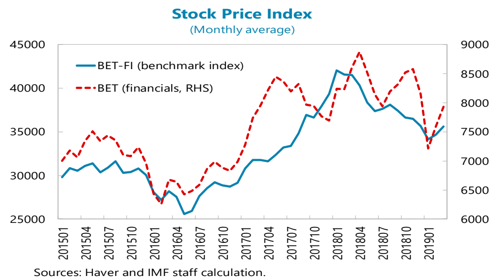
- Heightened policy uncertainty surrounding the implementation of these measures initially led to the largest one-day **stock market** drop (over 15 percent) since the GFC, followed by some recovery once the revision of the measures was indicated.[3]
- With signs of some financial outflows and sharply higher trade deficit in January 2019, the lei-euro **exchange rate** depreciated by about 2 percent in January. Romania's exchange rate and financial flow movement contrasted with the backdrop of a broadly favorable "risk-on" environment of portfolio inflows into emerging markets since Q4 2018.

[3] Romania is classified as a Frontier equity market, limiting its foreign investor base.

- The EMBI **spreads** for Romania have widened relative to CEE peers since 2017, with an additional widening since December 2018. A major credit rating agency in March 2019 had signaled a possible downgrade to sovereign rating outlook, conditional on corrective actions for GEO 114, but subsequently kept the outlook after changes were made by end-March.

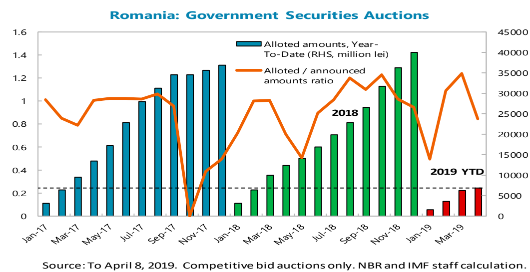
Annex Figure 1. Romania: Recent Market Developments

Sharp stock market decline in December 2018 led by banks/financials following GEO 114, partial recovery thereafter as measures revised.



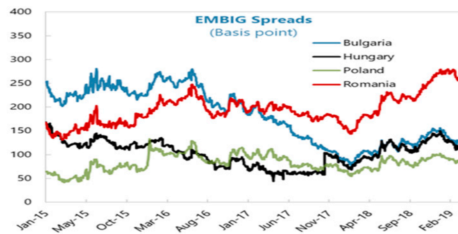
Sources: Haver and IMF staff calculation.

Government lei securities auctions underperformed in January-February 2019, with recovery from March.

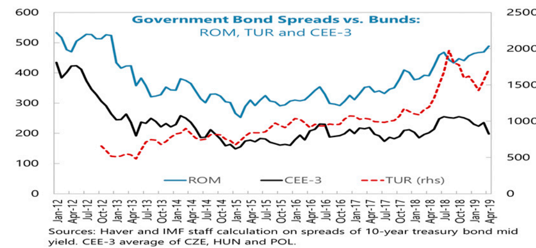


Source: To April 8, 2019. Competitive bid auctions only. NBR and IMF staff calculation.

External bond spreads relative to peers have risen more over year 2018, peaking in late December 2018-January 2019.

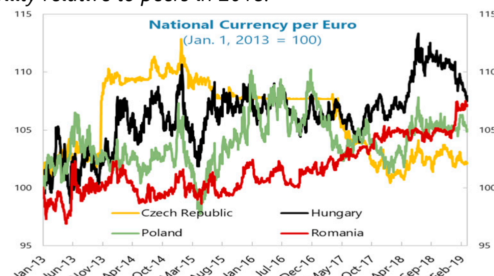


Spreads relative to German bunds have also been on upward trajectory and diverged more relative to peers since late 2018.

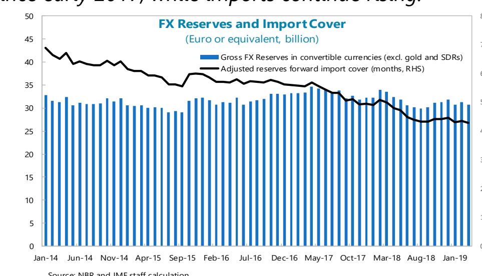


Sources: Haver and IMF staff calculation on spreads of 10-year treasury bond mid yield. CEE-3 average of CZE, HUN and POL.

Currency depreciation in January 2019, after a period of stability relative to peers in 2018.



While still adequate, reserves levels deteriorating somewhat since early 2017, while imports continue rising.



Sources: Haver, NBR and IMF staff calculations.

C. Results of the Growth-at-Risk Model

4. Findings of the Fund's Growth-At-Risk (GaR) model.

To illustrate the consequence of potential vulnerabilities in the event that significant tail risks from the IMF's Global Risk Assessment Matrix materialize (see Annex-RAM), we use a partial-least-squares

version of the Fund's Growth-At-Risk model (WP/19/36) that was customized and calibrated with Romania's data.

5. Model summary and caveats. The GaR estimates the distribution for GDP growth rates conditional on macro-financial variables, which are combined in partitions. For Romania, the main regressors for the four partitions are:

(i) Domestic financial conditions (one-week and 3-month ROBOR, interest rate volatility and inflation)

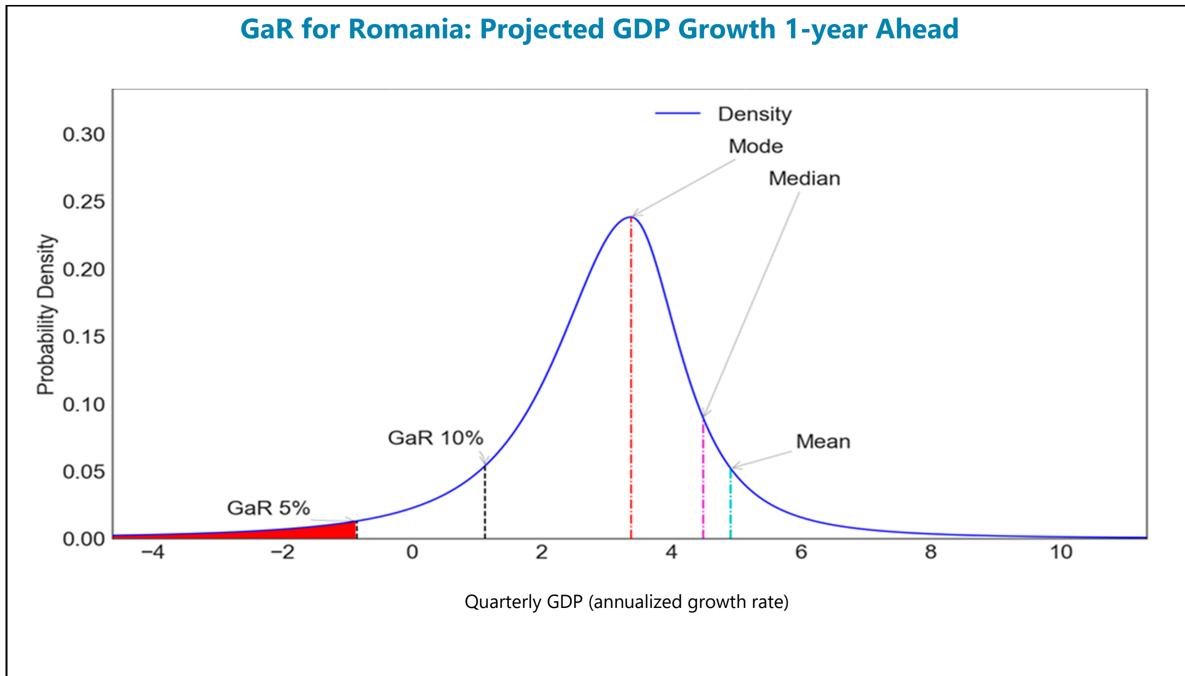
(ii) Main trading partners' macro conditions (Germany's GDP growth and share of exports relative to its GDP, Romania import shares for Germany, France and Italy)

(iii) Euro area (EA) financial conditions (EA VIX, 1-week Euribor, EA inflation)

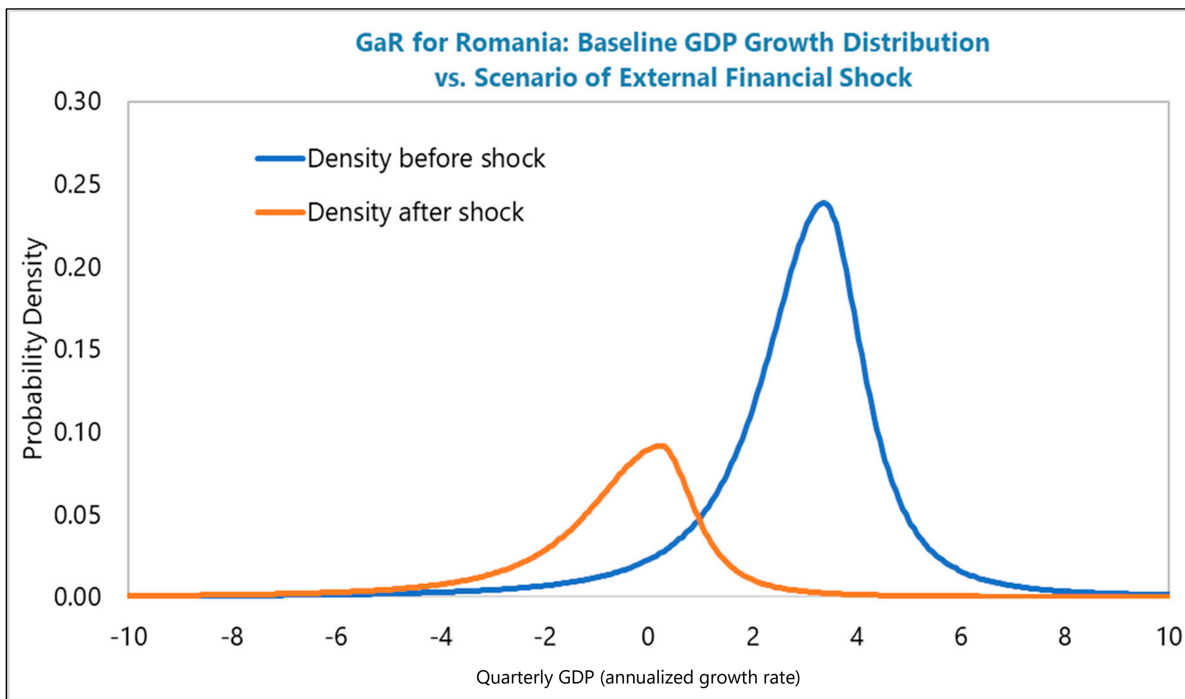
(iv) World financial conditions (VIX, CEE bond flows, oil prices and its implied volatility)

Because of data limitations, the model is estimated for Romania starting from year 2000 (or in a few cases from 2008 onwards). The short sample period limits the statistical accuracy and applicability of the results for Romania. The modelling also does not factor in the availability of buffers which exist in the case of Romania (e.g. FX reserves and fiscal financing buffer). Such buffers may be utilized in response to adverse shocks, assuming the shock is temporary.

6. Results. The GaR analysis shows that external financial conditions have by far the largest adverse growth impact in the downside tails of the distribution, especially under an external volatility shock, such as occurred during the GFC and the European crisis. Domestic financial conditions have a relatively small influence, reflecting low domestic financial intermediation. Trade partner growth has been a steady contributing factor to Romania's growth since year 2000, reflecting Romania's rising export market share especially in autos (Dacia and Ford FDI). The historical distribution and 1-year ahead projected distribution of GDP growth suggest that Romania has a relatively high trend growth (close to 3.3 percent) which could continue conditional on recent factors. However, there is a non-negligible probability of a sharp growth deceleration in the event of an external financing shock.



To illustrate the sensitivity of growth to adverse external financing shocks, the VIX was shocked by ½ standard deviation, as a key external financial volatility factor. The resulting values of the VIX are similar to the levels that prevailed in 2010 and briefly in 2015. This would shift the distribution to one with a mode of virtually recessionary levels (orange distribution below, relative to the original distribution).



Annex III. Risk Assessment Matrix (RAM) 1/

Risk	Relative Likelihood and Transmission Channels	Expected Impact if Risk is Realized	Policy Response
External risks			
1. Weaker-than-expected global growth, notably in Europe (short / medium term)	**High** • Significantly lower exports, given Romania's trade integration with Europe, worsening the CA deficit at a conjuncture where imports are still elevated on domestic demand stimulus.	**High/Medium** • Worsening CA deficit making external financing challenging, and potentially trigggering higher portfolio outflows as investors reassess risks. • Weaker investment activity, slower growth and rise in unemployment • Slowing activity resulting in weaker fiscal revenues and increase in borrowing costs	• Allow greater exchange rate flexibility. • If medium-term inflation outlook remains contained, some monetary loosening could also be undertaken. • Utilize some of fiscal financing buffer, on a temporary basis, until markets settle down. • Diversify export markets and products, including through integration in new supply chains over the medium-term • Improve business environment to attract new investments, including FDI.
2. Rising protectionism and retreat from multilateralism (short / medium term)	**High** • Escalating and sustained trade actions (including auto tariffs) lower Romania's exports, which are integrated into European automotive supply chains. • Lower FDI in affected sectors.	**Medium** • Decline in exports, worsening CA deficit • Weaker investment activity. • Slower growth and rise in unemployment	• Allow greater exchange rate flexibility. • Diversify export markets and products, including thorugh integration in new supply chains. • Improve business environment to attract new investments, including FDI. • Strengthen multilateral and regional collaboration.
3. Sharp tightening of global financial conditions, notably sustained rise in risk premium in reaction to concerns about a disorderly Brexit (short term)	**Medium** • Investors may sell Romanian financial assets after reassessment of risks, as outflows could arise from foreign holdings of government bonds and short-term debt. • Possible disruptions to UK-related trade flows (4% of direct exports). • Financial market volatility could lead to a rapid and significant rise in interest rates and currency depreciation.	**Medium** • Increase in borrowing costs • Risk of exchange rate overshooting and financial instability. • NPLs rise due to weakened repayment capacity of borrowers of lei and FX loans.	• Tighten monetary settings, allow greater exchange rate flexibility. • Utilize some of fiscal financing buffer, on a temporary basis, until markets settle down.
Domestic risks			
4. Excessive fiscal relaxation and wage increases resulting in loss of fiscal credibility (short/medium term)	**High** • Associated worsening of market sentiment, and fiscal financing turns challenging. • Romania enters EU's Excessive Deficit Procedure • External competitiveness suffers. • Risk of credit rating downgrade on fiscal and debt trajectory.	**High/Medium** • Rapid deterioration in twin deficits (current account and fiscal), with increased financing constraints. • Possible feedback loops through banks, given debt exposures (sovereign-bank nexus). • Loss of external competitiveness on surging labor costs, and increased unemployment of lower-segments of workforce.	• Tighten monetary and fiscal policies to reduce aggregate demand, within a prudent policy mix. • Implement wage and pension changes in line with fiscal space, while tightening spending reviews and strengthening budget composition towards quality investment. • Raise revenues and tax administration efficiency. • Articulate medium-term fiscal framework and ensure predictable policies, with some objective criteria (e.g. minimum wage increases tied to competitiveness/productivity gains, and public wages and pensions considering available fiscal space)
5. Slippages in macro-critical structural reforms and continued heightened policy uncertainty (short / medium term)	**High/Medium** • Uncertainty about business environment • Risk of credit rating downgrade and increased cost of capital	**Medium** • Suppressed investment and further delays in infrastructure upgrades • Stagnant productivity growth and loss of competitiveness • New fiscal risks could emerge	• Re-start the structural reform process • Reduce uncertainty associated with new policy initiatives by (i) developing, implementing and adhering to longer-term policy frameworks, (ii) conducting high-quiality prior impact assesments, (ii) seeking prior consultation with stakeholders and (iii), when advisable, allowing for transitional periods in poicy implementation

1/ The RAM shows events that could materially alter the baseline path. (The scenario most likely to materialize in the view of IMF staff.) The relative likelihood of risks is staff's subjective assessment of risks surrounding the baseline. Non-mutually exclusive risks may interact and materialize jointly.

Annex IV. Implementation of the 2018 Article IV Key Recommendations

Key Recommendations	Policy Actions
Fiscal	
Bring the 2018 fiscal deficit below a cyclically neutral level to reduce the burden on monetary policy (for macroeconomic stabilization) and improve the consumption-investment balance.	**Not implemented.** The cyclically adjusted fiscal deficit widened further in 2018, with continued bias towards consumption, reflecting expenditure increases (mostly wages, and to a lesser extent interest costs and pensions) and lower personal income taxes, despite higher social security contributions (following a shift) and higher non-tax revenues. The current account deficit widened further.
Measures to lower the deficit should avoid further deterioration of the budget structure and protect capital spending.	**Not implemented.** The budget deficit target was met through one off or low-quality measures involving extraordinary SOE dividends, retrospective EU financing, postponed VAT refunds and deferment of some spending. Share of rigid items increased, while capital spending as a ratio of GDP remained close to the compressed level of 2017.
Improve fiscal policy efficiency by improving tax collection efficiency, including by reforming tax administration for the VAT and operationalizing new IT infrastructure. Bolster expenditure efficiency by undertaking expenditure reviews and adopting centralized procurement system, while continuing efforts to improve EU funds absorption.	**Limited progress.** Apart from electronic cash registers, limited reforms of tax administration were undertaken, and a longstanding IT modernization project was cancelled. Centralized procurement was launched but progress on spending reviews was modest, while absorption of new EU funds for infrastructure was weak.
Monetary and financial	
Continue tightening monetary policy to curb inflation and anchor expectations.	**Implemented.** The NBR raised its policy rate three times in H1 2018, and further tightened liquidity management to strengthen policy transmission to other rates. Inflation fell back to within the target band at end 2018.
Central bank and monetary policy should continue to stay independent, refraining from stimulating activity at the cost of higher inflation.	**Partially implemented.** NBR tightened monetary policy to achieve its inflation target, but the government introduced in December a bank asset tax linked to interbank rates, with the tax levels calibrated to a government-determined benchmark, potentially undermining monetary policy.
Arising from the FSAP, address vulnerabilities from exposure of banks to the government and the real estate sector, including continuing to scale back the Prima Casa guarantee program.	**Implemented/Substantial progress.** The central bank introduced a debt-service-to-income limit on household loans effective January 2019. The government thus far did not scale back the Prima Casa program in 2019.
Legislative initiatives that hamper financial intermediation and stability should be avoided.	**Limited progress.** Three legislative initiatives that affected the banking sector were adopted by the parliament but struck down by the Constitutional Court in March 2019. In December 2018 government introduced a sizable asset tax on the banking sector (subsequently scaled back in March 2019).
Structural reforms	
Strengthen public investment management institutions, while renewing commitment to strong corporate governance for SOEs. Plans for a sovereign investment fund and a development bank should reflect international best practices. Establish a transparent minimum wage mechanism based on objective set of criteria.	**Limited progress.** While higher than the previous year, EU funds absorption remained relatively low in 2018 for the programming period 2014-2020. Many SOEs in practice appear to not have applied corporate governance legislation (GEO 109) to their interim boards. Legal framework for the sovereign investment fund was established, but lacked clarity in defining objectives, risks and investment strategy, with initial board exemptions from corporate governance legislation. Minimum wages were raised in early 2018 without reference to criteria.

Annex V. Debt Sustainability Analysis

Public debt in Romania is expected to remain relatively low but rise gradually over the medium term. Under the baseline scenario, the public debt-to-GDP ratio is projected to reach 43.1 percent by 2024 from the current level of 36.7 percent. Gross public financing needs (7.5 percent of GDP in 2018) are expected to increase to 8.4 percent in 2019 and remain above 8 percent by 2024. While the DSA suggests that public debt is sustainable under various shocks, in the recession scenario debt reaches around 52 percent by 2024.[1] The combined macro-fiscal shock shifts the debt trajectory most significantly, pushing debt to 57 percent by 2024. Exposure to international capital outflows continue to present a notable risk, with the associated debt profile vulnerability indicator exceeding the upper early warning benchmarks.

A. Comparison with the Previous Assessment

1. The baseline debt trajectory has increased relative to last year's DSA. The debt outturn for 2018 was marginally lower-than expected, because the fiscal balance remained contained below 3 percent (outturn of 2.96 compared to 3.6 percent of GDP in 2018 DSA). Notwithstanding the lower debt base in 2018, the medium-term trajectory for debt is higher due to: (i) higher projected deficits for 2019-2024 compared to 2018 DSA, and (ii) lower projected growth for 2020-23 compared to 2018 DSA. Under the baseline scenario, the budget deficit is expected to exceed 3.5 percent over the period 2019-2023—without additional measures—thus violating the 3 percent rule under the Stability and Growth Pact. The budget deficit is expected to peak in 2022 at 3.7 percent of GDP due to increasing pension expenditures and the peak of the EU financing cycle, and gradually decline thereafter.

B. Baseline and Realism of Projections

2. Debt level. Under the baseline scenario, gross debt level (including guarantees) is projected to rise gradually over the medium term, reaching 43.1 percent in 2024. Gross financing needs are projected to increase to 8.3 percent of GDP by 2022—from 7.5 percent in 2018—and stabilize thereafter.

3. Fiscal balance and adjustment. In the baseline projection, the budget deficit peaks in 2022 at 3.7 percent of GDP and declines to 3.3 percent of GDP in 2024. The deterioration in the budget deficit in 2019 is mainly driven by the continued wage and pension increases. Over the medium term, revenue and expenditure projections are driven by the macroeconomic projections for key variables[2] and the assumption that absorption of EU funds will gradually improve over the medium term.[3] Taking into account the distribution of fiscal adjustment episodes provided in the DSA template (Figure 2), the projected 3-year adjustment in the cyclically-adjusted primary balance

[1] This scenario assumes a drop in real GDP growth to -0.9 percent in 2020 and 2021, with a sharp recovery thereafter.
[2] Including GDP, private consumption growth, inflation, imports, the exchange rate, employment growth, and wage growth.
[3] Higher absorption of EU funds leads to higher grants and lower capital spending directly funded out of the budget. Both in turn result in a slight increase in total capital spending over the medium term.

(CAPB) of 0.5 percent of GDP indicates that there may be room for a greater adjustment in Romania. Similarly, the 3-year average level of the CAPB places Romania in lower end of the distribution.

4. Growth. Considering the high sensitivity of Romania's debt dynamics to surprises in GDP growth, there seems to be no systematic projection bias in the baseline assumption for growth that could undermine the DSA assessment (Figure 2). The current real GDP growth projection of 4.0 percent for 2019 is significantly lower than the authorities' forecast of 5.5 percent. Reflecting the temporary nature of the fiscal impulse, as well as the slow progress in structural reforms, medium-term growth is expected to stabilize at 3.0 percent of GDP. The boom-bust analysis is not triggered because the three-year cumulative change in the credit-to-GDP ratio does not exceed 15 percent in Romania and output gap has been positive for less than three years.

5. Maturity, rollover and other risks. To manage financing risk, the authorities maintain a foreign currency financing buffer. The average maturity of government securities issued on the domestic market was 3.2 years at the end of 2018. The authorities have been addressing rollover risks under a debt management strategy which aims to issue longer-term securities as well as lengthen the yield curve. However, public debt continues to be vulnerable to exchange rate risk, with foreign currency denominated debt accounting for about half of total public debt. The new pension law presents a significant risk. An alternative scenario, incorporating the fiscal impact of the new pension law (see text table) shows public debt in 2024 reaching 59 percent of GDP—a 16 percentage point increase relative to the medium-term baseline.[4] At the same time, public gross financing needs jump to 14.4 percent of GDP.

C. Stochastic Simulations

6. The fan charts illustrate the possible evolution of the debt ratio over the medium term, based on both the symmetric and asymmetric distributions of risk. Under the symmetric distribution, there is a high level of certainty that debt will remain below 60 percent of GDP (threshold under the Stability and Growth Pact) over the medium term.

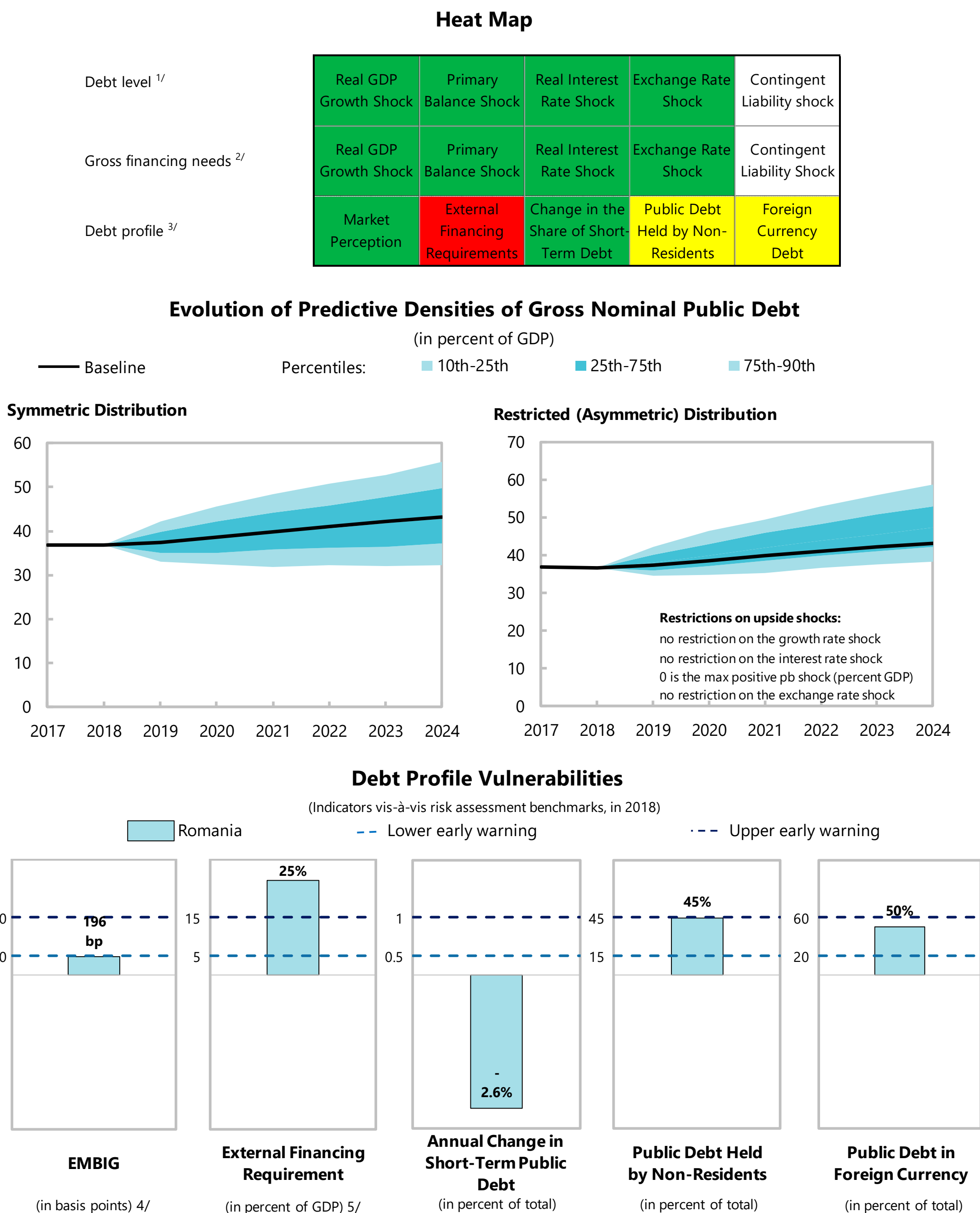
D. Stress Tests

7. Real GDP growth. The debt ratio remains below 60 percent of GDP under all scenarios (Figure 5) – however, it is most sensitive to the real GDP growth shock, under which debt reaches about 52 percent of GDP and public gross financing needs surge to 11.9 percent of GDP in 2021.

8. Combined shock. A combined shock incorporates the largest effect of individual shocks on all relevant variables (real GDP growth, inflation, primary balance, exchange rate and interest rate). Under this scenario, debt would reach 57 percent of GDP in 2024 without showing signals of a declining trajectory. Gross financing needs average at 11 percent over the 2021-2024 period.

[4] The scenario assumes that the widening fiscal deficits trigger a 300 bp increase in financing costs and a zero net impact on GDP growth rates, as the direct fiscal stimulus and worsening economic sentiment broadly offset.

Figure 1. Romania: Public DSA Risk Assessment



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

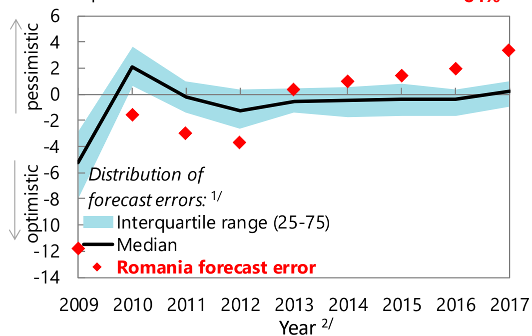
4/ EMBIG, an average over the last 3 months, 21-Dec-18 through 21-Mar-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

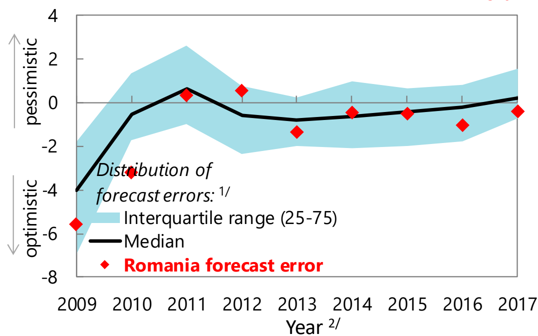
Figure 2. Romania: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus all countries

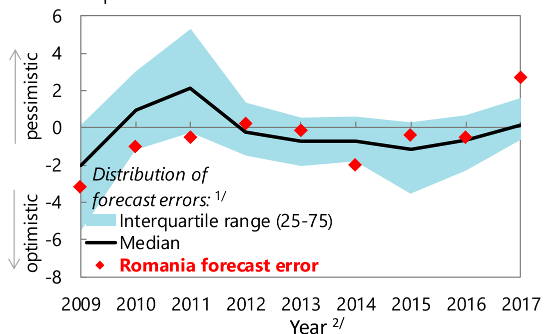
Real GDP Growth
(in percent, actual-projection)
Romania median forecast error, 2009-2017: **0.37**
Has a percentile rank of: **84%**



Primary Balance
(in percent of GDP, actual-projection)
Romania median forecast error, 2009-2017: **-0.52**
Has a percentile rank of: **48%**

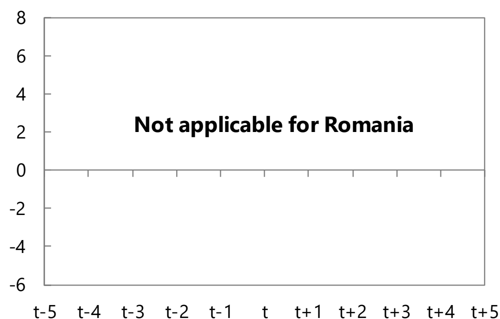


Inflation (Deflator)
(in percent, actual-projection)
Romania median forecast error, 2009-2017: **-0.48**
Has a percentile rank of: **45%**



Boom-Bust Analysis 3/

Real GDP growth
(in percent)
Roma...



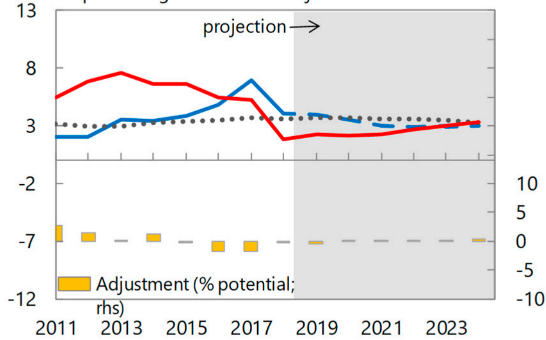
Source : IMF staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries
2/ Projections made in the spring WEO vintage of the preceding year
3/ Not applicable for Romania, as it meets neither the positive output gap criterion nor the private credit growth criterion.

Figure 2. Romania: Public DSA – Realism of Baseline Assumptions (concluded)

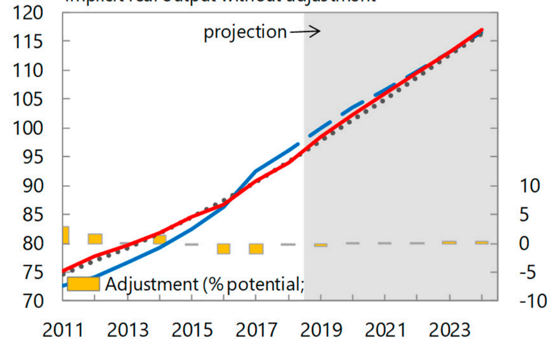
Growth and Level of Output in Absence of Fiscal Adjustment

Assumed multiplier of 1, persistence of 0.6

Real GDP Growth
(in percent)
Baseline real growth
Baseline real potential growth
Implicit real growth without adjustment

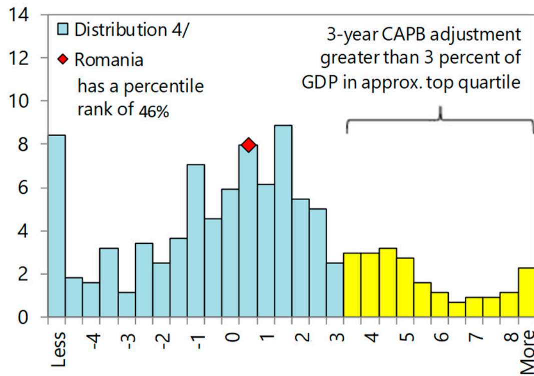


Real Output Level
(Baseline real output in 2019=100)
Baseline real output
Baseline real potential output
Implicit real output without adjustment

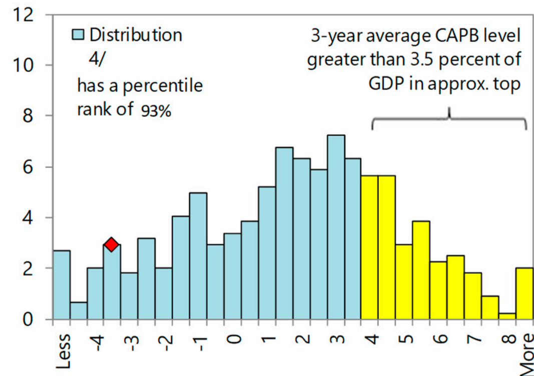


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Source : IMF staff.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 3. Romania: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent of GDP unless otherwise indicated)

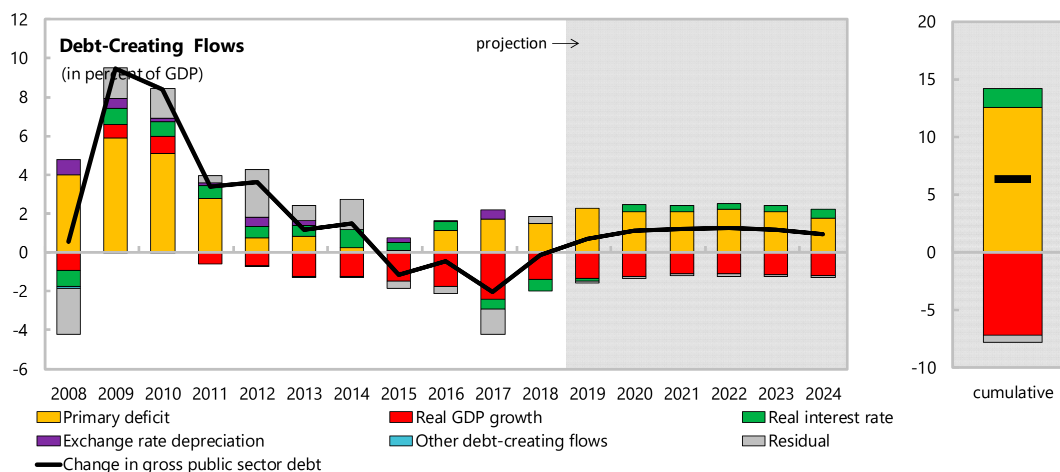
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	32.9	36.9	36.7	37.4	38.6	39.8	41.1	42.2	43.1
Of which: guarantees	2.3	2.0	2.0	1.8	1.7	1.6	1.5	1.4	1.3
Public gross financing needs	11.1	7.6	7.5	8.4	7.7	7.5	8.3	7.9	8.2
Real GDP growth (in percent)	2.2	7.0	4.1	4.0	3.5	3.0	3.0	3.0	3.0
Inflation (GDP deflator, in percent)	4.6	4.7	5.9	4.6	3.1	3.3	3.4	3.3	3.0
Nominal GDP growth (in percent)	7.0	12.0	10.2	8.8	6.7	6.4	6.5	6.4	6.1
Effective interest rate (in percent) [4/]	6.0	3.6	4.3	4.5	4.3	4.4	4.3	4.3	4.2

As of March 21, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		191
5Y CDS (bp)		123
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BBB-	BBB-
Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.9	-2.0	-0.1	0.7	1.1	1.2	1.3	1.2	0.9	6.4	
Identified debt-creating flows	2.4	-0.7	-0.5	0.8	1.3	1.3	1.4	1.3	1.0	7.1	
Primary deficit	2.3	1.7	1.5	2.3	2.1	2.1	2.2	2.1	1.8	12.5	-0.8
Primary (noninterest) revenue and gr	31.3	28.0	29.4	29.8	30.5	30.7	30.7	30.6	30.3	182.5	
Primary (noninterest) expenditure	33.6	29.7	30.9	32.1	32.6	32.8	32.9	32.7	32.0	195.1	
Automatic debt dynamics [5/]	0.1	-2.4	-1.9	-1.5	-0.9	-0.8	-0.8	-0.8	-0.8	-5.5	
Interest rate/growth differential [6/]	-0.2	-2.9	-2.0	-1.5	-0.9	-0.8	-0.8	-0.8	-0.8	-5.5	
Of which: real interest rate	0.5	-0.5	-0.6	-0.1	0.4	0.3	0.3	0.4	0.4	1.7	
Of which: real GDP growth	-0.7	-2.4	-1.4	-1.4	-1.2	-1.1	-1.1	-1.2	-1.2	-7.1	
Exchange rate depreciation [7/]	0.3	0.5	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
####	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.6	-1.3	0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.7	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as .

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

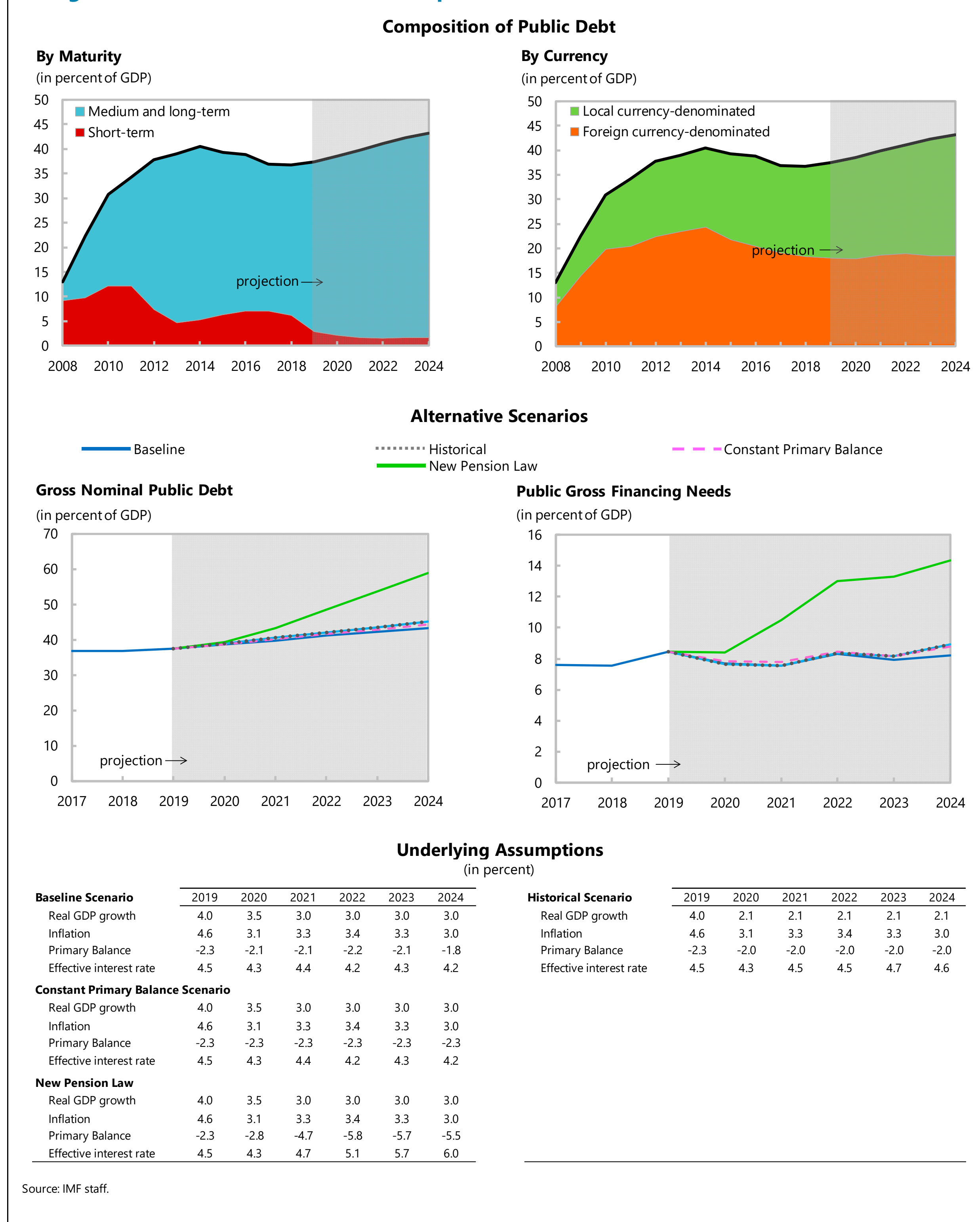
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

Figure 4. Romania: Public DSA – Composition of Public Debt and Alternative Scenarios

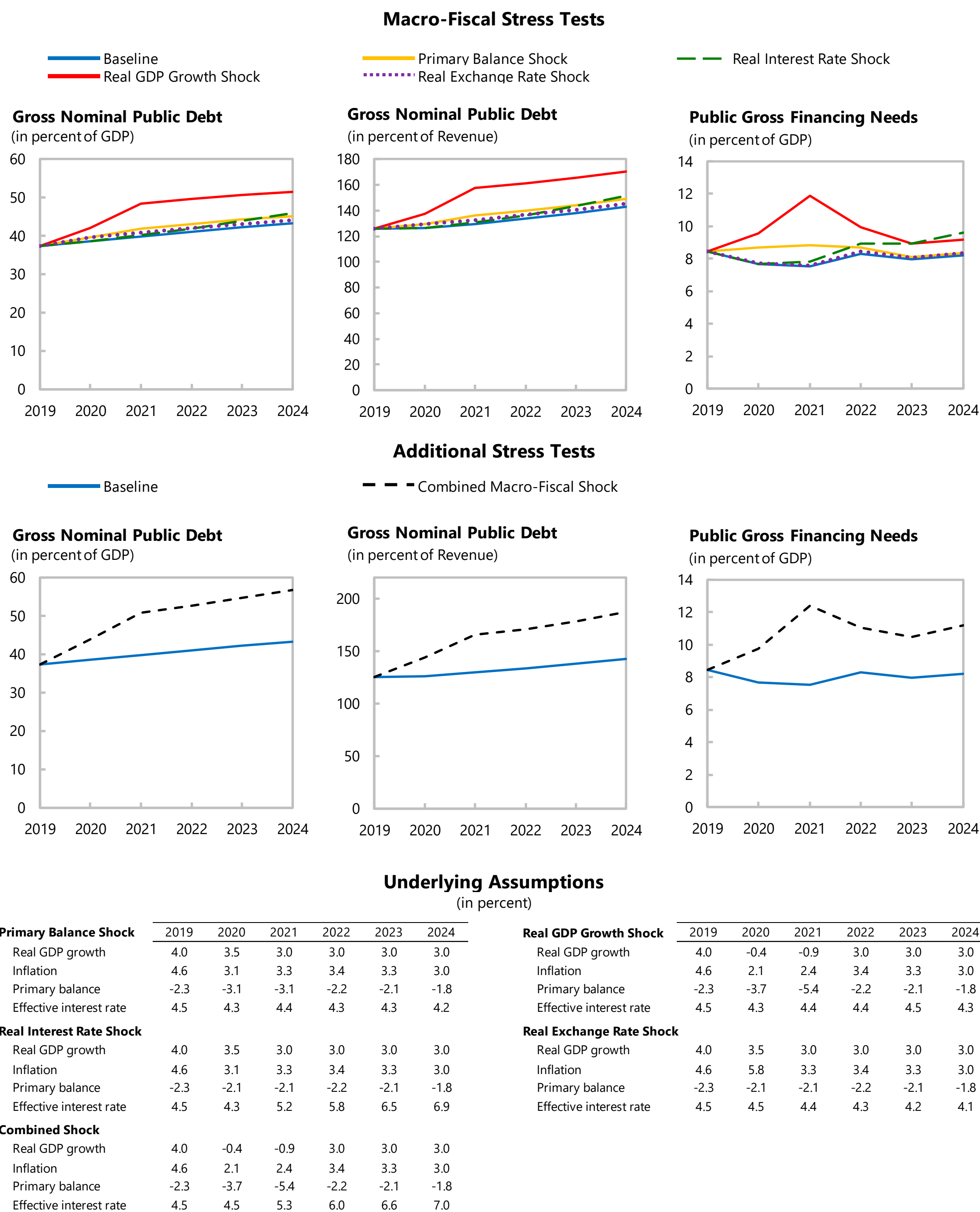


Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.0	3.5	3.0	3.0	3.0	3.0
Inflation	4.6	3.1	3.3	3.4	3.3	3.0
Primary Balance	-2.3	-2.1	-2.1	-2.2	-2.1	-1.8
Effective interest rate	4.5	4.3	4.4	4.2	4.3	4.2
Constant Primary Balance Scenario						
Real GDP growth	4.0	3.5	3.0	3.0	3.0	3.0
Inflation	4.6	3.1	3.3	3.4	3.3	3.0
Primary Balance	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3
Effective interest rate	4.5	4.3	4.4	4.2	4.3	4.2
New Pension Law						
Real GDP growth	4.0	3.5	3.0	3.0	3.0	3.0
Inflation	4.6	3.1	3.3	3.4	3.3	3.0
Primary Balance	-2.3	-2.8	-4.7	-5.8	-5.7	-5.5
Effective interest rate	4.5	4.3	4.7	5.1	5.7	6.0

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.0	2.1	2.1	2.1	2.1	2.1
Inflation	4.6	3.1	3.3	3.4	3.3	3.0
Primary Balance	-2.3	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	4.5	4.3	4.5	4.5	4.7	4.6

Source: IMF staff.

Figure 5. Romania: Public DSA – Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	4.0	3.5	3.0	3.0	3.0	3.0
Inflation	4.6	3.1	3.3	3.4	3.3	3.0
Primary balance	-2.3	-3.1	-3.1	-2.2	-2.1	-1.8
Effective interest rate	4.5	4.3	4.4	4.3	4.3	4.2
Real Interest Rate Shock						
Real GDP growth	4.0	3.5	3.0	3.0	3.0	3.0
Inflation	4.6	3.1	3.3	3.4	3.3	3.0
Primary balance	-2.3	-2.1	-2.1	-2.2	-2.1	-1.8
Effective interest rate	4.5	4.3	5.2	5.8	6.5	6.9
Combined Shock						
Real GDP growth	4.0	-0.4	-0.9	3.0	3.0	3.0
Inflation	4.6	2.1	2.4	3.4	3.3	3.0
Primary balance	-2.3	-3.7	-5.4	-2.2	-2.1	-1.8
Effective interest rate	4.5	4.5	5.3	6.0	6.6	7.0

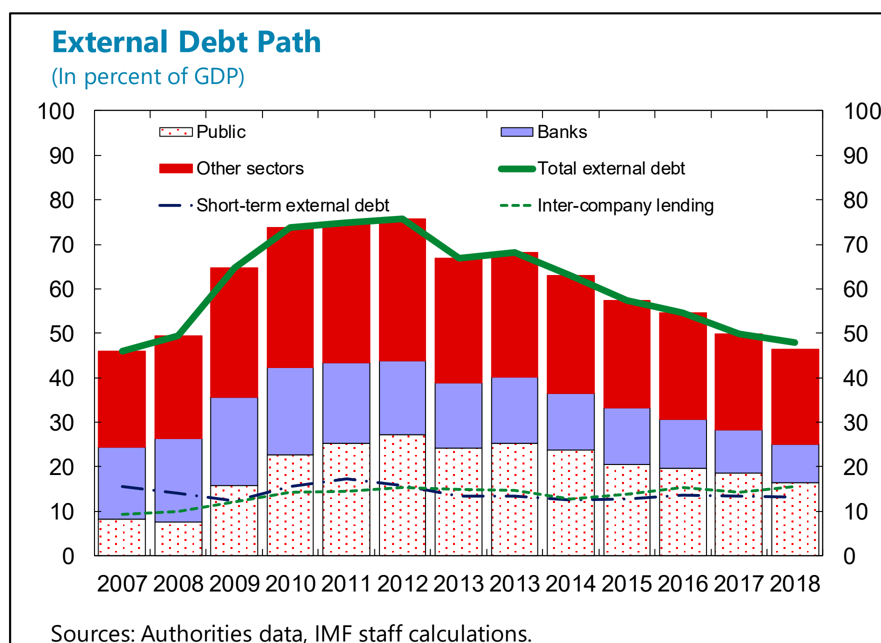
Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	4.0	-0.4	-0.9	3.0	3.0	3.0
Inflation	4.6	2.1	2.4	3.4	3.3	3.0
Primary balance	-2.3	-3.7	-5.4	-2.2	-2.1	-1.8
Effective interest rate	4.5	4.3	4.4	4.4	4.5	4.3
Real Exchange Rate Shock						
Real GDP growth	4.0	3.5	3.0	3.0	3.0	3.0
Inflation	4.6	5.8	3.3	3.4	3.3	3.0
Primary balance	-2.3	-2.1	-2.1	-2.2	-2.1	-1.8
Effective interest rate	4.5	4.5	4.4	4.3	4.2	4.1

Source: IMF staff.

External Debt

9. The external debt continued the downward trend in 2018. After peaking in 2012 at the 75.7 percent of GDP, the gross external debt has been gradually declining to 48 percent of GDP in 2018. Private sector deleveraging, both in banking and non-banking sector, has been the main driver of the declining debt. The short-term debt accounted for 28 percent of total external debt in 2018 and is largely covered by the inter-company lending. Public external debt at 16.4 percent of GDP, remains low by international standards.

External Debt Path
(In percent of GDP)



Sources: Authorities data, IMF staff calculations.

10. Going forward, the external debt is expected to plateau in the baseline scenario. Under the current policies, the external debt will only marginally decline to around 46 percent of GDP in 2025, despite strong nominal GDP growth. As a result, the debt dynamics under the baseline scenario is slightly higher than in the scenario with key variables at their historic level. The gross external financing needs are expected to gradually decline over the medium term but to stay above 20 percent of GDP. Despite the high financing needs, the roll-over risk of the non-banking sector is limited, as large portion of debt stems from inter-company lending. In addition, Romanian non-banking sector has also claims abroad that partly hedge their external liabilities.

11. Staff analysis indicates that Romania's debt dynamics is susceptible to most shocks. The debt stays close to the 2018 level under the interest rate shock scenario, while it slightly increases in the growth-rate and current account shock scenarios. However, in a tailored combined shocks scenario (permanent ½ standard deviation shock applied to growth, current account and interest rate), the external debt reaches 55 percent of GDP in 2024. Moreover, a stress scenario with 30 percent depreciation indicates that the external debt would increase sharply to 69 percent of GDP in 2020, and hover around that level over the medium term.

Table 1. Romania: External Debt Sustainability Framework, 2014-2024
(In percent of GDP, unless otherwise indicated)

	Actual				Est.			Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	63.0	57.4	54.5	49.8	48.1			**47.3**	**46.5**	**46.2**	**45.9**	**45.9**	**46.1**	**0.9**
Change in external debt	-5.2	-5.6	-2.9	-4.7	-1.7			-0.9	-0.7	-0.3	-0.3	0.0	0.1	
Identified external debt-creating flows (4+8+9)	-0.5	-0.7	1.4	0.9	3.3			6.2	6.2	5.9	5.7	5.5	5.3	
Current account deficit, excluding interest payments	-1.6	-0.6	0.6	1.9	2.7			3.8	3.6	3.2	3.2	3.1	3.1	
Deficit in balance of goods and services	0.4	0.6	0.9	2.1	3.2			4.5	4.2	3.8	3.6	3.5	3.2	
Exports	41.2	41.0	41.2	41.5	41.6			42.8	42.7	42.6	42.3	42.1	42.2	
Imports	41.6	41.6	42.1	43.6	44.9			47.3	46.9	46.4	46.0	45.6	45.4	
Net non-debt creating capital inflows (negative)	1.9	1.9	2.7	2.7	2.5			2.5	2.5	2.4	2.4	2.3	2.2	
Automatic debt dynamics 1/	-0.8	-2.1	-1.9	-3.7	-1.9			-0.1	0.1	0.2	0.2	0.1	0.0	
Contribution from nominal interest rate	2.2	1.8	1.5	1.3	1.8			1.7	1.6	1.6	1.5	1.4	1.3	
Contribution from real GDP growth	-2.2	-2.3	-2.6	-3.5	-1.9			-1.8	-1.5	-1.3	-1.3	-1.3	-1.3	
Contribution from price and exchange rate changes 2/	-0.8	-1.6	-0.8	-1.5	-1.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-4.8	-4.8	-4.3	-5.6	-5.0			-7.1	-6.9	-6.2	-6.0	-5.5	-5.1	
External debt-to-exports ratio (in percent)	153.0	140.0	132.4	120.0	115.6			110.4	109.0	108.6	108.5	109.0	109.2	
Gross external financing need (in billions of Euros) 4/	41.9	43.9	43.3	43.0	49.9			53.9	55.0	54.3	58.7	59.2	61.3	
in percent of GDP	27.9	27.4	25.4	22.9	24.6			24.9	23.8	22.1	22.4	21.3	20.8	
Scenario with key variables at their historical averages 5/								**47.3**	**44.9**	**43.2**	**41.6**	**40.3**	**39.2**	**2.1**
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	3.4	3.9	4.8	7.0	4.1	2.1	3.9	4.0	3.5	3.0	3.0	3.0	3.0	
GDP deflator in Euros (change in percent)	1.2	2.6	1.4	2.9	3.9	1.3	4.1	2.5	3.1	3.3	3.4	3.3	3.0	
Nominal external interest rate (in percent)	3.4	3.1	2.8	2.7	4.0	3.3	0.4	3.8	3.7	3.6	3.4	3.2	3.1	
Growth of exports (Euro terms, in percent)	8.0	6.2	6.7	11.0	8.5	8.7	10.8	9.6	6.4	6.1	6.0	5.9	6.2	
Growth of imports (Euro terms, in percent)	7.1	6.7	7.5	14.1	11.2	5.7	13.6	12.6	5.6	5.3	5.6	5.5	5.6	
Current account balance, excluding interest payments	1.6	0.6	-0.6	-1.9	-2.7	-1.2	1.8	-3.8	-3.6	-3.2	-3.2	-3.1	-3.1	
Net non-debt creating capital inflows	-1.9	-1.9	-2.7	-2.7	-2.5	-2.1	0.5	-2.5	-2.5	-2.4	-2.4	-2.3	-2.2	

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

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

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

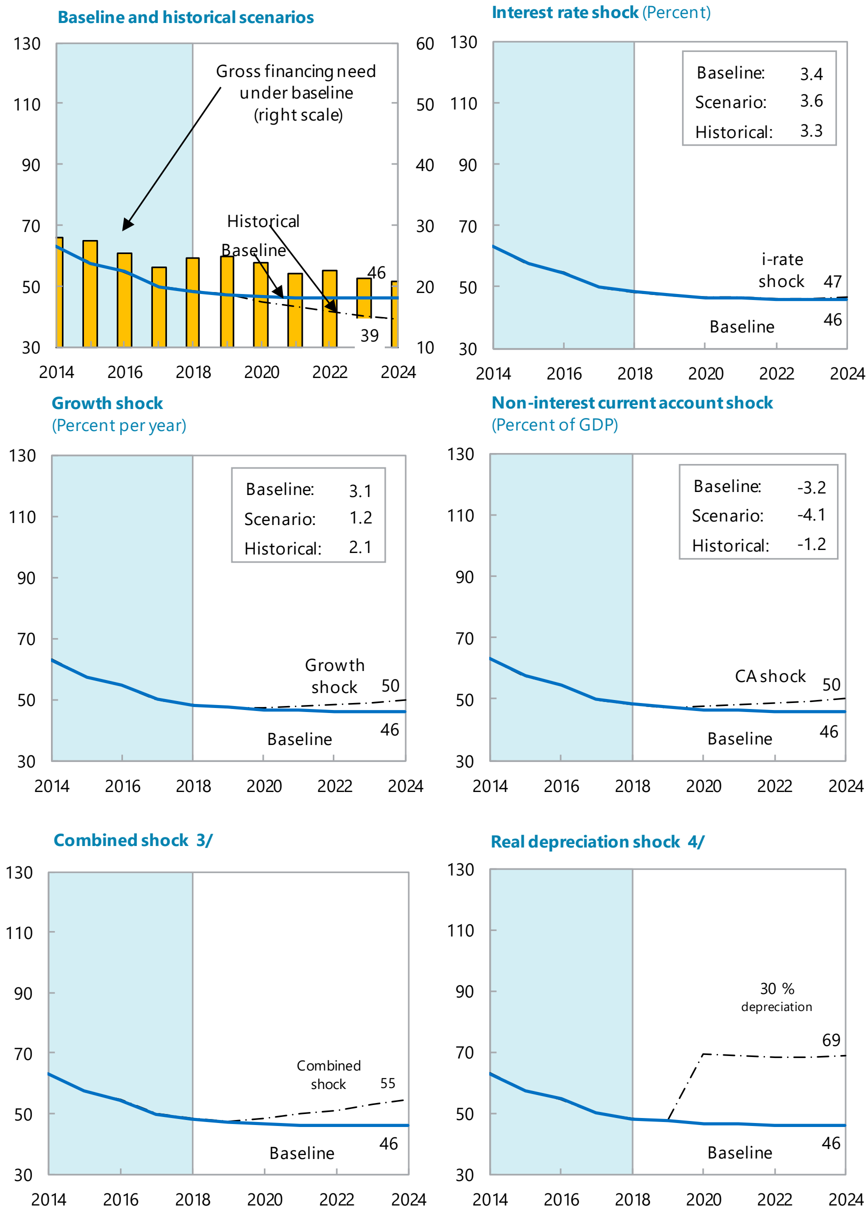
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure 6. Romania: External Debt Sustainability: Bound Tests [1/, 2/]

(External Debt in percent of GDP)



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

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

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 0.5 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2019.

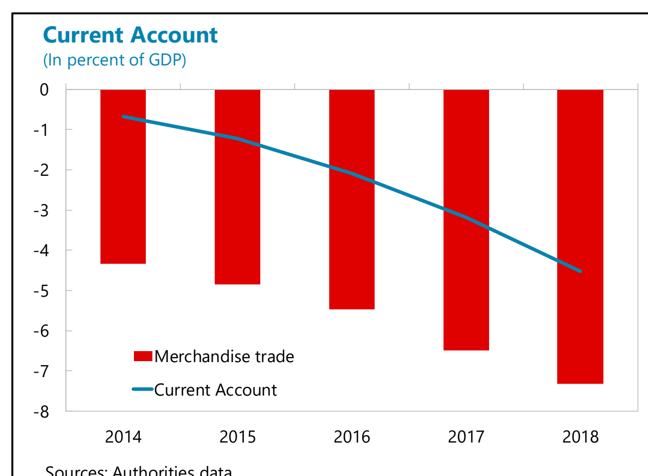
Annex VI. External Sector Assessment

Romania's external position in 2018 was weaker than implied by medium-term fundamentals and desirable policy settings. The current account deficit widened to 4.5 percent of GDP in 2018 and is expected to deteriorate further in 2019, suggesting rising external imbalances and moderate exchange rate overvaluation. Policy recommendations to address the external imbalance include durable fiscal consolidation, greater exchange rate flexibility, and structural reforms to boost productivity and competitiveness. While deteriorating relative to the previous year, reserves currently remain adequate according to most IMF metrics.

Current Account

Background

1. Romania's current account (CA) deficit continued to deteriorate over the last 5 years. The current account deficit surged to 4.5 percent of GDP in 2018 from 3.2 percent of GDP in 2017, despite slower growth. This reflects surging consumption imports fueled by strong wage growth over the last two years. The current account balance is expected to further deteriorate in 2019, driven by slowing exports and relatively strong imports due to continued wage growth, and stay above 4 percent over the medium-term.



Assessment

2. The CA model of the EBA-lite methodology suggests that Romania's external position at end-2018 was weaker than implied by medium-term fundamentals and desirable policy settings. The cyclically adjusted CA norm is estimated at a deficit of 1.9 percent of GDP, while the multilaterally consistent norm is estimated at a deficit of 1.4 percent of GDP. This implies a CA gap of -2.5 percent of GDP in 2018 and a real effective exchange rate (REER) overvaluation of about 8 percent, albeit subject to uncertainty around these point

Romania: EBA-lite Current Account Model Results, 2018

a	**CA-Actual**	-4.5%
b	Cyclical Contributions (from model)	-0.6%
c=a-b	**Cyclically adjusted CA**	**-3.9%**
d=k-h-m	**CA-Norm**	-2.5%
e=d-b	**Cyclically adjusted CA Norm**	-1.9%
f	**Multilaterally Consistent Cyclically adjusted**	**-1.4%**
g=c-f	**CA-Gap**	**-2.5%**
h	of/which Policy gap	0.03%
i	Elasticity	-0.31
j=g/i	**REER Gap**	**8%**
k	CA-Fitted	-2.5%
l=a-k	Residual	-0.02
m	Natural Disasters and Conflicts	0.0%

Source: IMF staff estimates.

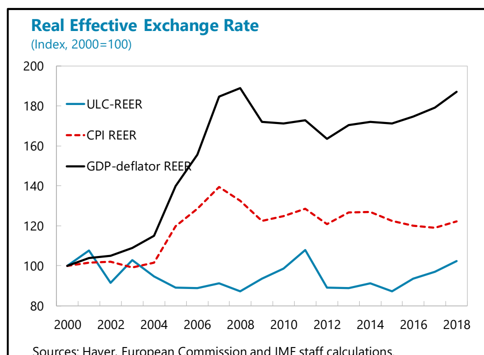
estimates. The current account gap is only partly explained by policy gaps and mostly by structural policies and distortions that are not captured by the model. Specifically, the domestic fiscal policy gap (2 percent of GDP in line with staff's fiscal policy recommendations) contributes -0.86 percent of GDP to the CA GAP, but is largely offset by a similar policy gap of trading partners. Moreover, negative gaps from fiscal policy and public health expenditure are offset by positive policy gaps from change in reserves and private sector credit.

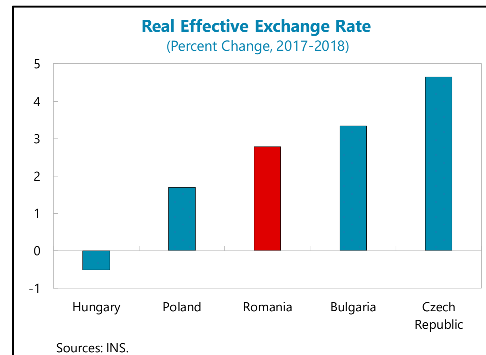
Real Exchange Rate

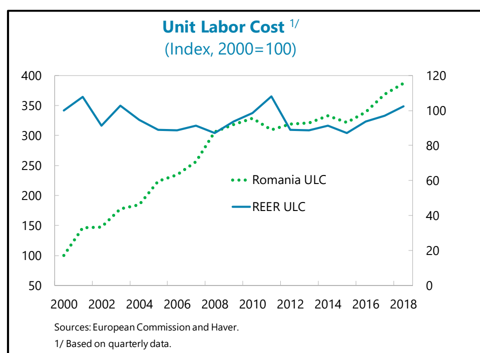
Background

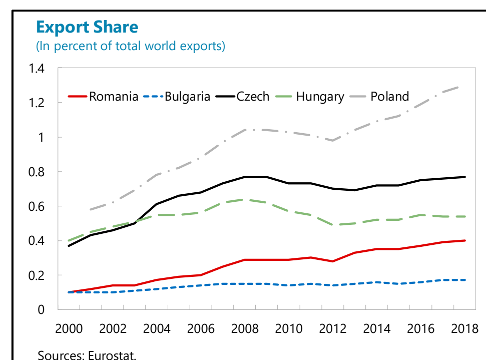
3. The real exchange rate (CPI-based) appreciated by 2.8 percent during the 2018, largely due to higher inflation than in trading partners. The leu real appreciation is in the mid-range of real exchange rate movements of comparator countries. The GDP-deflator based real exchange rate appreciated by about 4.4 percent. Moreover, the unit labor cost increased about 4 percent, as wage growth outpaced productivity growth, and the ULC-based REER appreciated about 5 percent.

4. The REER appreciation trend suggested a decline in Romania competitiveness. Despite the REER appreciation, Romania's export share increased over the last few years from 0.35 in 2014 to 0.39 percent of total world's export in 2017. This increase in export share is largely due to exports of FDI enterprises that are integrated in the global value chains and does not necessarily imply that cost competitiveness in exports has improved. However, the increase in imports, as a share of GDP (Box 1), suggests a decline in competitiveness in the domestic market, due to continued wage-driven cost pressures on domestic producers.









Assessment

5. Based on the Index of Real Effective Exchange Rate (IREER) model of the EBA-lite approach, the estimated REER gap implies an overvaluation of about 10 percent, which is broadly consistent with the CA-model based assessment.

Romania: EBA-Lite IREER Model Results, 2018		
a	**Ln(REER) Actual**	4.58
b	**Ln(REER) Fitted**	4.48
c=b-f-g	**Ln(REER) Norm**	4.48
d=b-a	**Residual**	0.10
e=a-c	**REER Gap**	10%
f	**Policy Gap**	0.2%
g	**Natural Disasters and Conflicts**	0.2%

Source: IMF staff estimates.

Capital and Financial Flows

Background

6. Based on preliminary data, the capital account recorded inflows of 1.2 percent of GDP, somewhat below the 5-yeard trend of 2 percent of GDP. This largely reflects slow absorption of EU funds. As in the previous years, the net FDI inflows (2.4 percent of GDP) were the main contributor to financing the CA deficit, covering about one half of it. A majority of the FDI inflows are reinvested earnings, and they are expected to continue to play an important role in financing the CA deficits over the medium-term. Portfolio flows at 1 percent of GDP slightly declined in 2018, due to lower sovereign bond issuance. There are no restrictions on the capital and financial account.

Assessment

7. While capital account inflows may pick up in case of a higher absorption of EU funds, the prospects for new FDIs are unclear (due to poor infrastructure, rising labor cost and still high policy uncertainty). Portfolio flows may pick up if the authorities issue more Eurobonds in the currently favorable low-interest rate environment, instead of issuing the bonds on the domestic market. But this could lead to higher spreads.

External Balance Sheet

Background

8. Romania's net international investment position (NIIP), at -43.6 percent of GDP in 2018, improved over the last five years. The improvement came mostly from a decline in liabilities, in particular other investment (comprising currency and deposits, loans and trade credits) as banks and companies gradually deleveraged.

9. While the NIIP improved in 2018 as a share of GDP compared to the 2017, it deteriorated in nominal terms (about 1%) as accumulation of liabilities was slightly higher than accumulation of assets. By end-2018, direct investment represented about 11 percent of gross assets and 56 percent of gross liabilities while portfolio investment was about 6 percent of gross assets and about 17 percent of gross liabilities.

Assessment

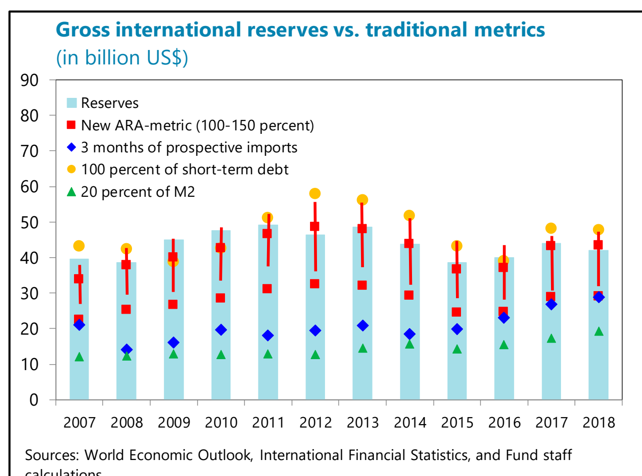
10. The external balance sheet does not appear to be a major source of risk for Romania's external sustainability. However, other investment liabilities (mostly loans to corporate sector and trade credits) at 20 percent of GDP could lead to liquidity problems in case of a sudden tightening of financial conditions.[1] According to staff's projections, the NIIP is expected to average around -46 percent of GDP over 2019–24.

Reserves

Background

11. Romania's exchange rate regime was classified as floating in 2018. Gross international reserves stood at 18 percent of GDP and could cover about 4.4 months of prospective imports or about 42 percent of M2. However, reserves stood at 89 percent of short-term debt. Reserves declined marginally in nominal terms, about 1 percent relative to 2017.

Gross international reserves vs. traditional metrics
(in billion US$)



Sources: World Economic Outlook, International Financial Statistics, and Fund staff calculations.

Assessment

12. While lower than in 2017, reserves remain adequate, exceeding thresholds for most metrics. The reserves were above 150 percent of the reserve-adequacy metric developed by the Fund for emerging markets. Reserves are also above comfortable thresholds for most other metrics, except being 89 percent of the short-term debt (at remaining maturity).

Overall Assessment

13. Staff's overall assessment is that Romania's external position is weaker than implied by fundamentals and desirable policy settings. Specifically, staff assesses the current account gap to be -1½ to -3½ percent of GDP and REER overvaluation to be 5-10 percent, in line with the EBA model results and taking into account uncertainty around any point estimate. To reduce the external imbalance, staff advises durable fiscal consolidation, greater exchange rate flexibility, and structural reforms to boost productivity and competitiveness.

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[1] They are partly offset by claims of Romanian corporate sectors toward non-residents.

Annex VII. Implementation of FSAP 2018: Key Recommendations

Recommendations (from Financial System Stability Assessment)	Agency	Time[1/]	Status[2/]
System Risks and Macroprudential Policies			
1. Strengthen the NCMO´s accountability framework by i) requiring proposed policy actions and distribution of votes to be publicly disclosed in the summary of meetings; and ii) developing a common assessment of systemic risk at each NCMO meeting.	NBR, MoPF, ASF	NT	Fulfilled
2. Apply a stressed DSTI limit to household loans and continue scaling back the Prima Casa program.	NBR, MoPF	NT	Partially fulfilled
3. Enforce a currency-differentiated LCR and NSFR for significant currencies.	NBR	NT	Fulfilled
4. Introduce a carefully calibrated Systemic Risk Buffer to increase resilience against risks from large exposures to the sovereign.	NBR, MoPF, ASF	NT	Work in progress
5. Ensure provisioning requirements for NBFLs tighten in line with the application of International Financial Reporting Standards (IFRS) 9 to banks.	NBR, MoPF	NT	Partially fulfilled
Sectoral Oversight			
Bank Regulation and Supervision			
6. Ensure consistency and objectivity in Supervisory Review and Evaluation Process (SREP) scores, findings and supervisory measures.	NBR	NT	Partially fulfilled
7. Enhance supervisory tools by incorporating more forward-looking views (e.g., bottom up stress testing tools) and conducting more thematic reviews.		MT	Work in progress
8. Strengthen bank corporate governance (number and profile of independent board members, content and periodicity of exchanges between the NBR and board members).		NT	Work in progress
9. Review and amend the regulation not governed by EU harmonization (e.g., transactions with related parties) in a more prudent manner.		NT	Work in progress
Financial Market Infrastructures			
10. Adopt the PFMI and formalize and strengthen cooperation between the NBR and the ASF for the supervision of the Bucharest Stock Exchange CSD.	NBR, ASF	NT	Partially fulfilled
11. Invest in more and more qualified IT staff, in particular in the area of cyber resilience, and implement a formal project management methodology.	NBR	I	Partially fulfilled
AML/CFT			
12. Address the remaining gaps in the AML/CFT preventive framework, including with respect to PEPs, and entity transparency; assess and mitigate the ML/TF risks.	MoJ / MoAI	I	Work in progress
Crisis Management and Bank Resolution			
13. Prepare a simulation exercise that includes all members of the macroprudential committee plus the FGDB.	all	I	Fulfilled
14. Seek an exemption from the Procurement law for bank resolution purposes.	NBR, MoPF	MT	Not possible
15. Include MoPF officers linked to bank resolution under personal legal protection provisions.	MoPF	MT	Work in progress
16. Ensure that Romania's interests are addressed in recovery and resolution plans of Romanian subsidiaries of foreign banks.	NBR	NT	Fulfilled
17. Diversify the investment policy of the FGDB, and establish operational procedures with the NBR that allows the FGDB to have accounts in the central bank and a repo line.	FGDB/NBR	NT	Partially fulfilled
18. Finalize and implement an ELA scheme and provisions for FX liquidity support.	NBR	NT	Work in progress

Agencies: ASF = Financial Services Authority; FGDB = Bank Deposit Guarantee Fund; MoPF = Ministry of Public Finance; NBR = National Bank of Romania.

1/ Time Frame: I (immediate) = within one year; NT (near term) = 1-3 years; MT (medium term) = 3-5 years.

2/ Refers to status or progress, as reported by the authorities.

INTERNATIONAL MONETARY FUND

ROMANIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 22, 2019

Prepared By | European Department

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FUND RELATIONS

(as of June 28, 2019)

Membership Status	Joined 12/15/72	Article VIII
General Resources Account	**SDR million**	**% Quota**
Quota	1,811.40	100.00
Fund holdings of currency	1,811.40	100.00
Reserve Tranche Position	0.00	0.00
SDR Department	**SDR million**	**% Allocation**
Net cumulative allocation	984.77	100.00
Holdings	988.03	100.33
Outstanding Purchases and Loans	**SDR Million**	**% Quota**
Stand-By Arrangements	0.00	0.00

Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	09/27/13	09/26/15	1,751.34	0.00
Stand-By	03/31/11	06/30/13	3,090.6	0.00
Stand-By	05/04/09	03/30/11	11,443.00	10,569.00
Stand-By	07/07/04	07/06/06	250.00	0.00
Stand-By	10/31/01	10/15/03	300.00	300.00
Stand-By	08/05/99	02/28/01	400.00	139.75
Stand-By	04/22/97	05/21/98	301.50	120.60
Stand-By	05/11/94	04/22/97	320.50	94.27
Stand-By	05/29/92	03/28/93	314.04	261.70
Stand-By	04/11/91	04/10/92	380.50	318.10

Overdue Obligations and Projected Payments to Fund[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2019	2020	2021	2022	2023
Principal					
Charges/interest	0.03	0.03	0.03	0.03	0.03
Total	0.03	0.03	0.03	0.03	0.03

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement

Romania has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions on making of payments and transfers on current international transactions except for those maintained solely for preservation of national or international security in accordance with UNSC resolutions and that have been notified to the Fund under the procedure set forth in Executive Board Decision No. 144-(52/51). De jure exchange rate arrangement is managed floating and the de facto exchange rate arrangement is floating.

Technical Assistance

Capacity building in Romania has been supported by substantial technical assistance from multilateral agencies and bilateral donors. The Fund has provided support in several areas with almost 30 technical assistance missions and expert visits since 2012.

Date	Purpose	Department
	Tax Administration	
March–April 2012	Strengthening the capacity of the National Agency for Fiscal Administration (ANAF).	FAD
July–August 2012	Organizational reforms, strategic direction, plan for restructuring of ANAF and implementation of a compliance strategy.	FAD
August–September 2012	Follow-up on the reorganization of ANAF.	FAD
November–December 2012	Follow-up with ANAF, particularly on the antifraud unit.	FAD
March–April 2013	Training to improve high net wealth individual compliance.	FAD
Apr., Sep., Nov. 2013, Jan. 2014	Follow-up with ANAF.	FAD
April 2014	Assistance to ANAF on pilot structural compliance project targeted at undocumented labor. Training on payroll audit.	FAD
April 2014	Stock taking on assistance and identification of future TA focus: compliance risk management, reorganization of ANAF, pilot projects.	FAD
January–February 2015	Follow-up and training to improve high net wealth individual compliance.	FAD
July-August 2015	Review of the performance of the large taxpayer office and tax compliance management concerning high wealth individuals.	FAD
April 2016	Tax compliance risk analysis related to large businesses.	FAD
November 2016	ANAF performance outcomes compare to international best practice.	FAD
	Tax Policy	
September 2013	Strengthening the property tax and natural resource tax regime.	FAD
September 2014	Follow-up assistance with creating a new natural resource tax regime.	FAD
June 2015	Workshop on petroleum tax regime design.	FAD
	Public Financial Management	
March 2012	Setting up commitment control and fiscal reporting systems.	FAD
October 2012	Follow-up assistance in setting up commitment control and fiscal reporting systems, especially methodologies and functionalities.	FAD
April 2013	Follow-up assistance in setting up commitment control and fiscal reporting systems, including methodology to verify arrears of local government.	FAD
December 2013	Follow-up assistance in setting up commitment control and fiscal reporting systems, including requirements from decentralization plans.	FAD
February 2014	Fiscal Transparency Evaluation.	FAD
January 2015	Follow-up assistance in setting up commitment control and fiscal reporting systems, review of public investment practices and program budgeting.	FAD
June 2015	Follow-up assistance on strengthening public investment management and implementing public expenditure reviews.	FAD
June 2016	Assistance on institutionalizing spending reviews and preparing spending review reports.	FAD
October 2016	Follow-up assistance to advise on piloting spending reviews.	FAD

Date	Purpose	Department
	Financial Sector Issues and Monetary Policy	
November 2012	Follow-up on program-related financial sector issues, including progress with contingency planning.	MCM
October 2014	Assessment of the monetary policy framework.	MCM
	Accounting and NPL	
October 2013	Achieving timely NPL write-off within the IFRS framework.	MCM

Expert Fund assistance has focused in recent years mostly on structural fiscal reforms, in particular modernizing tax administration, strengthening public financial management, and reviewing tax policy options. Technical assistance to the National Bank of Romania focused on upgrading contingency planning, dealing with non-performing loans, and reviewing monetary and exchange rate policy tools.

Article IV Consultations

Romania is on a 12-month consultation cycle. The previous Article IV consultation was concluded by the Executive Board on June 4, 2018.

FSAP and ROSC

A joint IMF-World Bank mission conducted an update assessment of Romania's financial sector as part of the Financial Sector Assessment Program (FSAP) during October 21-November 31, 2017, and January 11–23, 2018. The Financial Sector Assessment Report (FSSA) was discussed at the Board in June 2018.

A pilot of the IMF's new Fiscal Transparency Evaluation took place in February 2014 and the findings were published in March 2015. It assessed the government's fiscal reporting, forecasting, and risks management practices against the IMF's revised Fiscal Transparency Code.

Resident Representative

The Fund has had a resident representative in Bucharest since 1991. After the term of the current regional resident representative, Mr. Alejandro Hajdenberg, expires in August 2019, the office will be operated as a local office from September 2019.

COLLABORATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- As of June 28, 2019, Romania has collaborations with the World Bank Group, the European Bank for Reconstruction and Development, and the European Investment Bank.

- Further information can be obtained from the following hyperlinks.

International Financial Institution	Hyperlink
The World Bank Group	https://www.worldbank.org/en/country/romania/overview#4
The European Bank for Reconstruction and Development (EBRD)	https://www.ebrd.com/country/romania.html
The European Investment Bank	https://www.eib.org/en/projects/regions/european-union/romania/index.htm

STATISTICAL ISSUES

(as of June 28, 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
National accounts: Quarterly and annual national accounts statistics are produced by the National Institute for Statistics (INS) using the *European System of Accounts 2010 (ESA 2010)*. Large contribution from changes in inventories as a balancing item introduce statistical uncertainties into the estimates, as were observed in 2018 and also in Q1 2019. Estimates are reported to the Fund on a timely basis for publication in the *International Financial Statistics (IFS)*. Provisional and semi-final versions are disseminated in the *Statistical Yearbook* and other publications, as well as on the web (www.insse.ro).
Prices: The Consumer Price Index is subject to standard annual reweighting, and is considered reliable. In January 2004, the INS changed the coverage of the Producer Price Index (PPI) to include the domestic and export sectors. PPI weights are revised every five years with revisions finalized three years after the new base year.
Labor market: Labor market statistics are broadly adequate. The definition used for employment is consistent with *ESA 2010*.
Public finances: Annual GFS data for the general government sector, including public corporations operating on a non-market basis, are reported on an accrual basis derived from cash data using various adjustment methods. Tax revenues are adjusted using the time-adjusted cash method; expense data are adjusted using due-for-payments data; and interest payments are calculated on an accrual basis. Accrual data are also available on a quarterly basis three months after the end of each quarter. EUR receives monthly cash budget execution data. Consolidated data on general government operations, financial assets and liabilities are reported for inclusion in the IMF *GFS annual database*.
Monetary and financial statistics: The National Bank of Romania (NBR) reports monetary and financial statistics for publication in the *IFS,* using the Standardized Report Forms (SRFs). The SRFs for the central bank and other depository corporations are reported on a monthly basis, while the SRF for Other Financial Corporations (OFCs) is reported on a quarterly basis. The NBR also reports data on some key series and indicators of IMF's Financial Access Survey including gender disaggregated data, mobile money and the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (commercial bank branches 100,000 adults and ATMs per 100,000 adults). **Financial Soundness Indicators (FSIs)**: The NBR reports all core and most encouraged FSIs for Deposit Takers on a quarterly basis. In addition, the NBR reports FSIs for the nonfinancial corporations (NFCs) and households (HHs) sectors, as well as those for real estate markets. However, FSIs for NFCs are reported with a long lag.

External sector statistics: The NBR routinely reports quarterly and annual balance of payments and international investment position statistics to the Fund and external debt statistics to the World Bank's QEDS database in a timely fashion. Since September 2014 the authorities implemented the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*), in line with other European countries. Romania participates in the IMF's Coordinated Portfolio Investment Survey (CPIS), Coordinated Direct Investment Survey (CDIS) and reports International Reserves and Foreign Currency Liquidity (IRFCL) Data Template.

II. Data Standards and Quality	
Romania is a subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 4, 2005.	A Data ROSC was published in November 2001.

Romania: Table of Common Indicators Required for Surveillance (as of July 2019)					
	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	June 2019	July 2019	D and M	D and M	M
Reserve/Base Money	May 2019	June 2019	D and M	W and M	M
Broad Money	May 2019	June 2019	M	M	M
Central Bank Balance Sheet	May 2019	June 2019	M	M	M
Consolidated Balance Sheet of the Banking System	May 2019	June 2019	M	M	M
Interest Rates[2]	June 2019	July 2019	M	M	M
Consumer Price Index	May 2019	June 2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	May 2019	July 2019	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q1 2019	June 2019	Q	Q	Q
External Current Account Balance	Apr 2019	June 2019	M	M	M
Exports and Imports of Goods and Services	Apr 2019	June 2019	M	M	M
Gross External Debt	Apr 2019	June 2019	M	M	M
International Investment Position[7]	Q1 2019	May 2019	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic non-bank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds), and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND

ROMANIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION— SUPPLEMENTARY INFORMATION

August 20, 2019

Prepared By European Department

This supplement provides information on key economic developments that became available after the staff report was issued. This information does not change the thrust of the staff appraisal.

1. Recent data releases point to still-robust growth and sustained inflation, amidst widening current account and fiscal deficits.

- **Growth.** According to flash estimates, GDP growth decelerated somewhat in the second quarter of 2019 to 4.6 percent y/y on a seasonally adjusted basis (4.9 percent y/y in the first quarter). Industrial production and exports slowed, but other indicators were buoyant: the construction sector grew strongly; retail sales and consumer confidence were firm as net wages continued to rise rapidly and unemployment remained low. Although the GDP expenditure components are not yet available, private consumption likely remained the main contributor to growth.

- **Inflation.** Headline inflation remained above the target band (2.5 percent ± 1 percent) at 4.1 percent y/y in July, rising from 3.8 percent y/y in June mainly on higher food inflation. Core inflation has remained above 3 percent since April, rising to 3.3 percent y/y in June and July, indicating higher domestic-driven inflation pressures.

- **Current account.** The current account deficit in the first half of 2019 reached about 2½ percent of GDP[1], widening by 38 percent compared to the same period in 2018 (about 1¾ percent of GDP[1]) mainly on higher imports. The share of foreign direct investment (FDI) in the financing structure fell below half (about the share of FDI in 2018), while portfolio bond inflows rose in recent months.

[1] Outturn for the first half year, as a ratio of full-year GDP.

- **Budget execution.** Preliminary outturns through June 2019 showed a deterioration in the fiscal position relative to the same period last year. The fiscal balance had a deficit of 1.9 percent of GDP[1] in January-June 2019 compared to a deficit of 1.6 percent over the same period in 2018. Revenue growth (with the exception of dividends) lagged expenditures, which were pushed up mainly by higher wage expenses.

2. Budget revision. The authorities passed a budget revision on August 12 which kept the 2019 deficit target at about 2.8 percent of GDP, raising both revenue and expenditure while maintaining the GDP growth forecast at 5.5 percent. Revenues were raised primarily based on higher dividend collections, anticipated yield from a tax amnesty and tax debt restructuring program passed on August 5, and EU retrospective financing. Expenditures were raised primarily to accommodate higher spending by local governments. Staff continues to view revenues as overestimated and some expenditures underestimated, which have been also consistent with budget performance to date. High-quality measures are in urgent need for fiscal consolidation towards the budget target.

3. The National Bank of Romania (NBR) kept its policy rate at 2.5 percent in its July and August policy meetings. The NBR has undertaken liquidity absorption operations, which have kept money market rates close to its policy rate.

STATEMENT BY MR. ANTHONY DE LANNOY, EXECUTIVE DIRECTOR FOR ROMANIA, MR. LIVIU VOINEA SENIOR ADVISOR TO THE EXECUTIVE DIRECTOR AND MR. MUGUR DRAGOS TOLICI SENIOR ADVISOR TO THE EXECUTIVE DIRECTOR

August 28, 2019

On behalf of the Romanian authorities, we would like to thank staff, led by Mr. Lee, for their productive engagement during the Article IV mission and express our appreciation for the constructive policy findings and recommendations reflected in their report. While the authorities argued that the Government's program and reform agenda warrant a more optimistic macroeconomic outlook than staff's baseline scenario, there is broad agreement between the authorities and staff on a wide range of issues. Going forward, the authorities will carefully consider the staff's recommendations.

Romania continued to register one of the highest economic growth among the EU countries, while unemployment dropped to record low levels. However, the strong economic performance has been accompanied by mounting tensions surrounding macroeconomic equilibria. After peaking up in the first half of 2018 inflation has returned within the central bank's target at the end of 2018. While the fiscal deficit remained within the EU rules, maintaining the deficit on target appears somewhat challenging, but the authorities reaffirmed their commitments to the EU fiscal framework and ensured consistency between policy objectives and sound public finances. Public and external debt levels remained low, while current account deficit widened on the back of strong import growth.

The resilience of the financial sector improved consistent with 2018 FSAP recommendations. The banking system is sound, NPL ratios continued to decrease and advance toward the EU average, adequate buffers were kept in place and the authorities aim at addressing the remaining vulnerabilities as raised in the FSAP. The medium-term challenges will be to foster a sustainable and more inclusive growth by strengthening public investment and structural reforms while complementing fiscal stimulus with improved EU funds absorption. The authorities are aware of existing vulnerabilities and remain fully committed to address these challenges adequately and consistently.

Growth remained solid and will maintain at a strong pace over the medium term. In 2018 economic growth remained strong reaching 4.1 percent**,** and per capita GDP recorded one of the fastest growth amongst new EU member states since 2016. Simultaneously the unemployment rate dropped to the 4.2, the lowest level in recent years. The expansion was primarily driven by private consumption, underpinned by higher purchasing power as a result of income policies focusing on achieving more inclusive growth. The private investment underwent a setback in 2018, when the contribution of gross fixed capital formation to GDP growth turned negative (-3.2 percent). Nevertheless, investment growth has resumed in Q1 2019 due to the rise in construction works and contributed to a stronger-than-anticipated acceleration of economic growth, to 5.0 percent from 4.1 percent in Q4 2018. Consistent with their higher estimates of potential growth, the accruing effects of growth-friendly tax-cuts and

steady improvement in the EU funds absorption, the authorities project faster growth than staff's baseline: 5.5 percent in 2019 and 5 percent over the medium term.

During the first three quarters of 2018 the inflation rate ran above the upper bound of the ±1 percentage point variation band of the 2.5 percent flat target given the persistence of significant excess aggregate demand, swift dynamic of unit wage costs and supply shocks. At the end of 2018, the annual CPI inflation stood at 3.3 percent, within the target band.

The external position remained sustainable in 2018, although the risk of external imbalances increased. The current account widened in 2018 by 1.3 percent of GDP (to 4.5 percent of GDP) on the back of strong import growth, boosted by buoyant consumption and slower growth of exports of goods and services, resulting in the lowest net export contribution to GDP growth in five years (-1.7 percent). The deficit is anticipated to remain at sustainable levels over the medium term, continuing to be financed mainly from non-debt-generating flows (FDI and EU funds), to allow for a downward trend of the external debt-to-GDP ratio. While staff's analysis suggests that Romania's external position in 2018 was weaker than fundamentals, the authorities have a more positive view and consider the EBA-lite CA model to underestimate the contribution of cyclical and structural factors to the current account deficit in 2018. Gross external debt continued the downward trend in 2018, reaching 48 percent of GDP from a peak of 75.7 percent of GDP in 2012. The share of short-term debt in total external debt remained low (28 percent of GDP) and the international reserves are adequate, exceeding thresholds for most metrics.

Romania continued and improved its presence in international capital markets in line with the Government Public Debt Management Strategy 2018 – 2020 therefore generating significant buffers. In the first 7 months of 2019 the Ministry of Public Finance issued Eurobonds amounting to EUR 5 bill, exceeding the planned external financing needs for the whole year, and ensuring the partial pre-financing of the estimated financing needs for 2020.
However, the authorities are fully aware of the risks associated with a sharper-than-expected external slowdown and adverse developments in global financial conditions, and continue to carefully monitor these risks.

While the output gap remained positive, budget deficits will be kept within the limits allowed by EU fiscal rules. The fiscal relaxation initiated in 2016 has continued, in line with the government's strategy of directly supporting economic growth through measures aimed at increasing the real disposable income of households. The budget deficit reached 3 percent of GDP in 2018, while the structural deficit rose to 3.0 percent (compared with the 1 percent-of-GDP target in the Stability and Growth Pact). The Convergence Program 2019-2022 foresees the ESA budget gradually decreasing to 2 percent of GDP in 2022, while the structural deficit is estimated to enter on an adjustment trajectory towards the MTO as of 2021, reaching a level of 2.4 % of GDP in 2022. The authorities are fully aware of the challenges to meet 2019-2020 targets and will take the necessary steps to comply with the EU fiscal rules. To mitigate the risks posed to public finances by the recently adopted Pension Law, the implementation of the

law will be matched by strong fiscal-structural reforms and the benefit increase will be subject to existing available fiscal space.

Like staff, the authorities concur on the urgency of improving revenue collection by reforming the tax administration, upgrading the IT infrastructure and adopting a modern compliance risk management system with technical assistance from FAD. On the expenditure side, the authorities are committed to increase expenditure efficiency and transparency by strengthening expenditure reviews and the procurement process. The draft amendments to the Public Procurement Law envisage increasing transparency in public procurement, enhancing the absorption of the EU funds and a better use of public funds.

Risks to debt sustainability are low, with the level of public debt-to-GDP ratio at only 35.0 percent at the end of 2018, and the DSA projecting the ratio to remain below the 60 percent threshold (under Stability and Growth pact) under all stress test scenarios.

Monetary policy is focused on bringing inflation in line with the target over the medium-term. Throughout 2018, the NBR continued the adjustment in its monetary policy stance that started in the last quarter of 2017. Following the noticeable increase in inflation in the first quarter of 2018, the central bank raised the policy rate three times by 0.25 percentage points, up to 2.5 percent, while tightening the liquidity in the banking system to help monetary management and mitigate FX pressures. With large swings in money market liquidity, amplified by a strong impact of main autonomous factors, the central bank pursued an adequate management of money market liquidity while underpinning the good functioning of money markets.

In the first quarter of 2019, higher domestic demand, currency depreciation and price disruptions associated with GEO 114/2018 have pushed the inflation above the target band. The NBR stressed its commitment to continue strict liquidity management while considering a greater flexibility of the exchange rate. The monetary stance will remain geared towards bringing the annual inflation (and maintaining over the medium term) in line with the flat target of 2.5 percent ±1percentage point variation band, in a manner further supportive of economic growth, while safeguarding financial stability. However, the NBR Board underlines that a coherent macroeconomic policy mix and progress in structural reforms designed to foster the growth potential over the long term are crucial for safeguarding a stable macroeconomic framework and enhancing the economy’s resilience to potential adverse developments.

The financial sector continues to be solid and resilient, and good progress has been made with implementing the 2018 FSAP recommendations. In 2018 the banking sector soundness indicators continued to comply with the required thresholds. The NPL further followed the downward trend started in 2014, reaching less than 5 percent at end 2018 (from 21.5 percent in 2013) while non-performing loans provisioning, at 58.5 percent, remained well above the EU-wide average. To support the improvement in asset quality, the systemic risk buffers came into effect starting in June 2018. The capitalization of the banking sector remained around 18

percent. The NBR will continue to closely monitor and supervise the banking system and take any necessary measures to ensure that banks maintain sufficient capital and liquidity.

The profitability of the banking sector consolidated its uptrend against the background of ongoing reduction in net impairment loss and a fast-paced leu-denominated lending. At the end of 2018, the ROA and ROE stand above the EU average at 1.6 percent and 14.6 percent respectively, while the average values over the past ten years ranked the Romanian banking sector 12th and 8th among the EU's 28 Member States.

At the same time, the unpredictability that followed the adoption of GEO 114/2018 heightened the risks associated with the legislative framework in the financial and banking sector. Following consultations between authorities and banking industry, the deficiencies were significantly reduced by the adoption of GEO 19, in March 2019.

The authorities broadly agreed with the conclusions of the 2018 FSAP mission and most of its recommendations have already been fully or partially implemented. To prevent excessive indebtedness and a worsening of the loan portfolio, a 40 percent ceiling on households' total level of indebtedness has been introduced on January 1, 2019. The authorities share staff's concerns over the sovereign bank nexus and are considering the introduction of a systemic risk buffer while conducting further impact analyses to avoid potential financial stability implications. The new legislation adopted in July 2019 has strengthened the AML/CFT framework and ongoing efforts will be done to fully comply with FATF standards.

Advancing structural reforms and improving EU absorption will enhance Romania's competitiveness and facilitate investment. The authorities are aware of the key challenges to improve the corporate governance of SOEs, to restructure those that have sustained long-standing problems and to pose a drain on the budget and raise EU-funds absorption. Steps have been taken to restructure major energy producers and to prepare IPOs for some of them. The selection of private management for SOEs in energy and transportation sectors is in different stages of execution and, upon completion, will contribute to improving the governance of the state-owned companies. The establishment of the Sovereign Fund for Development and Investments is no longer on the Government's agenda, eliminating a source of uncertainty on the governance of SOEs.

The authorities and staff agreed that efforts are needed to improve investments in infrastructure, including by more effective EU funds absorption. Some of the measures implemented under GEO 114/2018 aimed to stimulate the construction sector while PPPs, for which a new framework was adopted, could provide additional funding for bridging the infrastructure gap. The EU funds remain the critical source of financing investment and a significantly improved absorption is top priority. Progress has been made to expedite the assessment process, improve the implementation of large infrastructure projects and reduce the administrative burden. The authorities will continuously focus on accelerating program implementations and maximizing the impact of EU funds while increasing transparency and accountability. The authorities are

confident that further building on this base will allow for a significant acceleration of the absorption in the coming years.

The authorities agree on the need to continue fighting against corruption and indicate that no further initiatives related to judicial system will follow.

The authorities would like to thank staff for the thorough and constructive discussions during the Article IV mission, and for their valuable advice on macroeconomic policies. They remain committed to focusing their strategy on promoting sustainable and inclusive growth, improving competitiveness and reducing vulnerabilities.