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Romania: Second and Third Reviews under the Stand-By Arrangement, Request Rephasing and Waiver of Nonobservance of Performance Criterion; Statement by the IMF Staff Representative; and Press Release on the Executive Board Discussion.

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on January 28, 2010, 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 February 5, 2010. 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 statement by the IMF staff representative.

- A Press Release on the Executive Board Discussion.

The documents listed below will be separately released.

- Letter of Intent sent to the IMF by the authorities of Romania*.

- Technical memorandum of Understanding*.

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

ROMANIA

Staff Report for the Second and Third Reviews Under the Stand-By Arrangement, Request for Rephasing and Waiver of Nonobservance of Performance Criterion

Prepared by the Staff Representatives European Department

Approved by Poul M. Thomsen and Aasim Husain

February 5, 2010

- **Stand-By Arrangement:** A 24 month, SDR 11.443 billion (€12.95 billion, US$17.07 billion, 1,110.77 percent of quota) Stand-By Arrangement was approved by the Executive Board on May 4, 2009 (Country Report No.09/183), and a first purchase of SDR 4.37 billion was made following the Board meeting. The second tranche of SDR 1.718 billion was made available upon completion of the first review in September 2009. The third and fourth tranches, subject to the completion of this review, amount to SDR 2.175 billion. The European Commission and the World Bank are also providing funds to cover the financing gap under the program.

- **Program status**: Most end-December 2009 quantitative performance criteria were met. The ceiling on the accumulation of domestic arrears at end September was missed and preliminary data suggest the end-December target was also missed. Staff support the waiver requested by the authorities. The end-2009 inflation rate was slightly higher than the central bank target, but remained well within the inner band of the inflation consultation mechanism. The indicative target on current expenditure was breached. The end-December structural benchmark on parliamentary approval of revised pension legislation was not met due to political difficulties ahead of presidential elections. The authorities have agreed to reschedule the benchmark for end-June 2010. All other structural benchmarks were met by the agreed deadlines.

- **Discussions**: Discussions were held in Bucharest during October 21-November 3, 2009 and January 20-27, 2010. The mission met with President Basescu, Prime Minister Boc, Finance Ministers Pogea and Vladescu, Central Bank Governor Isarescu and other senior officials, representatives of labor and business organizations, and of financial institutions. The staff team comprised J. Franks (head), C. Fernandez Valdovinos, B. Yontcheva (all EUR); N. Hobdari (SPR); F. Hasanov (FAD); L. Zanforlin (MCM). T. Lybek (Resident Representative) assisted the mission. Staff from the EC and the WB also joined the discussions.

Contents Page

I. Introduction and Summary 3

II. Recent Developments 4

III. Policy Discussions 7
A. Revised Macroeconomic Framework 7
B. Fiscal Policies 7
C. Financial Sector 10
D. Monetary and Exchange Rate Policies 12

IV. Program Modalities and Other Issues 12

V. Staff Appraisal 14

Boxes
1. Could an Export Driven Recovery be Expected? 6
2. Stand-By Arrangement 16

Figures
1. Selected Economic Indicators 17
2. Public Debt Sustainability: Bound Tests 18
3. External Debt Sustainability: Bound Tests 19
4. Financial Markets Developments 20
5. Monetary Policy Developments 21

Tables
1. Quantitative Program Targets 22
2. Structural Conditionality for the Program 23
3. Selected Economic and Social Indicators, 2005–11 24
4. Balance of Payments, 2005–11 25
5. Gross Financing Requirements, 2009–11 26
6. General Government Operations, 2005–11 27
7. Monetary Survey, 2005–11 29
8. Schedule of Reviews and Purchases 30
9. Indicators of Fund Credit, 2009–16 31
10. Public Sector Debt Sustainability Framework, 2004–14 32
11. External Debt Sustainability Framework, 2004–14 33

Attachments
I. Letter of Intent (LOI) 34
II. Technical Memorandum of Understanding (TMU) 42

I. Introduction and Summary

1. **Program performance has remained broadly on-track since conclusion of the first review.** Political difficulties prevented the completion of the second SBA review scheduled for mid-December 2009.[1] The political situation has now stabilized (see below) allowing the review to proceed. Most quantitative performance criteria for end-December 2009 were met, including the general government deficit target. However, the ceiling on general government domestic arrears was breached by a small margin. The authorities have reformed arrears monitoring and improved payments, and the arrears stock is now below June levels. The indicative target on general government current expenditure has also been exceeded. One structural benchmark (passage of revised pension legislation) was not met following political uncertainties at end-year, which did not allow the interim government to submit legislation to Parliament. Staff assessment of the structural benchmark on the passage of the wage bill is "partially met" (see below).

2. **Improvement in the global economic outlook and strong efforts to implement the program have strengthened confidence and led to a reduction in financial market risks.** Since the Stand-By Arrangement (SBA) was approved in May, 2009, pressures on the exchange rate have subsided, reserves have grown, CDS spreads have come down and domestic interest rates have steadily fallen. This has created room for a cautious reduction in the central bank policy rate and has enabled the treasury to extend maturities and lower its borrowing costs in the domestic market. A temporary increase in spreads in late 2009 due to the political uncertainties and the delay in concluding the SBA review has now been fully reversed.

3. **Nevertheless, risks to program implementation remain.** The authorities' spending-based consolidation strategy for 2010 carries significant risks, not least in view of past difficulties in executing challenging reforms, notably in areas like public wages and pensions. Several of the authorities' proposed fiscal remedies—such as cuts in public employment and tighter controls on current spending in both central government and decentralized entities—may prove politically difficult. Sluggish output recovery and rising unemployment could also increase social strains, raising the risk of a populist backlash to fiscal adjustment. The banking sector also remains vulnerable, as non-performing loans (NPLs) continue to rise, putting pressure on capital and liquidity and discouraging banks from resuming lending. Finally, while progress has been made with structural reforms, the authorities still need to address remaining weaknesses in the unitary wage law through a follow-up implementing legislation and closely oversee the passage of the fiscal responsibility law and pension reform.

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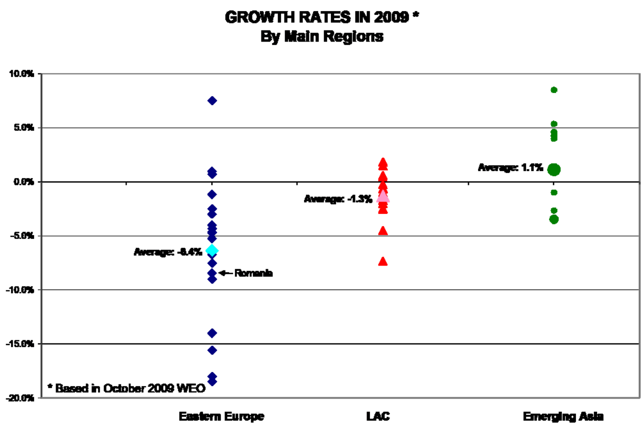
[1] Tensions between coalition partners in the run-up to presidential elections led to the collapse of the government in October. Subsequent attempts to form a new cabinet failed, and the outgoing administration was legally prohibited from submitting the 2010 budget (a prior action for concluding the second review). Under these circumstances, the mission was unable to finalize agreement on fiscal issues.

4. **The political situation has normalized.** President Basescu's reelection victory was confirmed by the Constitutional Court and he was able to assemble a narrow majority in Parliament to name a new government. Both the President and the Prime Minister have reaffirmed their strong commitment to the Fund program.

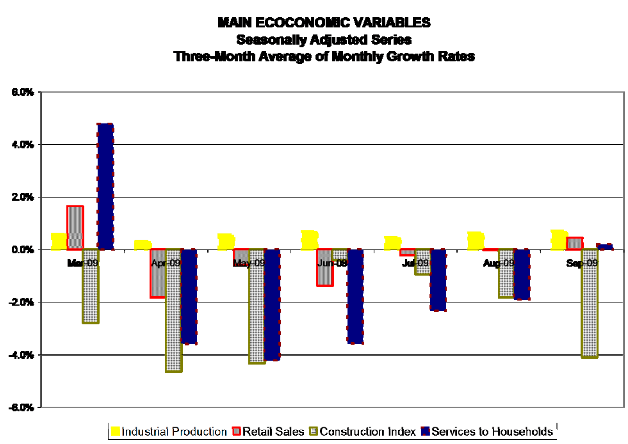
II. Recent Developments

5. **The economy is showing signs of an incipient recovery.** Romania has been hard hit by the global economic downturn. Economic activity remained weak throughout the third quarter of 2009, contracting by 0.6 percent q-o-q and by 7.1 percent y-o y. Nevertheless, high-frequency indicators confirm that production levels are stabilizing and positive economic developments in the euro-zone are starting to boost industrial production and exports. Key real macroeconomic variables are now growing on a monthly basis. At the current pace, economic activity is expected to turn positive in the first quarter of 2010.

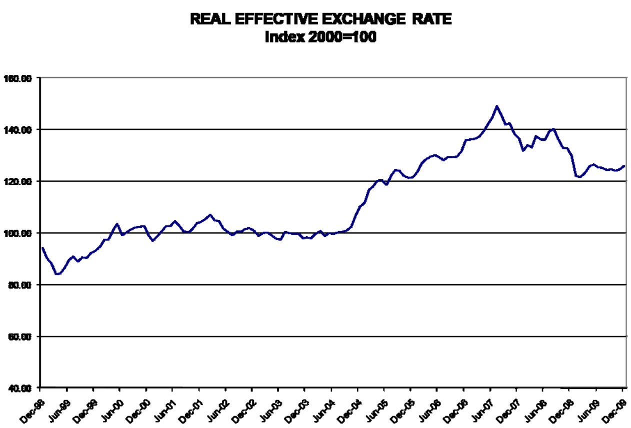


6. **Despite the sharp downturn, inflation has remained relatively high by regional standards.** End-2009 CPI inflation was 4.7 percent, down from 6.3 percent in 2008 but above the upper bound of the NBR's inflation target range. After dropping early in the year, inflation edged slightly up at year-end due to excise tax increases on alcohol and tobacco. Price developments in non-food items showed persistent inflationary pressures, reflecting rigidities in labor and product markets as well as asymmetric pass-through effects from currency depreciation. Nevertheless, as the impact of the tax hike fades, inflation is expected to ease to within the central bank's target band.

7. **External financing pressures have diminished, as the current account is shrinking faster than anticipated and net capital inflows are higher than initially projected.** The current account adjustment was faster mainly due to imports falling more rapidly than exports. However, export demand has recently rebounded and the sharp nominal decline of the

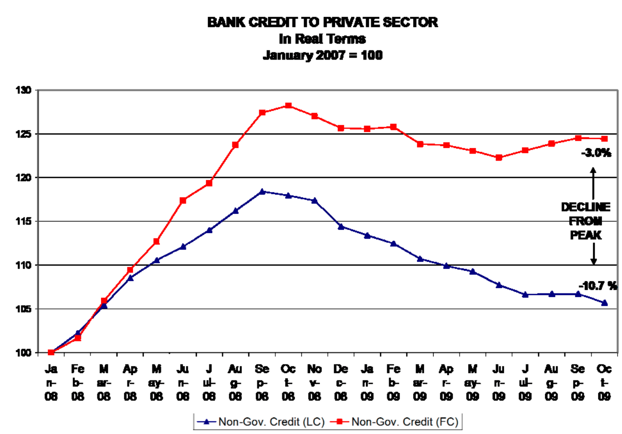


leu against the euro at the beginning of the crisis has generated a real depreciation which helped to boost competitiveness (see Box 1). Although capital inflows declined during 2009—with FDI estimated to have fallen by about 55 percent compared to 2008, and a less-than-full rollover of maturing private external debt—net capital flows were better than anticipated under the program.[2]



8. **The downturn has exacerbated the vulnerable fiscal position of the country.** Tax collections felt sharply early in the year, reflecting plunging trade, incomes, and spending. At the same time, current spending has proved difficult to hold down, with overruns in several areas--including the public wage bill--which were compensated by cuts in capital spending, lower interest payments and some improvements in revenue collections late in the year. The delayed implementation of measures designed to cut expenditures in the last quarter (the 10-day furlough and the restructuring of state agencies) reduced savings, but the government was able to meet the end-year deficit target.

9. **Financial market stress has eased in recent months, but credit conditions remain tight.** The government has been able to finance its short-term requirements in the local bond market without significant pressure on local rates, in part due to the easing of banks' reserve requirements. In international markets, sovereign CDS spreads for Romania are now close to their levels preceding the collapse of Lehman Brothers. Banks have sharply reduced credit growth as a result of lower economic activity and in order to solidify their financial positions in light of capital needs and liquidity constraints, stricter lending standards, and worsening asset quality.[3]



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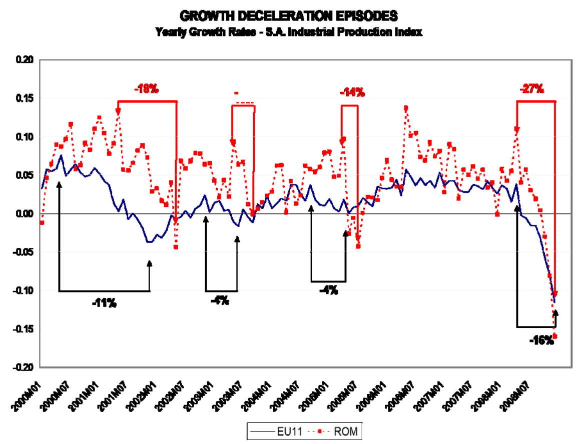
[2] The rollover rate of private external debt improved gradually during 2009, as global financial conditions stabilized and confidence improved following the SBA-supported program. For the year as a whole, the rollover rate for banks and corporates averaged, respectively, about 90 percent and 75 percent, broadly in line with the original program projections.

[3] At end-October, credit to the private sector in local currency had contracted from its peak by almost 11 percent in real terms (deflated by CPI). Loans in foreign currency in euro terms have increased in recent months but

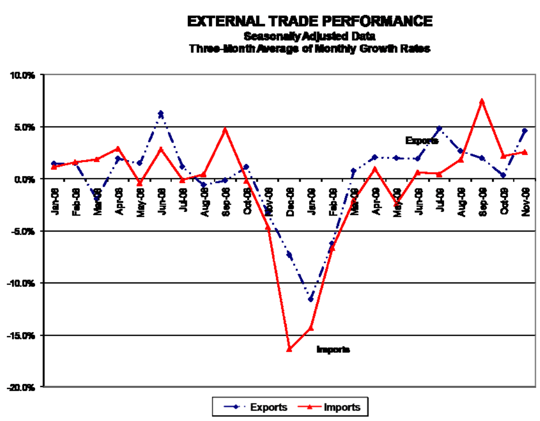
(continued)

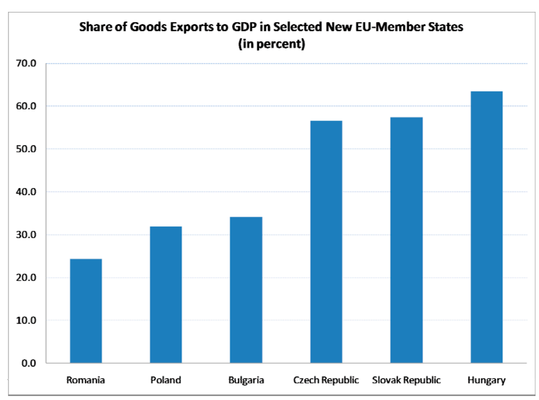
Box 1: Could an External Driven Recovery be Expected?

Romania has had a high degree of business cycle correlation with the EU countries in recent years, reflecting strong trade and financial linkages. The EU constitutes the largest trading partner for Romania, accounting for nearly 55 percent of total external trade. In addition, the bulk of the large FDI and other capital inflows to Romania originate from the EU. It is, for example, the origin of nearly 80 percent of Romania's FDI stock—which had increased to about 40 percent of GDP as of end-2008. Virtually all of Romania's remittances also come from Romanians working in EU countries.



While trade may be an important source of growth in the short term, a recovery in domestic demand will be key to achieve sustained growth. The upturn in the EU may have a positive impact on Romania in 2010. Higher demand for Romania's exports would reflect both the ongoing EU recovery and the significant real depreciation since the onset of the global financial crisis (the real effective exchange rate depreciated by about 10 percent between August 2008 and December 2009). Indeed, following a collapse in external trade starting in late-2008, there has been an important pick-up in exports in recent months. For countries badly hit by the Asian crisis in 1997–98, the external sector channel was crucial to re-invigorate the economies. However, the export boost to the economy in Romania is likely to be limited, as the trade remains relatively low in GDP and the EU recovery is expected to be tepid at least in the near term.





The growth impact through the financial channel will likely be minimal as well. Bank-financed capital inflows are likely to remain weak in the near term. In addition, it will take a while before employment in the EU countries recovers, suggesting that remittances will remain subdued in 2010

only because of repatriation of loan portfolios previously held off-shore, and they are still 3 percent below peak levels.

III. POLICY DISCUSSIONS

A. Revised Macroeconomic Framework

10. **With a better global and regional outlook, prospects for recovery in 2010 have improved**:

- *Growth.* GDP is now expected to recover by 1.3 percent in 2010 (up from near zero in the revised program) (Table 3). This reflects the nascent recovery in the euro area, as well as the carry-over effects from developments during the first half of 2009. The recovery is expected to be slow, however, with the combined impact of rising unemployment, deleveraging by households and corporates, and tight credit conditions likely to weigh on domestic demand. The medium-term outlook remains broadly unchanged from the original program, with the output gap expected to close by 2013–14.

- *Inflation.* CPI inflation is projected to fall to around 3.5 percent by end-2010. Following the initial boost to inflation from the excise tax increases and adjustment in regulated prices (electricity) in January, the still large output gap and weak labor market will put downward pressures on inflation during the remaining of the year.

- *Current account.* As a result of the deeper recession, the current account has been adjusting faster than expected. Staff now estimates the current account deficit to have contracted from 12½ percent of GDP in 2008 to about 4½ percent in 2009 (compared to 7½ percent under the program). In 2010 it would widen to about 5½ percent of GDP, closer to its estimated sustainable medium-term level (Table 4). The widening deficit would be due to an expected deterioration in the terms of trade and a recovery in import volumes following improvements in economic activity.

11. **The outlook continues to be subject to large uncertainties, but risks are broadly balanced.** Downside risks include: (i) negative feedback loops between real and financial sectors; (ii) another bout of regional financial market turbulence that could trigger further capital outflows and destabilizing exchange rate depreciation; and (iii) negative political developments which could slow program implementation, especially given that the new government holds only a slim majority in Parliament. A stronger global economic recovery, especially in the EU, would further improve prospects for a pick-up in external demand and could boost economic activity.

B. Fiscal Policies

12. **Despite consolidation efforts in 2009, Romania faces major fiscal challenges in 2010 and beyond.** The authorities need to reduce the deficit to a more sustainable level to stabilize the public debt-to-GDP ratio and to meet their goal of complying with the Maastricht criteria for accession to the Euro area, while ensuring that adjustment does not

hamper economic recovery or produce undue social hardship. The projected sluggish recovery and the high unemployment rate make this objective more challenging. Beyond 2010, further measures will be required to counter a deteriorating baseline deficit driven by population aging and high recurrent spending.

13. **The 2010 budget targets a deficit of 5.9 percent of GDP for the general government.** The target (agreed at the time of the first review) remains appropriate given the largely unchanged macroeconomic outlook and the need to strengthen fiscal sustainability. This deficit target aims to strike an appropriate balance between the short-term fiscal policy response to the still weak economic recovery and medium-term consolidation objectives. Approval by Parliament of a 2010 budget consistent with the program was a prior action for this combined review.

14. **Most measures to reach the deficit target will be on the expenditure side**. With unchanged fiscal policies, the fiscal deficit would rise to around 8.4 percent of GDP in 2010 (text table), requiring 2½ percent of GDP in adjustment to meet the agreed target. The authorities' strategy to achieve the target focuses on expenditure cuts to counter the buildup in spending over the last few years. Key measures include: (i) rationalization of the public sector wage bill (through a freeze on wages; cuts in overtime and premia; and, a significant reduction in employment, as well as the implementation of the new public wage law passed in October 2009); (ii) savings from a better control on fraudulent disability pensions, early retirement claims, and social benefits; (iii) a freeze on goods and services spending, pensions (except the minimum social pension), and savings due to the reorganization of state agencies. On the revenue side, a new turnover tax on medical goods suppliers, and net lending repayments will contribute about 20 percent of the deficit adjustment. In light of uncertainties surrounding the implementation of these policies, the government is prepared to take contingency measures (including on the revenue side) if the desired savings are not on track by the time of the fourth review mission.

Fiscal program (in percent of GDP)

	2010
Overall deficit - revised macroframework, no measures	8.4
Overall deficit - program	5.9
Required adjustment effort, ***of which:***	**2.5**
Turnover tax on medical distributors	0.1
Net lending repayment	0.4
Unpaid 4-day furlough	0.1
Reduction in personnel spending (wage freeze, premia, employment cuts, etc)	0.7
Freeze in goods and services, some transfers, and other expenditure	0.3
Saving/cuts in goods and services due to restructuring, layoffs, etc.	0.15
Pension freeze and pension reform savings	0.75

15. **Strengthening budgetary procedures and expenditure management and providing greater transparency should be at the center of the government's policies to**

avoid recurrence of expenditure arrears. The government has started to clear the stock of payment arrears, and it lowered the arrears stock by around RON 100 million between June and December 2009. Under the proposed rephasing, two-thirds of the end-2009 stock of outstanding arrears will be paid in 2010 and the rest by end-April 2011 (see LOI paragraph 9). As most arrears are in the health sector, the government will institute a new patient participation fee system with a view to using the revenues to help clear arrears in this sector. The government has improved the monitoring of arrears and will take further action based on recommendations of an upcoming IMF technical assistance mission. In addition, the repayment process of VAT refunds will be improved further per recommendations of the IMF technical assistance mission in August 2009.

16. **The authorities are committed to further strengthening the public compensation reform.** The initial reform law was approved by parliament in September 2009. The legislation lays out the principles of the new system by introducing a unified and simplified pay scale across the general government; reforming and capping bonuses for civil servants; and by setting a clear mandate to reduce the wage bill to 7 percent of GDP by 2015. While this approval is an important step forward, the legal framework for public employment and compensation system still lacks important elements to ensure compliance with best practices and program objectives.[4] With advice from the World Bank, the authorities are working on implementing legislation—detailing the new system— to address remaining weaknesses. Adoption of this legislation is a structural benchmark for end-September 2010.

17. **Progress has been made on key institutional reforms necessary to achieve fiscal sustainability over the medium term, but additional steps will be taken in 2010.** Legislation to re-structure about 100 state agencies was recently approved by parliament and it should bring savings in the wage bill and in goods and services spending. Pension reform legislation will be submitted to parliament in the coming weeks and will be approved by end-June 2010 (structural benchmark).[5] A draft fiscal responsibility law has been prepared in line with program requirements and sent to parliament for approval before end-March 2010 (structural benchmark).[6] The government has also taken legislative measures to improve the

[4] In particular, the new organic law rigidly ties the entire pay scale to a single reference wage, which is envisaged to increase by 56 percent between 2010 and 2015 requiring unfeasible cuts in public employment to reach the wage bill targets. Also, pay is not benchmarked on private sector salaries and not grouped by type of work responsibility as recommended by World Bank experts. Finally, the bonus reforms are more timid than staff had advocated.

[5] The reform aims at enhancing the long-term sustainability of the pension system by including measures to: (i) gradually indexing pensions to inflation; (ii) equalizing retirement ages between men and women at 65 by 2030; (iii) reducing early retirement and improving participation rates; and (iv) tightening the eligibility criterion of disability pensions.

[6] The draft law foresees a number of important improvements: a medium-term budgetary framework is set up with binding targets on the overall deficit and personnel spending for the first two years and on other major fiscal aggregates for the forthcoming budget year; limits on in-year budget revisions are introduced; and a fiscal council is created to assess official macroeconomic and revenue forecasts and monitor compliance with the government fiscal strategy.

monitoring and control of SOEs (end-June 2010 structural benchmark was already met) and has set an indicative program target for the operating balance of the 10 largest loss-making firms (see LOI ¶11). The authorities are committed to approve legislation to improve financial controls in local governments (end-June 2010 structural benchmark). Legislation to improve tax administration, based on IMF technical assistance, will be adopted by emergency ordinance by end-April 2010 (structural benchmark).

18. **The authorities remain committed to reducing the fiscal deficit to more sustainable levels in the medium term.** They have expressed their intention to decrease the deficit below the Maastricht criterion of 3 percent of GDP by 2012.[7] This envisaged path would require adjustment of the structural deficit of around 1¼ percent of GDP per year in 2011 and 2012, in addition to the anticipated cyclical recovery in revenues. Full implementation of the institutional reforms under the new Fiscal Responsibility Law will help underpin fiscal discipline beyond the program period,[8] while slated reforms in pension and wage legislation together should provide around 1 point of GDP of adjustment. If fully implemented, Romania's focus on expenditure reforms should contribute to the sustainability of its current consolidation effort, as studies have shown that sustained adjustment episodes generally rely mainly on spending reductions.[9]

C. Financial Sector

19. **The Romanian banking system has so far withstood the impact of the deep contraction in economic activity**. Romania's banking system remains generally well capitalized, with an average capital adequacy ratio of 13.5 percent at end-December, and shareholders have provided the necessary funds when some banks came under capital pressures. However, the downturn is increasingly undermining loan quality; NPLs as percentage of total loans more than doubled during 2009, to 15.3 percent at end-December. Rising provisions have dented banks' profits, but improvements in efficiency and valuation gains maintained the system in slight profitability for the year. The ratio of total provisions to loans in the doubtful and loss categories

Romanian Banking System - Core Indicators
In Percentage

	Dec 07	Jun 08	Dec 08	Jun 09	Dec 09
Capital Adequacy Ratio	13.8	12.8	13.8	13.5	13.5
Leverage Ratio 1/	7.3	7.3	8.1	6.9	...
NPL Ratio 2/	4	4.7	6.5	11.8	15.3
RoA 3/	1	1.4	1.6	0.1	0.2
RoE 4/	9.4	15.8	17	0.6	2.7

1/ Level 1 own funds / Total average assets.
2/ Unadjusted exposures to loans classified as doubtful and loss / Total loans excluding off balance sheet items.
3/ Return on Assets/ Average assets.
4/ Return on Equity / Average net capital.

[7] Due to differences between Romanian cash budget accounting and ESA95 standards, the budget on a cash basis would have to fall below 2½ percent of GDP.
[8] The fiscal responsibility law envisages a two year overall deficit and personnel spending binding targets that should provide a benchmark for the authorities medium term strategy (2011-13) to be drafted by end-May 2010.
[9] "Experience with large fiscal adjustments", Occasional Paper no. 246, 2006.

remained stable at around 50 percent for the system, but credit quality indicators continue to deteriorate.

20. **The parents of the largest foreign owned banks have been broadly complying with commitments made under the Bank Coordination Initiative.** Banks have recently reaffirmed their commitments under the initiative, including maintaining their overall exposure to the country despite delays in program disbursements. While actual exposures to Romania have fluctuated across institutions, the nine banks have maintained their exposures between March and December 2009 as a group. A new reporting format allows the NBR to monitor such exposures by including banking groups' cross-border exposures to the country.

21. **The authorities are undertaking legislative actions to improve the safety net to deal with financial distress**. The NBR has drafted legal amendments to strengthen the resolution framework for problem banks, to supplement the existing authority of the special administrator to implement promptly a broad range of measures and to make the NBR the sole entity with decision power on the appropriate proceedings to deal with an insolvent institution. The new amendments will also provide the same seniority to the Deposit Guarantee Fund's (DGF) claims as that of depositors and address the various components of the bank resolution structural benchmark. The authorities are in the process of finalizing the drafting of the amendments and the legislative process is expected to be completed by end-March. The own resources of the DGF will be enhanced through increases in the effective contribution rate. In addition, the NBR, as other EU central banks, has also prepared contingency plans.

22. **The NBR is striving to improve the banking supervisory and regulatory framework.** Liquidity requirements have been further amended and improved in the definition of effective and necessary liquidity matching, while a reporting requirement has been established for liquidity ratios across different currencies. Loan classification requirements for rescheduled or restructured loans have been modified with a view to preserve credit discipline and encourage loan workouts. Formally raising the minimum level of the capital adequacy ratio from 8 percent to 10 percent remains a medium-term objective, while the authorities remain committed to adopting International Financial Reporting Standards (IFRS) for banks by 2012.

23. **The authorities are closely monitoring risks from developments in neighboring countries.** Spillover effects from events in Greece would be mainly through the financial channel, as trade between the two countries is not significant. Greek banks hold a notable share of the Romanian banking market (about 20 percent). While concerned about recent developments, the authorities felt comfortable that the local subsidiaries of Greek banks were sufficiently liquid and well capitalized to withstand market volatility. The four largest Greek banks in Romania have actively participated in the Bank Coordination Initiative's exposure and capital commitments. In addition, the comfortable level of NBR reserves (well over 100 percent of short-term debt) should provide a significant cushion for the central bank to

counter renewed capital outflows. The authorities also remain vigilant concerning the possibility of broader negative confidence effects on markets in the region.

D. Monetary and Exchange Rate Policies

24. **Moderating inflationary and exchange rate pressures have allowed the NBR to gradually ease monetary policy during 2009**. With fiscal policy back on sounder footing, the NBR gradually adjusted monetary policy throughout the year as inflation and exchange rate pressures abated. The central bank has reduced reserve requirements (particularly on foreign exchange), progressively lowered its policy rate (most recently by 50 basis points to 7.0 percent in February 2010), and injected significant liquidity into the domestic money markets as needed (mainly through repo facilities). Going forward, heightened inflation risks reflect several factors, including the recent rebound in international energy prices, pressures from future administered price increases, and the persistence of structural rigidities, (such as import price stickiness) that could limit the benefit of any appreciation. Given that underlying price pressures have remained strong, monetary policy needs to be cautiously managed to anchor inflation expectations while adjusting for exchange rate pressures.

25. **The stronger-than-expected balance of payments has allowed the central bank to increase gross reserves and accumulate a comfortable margin in its NFA position.** Gross international reserves rose to about €31 billion at end-2009, whereas NFA was €5.1 billion above the end-2009 program target. As a result, the coverage of gross international reserves increased from about 80 percent of short-term external debt prior to the SBA approval to well over 100 percent at end-2009. Given the improved current and capital account outlook, the NFA targets for 2010 have been adjusted to lock in about half of this overperformance.

IV. Program Modalities and Other Issues

26. **The attached Letter of Intent (LOI) describes the authorities' progress in implementing their economic program and sets out their commitments through end-June 2010**.

- *Some modifications to the program's conditionality are proposed* (Tables 1–2)***:*** (i) Given the improved current and capital account outlook, the NFA target for end-2010 will be increased to lock in part of the overperformance during 2009, while allowing for additional room for exchange rate intervention, if needed; (ii) The target on government domestic payments arrears will be modified and rephased to target full-elimination of arrears by end-April 2011; (iii) An adjustor will be added to the quarterly general government deficit targets to require deficit reduction if current spending exceeds the program's indicative target in the previous quarter; (iv) A quarterly indicative target will be established for the operating balance of 10 loss-making SOE's; (v) The structural benchmark on the adoption of a new pension law is to be moved from end-December, 2009 to end-June, 2010; and (vi) The target date for approval of tax administration reforms will moved to end-April, 2010, from end-March.

- *New structural benchmarks are proposed* (Table 2): (i) approval of implementing legislation for the organic wage law (end-September 2010); (ii) approval by parliament of the Fiscal Responsibility Law (end-March); and (iii) Measures to strengthen the financial footing of the Deposit Guarantee Fund (end-September 2010).

27. **Program modalities**. The Fund arrangement remains adequate to meet Romania's balance of payment needs through end-2010, alongside financing commitments from the European Union and the World Bank. The estimated external financing needs for the year has declined somewhat against the backdrop of a faster-than-envisaged adjustment in the current account. However, staff intends to leave the phasing as initially programmed given the fragility of the stabilization process and unsettled regional markets.

28. **Use of Fund resources**. The authorities intend to draw the amount available at the completion of the reviews (SDR 2.175 billion) and have requested that half of the disbursement be used for budgetary support. Staff supports the authorities' request as the proposed use remains consistent with addressing Romania's balance of payments needs. While part of the projected fiscal deficit could be financed in the domestic and external private markets, covering the remaining gap would strain the relatively shallow domestic market. The Fund disbursement, together with a €1 billion disbursement from the EC in March, would facilitate Romania's return to the Eurobond market later in the spring. This would allow the authorities to exit the exceptional reliance on Fund resources for budget support after this review.

29. **Romania's capacity to repay the Fund is expected to remain strong.** Fund credit outstanding would peak in 2011 at 31.6 percent of gross reserves. Peak payments would be in 2013–14 at a still manageable 12.8 and 14.5 percent of gross reserves, respectively. Romania's strong political commitment to the SBA program and its excellent track record servicing external obligations, also provide comfort that it will fulfill its financial obligations to the Fund in a timely manner.

30. **Fund staff has continued to cooperate closely with the staff of the European Commission (EC) and the World Bank (WB).** Fund, EC and the WB staff have consulted each other regularly regarding economic and policy developments in Romania, and they participated jointly in meetings with the authorities. The EC disbursed its first tranche of its support in July 2009 (€1½ billion) and a second tranche is expected to be disbursed in March 2010 (€1 billion). The WB disbursed its first tranche (€0.3 billion) in September 2009, with the remaining tranches (€0.7 billion in total) expected in 2010 and early 2011.

V. Staff Appraisal

31. **Financial tensions have eased and the economic downturn has bottomed out in Romania.** Output remains subdued, however, and the country remains highly vulnerable to external shocks, including the spillover from any renewed regional difficulties. Nevertheless, there are several encouraging signs. Industrial output and export volumes have stabilized and are now growing. The exchange rate has stabilized, and the risk premium on Romania has eased considerably. The depreciation at the beginning of the crisis has improved external competitiveness, while confidence appears to be growing among investors. The short-term outlook for growth and external financing is now less worrisome, but sizeable macroeconomic risks remain.

32. **The authorities' strategy remains broadly appropriate.** Fiscal policy is geared toward restoring sound public finances over the medium term, while taking into account the limits to consolidation during the economic downturn; monetary and financial policies focus on maintaining macro-financial stability; and the structural reform agenda aims at establishing the foundations for a sustainable fiscal position and strong growth. Nevertheless, the government remains prepared to take additional measures, if necessary, to underline its commitment to macroeconomic stability.

33. **In staff's view, the government's preferred fiscal adjustment strategy is ambitious, but comes with implementation risks.** Implementing strong and credible fiscal adjustment is the key policy challenge in 2010. The proposed policies for the short and medium term strike an adequate balance between supporting the fledgling economic recovery and containing high structural fiscal deficits. However, the adjustment strategy entails politically difficult decisions to cut public employment, freeze wages and pensions, and reduce current spending. Given Romania's past experience in public sector reforms, this strategy requires a very strong and steadfast implementation effort within a potentially difficult political setting. Staff supported the government's reform strategy to reverse the large increase in current spending during recent years but has also proposed a more balanced adjustment mix between revenue measures and spending cuts. The authorities preferred not to rely heavily on revenue policies until a significant consolidation in economic recovery is well underway. To mitigate the resulting risk to program targets and medium term sustainability, the government should continue and strengthen recent legal initiatives to improve expenditure controls; permanently reduce the wage bill; and, mitigate fiscal risks arising from decentralized entities. In this effort, the authorities will benefit from the recommendations of IMF technical assistance missions in tax administration, budget execution and controls, and expenditure rationalization.

34. **Monetary and exchange rate policy should continue to target inflation over the medium term, while taking into account risks to financial stability.** Financial stress has eased significantly with the international financial package and recovering global financial markets, allowing for interest rate cuts and reductions in reserve requirements in recent months. While the monetary easing experienced was well calibrated in 2009, monetary

policy in 2010 should be conditioned on evidence that underlying inflation stays on a downward path and that risks of exchange rates pressures remains negligible. It is crucial for future credibility that the NBR attain its inflation target in 2010, after missing the target in the past three years (albeit by small margins). Particular attention needs to be paid to addressing the causes of persistence in nontradables inflation.

35. **The authorities' financial sector support program has helped safeguard financial stability, but challenges remain.** It is essential that the authorities continue to implement measures to preserve financial stability, including by promptly enhancing the funding regime of the DGF. Funding levels in the banking system have remained stable and average capital levels are well above regulatory requirements, but pressures on capital will continue to rise due to the impact of the economic downturn on credit quality. The authorities should also continue to carefully monitor risks that may arise from lending to households in foreign currency. Efforts that banks have implemented in a decentralized approach to rescheduling and restructuring have been broadly adequate to address the debt service pressure in the population while preserving credit discipline. In staff's view the authorities should not seek to modify the current framework that allows banks to rely on their in-house expertise for the collection of their claims.

36. **On the basis of Romania's performance under the SBA, staff supports the authorities' request for completing the second and third reviews,** including a waiver for the nonobservance of the end-December 2009 performance criterion on the accumulation of domestic arrears Staff also recommends establishment of quantitative conditionality for end-March and end-June 2010, and approval of the modification of program conditionality, as specified in the Letter of Intent.

Box 2. Romania: Stand-By Arrangement

Access: SDR 11.443 billion.

Length: 24 months.

Phasing. SDR 4.37 billion was made available upon the Board's approval of the arrangement on May 4, 2009, and the second tranche of SDR 1.718 billion was made available upon completion of the first review under the SBA on September 21, 2009. The third and fourth tranches, subject to the completion of this review that combines the second and third reviews, amount to SDR 2,175 billion. The four subsequent disbursements are contingent upon completion of further quarterly reviews, starting from June 15, 2010 and ending on March 15, 2011, and will equal SDR 3.180 billion.

Conditionality

- ***Quantitative Performance Criteria***
  - A floor on the change in net foreign assets
  - A ceiling on general government domestic arrears
  - A floor on the overall general government cash balance
  - A ceiling on general government guarantees
  - Non-accumulation of external debt arrears

- ***Quantitative Indicative Target***
  - General government current primary spending
  - Operating balance of the 10 largest loss-making SOEs.

- ***A consultation band around the 12-month rate of inflation of consumer prices.***

- ***Prior Actions***
  - Approval of agreed fiscal measures for 2010, including 2010 budget. *Prior action for Board consideration of second and third reviews.*

- ***Structural Benchmarks***
  - Passage of implementing public wage legislation. *By September 30, 2010.*
  - Approval of fiscal responsibility legislation by parliament. *By March 30, 2010.*
  - Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF. *By March 31, 2010.*
  - Passage of revised pension legislation. *By June 30, 2010.*
  - Approval of tax administration reforms. *By April 30, 2010 and ratified by parliament by June 30, 2010.*
  - Approval of reforms of local governments. *By June 30, 2010*
  - Approval of reforms of SOE finances. *By June 30, 2010 (Met)*
  - Measures to enhance the funding regime of the deposit guarantee fund. *By September 30, 2010*

Figure 1. Romania: Selected Economic Indicators

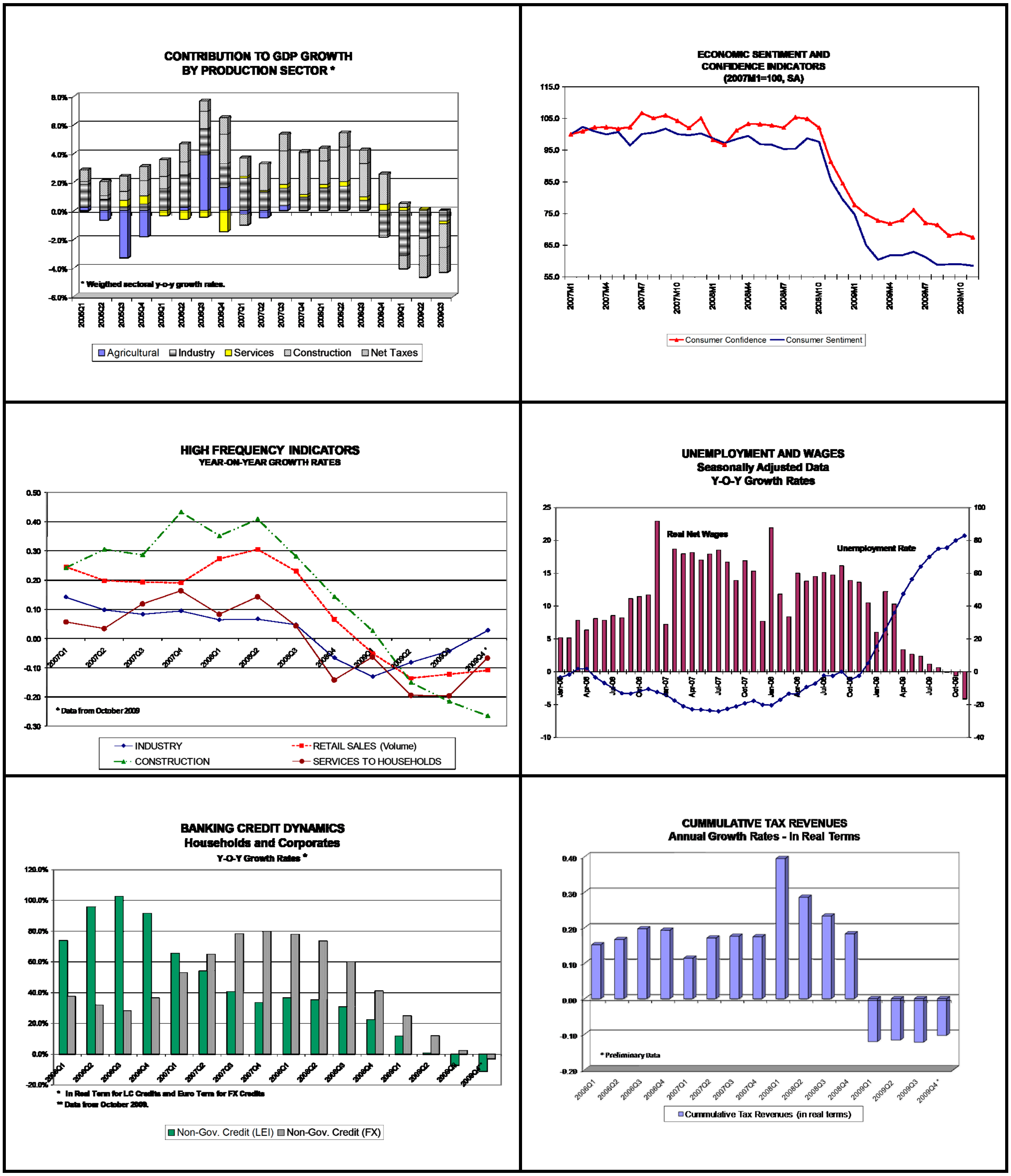
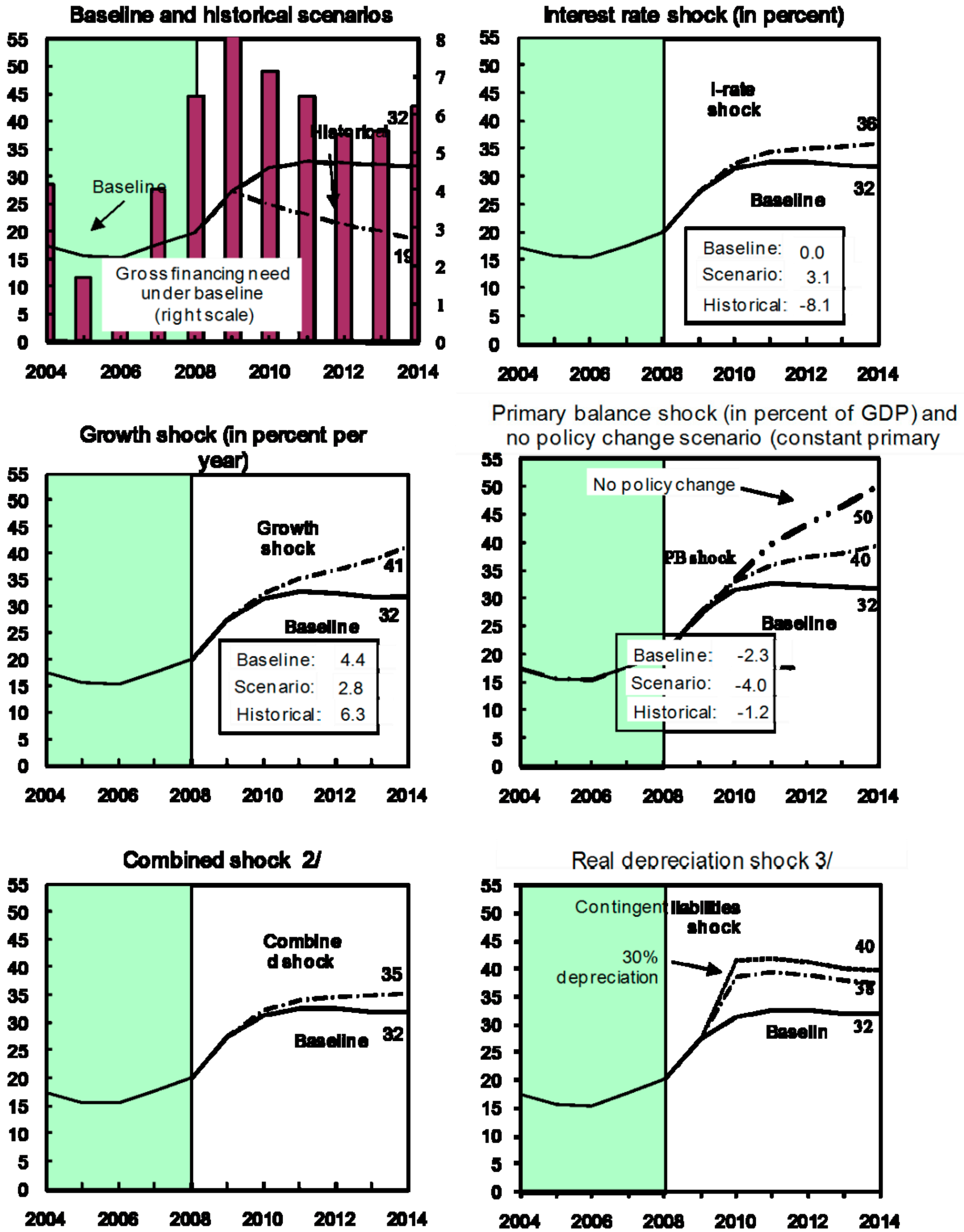
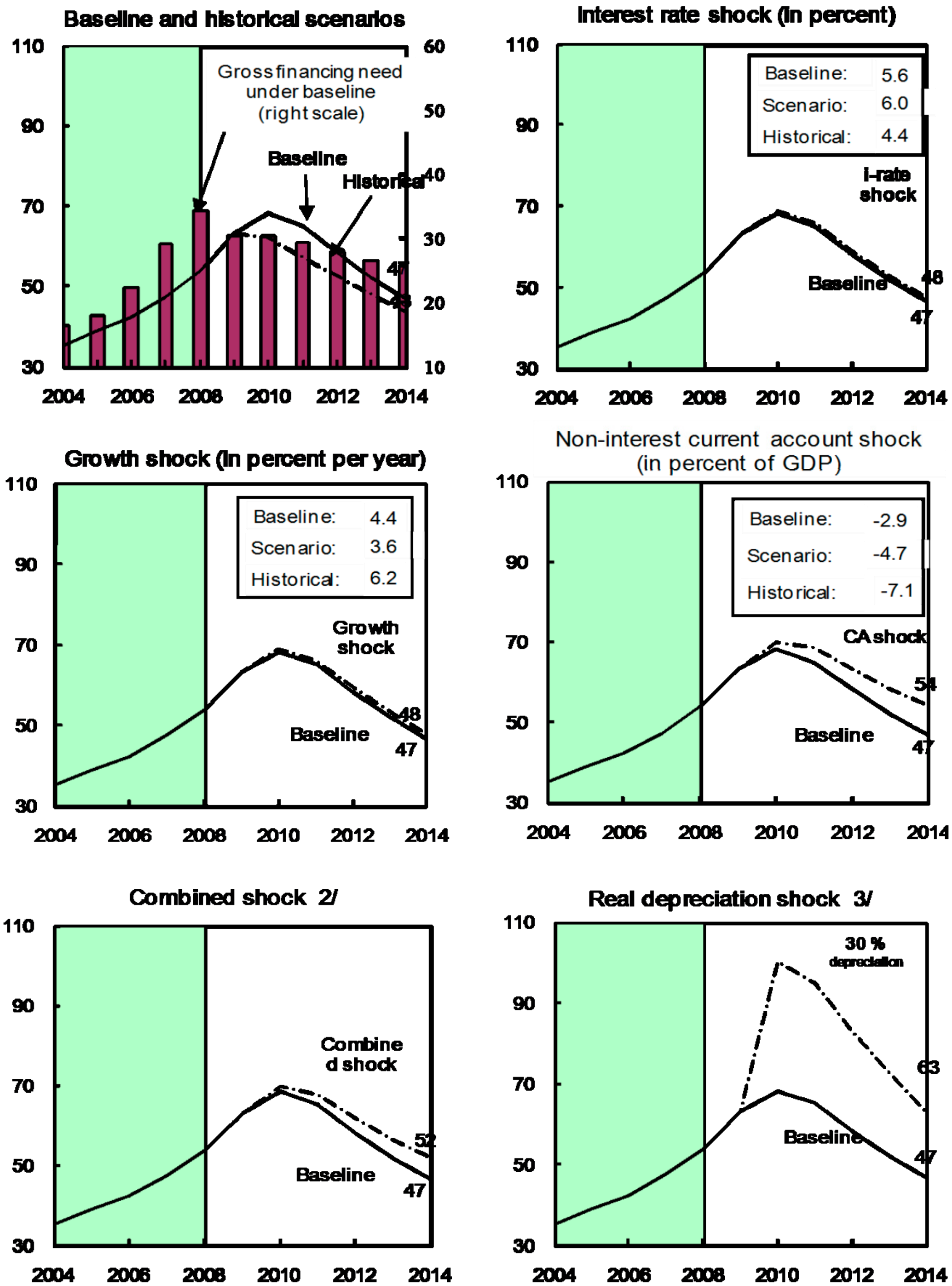


Figure 2. Romania: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



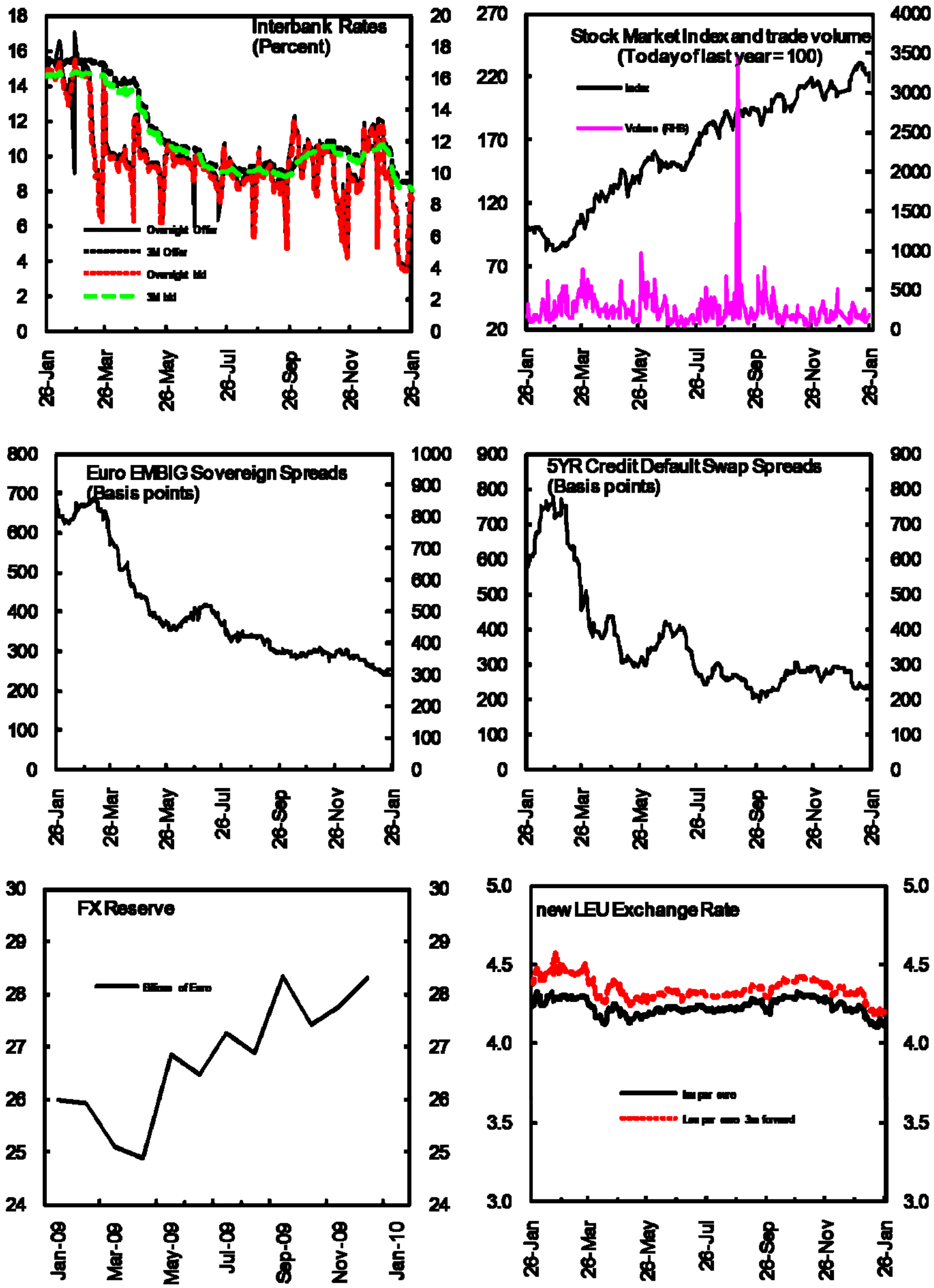
Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Seven-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

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



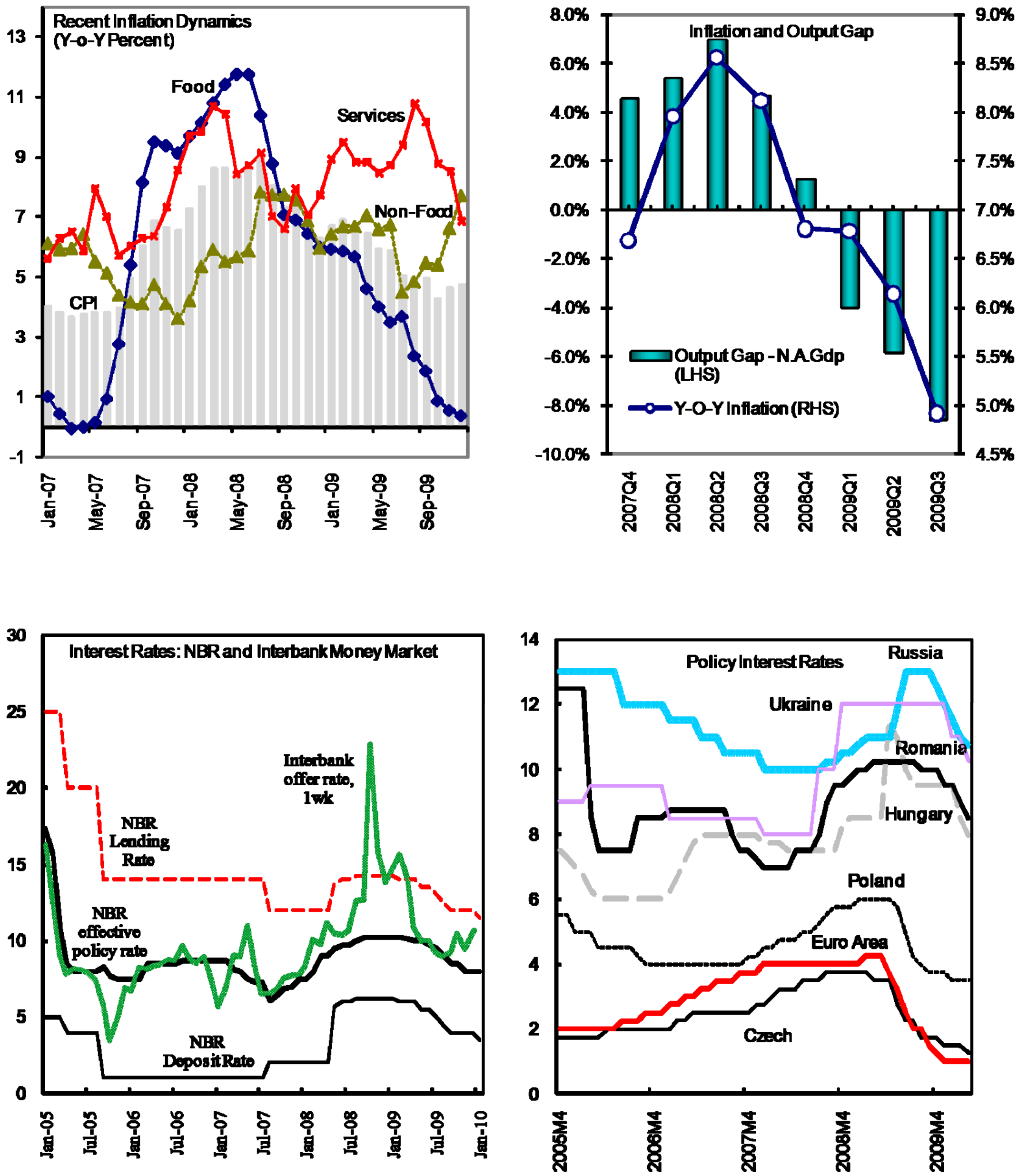
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviati shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. 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 2009.

Figure 4: Romania: Financial Markets Developments



Source: Bloomberg, DataStream, IFS.

Figure 5. Romania: Monetary Policy developments



Source: Haver; EMEA; IMF staff esitmates.

Table 1. Romania: Quantitative Program Targets

	2008	2009						2010			
	Dec	March	June	Sept		Dec		March	June	Sept	Dec
				Revised							
	Actual	Actual	Actual	Program	Actual	Program	Est.	Prog.	Prog.	Proj	Proj
I. Quantitative Performance Criteria											
1. Cumulative change in net foreign assets (mln euros) 1/3/	25,532	-3,500	-5,119	-8,720	-4,566	-10,000	-4,874	-2,000	-2,500	-2,000	-2,000
2. Cumulative floor on general government overall balance (mln lei) 2/	-24,655	-8,300	-14,456	-26,900	-25,563	-36,500	-36,101	-8,250	-15,540	-21,800	-31,900
3. Stock in general government arrears from the end of previous year (bn lei)	1.06	1.41	1.55	1.1	1.4	0.91	1.50	1.27	1.09	0.81	0.48
4. Ceiling on general government guarantees issued during the year (face value, bn lei)	0.0	...	0.02	7.7	0.7	7.7	2.1	12.0	12.0	12.0	12.0
II. Continuous Performance Criterion											
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0	0	0	0	0	0
III. Inflation Consultation											
6. 12-month rate of inflation in consumer prices											
Outer band (upper limit)	8.3	8.7	7.9	7.7	...	6.5	...	6.5	6.0	5.75	5.5
Inner band (upper limit)	7.3	7.7	6.9	6.7	...	5.5	...	5.5	5.0	4.75	4.5
Center point	*6.3*	*6.7*	*5.9*	*5.7*	*4.8*	*4.5*	*4.7*	*4.5*	*4.0*	*3.75*	*3.5*
Inner band (lower limit)	5.3	5.7	4.9	4.7	...	3.5	...	3.5	3.0	2.75	2.5
Outer band (lower limit)	4.3	4.7	3.9	3.7	...	2.5	...	2.5	2.0	1.75	1.5
IV. Indicative Target											
7. General government current primary spending (excl. EU funds and social assistance, mln	92,327	22,149	43,238	63,725	63,878	81,015	85,637	32,900	65,100	97,500	131,300

1/ The December 2008 figure is a stock.
2/ The December 2008 figure is for the whole year.
3/ NFA targets for end December have been adjusted as actual disbursements fell short of projected levels by EUR 1 bn.

Table 2. Romania: Structural Conditionality for the Program

		Measure	Target Date	Comment
Fiscal Policy				
	1.	Ratification by parliament of fiscal measures equivalent to 1.1 percent of GDP	August 31, 2009	Met in April 2009
	2.	Passage of revised public compensation legislation	October 30, 2009	Partially met
	3.	Presentation of fiscal responsibility legislation and implementation plan to parliament	November 30, 2009	Met
	4.	Passage of revised pension legislation	December 31, 2009	Revised to end-June 2010
	5.	Passage of an agreed 2010 budget	December 31, 2009	Met in January 2010
	6.	Approval of legislation and internal regulations by ordinance necessary to implement tax administration reforms	April 30, 2010	
	7.	Approval of institutional reforms measures to mitigate fiscal risks from local governments	June 30, 2010	
	8.	Legislative changes to improve monitoring and control of SOEs	June 30, 2010	Met
	9.	Passage of amendment to the banking law to strengthen NBR's power to request increase in share capital and limit profit distribution	June 30, 2009	Met
Financial Sector				
	1.	Passage of amendments to deposit insurance legislation to broaden grounds for activation, expedite payouts and provide line of credit from government	August 30, 2009	Met
	2.	Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework	March 31, 2010	
New Conditionality to be Proposed				
	1.	Passage of Fiscal Responsibility Law	March 30, 2010	
	2..	An indicative target on the floor for the financial balance of the largest SOE	March 30, 2010	
	3.	Passage of implementing legislation for the organic wage law	September 30, 2010	
	4.	Measures to enhance the funding regime of the deposit guarantee fund.	September 30, 2010	

Table 3. Romania: Selected Economic and Social Indicators, 2007–11

	2007	2008	2009			2010		2011
			Prog.	Rev. Prog.	Proj.	Rev. Prog.	Proj.	Proj.
Output and prices			(Annual percentage change)					
Real GDP	6.2	7.1	-4.1	-8.5	-7.0	0.5	1.3	4.7
Domestic demand	14.3	8.9	-8.2	-13.4	-14.0	1.4	0.1	4.1
Net exports (contribution)	-16.6	-6.3	7.8	10.6	12.7	-1.3	1.1	-0.4
Consumer price index (CPI, average)	4.8	7.8	5.9	5.5	5.6	3.6	3.9	3.3
Consumer price index (CPI, end of period)	6.6	6.3	4.5	4.3	4.7	3.0	3.2	3.4
Unemployment rate	4.3	4.0	8.9	9.6	7.9	10.0	7.9	6.0
Nominal wages	22.6	23.6	5.9	2.0	2.7	3.8	4.4	5.1
Saving and Investment			(In percent of GDP)					
Gross domestic investment	31.1	31.4	30.8	30.6	31.5	29.7	30.7	30.9
Gross national savings	17.6	19.0	23.2	25.1	27.0	24.0	24.9	24.9
General government finances								
Revenue	32.5	32.8	33.0	31.6	30.8	31.7	31.3	30.7
Expenditure	35.6	37.8	37.5	39.0	38.1	37.7	37.3	35.1
Fiscal balance	-3.1	-4.9	-4.6	-7.3	-7.3	-5.9	-5.9	-4.4
Privatization proceeds	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
External financing	0.1	0.5	2.8	4.4	2.8	2.1	4.2	0.7
Domestic financing	2.9	4.4	1.8	2.9	4.5	3.8	1.7	3.6
Structural fiscal balance 1/	-4.3	-7.0	-3.8	-4.7	-5.3	-2.3	-3.2	-2.2
Gross public debt (direct debt only)	17.6	19.9	23.6	27.9	27.5	32.3	31.7	33.0
Money and credit			(Annual percentage change)					
Broad money (M3)	33.7	17.5	6.6	4.0	5.8	5.6	6.6	6.9
Credit to private sector	60.4	33.7	16.4	-1.7	1.7	5.6	5.8	13.6
Interest rates, eop			(In percent)					
Euribor, six-months	4.79	3.52	-	-	-	-	-	-
NBR policy rate	7.50	10.25	-	-	-	-	-	-
NBR lending rate (Lombard)	12.00	14.25	-	-	-	-	-	-
Interbank offer rate (1 week)	7.81	13.90	-	-	-	-	-	-
Balance of payments			(In percent of GDP)					
Current account balance	-13.5	-12.4	-7.5	-5.5	-4.5	-5.7	-5.8	-6.0
Merchandise trade balance	-14.4	-13.4	-7.1	-6.7	-5.9	-7.3	-7.5	-7.5
Capital and financial account balance	17.5	13.4	-2.3	1.0	-1.5	3.1	5.0	6.6
Foreign direct investment balance	5.7	6.8	2.9	4.3	3.4	4.5	4.5	4.5
International investment position	-40.2	-52.9	-55.6	-57.9	-56.3	-56.3	-53.6	-54.3
Gross official reserves	23.2	21.4	24.6	28.6	25.6	31.6	31.1	30.2
Gross external debt	47.3	53.7	64.2	67.7	62.8	70.8	68.3	65.3
Exchange rates								
Lei per euro (end of period)	3.5	4.0	-	-	-	-	-	-
Lei per euro (average)	3.3	3.7	-	-	-	-	-	-
Real effective exchange rate								
CPI based (depreciation -)	9.0	-4.2	-	-	-	-	-	-
Memorandum Items:								
Nominal GDP (in bn RON)	412.8	504.0	531.3	497.4	505.5	525.2	538.9	595.4

Social Indicators (reference year in parentheses)

Per capita GNI (Atlas method, 2005): US $4445; **Income distribution** (GINI index, 2000): 30.3; **Poverty rate** (2005): 13 p.c.;
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; Fund staff estimates and projections; and World Development Indicators database.

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

Table 4. Romania: Balance of Payments, 2005–11
(In billions of euros, unless otherwise indicated)

	2005	2006	2007	2008	2009			2010		2011
					Orig. Prog.	1st Review	Prel	1st Review	Proj.	Proj.
Current account balance	-6.9	-10.2	-16.7	-16.9	-9.0	-6.5	-5.4	-6.8	-6.8	-7.8
Merchandise trade balance	-7.8	-11.8	-17.8	-18.4	-8.6	-7.9	-7.1	-8.7	-8.7	-9.7
Exports (f.o.b.)	22.3	25.9	29.5	33.6	30.5	28.6	28.9	29.9	29.9	31.5
Imports (f.o.b.)	-30.1	-37.6	-47.4	-52.0	-39.1	-36.5	-36.0	-38.6	-38.6	-41.2
Services balance	-0.3	0.0	0.5	0.8	1.6	0.2	0.2	0.3	0.3	0.4
Exports of non-factor services	4.1	5.6	6.9	8.8	8.6	6.7	6.6	7.0	7.0	7.5
Imports of non-factor services	-4.4	-5.6	-6.5	-7.9	-7.0	-6.5	-6.5	-6.8	-6.8	-7.1
Income balance	-2.3	-3.2	-4.2	-5.4	-6.7	-3.5	-2.6	-3.3	-2.7	-3.1
Receipts	1.2	1.7	2.4	2.3	2.0	1.2	1.3	1.4	1.5	1.9
Payments	-3.6	-5.0	-6.6	-7.6	-8.7	-4.7	-3.8	-4.8	-4.2	-5.0
Current transfer balance	3.6	4.8	4.8	6.0	4.7	4.7	4.0	5.0	4.4	4.6
Capital and financial account balance	12.1	14.8	21.9	18.3	-2.7	1.2	-0.9	3.8	5.2	8.4
Capital transfer balance	0.6	0.0	0.8	0.6	2.7	0.8	0.8	0.7	0.7	0.6
Foreign direct investment balance	5.2	8.7	7.0	9.3	3.5	5.0	4.0	5.4	5.0	5.6
Portfolio investment balance	0.3	-0.4	0.4	-1.2	-0.8	-0.4	-0.4	-0.2	-0.2	0.5
Other investment balance	6.0	6.5	13.6	9.6	-8.1	-4.2	-5.4	-2.1	-0.3	1.7
General government 1/	0.6	-0.1	-0.6	0.6	-0.3	1.9	0.6	-0.5	1.4	0.0
Domestic banks	2.6	3.7	6.0	3.3	-1.1	-2.4	-1.6	0.0	0.0	0.0
Other private sector	2.8	2.8	8.3	5.8	-6.7	-3.7	-4.4	-1.7	-1.7	1.6
Errors and omissions	0.4	0.6	-0.6	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Prospective financing	...	...	...	...	3.3	3.1	2.1	3.8	4.8	0.2
European Commission	...	...	...	...	2.5	2.5	1.5	2.4	3.4	0.2
World Bank	...	...	...	...	0.5	0.3	0.3	0.7	0.7	0.0
EIB/EBRD	...	...	...	...	0.3	0.3	0.3	0.7	0.7	0.0
Overall balance	5.6	5.3	4.6	0.6	-8.5	-2.2	-4.3	0.7	3.2	0.7
Financing	-5.6	-5.3	-4.6	-0.7	8.5	2.2	4.3	-0.7	-3.2	-0.7
Gross international reserves (increase: -)	-5.4	-5.2	-4.5	-0.7	0.0	-4.5	-2.6	-4.1	-6.9	-1.7
Use of Fund credit, net	-0.1	-0.1	-0.1	0.0	8.5	6.7	5.9	3.4	3.7	0.9
Purchases 2/	0.0	0.0	0.0	0.0	8.5	6.7	5.9	3.4	3.7	0.9
Repurchases	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities, net 3/	-0.1	0.0	0.0	0.0	0.0	0.0	1.0	0.0	0.0	0.0
Memorandum items:					(In percent of GDP)					
Current account balance	-8.6	-10.4	-13.5	-12.4	-7.5	-5.5	-4.5	-5.7	-5.5	-5.8
Foreign direct investment balance	6.6	8.9	5.7	6.8	2.9	4.3	3.4	4.5	4.1	4.2
Merchandise trade balance	-9.8	-12.0	-14.4	-13.4	-7.1	-6.7	-5.9	-7.3	-7.1	-7.2
Exports	27.9	26.4	23.9	24.6	25.5	24.3	24.0	25.0	24.2	23.6
Imports	-37.7	-38.4	-38.3	-38.0	-32.6	-31.0	-29.8	-32.2	-31.3	-30.8
Gross external financing requirement	16.3	20.0	26.9	33.8	35.1	32.0	30.4	31.1	29.9	29.1
					(Annual percentage change)					
Terms of trade (merchandise)	2.8	6.4	5.3	-3.3	8.4	8.1	8.0	-0.7	-5.0	-1.6
Merchandise export volume	6.1	6.8	8.7	10.5	-7.0	-13.0	-13.1	3.0	1.4	3.8
Merchandise import volume	15.0	22.3	26.1	3.5	-15.2	-21.6	-23.9	3.5	0.5	3.4
Merchandise export prices	9.6	8.5	5.2	3.0	-2.4	-2.1	-1.0	1.4	2.0	1.6
Merchandise import prices	7.0	2.2	-0.1	6.1	-11.1	-10.5	-9.1	2.1	6.9	3.2
					(In billions of euros)					
Gross international reserves 3/	18.1	22.7	28.7	28.3	29.4	33.7	30.9	37.8	37.7	39.4
GDP	79.7	97.8	123.6	136.8	119.7	117.7	120.6	119.7	123.6	133.9

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

1/ For 2009, projections include IMF disbursement to the Treasury amounting to €1.7 billion, and a projected issuance of an Euro bond of €0.5 billion, both in the second half of the year. These inflows were not included in the original program projections.

2/ For 2009, total IMF disbursement is projected to amount to €8.4 billion, of which €1.7 will be disbursed directly to the Treasury, and included in the capital and financial account as noted in footnote 1.

3/ Projection for 2009 includes the allocation of SDR 908.8 million (about € 1 billion) that was made avaialable in two tranches in August and September 2009.

Table 5. Romania: Gross Financing Requirements, 2009-11
(In billions of euros, unless otherwise indicated)

	2009									2010					2011	Total
	Q1	Q2	Q3		Q4		Year			Q1	Q2	Q3	Q4	Year		2009-11
	Act	Act	1st Review	Act	1st Review	Prel	Orig Prog	1st Review	Prel	Proj	Proj	Proj	Proj	Proj.	Proj.	
I. Total financing requirements	11.5	14.3	7.3	10.7	8.8	8.8	43.9	41.5	45.3	10.6	6.9	8.8	8.2	32.5	40.7	151.1
I.A. Current account deficit	0.7	1.7	2.0	0.9	2.1	2.1	9.0	6.5	5.4	2.6	1.5	1.3	1.3	6.8	7.8	26.6
I.B. Short-term debt	8.4	9.3	3.5	6.4	3.5	4.0	22.5	24.7	28.1	5.1	3.4	5.0	3.4	16.7	16.7	78.2
Public sector	2.8	4.1	0.0	0.9	0.0	0.3	0.3	6.9	8.1	0.2	0.1	0.2	0.1	0.6	0.6	9.9
Banks	3.6	4.5	1.7	3.9	1.7	2.4	10.6	11.5	14.4	3.4	1.8	3.3	1.8	10.3	10.3	45.3
Corporates	2.0	0.7	1.8	1.6	1.8	1.3	11.6	6.3	5.6	1.5	1.5	1.5	1.5	5.8	5.8	23.0
I.C. Maturing medium- and long-term debt	1.5	2.6	1.2	1.3	2.8	3.7	9.3	8.2	9.1	2.2	1.5	2.1	1.4	7.1	16.2	39.6
Public sector	0.2	0.3	0.2	0.2	0.3	0.5	1.0	1.0	1.2	0.2	0.3	0.9	0.3	1.6	3.3	7.8
Banks	0.8	1.6	0.5	0.3	1.1	1.8	1.8	4.0	4.5	0.9	0.3	0.6	0.4	2.2	5.2	14.1
Corporates	0.5	0.7	0.5	0.8	1.4	1.4	6.5	3.1	3.4	1.1	0.9	0.6	0.7	3.3	7.7	17.7
I.D. Other net capital outflows 1/	0.9	0.7	0.6	2.1	0.4	-1.0	3.1	2.2	2.7	0.8	0.6	0.4	0.2	1.9	0.0	6.4
II. Total financing sources	9.6	11.2	6.4	8.4	7.4	9.2	32.2	34.5	38.3	8.8	5.9	8.0	6.9	29.6	40.8	138.4
II.A. Foreign direct investment, net	1.5	1.4	1.1	0.6	1.0	0.6	3.5	5.0	4.0	1.0	1.1	1.4	1.5	5.0	5.6	19.7
II.B. Capital account inflows (EU)	0.0	0.0	0.3	0.3	0.5	0.5	2.7	0.8	0.8	0.2	0.2	0.2	0.2	0.7	0.6	2.9
II.C. Short-term debt	6.8	7.2	3.4	4.6	3.4	4.5	18.6	20.7	23.1	4.7	3.2	5.1	3.7	16.7	16.7	73.2
Public sector	3.7	3.0	0.2	0.8	0.2	0.8	0.3	7.1	8.3	0.2	0.1	0.2	0.1	0.6	0.6	10.1
Banks	2.4	3.3	1.5	2.6	1.5	2.5	9.6	8.8	10.8	3.2	1.8	3.4	1.9	10.3	10.3	41.7
Corporates	0.7	0.9	1.6	1.2	1.6	1.2	8.7	4.9	4.0	1.2	1.4	1.5	1.7	5.8	5.8	21.4
II.D. Medium- and long-term debt	1.3	2.6	1.6	2.9	2.4	3.6	7.4	8.0	10.4	3.0	1.3	1.4	1.5	7.2	17.9	42.6
Public sector 2/	0.0	0.2	0.7	0.4	0.1	0.4	0.7	1.1	1.0	1.2	0.2	0.2	0.2	1.7	3.4	7.8
Banks	0.8	2.0	0.5	1.8	1.0	1.9	1.7	4.3	6.5	0.9	0.3	0.6	0.4	2.2	5.2	16.0
Corporates	0.5	0.4	0.5	0.7	1.3	1.3	5.0	2.6	2.9	0.9	0.9	0.6	0.9	3.3	9.4	18.8
III. Increase in gross reserves	-4.7	1.8	2.9	1.9	1.3	0.2	0.0	4.5	2.2	1.7	1.1	0.6	3.3	6.7	1.2	16.8
IV. Errors and omissions	0.2	-0.1	0.0	-0.5	0.0	-0.4	11.8	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	-0.7
V. Program financing	0.0	4.9	3.8	3.8	2.8	0.2	11.8	11.5	8.9	3.5	2.1	1.3	2.6	9.6	1.1	19.6
IMF	0.0	4.9	1.9	1.9	1.6	0.0	8.5	8.4	6.8	2.3	0.8	0.8	0.8	4.8	0.9	12.6
Others	0.0	0.0	1.9	1.9	1.2	0.2	3.3	3.1	2.1	1.2	1.3	0.5	1.8	4.8	0.2	7.0
European Commission	0.0	0.0	1.5	1.5	1.0	0.0	2.5	2.5	1.5	1.0	1.2	0.0	1.2	3.4	0.2	5.0
World Bank	0.0	0.0	0.3	0.3	0.0	0.0	0.5	0.3	0.3	0.0	0.0	0.3	0.4	0.7	0.0	1.0
EIB/EBRD	0.0	0.0	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.3	0.7	0.0	1.0
VI. Other Financing 3/	0.0	0.0	0.0	1.0	0.0	0.0	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Memorandum items:																
Rollover rates for amortizing debt (in percent)																
Banks	72	87	92	105	92	105	91	84	91	95	98	102	108	100	100	...
Corporates	48	93	90	79	90	90	76	79	76	85	95	105	118	100	100	...
Gross international reserves 3/	27.4	28.7	32.4	30.6	33.9	30.9	29.4	33.9	30.9	32.5	33.6	34.2	37.7	37.7	39.4	...
Coverage of gross international reserves																
- Months of imports of GFNS (next year)	8.5	8.6	...	...	...	...	7.4	9.0	8.2	...	...	...	...	9.4	8.8	...
- Short-term external debt (in percent)	98	112	116	126		124	93	122	124	122	125	128	141	141	147	...

Source: IMF staff estimates.

1/ Includes includes portfolio equity, financial derivatives and other investments, assets position.

2/ Excludes the disbursements by the IMF directly to the Treasury, amounting to €0.9 billion in 2009Q3 and €0.8 billion in 2009Q4.

3/ Reflects two SDR allocations in August and September 2009.

Table 6. Romania: General Government Operations, 2005–11
(In percent of GDP)

	2005	2006	2007	2008	2009			2010		2011
					Prog.	Rev. prog.	Prel.	Rev. prog.	Proj.	Proj.
Revenue	31.4	32.3	32.5	32.8	33.0	31.6	30.9	31.7	31.2	30.6
Taxes	27.3	28.2	28.1	28.5	28.1	27.5	27.0	27.8	26.6	26.4
Taxes on profits	2.7	2.7	2.9	2.9	2.6	2.6	2.7	2.6	2.4	2.4
Taxes on income	2.4	2.8	3.5	3.7	3.5	3.8	3.7	3.7	3.5	3.5
Value-added taxes	7.8	8.1	7.6	8.1	7.4	7.0	6.8	7.0	6.6	6.6
Excises	3.1	3.1	3.0	2.7	2.9	2.9	3.1	3.2	3.4	3.4
Customs duties	0.8	0.8	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Social security contributions	9.5	9.6	9.6	9.7	10.3	9.8	9.5	9.8	9.2	9.0
Other taxes	1.1	1.2	1.4	1.3	1.3	1.3	1.2	1.4	1.4	1.4
Nontax revenue	3.2	3.3	3.4	3.2	3.1	2.4	2.9	2.4	3.2	2.8
Capital revenue	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.2	0.1	0.1
Grants, including EU disbursements	0.6	0.5	0.8	0.9	1.6	1.6	1.0	1.4	1.3	1.3
Financial operations and other	...	...	...	0.0	...	...	0.0	...	...	...
Expenditure	32.1	33.7	35.6	37.8	37.5	39.0	38.1	37.7	37.1	34.9
Current expenditure	29.1	29.4	30.9	33.2	34.1	35.9	34.3	34.5	33.3	31.4
Compensation of employees	7.4	8.0	8.2	9.1	7.8	9.0	9.2	8.7	8.4	7.7
Maintenance and operations	6.3	6.2	6.1	6.4	5.1	5.1	5.5	4.6	5.1	4.6
Interest	1.2	0.8	0.7	0.7	1.6	1.6	1.2	1.7	1.7	1.8
Subsidies	2.2	2.2	1.7	1.6	1.2	1.3	1.4	1.1	1.2	1.1
Transfers 1/	12.0	12.2	14.2	15.4	17.7	18.1	16.5	17.6	16.4	15.7
Pensions	5.8	5.4	5.5	6.6	7.4	8.0	7.9	7.7	7.5	7.0
Other social transfers	3.7	3.6	3.9	4.2	4.4	4.8	4.8	4.7	4.5	4.3
Other transfers 2/	2.1	2.5	4.1	3.5	5.2	4.6	3.3	4.6	4.0	4.0
o\w contribution to EU budget	...	...	0.9	0.9	1.0	1.1	1.1	1.2	1.1	1.1
o\w pre-accession EU funds	...	...	...	...	0.8	0.9	0.6	0.7	0.6	0.3
Other spending	0.4	0.8	0.7	1.2	0.7	0.7	0.5	0.6	0.5	0.4
Proj. with ext. credits	0.0	0.0	0.0	0.0	0.8	0.8	0.4	0.8	0.5	0.5
Capital expenditure 3/	3.0	4.3	4.8	4.7	3.5	3.3	4.3	3.1	3.8	3.5
Reserve fund	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.0
Net lending	0.0	0.0	0.0	-0.1	0.0	-0.4	-0.5	0.0	0.0	0.0
Fiscal balance	-0.7	-1.4	-3.1	-4.9	-4.6	-7.3	-7.2	-5.9	-5.9	-4.3
Primary balance	0.5	-0.6	-2.4	-4.2	-3.0	-5.8	-6.0	-4.2	-4.2	-2.5
Financing	0.7	1.4	3.1	4.9	4.6	7.3	7.2	5.9	5.9	4.3
Privatization proceeds	1.3	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
External	0.5	0.2	0.1	0.5	2.8	2.9	2.8	4.4	4.3	0.7
Domestic	-1.1	0.7	2.9	4.4	1.8	4.4	4.4	1.6	1.6	3.6
Financial liabilities										
Gross public debt 4/	20.4	18.4	19.9	21.8	25.3	29.4	29.1	33.8	33.1	34.1
Gross public debt excl. guarantees	15.6	15.4	17.6	19.9	23.6	27.9	27.4	32.3	31.5	32.7
External	10.6	7.9	7.2	7.1	9.4	11.6	9.9	13.0	13.6	13.0
Domestic	5.0	7.5	10.4	12.8	14.2	16.3	17.6	19.2	18.0	19.8
Memorandum items:										
Total capital spending	...	...	...	6.0	5.8	5.6	5.7	5.2	5.6	5.3
Fiscal balance (ESA95 basis)	-1.4	-2.2	-2.5	-5.3	...	...	...	...	...	...
Output gap 5/	-0.4	2.2	3.2	5.4	-2.4	-6.8	-5.3	-9.5	-7.3	-6.2
Conventional structural fiscal balance	-0.6	-2.1	-4.3	-7.0	-3.7	-4.7	-5.2	-2.3	-3.2	-2.2
Nominal GDP (in billions of RON)	289.0	344.7	412.8	504.0	531.3	497.4	505.5	525.2	540.9	599.9

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

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

2/ Includes co-financing of EU projects.

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

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

5/ Percentage deviation of actual from potential GDP.

(continued)

Table 6. Romania: General Government Operations, 2005–11 (concluded)
(In millions of RON)

	2005	2006	2007	2008	2009			2010		2011
					Prog.	Rev. prog.	Prel.	Rev. prog.	Proj.	Proj.
Revenue	90,679	111,388	134,173	165,549	175,125	157,239	156,373	166,724	168,847	183,622
Taxes	79,016	97,155	116,066	143,855	149,267	136,827	136,350	146,028	143,870	158,582
Taxes on profits	7,793	9,319	11,917	14,426	13,594	13,056	13,466	13,439	12,964	14,595
Taxes on income	6,814	9,787	14,402	18,523	18,347	18,826	18,551	19,596	19,076	20,910
Value-added taxes	22,538	27,763	31,243	40,874	39,476	34,642	34,322	36,865	35,549	39,822
Excises	9,079	10,626	12,552	13,646	15,566	14,666	15,646	16,741	18,369	20,374
Customs duties	2,187	2,596	856	962	699	533	656	556	711	758
Social security contributions	27,476	33,021	39,443	49,008	54,831	48,798	47,829	51,646	49,773	53,883
Other taxes	3,129	4,043	5,653	6,416	6,755	6,305	5,879	7,184	7,429	8,240
Nontax revenue	9,232	11,457	13,991	15,892	16,622	11,895	14,487	12,560	17,439	16,681
Capital revenue	752	1,020	963	1,076	965	796	546	841	497	552
Grants	1,679	1,756	3,154	4,702	8,271	7,721	5,057	7,296	7,040	7,808
o/w EU pre-accession funds	...	...	...	...	4,380	4,380	2,959	3,415	3,415	2,093
Financial operations and other	...	...	...	25	...		-67	...	...	...
Expenditure	92,660	116,050	147,141	190,407	199,436	193,728	192,782	197,812	200,754	209,535
Current expenditure	83,975	101,232	127,513	167,095	180,929	178,414	173,445	181,190	180,082	188,411
Compensation of employees	21,356	27,593	33,696	45,608	43,601	44,893	46,676	45,521	45,657	46,058
Maintenance and operations	18,324	21,381	25,187	32,012	26,945	25,202	28,028	24,303	27,565	27,879
Interest	3,417	2,736	3,096	3,776	8,362	7,872	6,063	8,908	9,200	10,813
Subsidies	6,321	7,429	6,875	7,899	6,118	6,650	7,215	5,985	6,252	6,337
Transfers 1/	34,557	42,093	58,660	77,800	93,897	90,021	83,407	92,526	88,782	94,412
Pensions	16,682	18,528	22,664	33,187	39,370	39,830	39,851	40,230	40,406	42,176
Other social transfers	10,758	12,333	16,186	20,973	23,613	23,979	24,101	24,776	24,459	25,569
Other transfers 2/	6,076	8,577	16,769	17,646	25,276	22,822	16,931	24,379	21,383	24,156
o\w contribution to EU budge	...	...	3,799	4,506	5,528	5,458	5,650	6,100	5,920	6,608
o\w pre-accession EU funds					4,380	4,380	2,959	3,415	3,415	2,093
Other spending	1,041	2,656	3,041	5,993	3,516	3,391	2,523	3,141	2,535	2,512
Proj. with ext. credits	0	0	0	0	4,128	3,776	2,056	3,948	2,625	2,911
Capital expenditure 3/	8,685	14,817	19,629	23,794	18,339	16,194	21,837	16,322	20,471	20,902
Reserve fund	0	0	0	0	168	863	0	300	201	223
Net lending	0	0	0	-481	0	-1,743	-2,500	0	0	0
Fiscal balance	-1,981	-4,662	-12,968	-24,858	-24,312	-36,489	-36,409	-31,088	-31,907	-25,913
Primary balance	1,437	-1,926	-9,872	-21,082	-15,950	-28,618	-30,346	-22,180	-22,707	-15,100
Financing	1,981	4,662	12,968	24,858	24,312	36,489	36,409	31,088	31,907	25,913
Privatization proceeds	3,660	1,500	600	371	0	0	0	0	0	0
External	1,492	732	324	2,284	14,715		14,087		23,474	4,481
Domestic	-3,171	2,430	12,044	22,203	9,596		22,322		8,433	21,432
Financial liabilities										
Gross public debt 4/	59,011	63,341	82,324	109,752	134,347	146,241	146,938	177,329	178,845	204,758
Gross public debt excl. guarantees	45,179	53,019	72,747	100,435	125,597	138,678	138,598	169,566	170,505	196,418
External	30,686	27,341	29,672	35,733	49,954	57,663	49,820	68,507	73,294	77,775
Domestic	14,493	25,678	43,075	64,702	75,643	81,015	88,778	101,059	97,210	118,642
Other liabilities										

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

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

2/ Includes co-financing of EU projects.

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

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

Table 7. Romania: Monetary Survey, 2005–11

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

	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09		Dec-10	Dec-11
					Prog.	Prel.	Proj.	Proj.
I. Banking System								
Net foreign assets	**41,501**	**38,734**	**29,371**	**13,470**	**-31,151**	**-17,550**	**-3,139**	**1,318**
In million euros	11,286	11,454	8,309	3,407	-6,796	-4,251	-683	300
o/w commercial banks	-6,511	-11,094	-18,666	-24,388	-25,693	-26,959	-26,959	-26,959
Net domestic assets	**45,025**	**72,087**	**118,745**	**160,558**	**216,750**	**201,585**	**199,339**	**208,331**
Public sector credit, net	3,297	3,546	9,571	17,268	26,865	39,801	48,870	70,361
Private sector credit	59,806	92,379	148,181	198,086	230,587	201,487	213,172	242,249
Other	-18,078	-23,837	-39,007	-54,796	-40,702	-39,703	-62,703	-104,279
Broad Money (M3)	**86,526**	**110,821**	**148,116**	**174,028**	**185,600**	**184,035**	**196,200**	**209,649**
Intermediate money (M2)	86,230	110,442	148,044	173,629	185,248	183,652	195,791	209,212
Money market instruments	295	379	72	399	352	383	409	437
Narrow money (M1)	33,760	48,726	79,914	92,549	98,741	90,682	96,676	109,459
Currency in circulation	11,386	15,130	21,442	25,287	28,656	28,397	30,274	30,469
Overnight deposits	22,375	33,596	58,473	67,262	70,085	62,284	66,401	78,990
II. National Bank of Romania								
Net foreign assets	**65,443**	**76,251**	**96,466**	**110,654**	**86,619**	**93,748**	**120,690**	**119,609**
In million euros	17,797	22,548	27,289	27,985	18,897	22,708	26,276	27,259
Net domestic assets	**-43,231**	**-41,671**	**-47,593**	**-60,186**	**-29,488**	**-37,072**	**-60,268**	**-58,798**
Public sector credit, net	-3,943	-9,562	-8,499	-1,428	-5,449	-1,428	-1,428	-1,428
Credit to banks, net	-23,224	-11,098	-4,034	853	30,238	18,968	-4,229	-2,759
Other	-16,064	-21,011	-35,060	-59,611	-54,277	-54,611	-54,611	-54,611
Reserve money	**22,212**	**34,580**	**48,873**	**50,468**	**57,131**	**56,676**	**60,422**	**60,811**
(Annual percentage change)								
Broad money (M3)	36.5	28.1	33.7	17.5	6.6	5.8	6.6	6.9
NFA contribution	9.7	-3.2	-8.4	-10.7	-25.4	-17.8	7.8	2.3
NDA contribution	26.8	31.3	42.1	28.2	32.0	23.6	-1.2	4.6
Reserve money	62.1	55.7	41.3	3.3	13.2	12.3	6.6	0.6
NFA contribution	182.2	48.7	58.5	29.0	-46.8	-33.5	47.5	-1.8
NDA contribution	-120.1	7.0	-17.1	-25.8	60.0	45.8	-40.9	2.4
Domestic credit, real	32.3	44.9	54.3	28.4	14.4	7.1	5.2	15.4
Private sector, at constant e/r	52.0	60.1	58.2	25.6	7.4	-0.7	-0.7	17.5
Public sector, real	5.2	2.6	153.3	69.1	48.9	120.9	19.0	39.2
Broad money (M3), at constant e/r	25.6	22.1	25.4	10.5	2.0	1.0	3.3	3.3
Private deposits, at constant e/r	35.0	32.5	31.7	13.0	1.6	3.5	3.4	8.0
Memorandum items:								
CPI inflation, eop	8.6	4.9	6.6	6.3	4.5	4.7	3.2	3.4
Inflation target	6.5 - 8.5	4 - 6	3 - 5	2.8 - 4.8	2.5 - 4.5	2.5 - 4.5	2.5 - 4.5	2.5 - 4.5
Interest rates (percent):								
Policy interest rate	7.50	8.75	7.50	10.25	...	...	...	...
Interbank offer rate, 1 week	7.00	7.42	7.81	13.90	...	...	...	...
Corporate loans 1/	12.90	11.50	11.60	19.50	...	...	...	...
Household deposits 1/	5.20	6.50	6.92	15.27	...	...	...	...
Share of foreign currency deposits in M3	28.8	27.5	27.9	30.3	...	...	...	...
Share of foreign currency private loans	54.7	47.3	54.3	57.8	...	...	...	...
M2 velocity	3.34	3.12	2.79	2.90	2.79	2.75	2.75	2.85
Money multiplier (M3/reserve money)	3.90	3.20	3.03	3.45	3.25	3.25	3.25	3.45

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

1/ Rates for new local currency denominated transactions.

Table 8. Romania: Schedule of Reviews and Purchases

Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
May 4, 2009	4,370	424.19	Approval of arrangement
September 21, 2009	1,718	166.76	First review and end-June 2009 performance criteria
December 15, 2009 1/	1,409	136.77	Second review and end-September 2009 performance criteria
February 19, 2010	766	74.35	Third review and end-December 2009 performance criteria
June 15, 2010	768	74.55	Fourth review and end-March 2010 performance criteria
September 15, 2010	769	74.65	Fifth review and end-June 2010 performance criteria
December 15, 2010	769	74.65	Sixth review and end-September 2010 performance criteria
March 15, 2011	874	84.84	Seventh and end-December 2010 performance criteria
Total	11,443	1110.76	

Source: IMF staff estimates.
1/ The amount of purchase for the second review was available from December 15, 2009, but was made together with the amount for the third review on February 19, 2010 given the delay in completing the second review.

Table 9. Romania: Indicators of Fund Credit, 2010–16 1/
(In millions of SDR)

	2010	2011	2012	2013	2014	2015	2016
Existing Fund Credit							
Stock 2/	6,088	6,088	4,781	1,737	0	0	0
Obligations 3/	75	75	1,381	3,091	1,748	0	0
Repurchase	0	0	1,307	3,044	1,737	0	0
Charges	75	75	74	47	11	0	0
Prospective Fund Credit under Stand-By Arrangement							
Disbursement	3,072	874	0	0	0	0	0
Stock 2/	4,481	5,355	5,355	4,251	1,683	109	0
Obligations 3/	46	65	66	1,167	2,612	1,587	110
Repurchase	0	0	0	1,104	2,568	1,574	109
Charges	46	65	66	63	43	14	1
Stock of existing and prospective Fund credit							
In millions of SDR	10,569	11,443	10,136	5,988	1,683	109	0
In percent of quota	1,026	1,111	984	581	163	11	0
In percent of GDP	9.2	9.3	7.2	3.7	0.9	0.1	0.0
In percent of exports of goods and services	31.0	31.9	26.3	14.4	3.8	0.2	0.0
In percent of gross reserves	30.3	31.6	28.1	18.0	5.6	0.4	0.0
Obligations to the Fund from existing and prospective Fund arrangements							
In millions of SDR	122	140	1,447	4,258	4,359	1,588	110
In percent of quota	11.8	13.6	140.4	413.3	423.2	154.1	10.7
In percent of GDP	0.1	0.1	1.0	2.6	2.4	0.8	0.0
In percent of exports of goods and services	0.4	0.4	3.7	10.2	9.8	3.3	0.2
In percent of gross reserves	0.3	0.4	4.0	12.8	14.5	5.8	0.4

Source: IMF staff estimates.

1/ Using IMF actual disbursements, SDR interest rate as well as exchange rate of SDR/US$ and US$/€ of January 28, 2010.
2/ End of period.
3/ Repayment schedule based on repurchase obligations.

Table 10. Romania: Public Sector Debt Sustainability Framework, 2004–14
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	17.4	15.6	15.4	17.6	19.9	**27.4**	**31.5**	**32.7**	**32.6**	**32.1**	**32.0**	-1.7
o/w foreign-currency denominated	10.1	8.7	6.9	7.3	7.4	14.3	22.7	20.1	17.3	14.3	11.1	
Change in public sector debt	-8.4	-1.7	-0.3	2.2	2.3	7.5	4.1	1.2	-0.1	-0.5	-0.1	
Identified debt-creating flows (4+7+12)	-3.8	-2.5	-2.9	0.1	2.9	7.1	4.1	1.2	-0.1	-0.5	-0.1	
Primary deficit	2.1	-0.4	0.6	2.4	4.2	6.0	4.2	2.5	1.7	1.4	1.5	
Revenue and grants	29.9	31.4	32.3	32.5	32.8	30.9	31.2	30.6	30.7	30.5	30.2	
Primary (noninterest) expenditure	32.1	31.0	32.9	34.9	37.0	36.9	35.4	33.1	32.4	31.9	31.8	
Automatic debt dynamics 2/	-5.3	-0.9	-3.0	-2.2	-1.2	1.1	-0.1	-1.3	-1.8	-1.9	-1.7	
Contribution from interest rate/growth differential 3/	-3.9	-1.5	-1.7	-1.8	-2.4	1.1	-0.1	-1.3	-1.8	-1.9	-1.7	
Of which contribution from real interest rate	-2.2	-0.8	-0.7	-1.0	-1.4	-0.3	0.3	0.0	-0.1	-0.3	-0.4	
Of which contribution from real GDP growth	-1.7	-0.6	-1.0	-0.8	-1.0	1.4	-0.3	-1.3	-1.7	-1.6	-1.3	
Contribution from exchange rate depreciation 4/	-1.4	0.6	-1.3	-0.4	1.2	...	...	...	...	...	...	
Other identified debt-creating flows	-0.6	-1.3	-0.4	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.6	-1.3	-0.4	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-4.6	0.7	2.6	2.2	-0.6	0.3	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	58.0	49.8	47.6	54.2	60.7	88.6	101.0	107.0	106.4	105.2	105.8	
Gross financing need 6/	4.1	1.7	1.8	4.0	6.5	8.1	7.1	6.5	5.5	5.6	6.2	
in billions of U.S. dollars	3.1	1.7	2.2	6.8	12.9	13.6	13.0	12.8	12.3	14.3	17.9	
Scenario with key variables at their historical averages 7/						**27.4**	**25.0**	**23.2**	**21.4**	**20.0**	**18.6**	-2.5
Scenario with no policy change (constant primary balance) in 2009-2014						**27.4**	**33.7**	**39.9**	**43.3**	**46.7**	**50.2**	-2.7
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	8.5	4.1	7.9	6.2	7.1	-7.0	1.3	4.7	5.7	5.6	4.5	
Average nominal interest rate on public debt (in percent) 8/	6.2	7.0	6.0	5.8	5.2	6.0	6.6	6.3	5.9	5.6	5.2	
Average real interest rate (nominal rate minus change in GDP deflator, in p	-9.3	-5.2	-4.5	-6.9	-8.8	-1.8	1.1	0.4	-0.1	-0.7	-1.0	
Nominal appreciation (increase in US dollar value of local currency, in perc	14.2	-6.2	19.4	6.5	-16.5	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	15.5	12.2	10.5	12.8	14.0	7.9	5.6	5.9	6.0	6.2	6.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	20.4	0.8	14.4	12.7	13.7	-7.3	-2.8	-2.1	3.3	4.1	4.1	
Primary deficit	2.1	-0.4	0.6	2.4	4.2	6.0	4.2	2.5	1.7	1.4	1.5	

1/ Coverage: general government. Gross public debt excluding guarantees is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as $-g$.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 11. Romania: External Debt Sustainability Framework, 2004–14

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 6/
Baseline: External debt	35.2	38.8	42.1	47.3	53.7	**63.3**	**68.3**	**65.2**	**58.3**	**52.1**	**46.6**	**-7.9**
Change in external debt	1.4	3.6	3.3	5.2	6.3	9.6	5.0	-3.1	-7.0	-6.2	-5.5	
Identified external debt-creating flows (4+8+9)	-4.7	-6.6	-5.3	-1.3	1.9	5.8	0.8	-1.6	-1.9	-1.6	-0.7	
Current account deficit, excluding interest payments	7.1	7.4	9.2	12.3	10.9	1.2	1.9	2.4	3.0	3.3	3.7	
Deficit in balance of goods and services	9.1	10.2	12.0	14.0	12.8	5.7	6.9	7.0	7.5	7.6	7.8	
Exports	35.8	33.0	32.2	29.5	31.0	29.5	31.2	30.4	28.4	26.9	25.8	
Imports	44.8	43.2	44.2	43.5	43.8	35.2	38.1	37.4	35.9	34.5	33.6	
Net non-debt creating capital inflows (negative)	-8.4	-6.9	-8.5	-6.0	-5.9	-3.0	-3.9	-4.6	-4.9	-4.9	-4.9	
Automatic debt dynamics 1/	-3.4	-7.0	-6.0	-7.6	-3.1	7.6	2.8	0.6	-0.1	-0.1	0.4	
Contribution from nominal interest rate	1.3	1.2	1.2	1.2	1.5	3.3	3.6	3.5	3.1	2.8	2.5	
Contribution from real GDP growth	-2.5	-1.1	-2.5	-2.1	-3.0	4.3	-0.8	-3.0	-3.2	-2.9	-2.1	
Contribution from price and exchange rate changes 2/	-2.2	-7.1	-4.7	-6.7	-1.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.1	10.1	8.6	6.5	4.4	3.8	4.2	-1.5	-5.1	-4.6	-4.8	
External debt-to-exports ratio (in percent)	98.5	117.4	130.9	160.5	173.1	214.7	219.3	214.6	205.0	193.7	180.4	
Gross external financing need (in billions of US dollars) 4/	9.9	14.2	21.7	35.9	47.0	36.6	37.4	39.3	42.9	47.1	51.7	
in percent of GDP	16.3	17.9	22.2	29.0	34.3	30.4	30.2	29.4	27.6	26.5	25.7	
Scenario with key variables at their historical averages 5/						**63.3**	**62.0**	**57.2**	**52.7**	**48.2**	**43.5**	**-10.7**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	8.5	4.1	7.9	6.2	7.1	-7.0	1.3	4.7	5.7	5.6	4.5	
GDP deflator in US dollars (change in percent)	7.0	25.4	13.7	19.0	3.3	-5.2	1.2	3.4	9.5	8.5	8.1	
Nominal external interest rate (in percent)	4.4	4.5	3.8	3.7	3.5	5.4	5.9	5.6	5.5	5.5	5.4	
Growth of exports (US dollar terms, in percent)	19.4	20.6	19.5	15.9	16.2	-16.1	8.4	5.6	8.3	8.4	8.6	
Growth of imports (US dollar terms, in percent)	23.4	25.9	25.4	24.5	11.3	-29.1	10.8	6.4	11.3	9.9	10.1	
Current account balance, excluding interest payments	-7.1	-7.4	-9.2	-12.3	-10.9	-1.2	-1.9	-2.4	-3.0	-3.3	-3.7	
Net non-debt creating capital inflows	8.4	6.9	8.5	6.0	5.9	3.0	3.9	4.6	4.9	4.9	4.9	

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

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ 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.

ATTACHMENT I. ROMANIA: LETTER OF INTENT (LOI)

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

Bucharest, February 5, 2010

Dear Mr. Strauss-Kahn:

1. While conditions remain difficult, we believe the worst of the crisis is now past and we expect modest positive growth in 2010. The comprehensive anti-crisis program supported by the Fund, the EU, and the World Bank has played a crucial role in normalizing financial conditions reversing economic imbalances, and setting the stage for economic recovery.

2. While there have been some challenges related to the uncertain political environment late last year, implementation of the IMF-supported program has continued to be strong (Tables 1 and 2):

- *Quantitative performance criteria and inflation consultation mechanism*. For end-September, all quantitative performance criteria and the continuous performance criterion on non-accumulation of external arrears were met, with the exception of the ceiling on general government domestic arrears. For end-December, once again all quantitative performance criteria were met except for the target on domestic arrears, for which final data are not yet available. Preliminary data suggest that arrears fell, but insufficiently to overcome overruns during the first part of the year, missing the end-December target by a small margin (0.1 percent of GDP). The indicative target on general government current primary spending was exceeded at both the end-September and end-December test dates. Inflation remained within the inner band of the inflation consultation mechanism throughout the period.

- *Structural benchmarks*. The structural benchmark on passage by parliament of new public compensation legislation was met before the end-October deadline; however, some components of the law fell short of the initial objectives. Implementing legislation in 2010 should rectify these shortcomings. A fiscal responsibility law was sent to parliament before the end-November benchmark date. The structural benchmark on passage of legislation to improve monitoring and control of state-owned enterprises (SOEs) was met in November 2009, ahead of the end-June 2010 deadline. Political difficulties prevented approval of pension reform legislation by the end-December target date. Revised legislation will be submitted to parliament in the coming weeks, and we expect legislative approval by end-June.

3. In view of this performance, we request completion of the second and third reviews under the Stand-By Arrangement. On the basis of the corrective measures being taken and the additional explanations given in this Letter, we request a waiver for the end-December performance criterion on general government arrears.

4. We believe that the policies set forth in the letters of April 4, 2009, September 8, 2009 and in this Letter are adequate to achieve the objectives of our economic program, but the government stands ready to take additional measures as appropriate to ensure achievement of its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this Letter or adopting new measures that would deviate from the goals of the program, and will provide the IMF and the European Commission with the necessary information for program monitoring.

Macroeconomic Framework for 2010

5. There are signs that economic activity is beginning to turn around. Key real macroeconomic variables are now growing on a monthly basis, and we expect economic growth to turn positive in the first quarter of 2010. For 2010 as a whole, growth is now forecast at around 1.3 percent, reflecting mainly the recovery in external markets. Unemployment will remain high, however, and economic stresses on firms and households will continue to weigh on banks' balance sheets. Despite the sharp downturn, inflation has remained relatively high. End-2009 CPI inflation was 4.7 percent, slightly above the upper bound of the National Bank of Romania's (NBR) inflation target range largely due to the impact of increases in excise duties and fuel prices. However, 2010 inflation is expected to ease to around 3½ percent by year-end on the back of prudent monetary policy implementation.

6. External financing pressures have eased faster than anticipated, as the current account adjusted more rapidly than expected in 2009 due to sharply lower imports, while net capital flows also held up better. In recent months, export demand has also begun to recover. As a result, net foreign assets exceeded the program target by some €5.1 billion at end-2009.

Fiscal Sector

7. In response to strong pressures in current expenditures that threatened to derail the fiscal performance in the second half of 2009, the government proposed in August a set of supplementary measures (including a two week unpaid furlough for most public workers) to reduce spending further. Despite prompt parliamentary approval, many components of the plan could not take effect until legal challenges were resolved in early November. However, enhanced revenue collections and underperformance on capital spending compensated for the excess spending in the third quarter, allowing the fiscal deficit target to be achieved. In the fourth quarter, partial implementation of the furlough and improved monitoring and control of expenditure both inside and outside the central government, along with some improvement in revenue collections, allowed the year-end deficit target to be met despite higher-than-programmed current expenditure.

8. The recently approved 2010 budget (a prior action for the review) is designed to achieve a fiscal deficit of 5.9 percent of GDP. This represents about 2½ percentage points of GDP adjustment (2 percent in structural terms). As anticipated in the September 2009 LOI, most measures to reach this deficit would be on the expenditure side (roughly 80 percent of the total adjustment from the baseline projection). We will implement measures to reduce the wage bill further, including a freeze on all but the lowest wages (0.3 percent of GDP in savings), a continuation of the replacement of only 1 of 7 departing workers and further cuts

in overtime and premia (0.2 percent of GDP), along with structural changes to reduce public sector employment (0.2 percent of GDP). Savings from implementation of the pension reform law due to a broader contribution base, better control on fraudulent disability pension claims, and fewer earlier retirements should yield another 0.1 percent of GDP. A freeze on goods and services, pensions (except the minimum social pension), and certain transfers, and some savings in goods and services due to reorganization of state agencies are expected to generate another 1.1 percent of GDP. On the revenue side, a turnover tax on medical distributors (0.1 percent of GDP) and repayments of net lending will contribute 0.6 percent of GDP in extra revenues. If these measures are not on track to deliver the expected consolidation, we agree to implement contingency measures to close any anticipated gap. To complement the fiscal consolidation, we are committed to improving public debt management in 2010. We will work to improve the maturity profile of public debt and build up a financial buffer in first half of the year to avoid seasonal financing pressures.

9. We have made progress in clearing the stock of domestic payments arrears, which proved much higher than was known at the time of our first letter of intent. The latest preliminary data (for December), indicate that arrears are now below the level of June 2009, but continue to be above the program targets. We have taken steps to improve monitoring and control mechanisms and will take further action on the advice of an upcoming IMF technical assistance mission. We have agreed to utilize initial revenues from new medical patient participation fees to pay down arrears in the medical sector. We will repay two-thirds of the remaining stock of arrears by end-2010, with full elimination of arrears now slated for end-April 2011. We request a rephasing of the corresponding performance criterion to reflect this more realistic objective. As outlined in the September LOI, we are conditioning guarantees and extra transfers to decentralized entities on their progress in reducing arrears. In addition, we will improve the repayment process of VAT refunds further per recommendations of the IMF technical assistance mission in August 2009.

10. We remain committed to structural reforms in the public sector to reduce long term expenditure pressures. We have already restructured around 100 state agencies, which should bring savings in the wage bill and goods and services spending in 2010. We have already sent the fiscal responsibility law to parliament and expect it will also be approved by end-March (structural benchmark). Building on IMF technical assistance recommendations, we will also adopt legislation (by emergency ordinance) to improve tax administration by end-April (structural benchmark) and to have it ratified by parliament by end-June 2010. To safeguard fiscal stability, we are preparing legislation to further improve financial relations with local governments (end-June structural benchmark).

11. We have made progress in improving the performance of SOEs and developing better monitoring mechanisms for financial results in public enterprises as outlined in our letter of September 8, 2009. We have also agreed on an indicative program target, beginning end-March 2010, on the operating balance of the ten largest loss-making public firms (see the accompanying TMU).

12. Implementing legislation for the unified wage law (adopted last year) will be agreed with IFIs over the coming months and is slated to be approved by parliament by end-September (structural benchmark). Revised pension reform legislation (consistent with the

agreement with the IFIs) will be submitted to parliament shortly and will be approved by end-June (structural benchmark). We have taken first steps in consolidating certain social benefits and are initiating work on a comprehensive reform to develop a more streamlined and transparent, means-tested social assistance system. To alleviate the immediate impact of the current crisis on the most vulnerable households, we will prepare in the coming months a temporary, targeted income supplement consistent with our overall fiscal objectives. We will consult with the World Bank, EC, and IMF before implementing the program. We will also begin developing, in consultation with the World Bank, comprehensive reforms of the public health system.

Financial Sector

13. The Romanian banking system has been able to sustain the protracted downturn in the economy and return to profit in the second half of 2009. Non-performing loans increased to 15.3 percent at end-December 2009, although the rate of increase is slowing, and the ratio of total provisions to loans in the doubtful and loss categories, on a gross basis, has remained stable at around 50 percent. As of end-December 2009, the average capital adequacy ratio remained at 13½ percent, with all banks having a ratio above 10 percent. The trend reflects the paid-in committed increases in capitalization in line with the expected capital needs for 2009.

14. Banks have been also broadly complying with their commitments made under the Bank Coordination Initiative in Vienna and Brussels. While individual bank exposures have fluctuated, as a group by end-December 2009 the nine banks had restored their March 2009 committed exposure to Romania. A new reporting format has been implemented that allows the NBR to better monitor exposures by including cross-border exposures to Romania at consolidated group level. All the committed capital increases were fully paid in as of September 30, as agreed under the program. There is also good progress toward increases in own funds that will enable them to maintain their capital adequacy ratio above 10 percent over the entire program period.

15. We remain committed to improving the safety net available to deal with financial distress. We intend to strengthen the resolution framework for problem banks, by upgrading our domestic legal norms in line with EU requirements. We will supplement the existing authority of the special administrator to implement promptly a broad range of measures, including purchase and assumption, sales of assets, and transfer of deposits while taking into account the provisions of EU legislation. We will also award the NBR the decision-making power with respect to the proceedings to deal with an insolvent credit institution by amending the bank insolvency regime to require NBR's authorization prior to the initiation of winding-up proceedings or liquidation proceedings. We expect to complete this process by end-March 2010 (structural benchmark). We will also abolish Subparagraph 3 of Article 4 of the DGF law, introduced by Ordinance 80/2009, which provides for automatic special administration regime upon activation of the DGF. The NBR as other EU central banks is ensuring that financial stability is maintained, including through contingency planning.

16. For deposit insurance, we will provide the same seniority to the DGF's claims as that of depositors (end-March 2010 structural benchmark). We will also further support financial

stability by gradually enhancing the funding regime of the DGF over the medium term. In this respect, we will ensure that reliance of the DGF on banks' contingent credit lines will be phased out by requiring increased accumulation of own resources. We intend to begin this process by increasing the effective contribution rate for 2011 (structural benchmark end-September 2010).

17. For overly indebted households, efforts that banks have implemented in a decentralized approach to rescheduling and restructuring have been broadly adequate to address the debt service pressures on the population, while preserving credit discipline. We will not seek to modify the current framework that allows banks to rely on their in-house expertise for the collection of their claims. We will encourage banks to continue their restructuring efforts and will monitor the results closely.

18. The NBR is continuing to improve the banking supervisory and regulatory framework, liquidity requirements have been further amended and improved in the definition of effective and necessary liquidity, and a reporting requirement has been established for liquidity ratios by currency as recommended in the 2008 FSAP Update. Provisioning requirements have been adjusted to allow up to 25 percent of collateral to be deducted and loan classification requirements for rescheduled or restructured loans have been modified with a view to preserve credit discipline, while encouraging loan workouts. We currently do not envisage further adjustments of the prudential framework. The NBR will continue to consult with Fund and EC staff prior to the introduction of key, new, or revised prudential regulations. Formally and permanently raising the minimum level of the capital adequacy ratio from 8 percent to 10 percent remains a medium-term objective. The NBR and the Ministry of Public Finance remain committed to adopting the necessary legal framework by the end of the program period for implementing comprehensive International Financial Reporting Standards (IFRS), with a view toward applying IFRS as of the beginning of 2012.

Monetary and Exchange Rate Policy

19. With fiscal policy back on sounder footing, the NBR gradually adjusted monetary policy over 2009, as inflation and exchange rate pressures abated, by reducing its reserve requirements and progressively lowering its policy rate, most recently by 50 basis points to 7.0 percent in February 2010. However, while inflation fell from 6.3 percent in 2008 to under 5 percent by September, the rate of slowdown stalled in Q4 2009, which caused the NBR to miss its target band on headline inflation by 0.2 percentage points at year-end (for reasons detailed in paragraph 5). Throughout the year, 12-month inflation remained high by regional standards as price developments in non-food items showed persistent inflationary pressures. Looking forward, the NBR foresees a moderation in inflation in 2010 to bring the CPI well within the target band. To this effect, the central bank will continue to prudently use its monetary policy instruments to anchor inflation expectations and reach the inflation targets of 3.5 percent in 2010 and 3 percent in 2011 (plus or minus 1 percentage point).

20. Better-than-anticipated net capital flows and faster-than-projected improvement in the current account due to better export performance and subdued domestic demand has led to sustained overperformance on the net foreign assets criterion at end-September and end-December. Given this situation, we propose a revision in the NFA targets for 2010 (see

TMU) to lock in half of the 2009 overperformance, while allowing for an appropriate degree of flexibility. The leu was under some downward pressure in late 2009, reflecting political uncertainties, but has since recovered to its highest level since 2008.

Program Modifications and Monitoring

21. The program will continue to be monitored through regular reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks. The quantitative targets for end-March and end-June 2010 and continuous performance criteria are set out in Table 1; and the structural benchmarks are set out in Table 2. The understandings between the Romanian authorities and IMF staff regarding the quantitative performance criteria and the structural measures described in this Memorandum are further specified in the TMU attached to this Memorandum. We request that the second and third reviews be combined, and that disbursements under the original program be rephased to allow the portion of the disbursement related to the third review to be disbursed on February 19, 2010. Also, to cover the higher fiscal financing needs in 2010 relative to the original program target, we request that half of the disbursement for both the second and third reviews (SDR 2,175 million) be channeled directly to the government.

/s/
Sebastian Teodor Gheorghe Vladescu
Minister of Public Finance

/s/
Mugur Constantin Isarescu
Governor of the BNR

Attachments

Table 1. Romania: Quantitative Program Targets

	2008	2009						2010			
	Dec	March	June	Sept		Dec		March	June	Sept	Dec
	Actual	Actual	Actual	Revised Program	Actual	Program	Est.	Prog.	Prog.	Proj	Proj
I. Quantitative Performance Criteria											
1. Cumulative change in net foreign assets (mln euros) 1/3/	25,532	-3,500	-5,119	-8,720	-4,566	-10,000	-4,874	-2,000	-2,500	-2,000	-2,000
2. Cumulative floor on general government overall balance (mln lei) 2/	-24,655	-8,300	-14,456	-26,900	-25,563	-36,500	-36,101	-8,250	-15,540	-21,800	-31,900
3. Stock in general government arrears from the end of previous year (bn lei)	1.06	1.41	1.55	1.1	1.4	0.91	1.50	1.27	1.09	0.81	0.48
4. Ceiling on general government guarantees issued during the year (face value, bn lei)	0.0	...	0.02	7.7	0.7	7.7	2.1	12.0	12.0	12.0	12.0
II. Continuous Performance Criterion											
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0	0	0	0	0	0
III. Inflation Consultation											
6. 12-month rate of inflation in consumer prices											
Outer band (upper limit)	8.3	8.7	7.9	7.7	...	6.5	...	6.5	6.0	5.75	5.5
Inner band (upper limit)	7.3	7.7	6.9	6.7	...	5.5	...	5.5	5.0	4.75	4.5
Center point	*6.3*	*6.7*	*5.9*	*5.7*	*4.8*	*4.5*	*4.7*	*4.5*	*4.0*	*3.75*	*3.5*
Inner band (lower limit)	5.3	5.7	4.9	4.7	...	3.5	...	3.5	3.0	2.75	2.5
Outer band (lower limit)	4.3	4.7	3.9	3.7	...	2.5	...	2.5	2.0	1.75	1.5
IV. Indicative Target											
7. General government current primary spending (excl. EU funds and social assistance, mln	92,327	22,149	43,238	63,725	63,878	81,015	85,637	32,900	65,100	97,500	131,300

1/ The December 2008 figure is a stock.
2/ The December 2008 figure is for the whole year.
3/ NFA targets for end December have been adjusted as actual disbursements fell short of projected levels by EUR 1 bn.

Table 2. Romania: Performance for Second and Third Review and Proposed New Conditionality

	Measure	Target Date	Comment
Quantitative performance criteria			
1.	Floor on net foreign assets	December, 2009	Met
2.	Floor on general government overall balance	September, 2009	Met
3	Floor on general government overall balance	December, 2009	Met
4.	Ceiling on general government guarantees	September, 2009	Met
5	Ceiling on general government guarantees	December, 2009	Met
6.	Ceiling on general government domestic arrears	September, 2009	Not met.
7	Non-accumulation of external debt arrears	December, 2009	Met
Quantitative Indicative Target			
	Ceiling on general government current primary spending	September, 2009	Not met.
	Ceiling on general government current primary spending	December, 2009	Not met.
Inflation consultation band			
	Inner band	December, 2009	Met.
	Outer band	December, 2009	Met.
Prior Action			
	Passage of an agreed 2010 budget	December 31, 2009	Met in January 2010
Structural benchmarks			
1.	Ratification by parliament of fiscal measures equivalent to 1.1 percent of GDP	August 31, 2009	Met in April 2009
2.	Passage of revised public compensation legislation	October 30, 2009	Partially met
3.	Presentation of fiscal responsibility legislation and implementation plan to parliament	November 30, 2009	Met
4.	Passage of revised pension legislation	December 31, 2009	Revised to end-June 2010
5.	Approval of legislation and internal regulations by ordinance necessary to implement tax administration reforms	April 30, 2010	
6.	Approval of institutional reforms measures to mitigate fiscal risks from local governments	June 30, 2010	
7.	Legislative changes to improve monitoring and control of SOEs	June 30, 2010	Met
8.	Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework	March 31, 2010	
New Conditionality to be Proposed			
1.	Passage of Fiscal Responsibility Law	March 30, 2010	
2.	An indicative target on the floor for the financial balance of the largest SOE	March 30, 2010	
3.	Passage of implementing legislation for the organic wage law	September 30, 2010	
4.	Measures to enhance the funding regime of the deposit guarantee fund.	September 30, 2010	

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

February 5, 2010

1. This Technical Memorandum of Understanding (TMU) updates and replaces the TMU dated September 8, 2009. It: (i) defines the variables subject to the quantitative targets specified in the Letter of Intent (LOI); (ii) describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets (Section I); and (iii) provides clarifications for some of the structural conditionality under the program (Section II). As is standard under all Fund arrangements, we will consult with the Fund before modifying measures contained in this Letter, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.

2. For the purposes of the program, *the exchange rates* of the Romanian Leu (RON) to the euro is set at RON 3.9852 = €1, to the U.S. dollar at RON 2.8342 = $1, to the Japanese yen at RON 3.1419 = ¥100, and to the pound sterling at RON 4.1169 = £1, the rates as shown on the National Bank of Romania's (NBR's) website as of December 31, 2008. The exchange rates to other currencies, where applicable, will also be the ones shown on the NBR's website as of December 31, 2008.

3. For the purposes of the program, the *general government* includes the entities as defined in the 2010 budget. These are: the central government (state budget, treasury, self-financed state entities included in the budget, etc.), local governments, social security funds (pension, health, and unemployment), road fund company, and administration of the property fund. This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform IMF staff of the creation of any such new funds or programs immediately.

I. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILING, AND CONTINUOUS PERFORMANCE CRITERIA

A. Floor on the Net Foreign Assets

4. **For program purposes, Net Foreign Assets (NFA) are defined as the NFA of the NBR minus Treasury liabilities to the International Monetary Fund.**

5. **NFA** of the National Bank of Romania (NBR) are defined as the euro value of gross foreign assets of the NBR (including reserve requirements of the commercial banking system held at the NBR) minus gross foreign liabilities of the NBR; and will be measured on the basis of the NBR's operational rather than accounting definitions. Non-euro denominated foreign assets and liabilities will be converted into euro at the program exchange rates.

6. **Gross foreign assets of the NBR** are defined to include the NBR's holdings of SDRs, the country's reserve position at the Fund, holdings of cash, securities and deposits abroad in convertible foreign currencies. Excluded from reserve assets are: (i) gold and other precious metals; (ii) assets in nonconvertible currencies; (iii) illiquid assets; (iv) any assets that are pledged, collateralized, or otherwise encumbered, unless there is also a gross foreign liability associated with it; (v) claims on residents; and (vi) claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

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

Floor on Cumulative Change in NFA from the Beginning of the Year 1/ (in mln. euros)

	2009	2010 2/			
	December	March	June	September	December
	(Stock)	PC	PC	IT	IT
Cumulative change in NFA	20,658	-2,000	-2,500	-2,000	-2,000
Memorandum Item:					
Gross Foreign Assets	28,418	300	700	2000	2,800

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

2/ Flows in 2010 are relative to end-2009 stock.

8. NFA targets will be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as external disbursements from official creditors (World Bank and the EC) that are usable for the financing of the overall central government budget. The NFA targets will also be adjusted upward by the increase in commercial bank reserve requirements held with the NBR relative to end-December, 2009 (€7,874.4 million), measured at program exchange rates.

9External program disbursements – Baseline Projections (in mln. euros)

	2010			
	March	June	September	December
Cumulative flows from end-December 2009	1,340	2,540	2,540	4,100

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

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

	2008	2009	2010			
	December (actual)	December (actual)	March	June	September	December
Outer band (upper limit)		6.5	6.5	6.0	5.75	5.5
Inner band (upper limit)		5.5	5.5	5.0	4.75	4.5
Center point	*6.3*	*4.7*	*4.5*	*4.0*	*3.75*	*3.5*
Inner band (lower limit)		3.5	3.5	3.0	2.75	2.5
Outer band (lower limit)		2.5	2.5	2.0	1.75	1.5

C. Performance Criterion on General Government Balance

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

Cumulative floor on general government balance	(In millions of lei)
End-December 2009 (actual)	-36,101
End-March 2010 (performance criterion)	-8,250
End-June 2010 (performance criterion)	-15,540
End-September 2010 (indicative target)	-21,800
End-December 2010 (indicative target)	-31,900

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

+ (i) net external financing, excluding valuation gains and losses;
+ (ii) change in net domestic credit from the financial system, excluding valuation gains and losses from deposits denominated in foreign currency and including adjustments for;
    + (a) received EU funds not yet spent (advance payments);
    + (b) claims of the government on EU funds;
    + (c) property fund obligations not yet paid;
+ (iii) change in the stock of issued government securities, net of valuation changes;
+ (iv) net changes in other financing.

12. If the difference between the general government deficit measured from above the line and from below the line is larger than lei 200 million each quarter during 2010, the Ministry of Public Finance will consult with IMF staff.

13. In the event that non-grant revenues exceed those projected under the program, the deficit target will be adjusted downward by one half of the surplus to allow for additional capital spending, while reducing the deficit further. The following table shows the accumulated projected non-grant revenue for 2010, to which the actual non-grant revenue will be compared.

Cumulative projected revenue of general government, net of EU funds	(In millions of lei)
End-December 2009 (actual)	151,508
End-March 2010 (projection)	37,800
End-June 2010 (projection)	77,600
End-September 2010 (projection)	119,500
End-December 2010 (projection)	161,800

14. In the event that current spending in the previous quarter exceeds the indicative target (defined below), deficit target for the next quarter will be adjusted downward by a corresponding amount.

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

15. The issuance of general government guarantees to the non-financial private sector and public enterprises will be limited during the program period. This ceiling may be adjusted upward by up to RON 4.3 billion relative to the original ceiling of RON 7.7 billion for

guarantees for financing the counterpart payments of investment projects financed by the EU or for guarantees on projects cofinanced by the EBRD, IFC, or EIB.

Ceiling on new general government guarantees issued from end-2008 until:	(In billions of lei)
End-December 2009 (actual)	2.1
End-March 2010 (performance criterion)	12
End-June 2010 (performance criterion)	12
End-September 2010 (indicative target)	12
End-December 2010 (indicative target)	12

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

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

Stock in general government arrears from the end of previous year	(In billions of lei)
End-November 2009 (stock, actual)	1.40
End-March 2010 (performance criterion)	1.27
End-June 2010 (performance criterion)	1.09
End-September 2010 (indicative target)	0.81
End-December 2010 (indicative target)	0.48
End-April 2011 (indicative target)	0.00

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

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

G. Indicative Target on General Government Current Primary Spending

18. The indicative target on current primary expenditure of the general government is defined as spending on personnel, goods and services excluding EU funds (specified under external grant category), subsidies, transfers to public entities, pensions (social security budget in social assistance category and one-third of the state budget in the same category), state aid and other spending in other transfers category, Reserve Fund, and other expenditure as classified in the monthly reporting tables:

Cumulative change in general government current primary expenditures	(In millions of lei)
End-December 2009 (actual)	85,637
End-March 2010 (indicative target)	32,900
End-June 2010 (indicative target)	65,100
End-September 2010 (indicative target)	97,500
End-December 2010 (indicative target)	131,300

H. Monitoring of Public Enterprises

19. As of 2009, the Ministry of Public Finance, the Ministry of Labor and Social Protection, and other pertinent institutions have implemented a monitoring system of public enterprises. During the program period, information will be provided to document that sanctions—decline in remuneration and dismissal of management according to Ordinances 37/2008 and 79/2008—are imposed if the budgets and company targets for restructuring are not observed.

20. A quarterly indicative target for 2010 will be set on the aggregate operating balance (earnings before interest and tax), net of subsidies, of the following public enterprises: (1) C.N. Cai Ferate CFR; (2) S.N. Transport CFR Calatori; (3) CN a Huilei; (4) SC Termoelectrica; (5) C.N. de Autostrazi si Drumuri Nationale; (6) S.C. Metrorex; (7) S.N. de Transport Feroviar CFR Marfa S.A.; (8) SC Electrocentrale Bucuresti; (9) Societatea Comerciala Electrificare CFR S.A.; and (10) S.C. Administratia Nationala a Imbunatatirilor Funciare. The data shall be reported with operating results by firm. The targets for end-March and end-June 2010 will be RON -1381 million and -2619 million respectively.

I. Reporting Requirements

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

Table 1. Romania: Data Provision to the IMF

Item	Periodicity
To be provided by the Ministry of Finance	
Preliminary monthly data on general government accounts	Monthly, on the 25th day of the following month
Quarterly final data on general government accounts	Quarterly cash data, on the 35th day past the test date Quarterly accrual data, on the 55th day past test date
The budget deficit of the general government using ESA95 definition	Quarterly, with a lag of three months
Preliminary data on below-the-line financing for the general government	Monthly, with a lag of no more than 35 days past the test date
Final quarterly data on below-the-line financing for the general government	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government	Preliminary monthly, within the next month. Quarterly, within 55 days
Stock of the central government external arrears	Daily, with a lag of not more than seven days
Public debt and new guarantees issued by the general government	Monthly, within one month
Preliminary monthly data on general government primary spending, net of EU disbursements	Preliminary monthly data will be reported to the IMF staff within 25 days
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
From 2010, the operating balance, profits, arrears, and personnel expenditures of 10 largest public enterprises by total expenditures	Quarterly, within 55 days
Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month

To be provided by the National Bank of Romania	
NFA data, by components, in both program and actual exchange rates	Weekly, each Monday succeeding the reporting week and with a 3 working day lag in the case of end-quarter data
Monetary survey data in the format agreed with IMF staff	Monthly, within 30 days of the end of the month
The schedule of contractual external payments of the *banking sector* falling due in the next four quarters, interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The schedule of contractual external payments of the *corporate sector* falling due in the next four quarters interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The stock of short-term external debt of banks and corporates	Monthly, 45 days after the end of each month
Balance of payments in the IMF format currently used to report	Monthly, 45 days after the end of each month
Exposure (deposits, loans, subordinated loans) of (i) foreign parent banks to their subsidiaries in Romania; (ii) IFI and (iii) other creditors to banks in Romania (by national and foreign currency).	Monthly, 20 days after the end of each month

II. STRUCTURAL CONDITIONALITY: SPECIFICATIONS

A. Bank Resolution

22. Legal amendments to the bank resolution framework, drafted in consultation with the IMF, will be enacted by end-March 2010 and will include the following elements:

- Banking Law

    a) The credit institutions law will specify a clear trigger for the early and mandatory appointment of a special administrator based on a regulatory threshold.

    b) The special administrator will be granted new authority to implement promptly a broad range of restructuring measures, which shall include purchase and assumptions, sales of assets, and transfers of deposits and the write-down of capital to absorb losses.

    c) The law will authorize the National Bank of Romania to determine the specific powers and tasks of the special administrator among a broad set of powers set forth in the law, which may include broad managerial powers, including those of the Board of Directors, Directorate or Supervision Council

d) The law will provide that purchase and assumptions and sales of assets are not subject to the approval of the credit institution shareholders or of the general assembly of shareholders. To this effect, the law will carve out the application of provisions in the companies law that require the above mentioned approvals, such as when the transfer of assets is substantial.

e) The law will provide legal protection for the special administrator's good faith actions in the performance of his duties.

f) The law will provide greater certainty for bank resolution measures, including purchase and assumptions, sales of assets and transfers of deposits decided or carried out in respect of a credit institution under special administration so that these measures may not be suspended or reversed by litigation (including by means of avoidance powers under the winding-up or insolvency proceedings); it will also clarify that the above measures are not subject to creditors' or debtors' consent.

- Winding up Law

g) The initiation of winding-up proceedings of credit institutions, or of their liquidation under the companies law will require the NBR's prior approval.

h) The law will provide seniority in insolvency to depositors' claims and the same priority ranking to the Deposit Guarantee Fund.

B. Deposit Guarantee Fund

23. The reliance on credit lines in the financing of the Deposit Guarantee Fund will be phased out by increasing the financial resources of the Fund. To this end, the NBR will decide on a gradual reduction in the fees for the credit lines and an increase in the contribution rate to levels to be determined at the time of the 4th review (structural benchmark end-September 2010).

C. Public Wage Legislation

24. Following the organic public wage law approved in October 2009, an implementing legislation will be approved before end-September 2010 that will abide by the following principles:

a. It will ensure the respect of the quantitative targets for the public wage bill included in the organic public wage law and the proposed changes will be fully costed.

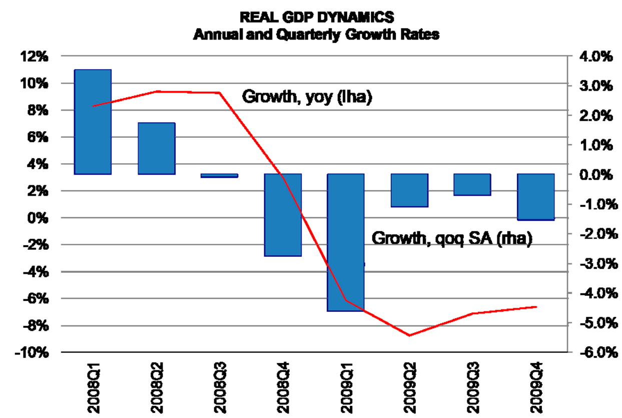
b. It will ensure that new salary grading structure is simplified and that pay will be linked based on job responsibility and qualification. The established new pay system will be benchmarked on private sector wages (through a salary survey) to ensure that public pay is broadly aligned with actual labor market conditions, within affordability constraints.

c. The regulation would phase in a limit of 30 percent on non-wage personnel expenditures with respect to total personnel expenditures and caps on individual bonuses for non-military personnel. For the purpose of this law, “stimulus” payments will be treated as bonuses.

Statement by the IMF Staff Representative
February 19, 2010

This statement reports on economic and policy developments since the staff report was issued on February 5, 2010. The information does not alter the thrust of the staff appraisal.

1. **Real output continued to decline in the last quarter of 2009.** According to the flash estimate, real GDP shrank by 1.5 percent q-o-q (seasonally adjusted) and 6.6 percent y-o-y, bringing the full-year decline to 7.2 percent, roughly in line with staff projections. Short term indicators confirm an incipient recovery in manufacturing, construction and exports, but consumer spending indicators (e.g. retail sales and services) are still declining.



2. **Headline inflation accelerated in January due to one-off factors.** Annual inflation picked up from 4.7 percent in December to 5.2 percent in January, largely on account of increases in excise taxes on tobacco and fuels. These factors were already anticipated in staff projections, the forecast for end-year inflation remains unchanged. Core inflation continued to decelerate on the back of weak domestic demand.

3. **The authorities continue to make progress on key reforms.** Pension reform legislation was approved by the cabinet last week and sent to Parliament for debate and approval (end-June structural benchmark). The draft law addresses significant weaknesses of the current system by improving long-term financial sustainability, while adequately safeguarding the average replacement rate for pensioners.

4. **The authorities are closely monitoring developments in the region.** At this stage, there is little sign of significant spillover effects from dynamics in Greece. The authorities remain comfortable with the level of liquidity and capitalization of local subsidiaries of Greek banks, and do not perceive any increase in financial stress due to recent developments.

INTERNATIONAL MONETARY FUND — EXTERNAL RELATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
February 19, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second and Third Review Under Stand-By Arrangement with Romania and Approves US$3.32 Billion Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second and third reviews of Romania's economic performance under a program supported by a 24-month Stand-By Arrangement (SBA). The completion of the reviews enables the immediate disbursement of SDR 2.18 billion (about €2.45 billion or about US$3.32 billion), bringing total disbursements under the program to SDR 8.26 billion (about €9.32 billion or about US$12.60 billion).

In completing the reviews the Executive Board also approved Romania's request for a waiver of non-observance of the end-December 2009 performance criterion pertaining to the ceiling on the accumulation of general government domestic arrears.

The SBA was approved on May 4, 2009 (Press Release No. 09/148) in the amount of SDR 11.443 billion (about €12.91 billion or about US$17.45 billion). The arrangement entails exceptional access to IMF resources, amounting to 1,111 percent of Romania's quota.

Following the Executive Board's discussion on Romania, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, stated:

"Policy implementation has been strong despite a difficult political and economic environment. Nonetheless, continued efforts to fully implement the economic program remains essential to strengthen macroeconomic stability and provide the basis for strong, sustainable growth.

"Despite recent consolidation efforts, Romania faces major fiscal challenges. The deficit needs to be reduced to stabilize the public debt-to-GDP ratio and to comply with the criteria for accession to the euro area. The 2010 deficit target strikes an appropriate balance between accommodating the still weak economic situation and medium-term consolidation objectives. However, the adjustment strategy entails politically difficult spending decisions and will require strong and steadfast implementation. The authorities are prepared to take additional measures, if necessary, to ensure attainment of their fiscal objectives. Additional reforms to strengthen fiscal controls are crucial, including in expenditure commitments, contingent liabilities, and public entities outside the central government. The authorities are strongly committed to pursue further structural reforms to permanently address the fiscal challenge and improve economic growth. Pension reform, public employment and wage reforms, and improvements in public sector efficiency will be key.

"The inflation targeting regime and flexible exchange rate policy have helped to cushion the impact of the crisis while providing an appropriate anchor for monetary policy. In 2010, the central bank will give priority to bringing inflation within its target band, which will require a cautious approach to further monetary easing.

"The Romanian financial sector continues to weather the crisis well, despite increasing non-performing loans. Continued supervisory vigilance will be necessary to respond to threats to the stability of the system, as well as to possible spillover effects."