June 2007
IMF Country Report No. 07/219

Romania: 2007 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; 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 2007 Article IV consultation with Romania, the following documents have been released and are included in this package:

- the staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 7, 2007, 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 May 2, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 23, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Romania.

The document listed below has been or will be separately released.

Selected Issues Paper

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INTERNATIONAL MONETARY FUND

ROMANIA

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with Romania

Approved by Juha Kähkönen and Martin Fetherston

May 2, 2007

Executive Summary

Background: Growth is strong, while inflation and unemployment are falling. However, strong credit growth, a widening current-account deficit and attendant increase in vulnerabilities raise concerns. During 2006, the National Bank of Romania (NBR) focused on improving the credibility of the inflation-targeting framework, but upward exchange rate pressure has prompted it to reduce interest rates. On current policies, the end-2007 inflation target will likely be missed, unless sizeable appreciation occurs, and the current account deficit will widen further. Short-term risks are manageable but, in the absence of a change in macroeconomic policies, an abrupt adjustment may become necessary.

Staff views: The current environment calls for policies to minimize external and financial-sector vulnerabilities, retain positive foreign-investor sentiment, and maximize benefits from EU accession. To achieve macroeconomic stability and relieve some pressure off monetary policy, staff advocated limiting the budget deficit to below one percent of GDP in 2007 and tightening public-sector wage policy. On interest rates, although the recent unification of the policy and the effective rates is welcome, the NBR’s aggressive series of cuts is premature.

The authorities’ views: The authorities broadly shared the staff’s assessment and agreed that the widening current account deficit and its attendant vulnerabilities are cause for concern. However, because of substantial infrastructure and social needs, low public debt, and fragile political situation, they found it difficult to take measures to correct the loose fiscal and wage policy stance. They noted that the budget deficit would not exceed their 2.8 percent of GDP target this year. The NBR acknowledged the upside risks in the inflation outlook and risks of larger external imbalances, and agreed with the need for tighter fiscal and wage policy and is prepared to raise interest rates if need be.

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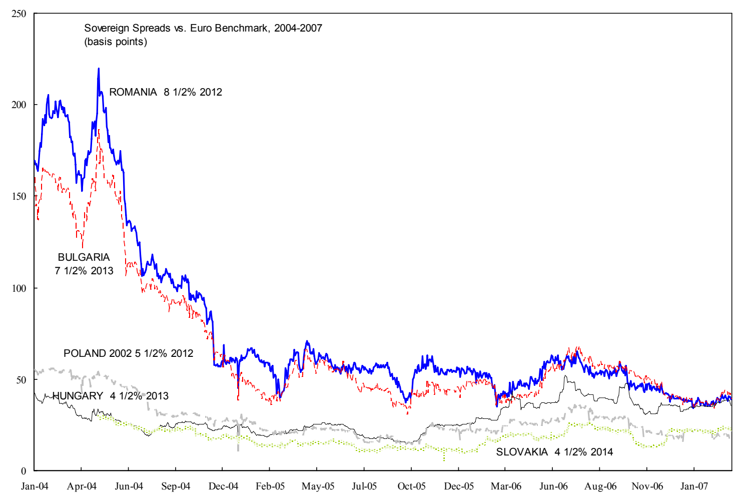
I. Introduction

1. **The discussions were held at a historic moment.** EU accession on January 1, 2007 follows a period of substantial achievements. After the 1999 currency crisis, macroeconomic imbalances narrowed through: fiscal adjustment and prudent monetary policy; measures to improve the SOEs' financial performance; and privatization. Output growth accelerated compared to the early years of transition, narrowing the income gap with the EU (Figure 1). The NBR achieved substantial disinflation, while macroeconomic stabilization and EU accession prospects helped boost investment, productivity, and potential output. Overall, policy objectives and actions have been broadly in line with Fund recommendations, although recent decisions have exacerbated excess demand (Box 1). Investor confidence in Romania's prospects has been high, but ongoing political tensions may eventually impact investor sentiment.



2. **Widening imbalances, however, call for a policy response.** Although EU convergence requires increased investment and foreign savings, the ongoing widening of the external imbalance is disconcerting. Moreover, a procyclical fiscal loosening exacerbates excess demand and heightens vulnerabilities. Rapid credit expansion is problematic. Accordingly, discussions focused on policies to minimize external and financial-sector vulnerabilities and maximize the benefits from EU accession.

II. Recent Developments

3. **Macroeconomic developments have been positive but there are areas of concern** (Figure 2). Specifically:

- **Economic growth was well above potential in 2006** (Table 1).[1] In addition to a recovery in agriculture, industrial output picked up substantially given strong gains in productivity. Domestic demand has grown even more strongly, owing to solid investment growth and a sharp increase in private consumption.

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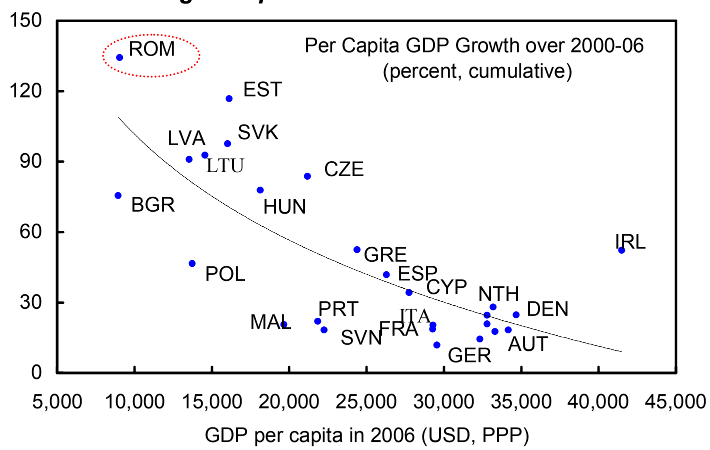
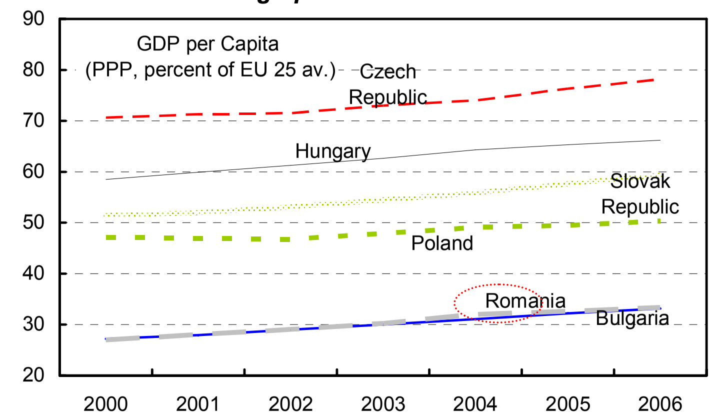
[1] As outlined in IMF Country Report No. 06/168, staff estimated sustainable annual economic growth of 5-6 percent.

Figure 1. Romania: Convergence, Real Exchange Rates, and External Imbalances, 2000–06

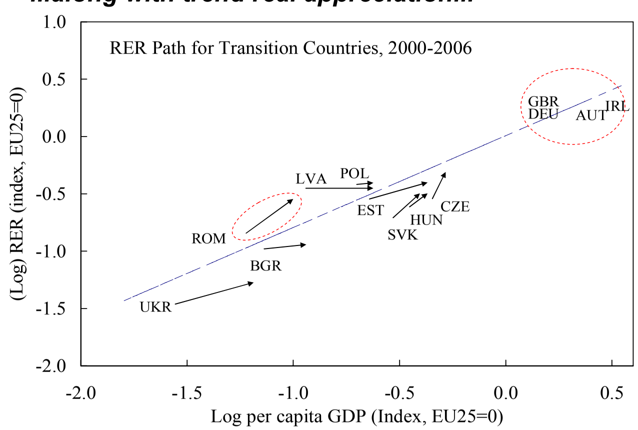
As convergence proceeds...



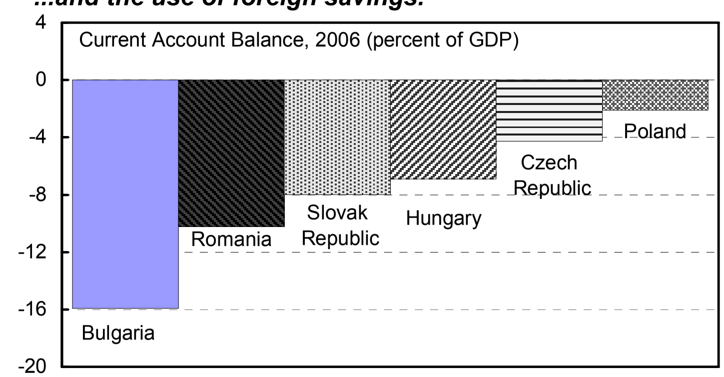
...incomes are catching up...



...along with trend real appreciation...



...and the use of foreign savings.



Sources: Romanian authorities, and staff calculations.

Box 1. Fund Policy Recommendations and Implementation

The authorities have broadly followed the Fund's policy advice, although recent policies diverge from recommendations.

Fiscal policy: While policy remained tight until November 2006, a substantial loosening took place in December; and the 2007 budget is procyclical.

Wage policy: Substantial increases in government wages during 2004-07 have not been in line with the Fund's long-standing recommendation for prudence, and have exacerbated demand pressures.

Monetary policy: Over the past two years, policy has been in line with Fund advice, and has been successful in lowering inflation.

Structural policies: Significant progress has been made on privatization. However, domestic gas prices are below international prices and the implementation of judicial reform agenda is pending.

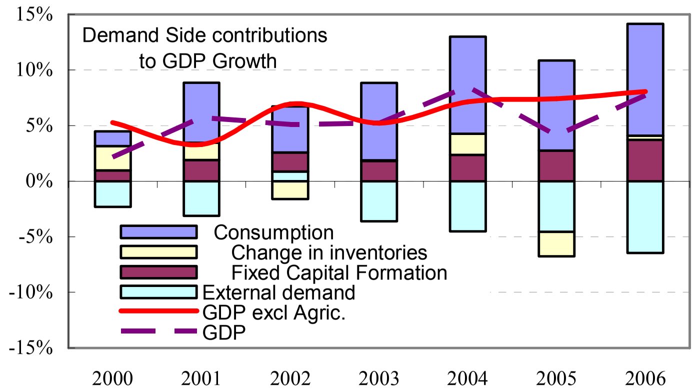
Romania: Key Macroeconomic Indicators, 2000–06

	2000	2001	2002	2003	2004	2005	2006 Prel. Estimates
(In percent of GDP, unless otherwise indicated)							
Real GDP growth (percent)	2.1	5.7	5.1	5.2	8.5	4.1	7.7
CPI (change in percent; end of period)	40.7	30.3	17.8	14.1	9.3	8.6	4.9
Current account balance	-3.7	-5.5	-3.3	-5.8	-8.4	-8.7	-10.3
General government balance	-4.0	-3.2	-2.6	-2.2	-1.0	-0.8	-1.7
Reserve cover (months of imports)	2.3	3.5	3.8	3.3	4.1	5.1	4.8
Reserves (in percent of short-term debt)	461.6	496.1	569.7	379.1	372.2	282.9	158.8
Gross external (MLT) debt	29.8	32.8	30.8	29.9	30.6	31.1	28.6
Public debt	27.8	27.5	26.0	23.6	23.2	19.9	18.5

Sources: Romanian authorities; and Fund staff estimates.

Figure 2. Romania: Growth, Inflation, and External Balance, 1999–2006

Increased growth.....

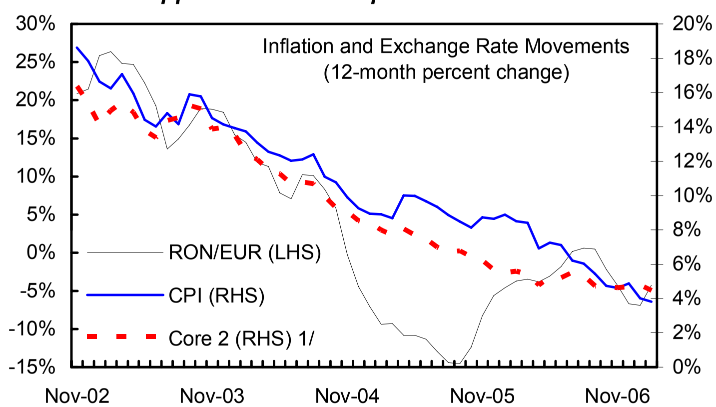


...reflects rising consumption and investment.....

Romania: Savings and Investment, 2002-06

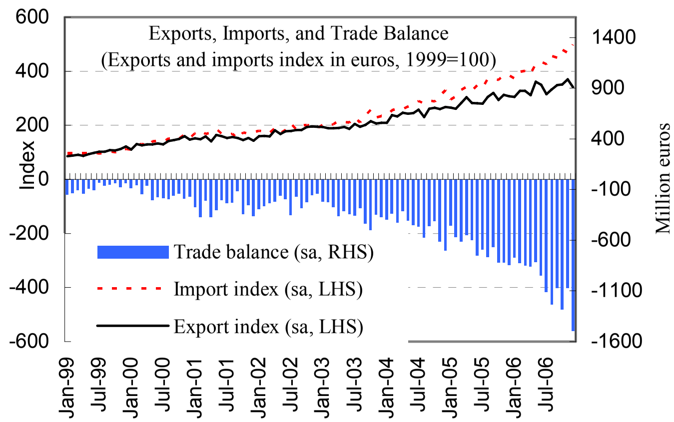
	2002	2003	2004	2005	2006
Total national savings	18.3	16.0	15.3	14.1	14.0
Non-government	17.7	14.9	13.6	12.2	11.9
Government	0.6	1.2	1.7	1.8	2.1
Total investment	21.7	21.8	23.8	22.7	24.2
Non-government	18.5	18.5	21.0	20.1	20.5
Government	3.2	3.4	2.8	2.6	3.7
Savings - investment balance	-3.3	-5.8	-8.5	-8.6	-10.3
Non-government	-0.7	-3.6	-7.4	-7.9	-8.6
Government	-2.6	-2.2	-1.0	-0.8	-1.7

..and while appreciation has helped ease headline inflation..



1/ Core 2 CPI excludes administered prices, volatile food items, and fuel.

...excess demand is reflected in higher imports.

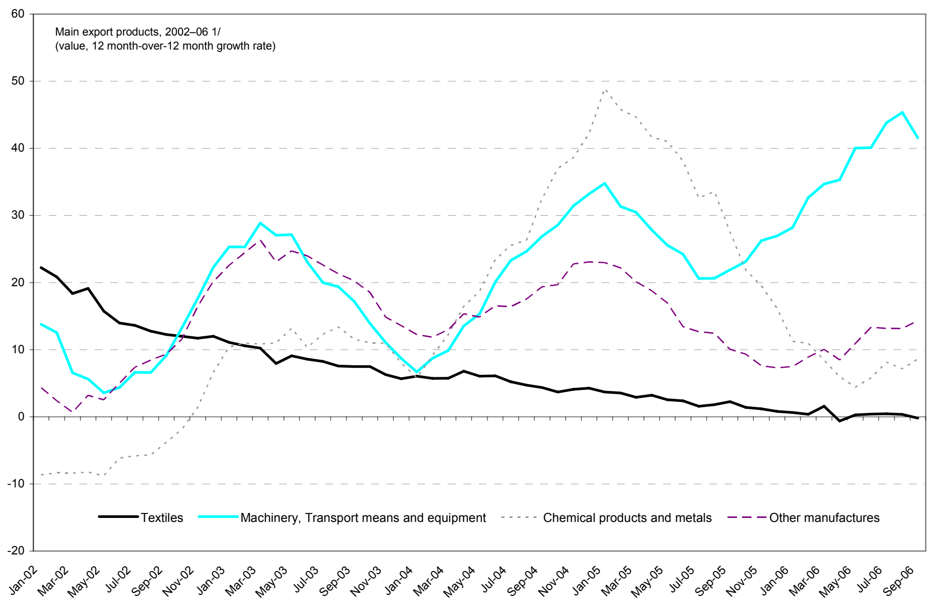


Sources: Romanian authorities, and staff calculations.

- **The inflation performance has been impressive.** In addition to prudent monetary and fiscal policies (through November 2006), disinflation benefited from the postponement of administered-price increases, favorable agricultural prices, and currency appreciation. Although CPI inflation has continued to fall recently—3.7 percent y-o-y at end-March—core inflation has remained relatively flat at 4½ percent.

- **Strong credit growth has been associated with expanding domestic demand.** From a low base, real domestic credit grew by 66 percent in 2006—reflecting both strong leu- and foreign-currency denominated credit (Figure 3).

- **Credit expansion has paralleled a widening current account deficit, but the overall balance-of-payments remains strong** (Table 2)**.** Export performance has



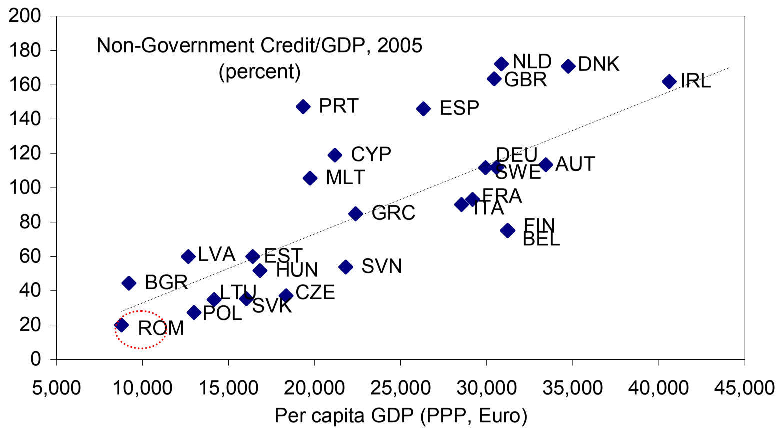
1/ Excludes mineral and agricultural products.
Source: Romanian authorities.

remained robust, driven by strong manufacturing exports and confirming the shift toward higher value-added goods. Moreover, the EU accession-related easing of trade barriers and financial support have already accelerated structural change and will boost trade. FDI covered 90 percent of the current account deficit, external debt remains low, and reserve cover is comfortable.

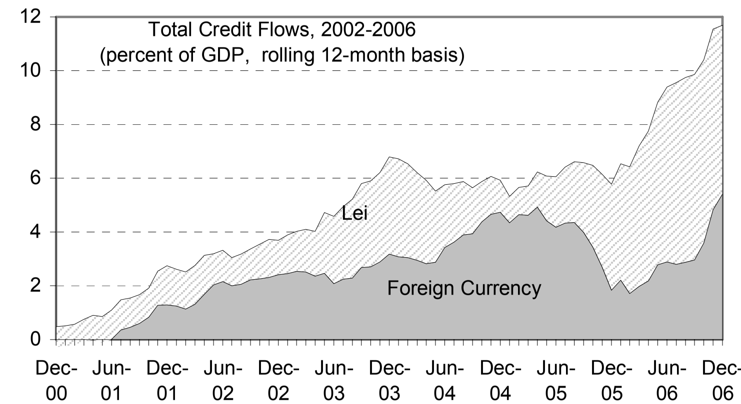
- **Despite an increasing current account deficit, staff's analysis indicates that Romania's exchange rate remains competitive.** The gains in competitiveness achieved by the 1999 correction in the exchange rate were preserved until end-2004 in an environment of low capital inflows. Following the adoption of greater exchange-rate flexibility and capital-account liberalization, the leu appreciated significantly in 2005. This, together with strong wage growth, resulted in a sharp real appreciation (Figure 4). In contrast, with slowing nominal appreciation and easing unit labor costs, the real exchange rate appreciated moderately in 2006. Further trend

Figure 3. Romania: Credit Growth, 2001–06

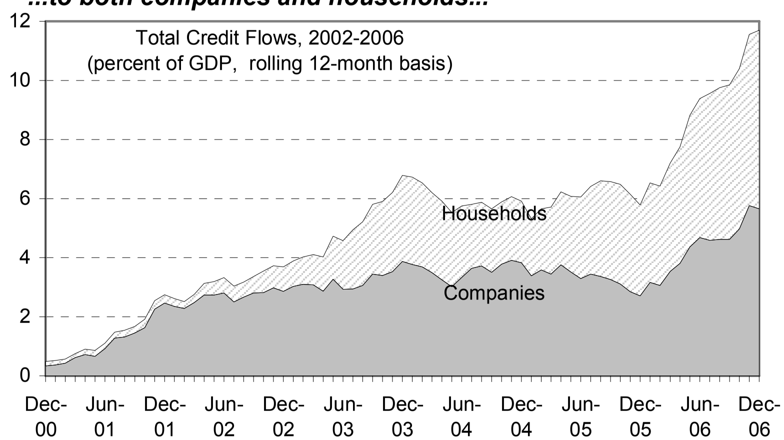
From a low base...



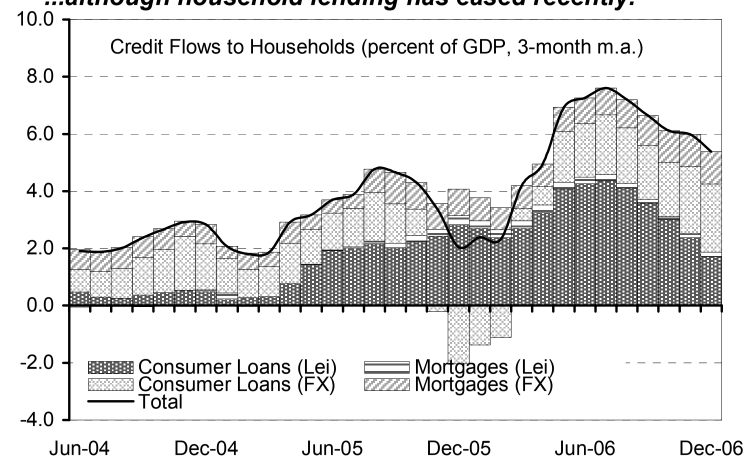
...credit has grown sharply...



...to both companies and households...



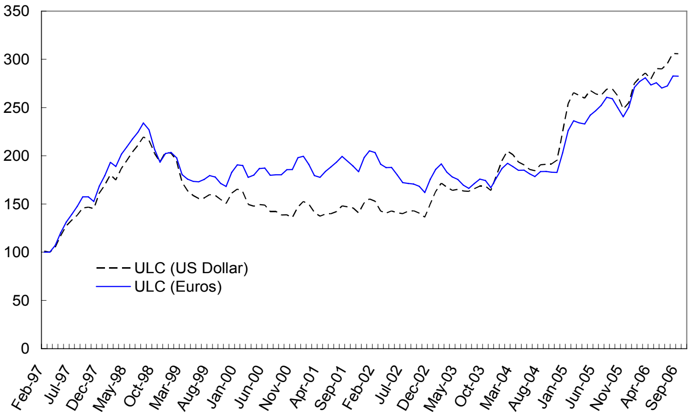
...although household lending has eased recently.



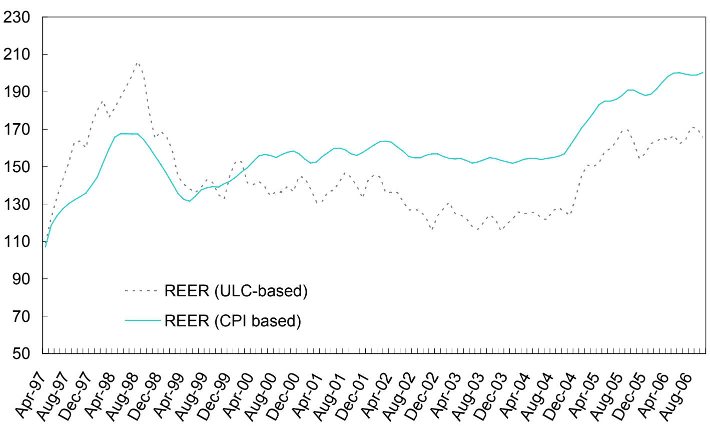
Sources: Romanian authorities, and staff calculations.

Figure 4. Romania: Competitiveness Indicators, 1997–2006

Romania: Unit Labor Cost, 1997-2006
(Jan 1997=100, 3-month moving average)

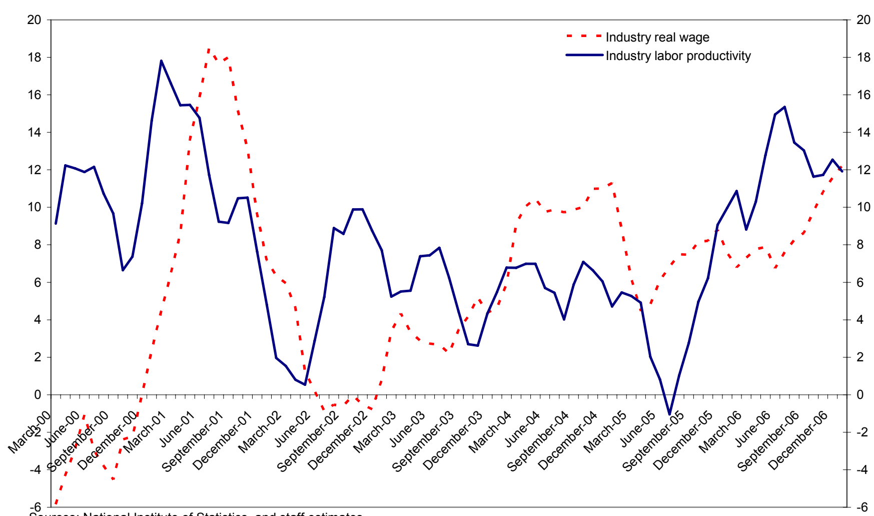


Romania: Real Exchange Rate, 1997-2006[1]
(Jan-Mar 1997=100, 3-month moving average)



1/CPI based measures use INS weights, while ULC based REER includes advanced economy partners only.

Romania: Real Wage Growth and Productivity in Industry, 2000-06
(3-month moving average)



Sources: National Institute of Statistics, and staff estimates.

real appreciation is to be expected, as price levels in Romania are still only half the euro-zone average, and ultimately, the price gap (in euro) will narrow in tandem with income convergence. However, staff's analysis suggests that there still exists margin for further appreciation, albeit at a measured pace, without unduly impacting the external balance (Box 2). This assessment is supported by rising profitability in manufacturing driven by strong productivity gains, good export performance, and substantial foreign investment.

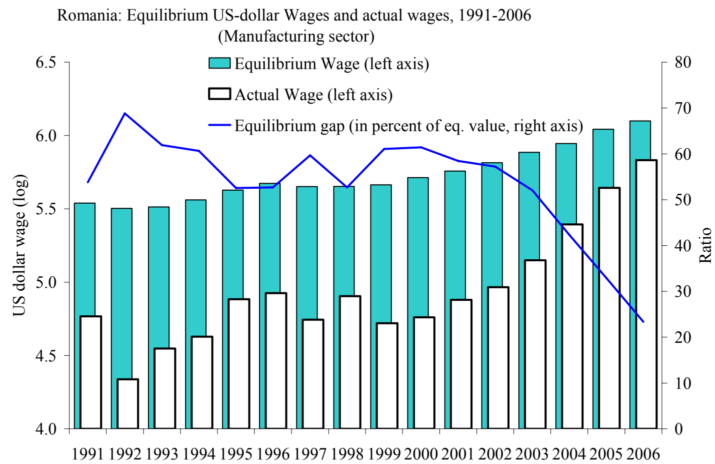
4. **Fiscal policy supported stabilization for most of last year, but there has been a significant procyclical loosening recently** (Figure 5)**.** Strong revenue collections and underutilization of the capital budget resulted in a fiscal surplus for most of 2006. However, a spending surge in December led to an annual deficit of 1.7 percent of GDP (Table 3). Indeed, more than 40 percent of the capital budget was spent in December 2006 alone. For the year, real government expenditure rose by 20 percent. The government revised the budget four times, increasing the deficit ceiling from 0.5 percent of GDP to 2.5 percent.

5. **Procyclical public-sector wage policies exacerbated domestic-demand pressures**. Such policies—influenced by trade unions and the fragile political environment—led to a substantial real increase in government wages, outpacing those of the private sector (Figure 6). The original wage allocation proved insufficient given average increases of 9-15 percent. Although the authorities had committed to freeze vacant positions (except EU-accession-related hiring) to offset wage overruns, government employment increased by 3⅓ percent. Moreover, on account of retroactive wages for teachers and judges due to legal settlement, and payment of bonuses, the wage bill increased by 36 percent. On a positive note, the government exercised prudence in the minimum wage (6½ percent) and controlled SOEs' wage bill.

6. **Following an inauspicious start, the NBR improved the credibility of its inflation targeting (IT) regime.** The NBR introduced IT in August 2005, but the announcement of the new framework coincided with an immediate test of the central bank's resolve—in the face of a surge in capital inflows, the NBR intervened heavily in the foreign exchange market and reduced interest rates sharply, rather than allowing further appreciation. Since then, however, the NBR has stopped intervening and has tightened monetary conditions. In 2006, it raised the reference policy interest rate, as well as the effective rate, to a unified level of 8.75 percent.

Box 2. Competitiveness

Equilibrium-based indicators of Romania's real exchange rate (RER) suggest that there is still room for further appreciation, albeit at a measured pace. Romania has long benefited from low wages vis-à-vis other economies. Using manufacturing wages in U.S. dollars as a proxy for the RER, the equilibrium wage is modeled as a function of different productivity measures and income. The results suggest that Romania's RER has been significantly undervalued throughout the 1990s, and that although the implied extent of undervaluation has narrowed since 2000, a gap of some 20 percent between the actual and the equilibrium wage remains.



Similar results are obtained from a PPP-based measure. When compared to a world-wide benchmark, transition economies have shown undervalued exchange rates for most of the transition. This is not surprising, given that most transition economies started the 1990s with extremely competitive costs and significantly undervalued RERs. Most experienced a trend real appreciation over the past decade, and looking forward, Romania will likely continue along a similar path. So, while the authorities should guard against complacency and monitor future productivity developments closely, staff analysis suggests that recent exchange-rate developments form part of a larger, ongoing structural process, and should not yet be viewed with undue alarm.

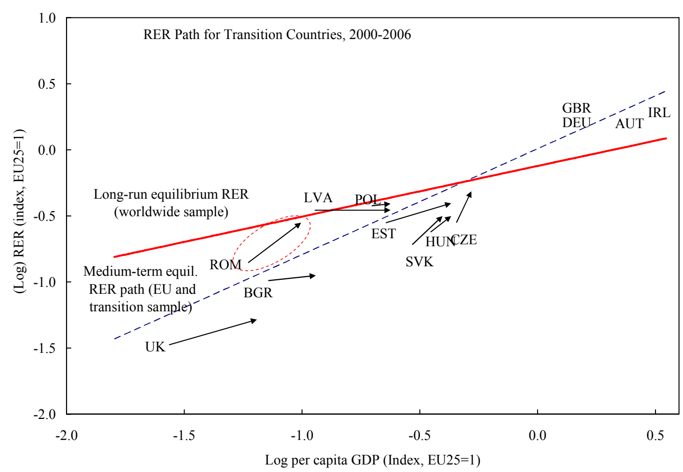
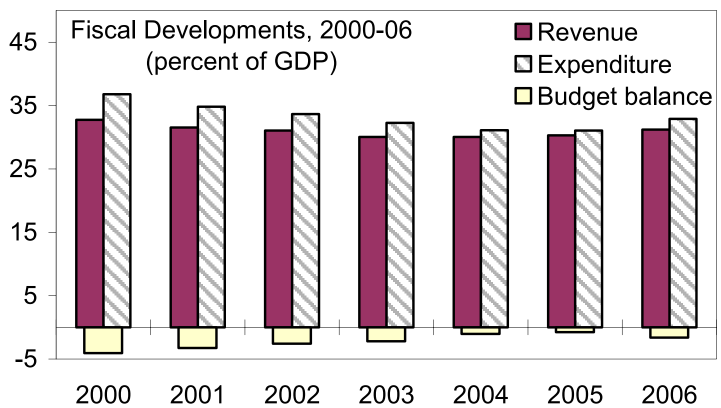
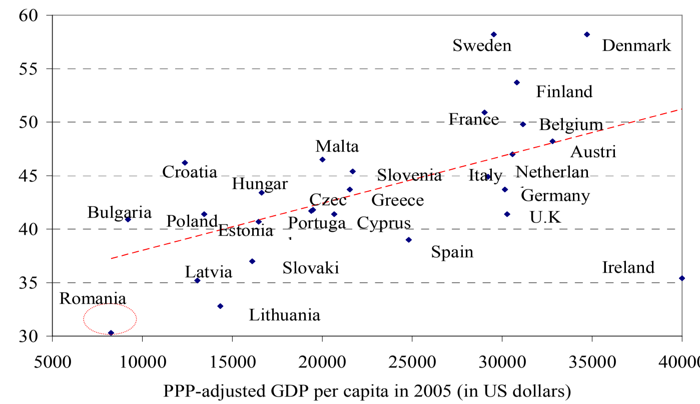


Figure 5. Romania: Fiscal Policy, 2000–07

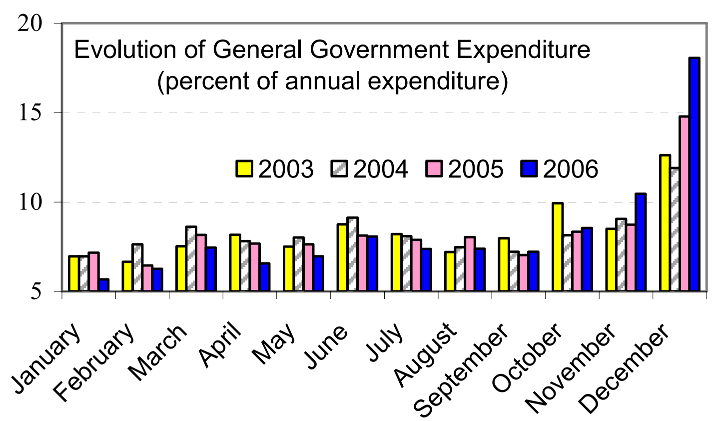
Recent fiscal consolidation has been good....



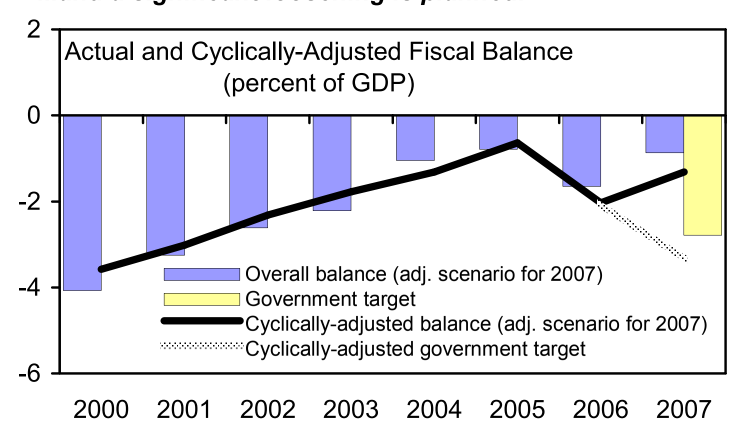
...but revenue is low....



...spending is uneven....

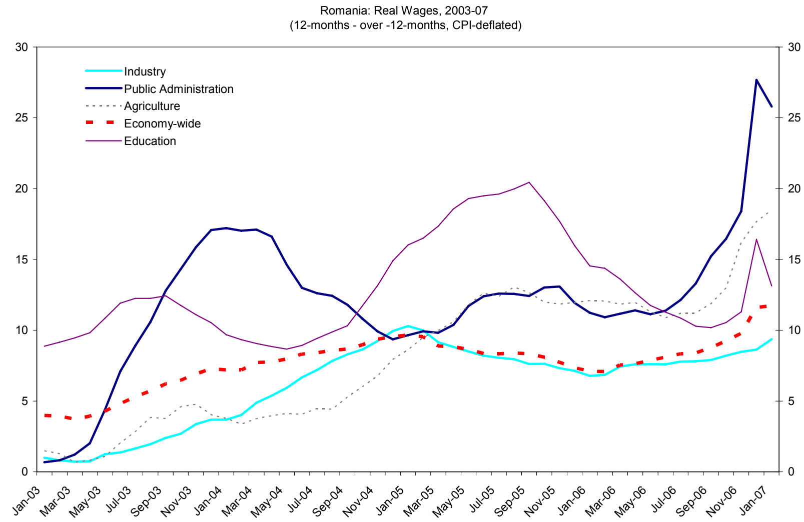


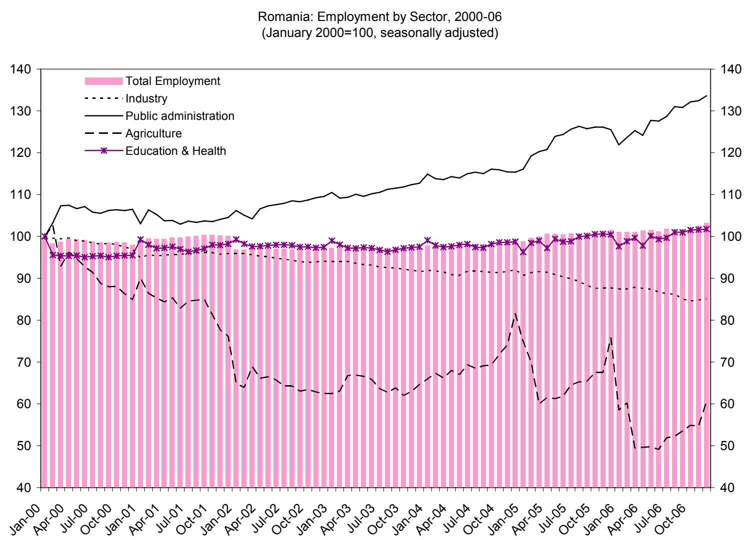
...and a significant loosening is planned.

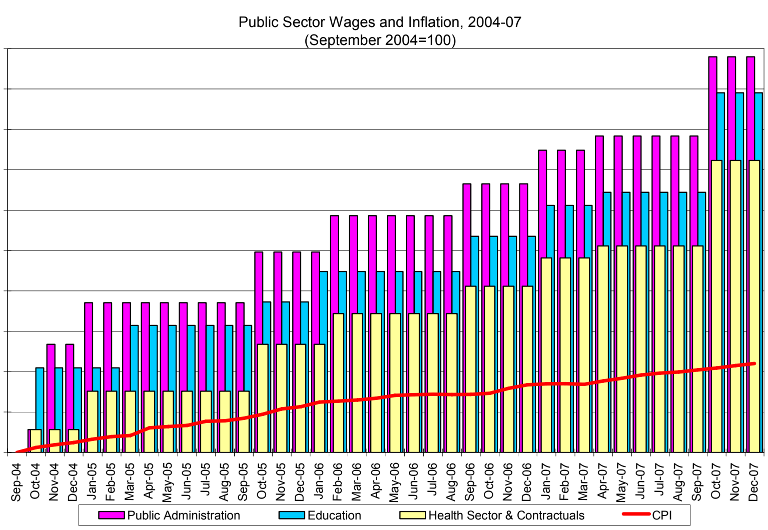


Sources: Romanian authorities, and staff calculations.

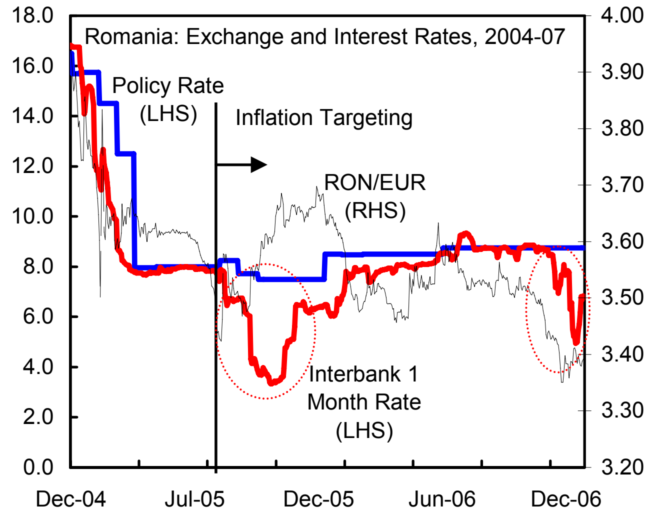
Figure 6. Romania: Public Sector Wages and Employment, 2000–07







7. **In early-2007, however, upward pressure on the exchange rate prompted the NBR to loosen policy.** The sharp appreciation since end-November 2006 caused the authorities to limit the amount of liquidity absorbed at the policy rate, channeling excess liquidity into the NBR's low-yield deposit facility, and once again driving the effective interest rate below the policy rate. Moreover, the NBR reduced the policy rate to 8 percent on February 9. The return of a gap between the effective and the policy rates strengthened the general perception that the inflation-targeting NBR is also keenly concerned about the pace of appreciation.



8. **Progress on structural reforms has been mixed and Romania performs below other EU entrants** (Figure 7)**.** The CEC bank privatization has been postponed and energy-sector privatization has stalled. Although recent increases in the domestic gas price are encouraging, a gap still exists from the international import price. Labor market rigidities remain, and the capital market is not very developed. Judicial reform has progressed in line with Romania's EU commitments, although questions remain about implementation, and Romania scores poorly on perceived corruption (Figure 7).

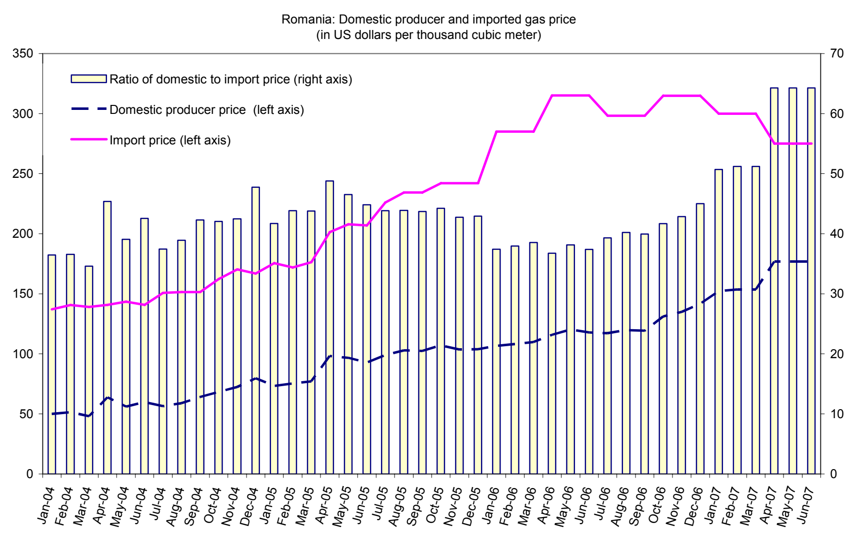


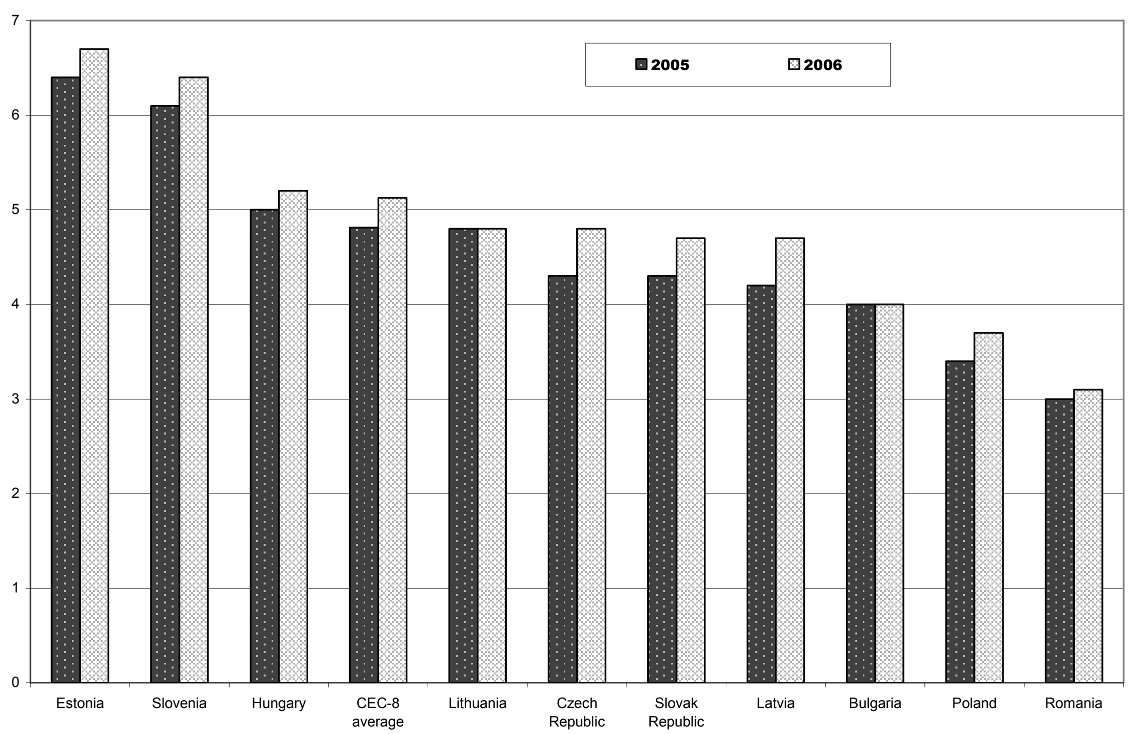
Figure 7. Selected Indicators of Structural Performance

Romania and Selected EU Countries: Average EBRD Transition Indicator Scores, 2005

	Private sector share of GDP EBRD mid-year estimate (%)	Enterprise reform & governance	Markets & trade	Financial institutions	Infrastructure reform
Bulgaria	70	3.3	3.2	2.5	2.9
Czech Republic	80	3.8	3.4	3.4	3.1
Estonia	75	3.8	3.3	3.4	3.7
Hungary	80	3.8	3.5	3.9	3.7
Latvia	65	3.3	3.2	2.8	3.0
Lithuania	70	3.4	3.4	3.0	2.8
Poland	75	3.6	3.5	3.5	3.7
Romania	**65**	**3.0**	**3.2**	**2.4**	**3.2**
Slovakia	80	3.8	3.5	2.8	2.4
Slovenia	65	3.3	3.4	3.0	3.3
EU-8 unweighted average	*74*	*3.6*	*3.4*	*3.2*	*3.2*

Sources: EBRD Transition Report 2006; and staff calculations.

Corruption perception index
(Score out of 10, highest score is least corrupt)



Source: Transparency International.

III. Policy Discussions

9. **Discussions centered on policies for reducing vulnerabilities and laying the foundations for sustainable growth:**

- How to design policies to address the widening external imbalance, while supporting the growth and inflation objectives?
- Strong and sustainable real convergence requires an expanding financial sector and sizeable capital inflows. How to minimize risks in a setting where credit, asset prices, and the real exchange rate may all be undergoing strong equilibrium adjustment?
- How to improve the business climate, and increase labor participation and employment to accelerate the pace of convergence?

A. Outlook, Vulnerabilities, and Risks

10. **There was broad recognition that meeting the authorities' macroeconomic objectives, on current policies, will be challenging.** With the economy overheating, the envisaged fiscal and incomes policy will add to demand, and contribute to a further widening of the current account deficit and inflationary pressures. There was agreement that such an outcome, combined with a delay in strengthening macroeconomic policies, increases the risk of a change in market sentiment, leading perhaps to a fall in capital inflows and a destabilizing swing in the exchange rate. In this event, a growth slowdown combined with a depreciation would weaken the debt-service capacity of households and enterprises, putting the banking system under strain (Box 3). Less dramatically, delayed adjustment over the near term increases the risk of a hard landing in the future, and could complicate meeting the Maastricht criteria.

Romania: Key Macroeconomic Indicators, 2006-08

	2006	2007 1/		2008
	Prel.	Staff Projections		Staff Proj.
	Estimates	Baseline	Adj.	Adj.
(In percent of GDP, unless otherwise indicated)				
Real GDP growth (percent)	7.7	7.0	6.5	4.8
CPI (change in percent; end of period)	4.9	5.5	4.5	4.8
Current account balance	-10.3	-11.7	-10.2	-9.6
General government balance	-1.7	-2.8	-0.9	-0.7
Reserve cover (months of imports)	4.8	4.5	5.0	4.9
Reserves (in percent of short-term debt)	158.8	145.8	156.8	163.9
Gross external (MLT) debt	28.6	26.4	26.1	25.1
Public debt	18.5	18.7	17.3	15.1

Sources: Romanian authorities; and Fund staff estimates.

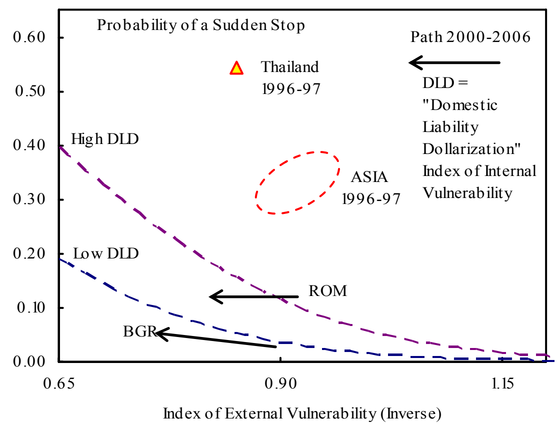
1/ The baseline scenario assumes meeting the government's fiscal deficit target.

Box 3. The Impact of a Sudden Stop

Although large current account deficits are a natural response to convergence, the size of the deficit and the emphasis on consumption have raised concerns about the economy's vulnerability to a change in foreign-investor sentiment. A sudden drop in external demand for Romanian assets would lead to a drop in funding, forcing a swift and painful adjustment. Staff has developed a model that seeks to estimate the likelihood and impact of a stop in capital flows.

Controlling for the type of capital inflow, the model focuses on: i) ***external vulnerability***, which captures the real exchange rate adjustment that would be necessary if the deficit were suddenly brought down to zero; and ii) ***internal vulnerability***, which captures the extent of currency-related balance-sheet mismatches.

The results suggest that despite a growing external imbalance, the risks of a stop have been kept in check by Romania's strong FDI financing. However, even FDI flows can slow sharply. Then, the immediate impact on GDP growth would be significant, perhaps as high as 7-8 percentage points, with some recovery in the first year after the crisis.



Estimation Results: Impact of a Sudden Stop on GDP Growth

Country	Current Account Deficit, 2006	Baseline		With a 5 ppt reduction in the current account deficit	
		Growth impact of sudden stop	Recovery in t+1	Growth impact of sudden stop	Recovery in t+1
Romania	10.3	-7.4	4.1	-5.9	3.8
Bulgaria	15.9	-8.5	4.2	-7.2	4.1

Sources: IFS, BIS, World Bank, and staff calculations.

11. **Staff thus called for prudent policies that will sustain growth and contain vulnerabilities.** In a setting of strong private-sector expansion and capital inflows, fiscal policy is key for assuring macroeconomic stability. Accordingly, staff advocated tightening fiscal and incomes policies to relieve some of the burden on monetary policy. With appropriate policies, staff expects strong growth, a continuation of disinflation and containment of the current account deficit. An updated debt sustainability analysis points to a sustainable current account deficit of 8 percent of GDP, which would stabilize the external debt-to-GDP ratio at 30 percent (Table 11 and Appendix IV). The scenario assumes continued FDI inflows, with a shift away from privatization-related flows, followed by a gradual slowdown in the outer years (Table 7).

B. Fiscal and Incomes Policies

12. **Staff found the authorities' fiscal plans inconsistent with maintaining macroeconomic stability.** The budget targets a deficit of 2.8 percent of GDP, which represents a significant expansion in the cyclically-adjusted fiscal deficit. Also, in staff's view, budget revenue projections are optimistic. This view is confirmed by revenue performance this year. On expenditure, the wage allocation does not incorporate all salary increases approved by parliament. Staff projects that, on current policies, the underlying deficit is 3½ percent of GDP. The recognition of additional Property-Fund claims and drawings on the National Development Fund would add yet further to the cash deficit.

Romania: General Government Balances, 2004-07
(In percent of GDP)

	2004	2005	2006		2007		
	Outcome	Outcome	Original Budget	Prelim. Outcome	Budget	Baseline 1/	Adjustment 2/
						Staff projections	
Total revenue	30.1	30.2	31.5	31.2	34.1	33.5	34.1
of which: Tax revenue	27.1	27.2	27.9	28.3	29.8	29.3	29.5
Personal income tax	2.9	2.4	2.6	2.9	3.4	3.4	3.4
Corporate income tax	3.0	2.7	2.8	2.7	3.0	3.0	3.0
VAT	6.7	7.8	8.1	8.1	9.0	8.4	8.4
Total expenditure	31.1	31.0	32.0	32.9	36.8	36.3	34.9
of which: Current expenditure	28.3	28.3	28.8	29.2	32.2	32.1	31.2
Personnel	4.8	5.4	5.5	6.1	6.2	6.4	6.2
Goods and services	7.3	7.5	6.4	6.6	7.1	7.0	6.7
Capital expenditure 3/	2.8	2.6	3.2	3.7	4.6	4.2	3.7
Overall balance	-1.0	-0.8	-0.5	-1.7	-2.7	-2.8	-0.9
Primary expenditure	29.8	29.9	30.9	32.1	35.9	35.4	34.1
Primary balance	0.2	0.3	0.6	-0.9	-1.8	-1.9	0.0

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

1/ On the basis of the approved budget and in line with staff's baseline scenario (adjusted for staff's projections for revenues and expenditures).

2/ On the basis of staff's proposed scenario.

3/ Capital expenditure under the two scenarios for 2007 is based on more realistic assumptions about the implementation capacity , also given the sharp increase in capital expenditure in December 2006.

13. **The authorities acknowledged the need for fiscal restraint, but also pointed to pressing needs.** Staff advocated a withdrawal of fiscal stimulus and a smooth path for medium-term consolidation. Recognizing the need for tax-legislation stability, the scope for revenue measures this year is limited, therefore the majority of the adjustment would fall on expenditure—considered feasible given last December's expenditure splurge. Staff noted that, in the face of significant capital inflows, a widening external imbalance, and an appreciating currency, greater fiscal adjustment would be desirable. However, provided disinflation is proceeding, the current account deficit is contained, and debt levels remain low, staff considered that a fiscal adjustment of ¾ percent of GDP relative to the 2006 outturn (1.9 percent relative to the government target), accompanied by tighter incomes policy would be an appropriate policy package for this year. The proposed adjustment would represent a strong counter-cyclical response to overheating, and would also take some pressure off monetary policy (Figure 5). Although the authorities considered this assessment balanced, they found the proposed adjustment infeasible, given Romania's infrastructure and

social needs, the political environment, and the favorable debt position. They felt confident that the 2.8 percent deficit ceiling would not be exceeded.

14. **There was agreement on the need to permanently strengthen revenue and advance expenditure reforms.** Romania's revenue ratio is considerably below all EU countries, and pressing spending needs argue for more resources. Staff urged the government to resist calls for tax cuts except for the relatively-high social contributions tax and distortionary exemptions (e.g., a reduced VAT rate, exemption of reinvested profits, and a differentiated car-registration tax). The authorities noted that, although they did not plan any tax changes, tax-administration improvements should strengthen revenues. On expenditure, they agreed with the need to proceed with much-needed reforms (e.g., civil service, education, health, and pensions).

15. **The authorities have vowed to strengthen revenue administration, in line with IMF staff and World Bank recommendations.** Their strategy aims at modernizing administration, broadening the tax base, and addressing shortcomings in the organizational structure and legal mandate of the Agency for Fiscal Administration.

16. **The authorities agreed that a strict public-sector wage policy is needed for disinflation, but pointed to pressure for rapid convergence with average EU wages.** The government has approved significant wage increases for 2007 (up to 20 percent on average) in three rounds; the minimum wage has been raised by 18 percent; and the monitoring of SOEs' wage bill has eased. The mission noted the risks associated with this wage policy and emphasized its incompatibility with the inflation objective (unless administered-price increases are delayed, which would be undesirable). To contain the wage bill, staff suggested reducing the envisaged increases, controlling bonuses, and closely monitoring additional hirings. A tightening of public-sector wages would give a signal for prudent private-sector settlements, as staff's analysis (outlined in a *Selected Issues Paper*) has found significant demonstration effects. To anchor inflationary expectations in the low digits, public-sector wages should increase moderately, once a year, and be incorporated in the budget. The authorities agreed with the risks of a loose wage policy, but noted the difficulty in attracting high-skilled staff, and pointed to the trade unions and the fragile political environment.

17. **There was agreement that improved transparency, enhanced monitoring, and a credible medium-term fiscal framework would strengthen the institutional setting of fiscal policy.** Some features of the present setting undermine its credibility: there are multiple budget revisions; medium-term policies and objectives are not elaborated; and expenditures increase sharply at year-end. Staff suggested establishing mechanisms to ensure the efficient allocation of resources and absorption of EU inflows, and noted the importance of conducting a ROSC update. Multiple budget revisions should be avoided, while improved public-spending management needs to ensure a uniform spending pattern over the year. The authorities agreed on the need to strengthen the budgetary process by developing a credible medium-term framework, but were hesitant in adopting medium-term expenditure ceilings.

C. Monetary and Exchange Rate Policies

18. **The NBR faces a challenging environment.** Its policy guidelines call for entry into ERM-II by 2010-12, and euro adoption by 2012–14. In staff's view, this timetable is feasible and appropriate. However, it implies that the NBR has only 4-6 years to bring nominal-convergence criteria down to Maastricht levels. At the same time, the NBR must negotiate Romania's ongoing process of real convergence, in which capital inflows, real incomes, and international purchasing power are rising steadily. The central bank thus faces a difficult dilemma—meeting its inflation goals through higher interest rates may put further upward pressure on the currency. Staff stressed, however, that in the long run the only sustainable solution is to lower nominal interest rates by firmly anchoring inflationary expectations. This requires a credible inflation-targeting framework.

Romania: Performance Relative to Maastricht Criteria, 2006

Nominal Convergence Indicators	Maastricht Criteria	Romania 2006
Inflation (percent, av.)	2.8 percent 1/	6.6
Long-term Interest Rates (percent per annum)	6.2 percent 2/	7.0 3/
Exchange Rate (v. Euro) (max. percent change vs 2-yr av.)	+/- 15 percent	+10/-6.1
General Government Deficit (percent GDP)	below 3 percent	1.7
Government Debt (percent GDP)	below 60 percent	18.5

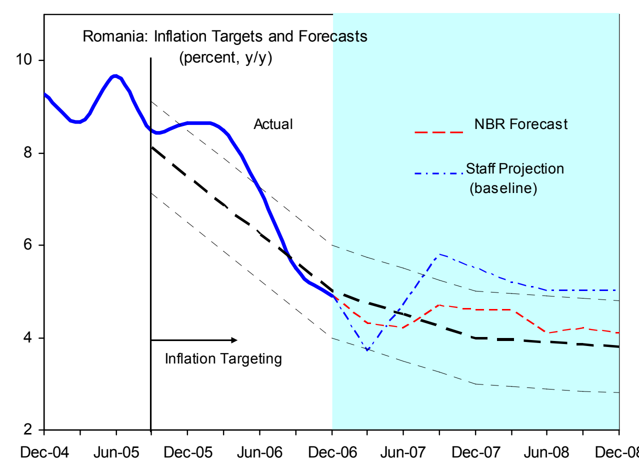
Sources: NBR, ECB Convergence Report.

1/ Less than 1.5 pp above the three-best performing member states.

2/ Less than 2 pp above the three-best performing member states.

3/ 5-year T-Bond issued March 1, 2007.

19. **Staff urged the NBR to focus on inflation and reunify the policy and effective interest rates as soon as possible.** At the time of the mission, the effective rate was about 6½ percent; in light of growing excess demand, staff suggested that this setting was too loose.[2] The NBR was urged to step up the volume of sterilization operations and so bring the effective rate in line with the policy rate of 8 percent. This would not only reassert the signaling role of the official policy rate, but would also represent a moderate monetary tightening and, with appropriate fiscal restraint, would be consistent with meeting the authorities' inflation targets for 2007 and 2008 (4.0 and 3.8 percent, respectively). In staff's view, these targets are feasible and reflect a realistic balance between rapid disinflation, and the ongoing pace of structural change. There are



[2] Staff estimates are based on a dynamic stochastic general equilibrium model outlined in a S*elected Issues Paper*.

significant risks to the inflation outlook, however, and if the authorities do not tighten fiscal and incomes policies, the NBR may have to increase interest rates further.

20. **The NBR generally agreed with the staff assessment, though it suggested that, taking into account previous appreciation and higher reserve requirements, monetary conditions were tighter than allowed for by staff.** The NBR further agreed that Romania still enjoyed a margin of competitiveness. However, it did not agree that concern about the pace of appreciation was necessarily inconsistent with the bank's inflation-targeting commitment. Given Romania's real convergence, the currency would likely continue on a medium-term upward path. But excessive short-term appreciation could leave the economy vulnerable to a sudden reversal, which would then adversely impact the pace of disinflation and the health of the financial sector.

21. **Following the mission, the NBR reduced the official policy rate further to 7½ percent.** Market participants interpreted the move as highlighting the NBR's focus on recent appreciation, rather than future inflation. In staff's view, such an aggressive loosening of monetary policy is premature. An effective nominal rate of 7½ percent is, in real terms, only marginally above the estimated neutral rate, and will do little to close the current output gap. Under the staff's baseline scenario, if rates are maintained at this level, and fiscal and incomes policies proceed as planned, the resulting rise in excess demand will likely push inflation above the upper band of the NBR target range, and will lead to a further widening of the current account deficit.

22. **Both sides expressed concern about the ongoing pace of credit growth.** Acknowledging that real convergence will naturally require an expanding financial sector, staff also stressed that current credit demand also partly reflects the continuing strength of excess demand. In any event, overly-rapid credit growth can magnify existing distortions and raise medium-term vulnerabilities, so the authorities were urged to maintain vigilance. There was agreement that administrative measures are often less and less effective over time, and are generally ill-suited to addressing a macroeconomic stabilization problem—as a first-best response to excess demand, the focus should be on higher interest rates. On reserve requirements, although levels in Romania are significantly higher than those in the EU, staff agreed that efforts to lower them should proceed cautiously. High reserve requirements do impose an added cost on domestic banks, and encourage disintermediation, but the authorities should take care that lowered reserves do not add to macroeconomic imbalances.

D. Financial Sector Issues

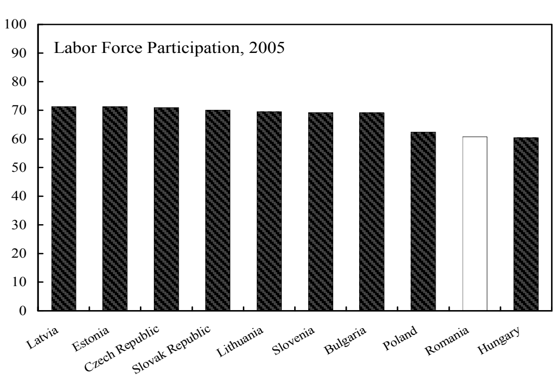
23. **Staff observed that, although the banking sector seems well-positioned to absorb adverse shocks, the authorities should nonetheless be alert to medium-term vulnerabilities.** Competitive pressures are increasing and spreads are falling, but the banking system remains liquid, well capitalized and profitable. Rates of return on equity and capital-adequacy ratios are high, while non-performing loan (NPL) ratios remain at moderate levels.

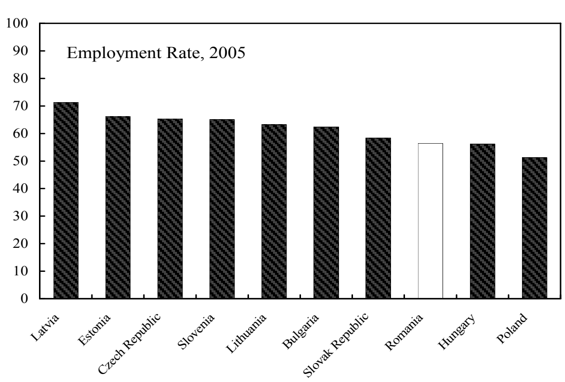
Moreover, the banking system is now almost 90 percent foreign owned. Foreign banks have been aggressive lenders, but also have relatively sophisticated risk-management policies, and can most likely rely on external support in the event of local liquidity problems or other adverse shocks.

24. **The authorities continue to make progress in strengthening their capacity for assessing financial-sector stability.** The NBR published its first Financial Stability Report in May 2006, and will release a second report by mid-2007. NBR stress tests suggest that the banking system remains resilient to the direct impact of interest-rate and exchange-rate movements, as well as a growth slowdown. However, in the context of rapid credit growth, indirect exposures through loan portfolios are much more difficult to assess. In this context, although NBR balance-sheet analysis indicates that the debt-service capacity of the corporate sector is healthy and rising, unhedged household borrowing is a concern, and the consequences of a less benign economy are difficult to predict. Therefore, staff urged the authorities to encourage high capital ratios and conservative provisioning practices. Given the dominant role of foreign-owned banks, the mission discussed NBR cooperation with regulatory and supervisory authorities in other countries. Memoranda of Understanding have been signed for all banks with a presence in Romania, and NBR staff are already participating in drills with other authorities to ensure a rapid and coordinated response to potential cross-border banking problems. The mission welcomed the authorities' desire to have an FSAP update this year.

E. Structural Policies

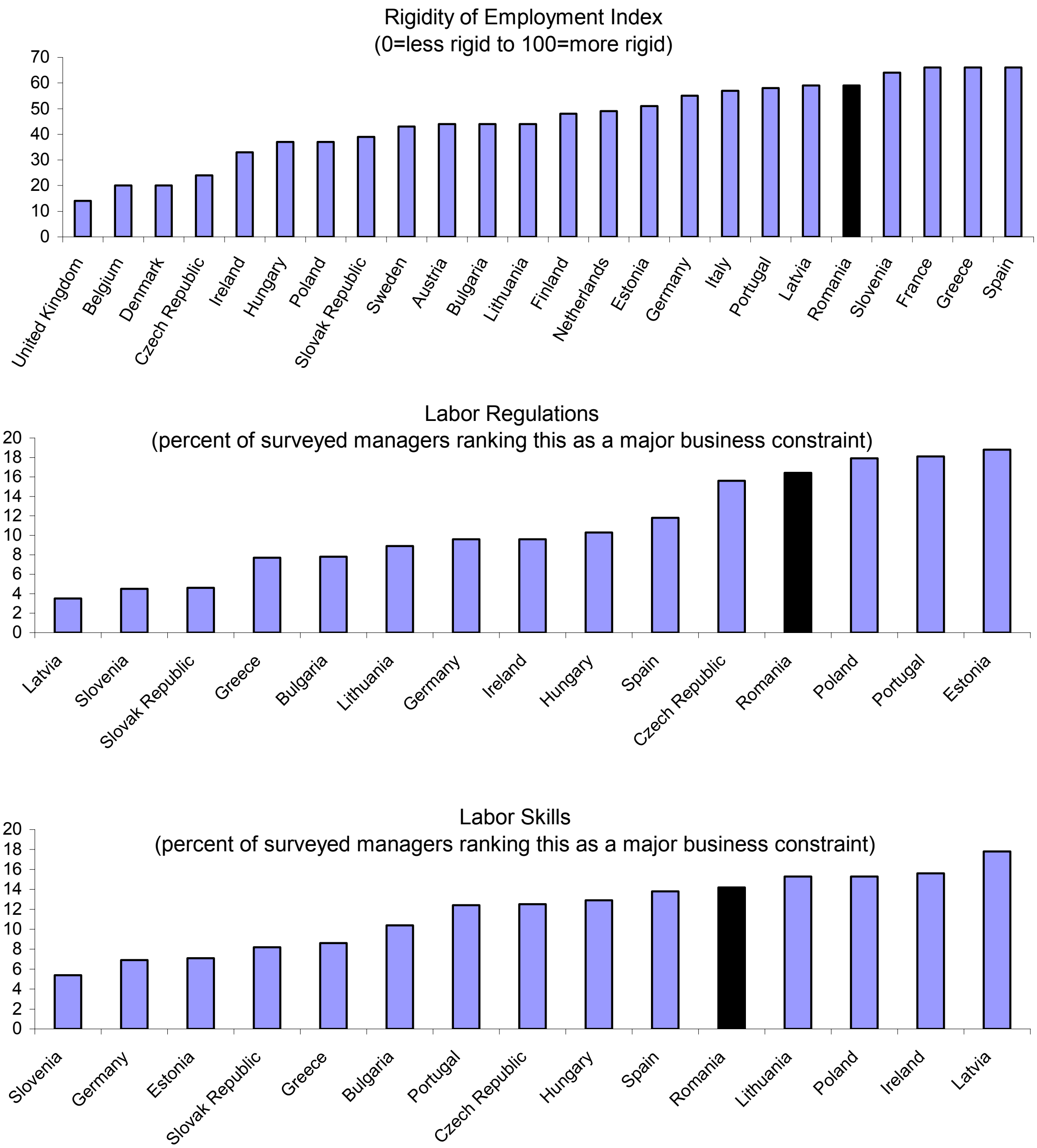
25. **There was agreement that structural reforms were crucial for real convergence**. The authorities acknowledged the need to continue with domestic gas price adjustments in line with opportunity cost developments and with their commitment to achieve import parity, but were hesitant to announce a specific schedule for such increases. Increasing labor-market participation and employment rates, will require an ambitious strategy encompassing





improved education system and training opportunities, and enhanced labor-market flexibility (Figure 8). The mission discussed the implications of aging (analyzed in a *Selected Issues Paper*), commending the authorities for their preparations for the second pillar, and urging them to strengthen their efforts to introduce it on January 1, 2008. Staff regretted that the

Figure 8. Characteristics of the Labor Market in Selected EU Members, 2005



Source: World Development Indicators, World Bank.

CEC privatization had been postponed, and noted the need to proceed with the privatization of energy-sector companies. Staff also noted the importance of developing the capital market. The authorities acknowledged the need to tackle corruption and noted their determination to forcefully implement their judicial reform agenda.

IV. Staff Appraisal

26. **Romania's prospects remain bright and the current juncture provides an excellent reform opportunity.** EU accession followed a period of important accomplishments. However, although growth is strong and convergence has been proceeding at a rapid pace, the outlook is clouded by widening imbalances. Domestic demand has been facilitated by rapid credit growth and procyclical fiscal and incomes policies. The confluence of positive factors that led to last year's impressive performance cannot be counted on to continue. The current juncture thus presents an opportunity to implement a reform program that will enhance Romania's growth potential and narrow the income gap with the EU.

27. **A tightening of policies is necessary to reduce vulnerabilities, lay down sustainable growth foundations, and lock in gains from EU membership.** Lasting increases in human and physical capital will only be possible with increased domestic savings and investment. The need to reduce external imbalances and vulnerabilities places a higher premium on consistent fiscal, incomes, and monetary policies, which serve as insurance against sudden shifts in market sentiment. A postponed response would only increase the need for more abrupt policy action later. The authorities' intention to adopt the euro provides an added incentive.

28. **Fiscal restraint is needed to ensure macroeconomic stability.** To this end, the authorities should aim at withdrawing fiscal stimulus this year, targeting a budget deficit of below 1 percent of GDP. Since the scope for revenue measures is limited, the majority of the adjustment must fall on expenditure. Moreover, staff cautions the authorities on the utilization of resources from the National Development Fund and additional Property Fund claims, both of which would result in a larger deficit, further compromising their macroeconomic objectives. Given Romania's pressing expenditure needs and low revenue ratio, there is a case for permanently strengthening revenue. In addition to broadening the tax base and modernizing tax administration, the government needs to resist calls for tax reduction (except social contributions) and distortionary exemptions.

29. **A strict public-sector wage policy is needed for successful disinflation and macroeconomic stability.** The approved wage increases in the public sector are incompatible with the inflation objective. Wage policy needs to be calibrated to the needs of a low inflation economy, featuring wage increases only once a year—which are moderate, transparent, and fully incorporated in the budget.

30. **Improved fiscal transparency, enhanced monitoring, and a credible medium-term framework are important elements of a strong institutional setting.** The experience of other accession countries suggests the importance of improving the efficiency of absorbing EU funds. Multiple revisions of the budget should be avoided, while expenditure management needs to be improved to ensure a uniform spending pattern over the year. To strengthen the budgetary process, a credible medium-term framework is needed.

31. **The central bank operates in a difficult policy environment.** Given that the immediate challenge is to firmly anchor inflationary expectations, the current series of aggressive interest-rate cuts appears premature. Although headline inflation has fallen recently, and an appreciating currency promises further relief over the short term, excess demand is still strong, and inflationary pressures are likely to reemerge toward the end of the year, especially in the wake of fiscal loosening. Staff welcomes the recent reunification of the policy and effective interest rates, which will help strengthen the signaling role of the policy rate, but considers that the current level of 7½ percent will do little to curb excess demand. The NBR therefore should stand ready to increase rates to ensure that the inflation targets remain within reach. Similarly, although reserve requirements are notably higher than in other EU countries, staff agrees that lowering the requirements should proceed cautiously.

32. **Financial-soundness indicators suggest that the banking system is well positioned to absorb adverse shocks, but the authorities still need to maintain their efforts to minimize vulnerabilities.** In the face of increasing competition and falling spreads, the banking sector remains liquid, well-capitalized, and profitable. Indicators and stress tests suggest that Romania's banks are still well-positioned to absorb the consequences of adverse interest-rate or exchange-rate movements, or of slower economic growth. However, the financial system is still in transition, and overly-rapid credit growth can magnify existing distortions and raise medium-term vulnerabilities. This places an added premium on effective supervision and regulation. Staff commends the NBR's continued progress in developing its capacity for assessing overall stability, and welcomes the authorities' desire to have an FSAP update this year.

33. **Structural reforms need to be accelerated to support real convergence.** The authorities are encouraged to accelerate privatization in the energy sector; announce a schedule for increased domestic producer gas prices in line with opportunity costs; put together a strategy to increase labor-market participation and employment rates; strengthen their efforts for the introduction of the second pension pillar; and forcefully implement their judicial reform agenda.

34. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Selected Economic and Social Indicators, 2002–07

	2002	2003	2004	2005	2006	2007	
					Prel. Estimate	Staff Projections Baseline 1/	Adj.
Real economy (change in percent) 2/							
Real GDP	5.1	5.2	8.5	4.1	7.7	7.0	6.5
Final domestic demand	5.5	8.3	10.4	10.1	12.5	10.8	9.1
CPI (end of period)	17.8	14.1	9.3	8.6	4.9	5.5	4.5
CPI (period average)	22.5	15.3	11.9	9.0	6.6	4.8	4.4
Unemployment rate (end of period; percent)	8.4	7.2	6.2	5.8	5.4	5.1	5.1
Gross national saving (percent of GDP)	18.3	16.0	15.4	14.0	14.0	13.4	14.9
Gross domestic investment (percent of GDP)	21.7	21.8	23.8	22.7	24.2	25.1	25.1
Public finance (general government, percent of GDP) 3/							
Revenue	29.6	28.7	30.0	30.2	31.2	33.5	34.1
Expenditure	32.3	30.9	31.1	31.0	32.9	36.3	34.9
Overall balance	-2.6	-2.2	-1.0	-0.8	-1.7	-2.8	-0.9
Primary balance	0.4	-0.2	0.2	0.3	-0.9	-1.9	0.0
Total public debt 4/	26.0	23.6	23.2	19.9	18.5	18.7	17.3
Money and credit (end of year, percent change)							
Nominal domestic credit	38.1	64.4	40.5	37.2	66.1	58.4	39.5
Real domestic credit 5/	38.2	23.3	40.1	33.8	29.4	42.4	36.0
Broad money	38.2	23.3	40.1	33.8	29.4	36.0	30.0
Interest rates (percent) 6/							
NBR interest rate (end of period)	21.5	23.4	18.8	7.2	8.8	-	-
Treasury bill rate (end of period)	17.4	18.4	11.5	5.5	5.5	-	-
Balance of payments (percent of GDP)							
Trade balance	-5.7	-7.5	-8.8	-9.8	-12.1	-13.5	-12.5
Current account balance	-3.3	-5.8	-8.4	-8.7	-10.3	-11.7	-10.2
Foreign direct investment	3.1	3.7	8.4	6.6	9.3	5.9	6.4
External debt	30.8	29.9	30.6	31.1	28.6	26.4	26.1
Official reserves (end-year, US$ million)	7,137	9,208	15,999	21,648	28,155	30,030	32,288
Reserve cover (months of prospective imports, in € terms))	3.8	3.3	4.1	5.1	4.8	4.5	5.0
Exchange rate							
Lei per euro (end of period)	3.51	4.17	3.96	3.66	3.41	-	-
Lei per US$ (end of period)	3.35	3.30	2.91	3.08	2.58	-	-
NEER appreciation (+) (percent)	-14.4	-11.1	-5.1	10.5	2.7	-	-
REER appreciation (+) (CPI-based, in percent, period average)	0.8	-3.2	2.6	18.0	7.6	-	-
REER appreciation (+) (ULC-based, in percent, period average)	-6.5	-5.5	5.1	24.9	3.8 7/	-	

Main export products are textiles and light machinery.

Social indicators (reference year):
Per capita GDP (2005): $4,445; **income distribution** (GINI coefficient, 2000): 30.3;
Poverty rate (2005)**:** 13 percent; **primary education completion rate** (2004): 94 percent; **gender pay gap** (2003): 18 percent;
Life expectancy at birth (2004): 71.3; **infant mortality per 1000 live births** (2004): 16.8.

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

1/ Assuming unchanged policy mix, including a 2.8 percent of GDP fiscal deficit in 2007.
2/ National accounts data are based on ESA95 guidelines.
3/ Beginning 2004, fiscal data are based on a new classification and thus they are not comparable to series before 2004.
4/ Including domestic public debt and external public debt (public and publicly guaranteed).
5/ Credit to the nongovernment sector; weighted average of real lei credit growth and U.S. dollar-measured foreign currency credit growth.
6/ NBR effective policy rate (combined sterilization operations and use of deposit facility), compounded.
7/ Average for period January-October.

Table 2. Romania: Balance of Payments, 2002-07
(In millions of euros, unless otherwise indicated)

	2002	2003	2004	2005	2006	2007	
					Prel.	Baseline	Adjustment
						Staff Projections	
Current account blance	**-1,623**	**-3,060**	**-5,099**	**-6,883**	**-9,973**	**-14,124**	**-12,385**
Ratio to annual GDP	-3.3	-5.8	-8.4	-8.7	-10.3	-11.7	-10.2
Current account balance plus FDI	-0.2	-2.1	0.0	-2.1	-0.9	-5.3	-3.8
Less estimated reinvested profits from FDI	-2.3	-4.7	-7.0	-7.3	-8.6	-10.1	-8.6
Goods and services	-2,747	-3,893	-5,536	-8,150	-11,753	-16,212	-14,997
Goods	-2,752	-3,955	-5,323	-7,806	-11,759	-16,274	-15,128
Exports	14,675	15,614	18,935	22,255	25,850	29,995	29,995
Imports	-17,427	-19,569	-24,258	-30,061	-37,609	-46,269	-45,123
Services	5	62	-213	-344	6	62	131
Receipts	2,468	2,671	2,903	4,104	5,513	6,671	6,671
Payments 1/	-2,463	-2,609	-3,116	-4,448	-5,507	-6,608	-6,540
Income, net	-488	-1,195	-2,535	-2,326	-3,014	-3,027	-3,019
Of which : Interest receipts	84	66	63	136	352	405	415
Of which : Interest payments	-517	-492	-515	-730	-998	-1,107	-1,090
Current transfers (net)	1,612	2,028	2,972	3,593	4,794	5,116	5,632
Of which : Official	290	199	126	70	196	148	274
Capital and financial account	**3,207**	**4,067**	**4,613**	**4,707**	**10,632**	**14,124**	**12,385**
Capital account	95	188	512	596	-33	1,626	1,647
Financial account	3,112	3,879	4,101	4,111	10,665	12,497	10,738
Direct investment 1/	1,515	1,946	5,127	5,237	9,053	7,728	7,727
Portfolio investment (net)	407	528	6	758	-36	727	727
Other investment (net)	2,690	1,887	3,409	4,443	6,806	5,781	5,754
Other invesment assets	550	211	-467	373	-134	200	200
Other investment liabilities	2,140	1,676	3,876	4,070	6,940	5,581	5,554
Of which: Official borrowing (net)	898	772	763	735	-218	-314	-341
Of which: IMF (net)	8	110	-138	-121	-127	-79	-79
Reserve assets 2/	-1,500	-483	-4,441	-6,327	-5,158	-1,737	-3,470
Net errors and omissions	**-1,584**	**-1,007**	**486**	**2,177**	**-659**	**0**	**0**
Memorandum items:							
Current account balance plus FDI	-108	-1,114	28	-1,646	-921	-6,397	-4,658
percent of GDP	-0.2	-2.1	0.0	-2.1	-0.9	-5.3	-3.8
Non-oil current account balance	-1,368	-2,866	-2,821	-4,247	-6,977	-11,000	-9,317
percent of GDP	-2.8	-5.4	-4.6	-5.4	-7.2	-9.1	-7.7
Export growth (percent)	15.4	6.4	21.3	17.5	16.2	16.0	16.0
Volume growth (percent)	10.6	7.8	10.2	4.5	6.0	7.7	7.7
Unit value growth (percent)	4.3	-1.3	10.0	12.5	9.6	7.7	7.7
Import growth (percent)	8.6	12.3	24.0	23.9	25.1	23.0	20.0
Volume growth (percent)	11.6	19.6	18.0	16.9	20.4	22.7	19.7
Unit value growth (percent)	-2.7	-6.1	5.1	6.0	3.9	0.3	0.2
GDP growth (percent change)	5.1	5.2	8.4	4.1	7.7	7.0	6.5
GDP (in billions of €)	48.5	52.6	60.7	79.1	97.1	120.2	121.3
Terms of trade (percentage change)	7.2	5.1	4.8	6.2	5.4	7.5	7.5
Total external debt (in millions of €)	16,157	17,734	21,762	31,093	41,141	47,521	47,493
Total external debt/GDP	33.3	33.7	35.8	39.3	42.4	39.5	39.2
MLT external debt (in millions of €)	14,927	15,757	18,556	24,638	27,718	31,716	31,689
Of which : Public and publicly guaranteed	9,127	9,557	10,256	11,291	10,694	11,108	11,080
MLT external debt/GDP (percent)	30.8	29.9	30.6	31.1	28.6	26.4	26.1
Debt service (in millions of €)	3,063	2,727	3,090	3,556	4,210	4,284	4,264
Debt service ratio	17.9	14.9	14.1	13.5	13.4	11.7	11.6
Gross official reserves of the NBR 2/	7,009	9,208	11,933	18,259	21,310	23,047	24,780
(in months of imports of goods and services)	3.8	3.3	4.1	5.1	4.8	4.5	5.0
(as percent of short-term debt)	569.7	379.1	372.2	282.9	158.8	145.8	156.8

Sources: Romanian authorities; and Fund staff estimates.

1/ Includes extrapolated staff estimates of reinvested earnings on foreign direct investment based on 2005 survey data.
2/ Includes gold.

Table 3. Romania: Summary of Consolidated General Government According to the New Classification, 2005-12 1/

	2005	2006			2007 2/				2005	2006			2007 2/			
	Actual	Approved Budget	4th Suppl. Budget 30-Nov-06	Preliminary Outturn	Approved Budget	Underlying Baseline	Meeting Target Baseline	Proposed Staff Adjustment	Actual	Approved Budget	4th Suppl. Budget 30-Nov-06	Preliminary Outturn	Approved Budget	Underlying Baseline	Meeting Target Baseline	Proposed Staff Adjustment
	(In millions of Lei)								(In percent of GDP)							
Total revenue	86,964.4	101,481.6	109,632.8	106,913.6	134,706.4	132,672.3	132,672.3	133,594.1	30.2	31.5	32.6	31.2	34.1	33.5	33.5	34.1
Current revenue	84,835.4	96,429.4	104,503.3	104,004.0	126,197.7	124,163.6	124,163.6	125,085.4	29.5	29.9	31.1	30.4	31.9	31.4	31.4	31.9
Tax revenue	78,379.8	90,116.8	96,764.5	96,773.9	117,802.8	115,768.7	115,768.7	115,515.5	27.2	27.9	28.8	28.3	29.8	29.3	29.3	29.5
Corporate income tax	7,793.0	8,909.9	9,719.3	9,315.3	11,839.3	11,669.9	11,669.9	11,583.0	2.7	2.8	2.9	2.7	3.0	3.0	3.0	3.0
Personal income tax	6,881.9	8,512.4	9,290.7	9,789.8	13,251.6	13,380.5	13,380.5	13,269.0	2.4	2.6	2.8	2.9	3.4	3.4	3.4	3.4
Property tax	1,880.2	2,761.4	2,653.7	2,544.4	2,964.0	2,964.0	2,964.0	2,964.0	0.7	0.9	0.8	0.7	0.7	0.7	0.7	0.8
VAT	22,537.8	26,047.0	28,626.1	27,763.0	35,487.0	33,303.5	33,303.5	33,051.0	7.8	8.1	8.5	8.1	9.0	8.4	8.4	8.4
Excises	9,079.4	10,702.4	11,439.6	10,588.1	13,909.2	12,924.9	12,924.9	12,815.5	3.2	3.3	3.4	3.1	3.5	3.3	3.3	3.3
Other indirect taxes	1,052.3	1,065.8	1,099.0	1,096.9	2,151.2	2,151.2	2,151.2	2,151.2	0.4	0.3	0.3	0.3	0.5	0.5	0.5	0.5
Customs	2,186.9	1,877.0	2,611.0	2,596.2	1,596.2	1,596.2	1,596.2	1,531.2	0.8	0.6	0.8	0.8	0.4	0.4	0.4	0.4
Other tax revenue	11.5	30.0	63.3	98.7	234.7	234.7	234.7	924.7	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2
Social contributions	26,956.8	30,210.9	31,261.8	32,981.4	36,369.6	37,543.7	37,543.7	37,225.9	9.4	9.4	9.3	9.6	9.2	9.5	9.5	9.5
Nontax revenue	6,455.6	6,312.6	7,738.8	7,230.1	8,394.9	8,394.9	8,394.9	9,569.9	2.2	2.0	2.3	2.1	2.1	2.1	2.1	2.4
Capital revenue	449.8	600.3	841.3	1,012.5	596.7	596.7	596.7	596.7	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Grants	1,679.2	4,451.9	4,288.2	1,897.1	7,912.0	7,912.0	7,912.0	7,912.0	0.6	1.4	1.3	0.6	2.0	2.0	2.0	2.0
Total expenditure	89,218.3	103,093.6	117,999.8	112,564.4	145,406.4	146,734.5	143,675.0	137,006.9	31.0	32.0	35.1	32.9	36.8	37.1	36.3	34.9
Current	81,630.8	92,790.0	104,167.3	99,869.2	127,186.7	128,514.8	126,905.3	122,497.2	28.3	28.8	31.0	29.2	32.2	32.5	32.1	31.2
Personnel	15,470.4	17,650.5	20,051.4	21,057.0	24,334.0	25,327.3	25,327.3	24,184.0	5.4	5.5	6.0	6.1	6.2	6.4	6.4	6.2
Goods and services	21,484.5	20,480.9	23,772.5	22,744.8	27,936.0	28,270.8	27,770.8	26,261.0	7.5	6.4	7.1	6.6	7.1	7.1	7.0	6.7
Interest 3/	3,007.6	3,488.8	3,048.5	2,489.7	3,529.9	3,529.9	3,529.9	3,249.9	1.0	1.1	0.9	0.7	0.9	0.9	0.9	0.8
Subsidies	6,462.6	6,393.4	7,646.8	7,429.4	4,982.6	4,982.6	4,982.6	4,982.6	2.2	2.0	2.3	2.2	1.3	1.3	1.3	1.3
Transfers 4/	34,283.3	43,433.6	47,283.9	44,963.9	64,578.5	64,578.5	63,978.5	62,503.5	11.9	13.5	14.1	13.1	16.3	16.3	16.2	15.9
Other expenditure	922.5	947.7	1,236.4	1,184.4	1,316.2	1,316.2	1,316.2	1,316.2	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Reserve fund	0.0	395.1	1,127.8	0.0	509.5	509.5	0.0	0.0	0.0	0.1	0.3	0.0	0.1	0.1	0.0	0.0
Capital	7,551.3	10,229.0	13,790.5	12,717.0	18,135.8	18,135.8	16,685.8	14,425.8	2.6	3.2	4.1	3.7	4.6	4.6	4.2	3.7
Net lending	36.2	74.6	42.0	-21.8	83.9	83.9	83.9	83.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	-2,253.9	-1,612.0	-8,367.0	-5,650.8	-10,700.0	-14,062.2	-11,002.7	-3,412.8	-0.8	-0.5	-2.5	-1.7	-2.7	-3.6	-2.8	-0.9
Memorandum items:																
Primary expenditure	86,210.7	99,604.8	114,951.3	110,074.7	141,876.5	143,204.6	140,145.1	133,757.0	29.9	30.9	34.2	32.1	35.9	36.2	35.4	34.1
Primary current expenditure	78,623.2	89,301.2	101,118.8	97,379.5	123,656.8	124,984.9	123,375.4	119,247.3	27.3	27.7	30.1	28.4	31.3	31.6	31.2	30.4
Primary balance	753.7	1,876.8	-5,318.5	-3,161.1	-7,170.1	-10,532.3	-7,472.8	-162.9	0.3	0.6	-1.6	-0.9	-1.8	-2.7	-1.9	0.0
Nominal GDP (millions of Lei)	288,048	322,500	335,900	342,418	381,900	395,450	395,450	392,103	288,048	322,500	335,900	342,418	395,450	395,450	395,450	392,103

Sources: Ministry of Public Finance; and Fund staff estimates and projections.

1/ The new budget classification broadened the coverage of the general government and moved the accounting closer to the ESA95 classification.

2/ The 2007 budget deficit target is 2.8 percent of (the authorities') GDP. This is equivalent to 2.7 percent using the staff's baseline-scenario GDP.

3/ Including called-up guarantees.

4/ Includes cofinancing of projects and the contribution to the EU budget beginning 2007.

Table 3 (continued). Romania: Summary of Consolidated General Government According to the New Classification, 2005-12 1/

	2005	2006						2007 2/				2008	2009	2010	2011	2012
	Actual	Approved Budget	1st Suppl. Budget 19-Apr-06	2nd Suppl. Budget 01-Jul-06	3rd Suppl. Budget 30-Aug-06	4th Suppl. Budget 30-Nov-06	Preliminary Outturn	Approved Budget	Underlying Baseline	Meeting Target Baseline	Proposed Staff Adjustment	Staff Projections				
	(In percent of GDP)															
Total revenue	30.2	31.5	32.3	33.0	32.9	32.6	31.2	34.1	33.5	33.5	34.1	34.4	34.9	35.6	36.0	36.3
Current revenue	29.5	29.9	30.7	31.4	31.3	31.1	30.4	31.9	31.4	31.4	31.9	32.1	32.5	32.9	33.0	33.1
Tax revenue	27.2	27.9	28.5	29.2	29.1	28.8	28.3	29.8	29.3	29.3	29.5	29.6	29.8	30.1	30.2	30.2
Corporate income tax	2.7	2.8	2.8	3.0	2.9	2.9	2.7	3.0	3.0	3.0	3.0	3.0	3.0	3.1	3.1	3.1
Profit	2.3	2.3	2.4	2.6	2.5	2.5	2.3	2.6	2.6	2.6	2.6	2.6	2.6	2.8	2.8	2.8
Capital gains and other	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Personal income tax	2.4	2.6	2.8	2.9	2.8	2.8	2.9	3.4	3.4	3.4	3.4	3.5	3.5	3.6	3.6	3.6
Salaries, dividends, etc	2.3	2.6	2.8	2.8	2.8	2.7	2.9	3.3	3.3	3.3	3.3	3.4	3.5	3.5	3.6	3.6
Other (local) taxes	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Property tax	0.7	0.9	0.8	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8
VAT	7.8	8.1	8.3	8.3	8.6	8.5	8.1	9.0	8.4	8.4	8.4	8.6	8.6	8.7	8.8	8.9
Excises	3.2	3.3	3.2	3.5	3.5	3.4	3.1	3.5	3.3	3.3	3.3	3.4	3.6	3.8	3.8	3.8
Other indirect taxes	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Customs	0.8	0.6	0.7	0.8	0.8	0.8	0.8	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other tax revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.3
Social contributions	9.4	9.4	9.4	9.4	9.4	9.3	9.6	9.2	9.5	9.5	9.5	9.1	9.0	8.9	8.8	8.7
Nontax revenue	2.2	2.0	2.2	2.2	2.2	2.3	2.1	2.1	2.1	2.1	2.4	2.6	2.6	2.7	2.8	2.9
Capital revenue	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	0.6	1.4	1.4	1.4	1.4	1.3	0.6	2.0	2.0	2.0	2.0	2.1	2.3	2.6	2.8	3.1
Total expenditure	31.0	32.0	33.1	35.4	35.4	35.1	32.9	36.8	37.1	36.3	34.9	35.1	35.4	35.9	36.3	36.7
Current	28.3	28.8	29.7	31.5	31.3	31.0	29.2	32.2	32.5	32.1	31.2	31.2	31.3	31.6	31.9	32.1
Personnel	5.4	5.5	5.6	5.8	5.9	6.0	6.1	6.2	6.4	6.4	6.2	6.2	6.2	6.2	6.3	6.3
Goods and services	7.5	6.4	6.8	6.9	6.9	7.1	6.6	7.1	7.1	7.0	6.7	6.8	6.8	6.9	6.9	6.9
Interest 3/	1.0	1.1	1.1	1.1	1.1	0.9	0.7	0.9	0.9	0.9	0.8	0.7	0.7	0.6	0.6	0.5
Subsidies	2.2	2.0	2.0	2.1	2.1	2.3	2.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.2
Transfers 4/	11.9	13.5	13.8	15.0	14.9	14.1	13.1	17.3	17.3	17.2	17.0	16.8	16.8	17.0	17.3	17.5
Other expenditure	0.3	0.3	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Reserve fund	0.0	0.1	0.1	0.2	0.1	0.3	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital	2.6	3.2	3.5	3.9	4.1	4.1	3.7	4.6	4.6	4.2	3.7	3.9	4.1	4.3	4.4	4.6
Net lending	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
Overall Balance	-0.8	-0.5	-0.9	-2.5	-2.5	-2.5	-1.7	-2.7	-3.6	-2.8	-0.9	-0.7	-0.5	-0.3	-0.3	-0.3
Memorandum items:																
Primary expenditure	29.9	30.9	32.1	34.3	34.3	34.2	32.1	35.9	36.2	35.4	34.1	34.4	34.7	35.3	35.7	36.1
Primary current expenditure	27.3	27.7	28.6	30.4	30.2	30.1	28.4	31.3	31.6	31.2	30.4	30.5	30.6	31.0	31.3	31.6
Primary balance	0.3	0.6	0.2	-1.4	-1.4	-1.6	-0.9	-1.8	-2.7	-1.9	0.0	0.0	0.2	0.3	0.2	0.2
Nominal GDP (millions of Lei)	288,048	322,500	322,500	322,500	330,300	335,900	342,418	395,450	395,450	395,450	392,103	440,610	491,178	546,167	600,008	656,560

Sources: Ministry of Public Finance; and Fund staff estimates and projections.

1/ The new budget classification broadened the coverage of the general government and moved the accounting closer to the ESA95 classification.

2/ The 2007 budget deficit target is 2.8 percent of (the authorities') GDP. This is equivalent to 2.7 percent using the staff's baseline-scenario GDP.

3/ Including called-up guarantees.

4/ Includes cofinancing of projects and the contribution to the EU budget beginning 2007.

Table 4. Romania: Monetary Survey, 2003–07

(In millions of redenominated lei, unless otherwise indicated; actual/projected exchange rates)

	2003	2004	2005				2006				2007			
	December	December	March	June	September	December	March	June	September	December	March	June	September	December
						Actual						Staff Projections		
Monetary Survey														
Net foreign assets (including valuation changes)	23,781	36,613	38,132	41,121	45,809	46,989	46,805	45,168	44,388	49,676	50,281	47,079	43,561	39,849
In millions of U.S. dollars	7,296	12,596	13,413	13,757	15,484	15,120	16,096	16,092	15,916	19,347	19,427	18,400	17,221	15,875
Of which: Commercial banks	-1,251	-3,255	-4,138	-4,233	-6,384	-6,610	-8,049	-9,283	-10,211	-11,471	-13,339	-14,943	-16,698	-18,621
NBR	8,547	15,851	17,551	17,990	21,868	21,730	24,145	25,376	26,127	30,819	32,765	33,342	33,919	34,496
Net domestic assets	22,294	27,921	29,825	33,079	34,343	39,343	40,723	49,886	54,957	62,035	66,053	76,138	90,403	112,113
Domestic credit	30,105	36,560	39,000	41,460	46,214	54,664	57,488	67,343	73,759	81,111	85,677	96,677	108,735	128,492
Government	-194	-5,243	-4,296	-7,496	-8,799	-3,943	-8,187	-9,113	-11,530	-12,173	-15,259	-14,762	-12,264	-6,790
Non-government	30,298	41,803	43,297	48,956	55,012	60,673	65,675	76,456	85,289	93,283	100,936	111,438	120,999	135,282
In foreign currency	16,794	25,400	26,175	29,413	32,476	32,762	32,670	36,405	40,013	44,042	46,094	50,214	54,678	62,252
(in millions of U.S. dollars)	5,152	8,739	9,207	9,840	10,977	10,542	11,235	12,970	14,347	17,153	17,809	19,625	21,616	24,800
In lei	13,504	16,403	17,121	19,543	22,536	27,911	33,005	40,051	45,276	49,241	54,842	61,224	66,322	73,031
Other items net	-7,811	-8,639	-9,176	-8,381	-11,870	-15,321	-16,765	-17,457	-18,802	-19,076	-19,625	-20,538	-18,332	-16,379
Broad money	46,075	64,534	67,957	74,200	80,152	86,332	87,528	95,054	99,346	111,711	116,334	123,217	133,963	151,962
Of which: Lei denominated (M2)	28,958	41,070	44,934	48,835	54,563	60,449	61,121	67,177	70,633	80,555	80,896	84,635	91,949	106,026
Currency in circulation	5,798	7,537	7,786	9,582	10,341	11,386	11,480	13,557	14,423	15,130	15,194	17,081	18,776	19,914
Lei deposits	23,160	33,533	37,148	39,254	44,222	49,063	49,641	53,620	56,210	65,425	65,702	67,554	73,173	86,112
Foreign currency deposits	17,117	23,464	23,023	25,365	25,589	25,883	26,407	27,877	28,712	31,157	35,437	38,583	42,015	45,936
In millions of U.S. dollars	5,251	8,072	8,098	8,486	8,649	8,329	9,081	9,932	10,295	12,134	13,692	15,079	16,610	18,300
Memorandum items: 1/														
Broad money (M2X) growth	23.3	40.1	41.1	46.5	41.3	33.8	28.8	28.1	23.9	29.4	32.9	29.6	34.8	36.0
NFA contribution 1/	4.2	27.8	26.2	28.3	21.5	16.1	12.8	5.5	-1.8	3.1	4.0	2.0	-0.8	-4.1
NDA contribution 1/	19.1	12.2	15.0	18.1	19.8	17.7	16.0	22.7	25.7	26.3	28.9	27.6	35.7	51.2
Lei-denominated money growth (M2)	27.6	41.8	53.2	50.0	47.8	47.2	36.0	37.6	29.5	33.3	32.4	26.0	30.2	31.6
Growth of currency in circulation	27.2	30.0	34.8	39.1	34.8	51.1	47.4	41.5	39.5	32.9	32.4	26.0	30.2	31.6
Real broad money growth	7.9	28.3	29.9	33.7	30.2	23.1	18.7	19.5	17.5	23.4	28.0	23.7	27.2	28.9
Real lei-denominated money growth (M2)	11.7	29.9	41.1	36.9	36.2	35.4	25.4	28.4	22.7	27.1	27.5	20.2	22.8	24.7
Real growth of currency in circulation	11.4	19.1	24.1	26.9	24.3	39.0	35.9	32.0	32.2	26.7	27.5	20.2	22.8	24.7
Growth of lei credit to nongovernment, adjusted 2/	102.4	21.5	19.3	33.7	46.4	70.3	92.8	104.9	100.9	77.3	65.3	52.4	45.0	48.3
Growth of lei credit to nongovernment, adjusted, real 2/	77.2	11.3	9.8	22.0	34.9	56.7	77.7	91.2	90.5	69.1	59.2	45.4	36.7	40.5
Growth of foreign currency credit, adjusted, in US$ 2/	38.1	60.5	69.7	60.4	52.8	20.6	22.0	31.8	30.7	62.7	58.5	51.3	50.7	44.6
Growth of credit to nongovernment, composite 2/ 3/	56.8	40.5	46.0	45.1	45.5	37.2	50.0	62.9	62.4	66.1	58.9	48.1	43.1	42.4
CPI inflation	14.2	9.2	8.6	9.6	8.5	8.7	8.5	7.2	5.5	4.9	3.8	4.8	6.0	5.5
Average exchange rate (lei/$)	3.30	2.89	2.76	2.97	2.86	3.08	2.92	2.80	2.77	2.58	2.59	2.56	2.53	2.51
Exchange rate (lei/$, e.o.p.)	3.26	2.91	2.84	2.99	2.96	3.11	2.91	2.81	2.79	2.57	2.59	2.56	2.53	2.51
M2X (Broad Money) velocity	4.6	4.0	4.1	3.9	3.6	3.5	3.9	3.6	3.5	3.1	3.3	3.2	3.0	2.7
M2 (Domestic Broad Money) velocity	7.3	6.3	6.2	5.9	5.3	4.9	5.5	5.1	4.9	4.3	4.7	4.6	4.3	3.8

Sources: Romanian authorities; and Fund staff estimates.

1/ All changes are 12-month rates of change, unless indicated otherwise. The NFA/NDA contribution rates are adjusted for the change in the EUR/US$ exchange rate from December 2003.
2/ Adjusted for write-offs in the last 12 months and changes in the US$/EUR exchange rate.
3/ Real lei credit growth and foreign currency credit growth, weighted by their respective shares.

Table 5. Romania: Balance Sheet of the National Bank, 2003–07 1/

(In millions of redenominated lei, unless otherwise indicated; actual/projected exchange rates, monthly averages)

	2003	2004	2005				2006				2007			
	December	December	March	June	September	December		June	September	December	March	June	September	December
							Actual				Staff Projections			
Net foreign assets (including valuation)	28,089	43,374	47,915	53,065	62,436	66,494	68,913	71,675	72,443	79,625	81,426	81,974	82,500	83,003
In millions of U.S. dollars	8,508	15,003	17,379	17,870	21,794	21,564	23,619	25,587	26,159	30,823	31,400	31,977	32,553	33,130
Net domestic assets	-15,526	-28,795	-32,838	-35,735	-43,803	-45,135	-48,105	-46,962	-44,864	-49,688	-51,178	-49,306	-46,868	-43,904
Total credit	-5,523	-17,862	-24,106	-24,397	-19,788	-27,086	-28,288	-23,726	-21,125	-25,161	-32,090	-30,808	-29,018	-26,594
Credit to banks	-4,101	-14,525	-20,944	-20,075	-13,636	-21,423	-23,278	-18,297	-12,905	-11,615	-19,144	-18,059	-16,466	-14,240
Deposit taking operations and CDs	-4,311	-14,636	-21,053	-20,150	-13,711	-21,469	-23,323	-18,341	-12,949	-11,659	-19,189	-18,106	-16,513	-14,288
Reverse repo	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to government	-1,422	-3,337	-3,162	-4,322	-6,152	-5,662	-5,010	-5,430	-8,221	-13,546	-12,946	-12,749	-12,552	-12,355
Treasury balance (+deficit, -surplus)	-1,422	-3,337	-3,162	-4,323	-6,153	-5,662	-5,010	-5,430	-8,221	-13,546	-12,946	-12,749	-12,552	-12,355
Treasury overdraft	-431	-2,861	-868	-1,722	-2,885	-3,431	-2,191	-3,136	-5,976	-3,996	-3,996	-3,996	-3,996	-3,996
Treasury deposits	992	477	2,294	2,600	3,268	2,231	2,819	2,293	2,245	9,550	8,950	8,753	8,556	8,359
Treasury bills	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Other items net	-10,003	-10,933	-8,732	-11,338	-24,015	-18,049	-19,817	-23,236	-23,739	-24,527	-19,089	-18,498	-17,850	-17,310
Lei reserve money	12,562	14,579	15,077	17,329	18,633	21,359	20,808	24,713	27,578	29,937	30,247	32,668	35,632	39,098
Currency	6,675	8,514	8,611	9,952	11,188	12,426	12,675	14,665	15,878	16,912	16,918	18,786	20,549	21,916
Bank deposits	5,887	6,065	6,466	7,377	7,445	8,933	8,133	10,048	11,701	13,025	13,329	13,882	15,082	17,183
Memorandum items: 2/														
Real reserve money growth (adjusted) 3/	14.6	30.2	24.2	29.2	24.6	34.8	27.2	33.1	40.3	28.1	33.0	19.5	15.3	23.6
Nominal reserve money growth (adjusted) 3/ 4/	31.0	42.2	34.9	41.6	35.2	46.5	38.0	42.6	48.0	34.3	38.1	25.2	22.3	30.4
NDA contribution	16.1	-79.5	-142.0	-122.8	-112.2	-112.1	-101.3	-64.8	-5.7	-27.2	-22.0	-16.5	-14.2	18.6
NFA contribution	14.5	121.7	176.8	164.4	147.4	158.6	139.3	107.4	53.7	61.5	60.1	41.7	36.5	11.8
CPI inflation	14.2	9.2	8.6	9.6	8.5	8.7	8.5	7.2	5.5	4.9	3.8	4.8	6.0	5.5

Sources: Romanian authorities; and Fund staff estimates.

1/ All values are defined on a monthly average basis.
2/ All changes are 12-month rates of change, unless indicated otherwise.
3/ Adjusted for changes in minimum reserve requirements.
4/ The minimum reserve requirement for lei deposits was decreased from 25 percent to 22 percent in April 2002, to 18 percent in December 2002, and to 16 percent in September 2005.

Table 6. Romania: Financial Soundness Indicators, 2003–06
(in percent, unless otherwise noted)

	2003	2004	2005	2006 4/
Number of banks (absolute numbers)	38	39	39	37
Capital Adequacy				
CAR	20.0	18.8	20.2	17.8
Capital/Total Assets	10.1	8.5	8.8	8.9
Asset Quality				
NPLs/Gross Loans 1/	8.3	8.1	8.3	8.4
NPLs/Capital 1/	35.6	36.6	35.3	41.1
Loan provisions and loan risk reserve/NPLs 1/	33.5	34.3	31.4	32.0
Loan provisions and loan risk reserve/Capital	11.9	12.5	11.1	13.2
Credit Risk Ratio 2/	3.4	2.9	2.6	2.8 5/
Past-due & Doubtful Loans (net)/Total Credit (net) 3/	0.31	0.28	0.26	0.20 5/
Earnings and Profitability				
Return on Average Assets	2.7	2.5	1.9	1.7
Return on Average Equity	20.0	19.3	15.4	13.9
Net interest income less provisions/assets	4.1	4.1	3.0	2.3
Net interest income less provisions/gross income	11.6	15.3	6.3	8.1
Liquidity				
Liquid assets/Total assets	62.7	63.6	61.8	54.4
Liquid assets/Short term liabilities	210.8	193.9	245.7	207.2
Other Indicators				
Foreign currency denominated loans/total loans	56.4	61.5	54.4	47.2
Foreign currency denominated liabilities/total liabilities	45.0	46.8	44.3	44.1
Total net foreign exchange position/capital	1.6	-2.0	-0.6	0.6
Off-balance sheet credit equivalents/Total loans	35.3	33.8	33.9	34.2

1/ NPL figures reflect unadjusted exposure to non-performing loans classified as: "loss," "doubtful," and "substandard" according to loans-classification regulations. The steady level of NPLs in the face of growing credit partly reflects Romania's relatively conservative classification and provisioning requirements. Provisioning requirements, net of collateral, are 100% for loss, 50% for doubtful.

2/ Credit Risk Ratio reflects unadjusted exposure to non-performing loans classified as "loss" and "doubtful" (as percent of gross loans) according to loans-classification regulations.

3/ Past-due and doubtful loans are net of collateral, according to banks' accounting balance sheets. The difference between this NPL ratio and the two ratios (1/ and 2/) results from the classification criteria enforced by Romania's loans classification and provisioning regulations (e.g. debtors' financial performance, currency denomination of income, principle of contamination, new borrower, etc).

4/ September 2006.

5/ December 2006.

Source: National Bank of Romania.

Table 7. Romania: Balance of Payments, 2005–2012
(In millions of euros, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012
		Prel.			Staff Projections 1/			
Current account blance	**-6,883**	**-9,973**	**-12,385**	**-13,770**	**-14,959**	**-16,126**	**-17,550**	**-18,869**
Ratio to annual GDP	-8.7	-10.3	-10.2	-9.6	-9.2	-8.8	-8.5	-8.2
Current account balance plus FDI	-2.1	-0.9	-3.8	-3.8	-3.9	-3.8	-3.8	-3.7
Less estimated reinvested profits from FDI	-7.3	-8.6	-8.6	-7.8	-7.4	-6.9	-6.7	-6.6
Goods and services	-8,150	-11,753	-14,997	-17,362	-18,222	-19,007	-19,742	-20,391
Goods	-7,806	-11,759	-15,128	-17,522	-18,592	-19,479	-20,342	-21,211
Exports	22,255	25,850	29,995	34,493	39,040	43,987	48,298	52,066
Imports	-30,061	-37,609	-45,123	-52,016	-57,632	-63,467	-68,639	-73,278
Services	-344	6	131	161	370	472	600	821
Receipts	4,104	5,513	6,671	7,738	8,744	9,706	10,579	11,479
Payments 2/	-4,448	-5,507	-6,540	-7,577	-8,374	-9,234	-9,980	-10,658
Income, net	-2,326	-3,014	-3,019	-2,785	-3,090	-3,416	-4,076	-4,748
Of which : Interest receipts	136	352	415	456	496	549	581	621
Of which : Interest payments	-730	-998	-1,090	-1,143	-1,199	-1,277	-1,377	-1,501
Current transfers (net)	3,593	4,794	5,632	6,377	6,354	6,296	6,269	6,269
Of which : Official	70	196	274	404	420	404	420	420
Capital and financial account	**4,707**	**10,632**	**12,385**	**15,145**	**16,329**	**17,670**	**19,290**	**20,831**
Capital account	596	-36	1,647	4,416	5,446	6,744	6,087	6,793
Financial account	4,111	10,665	10,738	10,729	10,882	10,926	13,203	14,038
Direct investment 2/	5,237	9,053	7,727	8,316	8,691	9,043	9,699	10,461
Portfolio investment (net)	758	-36	727	572	707	869	1,067	1,305
Of which : Public bond drawing (net)	194	58	727	600	720	864	1,037	1,244
Other investment (net)	4,443	6,806	5,754	4,288	3,867	4,044	4,287	4,565
Other invesment assets	373	-134	200	0	0	0	0	0
Other investment liabilities	4,070	6,940	5,554	4,288	3,867	4,044	4,287	4,565
Of which: Official borrowing (net)	735	-218	-341	-250	-97	35	140	233
Of which: IMF (net)	-121	-127	-79	0	0	0	0	0
Reserve assets 3/	-6,327	-5,158	-3,470	-2,447	-2,382	-3,030	-1,849	-2,293
Net errors and omissions	**2,177**	**-659**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items:								
Current account balance plus FDI	-1,646	-921	-4,658	-5,454	-6,268	-7,083	-7,851	-8,408
Ratio to GDP	-2.1	-0.9	-3.8	-3.8	-3.9	-3.8	-3.8	-3.7
Non-oil Current account balance	-4,247	-6,977	-9,317	-10,764	-11,982	-13,052	-14,380	-15,683
Ratio to GDP	-5.4	-7.2	-7.7	-7.5	-7.4	-7.1	-7.0	-6.8
Export growth (percent)	17.5	16.2	16.0	15.0	13.2	12.7	9.8	7.8
Volume growth (percent)	4.5	6.0	7.7	7.5	7.2	7.0	5.6	4.5
Unit value growth (percent)	12.5	9.6	7.7	7.0	5.6	5.3	4.0	3.2
Import growth (percent)	23.9	25.1	20.0	15.3	10.8	10.1	8.2	6.8
Volume growth (percent)	16.9	20.4	19.7	13.9	9.6	8.9	6.9	5.6
Unit value growth (percent)	6.0	3.9	0.2	1.2	1.1	1.1	1.1	1.1
GDP growth	4.1	7.7	6.5	4.8	5.3	5.6	5.5	5.5
GDP (in billions of €)	79.1	97.1	121.3	142.9	161.9	184.0	206.2	229.0
Terms of trade (percentage change)	6.2	5.4	7.5	5.7	4.4	4.1	2.8	2.0
Total external debt (in millions of €)	31,093.4	41,140.6	47,493.1	52,470.0	57,229.0	62,396.0	68,071.1	73,941.2
Total external debt/GDP	39.3	42.4	39.2	36.7	35.3	33.9	33.0	32.3
MLT external debt (in millions of €)	24,638	27,718	31,689	35,856	40,360	45,267	50,619	56,489
Of which : Public and publicly guaranteed	11,291	10,694	11,080	11,403	12,012	12,916	14,123	15,660
MLT external debt/GDP (percent)	31.1	28.6	26.1	25.1	24.9	24.6	24.6	24.7
Debt service (in millions of €)	3,556	4,210	4,264	4,486	4,633	4,848	5,141	5,513
Debt service ratio	13.5	13.4	11.6	10.6	9.7	9.0	8.7	8.7
Gross official reserves of the NBR 3/	18,259	21,310	24,780	27,227	29,609	32,640	34,489	36,782
(in months of imports of goods and services)	5.1	4.8	5.0	4.9	4.9	5.0	4.9	4.9
(as percent of short-term debt)	282.9	158.8	156.8	163.9	175.5	190.5	197.6	210.8

Sources: Romanian authorities; and Fund staff estimates.

1/ Under the adjustment scenario.

2/ Includes extrapolated staff estimates of reinvested earnings on foreign direct investment based on 2005 survey data.

3/ Includes gold.

Table 8. Romania: Medium-Term Projections, 2002–2012
(in percent of GDP unless otherwise indicated)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Prel.						
						Staff Projections (Adjustment Scenario)					
Income and prices											
Nominal GDP (in millions of re-denominated lei	151,475	197,565	246,469	288,048	342,418	392,103	440,610	491,178	546,167	600,008	656,560
Nominal GDP (in billions of US dollars)	45.8	59.5	75.5	98.9	121.9	157.7	186.8	212.3	242.7	274.2	307.2
(growth rates)											
Real GDP	5.1	5.2	8.5	4.1	7.7	6.5	4.8	5.3	5.6	5.5	5.5
Domestic Demand	3.9	8.4	12.1	7.9	12.8	10.4	7.8	6.6	7.2	6.4	5.9
Household consumption	5.3	8.5	14.5	9.7	14.1	9.5	6.0	5.0	5.5	6.0	5.7
Government consumption	3.0	7.5	-3.2	8.7	2.4	5.9	7.2	7.3	8.5	7.1	6.4
Gross fixed investment	8.2	8.6	11.1	12.6	16.1	10.5	7.5	7.5	7.6	5.5	5.6
of which: non government	8.3	8.1	12.1	13.5	13.2	11.0	7.0	7.0	7.0	5.0	5.0
of which: government	8.1	13.2	2.0	1.5	54.3	6.1	12.5	12.5	12.8	9.4	10.2
Increase in stocks (contribution) 1/	-1.6	0.1	1.9	-2.2	0.4	0.1	0.1	0.0	0.0	0.0	0.0
External Demand (contribution)	0.9	-3.6	-4.5	-4.6	-6.5	-3.8	-2.7	-1.4	-1.7	-1.1	-0.8
Exports of goods and services	17.5	8.4	13.9	8.1	10.6	8.8	7.7	7.2	6.7	5.5	4.6
Imports of goods and services	12.0	16.0	22.1	16.6	23.0	14.9	11.7	8.5	8.9	6.9	5.6
GDP deflator, p.a.	23.4	24.0	15.0	12.3	10.4	7.5	7.2	5.9	5.3	4.1	3.7
CPI, e.o.p.	17.8	14.1	9.3	8.6	4.9	4.5	4.8	4.0	3.0	2.8	2.8
CPI, p.a.	22.5	15.3	11.9	9.0	6.6	4.4	4.8	4.3	3.5	2.9	2.8
Saving and investment balances 2/											
Total domestic saving	16.0	14.5	14.7	12.4	12.1	12.8	13.5	14.6	15.5	16.0	16.4
Net factor receipts and transfers from abroad	2.3	1.6	0.7	1.6	1.8	2.2	2.5	2.0	1.6	1.1	0.7
Total national saving	18.3	16.0	15.4	14.0	14.0	14.9	16.0	16.6	17.1	17.0	17.1
Non-government	17.7	14.9	13.7	12.2	11.9	12.1	12.8	12.9	13.1	12.9	12.9
Government	0.6	1.2	1.7	1.8	2.1	2.8	3.2	3.6	4.0	4.1	4.2
Total investment	21.7	21.8	23.8	22.7	24.2	25.1	25.6	25.8	25.8	25.5	25.3
Non-government investment	18.5	18.5	21.0	20.1	20.5	21.4	21.7	21.7	21.5	21.1	20.7
Government investment	3.2	3.4	2.8	2.6	3.7	3.7	3.9	4.1	4.3	4.4	4.6
Gross fixed capital formation	21.3	21.4	21.8	23.1	24.6	25.4	25.7	25.9	25.9	25.6	25.4
Increase in stocks	0.4	0.4	1.9	-0.4	-0.4	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1
Savings - investment balance	-3.3	-5.8	-8.4	-8.7	-10.3	-10.2	-9.6	-9.2	-8.8	-8.5	-8.2
Non-government	-0.7	-3.6	-7.3	-7.9	-8.6	-9.3	-8.9	-8.8	-8.4	-8.2	-7.9
Government	-2.6	-2.2	-1.0	-0.8	-1.7	-0.9	-0.7	-0.5	-0.3	-0.3	-0.3
External debt	30.8	29.9	30.6	31.1	28.6	26.1	25.1	24.9	24.6	24.6	24.7
Public Debt 3/	26.0	23.6	23.2	19.9	18.5	17.3	15.1	13.8	12.7	12.1	11.6

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

1/ Includes statistical discrepancy.
2/ Beginning 2004, fiscal data are based on a new classification and thus ratios are not comparable to series before 2004.
3/ Includes domestic and external public debt, public and publicly guaranteed.

Table 9. Romania: Indicators of External Vulnerability, 2000–06 1/

(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006
Financial Indicators							
Public sector debt	27.9	27.5	26.0	23.6	23.2	19.9	18.5
Broad money (percent change, 12-month basis)	38.0	46.2	38.1	23.3	40.1	33.8	29.4
Credit to non-government (percent change, 12-month basis)	56.4	69.4	81.1	68.4	57.2	49.0	74.2
Real credit to non-government (percent change, 12-month basis) 2/	7.4	26.0	47.8	46.1	40.5	37.2	66.1
Monthly weighted average T-bill rate	62.4	38.4	17.4	18.4	11.5	6.2	--
Monthly weighted average real T-bill rate 3/	15.4	6.3	-0.3	3.7	2.0	-2.2	--
External Indicators							
Exports (percent change, 12-month basis in €)	21.9	12.9	15.4	6.4	21.3	17.5	16.2
Imports (percent change, 12-month basis in €)	19.1	22.1	8.6	12.3	24.0	23.9	25.1
Terms of Trade (percent change, 12-month basis)	2.7	8.0	7.2	5.1	4.8	6.2	0.4
Current account balance	-3.7	-5.5	-3.3	-5.8	-8.4	-8.7	-10.3
Current account balance after FDI	-0.2	-2.0	-0.2	-2.1	0.0	-2.1	-0.9
Errors and omissions	-0.3	1.2	-3.3	-1.9	0.8	2.8	-0.7
Gross official reserves (in € millions)	3,725	5,509	7,009	9,208	11,933	18,259	21,310
(in months of imports GNFS of the following year)	2.3	3.3	3.8	3.3	4.1	5.1	4.8
Central Bank short-term foreign liabilities (in € millions)	109	112	0	0	0	0	0
Gross reserves of the banking system (in € millions)	5,276	7,231	8,051	8,247	13,151	19,362	21,410
(in months of imports GNFS of the following year)	3.4	4.4	4.4	3.6	4.6	5.4	5.0
Short term foreign liabilities of the commercial banks (in €)	244	415	522	1,028	1,489	2,269	6,640
Open foreign currency position of the commercial banks (in €)	345	397	404	357	310	440	...
Official reserves/Broad money (M2)	47.2	76.0	86.8	98.8	112.2	111.7	98.2
Official reserves/ Money Supply (M1) 4/	108.6	176.9	191.9	282.1	300.0	275.1	223.7
Total short term external debt by remaining maturity 5/	2.0	2.5	2.5	3.8	5.3	8.2	13.8
In percent of reserves	15.3	15.4	15.3	24.0	24.4	33.3	62.7
In percent of total debt	6.7	7.6	7.6	11.1	14.7	20.8	32.6
Total external debt (in € millions)	11,984	14,689	16,157	17,734	21,762	31,093	41,141
Of which: Public and publicly guaranteed debt	7,477	8,778	9,127	9,557	10,256	11,291	10,694
Total external debt (in percent of exports of G&S)	90.9	98.0	94.3	97.0	99.7	118.0	131.2
Total external debt/ GDP	29.9	32.7	33.3	33.7	35.8	39.3	42.4
External interest payments (in percent of exports of G&S)	3.8	3.8	3.0	2.7	2.4	2.8	3.2
External amortization payments (in percent of exports of G&S)	9.4	12.8	14.8	12.2	11.8	10.7	10.2
Exchange rate (per US$, period average)	2.2	2.9	3.3	3.3	3.3	2.9	2.8
Exchange rate (per €, period average)	2.0	2.0	3.1	3.8	4.1	3.6	3.5
REER appreciation (+) (12-month basis)	2.2	1.5	0.8	-3.2	2.6	18.0	7.6
Financial Market Indicators							
Stock market index							
Foreign currency debt ratings							
Moody's	B3	B2	B1	Ba3	Ba1	Ba1	Baa3
Standard and Poor's	B-	B	B+	BB	BB+	BBB-	BBB-
Spread of benchmark bonds (basis points, end of period) 6/	406	400	286	161	58	49	38

Sources: Romanian authorities; and Fund staff estimates.

1/ All stocks are reported as of end of period.
2/ Real credit growth is weighted average of real lei credit growth, and U.S. dollar-measured foreign currency growth.
3/ The real rate is based on the ex-post 12-month CPI inflation. Most recent T-Bill auction was September, 2005.
5/ On-balance-sheet only. The overall open currency position, including off-balance-sheet items and capital paid in foreign exchange, was US$40 million long at end-August 2005.
4/ Narrow money is defined as currency plus lei-denominated sight deposits.
5/ Defined as short-term debt by original maturity basis plus amortization falling due on medium-term loans and bonds.
6/ For 2000, the benchmark bond is the '02; in 2001-2006, the spread quoted is the J.P. Morgan's EMBI Global Government Spread Romania index.

Table 10. Romania: Public Sector Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	**Debt-stabilizing primary balance 9/**
1 **Baseline: Public sector debt 1/**	26.0	23.6	23.2	19.9	18.5	**17.3**	**15.1**	**13.8**	**12.7**	**12.1**	**11.6**	**-0.7**
o/w foreign-currency denominated	18.8	18.2	16.9	14.2	11.0	9.1	8.0	7.4	7.0	6.8	6.8	
2 Change in public sector debt	-1.5	-2.4	-0.3	-3.4	-1.3	-1.3	-2.2	-1.3	-1.0	-0.7	-0.5	
3 Identified debt-creating flows (4+7+12)	-3.1	-4.5	-5.5	-2.1	-5.8	-1.9	-1.4	-1.1	-1.0	-0.8	-0.7	
4 Primary deficit	-0.4	0.2	-0.2	-0.3	0.9	0.0	0.0	-0.2	-0.3	-0.2	-0.2	
5 Revenue and grants	29.6	28.7	30.0	30.2	31.2	34.1	34.4	34.9	35.6	36.0	36.3	
6 Primary (noninterest) expenditure	29.3	28.9	29.8	29.9	32.1	34.1	34.4	34.7	35.3	35.7	36.1	
7 Automatic debt dynamics 2/	-2.4	-4.4	-5.0	-1.4	-4.4	-1.5	-1.2	-0.9	-0.8	-0.6	-0.5	
8 Contribution from interest rate/growth differential 3/	-3.3	-4.0	-3.4	-2.3	-2.4	-1.5	-1.2	-0.9	-0.8	-0.6	-0.5	
9 Of which contribution from real interest rate	-2.2	-3.0	-1.8	-1.5	-1.1	-0.5	-0.4	-0.2	-0.1	0.1	0.1	
10 Of which contribution from real GDP growth	-1.1	-1.0	-1.6	-0.8	-1.3	-1.1	-0.7	-0.7	-0.7	-0.6	-0.6	
11 Contribution from exchange rate depreciation 4/	0.9	-0.4	-1.6	0.9	-2.0	...	...	...	...	...	...	
12 Other identified debt-creating flows	-0.4	-0.2	-0.3	-0.4	-2.3	-0.4	-0.2	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	-0.4	-0.2	-0.3	-0.4	-2.3	-0.4	-0.2	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	1.6	2.1	5.2	-1.3	4.5	0.6	-0.8	-0.1	0.0	0.1	0.2	
Public sector debt-to-revenue ratio 1/	87.6	82.1	77.3	65.8	59.4	50.7	43.8	39.4	35.8	33.5	31.9	
Gross financing need 6/	6.0	4.5	3.1	2.3	2.9	1.8	1.6	1.2	1.0	1.0	0.9	
in billions of U.S. dollars	2.7	2.7	2.3	2.3	3.5	2.9	2.9	2.6	2.5	2.6	2.8	
Scenario with key variables at their historical averages 7/						**17.3**	**11.8**	**8.6**	**6.4**	**4.9**	**3.9**	**-1.1**
Scenario with no policy change (constant primary balance) in 2007-2012						**17.3**	**15.1**	**14.1**	**13.3**	**12.8**	**12.6**	**-0.7**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.1	5.2	8.5	4.1	7.7	6.5	4.8	5.3	5.6	5.5	5.5	
Average nominal interest rate on public debt (in percent) 8/	14.1	10.2	6.7	5.3	4.4	5.1	4.8	4.9	4.9	4.8	4.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-9.3	-13.8	-8.2	-7.0	-6.0	-2.4	-2.4	-1.0	-0.4	0.7	0.9	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-5.7	2.8	12.1	-5.7	19.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	23.4	24.0	15.0	12.3	10.4	7.5	7.2	5.9	5.3	4.1	3.7	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.2	3.8	12.1	4.5	15.7	13.1	5.7	6.4	7.3	6.7	6.8	
Primary deficit	-0.4	0.2	-0.2	-0.3	0.9	0.0	0.0	-0.2	-0.3	-0.2	-0.2	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 11. Romania: External Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	33.3	33.7	35.8	39.2	42.4	**39.2**	**36.7**	**35.3**	**33.9**	**33.0**	**32.3**	**-7.5**
Change in external debt	0.6	0.4	2.1	3.3	3.2	-3.2	-2.5	-1.4	-1.4	-0.9	-0.7	
Identified external debt-creating flows (4+8+9)	-3.8	-5.7	-7.2	-6.4	-6.6	1.6	2.1	2.1	2.0	2.0	1.9	
Current account deficit, excluding interest payments	2.3	4.9	7.7	7.8	9.2	9.3	8.8	8.5	8.1	7.8	7.6	
Deficit in balance of goods and services	5.1	7.5	9.2	10.3	12.1	12.4	12.1	11.3	10.3	9.6	8.9	
Exports	35.2	34.7	36.2	33.2	32.3	30.2	29.5	29.5	29.2	28.6	27.8	
Imports	40.3	42.1	45.4	43.5	44.4	42.6	41.7	40.8	39.5	38.1	36.7	
Net non-debt creating capital inflows (negative)	-3.2	-3.8	-8.6	-6.6	-9.4	-6.5	-5.9	-5.5	-5.0	-4.8	-4.7	
Automatic debt dynamics 1/	-3.0	-6.7	-6.3	-7.6	-6.4	-1.2	-0.8	-1.0	-1.0	-1.0	-1.0	
Contribution from nominal interest rate	1.1	0.9	0.8	0.9	1.0	0.9	0.8	0.7	0.7	0.7	0.7	
Contribution from real GDP growth	-1.5	-1.3	-2.2	-1.1	-2.4	-2.1	-1.6	-1.7	-1.7	-1.7	-1.6	
Contribution from price and exchange rate changes 2/	-2.6	-6.3	-4.9	-7.3	-5.0	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.4	6.1	9.4	9.7	9.8	-4.8	-4.6	-3.4	-3.5	-2.9	-2.6	
External debt-to-exports ratio (in percent)	94.6	97.3	99.1	118.0	131.2	129.5	124.2	119.8	116.2	115.6	116.4	
Gross external financing need (in billions of US dollars) 4/	4.7	7.0	11.9	15.7	24.6	37.1	42.7	45.6	47.8	50.6	53.5	
in percent of GDP	10.1	11.7	15.7	15.9	20.2	23.5	22.9	21.5	19.7	18.5	17.4	
Scenario with key variables at their historical averages 5/						**39.2**	**35.8**	**32.1**	**28.7**	**25.6**	**22.8**	**-7.0**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.1	5.2	8.4	4.1	7.7	6.5	4.8	5.3	5.6	5.5	5.5	
GDP deflator in US dollars (change in percent)	8.5	23.4	17.0	25.8	14.5	21.5	13.0	8.0	8.3	7.0	6.2	
Nominal external interest rate (in percent)	3.7	3.6	3.2	3.4	3.2	2.7	2.4	2.3	2.2	2.2	2.2	
Growth of exports (US dollar terms, in percent)	20.1	27.8	32.4	20.3	19.9	21.1	15.7	13.6	13.0	10.6	8.9	
Growth of imports (US dollar terms, in percent)	11.7	35.9	36.7	25.4	25.9	24.1	15.9	11.2	10.8	9.0	7.7	
Current account balance, excluding interest payments	-2.3	-4.9	-7.7	-7.8	-9.2	-9.3	-8.8	-8.5	-8.1	-7.8	-7.6	
Net non-debt creating capital inflows	3.2	3.8	8.6	6.6	9.4	6.5	5.9	5.5	5.0	4.8	4.7	

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 US dollar terms, g = real GDP growth e = nominal appreciation (increase in dollar 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; dollar 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, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

APPENDIX I. ROMANIA: RELATIONS WITH THE FUND
(As of February 28, 2007)

Mission: February 21-March 7, 2007. The concluding statement is available at http://www.imf.org/external/np/ms/2007/031307a.htm

Staff team: Messrs. van der Mensbrugghe (Head), Christou, Klemm, and Tiffin (all EUR) and Ms. Brunschwig (PDR). Mr. Fernandez-Ansola, senior regional resident representative, participated in the discussions. Mr. Croitoru (OED) also participated in policy discussions.

Country Interlocutors: The President, Prime Minister, Deputy Prime Minister, the Ministers of Public Finance, Economy, Labor, European Integration, and Transportation, the Governor and Deputy Governor of the National Bank of Romania, other senior officials, and members of parliament, including opposition parties. Also, the EC, EBRD, IBRD, academics, bankers, labor unions, employers' associations, think tanks, and the foreign investors council.

Fund relations: Romania is on a 12-month consultation cycle, and the 2006 consultation was concluded on April 26, 2006. The associated Executive Board assessment and the staff report and other mission documents are available at http://www.imf.org/external/pubs/cat/longres.cfm?sk=19211.0. Romania has accepted the obligations of Article VIII, Sections 2-4 with effect from March 25, 1998. Romania's exchange system is free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions that are maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Data: Romania subscribes to the SDDS, and the data quality is deemed appropriate for surveillance purposes.

I. Membership Status: Joined 12/15/72; Article VIII

II. General Resources Account:	SDR million	% Quota
Quota	1,030.20	100.00
Fund holdings of currency	1,078.43	104.68
III. SDR Department:	SDR million	% Allocation
Net cumulative allocation	75.95	100.00
Holdings	0.58	0.76

IV. Outstanding Purchases and Loans:

	SDR million	% Quota
Stand-By Arrangements	48.22	4.68

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
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

VI. Projected Payments to Fund (Expectations Basis)[1]
(SDR million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2007	2008	2009	2010	2011
Principal	48.22				
Charges/interest	3.53	3.22	3.21	3.21	3.21
Total	51.75	3.22	3.21	3.21	3.21

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Exchange Rate Arrangements

Romania has maintained a de jure inflation-targeting regime since August 2005, but has also characterized its exchange-rate approach as a managed float. In this context, the authorities

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[1] This schedule presents all currently scheduled payments to the IMF, including repayment expectations where applicable and repayment obligations otherwise. The IMF Executive Board can extend repayment expectations (within predetermined limits) upon request by the debtor country if its external payments position is not strong enough to meet the expectations without undue hardship or risk.

have intervened, often heavily, in response to perceived excessive exchange rate movements, but have no formal predetermined path. The official reference rate published by the NBR is an average of rates reported for interbank and client transactions. Romania has accepted the obligations of Article VIII, Sections 2, 3, and 4, with effect from March 25, 1998. Romania's exchange system is free of restrictions on the making of payments and transfers for current international transactions.

X. Article IV Consultation

Romania is on the 12-month consultation cycle subject to the provisions of the decision on consultation cycles approved by the Board on July 15, 2002. The last consultation was concluded on April 26, 2006.

XI. Technical Assistance

The transition in Romania has been supported by substantial technical assistance from multilateral agencies and bilateral donors. The Fund has provided support in a number of areas with more than 40 technical assistance missions since 1990, although the authorities have had a mixed record with regard to implementation. Expert Fund assistance has focused on a number of key areas, including: fiscal reforms; modernization of the central bank and the banking system; creating a market-oriented legal structure; training; and improving the collection and reporting of statistics. The implementation of a comprehensive tax administration reform designed in line with the recommendations of several technical assistance missions of the Fund's Fiscal Affairs Department started in January 2003. A report on the observance of standards and codes (ROSC) on fiscal transparency was completed on November 6, 2002 (IMF Country Report No. 02/254). Furthermore, in 2003 an FSAP was completed, while technical assistance by the Fund's Monetary and Capital Markets Department on inflation targeting is ongoing.

XII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the National Bank of Romania (NBR) is subject to full safeguards assessment with respect to the Stand-By Arrangement approved on July 7, 2004. The assessment was completed on June 17, 2004 and concluded that safeguards in place at the NBR appear generally adequate. However, certain weaknesses were identified in the internal audit and controls system, and the safeguards assessment recommended measures to address them.

XIII. Anti-Money Laundering and Combating the Financing of Terrorism framework

The legislative framework for anti-money laundering and combating the financing of terrorism (AML/CFT) has been updated recently to bring Romania in line with international standards, in the context of Romania's EU accession. The AML/CFT system continues, however, to suffer from severe shortcomings, including in the supervisory area. While the level of AML supervision is improving in the banking sector and the NBR appears to be taking this issue seriously, it remains extremely weak for the financial sector at large. In addition, there is very little, if any, oversight of the non-financial sector for AML/CFT purposes and the authorities have started only recently to inspect casinos, a sector which appears to be particularly vulnerable to money laundering risks. Finally, while AML requirements have been extended to cover financing of terrorism recently, additional training of reporting entities and competent authorities in this area remains necessary.

XIV. Resident Representative

The Fund has had a resident representative in Bucharest since 1991. Mr. Juan Jose Fernandez-Ansola assumed the post of senior regional resident representative in September 2006.

Appendix II. Romania: Relations with the World Bank

A. Partnership in Romania's Development Strategy

1. The Romanian authorities are pursuing a strategy designed to achieve macroeconomic stability and establish sustainable economic growth and poverty reduction, that will allow closer integration of their economy with the rest of the European Union. Key elements of this strategy include tightening payments discipline throughout the economy, especially in the energy sector, hardening budget constraints for state-owned enterprises, actively pursuing enterprise and banking privatization and restructuring, and strengthening the social safety net. Over the medium term, continuation of the current economic recovery will depend critically on the maintenance of reform momentum and moving steadily ahead with governance and private sector development reforms. Such reforms would stress transparency and accountability in government, judicial reforms, improvements in the business environment, and actions to strengthen the regulation and oversight of financial and capital markets.

2. In broad terms, the IMF has taken the lead in assisting Romania in achieving macroeconomic stability. As such its program focus is on the fiscal framework, monetary policy, and those elements of the structural reform program that have a direct bearing on the macroeconomic situation. The main vehicles for its dialogue with the authorities have been the Stand-By Arrangement (SBA) covering the period October 31, 2001 to October 15, 2003 and a precautionary SBA which ended in June 2006. The authorities have not sought a further program with the IMF, but dialogue on key issues continues in the context of the Article IV Reviews.

3. The World Bank has taken the lead in policy dialogue on structural issues, including poverty reduction measures, private sector development, institution building and governance. It has a range of instruments through which it conducts dialogue, including adjustment lending operations such as PSAL 1 and PSAL 2, a series of Programmatic Adjustment Loans, the first of which went to the Bank Board in September 2004, several sector investment operations, and economic work such as the Public Expenditure and Institutions Review, and the Country Economic Memorandum focused on restructuring for EU integration. The Bank's analysis is shared with the IMF and is used as input to the fiscal framework, including structural reform measures which have important fiscal implications, such as energy sector reform and restructuring. There are further areas of formal joint responsibility such as the Financial Sector Assessment Program (FSAP).

4. Overall the IMF and World Bank staff maintain a close collaborative relationship in supporting the Government's reform program and are coordinating their policy advice to the Romanian authorities.

B. IMF-World Bank Collaboration in Specific Areas

Areas in which the World Bank leads and there is no direct IMF involvement

5. The policy areas in which the Bank leads and which are not directly incorporated into the IMF program or country dialogue include strengthening the social safety net, revitalizing the economy in rural areas, institution building and governance, and improving the business environment. Bank policy dialogue for strengthening the social safety net includes poverty monitoring, social assistance, pension reform, health sector reforms, and labor retraining and redeployment. These have been supported by the Bank's Social Sector Development Loan, two Social Development Fund Loans, and two Mine Closure Loans. A Social Inclusion Loan, aimed at improving the living conditions of economically disadvantaged groups, in particular the Roma population, was approved by the Bank's Board in June 2006. These loans are further supported by analytical work such as the recently completed Pension Reform Study and the ongoing poverty monitoring.

6. The Bank has a range of programs to revitalize the economy in rural areas. These include the Rural Finance Loan and a Rural Development Loan which support, respectively, income generation activities and public infrastructure investments, and will be complemented by a planned Farm Restructuring Loan to facilitate farmers' access to EU grant funds by supporting completion of rural land title registration and delivery of income and asset management advisory services to farmers. In addition, the Bank is planning to finance an Integrated Nutrient Pollution Control Loan, complemented by a Global Environment Facility Grant, which will support the promotion of good agricultural practices and capacity-building activities to access EU structural funds to meet the EU Nitrate Directive. The ongoing Irrigation Rehabilitation loan supports infrastructure rehabilitation and institutional reform. The MAKIS project supports the capacity of the agricultural sector to meet the health and food safety requirements of the EU, and the modernization and reform of selected research institutions. Supporting economic work includes a Regional Development Policy Note.

7. The Bank has a strong institution building and governance program. This builds on reforms in local public finance and taxation and decentralization. Policy dialogue has been informed by the Public Expenditure and Institutions Review which included analysis and recommendations addressing institutional constraints to absorption of EU grants, deepening the Medium Term Expenditure Framework, and addressing sectoral expenditure priorities with effective planning and sustainable financing. The policy dialogue has also been supported by a Country Financial Accountability Assessment (CFAA). The Bank completed a Diagnostic Survey of Corruption in Romania prior to the Government's preparing of its National Program for Prevention of Corruption. The first Programmatic Adjustment Loan to Romania was approved by the World Bank Board in September 2004. It focused on institutional and governance reforms in the public service and the judiciary as well as public expenditure management as well as the remaining structural reform agenda. It was supported by a $18.6 million Private and Public Sector Institution Building Loan which provides

technical assistance for these activities and others relating to privatization. Other institution-building support includes financing of a cadastral and land titling project, a hazards mitigation project cofinanced by a GEF grant which focuses on damage from earthquakes, floods toxic wastes and other hazards in high risk areas, and a loan financing modernization of the judiciary.

8. Policy advice and support for reforms in the business environment have been offered by the Bank in several areas. Through PSAL 1, PSAL 2, and PAL 1 the Bank has focused on reducing barriers to entry for firms and joint ventures, implementing internationally recognized accounting standards, and introducing improved bankruptcy and liquidation procedures. All of these initiatives have been supported by technical assistance provided under the PPIBL.

9. The Bank is very active in the transport sector. It is financing a Transport Restructuring Loan ($225 million) as well as a Transport Sector Support Loan ($180 million). And a new operation under preparation would finance water and wastewater infrastructure investments at the municipal level, and building capacity for project preparation needed to access and absorb EU grant funds..

Areas in which the World Bank leads and its analysis serves as input into the IMF program

10. The Bank has supported the GOR's privatization program through the PAL program which includes targets and timelines for privatization of commercial SOEs and financial institutions. The program builds on the progress established under PSALs 1 and 2 which identified pools of SOEs from which set minimum numbers of enterprises are selected for case-by-case privatization and workout. Specific enterprises including Alro, Alprom, and Petrom, were also identified. The PAL program includes further targets for privatization of commercial enterprises and enterprises in the energy and banking sectors.

11. The Bank has led the dialogue on restructuring, reform and eventual privatization of enterprises in the electricity, district heating and gas industries and on the adoption of regulatory legislation in preparation for privatization to strategic investors. As part of this process the Bank is supporting, inter alia, energy tariff reforms and reforms in the electricity, district heat and gas sectors. These objectives are woven into the policy conditions of the PAL program, along with conditions related to the privatization of electricity distribution enterprises. These conditions have been closely coordinated with the IMF since the SBAs have also included provisions for structural reforms in the energy sector including tariff setting, arrears clearance and collection rates. The Bank is leading the IFI dialogue with the Government on such critical long-term issues as power generation sector restructuring and the integration of the Romanian power sector with the South East European Regional Electricity Market and with the EU's electricity market, and provides assistance on the associated regulatory and market operation issues. The Bank has also provided technical assistance to the Ministry of Industry to establish a system of pricing and taxation of gas

consistent with attracting further investment into the industry. Policy dialogue in these and other areas, notably including the district heating sector, will be further facilitated by ongoing dialogue with the Government on the recently completed Energy and Infrastructure Strategy paper and its operational recommendations.

12. The Bank has taken the lead in dialogue and policy advice regarding regulation, restructuring, privatization and liquidation of banks. Under PSAL 1 the Law on Bank Privatization was modified and transparent privatization procedures established. Liquidity and solvency requirements of the NBR were tightened and provisions introduced for improved compliance with prudential regulations and external audits conducted according to International Accounting Standards. Legal and institutional reforms were introduced for orderly disposition of non-performing assets. These policy changes underpinned liquidation of the most troubled bank (Bancorex) while Bank Agricola was restructured and eventually privatized as were two smaller state owned banks. This policy agenda has been continued under the PAL program and included privatization of the largest state bank BCR. The Bank is continuing the dialogue with the government on the need to move forward with further improvements of the legal and regulatory framework for the securities and insurance sectors. The PPIBL will provide funding for these activities.

Areas of shared responsibility

13. While the Bank has taken the lead in privatization and in structural reforms in the energy sector as described above, the IMF has a strong interest from a macroeconomic perspective since privatization revenues have been primarily used to retire public debt, and quasi-fiscal deficits of the SOEs present a threat to macroeconomic stability. Accordingly, there is a high degree of consultation and coordination between the two institutions on these matters. While the terms of the respective programs are mutually consistent and supportive, the focus and motivation for the Bank's program are on the efficiency of the resulting market structures, improved enterprise operation, service delivery and financial performance, and the transparency of the process and improvement in overall sector governance, and that of the IMF is on immediate revenue generation and expenditure control, and containment of ongoing fiscal burdens.

14. The Bank and the IMF jointly conducted a Financial Sector Assessment Program which was completed in June 2003.

Areas in which the IMF leads and its analysis serves as input into the World Bank program

15. The Fund leads the dialogue on fiscal matters. The IMF also leads the dialogue on policies to contain certain expenditures in the public sector. These include policies regarding wage-setting in both the public service and SOEs and the budgets of SOEs.

16. In these areas the Bank takes into account the policy recommendations of the IMF and ensures that its own policy advice is consistent.

Areas in which the IMF leads and there is no direct World Bank involvement

17. The IMF is fully responsible for the dialogue on monetary policy, interest rates, the exchange rate regime, the balance of payments and all the related statistical and measurement issues.

C. World Bank Group Strategy and Lending Operations

18. The current Country Partnership Strategy (CPS) for Romania was presented to the World Bank's Board on May 16, 2006. It was designed to facilitate Romania's integration with the EU building on three pillars: (a) accelerating structural and institutional reforms to support sustainable growth; (b) addressing fiscal vulnerabilities and modernizing the public sector; and (c) targeting poverty reduction and promoting social inclusion. A flexible lending program of $450 million to $550 million per year was envisaged using a mix of investment lending and programmatic Development Policy Loans. Base case lending includes investment projects subject to pre-conditions of appropriate sector policy and an acceptable medium term sector expenditure framework. High case lending would be a combination of investment and development policy lending where the latter would require maintenance of an appropriate macroeconomic framework as per Bank guidelines and periodic review in consultation with the IMF.

19. Since the beginning of the CPS period several investment loans have been made. However, no further DPLs have been concluded and after PAL 1, the PAL program is being dropped.

20. The World Bank has been active in Romania since 1991, and the portfolio is now the largest in the ECA Region in terms of number of projects and second largest in commitments. The active IBRD and GEF portfolio as of January 1, 2007 consists of 23 projects with aggregate net commitments totaling $1.785 billion and a total undisbursed balance of $1.27 billion. Sector composition in terms of net commitments is dominated by environment and socially sustainable development (35 percent, 12 projects), and energy and infrastructure (39 percent, 5 projects), followed by the social sectors (14 percent, four projects).

21. Implementation of projects in the Bank's Romania portfolio has slowed in recent years. In FY06 and FY07 Romania's annual disbursement ratio fell below its 16 percent historical average and from a peak of 27 percent in FY03. Today, 86 percent of the portfolio's net commitments have been approved in the last four FYs, and three-quarters of them are less than three years old. Given that new loans typically do not start disbursing very much during the first two years following loan approval, this accounts for about 80 percent of

the portfolio disbursement slowdown. The Bank the Ministry of Finance are working together to address this issue.

22. IFC has dedicated substantial resources to assist the development of capital markets and infrastructure (utilities and telecommunication), and provide support for small and medium enterprises (SMEs). To date, IFC has committed over US$772 million of its own funds in 42 projects and has arranged over $241 million in syndications to support projects in the financial markets, information technology, food and beverage, general manufacturing, health care and infrastructure. As of January 2007, IFC portfolio in Romania stood at $411 million. In addition to investments, IFC has undertaken a number of advisory assignments aimed at supporting the privatization and restructuring of large state-owned enterprises, public utilities and the health sector.

Questions may be referred to Ron Hood (473-0115) or Myla Williams (473-6997).

APPENDIX III. ROMANIA: STATISTICAL ISSUES

1. Data collection and reporting are adequate for surveillance and program monitoring, but the quality of the national accounts, price, fiscal, and balance of payments data needs improvement. The authorities have made progress in improving economic and financial statistics with technical assistance, including from the Fund, over the past several years. Romania began participating in the GDDS in February 2001 and graduated to subscription to the SDDS in May 2005.

Real Sector

2. Quarterly and annual national accounts statistics are produced by the National Institute for Statistics (INS) using the *European System of Accounts 1995 (ESA95)*. Estimates are methodologically sound and are reported to the Fund on a timely basis for publication in the *International Financial Statistics (IFS)*. However, quarterly and annual national accounts are not harmonized on a regular basis and late revisions have sometimes been significant. Provisional and semi-final versions are disseminated in the Statistical Yearbook and other publications, and on the web (www.insse.ro).

3. The Consumer Price Index (CPI) is subject to standard annual re-weighting, and it is considered reliable. In January 2004, the INS changed the coverage of the PPI to include the domestic and export sectors.

Public Finance

4. Annual GFS data are reported on an accrual basis derived from cash data using various 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. Beginning in 2002, the Special Fund for Development of the Energy System, Special Fund for Public Roads, Special Fund "Romanian Agriculture Development," and Special Fund "Romania" were included in the state budget, while the Special Fund for Insured Protection was eliminated from general government accounts. The reported data excluded data on the Agency for Recovery Bank Assets.[1] EUR receives monthly budget data. The authorities introduced a new budget classification for the 2006 budget and have also produced the 2004-05 budget outturns on the basis of the new classification.

[1] Formerly, the Agency for Bank Asset Recovery and the Authority for Privatization and Management of State Ownership.

5. Consolidated data on central government operations are reported for inclusion in the *GFS Yearbook, albeit with a significant time lag, while c*onsolidated general government data were reported for the first time for inclusion in the *2005 GFS Yearbook. Q*uarterly data are not reported for *IFS*, but the Ministry of Finance agreed to participate in the high frequency data project to submit monthly and quarterly cash data on the central government according to the *GFSM 2001* framework.

Monetary and Financial

6. The National Bank of Romania (NBR) reports monetary and financial statistics on a regular and timely basis for publication in the *IFS*. Since December 2004, the NBR reports monetary data to STA using the Standardized Report Forms (SRFs), which are designed in accordance with the methodology in the *Monetary and Financial Statistics Manual (MFSM)*. The monetary data in the SRFs format are being published in the new *IFS Supplement*, beginning with the first issue (September 2006). The *IFS Supplement* contains data for countries that regularly report monetary data in accordance with the *MFSM* methodology.

7. Nevertheless, monetary statistics need to be reconciled with government finance statistics. In line with *1993 SNA* and *MFSM*, accrued interest on deposits and loans, and securities other than shares should be incorporated in the corresponding outstanding amount of the financial instrument.

8. Romania is one of the first 40 countries whose data and metadata for financial soundness indicators (FSIs) are posted on the IMF's website (http://www.imf.org/external/np/sta/fsi/eng/cce/index.htm).

Balance of Payments

9. The NBR routinely reports balance of payments statistics to the Fund in a timely fashion. A 2003 STA mission undertook a detailed review of the NBR's compilation methodology for balance of payments and international investment position statistics, developed in consultation with Eurostat, and concluded that the proposed system is broadly appropriate. The STA mission supported implementation of this compilation system in 2004, along with a new FDI survey.

ROMANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(AS OF APRIL 10, 2007)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Mar. 2007	Apr. 2007	D and M	D and M	D and M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar. 2007	Apr. 2007	D and M	W and M	M
Reserve/Base Money	Jan. 2007	Mar. 2007	D and M	W and M	M
Broad Money	Jan. 2007	Mar. 2007	M	M	M
Central Bank Balance Sheet	Jan. 2007	Mar. 2007	M	M	M
Consolidated Balance Sheet of the Banking System	Jan. 2007	Mar. 2007	M	M	M
Interest Rates[2]	Mar. 2007	Apr. 2007	M	M	M
Consumer Price Index	Feb. 2007	Mar. 2007	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Dec. 2006	Feb. 2007	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Jan. 2007	Feb. 2007	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2006	Feb. 2007	M	M	M
External Current Account Balance	Dec. 2006	Jan. 2007	M	M	Q
Exports and Imports of Goods and Services	Jun. 2006	Jan. 2007	M	M	M
GDP/GNP	Q4 2006	Mar. 2007	Q	Q	Q
Gross External Debt	Dec. 2006	Feb. 2007	M	M	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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 nonbank 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).

APPENDIX IV ROMANIA. EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

A. External Sustainability

1. **With appropriate policies in place, Romania's external sustainability will remain under control over the medium term**. Under the baseline scenario, the external debt-to-GDP ratio is expected to decrease slightly to about 32 percent over the medium term. Romania's gross external financing needs are projected to increase from 20¼ to 23½ percent of GDP in 2007, after which they are expected to fall steadily, reaching 17½ percent of GDP by the end of the projection period.

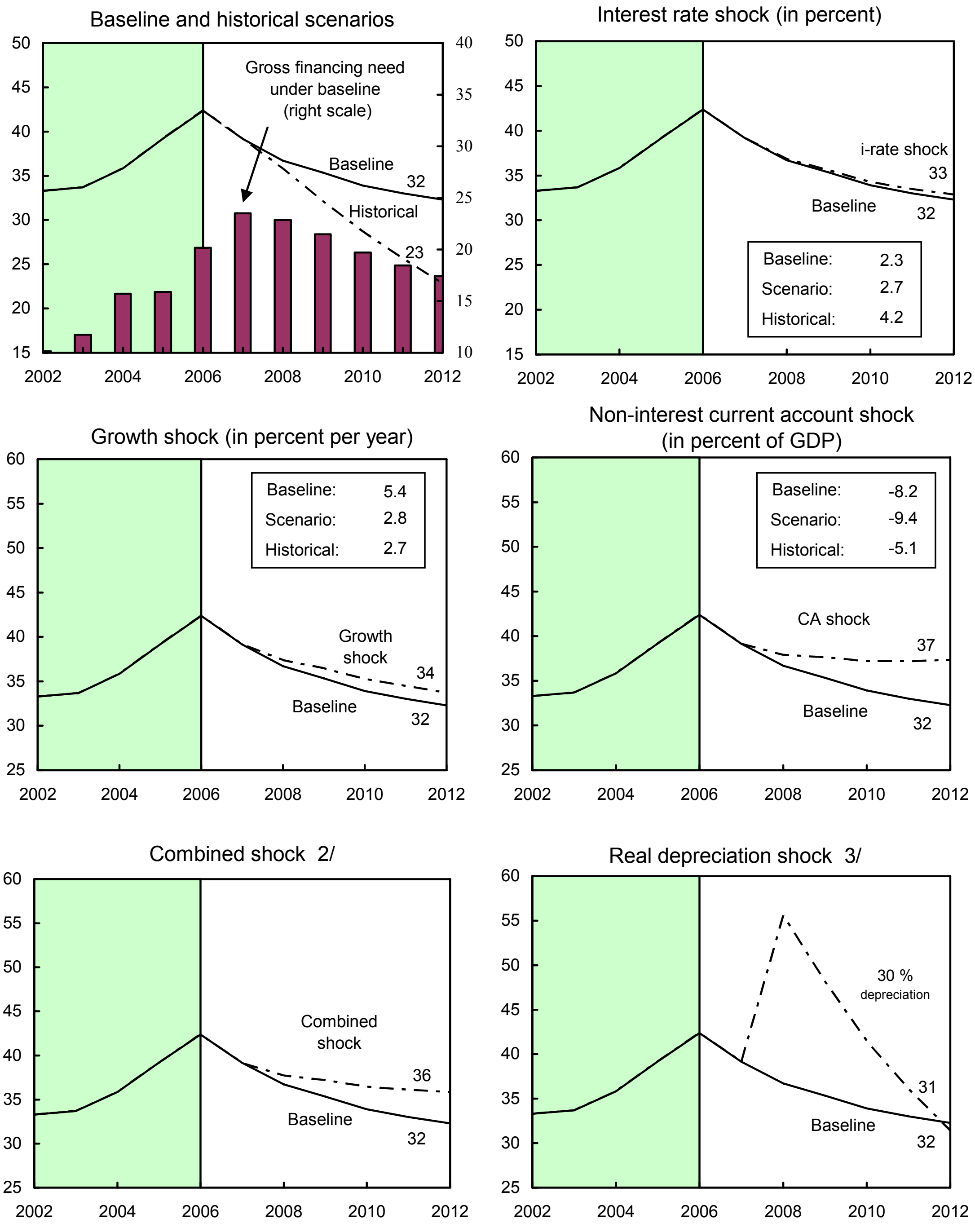
2. **The standard stress tests (B1-B4) show that Romania's external debt would remain under control in all scenarios.** In all cases, debt ratios would end up well below 40 percent at the end of the projection period. The highest ratio is reached in case of a current account shock, which would lead to a debt-to-GDP ratio of 37¼ percent. In the case of a depreciation, debt levels would initially jump to 55½ percent of GDP, but then steadily fall back to 31½ percent by the end of the 2012. Because of these risks, and since external sustainability is viewed as the greatest medium-term risk, policies to contain domestic demand (through lower consumption and import growth) remain key to maintain Romania's external sustainability.

B. Fiscal Sustainability

3. **Public sector debt is expected to remain under control over the medium term.** With appropriate policies in place, the primary balance would remain in surplus over the medium term. This path of fiscal accounts would lead to a fall in the public sector debt from the current level of 18½ percent of GDP to about 11½ percent of GDP by 2012. A primary deficit of 0.7 percent of GDP would stabilize public debt at this level.

4. **Stress tests on public-debt dynamics suggest that fiscal sustainability remains vulnerable to real GDP growth and interest rate shocks.** Should GDP growth slow down from its current rate of 7.7 percent to around 3 percent over the medium-term, public debt would reach 26.1 percent of GDP by 2012. If the interest rate increased by one standard deviation, debt would reach 25.6 percent of GDP. In case of shocks to the real exchange rate, the primary balance, or combined shocks, however, debt ratios would remain below 25 percent of GDP throughout the projection period.

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



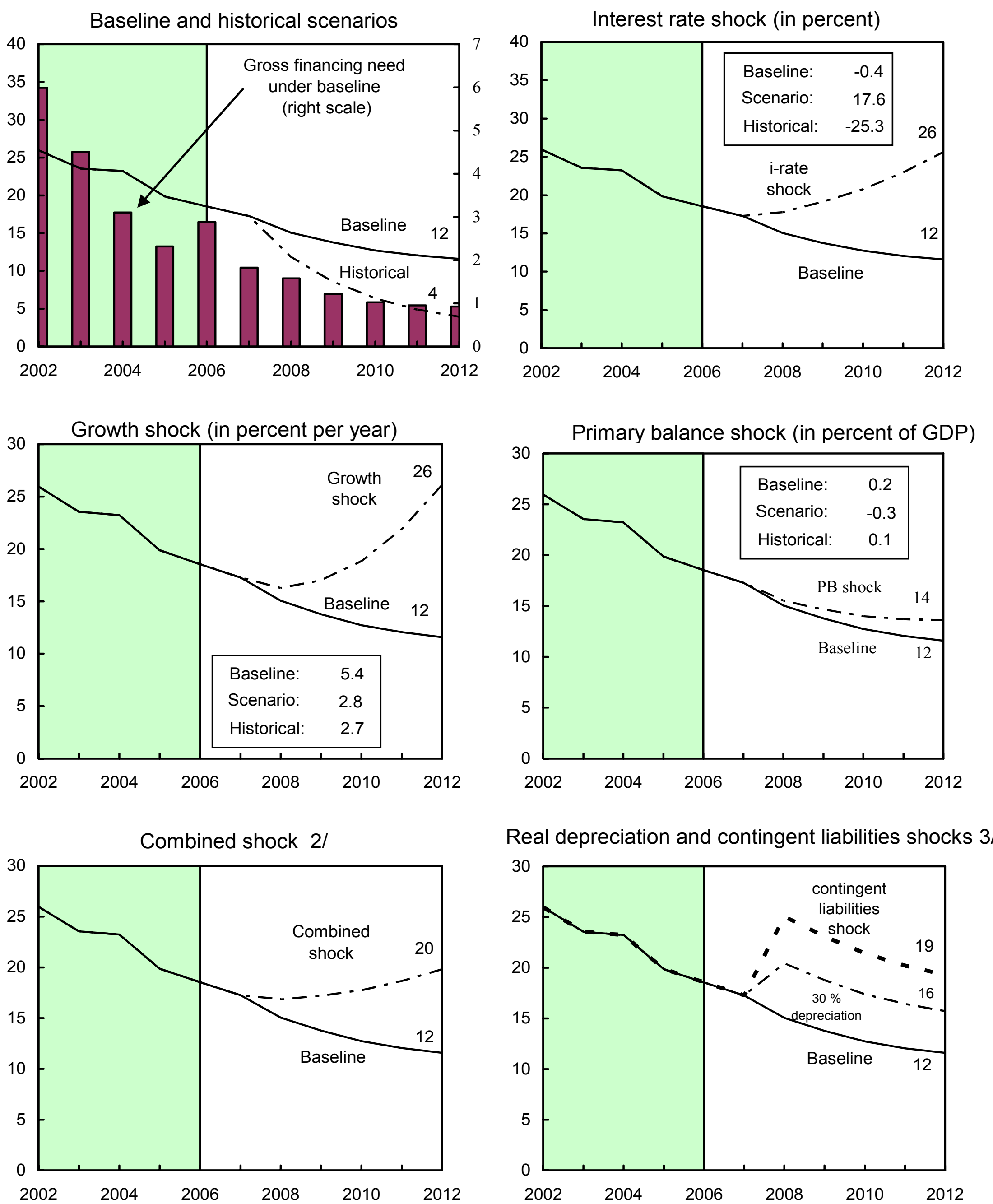
Source: Staff estimates.

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

3/ One-time real depreciation of 30 percent occurs in 2008.

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



Source: 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2008, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
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FOR IMMEDIATE RELEASE
May 30, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with Romania

On May 23, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Romania.[1]

Background

Romania stands at a historic juncture. Accession to the European Union on January 1, 2007 represents a substantial achievement and reflects a determined stabilization effort on the part of the authorities. Output growth has been very strong at 7.7 percent for 2006, and headline inflation has fallen, reaching 3.7 percent (year-to-year) in March 2007 compared to 8.4 percent for the same period last year. For most of 2006, the authorities maintained a policy of fiscal consolidation, owing to strong revenue collections and underutilization of the capital budget. Similarly, the National Bank of Romania focused on strengthening the credibility of Romania's inflation-targeting framework, tightening monetary conditions and successfully meeting its end-2006 inflation goal.

Nonetheless, despite healthy export growth, the current account deficit widened to 10.3 percent of GDP in 2006, as growing excess demand, rising wages, and strong credit growth helped prompt a surge in imports. Moreover, fiscal policy was loosened significantly in December, driving the budget balance from a surplus in November to an end-year deficit of 1.7 percent. The fiscal deficit target for 2007 is wider still at 2.8 percent and substantial government wage

[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. 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.

increases have already been approved (up to 20 percent) along with an 18-percent minimum-wage hike for 2007. In addition, appreciation pressures in early 2007 set the background for a loosening of the key monetary policy instrument. The policy interest rate was cut from 8.75 percent to 8.00 percent in February and by a further 50 basis points to 7.5 percent in March.

Executive Board Assessment

Executive Directors commended Romania's accomplishments—including strong output and export growth, substantial disinflation, low external debt, and a comfortable level of international reserves—which paved the way for Romania's recent accession into the EU. Directors cautioned, however, that the economic outlook is clouded by a widening current account imbalance and the risk of a resurgence of inflationary pressures, as a result of strong domestic demand that is being fuelled by rapid credit growth and procyclical fiscal and incomes policies.

Directors emphasized the need for policies that reduce vulnerabilities, support sustainable growth, and maximize the gains from EU membership. Key medium-term challenges will be to raise per capita income, which remains well below the EU average, and to lay the groundwork for eventual euro adoption. Against this background and to guard against sudden shifts in market sentiment in the current uncertain political environment, Directors called for consistent and prudent fiscal, incomes, and monetary policies, and vigorous implementation of structural reforms.

Directors expressed concern about the recent procyclical fiscal loosening and the possibility that Romania may fail to meet the Maastricht criteria in its first year of EU membership. They urged a tighter fiscal stance in 2007 to contain domestic demand, accompanied by the establishment of prudent medium-term fiscal goals. Given Romania's pressing expenditure needs and low revenue ratio, Directors stressed the need to permanently boost revenue, and welcomed plans to strengthen tax administration and broaden the tax base.

Directors urged the authorities to strengthen public financial management, restrain expenditure growth, and enhance the quality and composition of public spending. In particular, multiple budget revisions and back-loaded expenditure should be avoided, and all approved expenditure should be reflected in the budget. Directors also encouraged the development of a credible medium-term fiscal framework to enhance the transparency and effectiveness of budget planning and execution, and to improve the efficiency of absorbing EU funds.

Directors considered that the envisaged wage policy for this year—including a sharp increase in the minimum wage and three rounds of increases in government wages—is incompatible with the inflation objective and could spill over to the private sector. They urged the authorities to pursue wage increases only once a year and to ensure that these are moderate, transparent, and fully incorporated in the budget.

Directors commended the central bank's commitment to price stability and the success in reducing inflation. At the same time, given the need to firmly anchor inflationary expectations and the credibility of the inflation targeting framework, Directors considered the recent interest rate cuts to be premature. They urged the authorities to increase interest rates as needed to attain the inflation targets. Although this may put further upward pressure on the currency, Directors noted that the exchange rate remains competitive and that the appreciation will help to contain inflation. Directors also considered it important to avoid any deviation between the policy and effective interest rates, and to reduce reserve requirements cautiously.

Directors were encouraged that financial soundness indicators and stress tests point to a relatively healthy and resilient financial system. Nevertheless, they cautioned that rapid growth of credit to the private sector, particularly foreign currency credit, can magnify medium-term vulnerabilities. Directors therefore emphasized the importance of effective domestic and cross-border supervision and regulation, and commended the central bank's continued progress in developing its capacity for assessing overall stability. They welcomed the authorities' interest in a Financial Sector Assessment Program update this year.

Directors emphasized the importance of ambitious structural reforms to support convergence to EU living standards. They encouraged the authorities to accelerate privatization in the energy sector and to announce a schedule for adjusting domestic producer gas prices in line with opportunity costs. Romania's low labor-market participation and employment rates suggest the need for a strategy encompassing an improved education system and enhanced labor-market flexibility. Directors encouraged the authorities to strengthen their efforts to introduce a second pension pillar and to improve the legal framework with a view to reducing corruption and enhancing the business environment.

Romania: Selected Economic and Social Indicators

	2002	2003	2004	2005	2006	2007	
					Prel. Estimate	Staff Projections	
						Baseline 1/	Adj.
Real economy (change in percent) 2/							
Real GDP	5.1	5.2	8.5	4.1	7.7	7.0	6.5
Final domestic demand	5.5	8.3	10.4	10.1	12.5	10.8	9.1
CPI (end of period)	17.8	14.1	9.3	8.6	4.9	5.5	4.5
CPI (period average)	22.5	15.3	11.9	9.0	6.6	4.8	4.4
Unemployment rate (end of period; percent)	8.4	7.2	6.2	5.8	5.4	5.1	5.1
Gross national saving (percent of GDP)	18.3	16.0	15.4	14.0	14.0	13.4	14.9
Gross domestic investment (percent of GDP)	21.7	21.8	23.8	22.7	24.2	25.1	25.1
Public finance (general government, percent of GDP) 3/							
Revenue	29.6	28.7	30.0	30.2	31.2	33.5	34.1
Expenditure	32.3	30.9	31.1	31.0	32.9	36.3	34.9
Overall balance	-2.6	-2.2	-1.0	-0.8	-1.7	-2.8	-0.9
Primary balance	0.4	-0.2	0.2	0.3	-0.9	-1.9	0.0
Total public debt 4/	26.0	23.6	23.2	19.9	18.5	18.7	17.3
Money and credit (end of year, percent change)							
Nominal domestic credit	38.1	64.4	40.5	37.2	66.1	58.4	39.5
Real domestic credit 5/	38.2	23.3	40.1	33.8	29.4	42.4	36.0
Broad money	38.2	23.3	40.1	33.8	29.4	36.0	30.0
Interest rates (percent) 6/							
NBR interest rate (end of period)	21.5	23.4	18.8	7.2	8.8	-	-
Treasury bill rate (end of period)	17.4	18.4	11.5	5.5	5.5	-	-
Balance of payments (percent of GDP)							
Trade balance	-5.7	-7.5	-8.8	-9.8	-12.1	-13.5	-12.5
Current account balance	-3.3	-5.8	-8.4	-8.7	-10.3	-11.7	-10.2
Foreign direct investment	3.1	3.7	8.4	6.6	9.3	5.9	6.4
External debt	30.8	29.9	30.6	31.1	28.6	26.4	26.1
Official reserves (end-year, US$ million)	7,137	9,208	15,999	21,648	28,155	30,030	32,288
Reserve cover (months of prospective imports, in € terms))	3.8	3.3	4.1	5.1	4.8	4.5	5.0
Exchange rate							
Lei per euro (end of period)	3.51	4.17	3.96	3.66	3.41	-	-
Lei per US$ (end of period)	3.35	3.30	2.91	3.08	2.58	-	-
NEER appreciation (+) (percent)	-14.4	-11.1	-5.1	10.5	2.7	-	-
REER appreciation (+) (CPI-based, in percent, period average)	0.8	-3.2	2.6	18.0	7.6	-	-
REER appreciation (+) (ULC-based, in percent, period average)	-6.5	-5.5	5.1	24.9	3.8 7/	-	

Main export products are textiles and light machinery.

Social indicators (reference year):
Per capita GDP (2005): $4,445; **income distribution** (GINI coefficient, 2000): 30.3;
Poverty rate (2005)**:** 13 percent; **primary education completion rate** (2004): 94 percent; **gender pay gap** (2003): 18 percent;
Life expectancy at birth (2004): 71.3; **infant mortality per 1000 live births** (2004): 16.8.

Sources: Romanian authorities; and Fund staff estimates and projections.
1/ Assuming an unchanged policy mix, including a 2.8 percent of GDP fiscal deficit in 2007.
2/ National accounts data are based on ESA95 guidelines.
3/ Beginning 2004, fiscal data are based on a new classification and thus they are not comparable to series before 2004.
4/ Including domestic public debt and external public debt (public and publicly guaranteed).
5/ Credit to the nongovernment sector; weighted average of real lei credit growth and U.S. dollar-measured foreign currency credit growth.
6/ NBR effective policy rate (combined sterilization operations and use of deposit facility), compounded. Treasury bill rate for 2007 is quoted from the most recent auction, on January 15, 2007.
7/ Average for period January-October.

Statement by Age Bakker, Executive Director for Romania and Lucian Croitoru, Senior Advisor to Executive Director May 23, 2007

The broad picture

The Romanian authorities appreciate the staff report and acknowledge that the report provides a realistic view of the policy challenges. They consider staff's assessment balanced and agree on the need to address imbalances. In designing their policy response to address imbalances, the authorities aim at reaching a policy mix that is adequate to preserve macrostability and sustain strong growth consistent with EU convergence. The authorities thank staff for the sound and professional advice and look forward to continued cooperation.

Macroeconomic performance has been strong, but areas of concern still exist. Growth reached 7.7 percent in 2006, with domestic demand growing even stronger. CPI inflation has continued to fall, reaching 3.8 percent y/y at end-April, below the NBR's 2007 target of 4 percent. Support for disinflation came from prudent macroeconomic policies, favorable agricultural prices, and currency appreciation. Core inflation, however, remained at around 4½ percent. Domestic credit grew sharply albeit from a still low base, associated with expanding domestic demand and a widening current account deficit (10.2 percent of GDP last year). With FDI covering 90 percent of the current account deficit, a pattern seen over recent years, the overall balance-of-payments remains strong, showing foreign investors' confidence in Romanian's economy. Exports have remained robust, and the reserve cover is comfortable.

Macroeconomic policies are supporting stabilization. Fiscal policy maintained a budgetary surplus until November last year. However, spending surged in December, turning the surplus into an annual deficit of 1.7 percent of GDP. The government exercised prudence in the minimum wage and reined in the SOEs' wage bill. Nonetheless, in a fragile political environment, real increases in governmental wages were granted, adding to domestic-demand pressures. Since October 2005 the NBR has stopped intervening in the foreign exchange market and has tightened monetary conditions, including through full sterilization. In 2006 it raised the policy interest rate to 8.75 percent, well above inflation. With inflation continuing to fall, and increased upward pressure on the exchange rate since end-November 2006, the NBR again limited the amount of liquidity absorbed at the policy rate, and reduced the policy interest rate three times, to 7.25 percent between February and May 2007. The banking system, 90 percent foreign-owned, is healthy and robust, and well-positioned to absorb adverse shocks. Foreign banks have sophisticated risk-management policies and can rely on external support in the event of adverse shocks.

Progress has been made in implementing structural reforms but some delays occurred in privatizing the last state-owned bank and the energy-sector companies.

Judicial reform has progressed in line with Romania's EU commitments. More recently, domestic gas prices have been raised, but a gap still exists with respect to international import prices. The CEC bank privatization has been postponed since the government assessed that a better price, as compared to the one offered by the winner of the tender, could be obtained when market conditions are more favorable, by which time the privatization will be launched again.

Looking forward, the authorities are committed to preserving macroeconomic stability, reducing vulnerabilities, and renewing reform efforts as prerequisites for sustained strong growth. The authorities acknowledge that to contain external imbalances and make further progress with disinflation, the macroeconomic policy mix needs to remain tight. Given pressing expenditure needs, including meeting Romania's contribution to the EU budget, further fiscal tightening seems unfeasible in 2007. However, despite recent reductions in interest rates, monetary conditions remain tight owing mainly to previous appreciation and relatively high reserve requirements. The authorities acknowledge that while the recent sharp leu appreciation has decreased external competitiveness, the exchange rate remains competitive. Hence, a moderate further appreciation would not cause significant deterioration in the external balance and could be accommodated as long as strong productivity gains are sustained. The authorities are aware that achieving growth consistent with the goal of convergence to EU living standards requires increased investment and employment creation. Therefore, they are improving their project-implementation capacity and are committed to further improving the investment climate, including by continuing privatization and enterprise restructuring to support productivity gains.

Fiscal policy

The authorities' view is that a deficit of 2.8 percent of GDP in 2007, although it represents a relaxation in the fiscal policy, is still consistent with macrostability. Meeting Romania's pressing needs for infrastructure with a lower deficit would have been possible with additional revenue measures. However, a revised Fiscal Code has been adopted recently and the need for tax-legislation stability limits the scope for revenue measures. The authorities are of the view that a deficit of this magnitude does not alter Romania's sound fundamentals, including the very low level of public debt. This, together with the anchor provided by the EU membership, makes the country less vulnerable to an abrupt change in market sentiment.

The authorities are confident that this deficit ceiling will not be exceeded. They will not reduce tax rates except for the relatively high social-contributions tax and will not allow tax exemptions. Moreover, the authorities have plans to strengthen the tax administration in line with IMF staff and World Bank recommendations. They will implement measures to modernize the tax administration, broaden the tax base, and to address shortcomings in the organizational structure and legal mandate of the Agency for Fiscal Administration. These improvements should strengthen revenues even this year.

The authorities agree that the institutional setting of fiscal policy needs to be strengthened by improving transparency, enhancing monitoring, and developing a medium-term fiscal framework. They acknowledge that the practice of multiple budget revisions and a skewed spending pattern, with surges in spending towards the end of the year, undermine the credibility of fiscal policy. In 2007 they intend to limit the number of budget revisions to one, as compared to four last year, as already provided for in their medium-term budgetary framework. The authorities are also working on creating mechanisms to ensure the efficient allocation of resources and absorption of the EU inflows, which will help implementing a uniform spending pattern over the year.

Wage policy

The wage policy envisaged for 2007 is looser as compared to last year, when it helped manage demand pressures and protect the competitiveness of the Romanian economy. In part, the loosening of the wage policy was needed to ensure an adequately skilled public sector labor force, but pressure from trade unions and the fragile political environment also exerted significant influence. The importance of maintaining and attracting high-skilled staff in the public sector is high at the present juncture given that drawing EU funds requires adequate management. The authorities acknowledge the risks of a loose wage policy and the strain it puts on reaching inflation objectives. Since reducing the envisaged increases is not feasible, the authorities will focus on controlling bonuses and closely monitoring additional hirings. This year the authorities were not successful in limiting the number of wage increases to only one to help anchoring inflation expectations. However, they have started preparations to attain this objective as of 2008, thus terminating the interim ad hoc increases seen in the past.

Monetary policy

The NBR is strongly committed to inflation targeting. It targets a CPI inflation of 4 percent for 2007 and 3.8 percent for 2008[1]. The NBR's view is that these targets are feasible, and the Bank stands ready to take all necessary steps to attain them. Recent cuts in the policy interest rate should not be viewed as a loosening of its commitment. When it decided to reduce interest rates in early 2007, the NBR started from the fact that monetary conditions were tight, a stance visible in disinflation overperformance relative to the target. The overperformance was supported by the previous appreciation, the level of reserve requirements, and the level of the effective interest rate itself. Even at the current level, in real terms, the effective interest rate is marginally above the neutral level estimated by the NBR. While remaining focused on inflation, the NBR is concerned about excessive short-term appreciation. This could leave the economy vulnerable to a sudden reversal, with negative consequences for the pace of disinflation and for the financial sector. The NBR

[1] These are the central values at end-year with ±1 percent band.

stresses that the small departure from the policy of full sterilization is of a temporary nature and plans to reunify the policy and effective interest rates as soon as possible.

The authorities maintain vigilance regarding strong credit growth. While rapid credit growth is a reflection of the real convergence in the financial sector, an overly rapid credit growth reflects the continuing strength of excess demand, with its associated medium-term vulnerabilities, and can magnify existing distortions. To tame credit growth, over the past few years the NBR has imposed administrative measures and high reserve requirements, distortions of which could be even higher than those associated with overly rapid credit growth. Therefore, debt-to-income ratios imposed by the NBR at the bank levels for household credit have been removed recently. Continuing to align with EU practice, and to reduce costs on domestic banks, the NBR is now considering reducing reserve requirements, which are much above those in the EU. In doing this, the NBR is going to proceed with caution, including by choosing an appropriate timing, so that reductions will not add to macroeconomic imbalances.

The capacity for assessing financial-sector stability is being strengthened. The NBR started publishing its Financial Stability Report last year and a second report will be issued by mid-2007. The banking system remains resilient to the direct impact of interest-rate and exchange-rate movements, as well as a growth slowdown, as suggested by the NBR stress tests. However, predicting consequences of a less benign economic environment is more difficult for indirect exposures through loan portfolio, which is difficult to assess in the context of rapid credit growth. In view of this, the authorities are encouraging high capital ratios and conservative provisioning practices. Building on the substantial progress made in strengthening the regulatory and supervisory framework, the NBR enhanced its cooperation with regulatory and supervisory authorities in other countries. To ensure a rapid and coordinated response to potential cross-border banking problems, Memoranda of Understanding have been signed for all banks operating in Romania, and NBR staff is already participating in drills with other authorities. The authorities intend to have an FSAP update this year.

Structural reforms

Continuation of structural reforms is crucial for real convergence. After increasing energy prices recently, the authorities are determined to continue more firmly with the adjustments to eliminate the gap from international prices by end-2008. However, the authorities have not announced a more detailed calendar for such increases. They also are determined to continue with the privatization of CEC and of energy-sector companies. Reforming the pension system has continued with the preparations for the second pillar and the authorities' plan to introduce it on January 2008. The authorities will also continue firmly with the implementation of their judicial reform agenda.