INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/113

ROMANIA

May 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; INFORMATIONAL ANNEX; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ROMANIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Romania, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 9, 2016 consideration of the staff report that concluded the Article IV consultation with Romania.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 9, 2016, following discussions that ended on March 15, 2016, 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 April 22, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Romania.

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

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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May 11, 2016

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IMF Executive Board Concludes 2016 Article IV Consultation with Romania

On May 9, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Romania.

The Romanian economy is on a cyclical upswing supported by strong domestic demand. Recent hikes in minimum and public wages, record low interest rates, low fuel prices, and a Value-Added Tax (VAT) reduction have boosted private consumption. A catch-up in absorption of European Union (EU) funds has contributed to an increase in investment. Annual headline inflation turned negative in June 2015 following a sharp reduction in VAT on food items from 24 to 9 percent. However, adjusting for the VAT changes, underlying inflation was 2.4 percent (year-over-year) in March 2016 (Eurostat estimate) despite the recent fall in international commodity prices and low inflation in the euro area. There has been welcome progress in reducing banking sector non-performing loans.

Growth is expected to reach 4.2 percent in 2016—largely due to the one-off stimulus to consumption from the recent fiscal expansion—and decelerate to 3.6 percent in 2017. Underlying inflation is expected to continue growing and the current account deficit to widen further because of import growth.

Two main risks to the economic outlook are electoral and external uncertainties. On the domestic side, populist measures in an election year could negatively affect market confidence and undermine investment. On the external side, a deterioration in emerging market risk perception could trigger capital outflows, a depreciation of the currency, and a substantial increase in the external debt-to-GDP ratio. Maintaining adequate reserve levels, a flexible exchange rate regime, and fiscal buffers will be key in mitigating risks. Improving Romania's long-term growth prospects to close the gap with advanced EU countries will depend on maintaining prudent macroeconomic policies and advancing the pace of structural reforms.

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

Executive Board Assessment[2]

Executive Directors welcomed the significant progress in reducing vulnerabilities after the global financial crisis, notably the marked improvements in fiscal and external balances and in the resilience of the banking sector. Directors observed, however, that there are downside risks to the economic outlook. They also noted with concern the recent procyclical fiscal relaxation, changes in financial sector legislation that could adversely affect financial stability, and the slowdown in structural reforms. Directors underscored the importance of implementing prudent economic policies and regaining the structural reform momentum to preserve Romania's hard-won gains and raise medium-term growth potential.

Directors emphasized the need to ensure fiscal sustainability and the credibility of the fiscal framework. In light of the large fiscal relaxation adopted last year, it is crucial that fiscal policy is anchored on a credible debt reduction path going forward. Repealing the planned tax reductions or postponing them until offsetting measures are identified will help achieve these objectives. Directors also underscored the importance of strengthening fiscal institutions and strictly enforcing fiscal rules and the fiscal responsibility law. They welcomed recent steps to enhance transparency in public spending, and called on the authorities to accelerate complementary reforms to strengthen the spending review unit, pass the procurement law, improve the targeting of social protection schemes, and strengthen public administration more broadly.

Directors highlighted the urgency of stepping up structural reforms to unlock Romania's potential growth, particularly by improving the efficiency of public investment and the business climate. They called for intensified efforts to strengthen the corporate governance of state-owned enterprises—including through passage of the draft legislation in parliament—and improve the planning and utilization of EU funds. Directors also encouraged further reforms in tax administration, focusing on large taxpayers and making tax administration more business friendly more generally. It will also be important that policies on public and minimum wages take into account fiscal space, productivity growth, and competitiveness considerations. Directors commended the authorities for the progress in fighting corruption and encouraged them to address remaining weaknesses.

Directors concurred that a tightening bias in monetary policy is appropriate given current inflation projections. They recommended that the authorities begin reducing the gap between the market and policy rates, absorb liquidity from the market, and further narrow the interest rate corridor, while continuing to enhance the effectiveness of the monetary policy framework.

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

Maintaining adequate international reserves remains crucial in light of elevated uncertainty in global financial markets.

Directors welcomed the significant progress in strengthening the financial sector, particularly in reducing non-performing loans. Priorities going forward are to pursue predictable and market-friendly policies and ensure proper oversight. In this context, Directors cautioned that poorly targeted measures for providing debt relief to borrowers could undermine financial stability, legal predictability, and credit growth. They called on the authorities to reconsider the recently passed measures and to put adequate safeguards in place. Sustained efforts to further deepen financial intermediation are critical to foster private investment and growth.

Romania: Selected Economic and Social Indicators, 2010–17

	2010	2011	2012	2013	2014	2015 Prel.	2016 Proj.	2017 Proj.
Output and prices			(Annual percentage change)					
Real GDP	-0.8	1.1	0.6	3.5	3.0	3.8	4.2	3.6
Contributions to GDP growth								
Domestic demand	-0.7	1.1	-0.4	-0.1	3.2	5.3	6.2	4.8
Net exports	-0.1	-0.1	1.1	3.6	-0.2	-1.5	-1.7	-1.2
Consumer price index (CPI, average)	6.1	5.8	3.3	4.0	1.1	-0.6	-0.4	3.1
Consumer price index (CPI, end of period)	8.0	3.1	4.9	1.6	0.8	-0.9	1.5	3.4
Core price index (CPI, end of period)	4.1	2.4	3.3	-0.2	1.1	-3.1	2.6	3.6
Producer price index (average)	4.4	7.1	5.4	2.1	-0.1	-2.2	...	...
Unemployment rate (average)	7.0	7.1	6.8	7.1	6.8	6.8	6.4	6.2
Nominal wages	2.5	4.9	5.0	5.0	5.3	8.5	9.4	7.1
Public sector wages	-10.8	-2.5	6.8	11.9	2.3	10.1	16.1	5.5
Private sector wages	7.4	7.2	4.4	3.2	6.1	8.0	7.8	7.5
Saving and Investment			(In percent of GDP)					
Gross domestic investment	26.8	27.9	26.8	25.6	25.2	25.6	24.6	24.8
Gross national savings	21.8	22.9	22.1	24.5	24.8	24.5	22.9	22.3
General government finances 1/								
Revenue	31.6	32.1	32.4	31.4	32.0	32.8	30.7	29.5
Expenditure	37.9	36.3	34.9	33.9	33.9	34.2	33.5	32.3
Fiscal balance	-6.3	-4.2	-2.5	-2.5	-1.9	-1.5	-2.8	-2.8
External financing	2.8	2.7	3.2	2.1	1.9	-0.5	1.0	1.3
Domestic financing	3.5	1.5	-0.8	1.4	1.2	1.1	1.5	1.5
Primary balance	-5.0	-2.8	-0.7	-0.8	-0.4	-0.2	-1.5	-1.3
Structural fiscal balance 2/	-6.1	-3.4	-1.7	-1.7	-0.5	-0.7	-3.0	-2.7
Gross public debt (including guarantees)	30.5	33.9	37.6	38.8	40.5	39.3	39.5	40.1
Money and credit			(Annual percentage change)					
Broad money (M3)	6.9	6.6	2.7	8.8	8.4	9.3	9.5	8.0
Credit to private sector	4.7	6.6	1.3	-3.3	-3.3	3.0	4.1	4.6
Interest rates, eop 3/				(In percent)				
NBR policy rate	6.25	6.0	5.25	4.0	2.50	1.75	1.75	...
NBR lending rate (Lombard)	10.25	10.0	9.25	7.0	4.75	4.25	3.25	...
Interbank offer rate (1 week)	3.6	6.0	5.9	1.8	0.7	0.6	0.4	...
Balance of payments			(In percent of GDP)					
Current account balance	-5.1	-4.9	-4.8	-1.1	-0.5	-1.1	-1.7	-2.5
Merchandise trade balance	-7.6	-7.0	-6.9	-4.0	-4.2	-4.8	-5.6	-6.3
Capital account balance	0.2	0.5	1.4	2.1	2.6	2.4	1.5	1.4
Financial account balance	-2.0	-2.0	-2.6	-3.0	0.1	0.8	-0.6	-1.7
Foreign direct investment balance	-1.8	-1.3	-1.9	-2.0	-1.8	-1.7	-1.8	-1.8
International investment position	-62.3	-64.2	-67.8	-61.7	-56.9	-50.9	-48.6	-46.5
Gross official reserves	28.3	27.9	26.5	24.6	23.6	22.1	21.9	21.7
Gross external debt	72.9	74.0	74.6	68.0	63.1	56.7	58.7	56.6
Exchange rates 3/								
Lei per euro (end of period)	4.3	4.3	4.4	4.5	4.5	4.5	4.5	...
Lei per euro (average)	4.2	4.2	4.5	4.4	4.4	4.4	...	...
Real effective exchange rate								
CPI based (percentage change)	2.0	2.9	-6.0	4.7	0.2	-3.7	...	...
GDP deflator based (percentage change)	1.3	1.8	-4.8	4.1	0.9	-0.3	...	...
Memorandum Items:								
Nominal GDP (in bn RON)	533.9	565.1	595.4	637.5	667.6	712.8	757.1	802.5
Potential output growth	2.0	1.9	2.1	2.3	3.0	3.0	3.2	3.3
Social and Other Indicators								
GDP per capita: US$9,995 (2014); **GDP per capita, PPP:** current international $19,801 (2014)								
People at risk of poverty or social exclusion: 39.5% (2014)								

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

1/ General government finances refer to cash data.

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

3/ For 2016: data as of April 20.

INTERNATIONAL MONETARY FUND

ROMANIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

April 22, 2016

KEY ISSUES

Background. Romania made important progress in addressing economic imbalances in recent years. Prudent policies, partly in the context of successive Fund-supported programs, reduced vulnerabilities, and the fiscal and current account deficits improved markedly. However, economic policies have weakened recently and hard-won gains are at risk. Fiscal policy is pro-cyclical and the fiscal deficit is projected to increase substantially in 2016 and remain high in 2017, putting public debt on a gradually rising trajectory. Progress on structural reforms has slowed. Some recently passed measures, and others under consideration in parliament, could threaten property rights and damage the financial sector.

Outlook and risks. Recent stimulus measures have raised cyclical—but not structural—growth. Underlying inflation, adjusted for recent tax reductions, is expected to gradually pick up. Risks to the outlook are tilted to the downside and relate mostly to a possible further weakening of policies in an election year and external uncertainties.

Policy recommendations. Regain the reform momentum, protect hard-won gains, and guard against further weakening of policies in the run up to elections.

- **Fiscal policy**. Anchor fiscal policy on a debt-reduction path and gradually reduce the cash deficit to 1½ percent of GDP by 2018. Strengthen the credibility of fiscal institutions and enhance governance, transparency, and efficiency of public administration.

- **Monetary policy**. Maintain the policy rate for now, but signal a tightening bias and begin to reduce the gap between the market and policy rates by absorbing excess liquidity from the market and narrowing the interest rate corridor.

- **Financial sector**. Sustain improvement in bank balance sheets and safeguard financial stability in the face of legislative initiatives that could undermine it. Support financial intermediation, including through promoting capital market development.

- **Structural reforms**. Sustain recent progress in the fight against corruption. Raise quality of public investment and increase EU funds absorption. Support private investment by making regulations and tax administration more business friendly while supporting revenues. Avoid excessive minimum wage increases in the near future.

Approved By
Thanos Arvanitis and Andrea Richter Hume

Discussions were held in Bucharest during March 2–15, 2016. The mission met with Prime Minister Cioloş, Minister of Public Finance Dragu, other members of the government, National Bank of Romania Governor Isărescu and staff, other senior officials, and representatives of political parties, labor and business organizations, and financial institutions. The staff team comprised R. Baqir (head), A. Hajdenberg, V. Stepanyan, P. Sodsriwiboon (EUR); S. Ahmed (SPR); and L. Forni (FAD). G. Tolosa, G. Babici and V. Barnaure (Resident Representative office) assisted the mission. S. Matei (Senior Advisor to the Executive Director) attended some of the meetings. A. Rhee and C. Rubio (both EUR) provided research and editorial assistance.

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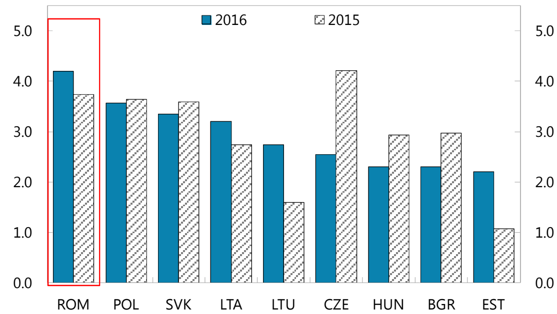
TABLES

ANNEXES

BACKGROUND

1. **Romania made important progress in addressing economic imbalances and restoring growth after the global financial crisis**. Prudent policies, partly in the context of successive Fund-supported programs, reduced vulnerabilities and the fiscal and current account deficits improved markedly. More recently, the banks' non-performing loans (NPL) have begun to come down. Per capita income has surpassed pre-crisis levels as growth has been robust and is projected to be amongst the highest in the region in the near term.

Real GDP Growth (projected)
(Percent)



Sources: IMF *World Economic Outlook*.

2. **However, economic policies have weakened recently and hard-won gains are at risk of being reversed**. Last year, parliament approved measures with broad political support that are projected to substantially increase the fiscal deficit in 2016 and keep it high in 2017. This stimulus was not needed as consumption growth was already strong. It will also reverse the consolidation trend of recent years and put public debt on a gradually rising trajectory. Recent measures to provide relief to distressed borrowers are not well targeted and could threaten property rights and damage the financial sector. Progress on structural reforms has slowed, constraining potential growth. The current technocratic government took office in November 2015 and the window for passing reforms legislation will narrow in the run up to parliamentary elections before end-2016.

3. **Governance problems have received more attention recently and Romania has made progress compared to its peers in the fight against corruption**. Corruption is not only a key socio-economic but also a key macroeconomic issue in Romania (Box 1). In recent years, Romania has been recognized for its progress in the fight against corruption and the anticorruption agency has high public opinion ratings. Romania's position in perception of corruption indicators produced by Transparency International and the World Bank has improved in recent years.

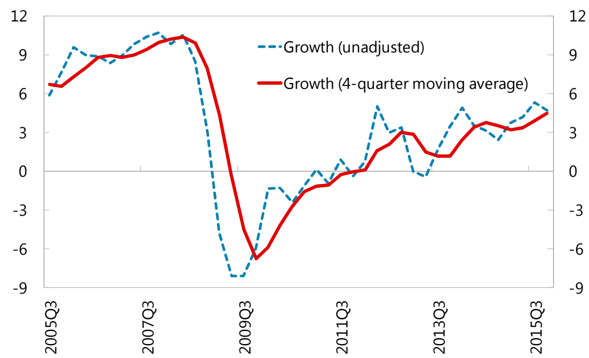
RECENT ECONOMIC DEVELOPMENTS

4. **The economy is on a cyclical upswing supported by strong domestic demand**. The recent growth pickup was driven mainly by private consumption on the back of recent hikes in minimum and public wages. In addition, record low interest rates, low fuel prices, and a VAT reduction on food items supported consumer confidence and demand (Figure 1). Investment has recently shown some signs of a pickup partly related to a catch-up in EU funds absorption and helped offset a weakening of exports in the second half of the year.

5. **Headline inflation has turned negative but underlying inflation—adjusted for recent VAT cuts—is positive and trending up** (Figure 4). Annual headline inflation turned negative in

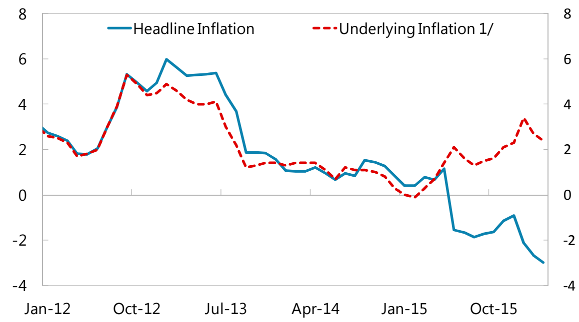
June 2015 following a sharp reduction in VAT on food items from 24 to 9 percent. However, adjusting for the VAT changes, underlying inflation has remained positive and been rising, despite the recent fall in international commodity prices and low inflation in the euro area. Although headline inflation may decline in the coming months due to indirect effects from the recent fall in oil prices and VAT reduction, pressure is building on underlying inflation due to a closing output gap, fast wage growth, and a strong fiscal impulse (Annex VI and Selected Issues Paper).

Real GDP excluding Agriculture
(year-on-year percent change)



Sources: Haver; and IMF Staff Estimates.

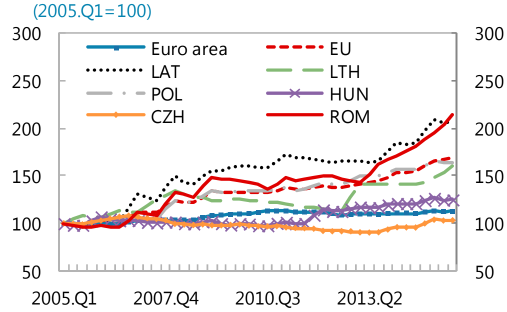
Inflation
(Year-on-year percent change)



1/ Harmonized Index of Consumer Prices (HICP) at constant tax rates.
Sources: Eurostat; and IMF staff estimates.

6. Nominal and real wage growth is accelerating (Figure 3). Overall wages grew by 11.6 percent (y/y) in January 2016, reflecting public wage and minimum wage hikes. Minimum wage is expected to be raised again to 1,250 lei in May 2016 (about €265) from 1,050 lei. These hikes marked a record high for Romania and are the steepest among European peers since 2000. As these exceeded productivity gains, unit labor costs increased by 2.2 percent in 2015 and by 7.6 percent since 2010.

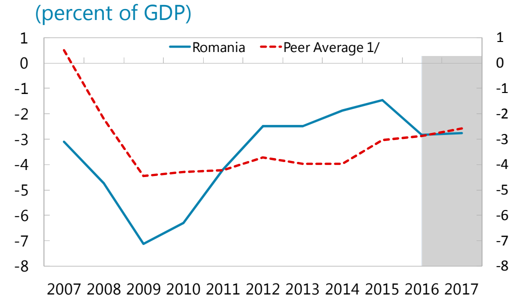
Monthly Minimum Wage 1/
(2005.Q1=100)



Sources: Eurostat, Haver, IMF staff calculations
1/ Data are in real term. Nominal monthly minimum wages are deflated by consumer price indices.

7. The 2015 fiscal deficit maintained the deficit reduction trend of recent years. The general government deficit (on a cash basis) was 1.5 percent of GDP in 2015, compared to 1.8 percent in the original budget. Revenues were 1.3 percent of GDP higher than budgeted as higher income taxes, VAT, and social security contributions more than offset lower EU funds absorption and because of a low base in 2014. Total expenditure was 0.9 percent higher mainly due to personnel spending. Public debt stood at around 40 percent at end-2015. Based on preliminary data, the budget recorded a surplus of

Overall Fiscal Balance
(percent of GDP)



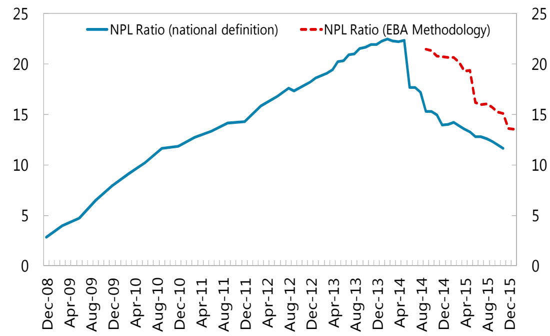
Sources: WEO Live; and IMF staff estimates.
1/ Peer countries include ALB, BIH, BGR, HRV, HUN, UVK, MKD, MNE, POL and SRB.

0.4 percent of GDP in the first quarter compared to 0.7 percent in the same period of 2015. The difference reflects mainly lower VAT revenues.

8. **The current account deficit is small and widened modestly in 2015**. The main drivers of last year's deficit were the increase in goods trade deficit and the almost doubling of primary income deficit due to estimated reinvested earnings and interest related to government payments. FDI inflows improved moderately due to the reinvestment of earnings and the recovery of the economy. Despite large repayments to the Fund and the EU, gross reserves of €35.5 billion at end-2015 were broadly adequate by most reserve adequacy metrics (Annex IV). The current account deficit is projected to gradually widen in 2016–17 as domestic demand grows, and reach around 3.5 percent of GDP over the medium term.

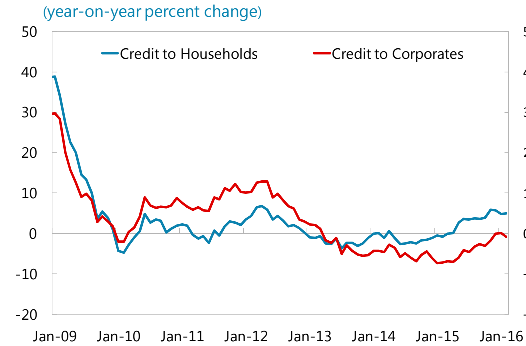
9. **Banks' NPLs have come down markedly and credit is beginning to grow but risks remain**. The NPL ratio fell to 14 percent at end-2015 compared to a peak of 22 percent in 2014Q1 reflecting write-offs and sales prompted by the National Bank of Romania's (NBR) efforts. Credit growth is beginning to turn the cycle, with growth in local currency lending more than offsetting the continued decline in foreign currency lending. The banking system, on average, continues to enjoy comfortable levels of capital adequacy and liquidity, and profitability is improving (Figure 6). Nevertheless, banks remain exposed to credit risk due to FX mismatches in borrowers' balance sheets and market risk related to large bond holdings. During last summer, four Greek-owned Romanian banks experienced substantial deposit withdrawals. The authorities deftly managed the stress episode and deposit withdrawals have largely been reversed. The NBR has also recently introduced additional capital buffer requirements such as a capital conservation buffer, a countercyclical capital buffer (currently set at zero), a buffer for systemically important institutions, and a systemic risk buffer to enhance the set of macro-prudential tools.

Non-performing Loans 1/
(Percent of total loans)



1/ In December 2015, NBR moved from a national definition to an EBA methodology-based definition of NPLs.
Sources: National Bank of Romania; and IMF staff calculations.

Credit Growth
(year-on-year percent change)



Source: National Bank of Romania.

OUTLOOK AND RISKS

10. Staff's baseline projection is for growth to remain above potential in 2016–17. After a near-term cyclical acceleration driven mostly by domestic consumption and a strong fiscal impulse, growth is expected to return gradually to potential. Given slow progress on structural reforms, staff's outlook for potential growth in the outer years remains unchanged from the time of the last Article IV consultation. Underlying inflation is expected to gradually pick up and the current account deficit to widen on import growth. Staff's baseline assumes that the authorities will not exceed 3 percent of GDP deficit in ESA terms (2.8 percent of GDP on a cash basis) as there is a wide level of political consensus to not exceed this threshold, but this would require additional measures.

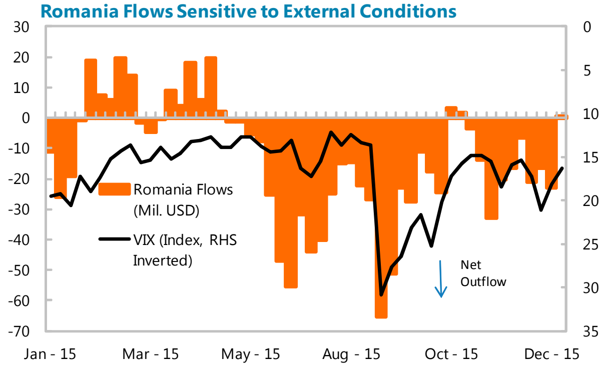
Macroeconomic Outlook
(Percent)

	2014	2015	2016	2017	2018
Real GDP (yoy)	3.0	3.8	4.2	3.6	3.3
CPI inflation (yoy, eop)	0.8	-0.9	1.5	3.4	2.7
Unemployment rate (average)	6.8	6.8	6.4	6.2	6.3
(In percent of GDP)					
Current account balance	-0.5	-1.1	-1.7	-2.5	-2.7
Fiscal balance (cash)	-1.9	-1.5	-2.8	-2.8	-2.8
Gross general government (direct debt only)	38.1	37.0	37.4	38.1	38.7
Gross external debt	63.1	56.7	58.7	56.6	52.7

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

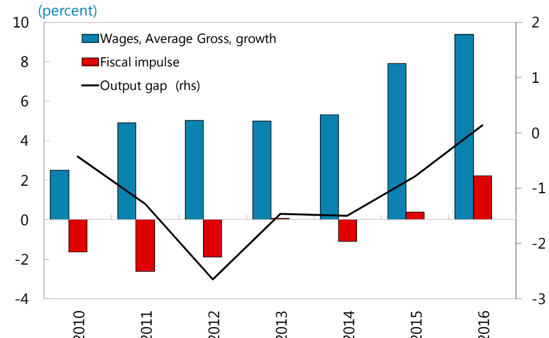
11. Risks to the outlook are tilted to the downside and relate mostly to the pre-electoral environment and external uncertainties (Annex II). Further fiscal stimulus in an election year may boost consumption in the short term but will undermine sustainability of public finances and could dent market sentiment. Inappropriate measures targeting the financial sector that lack proper impact analysis and consultation could harm credit intermediation and investment, and undermine financial stability. On the external side, an abrupt deterioration in emerging market risk perception could trigger currency depreciation and raise the external debt-to-GDP ratio (Annex III). During the recent period of elevated volatility in emerging markets in 2015, Romania experienced sudden capital outflows, though not as pronounced as in regional peers. Maintaining adequate reserve levels, exchange rate flexibility, and fiscal buffers will be key in mitigating risks.

Romania Flows Sensitive to External Conditions



Sources: Flows represent ETFs/Mutual Funds, EPFR.

Output Gap, Wage Growth, and Fiscal Impulse[1/]
(percent)



Source: IMF staff calculations.
1/ Measured as the annual change in the primary structural general government fiscal deficit.

12. Authorities' views. The authorities broadly agreed with staff's views on the near-term outlook and risks but had higher expectations for medium-term growth (above 4 percent during

2017–19). They expected that improved investor confidence and measures to enhance business environment will provide for stronger investment and contribute to higher potential output growth.

POLICY DISCUSSIONS

A. Fiscal Policy

13. Fiscal policy is pro-cyclical and will put public debt on a gradually rising trajectory. The authorities adopted in late 2015 a package of large tax cuts costing 1.4 percent of GDP in 2016 and a further 0.8 percent of GDP in 2017 (table). This includes a reduction of the standard VAT rate from 24 to 20 percent in 2016 and to 19 percent in 2017, and reduction of fuel excises, dividend tax, health contributions and the elimination of the special construction tax.[1] Furthermore, several expenditure-expanding measures were introduced, notably ad-hoc salary increases costing 1½ percent of GDP in gross terms. Reflecting this, staff projects the cash deficit to escalate to 3¼ percent in 2017 under current policies, well above the authorities' cash deficit target of 2.8 percent of GDP for 2016 and 2017.[2] Even if the authorities' deficit path is achieved, public debt will exceed 40 percent of GDP and continue to gradually rise over the medium term.

Revenue Effects from New Tax Code and Public Wage Measures
(percent of GDP)

	2016	2017
New tax code	-1.4	-0.8
Value-added tax	-1.0	-0.4
Excises	0.0	-0.3
Personal Income Taxes	-0.3	0.0
Corporate Income Taxes	-0.1	0.0
Property taxation	0.0	-0.1
Public wage measures (In percent of GDP)	1.0	0.0
Additional spending	1.5	0.0
Additional revenues (mainly social security contributions)	0.5	0.0
Total effect on the budget	2.4	0.8

Sources: Romanian authorities; and IMF staff calculations.

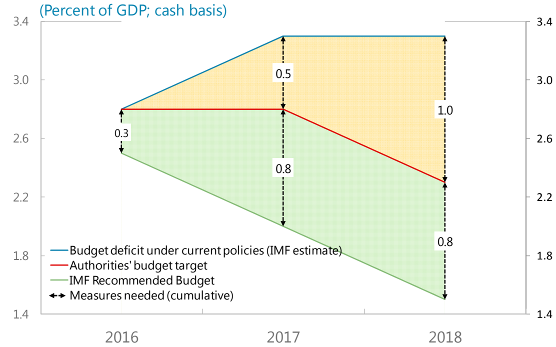
Fiscal Balance Targets
(percent of GDP; cash basis)

	2016	2017	2018
Budget deficit under current policies (IMF estimate)	2.8	3.3	3.3
Authorities' budget target	2.8	2.8	2.3
Measures needed (cumulative)*	0.0	0.5	1.0
IMF-recommended budget	2.5	2.0	1.5
Additional measures needed (cumulative)*	0.3	0.8	0.8

Sources: Romanian authorities; and IMF staff calculations.

* The line "Measures needed (cumulative)" indicates the annual measures starting from 2016 in cumulative terms needed, in the IMF staff's view, to reach the authorities' budget target. The 2017 target of 2.8 percent of GDP in cash terms corresponds to around 3 percent in ESA terms. The last line ("Additional measures needed (cumulative)") indicates in cumulative terms the additional measures needed to bring the deficit from the "Authorities' budget target" to the "IMF-recommended budget."

Fiscal Balance Targets
(Percent of GDP; cash basis)



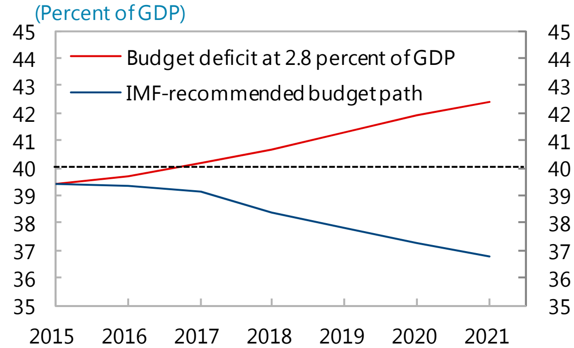
Sources: Romanian authorities; and IMF staff calculations.

[1] The new tax code involves a welcome simplification of taxation legislation and has some small measures with positive revenue effects, including base broadening of social security contributions.

[2] The budget deterioration related to the new tax code and the public wages increases is estimated at about 2.4 percent of GDP in 2016 and 0.8 percent in 2017 as shown in the text table. The increase in the 2016 deficit over 2015 is less than 2.4 percent of GDP mainly because the 2015 deficit incorporated about 1.1 percent of GDP of temporary deficit-increasing factors that will not occur in 2016 and 2017.

14. Fiscal policy should instead be anchored on a well-defined debt-reduction path. The current fiscal stance implies a structural relaxation of 2¼ percent in 2016 and is inappropriate from demand management perspective and, if unaddressed, risks returning Romania to the detrimental pre-crisis pattern. It also moves Romania away from its Medium-Term Objective (MTO) of 1 percent of GDP deficit (Annex V). Moreover, even though the current level of public debt is not high relative to conventional metrics (Annex III), public debt tripled between 2008 and 2015, showing the vulnerability to a sudden deterioration in public finances and the need for adequate fiscal buffers. The importance of keeping debt on a downward path was emphasized in previous Article IV consultations (Annex I).

Public Debt Dynamics
(Percent of GDP)



Sources: National Authorities; and IMF staff calculations.
Note: The line "Budget deficit at 2.8 percent of GDP" is based on a deficit of 2.8 percent of GDP in cash terms (equivalent to 3 percent in ESA terms) from 2016 onwards.

15. Staff recommended gradual adjustment to lower the cash deficit to 1.5 percent of GDP by 2018. The effort should start this year by finding and preserving savings aiming to keep the deficit below 2.5 percent of GDP. For 2017, staff recommended a deficit of 2 percent of GDP. Given relatively low levels of public spending, staff recommends achieving the adjustment by postponing the further tax reductions on VAT and excises scheduled to come into effect next year until other off-setting measures can be identified. This would generate savings of ¾ percent of GDP. As the incremental adjustment recommended for 2017 is ½ percent of GDP, these savings could be used for both achieving the deficit target and addressing other needs such as in the health and education sectors or for the gradual implementation of the unified wage law.[3]

16. Staff supported the government's efforts to bolster efficiency and transparency in government spending and public administration. The authorities have made progress in prioritization of large public investment projects—as recommended by the August 2015 TA mission on public financial management—and the mission recommended extending this to cover medium-sized and local government investments. Steps have also been taken to enhance transparency of spending of public entities and the government plans to widen the use of centralized procurement. Staff recommended early passage of the public procurement law that should help to improve accountability and efficiency of public spending. The government also plans to carry out a spending review and staff recommended that the review start with a few pilot sectors to identify room for efficiency gains (see Selected Issues Paper). Targeting of social protection schemes should be strengthened. The approval of the draft law on natural resource taxation will give certainty on the tax framework.

[3] Recent public wage increases have exacerbated distortions in the remuneration system. Staff has recommended in the past to eliminate these distortions through adopting and gradually implementing a unified wage law in line with available fiscal space.

17. The national and sub-national fiscal rules are sound but their enforcement has been weak, undermining the credibility of the fiscal institutions. The Fiscal Responsibility Law (FRL), fiscal council, and fiscal rule follow European standards (Annex V). However, the budget for 2016, approved outside the context of a program with international financial institutions, breaches the fiscal rule. In order to do so, the budget law waived the provisions of the FRL and of the fiscal rule. There is scope to better integrate the Fiscal Council's work into the decision making of parliament, increase public awareness of the rules, better track the risk of breaching them, and strengthen the automatic sanctions envisaged by the FRL to incentivize responsible parties to apply the rules.

Authorities' views

18. The authorities agreed with the merits of anchoring fiscal policy on a debt reduction path but believed that next year's deficit target was achievable without further measures and that there was little appetite in parliament to reduce the deficit further. The authorities agreed with the importance of finding and preserving fiscal savings and were confident that this year's cash deficit target of 2.8 percent of GDP would be met. For next year, they believed that the deficit target of 2.8 percent was achievable without further measures, unlike under staff projections. They viewed that reducing the 2017 deficit further would require legislative action, such as postponing the further tax reductions on VAT and excises scheduled to come into effect in 2017, for which they expected to find little support in parliament.

B. Structural Reforms

19. A renewed push for structural reforms is needed to improve public and private investment and raise potential growth. These reforms were one of the main focus areas of the most recent Fund-supported program. However, progress was mixed and the program went off track partially because of insufficient progress on structural reforms. While progress has been made to improve governance, other structural reforms have stalled and seem insufficient to raise private investment which remains well below pre-crisis levels. The key challenges are to improve the corporate governance of state-owned enterprises (SOEs), restructure those that have sustained long-standing problems and pose a drain on the budget, raise EU-funds absorption, and improve the investment climate.

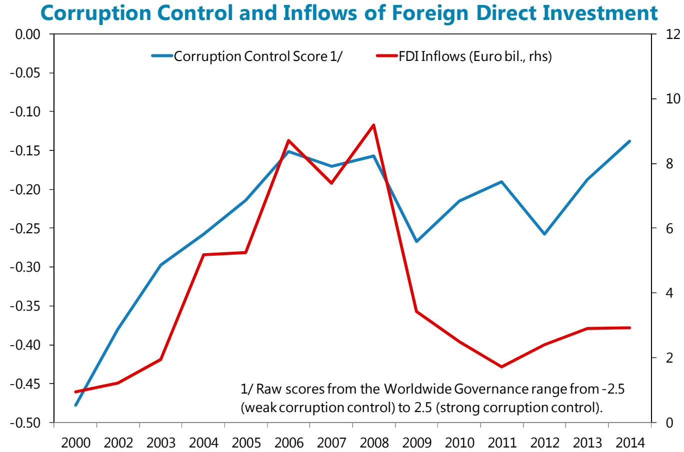
20. Staff welcomed recent progress in the fight against corruption and encouraged continued vigor to address remaining challenges.

- Corruption has been one of the top three obstacles for doing business in Romania according to the World Bank's and EBRD's Business Environment and Enterprise Performance survey, holding back investment and growth. It is also associated with lower tax collections as evidenced by Romania's large VAT gap in the EU (estimated at almost 6 percent of GDP) and misallocation of public resources; in a recent EU survey over half of the companies that participated in a public procurement procedure in the last three years believed there was collusive bidding, conflict of interests in the evaluation of bids, and bribes and kickbacks. Romania is one of two countries in the EU subject to the "cooperation and verification mechanism" to help improve governance.

- The authorities have undertaken several measures to step up the fight against corruption including passage of a new Criminal and Criminal Procedures Code in 2014, stepping up efforts to investigate and prosecute those suspected of corruption—including high profile figures, expediting the judicial process to secure convictions, and measures to enhance the transparency and efficiency of government spending discussed in ¶16. As a result, Romania's ranking in corruption indicators has improved. In its most recent assessment released in January 2016, the European Commission (EC) noted that the "track record of the key judicial and integrity institutions to address high-level corruption has remained impressive."

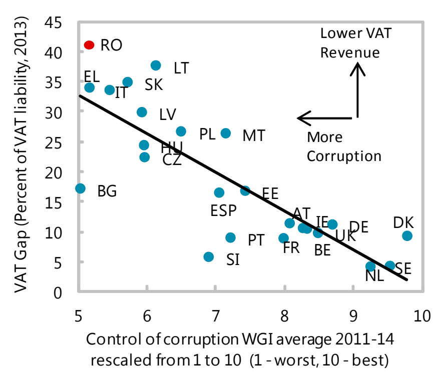
- Notwithstanding this progress, further reforms are needed in the areas of public procurement and allocation of public funding, effectiveness of corruption investigations, establishment of conflict of interest rules, and strengthening the National Integrity Agency's capabilities to monitor asset declarations (Box 1).

Corruption Control and Inflows of Foreign Direct Investment



Sources: World Bank *Worldwide Governance Indicators;* and IMF *World Economic Outlook.*

VAT Collections Gap and Corruption Control

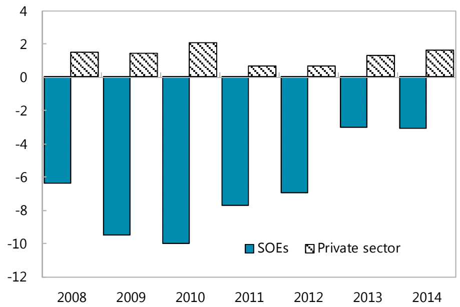


Source: World Bank's Worldwide Governance Indicators (WGI) and European Commission. VAT gap measures the difference between potential and actual VAT collection.

Improving public investment

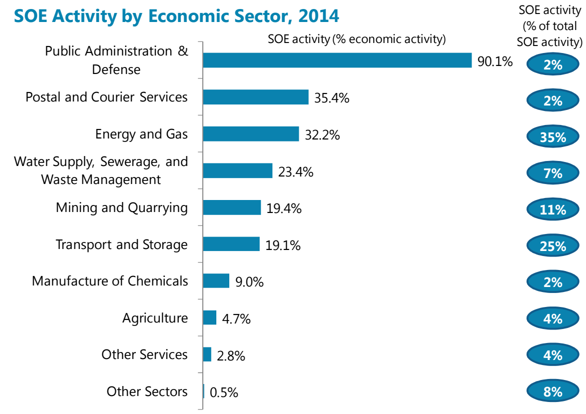
21. Reforms that improve the efficiency of public investment in critical infrastructure sectors are essential for sustainable growth. SOEs play an important role in the major infrastructure sectors and their improved governance as well as larger involvement of private capital in those sectors remain key reform priorities. Staff recommended early adoption and steadfast implementation of the draft legislation on improving corporate governance of SOEs. Staff also advised to accelerate initial public offerings (IPOs) and the privatization program. All SOEs should be put on a firm financial footing. In some cases aggressive restructuring may be required, and in other cases, liquidation. These reforms would help improve the professionalism of SOEs' management and resource allocation, raise profitability, reduce subsidies, and contain contingent liabilities for the state. In the energy sector, market deregulation for non-residential consumers has been largely successful and the deregulation of electricity and gas markets for residential consumers should continue.

Net Profit Margin 1/ 2/
(Percent)



1/ Excludes four highly profitable energy SOEs.
2/ Adjusted for the defense companies arrears clearance in 2014.
Sources: Romanian authorities; and IMF staff estimates.

SOE Activity by Economic Sector, 2014



Sources: Ministry of Public Finance; and IMF staff estimates.

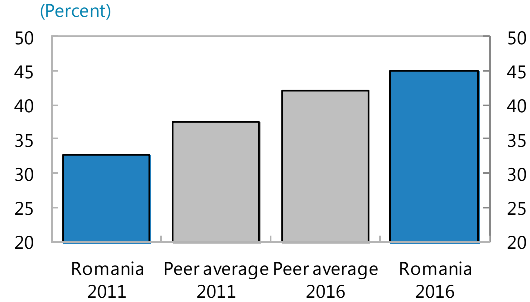
22. Improving absorption of EU funds will boost infrastructure investment. Several actions can help: passing the draft procurement law currently in parliament transposing EU directives, preparing an action plan for the new programming period (2014–20), appropriately preparing documentation to be sent to the EC to avoid delays in processing, and prioritizing projects. Shifting ongoing projects under the previous programming period (2007–13) to the new programming period can increase absorption as some of the steps for their implementation would already have been completed. More generally, there should be a systematic effort to limit domestic financing of projects that qualify for EU funds.

Raising private investment

23. Making regulations and tax administration business friendly will support revenues and help attract private investment, particularly FDI. Overall, Romania ranks 37th out of 189 countries in the 2016 Doing Business rankings (a lower rank signifies better ranking). Nevertheless, there is room for improvement in the areas of construction permits, property registration, protection of minority investors, and tax administration. Regarding the latter, reform efforts should focus on the taxpayers' single window, electronic filing, consolidation of small taxes, online centralized taxpayer database, and improving timeliness of VAT refunds. In addition, revenue collection will improve if the tax administration agency strengthens its risk-based audit system and large taxpayer unit. The authorities have requested further Fund technical assistance to make progress in this area.

24. Minimum wage rises well beyond productivity gains could do more harm than good (Annex VII and Selected Issues Paper). Minimum wage policy can provide protection to low income workers. However, with the sharp hike planned for this year, the ratio of minimum-to-average wage in Romania will surpass the regional average (chart). This may undermine external competitiveness and hamper job creation, particularly for low-skilled labor

Minimum to Average Wage Ratio 1/
(Percent)



Sources: Eurostat; national authorities, and IMF staff calculations.
1/ 2016 data are based on minimum wage increases announced by the authorities and IMF staff projections. "Peer average" refers to the average for 17 regional countries.

and in labor-intensive industries. Staff recommended that the pace of future minimum wage increases be moderate and balance social considerations with competitiveness, productivity growth, and employment prospects. More generally, it would be useful to establish labor market expert committee and periodically reassess the impact of labor market policy including minimum wages.

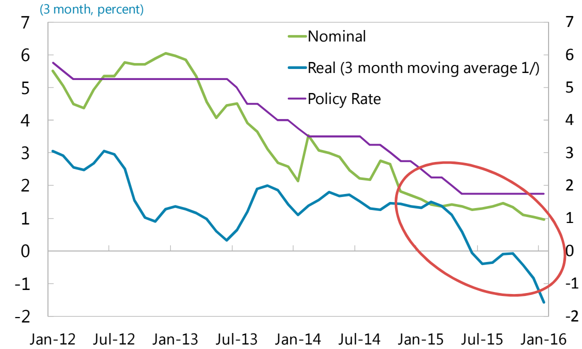
Authorities' views

25. The authorities broadly agreed with staff recommendations and hoped to make progress in pending areas. On corruption they emphasized that Romania should be recognized for the progress it has made in the fight against corruption; many other countries in the region had worse corruption indicators and had made less progress. They were hopeful that amendments to the revised law on corporate governance for SOEs and the draft procurement law would be passed soon by parliament. They noted that prospects for IPOs depended on progress in the legal case regarding one of the SOEs. The authorities broadly shared staff's assessment on minimum wage policy. They have established a working group comprising government officials and social partners to study and make clear guidelines for setting the minimum wage, following the EC's recommendation. The new mechanism will help to improve the transparency in determining the future level of minimum wage. The working group is expected to present the new proposal by May 2016.

C. Monetary Policy

26. Against the backdrop of declining inflation, policy rate cuts provided significant stimulus in recent years. The policy rate has declined from 6 percent in 2011 to the current 1.75 percent. The NBR also narrowed the interest rate corridor, in line with previous staff advice, and further reduced the minimum reserve requirements (MRRs) on both leu- and FX-denominated liabilities. However, there has been a persistent gap between the interbank and the policy rates which could undermine the effectiveness of the monetary policy framework, as also highlighted in past Fund technical assistance. Easy monetary conditions and a sharp increase in government spending in late 2015 have contributed to a buildup of liquidity in the banking system. Real interest rates, adjusting for underlying inflation, have turned negative.

Interbank Offer Rates
(3 month, percent)

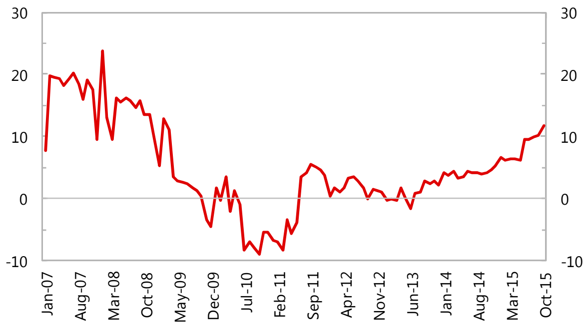


Sources: Haver; Eurostat; National Bank of Romania; and IMF staff calculations.
1/ Computed using the underlying inflation rate, adjusted for VAT changes.

27. While headline inflation is currently negative, underlying inflation, adjusted for recent tax changes, has been rising. Given strong domestic demand, a closing output gap, the large fiscal impulse, and significant wage growth, headline inflation (without policy action) is expected to rise to close to 3½ percent, the upper bound of the variation band of the inflation target, by end-2017 under staff and NBR projections.

Real Wage Growth

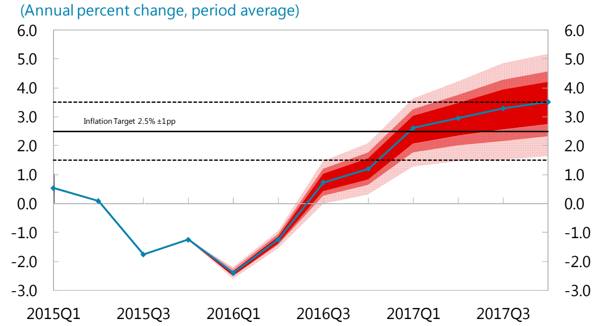
(Percent)



Sources: Haver Analytics; and IMF staff calculations.

Inflation Projections 1/

(Annual percent change, period average)



Sources: INS; and IMF staff estimates.

1/ The uncertainty interval was calculated based on the annual CPI inflation forecast errors for Romania from the IMF *World Economic Outlook* during April 2003-October 2015, following the methodology described in Elekdag and Kannan (2009).

28. Under current inflation projections, staff recommended leaving the policy rate unchanged for now but to begin to reduce the gap between the policy and interbank rates. Given current negative headline inflation, low expected imported inflation, and the uncertainty around inflation expectations, the policy rate can be left unchanged until projected inflation moves more clearly above target. Nonetheless, the NBR should consider signaling a tightening bias and begin to reduce the gap between the market and policy rates by absorbing liquidity and narrowing the interest rate corridor; this will also strengthen the monetary policy framework. Given the large pro-cyclical fiscal impulse, monetary policy may need to shoulder some of the burden for managing domestic demand.

29. In staff's view the Romanian leu is broadly in line with medium-term fundamentals (Annex IV). Staff's overall assessment is that Romania's external position in 2015 was broadly in line with fundamentals. Reserve coverage is broadly adequate according to most reserve adequacy metrics. In line with staff recommendations, the NBR limited interventions in 2015 compared to the previous year. However, the excess liquidity in the domestic market and worsening of global sentiment prompted it to increase FX sales in the latter part of 2015 and in early 2016.

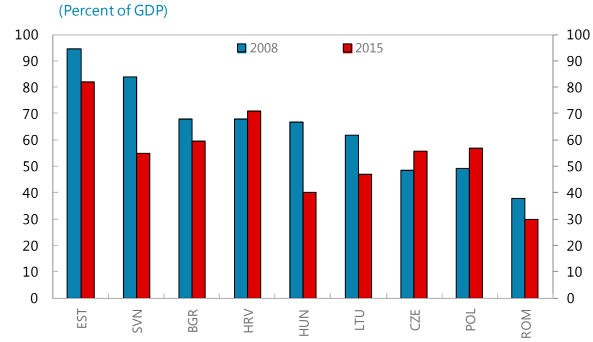
Authorities' views

30. The authorities noted that monetary policy decisions would depend on NBR Board's views regarding inflationary pressures and impact on financial markets. They agreed that inflation projections had risen and were approaching the upper bound of the variation band of the inflation target in 2017. Nevertheless, they also pointed out that in the current regional environment of low rates, monetary tightening may prompt short-term capital inflows and hence their preference for a gradual approach to policy normalization. The authorities also shared staff's view that the Romanian currency is broadly in line with its equilibrium level. They recognized the importance of maintaining adequate reserves, particularly against heightened uncertainty in international financial markets.

D. Financial Sector

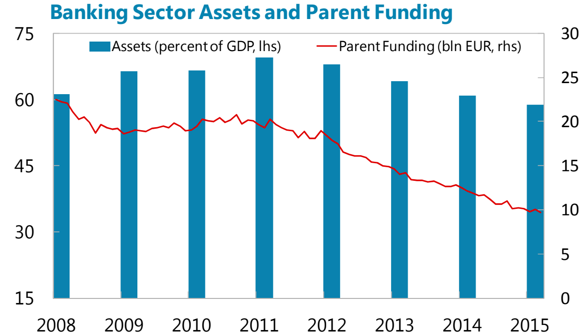
31. The authorities need to sustain their efforts to improve bank balance sheets and resist measures that could undermine the stability of the banking system and legal predictability. The recent reduction in NPLs is welcome, and efforts to encourage write-offs and sales of distressed assets should continue. A key near-term risk to bank balance sheets is legislative initiatives that would allow unilateral and retroactive changes to contracts. In April 2016, parliament adopted with broad support a law allowing consumers to unilaterally discharge any debt owed to banks that is collateralized by residential real property through the transfer of the collateral to the creditor ("Giving in Payment" law; Box 2). The intended relief to distressed borrowers is not well targeted and the retroactive application of the law could negatively affect bank balance sheets, undermine private property rights, legal predictability and investor sentiment, and curtail credit provision. Debt relief to distressed borrowers should be targeted including through stringent eligibility requirements while respecting the sanctity of contracts and all such mechanisms should be subject to adequate safeguards. Staff expressed similar concerns about the forced conversion of foreign-currency denominated loans being considered in parliament that would also entail a retroactive change in contracts. In this regard, the authorities should also revisit some elements of existing legislation on abusive clauses in order to dispel another important source of uncertainty, while securing fairness for all stakeholders. Finally, staff recommended putting in place the necessary prerequisites, such as the adequate institutional infrastructure, implementing regulations, or operational systems (e.g., templates), for implementing the recently adopted personal insolvency law.

Private Sector Credit in Selected European Countries
(Percent of GDP)



Sources: Haver Analytics, IMF staff estimates.

Banking Sector Assets and Parent Funding

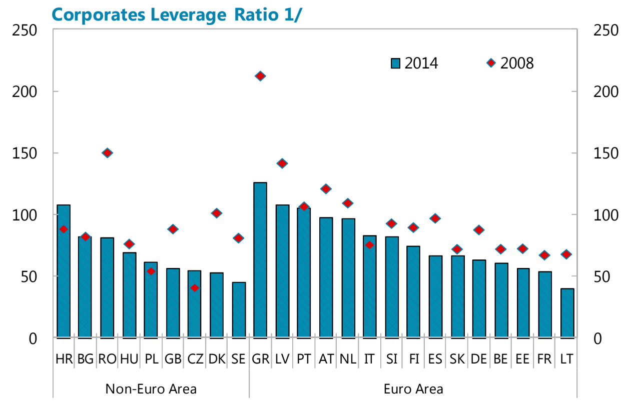


Sources: Haver Analytics; and National Bank of Romania.

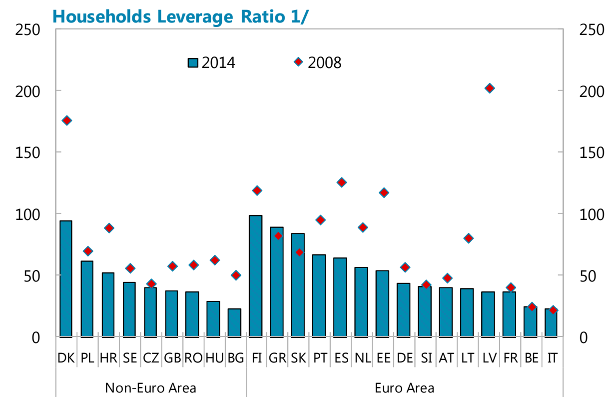
32. A key medium term challenge is to raise financial intermediation to better serve growth needs. Romania has one of the lowest ratios of private credit to GDP in the region and relatively moderate levels of corporate and household debt. Staff analysis suggests that both supply and demand factors have been at play since the 2008 global financial crisis.[4] More recently, non-financial corporations' indicators point to some improvement in liquidity and profitability ratios and household incomes have been on the rise. Nonetheless, raising intermediation is important to help support investment and will require Romania to boost domestic deposits and develop alternative sources

[4] See Selected Issues Paper for a detailed discussion on financial sector developments and macro-financial linkages in Romania.

of funding for banking sector absent renewed flows from parent banks. The implementation of the recently adopted new covered bond law should contribute to the development of long-term bank funding and intermediation, albeit the "Giving in payment" law enforcement may jeopardize covered bonds issuance. Sustaining the recent progress in NPL reduction will support banks' ability to cater to credit demand. Results of the ongoing asset quality review would be helpful in this regard to identify the scope of further effort needed in this area.



1/ Non-financial Corporations Financial Debt to Equity ratio.
Sources: Eurostat; and IMF staff calculations.



1/ Households Debt to Net Financial Assets ratio.
Sources: Eurostat; and IMF staff calculations.

33. Significant progress has been made on restructuring the Financial Supervisory Authority (FSA) and strengthening its intervention and resolution tools. This should help address challenges in the insurance sector. The FSA recently implemented comprehensive balance sheet reviews and stress testing exercises which covered virtually the whole insurance sector. The balance sheet reviews revealed a number of deficiencies including capital shortfalls in several insurance companies. The largest insurance company entered bankruptcy in late 2015, while another major insurance company is currently under resolution. Staff welcomed recent progress to strengthen the FSA, including the adoption of recent legislation that strengthens its intervention and resolution tools, and encouraged it to address the revealed shortfalls to ensure adequate capitalization in the insurance sector.

Authorities' views

34. The authorities broadly agreed with staff's views. They shared staff's concerns regarding the potential impact of harmful legislative initiatives and mentioned additional capital buffers as a possible contingency measure. They expressed commitment to further improve the quality of financial intermediaries' portfolios and ensure that both bank and non-bank financial institutions hold adequate capital. They also agreed that increasing financial intermediation is an important objective for the medium term including through promoting capital market development.

STAFF APPRAISAL

35. Romania made important progress in reducing vulnerabilities after the global financial crisis but the recent weakening of policies puts the gains at risk. The fiscal and current account deficits have improved markedly since the global financial crisis and banks' loan portfolio quality has strengthened. Stronger policies and fundamentals have helped Romania achieve robust growth and avoid pressures from elevated market volatility. It is important that sound policies and reforms continue to sustain strong and inclusive growth, at a time that downside risks have increased.

36. Fiscal policy needs to put public debt on a downward trajectory. Romania achieved impressive fiscal consolidation since 2009—one of the largest amongst peers. However, the large fiscal relaxation approved last year provides stimulus when consumption growth is already strong. If no further measures are taken, next year's fiscal deficit will likely breach the EU's excessive deficit procedure (EDP) threshold. Even if the deficit is kept at the authorities' cash budget target of 2.8 percent of GDP (3 percent in ESA terms), public debt will exceed 40 percent of GDP and continue to gradually rise. Instead, gradual adjustment to reduce the cash deficit to 1½ percent of GDP by 2018 will help keep debt on a downward path. Postponing the tax reductions scheduled to come into effect in 2017 will help achieve this goal.

37. More broadly, the credibility of fiscal institutions should be strengthened. The waiving of the provisions of the FRL and the fiscal rule undermines the credibility of the policy framework and the budget process. In this regard, it is important that the work of the Fiscal Council is integrated better into decision making.

38. Reforms should be accelerated to make public administration more efficient and transparent. These reforms include further progress in prioritization of public investment projects, fully operationalizing the recently created spending review unit, strengthening targeting of social protection schemes, extending centralized procurement to generate savings, and passage of the public procurement law. Recent efforts to enhance transparency of spending of public entities are welcome and should help to improve accountability and efficiency of public spending. Early passage of legislation on natural resource taxation will help to give certainty on the tax framework.

39. Continued structural reform efforts are needed to improve public and private investment and raise potential growth. The efficiency of public investment in critical infrastructure sectors can be enhanced by strengthening the corporate governance of SOEs—including through the passage of draft legislation in parliament—and better planning and utilization of EU funds. The tax administration agency should focus more on high revenue potential tax payers while becoming more business friendly. Reforms need to focus on taxpayers' single window, electronic filing, consolidation of small taxes, online centralized taxpayers' database, and improving promptness of VAT refunds.

40. There has been welcome progress in the fight against corruption and more needs to be done. Improving governance and the fight against corruption are not only key socio-economic issues, they are also macro-relevant in Romania. The anticorruption agency enjoys growing public confidence and efforts in this direction should be sustained.

41. Policies for public and minimum wages should take into account fiscal space and competitiveness considerations. On public sector wages, there is a need to eliminate the distortions in the remuneration system. Current budget plans do not provide fiscal space for the unified wage law that would help address these distortions. Postponement of the 2017 tax reductions would provide space for the phased implementation of this law. On minimum wage, moderating the pace of future increases will help balance social considerations with competitiveness, productivity growth, and employment prospects.

42. A tightening bias in monetary policy is warranted on current inflation projections. Inflation projections have risen to the upper bound of the variation band of the central bank's inflation target on account of a closing output gap, sharp wage increases, and the fiscal stimulus. While the policy rate can be left unchanged until projected inflation moves more clearly above target, the NBR should begin to reduce the gap between the market and policy rates by absorbing liquidity from the market and narrowing the interest rate corridor. Interventions in the foreign exchange market should be limited to smoothing excessive volatility.

43. There has been important progress in reducing NPLs and threats to financial stability need to be guarded against. Sustained efforts towards reducing NPLs are welcome. Removing provisions in legislative initiatives that could undermine financial stability and legal predictability, and finding better ways to target relief to distressed borrowers, will mitigate risks. Increasing financial intermediation while maintaining financial sector stability will support growth needs.

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

Box 1. Romania's Recent Anticorruption Campaign

Corruption issues are highly macro-relevant in Romania. They affect three areas in particular: government revenues, government expenditure, and competitiveness and FDI.

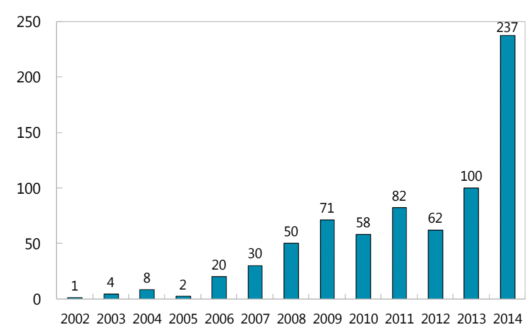
i) **Corruption undermines government revenue**. It can lead to foregone tax revenue, as evidenced for example by Romania's VAT gap being the largest in the EU. Corruption is also associated with larger unofficial activity. The size of the shadow economy in Romania was estimated to be 28 percent of GDP in 2014, which is the second highest percentage in the EU. A large shadow economy leads to reduced state revenues which in turn reduce the quality and quantity of goods and services publicly provided.

ii) **Corruption can lead to a suboptimal composition of government expenditure**. It induces government officials to choose expenditure on the basis of opportunities for inflating spending and obtaining more rents instead of public welfare. Thus, it can bloat the budget for domestically financed capital spending with low effectiveness as shown by the slow pace of infrastructure deployment (see the 2015 Selected Issues Papers). Public procurement represents an important share of the Romanian economy. Public works, goods and services constituted about 12 percent of GDP in Romania in 2015 and, as shown by a number of external audits, there is still a general perception of high levels of corruption. The deficient application of public procurement rules triggers substantial financial corrections and contributes to a low absorption of EU funds. As highlighted by the EU anticorruption report, businesses report a number of widespread practices, including the involvement of bidders in the design of proposal specifications, conflicts of interest in the evaluation of bids, specifications being tailor made for particular companies, and the abuse of noncompetitive or fast-track procedures. There is a high perception that public funds are being diverted and frequent experiences of irregular payments and bribes. An earlier World Bank survey showed that state sector entities with better systems of public administration tended to have lower levels of corruption.

iii) **Finally, corruption depresses foreign direct investment and is a key obstacle to Romania's competitiveness**. Corruption is one of the top three obstacles for doing business in the World Bank's and EBRD's Business Environment and Enterprise Performance survey. At a cross-country level several studies have demonstrated the negative effects of corruption on growth. Ugur (2014) shows that corruption has a negative effect on per-capita GDP growth, even after controlling for possible biases in the underlying empirical analyses. Ugur and Dasgupta (2011) find that a one-unit improvement in the perceived corruption index can lead to an increase of 0.59 to 0.86 percentage-points in the growth rate of per-capita GDP, depending on the sample of countries analyzed.

Romania has recently been recognized for its anticorruption efforts and these efforts should be sustained. The country's anticorruption agency (DNA) has increasingly been recognized by international agencies and in international media for its fights against corruption. In its most recent assessment released in January 2016, the EC described the "track record of the key judicial and integrity institutions to address high-level corruption has remained impressive."

DNA Announcements of the Politically-Connected Cases



Source: Political Corruption in Romania, *DNA Database.*

Box 1. Romania's Recent Anticorruption Campaign (concluded)

In the course of 2015 alone, DNA indicted over 1,250 defendants, and this included the prime minister, former ministers, members of parliament, mayors, presidents of county councils, judges, prosecutors and a wide variety of senior officials. It has also increased its interim asset freezing measures relating to these cases, to reach a figure of €452 million. Anecdotal reports suggest that one reason behind last year's investment under-spending was fear of being caught in the recent anticorruption effort. Public confidence in the institution has jumped, as also reflected in opinion polls.

Romania needs to do more in its anticorruption fight and sustaining recent momentum will have big payoffs. The most recent CVM report stressed that while there have been steps to tackle general corruption, further consolidation of reform is needed to ensure the irreversibility of progress. The report suggests strengthening of prevention and control mechanisms with regard to public procurement and public contracts, including in state-owned companies, as well as strengthening safeguards when it comes to allocation of public funding. Similarly, in its January 2016 Report, the Council of Europe's Group of States against Corruption (GRECO) commended the country's progress in enhancing the anticorruption framework. It nevertheless recommended several anticorruption measures, including the provision of a transparent system for lifting parliamentary immunity for corruption investigations, establishment of conflicts of interest rules for parliamentarians, and strengthening the National Integrity Agency's capabilities to monitor asset declarations. Finally, ensuring that the AML/CFT regime with respect to domestic politically exposed persons is in line with the international standard and effectively implementing AML/CFT tools could also support efforts to prevent, deter and detect laundering of corruption proceeds.

Making progress on anticorruption will directly support many of the Fund's policy recommendations and, vice versa, many of the Fund's policy recommendations will help with the anticorruption efforts. Anticorruption and, more broadly governance, is an overarching issue that would support progress in many of the Fund's recommendations. It would support spending efficiency, particularly in the health and education sectors, as discussed in the accompanying Selected Issues Paper. Adopting procurement reform will similarly go hand in hand with the anticorruption efforts. The Fund's recommendations for a unified wage law would help reduce the incentives of public employees to seek compensation through corruption. Improving the corporate governance of the SOE sector would help reduce a big source of patronage, improve efficiency, and allow saved public resources to be used elsewhere. Finally, bringing tax evaders in the tax net will allow the government to reduce the pro-cyclicality of the budget, help resume the deficit reducing trend, and raise the incentive of those already in the tax net to contribute their share.

Box 2. Debt Discharge (Giving in Payment) Law

The Romanian banking sector faces risks associated with potentially harmful legislative initiatives that allow unilateral and retroactive change of contracts. One such initiative is the law on the discharge of debt obligations assumed through credit agreements through the transfer of mortgaged property ("Giving in Payment" law). The law was first approved by the parliament in November 2015; however, President Iohannis sent the bill back to the parliament for reconsideration. In April 2016 the parliament approved the law in a final vote.

The "Giving in Payment" law contains a number of controversial provisions that could be potentially detrimental to the economy. While the law was presented as a measure to help distressed households with mortgages, Romanian banks and the NBR have argued that some of the provisions can create legal uncertainties and moral hazard and may pose systemic risk to banks. The law permits consumers as well as their co-debtors and pledgors meeting the following criteria to discharge their loans in entirety through the transfer of the collateral to the creditors: (i) the loan is less than 250,000 euros at origination; (ii) the loan is collateralized by residential real property; and (iii) the creditors are credit institutions, non-bank financial institutions or their assignees. Should the right be exercised by the debtor, the creditor would no longer have recourse to any other assets or income of the debtor beyond the pledged collateral in case of any deficiency claim. The law applies not only to new loans but also to existing ones, including in situations where property was foreclosed in the past or foreclosure proceedings are ongoing. It does not specify any other economic or other eligibility criteria for borrowers and does not appear to take into account the borrower's ability to pay. The ECB noted that the draft law introduces unprecedented changes into the legal framework applicable to credit agreements in Romania and will significantly undermine legal certainty and the adequate management of credit risk in financial institutions.[1] The EC in its latest country report on Romania has also expressed major concerns including regarding the retroactive applicability of the law.

The application of the law may lead to substantial losses for banks and undermine payment culture and future access to credit. While it is hard to provide reliable estimates of the potential impact of the law due to both legal and behavioral uncertainties, some available data allows gauging the possible magnitude of such an impact. The amount of overdue loans which would be eligible for an application under the law is not very high at around RON 5 billion which could be the lower limit of the amount the banks would have to write-off (the write-offs would be smaller by the amount of provisions for overdue loans but such data was not available). In addition, there may be "underwater mortgage" cases where borrowers who are still current on their payments, and have the ability to continue making payments, may choose to use the provisions of the "Giving in Payment" law to receive a discharge of any deficiency claim and transfer the entire collateral risk to the bank. A hypothetical assumption of 20 percent of total loans being loans where borrowers decide to take advantage of the law because they have "underwater mortgages" would add RON 8 billion to the amount of possible write-offs. Thus, the amount of potential write-offs could be in the range of RON 5–13 billion. Applying a further assumption that the banks incur a loss of 25 percent of the loan value when they sell the underlying immovable property, the overall loss to banks could be in the range of RON 1.3–3.3 billion (up to 4 percent of commercial banks total capital). These estimates could be higher if there is significant use of "Giving in Payment" law. The banks will also incur additional operational expenses in order to manage and sell the portfolio of immovable property that they will take on their balance sheets. Besides the direct impact of the law on bank balance sheets, a key negative spillover from the law would be that it could undermine future credit expansion and investor confidence by making the legal framework less predictable. There are also risks that contingent liabilities are created for the state in case banks go to courts and claim compensation from the Romanian state.

Mortgage-Backed Loans 1/
(end-February 2016)

	Residential mortgages	Housing development	Consumer loans	Total
Loan agreements (thous.)	99.0	75.8	168.3	343.2
Number of loans overdue 30+ days (thous.)	4.7	4.8	17.6	27.1
Outstanding loans (billion lei)	15.7	10.2	20.9	46.8
Loans overdue 30+ days (billion lei)	0.9	0.9	3.0	4.7
Share of overdue loans (percent)	5.9	8.5	14.1	10.1

Sources: National Bank of Romania; and IMF staff calculations.
1/ Excludes loans extended under Prima Casa and loans with amounts in excess of euro 250,000 at origination.

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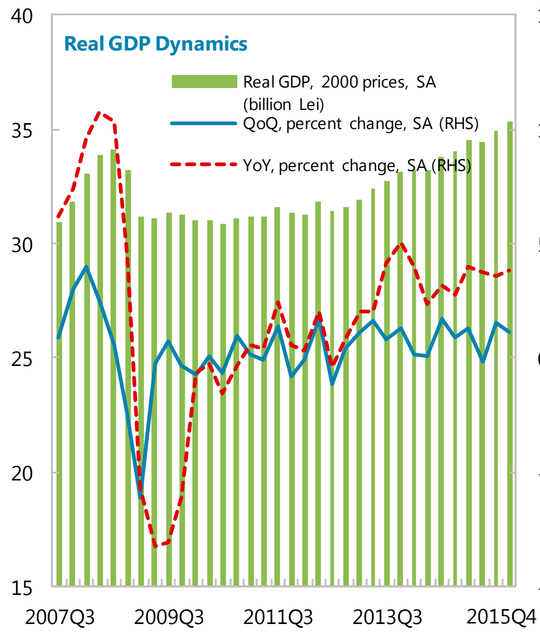
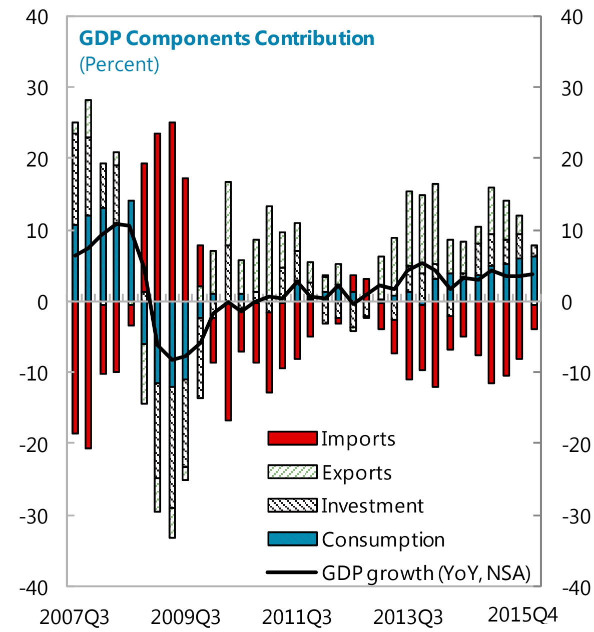
[1] See ECB opinion of December 18, 2015: https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2015_56_f_sign.pdf.

Figure 1. Romania: Real Sector, 2007–16

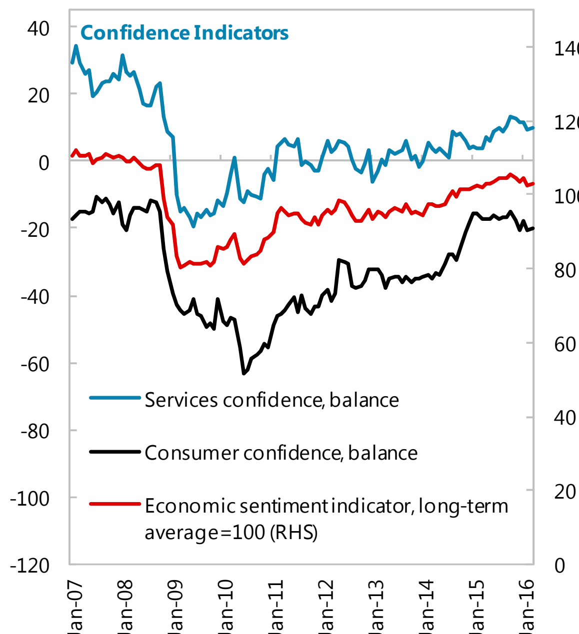
The economic recovery has firmed...



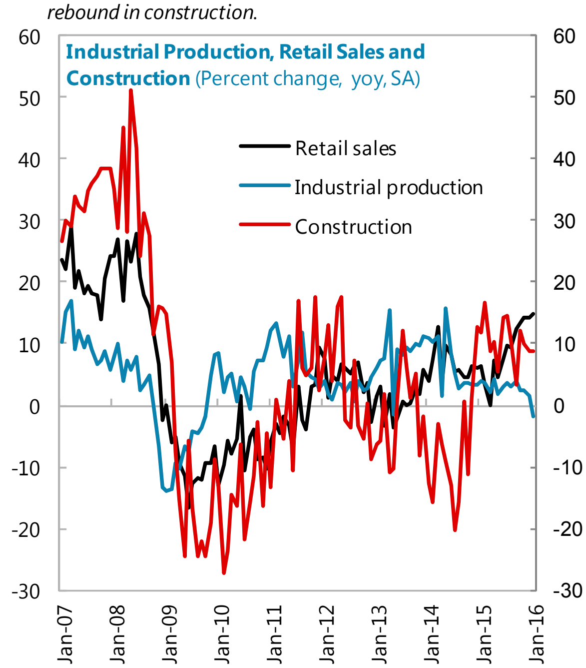
...as domestic demand revived, mainly driven by consumption growth.



Consumer and economic confidence indicators are approaching pre-crisis levels...



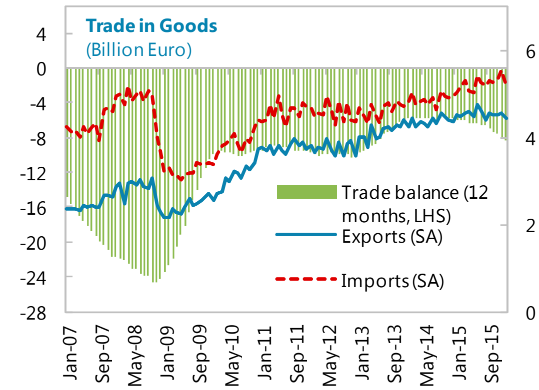
...which supports a firmer recovery in retail sales and a rebound in construction.



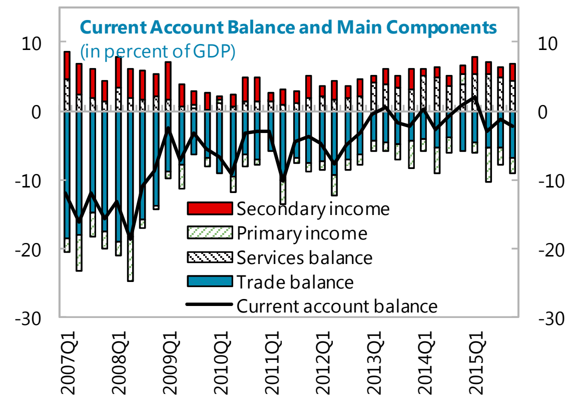
Sources: Haver Analytics; and IMF staff calculations.

Figure 2. Romania: External Sector, 2007–16

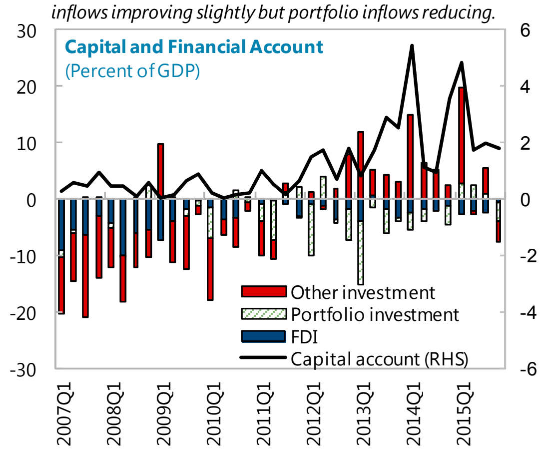
The trade balance in goods deteriorated in 2015 due to a pickup in imports and slowdown in export growth.



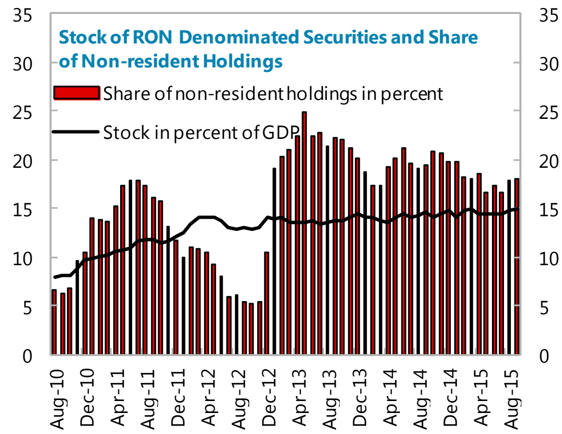
The current account deficit widened moderately in 2015 due to the increase in deficit in goods and primary income.



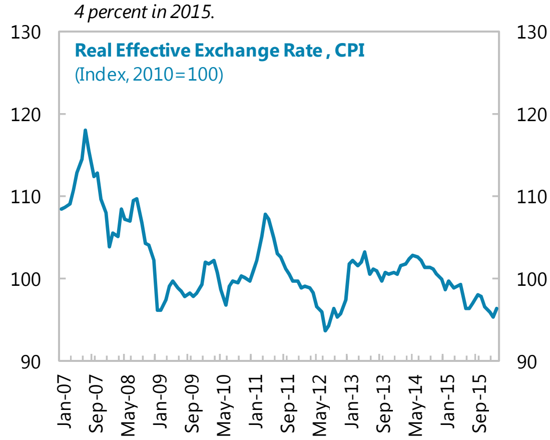
The public and private inflows were moderate, with FDI inflows improving slightly but portfolio inflows reducing.



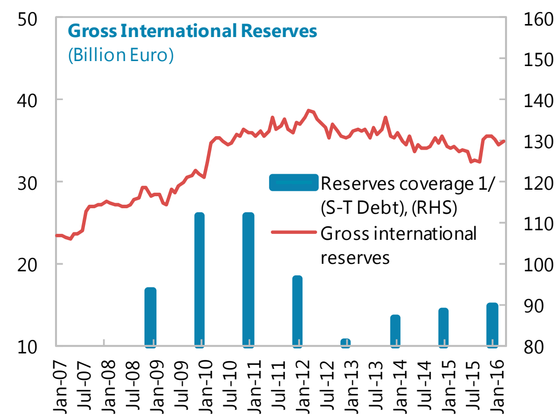
Non-resident holdings of government debt remained stable.



The real exchange rate has depreciated around 4 percent in 2015.



Foreign reserve coverage remains broadly adequate.

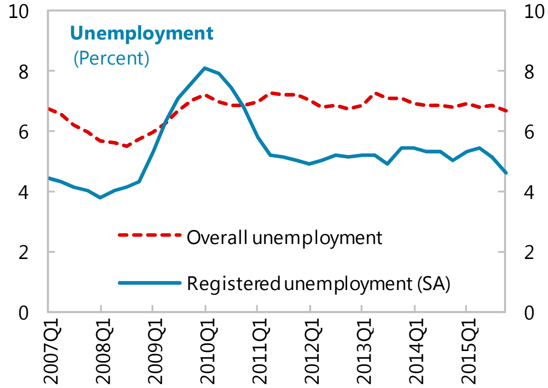


Sources: Haver Analytics; National Bank of Romania, IMF Information Notice System (INS); and IMF staff calculations.

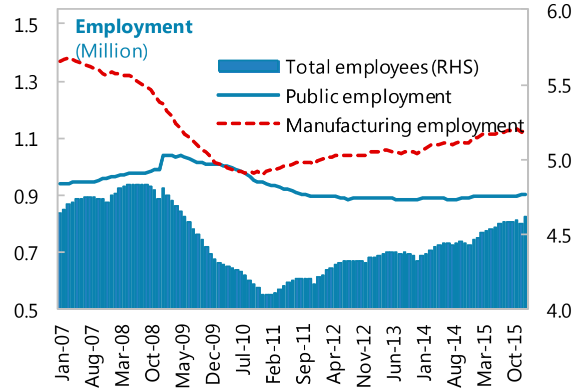
1/ Reserves coverage is based on end-of-year data.

Figure 3. Romania: Labor Market, 2007–16

Overall unemployment remains little changed over the last several years.

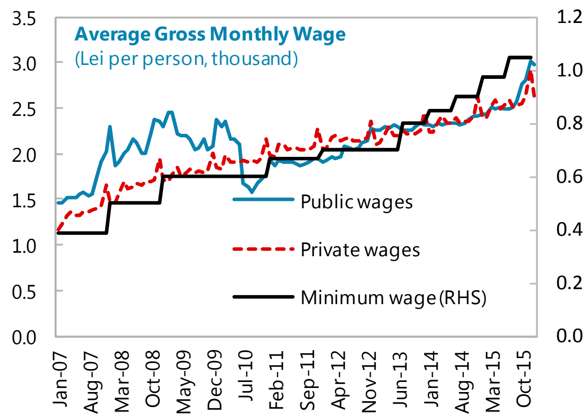


Total employment has been recovering, while public employment remains below pre-crisis levels.

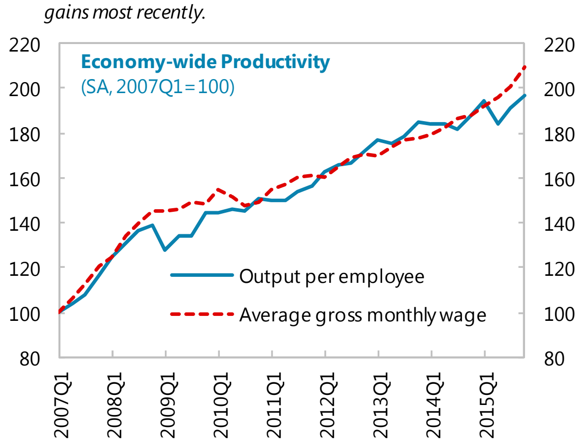


Real wage growth has been on an upward trend in the past two years.

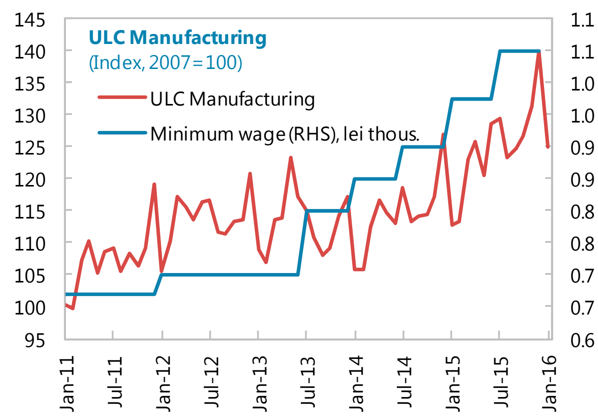
Minimum wages have sharply increased and public wages, which were cut during the crisis, have been restored.



Wage increases exceeded the economy-wide productivity gains most recently.



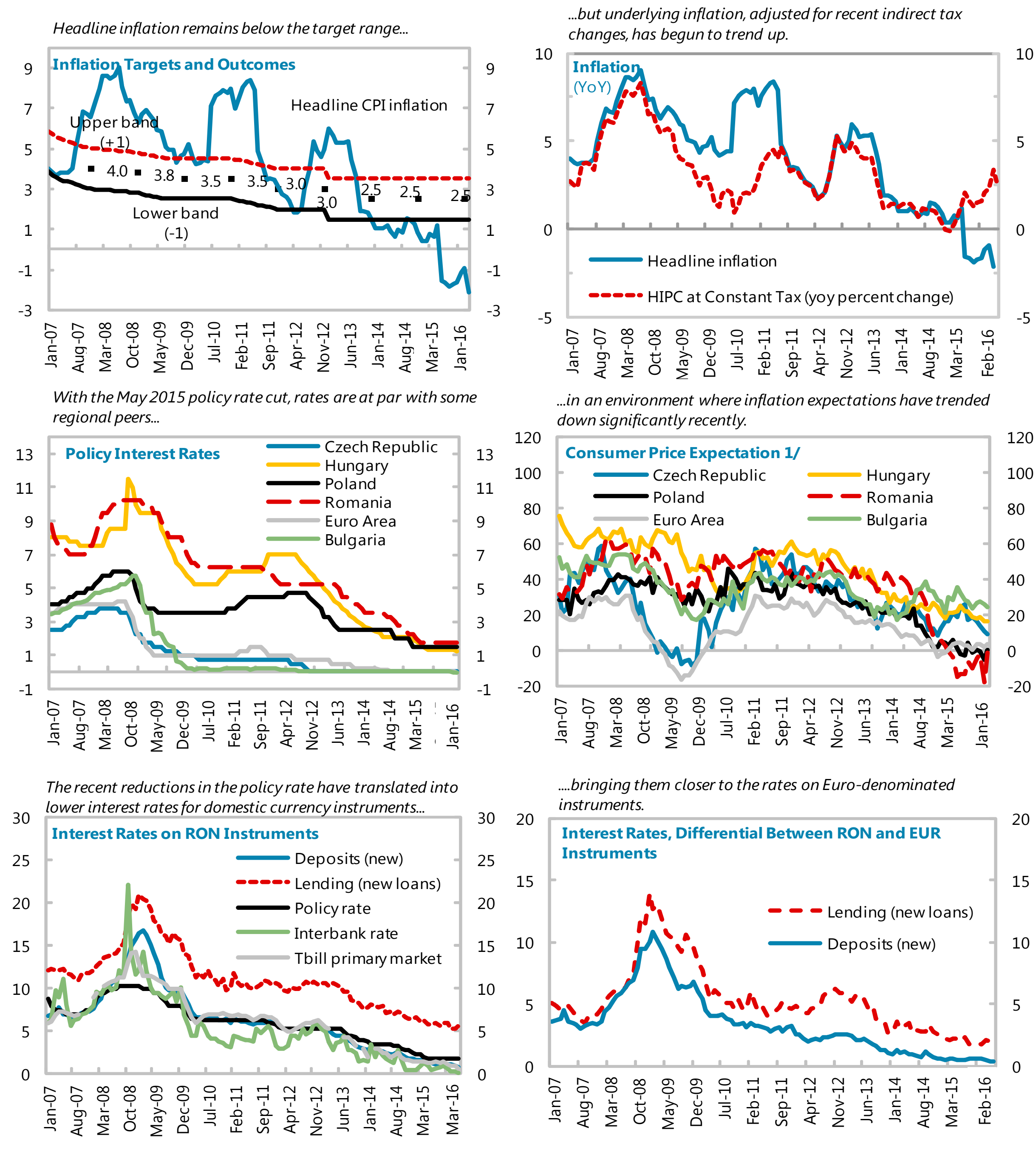
Unit labor costs in the manufacturing sector, despite large fluctuations, have been on an upward trend.



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

Figure 4. Romania: Monetary Sector, 2007–16

(Percent)

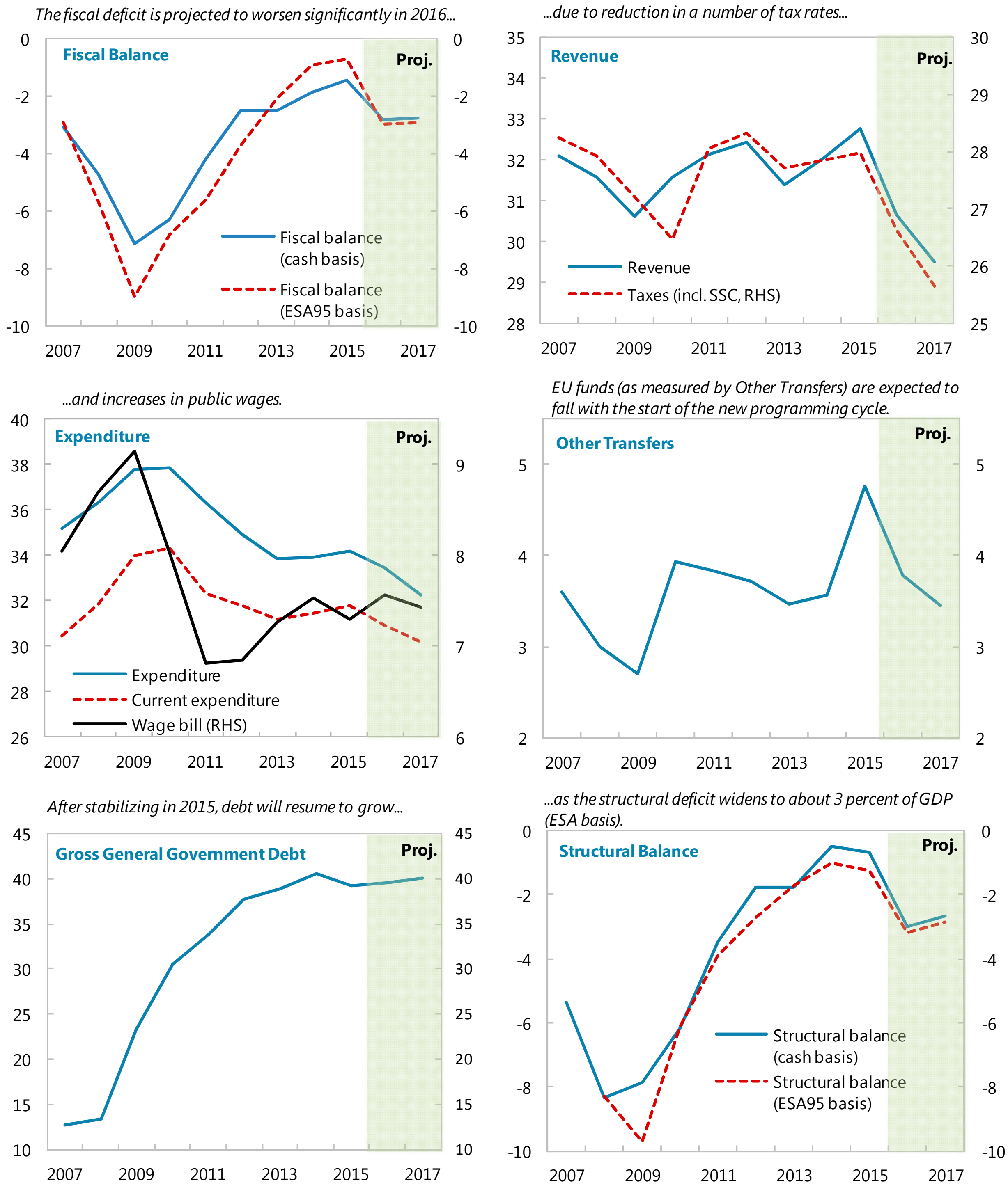


1/ Equals to the percentage of favourable answers minus the percentage of unfavourable answers in the survey on price trends over the next 12-month.

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

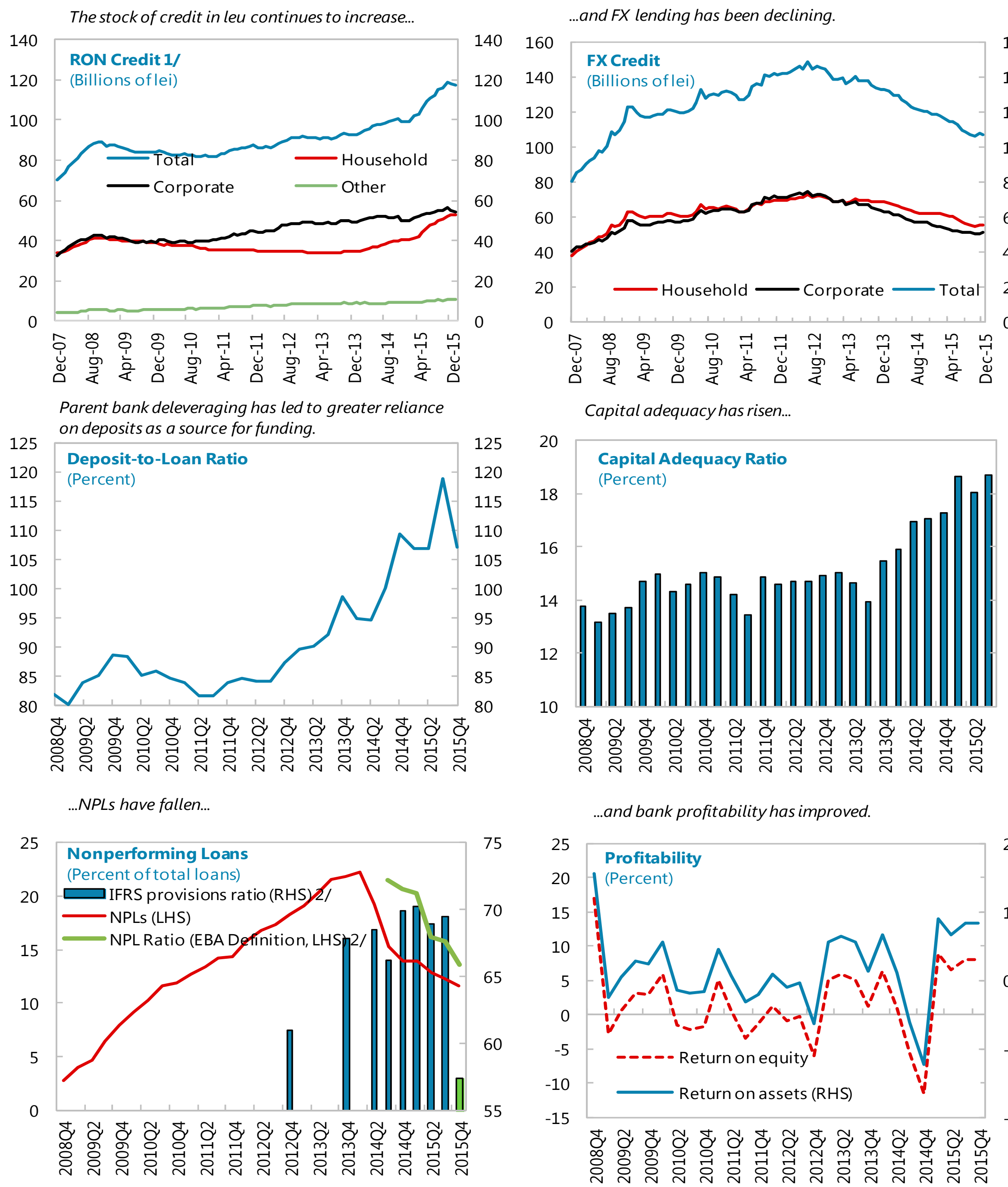
Figure 5. Romania: Fiscal Operations, 2007–17

(Percent of GDP)



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

Figure 6. Romania: Financial Sector, 2007–15



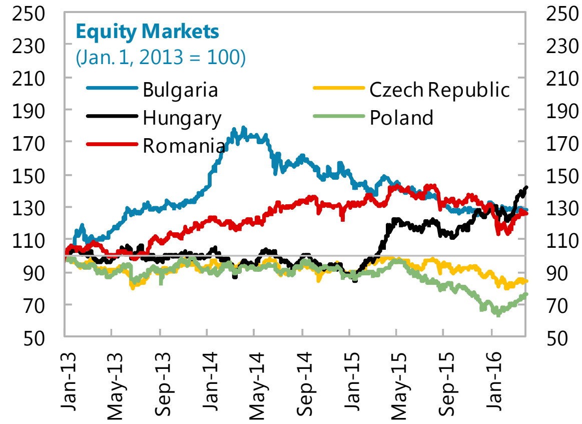
1/ Excludes credit to central government.

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

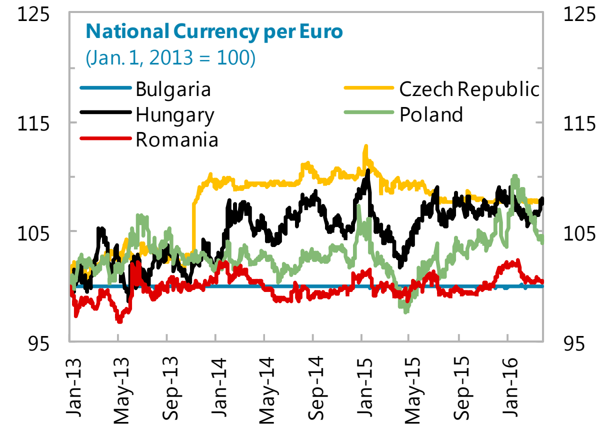
Sources: Dxtime; and National Bank of Romania.

Figure 7. Romania: Financial Developments, 2013–16

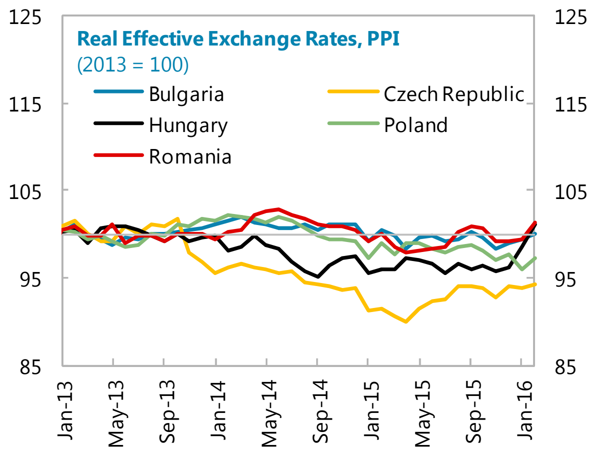
Romania's stock market index picked up slightly in March after recent decline.



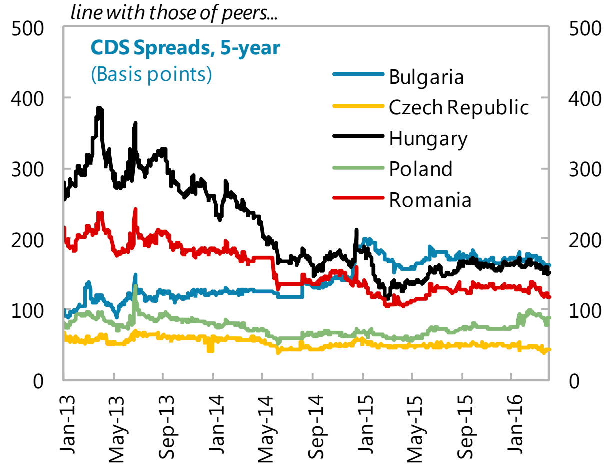
The leu depreciated slightly over the past year in nominal terms...



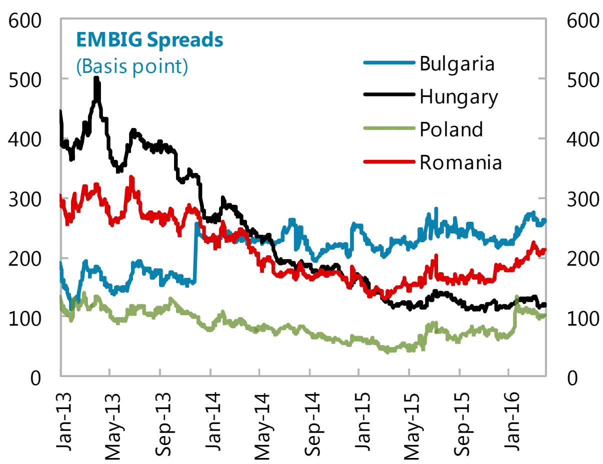
...and fluctuated slightly in real terms.



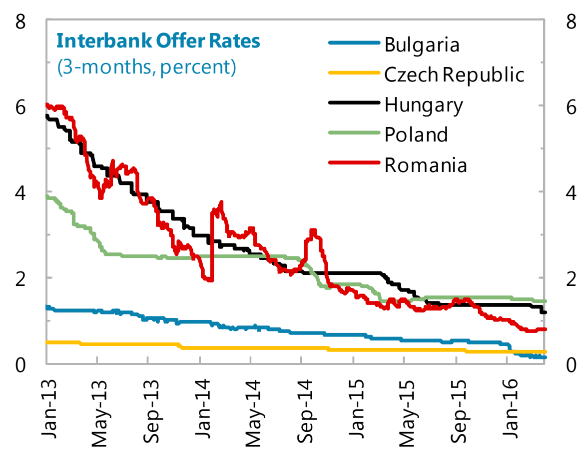
Romania's CDS spread has declined somewhat recently in line with those of peers...



...however, Romania's EMBIG spreads remain elevated.

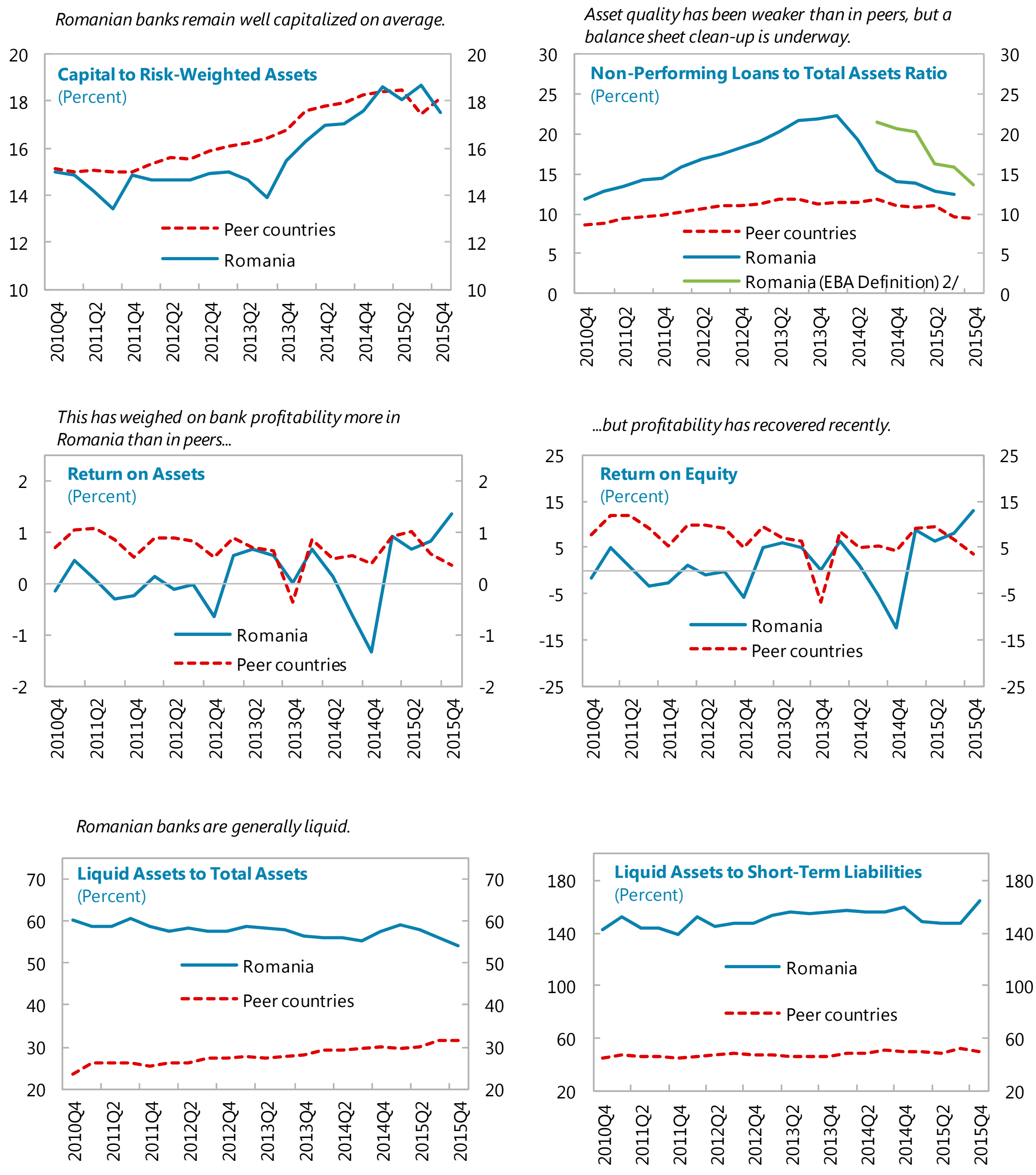


Interbank rates have been declining.



Sources: Bloomberg; and Haver Analytics.

Figure 8. Romania and Peer Countries: Financial Soundness Indicators, 2010–15 1/



Sources: Haver Analytics; and National Bank of Romania.

1/ Unweighted average of Bulgaria, Croatia, Czech Republic, Hungary, Poland, Slovakia and Slovenia.

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

Table 1. Romania: Selected Economic and Social Indicators, 2010–17

	2010	2011	2012	2013	2014	2015 Prel.	2016 Proj.	2017 Proj.
Output and prices				(Annual percentage change)				
Real GDP	-0.8	1.1	0.6	3.5	3.0	3.8	4.2	3.6
Contributions to GDP growth								
Domestic demand	-0.7	1.1	-0.4	-0.1	3.2	5.3	6.2	4.8
Net exports	-0.1	-0.1	1.1	3.6	-0.2	-1.5	-1.7	-1.2
Consumer price index (CPI, average)	6.1	5.8	3.3	4.0	1.1	-0.6	-0.4	3.1
Consumer price index (CPI, end of period)	8.0	3.1	4.9	1.6	0.8	-0.9	1.5	3.4
Core price index (CPI, end of period)	4.1	2.4	3.3	-0.2	1.1	-3.1	2.6	3.6
Producer price index (average)	4.4	7.1	5.4	2.1	-0.1	-2.2	...	...
Unemployment rate (average)	7.0	7.1	6.8	7.1	6.8	6.8	6.4	6.2
Nominal wages	2.5	4.9	5.0	5.0	5.3	8.5	9.4	7.1
Public sector wages	-10.8	-2.5	6.8	11.9	2.3	10.1	16.1	5.5
Private sector wages	7.4	7.2	4.4	3.2	6.1	8.0	7.8	7.5
Saving and Investment				(In percent of GDP)				
Gross domestic investment	26.8	27.9	26.8	25.6	25.2	25.6	24.6	24.8
Gross national savings	21.8	22.9	22.1	24.5	24.8	24.5	22.9	22.3
General government finances 1/								
Revenue	31.6	32.1	32.4	31.4	32.0	32.8	30.7	29.5
Expenditure	37.9	36.3	34.9	33.9	33.9	34.2	33.5	32.3
Fiscal balance	-6.3	-4.2	-2.5	-2.5	-1.9	-1.5	-2.8	-2.8
External financing	2.8	2.7	3.2	2.1	1.9	-0.5	1.0	1.3
Domestic financing	3.5	1.5	-0.8	1.4	1.2	1.1	1.5	1.5
Primary balance	-5.0	-2.8	-0.7	-0.8	-0.4	-0.2	-1.5	-1.3
Structural fiscal balance 2/	-6.1	-3.4	-1.7	-1.7	-0.5	-0.7	-3.0	-2.7
Gross public debt (including guarantees)	30.5	33.9	37.6	38.8	40.5	39.3	39.5	40.1
Money and credit				(Annual percentage change)				
Broad money (M3)	6.9	6.6	2.7	8.8	8.4	9.3	9.5	8.0
Credit to private sector	4.7	6.6	1.3	-3.3	-3.3	3.0	4.1	4.6
Interest rates, eop 3/				(In percent)				
NBR policy rate	6.25	6.0	5.25	4.0	2.50	1.75	1.75	...
NBR lending rate (Lombard)	10.25	10.0	9.25	7.0	4.75	4.25	3.25	...
Interbank offer rate (1 week)	3.6	6.0	5.9	1.8	0.7	0.6	0.4	...
Balance of payments				(In percent of GDP)				
Current account balance	-5.1	-4.9	-4.8	-1.1	-0.5	-1.1	-1.7	-2.5
Merchandise trade balance	-7.6	-7.0	-6.9	-4.0	-4.2	-4.8	-5.6	-6.3
Capital account balance	0.2	0.5	1.4	2.1	2.6	2.4	1.5	1.4
Financial account balance	-2.0	-2.0	-2.6	-3.0	0.1	0.8	-0.6	-1.7
Foreign direct investment balance	-1.8	-1.3	-1.9	-2.0	-1.8	-1.7	-1.8	-1.8
International investment position	-62.3	-64.2	-67.8	-61.7	-56.9	-50.9	-48.6	-46.5
Gross official reserves	28.3	27.9	26.5	24.6	23.6	22.1	21.9	21.7
Gross external debt	72.9	74.0	74.6	68.0	63.1	56.7	58.7	56.6
Exchange rates 3/								
Lei per euro (end of period)	4.3	4.3	4.4	4.5	4.5	4.5	4.5	...
Lei per euro (average)	4.2	4.2	4.5	4.4	4.4	4.4	...	...
Real effective exchange rate								
CPI based (percentage change)	2.0	2.9	-6.0	4.7	0.2	-3.7	...	...
GDP deflator based (percentage change)	1.3	1.8	-4.8	4.1	0.9	-0.3	...	...
Memorandum Items:								
Nominal GDP (in bn RON)	533.9	565.1	595.4	637.5	667.6	712.8	757.1	802.5
Potential output growth	2.0	1.9	2.1	2.3	3.0	3.0	3.2	3.3

Social and Other Indicators

GDP per capita: US$9,995 (2014); **GDP per capita, PPP:** current international $19,801 (2014)

People at risk of poverty or social exclusion: 39.5% (2014)

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

1/ General government finances refer to cash data.
2/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.
3/ For 2016: data as of April 20.

Table 2. Romania: Medium-Term Macroeconomic Framework, Current Policies, 2012–21

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
GDP and prices (annual percent change)										
Real GDP	0.6	3.5	3.0	3.8	4.2	3.6	3.3	3.3	3.3	3.3
Agriculture 1/	-26.1	33.7	2.4	-9.4	...	...	...	...	...	...
Non-Agriculture 1/	2.5	2.1	3.0	4.4	...	...	...	...	...	...
Real domestic demand	-0.4	-0.1	3.1	5.3	6.1	4.5	3.8	3.5	3.4	3.4
Consumption	1.1	-0.3	3.1	5.2	6.1	4.5	3.6	3.4	3.3	3.4
Investment	0.1	-5.4	2.5	8.8	4.3	4.6	4.3	3.7	3.8	3.4
Exports	1.0	19.7	8.6	5.5	5.9	6.0	6.2	6.2	6.2	6.2
Imports	-1.8	8.8	8.9	9.1	9.0	7.7	6.9	6.4	6.2	6.2
Consumer price index (CPI, average)	3.3	4.0	1.1	-0.6	-0.4	3.1	3.0	2.7	2.6	2.5
Consumer price index (CPI, end of period)	4.9	1.6	0.8	-0.9	1.5	3.4	2.7	2.7	2.6	2.5
Saving and investment (in percent of GDP)										
Gross national saving	22.1	24.5	24.8	24.5	22.9	22.3	22.2	22.0	21.8	21.7
Gross domestic investment	26.8	25.6	25.2	25.5	24.6	24.8	24.9	25.1	25.2	25.2
Government	5.8	5.6	5.7	6.2	4.9	4.5	4.1	4.2	4.1	4.0
Private	21.0	20.0	19.5	19.3	19.8	20.3	20.8	20.9	21.1	21.2
General government (in percent of GDP)										
Revenue	32.4	31.4	32.0	32.8	30.7	29.5	29.1	29.0	28.8	28.7
Expenditure	34.9	33.9	33.9	34.2	33.5	32.3	31.8	31.8	31.6	31.5
Fiscal balance 2/	-2.5	-2.5	-1.9	-1.5	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8
Structural fiscal balance 3/	-1.7	-1.7	-0.5	-0.7	-3.0	-2.7	-2.6	-2.7	-2.7	-2.7
Gross general government debt (direct debt only)	35.3	36.5	38.1	37.0	37.4	38.1	38.7	39.4	40.1	40.7
Gross general government debt (including guarantees)	37.6	38.8	40.5	39.3	39.5	40.1	40.5	41.2	41.8	42.3
Monetary aggregates (annual percent change)										
Broad money (M3)	2.7	8.8	8.4	9.3	9.5	8.0	7.0	6.0	6.0	6.0
Credit to private sector	1.3	-3.3	-3.3	3.0	4.1	4.6	4.3	4.1	4.0	4.0
Balance of payments (in percent of GDP)										
Current account	-4.8	-1.1	-0.5	-1.1	-1.7	-2.5	-2.7	-3.0	-3.4	-3.5
Trade balance	-6.9	-4.0	-4.2	-4.8	-5.6	-6.3	-6.4	-6.7	-7.0	-7.1
Services balance	1.9	3.3	3.9	4.3	3.9	3.9	3.9	4.0	4.0	4.0
Income balance	-1.7	-2.2	-1.3	-2.4	-2.0	-2.0	-2.1	-2.1	-2.2	-2.2
Transfers balance	2.0	1.9	1.1	1.8	1.9	2.0	1.9	1.8	1.7	1.8
Capital account balance	1.4	2.1	2.6	2.4	1.5	1.4	1.1	1.0	1.0	0.9
Financial account balance	-2.6	-3.0	0.1	0.8	-0.6	-1.7	-2.8	-3.1	-3.7	-4.0
Foreign direct investment, balance	-1.9	-2.0	-1.8	-1.7	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Memorandum items:										
Gross international reserves (in billions of euros)	35.4	35.4	35.5	35.5	36.7	38.6	40.8	43.0	45.3	47.3
Gross international reserves (in months of next year's imports)	7.3	6.8	6.4	6.2	5.9	5.7	5.7	5.7	5.7	5.7
International investment position (in percent of GDP)	-67.8	-61.7	-56.9	-50.2	-48.6	-46.5	-45.4	-45.0	-44.9	-45.1
External debt (in percent of GDP)	74.6	68.0	63.1	56.7	58.7	56.6	52.7	48.9	45.6	42.4
Short-term external debt (in percent of GDP)	15.7	13.3	12.6	12.4	12.1	11.7	11.1	10.5	9.9	9.3
Terms of trade (merchandise, percent change)	-3.4	0.4	0.9	1.2	0.0	-0.1	0.6	-0.3	-0.5	-0.2
Nominal GDP (in billions of lei)	595.4	637.5	667.6	712.8	757.1	802.5	850.7	898.6	949.7	1,005.2
Output gap (percent of potential GDP)	-2.6	-1.5	-1.5	-0.8	0.1	0.4	0.3	0.2	0.1	0.0
Potential GDP (percent change)	2.1	2.3	3.0	3.0	3.2	3.3	3.3	3.3	3.3	3.3

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

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

2/ Includes in 2011–12, the National Program for Infrastructure Projects (PNDI), which was cancelled thereafter.

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

Table 3. Romania: Balance of Payments, 2010–17

(In billions of euros, unless otherwise indicated)

	2010	2011	2012	2013	2014 Prel.	2015 Prel.	2016 Proj.	2017 Proj.
Current account balance	-6.4	-6.6	-6.4	-1.5	-0.7	-1.8	-2.9	-4.4
Merchandise trade balance	-9.6	-9.4	-9.3	-5.8	-6.3	-7.8	-9.4	-11.1
Exports (f.o.b.)	32.7	40.1	39.9	43.9	46.8	49.1	48.9	52.4
Imports (f.o.b.)	42.4	49.5	49.2	49.7	53.1	56.9	58.2	63.6
Services balance	1.5	1.7	2.5	4.7	5.9	6.9	6.6	6.9
Exports of non-factor services	7.8	8.7	9.9	13.4	15.1	16.8	16.6	17.9
Imports of non-factor services	6.3	7.0	7.4	8.7	9.2	9.8	10.1	11.0
Primary income, net	-1.5	-1.7	-2.3	-3.1	-1.9	-3.8	-3.4	-3.6
Receipts	1.4	1.9	2.2	2.5	2.2	2.4	2.5	2.6
Payments	2.9	3.6	4.5	5.6	4.1	6.2	5.8	6.2
Secondary income, net	3.2	2.8	2.7	2.7	1.7	2.8	3.2	3.5
Capital account balance	0.2	0.7	1.9	3.0	4.0	3.9	2.6	2.5
Financial account balance	-2.5	-2.7	-3.4	-4.4	0.2	1.3	-1.0	-3.1
Foreign direct investment balance	-2.3	-1.7	-2.6	-2.9	-2.7	-2.8	-3.0	-3.3
Portfolio investment balance	-0.9	-1.6	-3.4	-5.5	-2.9	0.7	-1.7	-2.3
Other investment balance	0.7	0.6	2.5	4.0	5.8	3.4	3.8	2.5
General government	-0.1	0.4	0.4	0.9	0.4	0.5	1.2	1.5
Domestic banks	-1.0	0.2	2.2	2.5	4.1	2.1	1.9	0.9
Other private sector	1.8	0.0	-0.1	0.7	1.3	0.8	0.6	0.1
Errors and omissions	0.7	1.1	1.2	0.2	-0.2	0.8	0.0	0.0
Multilateral financing	3.7	3.5	1.0	0.7	0.3	-0.8	...	...
European Commission	2.2	1.4	0.0	...	...	...	...	...
World Bank	0.0	0.7	0.0	0.7	0.3	0.8	...	...
EIB/EBRD/IFC	1.5	1.4	1.0	...	...	...	...	...
Overall balance	0.7	1.4	1.1	6.8	3.2	0.8	0.6	1.1
Financing	-0.7	-1.4	-1.1	-6.8	-3.2	-0.8	-0.6	-1.1
Gross international reserves ("-": increase)	-3.5	-0.9	1.5	-2.1	1.2	0.6	-1.3	-1.8
Use of IMF credit, net	4.3	0.9	-1.6	-4.6	-4.4	-1.4	-0.1	0.0
Purchases 1/	4.3	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	0.0	0.0	-1.6	-4.6	-4.4	-1.4	-0.1	0.0
Other liabilities, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:				(In percent of GDP)				
Current account balance	-5.1	-4.9	-4.8	-1.1	-0.5	-1.1	-1.7	-2.5
Foreign direct investment balance	-1.8	-1.3	-1.9	-2.0	-1.8	-1.7	-1.8	-1.8
Merchandise trade balance	-7.6	-7.0	-6.9	-4.0	-4.2	-4.8	-5.6	-6.3
Exports	25.8	30.1	29.9	30.4	31.2	30.6	29.2	29.5
Imports	33.4	37.1	36.8	34.4	35.4	35.5	34.8	35.8
Gross external financing requirement	26.9	29.2	33.9	31.6	27.7	26.2	25.4	23.5
				(Annual percent change)				
Terms of trade (merchandise)	1.3	1.8	-3.4	0.4	0.9	1.2	0.0	-0.1
Export volume	15.2	11.9	1.0	19.7	8.6	6.3	5.9	6.0
Import volume	12.6	10.2	-1.8	8.8	8.9	8.3	9.0	7.7
Export prices	7.8	7.3	-5.2	-1.1	-1.5	-1.8	-6.1	1.2
Import prices	6.7	4.6	1.1	-9.1	1.8	-1.0	-6.1	1.3
				(In billions of euros)				
Gross international reserves 2/	36.0	37.3	35.4	35.4	35.5	35.5	36.7	38.6
Excluding IMF credit	24.7	25.3	24.4	29.5	35.5	35.4	36.7	38.6
of which: Excluding banks' required reserves	29.3							
GDP	126.8	133.3	133.6	144.3	150.2	160.4	167.4	177.6

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

1/ Includes IMF disbursement to the Treasury of €0.9 billion in 2009 and €1.2 billion in 2010.

2/ Operational definition, reflecting valuation effects and the allocation of SDR 908.8 million that was made available in two tranches in August and September 2009.

Table 4. Romania: Gross External Financing Requirements, 2012–17

(In billions of euros, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017
					Proj.	Proj.
I. Total financing requirements	**44.0**	**49.8**	**48.2**	**47.4**	**34.5**	**34.8**
I.A. Current account deficit	5.8	1.3	0.7	1.8	2.9	4.4
I.B. Short-term debt	25.8	22.2	21.0	19.8	20.4	21.0
Public sector	7.5	8.6	9.1	8.5	7.0	7.0
Banks	14.1	9.0	7.8	7.7	9.2	9.7
Corporates	4.2	4.6	4.0	3.7	4.2	4.4
I.C. Maturing medium- and long-term debt	12.1	26.5	25.8	24.8	10.7	9.4
Public sector	2.8	15.2	17.7	15.4	2.6	1.7
Banks	4.9	6.5	3.9	5.9	4.2	4.2
Corporates	4.4	4.8	4.2	3.6	3.9	3.5
I.D. Other net capital outflows 1/	0.3	-0.2	0.8	1.0	0.5	0.0
II. Total financing sources	**42.3**	**56.3**	**51.2**	**48.9**	**35.2**	**37.1**
II.A. Foreign direct investment, net	2.2	3.1	2.7	2.8	3.0	3.3
II.B. Capital account inflows	1.9	3.2	4.0	3.9	2.6	2.5
II.C. Short-term debt	23.3	22.4	19.6	21.5	20.9	21.6
Public sector	6.7	8.1	9.3	8.3	7.0	7.0
Banks	12.1	9.0	6.4	9.0	9.5	10.0
Corporates	4.5	5.2	3.9	4.2	4.4	4.6
II.D. Medium- and long-term debt	14.9	27.5	25.0	20.7	8.7	9.8
Public sector	6.7	20.5	19.5	15.1	3.1	3.6
Banks	5.1	3.8	2.4	3.0	2.4	2.9
Corporates	3.1	3.2	3.1	2.5	3.1	3.2
Errors and omissions	0.9	-0.4	-0.2	0.2	0.0	0.0
III. Increase in gross international reserves	-1.4	2.1	-1.2	-0.6	1.3	1.8
IV. Financing gap	**-0.6**	**-3.9**	**-4.1**	**-2.3**	**0.6**	**-0.5**
V. Program financing	**-0.6**	**-3.9**	**-4.1**	**-2.3**	**0.6**	**-0.5**
IMF 2/	-1.6	-4.6	-4.4	-1.5	-0.1	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	-1.6	-4.6	-4.4	-1.5	-0.1	0.0
European Commission	0.0	0.0	0.0	-1.5	0.0	-1.2
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0
Principal repayments	0.0	0.0	0.0	-1.5	0.0	-1.2
Others	1.0	0.7	0.3	0.8	0.8	0.7
World Bank	0.0	0.7	0.3	0.8	0.8	0.7
EIB/EBRD/IFC	1.0	...	...	...	...	...
Memorandum items:						
Rollover rates for amortizing debt ST (in percent)						
Public sector	90	95	102	99	100	100
Banks	85	100	82	117	103	104
Corporates	107	113	96	114	104	104
Rollover rates for amortizing debt MLT (in percent)						
Public sector	240	134	111	98	120	217
Banks	104	59	60	52	59	70
Corporates	71	67	74	71	81	92
Rollover rates for total amortizing debt (in percent)						
Public sector	131	120	108	98	105	123
Banks	90	83	75	89	89	94
Corporates	89	90	85	93	93	99
Gross international reserves 3/	35.4	35.4	35.5	35.5	36.7	38.6
Coverage of gross international reserves						
- Months of imports of GFNS (next year)	7.3	6.8	6.4	6.2	5.9	5.7
- Short-term external debt (in percent)	80.3	86.6	88.3	89.6	98.7	99.4

Sources: Romanian authorities; and IMF staff estimates and projections.
1/ Includes portfolio equity, financial derivatives and other investments.
2/ SDR interest rate as well as exchange rate of SDR/US$ and US$/€ of January 15, 2015.
3/ Operational definition.

Table 5a. Romania: General Government Operations, 2010–17 1/

(In percent of GDP)

	2010	2011	2012	2013	2014	2015 Prelim.	2016 Proj.	2017 Proj.
Revenue	31.6	32.1	32.4	31.4	32.0	32.8	30.7	29.5
Taxes	26.0	27.6	27.8	27.2	27.4	27.5	26.1	25.1
Corporate income tax	2.1	2.0	2.0	1.9	2.0	2.1	2.0	2.0
Personal income tax	3.4	3.4	3.5	3.6	3.5	3.8	3.6	3.6
VAT	7.4	8.5	8.5	8.1	7.6	8.0	6.9	6.6
Excises	3.2	3.4	3.4	3.3	3.6	3.6	3.6	3.2
Customs duties	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social security contributions	8.6	9.0	8.7	8.5	8.6	8.1	8.1	8.1
Other taxes	1.3	1.2	1.6	1.7	1.8	1.7	1.8	1.5
Nontax revenue	3.7	3.2	3.1	2.7	2.6	2.7	2.6	2.5
Capital revenue	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1
Grants, including EU disbursements	1.8	1.2	1.4	1.4	1.7	2.4	1.8	1.7
Expenditure	37.9	36.3	34.9	33.9	33.9	34.2	33.5	32.3
Current expenditure	34.3	32.3	31.8	31.2	31.5	31.8	30.9	30.2
Compensation of employees	8.0	6.8	6.9	7.3	7.5	7.3	7.6	7.4
Goods and services	5.5	5.6	5.8	6.1	5.9	5.7	5.7	5.6
Interest	1.4	1.6	1.8	1.7	1.5	1.3	1.5	1.5
Subsidies	1.3	1.1	1.0	0.8	0.9	0.9	0.9	0.8
Transfers	17.8	16.8	16.1	15.3	15.5	16.5	15.3	14.8
Pensions	7.9	8.4	8.1	7.7	7.7	7.2	6.8	6.7
Other social transfers	5.0	3.6	3.2	3.0	2.9	3.4	3.7	3.5
Other transfers 2/	4.4	4.3	4.3	4.0	4.2	5.3	4.3	3.9
Other spending	0.5	0.6	0.5	0.5	0.6	0.6	0.5	0.5
Projects with external credits	0.3	0.4	0.3	0.1	0.1	0.1	0.1	0.1
Capital expenditure 3/	3.6	4.1	3.2	2.8	2.6	2.6	2.6	2.1
Reserve fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending and expense refunds	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	0.0	0.0
Fiscal balance	-6.3	-4.2	-2.5	-2.5	-1.9	-1.5	-2.8	-2.8
Primary balance	-5.0	-2.8	-0.7	-0.8	-0.4	-0.2	-1.5	-1.3
Financing	6.3	4.2	2.5	2.5	1.9	1.5	2.8	2.8
External borrowing (net)	2.8	2.7	3.2	2.1	1.9	-0.5	1.0	1.3
Domestic borrowing (net)	3.9	2.2	0.9	1.4	1.2	1.1	1.5	1.5
Use of deposits	-0.4	-0.7	-1.7	-1.0	-1.3	1.3	0.3	0.0
Privatization proceeds	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities								
Gross general-government debt 4/	30.5	33.9	37.6	38.8	40.5	39.3	39.5	40.1
Gross general-government debt excl. guarantees	27.6	31.8	35.3	36.5	38.1	37.0	37.4	38.1
External	12.7	15.1	17.0	18.0	20.0	18.6	18.6	18.8
Domestic	14.9	16.7	18.3	18.5	18.2	18.4	18.8	19.2
Memorandum items:								
Total capital spending	7.1	7.6	6.4	5.6	5.3	6.2	5.3	4.5
Fiscal balance (ESA95 basis)	-6.7	-5.6	-3.7	-2.1	-0.9	-0.7	-3.0	-2.9
Gross general government debt (ESA95 basis)	29.9	34.2	37.4	38.0	39.8	38.4	39.2	…
Output gap 5/	-0.4	-1.3	-2.6	-1.5	-1.5	-0.8	0.1	0.4
Cyclically adjusted balance 6/	-6.1	-3.7	-1.6	-2.0	-1.4	-1.2	-2.9	-2.9
CAPB 6/	-4.8	-2.2	0.2	-0.3	0.2	0.2	-1.4	-1.4
Structural fiscal balance (ESA95 basis) 6/							-3.2	-2.8
Structural fiscal balance 6/	-6.1	-3.4	-1.7	-1.7	-0.5	-0.7	-3.0	-2.7
Gross general government debt (authorities definition) 7/	36.4	39.5	40.5	41.9	44.3	44.3	…	…
Nominal GDP (in billions of lei)	533.9	565.1	595.4	637.5	667.6	712.8	757.1	802.5

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

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

2/ Includes EU-financed capital projects.

3/ Does not include all capital spending.

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

5/ Percentage deviation of actual from potential GDP.

6/ Expressed in percentage of potential GDP.

7/ Includes guarantees and intra-governmental debt.

Table 5b. Romania: General Government Operations, 2010–17

(In millions of lei)

	2010	2011	2012	2013	2014	2015 Prelim.	2016 Proj.	2017 Proj.
Revenue	168,635	181,567	193,148	200,038	213,834	233,554	232,127	236,776
Taxes	138,667	155,710	165,702	173,489	182,586	195,906	197,767	201,781
Corporate income tax	10,969	11,030	11,826	12,191	13,684	14,803	15,234	16,119
Personal income tax	17,957	19,461	20,956	22,736	23,692	27,288	27,127	29,130
VAT	39,246	47,917	50,516	51,827	50,879	57,132	52,319	52,737
Excises	17,312	19,105	20,260	21,106	24,095	26,018	27,165	25,518
Customs duties	574	674	707	620	643	816	850	926
Social security contributions	45,704	50,637	51,658	54,379	57,612	57,604	61,502	65,308
Other taxes	6,905	6,885	9,778	10,630	11,982	12,245	13,570	12,042
Nontax revenue	19,796	18,217	18,328	17,153	17,188	19,495	19,404	20,103
Interest Revenue	595	718	279	182	157	743	789	377
Capital revenue	685	766	653	650	1,073	918	957	991
Grants	9,494	6,874	8,422	9,112	11,189	16,984	14,000	13,901
o/w EU pre-accession funds	4,054	765	443	201	15	6	0	0
Financial operations and other	-6	0	43	-365	1,798	250	0	0
Expenditure	202,256	205,277	207,921	215,810	226,327	243,915.5	253,559	259,010
Current expenditure	183,243	182,709	189,274	198,957	210,136	226,688	234,077	242,375
Compensation of employees	42,839	38,496	40,799	46,299	50,247	52,026	57,335	59,581
Goods and services	29,541	31,643	34,444	38,580	39,582	40,808	43,111	44,949
Interest	7,275	8,883	10,710	10,749	10,199	9,572	11,069	12,079
Subsidies	6,735	6,407	6,122	5,150	6,094	6,275	6,464	6,664
Transfers	95,060	95,172	95,585	97,310	103,422	117,552	115,564	118,536
Pensions	42,107	47,469	48,051	49,374	51,539	51,539	51,707	54,118
Other social transfers	26,505	20,539	18,997	19,005	19,663	24,407	27,666	28,458
Other transfers 1/	23,514	24,049	25,569	25,712	27,942	37,618	32,657	31,643
Other spending	2,933	3,115	2,968	3,219	4,278	3,988	3,535	4,318
Projects with external credits	1,794	2,108	1,614	869	592	456	533	565
Capital expenditure 2/	19,441	23,056	19,305	17,855	17,140	18,263	19,383	16,528
Reserve fund	0	0	0	0	0	0	100	107
Net lending and expense refunds	-428	-488	-657	-1,002	-949	-1,036	0	0
Fiscal balance	-33,621	-23,710	-14,774	-15,772	-12,493	-10,361	-21,432	-22,234
Primary balance	-26,941	-15,545	-4,343	-5,206	-2,451	-1,532	-11,152	-10,531
Financing	33,621	23,710	14,774	15,772	12,493	10,361	21,432	22,234
External borrowing (net)	14,807	15,250	19,271	13,351	12,591	-3,809	7,907	10,415
Domestic borrowing (net)	20,841	12,377	5,305	8,972	8,194	7,693	11,214	11,769
Use of deposits	-2,161	-3,827	-9,916	-6,630	-8,745	9,004	2,261	0
Privatization proceeds	289	0	5	25	0	0	50	50
Financial liabilities								
Gross general-government debt 3/	163,022	191,423	224,040	247,499	270,338	280,173	299,294	321,477
Gross general-government debt excl. guarantees	147,261	179,639	210,254	232,766	254,472	264,032	283,153	305,337
External	67,717	85,382	101,476	114,997	133,248	132,597	140,504	150,919
Domestic	79,544	94,257	108,778	117,769	121,224	131,435	142,650	154,418
Memorandum item:								
Gross general government debt (authorities definition) 4/	194,459	223,268	240,843	267,151	295,656	315,692	…	

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

1/ Includes EU-financed capital projects.

2/ Does not include all capital spending.

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

4/ Includes guarantees and intra-governmental debt.

Table 5c. Romania: Consolidated Government Balance Sheet, 2010–14

(In millions of lei, unless otherwise indicated)

	2010	2011	2012	2013	2014
Net worth and its changes:	528,971	495,709	497,159	526,277	522,343
Nonfinancial assets	570,521	582,568	597,894	643,361	665,417
Fixed assets	556,739	568,669	583,573	628,600	648,510
Buildings and structures	....	....	....	....	....
Machinery and equipment	....	....	....	....	....
Other fixed assets	....	....	....	....	....
Inventories	13,782	13,899	14,321	14,761	16,907
Valuables	....	....	....	....	....
Nonproduced assets	....	....	....	....	....
Financial assets	159,092	153,768	172,411	174,871	174,586
by instrument					
Monetary gold and SDRs	-	-	-	-	-
Currency and deposits	19,850	19,658	30,664	37,017	48,061
Securities other than shares	-	-	-		
Loans	6,345	6,633	6,666	6,403	6,463
Shares and other equity	90,891	81,654	84,091	75,289	81,321
Insurance technical reserves	-	-	-	-	-
Financial derivatives	-	-	-	-	-
Other accounts receivable	42,005	45,824	50,990	49,840	51,135
by debtor					
Domestic	....	....	....	....	....
Foreign	....	....	....	....	....
Liabilities	200,642	240,628	273,146	291,956	317,660
by instrument					
Special Drawing Rights (SDRs)	-	-	-	-	-
Currency and deposits	4,677	6,398	4,987	4,222	6,755
Securities other than shares	84,731	110,589	145,165	167,839	202,936
Loans	73,763	81,526	81,829	80,852	75,412
Shares and other equity	7,930	5,583	2	-	-
Insurance technical reserves	-	-	-	-	-
Financial derivatives	1,177	69	-	-	-
Other accounts payable	28,365	36,463	41,163	39,043	32,558
by debtor					
Domestic	101,216	121,387	137,791	157,771	-
Foreign	99,426	119,240	135,354	132,958	-
Memorandum items					
Net financial worth	(41,550)	(86,860)	(100,735)	(117,084)	(143,074)
Maastricht debt	159,617	193,201	222,797	242,194	265,709
Memorandum:					
Nominal GDP (Lei - billions)	533.9	565.1	595.4	637.5	667.6

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

Table 6. Romania: Monetary Survey, 2011–17

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

	2011	2012	2013	2014	2015	2016	2017
					Prelim.	Proj.	Proj.
				I. Banking System			
Net foreign assets	**15,740**	**30,203**	**60,659**	**94,282**	**108,427**	**123,306**	**135,569**
In millions of euros	3,644	6,820	13,525	21,035	23,964	27,280	30,026
o/w commercial banks	-21,846	-18,594	-15,953	-11,778	-9,849	-7,903	-7,004
Net domestic assets	**200,468**	**191,815**	**180,937**	**167,549**	**177,874**	**190,194**	**203,011**
General government credit, net	52,596	49,599	44,985	39,194	46,658	52,135	57,481
Private sector credit	223,037	225,836	218,462	211,164	217,532	226,376	236,847
Other	-75,165	-83,620	-82,510	-82,809	-86,317	-88,317	-91,317
Broad Money (M3)	**216,208**	**222,018**	**241,547**	**261,831**	**286,301**	**313,500**	**338,580**
Money market instruments	4,149	188	296	258	129	142	153
Intermediate money (M2)	212,059	221,830	241,251	261,573	286,172	313,358	338,427
Narrow money (M1)	85,834	89,020	100,311	118,582	149,602	165,383	173,787
Currency in circulation	30,610	31,477	34,785	39,890	46,482	51,683	54,309
Overnight deposits	55,224	57,543	65,526	78,691	103,120	113,701	119,478
				II. National Bank of Romania			
Net foreign assets	**110,106**	**112,552**	**132,202**	**147,071**	**152,988**	**159,029**	**167,193**
In millions of euros	25,489	25,414	29,479	32,813	33,813	35,183	37,031
Net domestic assets	**-48,541**	**-55,244**	**-63,537**	**-78,694**	**-78,998**	**-71,985**	**-75,726**
General government credit, net	-13,564	-24,973	-31,204	-41,757	-37,675	-32,675	-28,675
Credit to banks, net	-19,529	-14,443	-23,266	-24,064	-27,465	-32,075	-39,641
Other	-15,448	-15,828	-9,067	-12,873	-13,857	-7,235	-7,410
Reserve money	**61,565**	**57,308**	**68,666**	**68,377**	**73,990**	**87,044**	**91,467**
				(Annual percent change)			
Broad money (M3)	6.6	2.7	8.8	8.4	9.3	9.5	8.0
NFA contribution	-1.7	6.7	13.7	13.9	5.4	5.2	3.9
NDA contribution	8.3	-4.0	-4.9	-5.5	3.9	4.3	4.1
Reserve money	11.7	-6.9	19.8	-0.4	8.2	17.6	5.1
NFA contribution	1.2	4.0	34.3	21.7	8.7	8.2	9.4
NDA contribution	10.5	-10.9	-14.5	-22.1	-0.4	9.5	-4.3
Domestic credit, real	5.9	-4.8	-5.9	-5.8	6.7	3.9	2.2
Private sector, real	3.3	-3.5	-4.8	-4.2	4.1	2.5	1.2
Public sector, real	18.2	-10.2	-11.1	-13.4	20.5	10.1	6.6
Broad money (M3), in real terms	3.4	-2.2	7.1	7.2	10.7	7.9	4.4
Private credit, nominal	6.6	1.3	-3.3	-3.4	3.1	4.1	4.6
Memorandum items:							
CPI inflation, eop	3.1	5.0	1.6	0.8	-0.9	1.5	3.4
NBR inflation target band	2.0 - 4.0	2.0 - 4.0	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5	1.5 - 3.5
Interest rates (percent) 1/							
Policy interest rate	6.0	5.25	4.00	2.75	1.75	1.75	…
Interbank offer rate, 1 week	6.0	5.9	1.8	0.7	0.6	0.4	
Corporate loans 2/	9.7	9.8	6.8	5.9	4.3	4.3	…
Household time deposits 2/	6.6	5.6	3.9	2.8	1.5	1.2	…
Share of foreign currency private deposits	33.6	36.7	34.5	33.9	33.3	…	…
Share of foreign currency private loans	63.4	62.5	60.9	56.3	49.3	…	…

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

1/ For policy and interbank rates: data as of April 2016; for loan and deposit rates: data as of February 2016.

2/ Rates for new local currency denominated transactions.

Table 7. Romania: Financial Soundness Indicators, 2010–15

(In percent)

	2010 Dec.	2011 Dec.	2012 Dec.	2013 Dec.	2014 Dec.	2015 Dec. Prel.
Core indicators						
Capital adequacy						
Capital to risk-weighted assets	15.0	14.9	14.9	15.0	17.3	17.5
Tier 1 capital to risk-weighted assets (1/)	14.2	13.9	13.8	13.7	14.3	15.1
Asset quality						
Nonperforming loans (2/) to total gross loans	11.9	14.3	18.2	21.9	13.9	13.6
IFRS Provisions for NPLs / NPLs	...	...	76.7	67.8	69.8	57.4
Earnings and profitability						
Return on assets	-0.2	-0.2	-0.6	0.1	-1.2	1.4
Return on equity (3/)	-1.7	-2.6	-5.9	1.3	-11.6	12.8
Net interest income to operating income	60.6	62.0	62.3	58.5	58.3	57.8
Noninterest expense to operating income (cost to income)	64.9	67.8	58.7	56.7	55.4	57.6
Personnel expense to operating income	21.0	21.9	26.0	25.5	24.9	26.6
Liquidity						
Liquid assets (4/) to total assets	60.0	58.7	57.6	56.3	57.4	54.2
Liquid assets (4/) to short-term liabilities (5/)	142.2	151.8	147.7	156.4	159.2	163.7
Liquid assets (4/) to total attracted and borrowed sources	80.9	75.8	76.4	73.5	74.1	57.0
Foreign exchange risk						
Net open position in foreign exchange, in percent of capital	-1.4	-4.7	-1.8	2.5	-2.0	0.8
Lending in foreign exchange, in percent of non-gov. credit	63.0	63.4	62.5	60.9	56.2	49.3
Foreign currency liabilities, in percent of total attracted and borrowed sources	43.5	44.8	46.3	45.2	42.9	41.5
Deposits in foreign exchange, in percent of non-gov. dom. deposits	36.0	33.5	36.4	34.1	33.2	32.4
Encouraged indicators						
Deposit-taking institutions						
Leverage ratio (6/)	8.1	8.1	8.0	7.7	7.3	7.3
Personnel expenses to noninterest expenses	32.3	32.3	44.3	44.9	45.0	46.2
Customer deposits to total (non-interbank) loans	84.8	84.0	87.3	98.7	109.5	116.5
Loan-to-Deposit (LTD) Ratio	117.9	119.1	114.5	101.3	91.3	85.8
Structural indicators (November 2015)						
Number of banks: 37; Number of foreign-owned subsidiaries/branches: 23/8; Share of deposits/loans of 5 largest banks: 58.2 percent/56.4 percent						

Source: National Bank of Romania.
1/ For 2008–10, market and operational risk are not used in compiling risk weighted assets.
2/ In December 2015, the NBR moved from a national definition to an EBA methodology-based definition of NPL's.
3/ Return on equity is calculated as net profit/loss to average own capital.
4/ Liquid assets = balance sheet assets and off balance sheets items with residual maturity of up to 3 months.
5/ Short term liabilities = balance sheet liabilities and off balance sheet items with residual maturity of up to 3 months.
6/ Tier 1 capital to average assets.

Annex I. Implementation of the 2015 Article IV Key Recommendations

Key Recommendations	Policy Actions
	Fiscal
Maintain fiscal adjustment achievements and put public debt as a share of GDP on a downward path	2015 fiscal deficit lower than targeted and public debt as a share of GDP declined, but 2016 budget envisages a substantially higher deficit raising the public debt ratio.
Improve revenue administration	Several administrative measures implemented that have strengthened tax collection (compared to a weak base though). Nonetheless, tax collection gap remains substantial.
Improve public expenditure management including through higher EU funds absorption	Tighter scrutiny of the selection of domestically financed investment projects and higher EU funds absorption, though far less than envisaged. Limited progress toward better investment planning and execution.
	Monetary and financial
Maintain easing bias and improve monetary policy framework	Policy eased throughout 2015. Interest rate corridor around policy rate narrowed, interventions in the foreign exchange market became more limited, and during last months of the year exchange rate became more flexible.
Continue intense watch on the banking and insurance sectors with a focus on better assessment of asset quality	Implemented a balance sheet review of major insurance companies. Initiated process to conduct an asset quality review for major banks. Continued close bank supervision.
Create effective insolvency frameworks	Personal insolvency law adopted but enforcement delayed by one year amid lack of development of effective secondary legislation and institutions.
Reduce non-performing loans (NPL)	Continued efforts towards further NPL reduction and a sharp recent reduction in the NPL ratio.
	Structural reforms
Further deregulate energy markets	Implemented the gas price deregulation for non-residential consumers. Continued implementation of electricity market deregulation.
Improve financial performance of state-owned enterprise (SOE) sector through better governance and restructuring	Improvement in overall financial situation, albeit to varying degrees across the sector. Weak implementation of the SOE corporate governance law. Strengthened legislation prepared in line with IFIs recommendations still to be adopted.
Increase private ownership in SOEs	Pursuit of majority privatization attempts of SOEs and initial public offerings unsuccessful.

Annex II. Romania: Risk Assessment Matrix (RAM) 1/

Risk	Relative Likelihood and Transmission Channels	Expected Impact if Risk is Realized	Policy Response
1. Tighter or more volatile global financial conditions	Medium ● Investors may sell Romanian financial assets after reassessment of risks and increases in U.S. term premia.	Medium ● Increase in borrowing costs ● Risk of exchange rate overshooting and financial instability	● Utilize some of fiscal financing buffer until markets settle down. ● Allow for exchange rate flexibility while offsetting excessive market volatility
2. A further deterioration in the fiscal balance above the targeted budget	Medium ● Loss of recently built fiscal credibility and associated worsening of market sentiment ● Romania enters EU's Excessive Deficit Procedure and public debt rises.	Medium ● Borrowing costs increase and private investment is crowded out weighing on growth prospects	● Reverse tax cuts, restrain future wage increases, cut lower priority expenditure ● Improve tax administration to raise more revenues
3. Persistent shortfall in public investment including through weak EU funds absorption	High ● Bottlenecks in public administration continue to hamper public investment and EU funds absorption.	Medium ● Delay in much-needed infrastructure upgrade would constrain growth prospects.	● Improve EU projects implementation capacity ● Improve investment prioritization, strengthen public investment review process, improve procurement framework
4. Adoption of potentially harmful legislation for financial sector	Medium ● Laws are adopted that contain retroactive and unilateral change of loan contracts.	Medium ● Commercial banks incur substantial losses ● Undermines future credit expansion and investor confidence by making the legal framework less predictable	● Intervene by providing liquidity to solvent banks that come under financial stress
5. Sharper-than-expected global growth slowdown	Medium ● Exports could fall, particularly if the euro area enters into a protracted period of slower growth. ● FDI could drop as investors reassess future euro area demand for Romanian exports.	Medium ● Lower growth, higher unemployment ● Potential widening of the current account deficit	● Allow limited use of automatic stabilizers to work as a sharp fiscal deterioration could worsen market sentiment ● Accelerate absorption of EU funds ● Allow for exchange rate flexibility while offsetting excessive market volatility
6. Persistently lower energy prices and low inflation in euro area	High ● Low energy prices and imported euro area low inflation pass through to the overall price level.	Low/Medium ● Deflation lasts longer and inflation stays below target in the medium term. ● Inflation expectations fall leading to their de-anchoring from inflation target. ● Domestic demand gets a boost from higher real incomes and lower production costs. ● Oil and gas producing companies cut investments, jobs and tax payments.	● Ease monetary policy if deflationary pressures materialize ● Strengthen policy communication to anchor inflation expectations.

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

Annex III. Debt Sustainability Analysis

Public debt in Romania is relatively low, but the recent partial reversal in fiscal adjustment exposes the fiscal position to risks. Under the baseline scenario, with deficit assumed to remain just below 3 percent of GDP, debt would moderately increase to reach slightly above 42 percent in 2021. However, the recent experience of Romania leading up to the 2008 crisis shows that a large pro-cyclical relaxation in fiscal balance could deteriorate substantially the debt dynamics. Moreover, the shock analysis shows that an adverse combination of macroeconomic shocks could bring the debt above the 60 percent threshold of the Stability and Growth Pact though below the 70 percent of GDP DSA benchmark. Finally, exchange rate volatility and exposure to international capital outflows are also risks, in consideration of the large share of foreign currency denominated debt and significant share of non-resident holders. Risks from known contingent liabilities are contained, since all outstanding guarantees are already included in public debt and banks are well capitalized and with limited exposure to short-term external debt. The external debt sustainability analysis indicates that the projected current account deficits remain sustainable.

Public Debt

1. **The macroeconomic and fiscal assumptions underpinning the DSA are those of the medium-term baseline scenario**. The output gap is expected to be slightly positive in 2016–18 and to be closed by 2021. Real growth would be close to 4 percent in 2016 and would stabilize at slightly above 3 percent afterwards. The fiscal balance is projected to deteriorate from 1.5 percent in 2015 to 2.8 percent (in cash terms; close to 3 percent in ESA terms) in 2016 and to remain close to 3 percent afterwards up until 2021. Under this scenario, Romania would not comply with the fiscal rules under the Fiscal Compact, but would conform to the 3 percent rule under the Stability and Growth Pact. Analysis of forecasts errors indicates that the size of the output contraction and of the fiscal deficit was underestimated during the crisis and the following slow recovery. More recently, growth projections were slightly pessimistic, while the forecast errors in the fiscal balance were broadly within the error band (interquartile range). Reflecting the deficit deterioration in 2016 and the projected flat path of the fiscal balance going forward, the three years average level of the cyclically adjusted primary balance in 2016 is slightly negative, while the maximum adjustment over a three-year horizon starting from 2016 is close to zero. Both are well below the 25 percentile benchmarks and suggest that baseline assumptions are realistic.

2. **Public debt is relatively low, but the share in foreign currency is relatively high**. Public debt, including guarantees, is estimated at 39.3 percent of GDP in 2015. It is projected to increase to

about 42 percent by 2021. Gross financing needs are projected to remain rather stable at about 8 percent of GDP over the projection horizon. To manage some of the financing risk, the authorities maintain a foreign currency financing buffer (excluding privatization proceeds), which is about 3.3 percent of GDP or almost five months of gross financing needs. Most of longer-term debt is official financing while the average maturity of government securities issued on the domestic market is about three years. The authorities have been addressing rollover risks under their debt management strategy with a view to issuing longer-term securities as well as lengthening the yield curve. With foreign currency denominated debt accounting for about 55 percent of public debt, public debt is also exposed to exchange rate risk. Moreover, non-residents share in domestic debt securities holdings is about 20 percent.

3. **Overall, public debt is sustainable but there is a risk it will rise above 60 percent under adverse scenarios**. The stress test scenarios indicate that weaker GDP growth could push the debt ratio to 55 percent of GDP by 2021. A combination of adverse macro shocks could push the debt above 60 percent threshold of the Stability and Growth Pact by 2020. Barring unexpected events, potential contingent liabilities of the government would be limited. SOE debt is estimated at around 7.5 percent of GDP (including SOEs under insolvency procedures). Despite remaining vulnerabilities of the banking system, including due to a large share of foreign currency denominated loans and high rollover needs, downside risks are contained as banks are generally well capitalized and their short-term external liabilities are below 4 percent of GDP.

External Debt

4. **The projected medium-term current account deficit of 3.5 percent of GDP is in line with a declining external debt-to-GDP ratio**. The current account deficit adjusted remarkably since the global financial crisis, from 11.8 percent of GDP in 2008 to 1.1 percent of GDP in 2015, primarily on the back of strong exports (both goods and services) and import compression. However, the deficit is expected to widen gradually owing to increase in imports as the economy recovers. The current account deficit in the last two years was financed by a combination of private and public inflows. Going forward, FDI inflows are likely to steadily improve as the economy grows and will contribute partly towards financing the current account deficit. External debt has been on a downtrend since 2012 due to the decline in private external liabilities, partly reflecting deleveraging in the banking sector. Going forward, the external debt as a share of GDP is expected to rise in 2016 by 2 percentage points, mainly due to the increase in private debt, but then gradually fall from 2017.

5. **The external debt sustainability analysis indicates that the projected current account deficits remain sustainable**. Gross external debt, at 56.7 percent of GDP at end-2015, was 6.4 percentage points below 2014. The improvement was due to the fall in both public and private sector debt. Around one-third of the external debt stock was public debt. Almost one-fifth of external debt was at short-term maturities, mainly of the non-bank sector. Short-term financing risk for non-bank private sector is expected to be limited, as a substantial portion of the short-term debt is intra-company loans with relatively low rollover risks.

6. **Romania could be vulnerable in the medium term if negative global market sentiment, induced by a broader emerging markets slowdown and/or oil price decline, leads to sharp currency depreciation**. Bound tests indicate a 30 percent currency depreciation shock would substantially increase the external debt-to-GDP ratio over the medium term. However, other standard shocks would only lead to a slower decline in the external debt-to-GDP ratio.

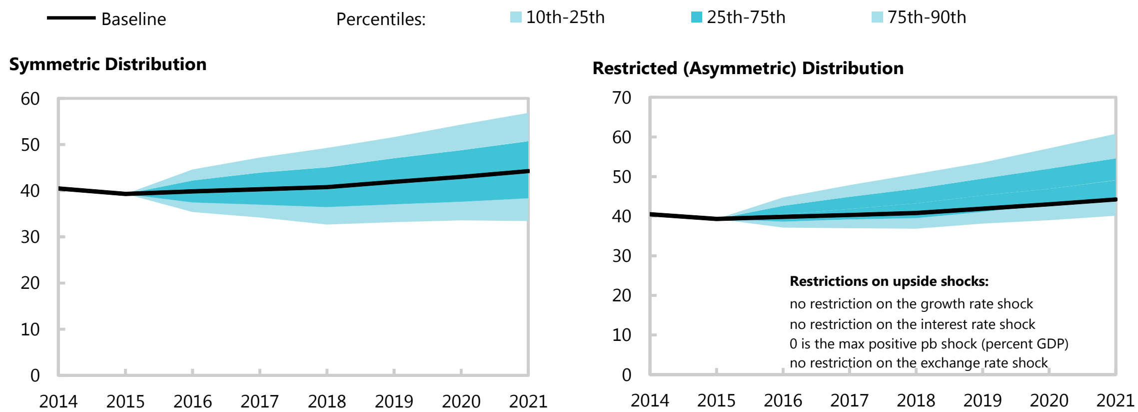
Annex III. Figure 1. Romania: Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

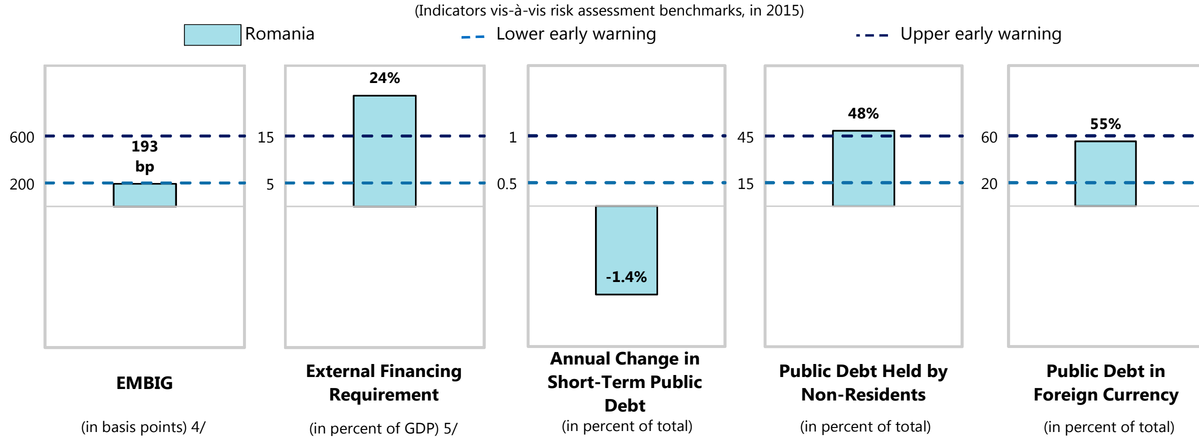
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

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

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

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

Lower and upper risk-assessment benchmarks are:

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

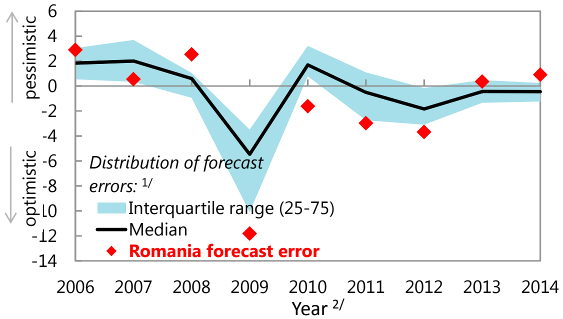
4/ EMBIG, an average over the last 3 months, 30-Dec-15 through 29-Mar-16.

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

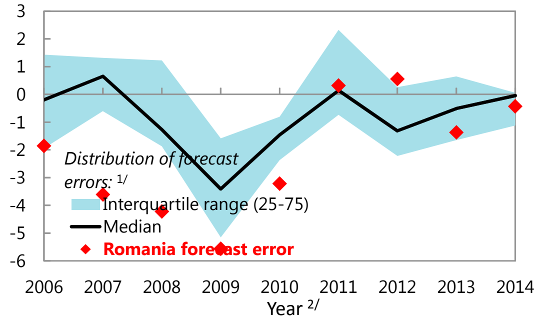
Annex III. Figure 2. Romania Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus program countries

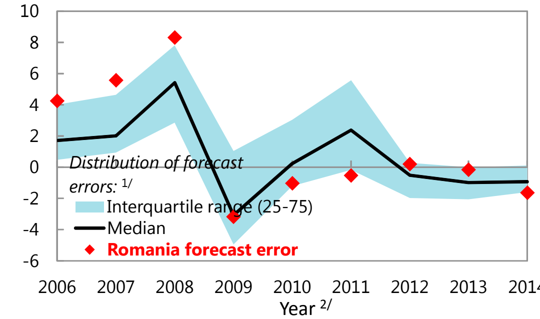
Real GDP Growth
(in percent, actual-projection)
Romania median forecast error, 2006-2014: **0.37**
Has a percentile rank of: **71%**



Primary Balance
(in percent of GDP, actual-projection)
Romania median forecast error, 2006-2014: **-1.86**
Has a percentile rank of: **16%**

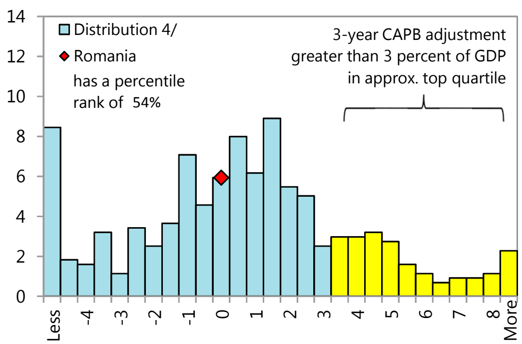


Inflation (Deflator)
(in percent, actual-projection)
Romania median forecast error, 2006-2014: **-0.16**
Has a percentile rank of: **32%**

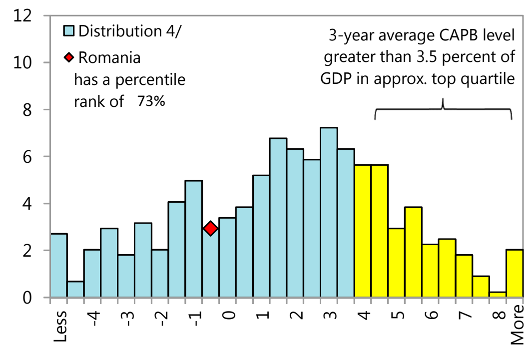


Assessing the Realism of Projected Fiscal Adjustment

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

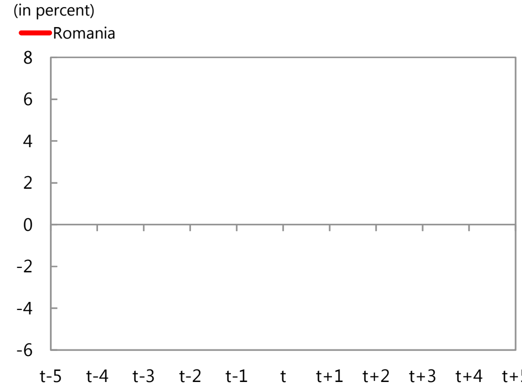


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes program countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Romania.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex III. Figure 3. Romania Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

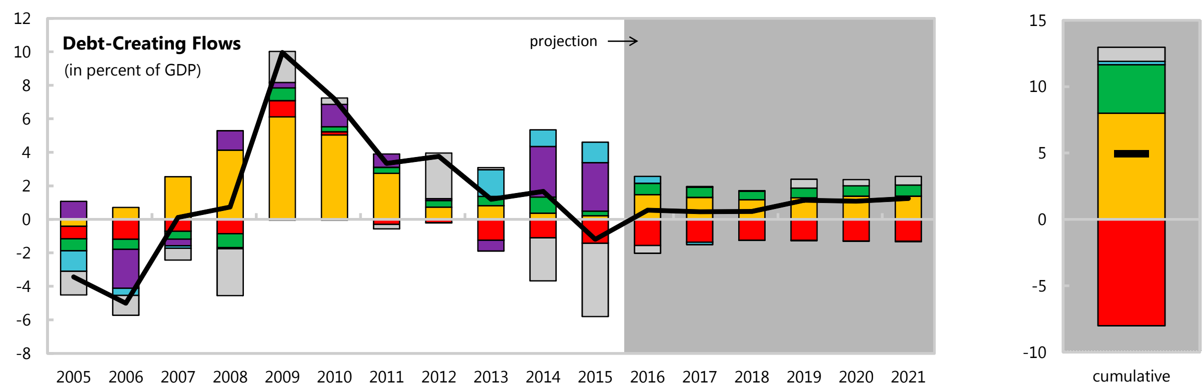
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections							As of March 29, 2016		
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021				
Nominal gross public debt	24.5	40.5	39.3	39.8	40.3	40.8	41.9	43.0	44.2		Sovereign Spreads		
Of which: guarantees	2.6	2.4	2.3	2.1	2.0	1.9	1.8	1.7	1.6		EMBIG (bp) 3/		190
Public gross financing needs	9.7	9.1	8.6	8.7	8.8	7.0	7.4	7.5	7.6		5Y CDS (bp)		123
Real GDP growth (in percent)	2.8	3.0	3.8	4.2	3.6	3.3	3.3	3.3	3.3		Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	8.2	1.7	2.9	1.9	2.3	2.7	2.3	2.3	2.5		Moody's	Baa3	Baa3
Nominal GDP growth (in percent)	11.4	4.7	6.8	6.2	6.0	6.0	5.6	5.7	5.8		S&Ps	BBB-	BBB-
Effective interest rate (in percent) [4/]	7.5	4.4	3.8	3.9	4.0	4.1	3.9	4.0	4.2		Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.0	1.7	-1.2	0.5	0.5	0.5	1.1	1.1	1.2	4.9	
Identified debt-creating flows	2.1	4.2	3.2	1.0	0.4	0.4	0.6	0.7	0.7	3.9	
Primary deficit	2.5	0.4	0.2	1.5	1.3	1.2	1.3	1.4	1.4	8.0	-0.6
Primary (noninterest) revenue and grants	31.6	32.0	32.7	30.6	29.5	29.0	28.9	28.8	28.6	175.4	
Primary (noninterest) expenditure	34.1	32.4	32.9	32.0	30.8	30.2	30.2	30.2	30.0	183.4	
Automatic debt dynamics [5/]	-0.3	2.9	1.7	-0.9	-0.8	-0.7	-0.7	-0.7	-0.6	-4.4	
Interest rate/growth differential [6/]	-0.5	-0.1	-1.1	-0.9	-0.8	-0.7	-0.7	-0.7	-0.6	-4.4	
Of which: real interest rate	0.0	1.0	0.3	0.7	0.6	0.5	0.6	0.6	0.7	3.7	
Of which: real GDP growth	-0.5	-1.1	-1.4	-1.6	-1.4	-1.2	-1.3	-1.3	-1.3	-8.0	
Exchange rate depreciation [7/]	0.2	3.0	2.9	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	1.0	1.2	0.4	-0.2	0.0	0.0	0.0	0.0	0.3	
Privatization receipts (negative)	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Increase in deposits	0.2	1.0	1.2	0.4	-0.1	0.0	0.0	0.0	0.0	0.3	
Residual, including asset changes [8/]	-0.1	-2.6	-4.4	-0.5	0.1	0.0	0.5	0.4	0.5	1.1	



Source: IMF staff.

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

2/ Based on available data.

3/ EMBIG.

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

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

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

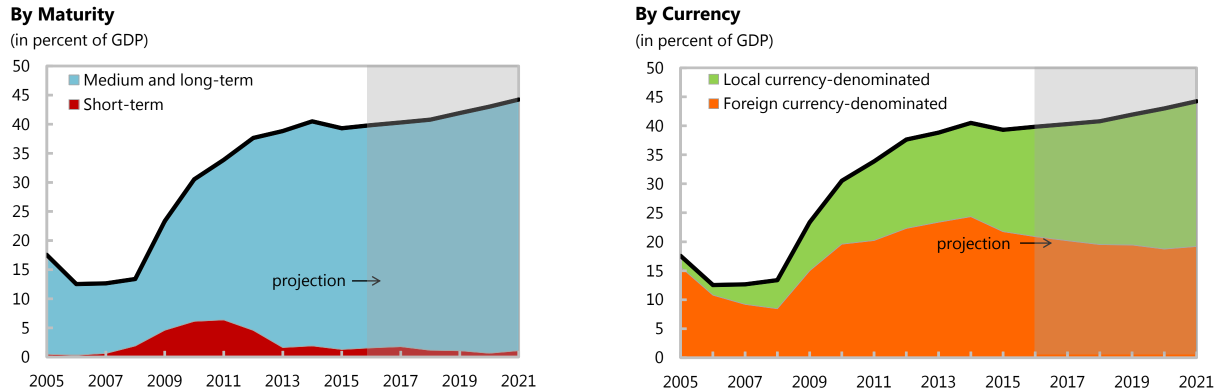
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

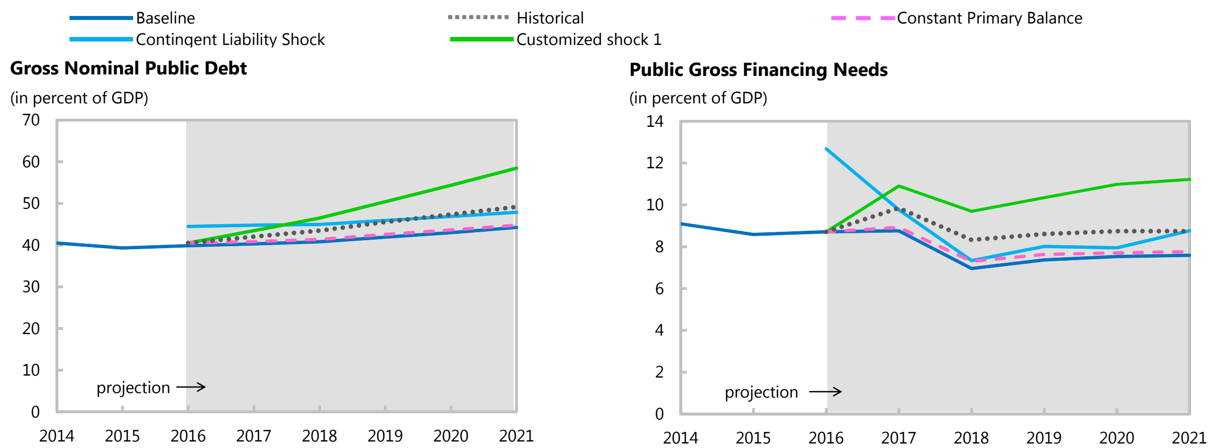
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex III. Figure 4. Romania Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	4.2	3.6	3.3	3.3	3.3	3.3
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary Balance	-1.5	-1.3	-1.2	-1.3	-1.4	-1.4
Effective interest rate	3.9	4.0	4.1	3.9	4.0	4.2
Constant Primary Balance Scenario						
Real GDP growth	4.2	3.6	3.3	3.3	3.3	3.3
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary Balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	3.9	3.9	4.0	3.9	4.0	4.3
Customized shock 1						
Real GDP growth	4.2	1.6	1.3	1.3	1.3	1.3
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary Balance	-1.5	-3.3	-3.2	-3.3	-3.4	-3.4
Effective interest rate	3.9	3.9	4.1	4.0	4.2	4.5

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	4.2	2.7	2.7	2.7	2.7	2.7
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary Balance	-1.5	-2.3	-2.3	-2.3	-2.3	-2.3
Effective interest rate 1/	3.9	3.9	3.7	3.4	3.3	3.4
Contingent Liability Shock						
Real GDP growth	4.2	3.6	3.3	3.3	3.3	3.3
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary Balance	-1.5	-1.3	-1.2	-1.3	-1.4	-1.4
Effective interest rate 1/	3.9	4.5	4.1	3.9	4.1	4.3

1/ Declining effective interest rate reflects negative historical real interest rates in Romania during the reference period.

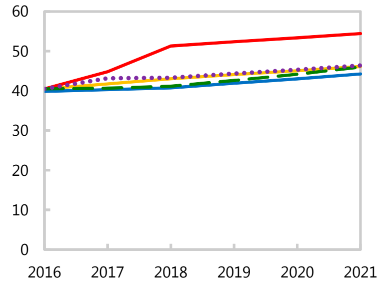
Source: IMF staff.

Annex III. Figure 5. Romania Public DSA—Stress Tests

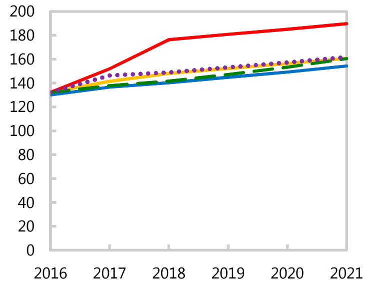
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

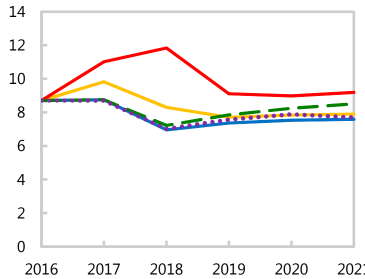
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



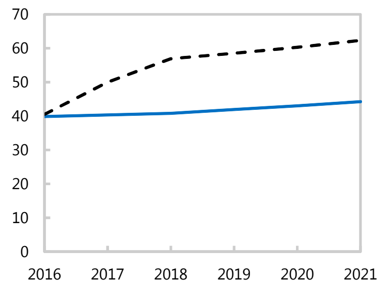
Public Gross Financing Needs
(in percent of GDP)



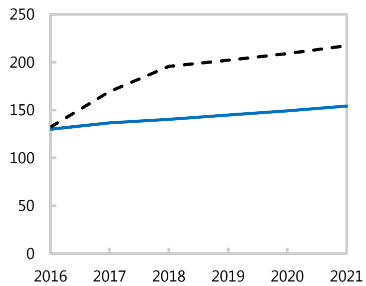
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

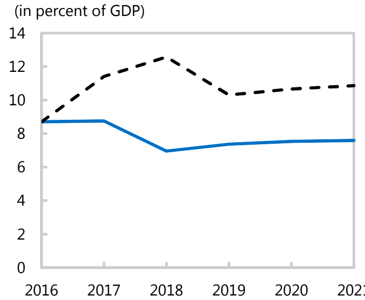
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

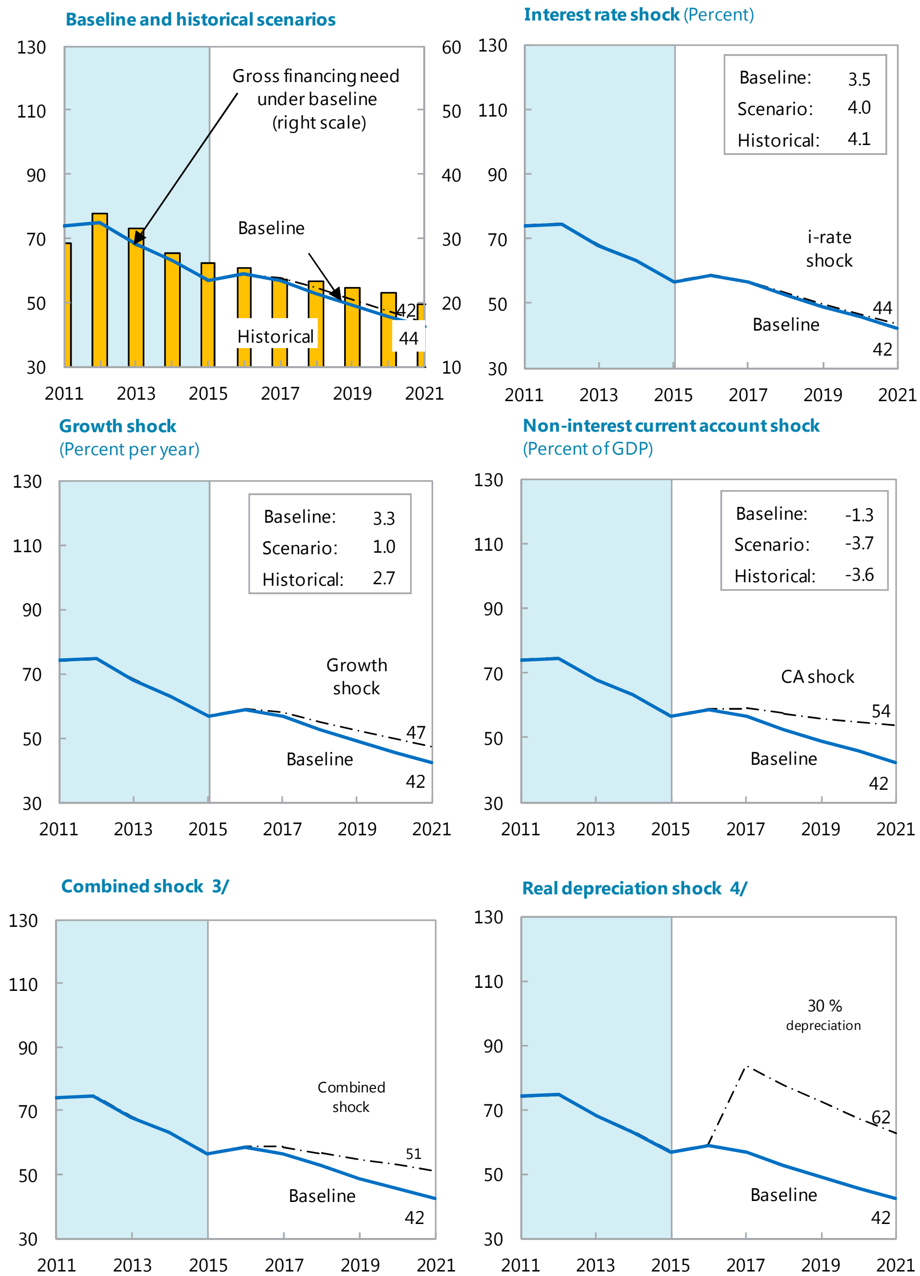
	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	4.2	3.6	3.3	3.3	3.3	3.3
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary balance	-1.5	-2.4	-2.2	-1.3	-1.4	-1.4
Effective interest rate	3.9	3.9	4.1	4.0	4.1	4.3
Real Interest Rate Shock						
Real GDP growth	4.2	3.6	3.3	3.3	3.3	3.3
Inflation	1.9	2.3	2.7	2.3	2.3	2.5
Primary balance	-1.5	-1.3	-1.2	-1.3	-1.4	-1.4
Effective interest rate	3.9	3.9	4.8	5.0	5.6	6.2
Combined Shock						
Real GDP growth	4.2	-1.1	-1.4	3.3	3.3	3.3
Inflation	1.9	1.1	1.5	2.3	2.3	2.5
Primary balance	-1.5	-3.1	-4.9	-1.3	-1.4	-1.4
Effective interest rate	3.9	4.3	4.7	5.2	5.7	6.3

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	4.2	-1.1	-1.4	3.3	3.3	3.3
Inflation	1.9	1.1	1.5	2.3	2.3	2.5
Primary balance	-1.5	-3.1	-4.9	-1.3	-1.4	-1.4
Effective interest rate	3.9	3.9	4.2	4.2	4.3	4.5
Real Exchange Rate Shock						
Real GDP growth	4.2	3.6	3.3	3.3	3.3	3.3
Inflation	1.9	8.1	2.7	2.3	2.3	2.5
Primary balance	-1.5	-1.3	-1.2	-1.3	-1.4	-1.4
Effective interest rate	3.9	4.3	4.0	3.8	3.9	4.2

Source: IMF staff.

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

(External debt in percent of GDP)



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

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

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

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

4/ One-time real depreciation of 30 percent occurs in 2013.

Annex III. Table 1. Romania: External Debt Sustainability Framework, 2011–21

(In percent of GDP, unless otherwise indicated)

	Actual				Est.			Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	74.0	74.6	68.0	63.1	56.7			**58.7**	**56.6**	**52.7**	**48.9**	**45.6**	**42.4**	**-2.8**
Change in external debt	1.1	0.6	-6.6	-4.9	-6.4			2.0	-2.1	-3.9	-3.8	-3.3	-3.2	
Identified external debt-creating flows (4+8+9)	0.0	2.6	-6.4	-4.0	-4.5			-2.2	-1.3	-0.8	-0.4	0.1	0.3	
Current account deficit, excluding interest payments	2.2	2.3	-1.6	-1.6	-0.6			-1.0	0.5	0.8	1.3	1.8	2.0	
Deficit in balance of goods and services	5.8	5.1	0.8	0.3	0.5			1.7	2.4	2.5	2.7	3.0	3.1	
Exports	36.6	37.3	39.7	41.2	41.1			39.1	39.6	40.3	40.8	41.5	41.9	
Imports	42.4	42.3	40.5	41.5	41.6			40.8	42.0	42.8	43.5	44.4	45.0	
Net non-debt creating capital inflows (negative)	-1.4	-2.1	-1.9	-1.7	-1.6			-1.7	-1.8	-1.8	-1.8	-1.8	-1.8	
Automatic debt dynamics 1/	-0.9	2.3	-2.9	-0.7	-2.3			0.4	0.0	0.1	0.1	0.1	0.1	
Contribution from nominal interest rate	2.7	2.5	2.6	2.0	1.7			2.7	2.0	1.9	1.7	1.6	1.5	
Contribution from real GDP growth	-0.7	-0.5	-2.4	-1.9	-2.2			-2.3	-2.0	-1.7	-1.6	-1.5	-1.4	
Contribution from price and exchange rate changes 2/	-2.8	0.3	-3.1	-0.8	-1.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	-2.0	-0.2	-1.0	-1.9			4.3	-0.9	-3.1	-3.4	-3.4	-3.5	
External debt-to-exports ratio (in percent)	202.3	200.2	171.1	153.0	137.9			150.1	143.0	130.8	119.8	110.0	101.1	
Gross external financing need (in billions of Euros) 4/	38.9	45.2	45.6	41.6	42.0			42.5	41.7	44.0	44.5	45.1	43.8	
in percent of GDP	29.2	33.9	31.6	27.7	26.2			25.4	23.5	23.3	22.3	21.4	19.6	
Scenario with key variables at their historical averages 5/								**58.7**	**57.5**	**54.3**	**50.7**	**47.2**	**43.7**	**-4.8**
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	1.1	0.6	3.5	3.0	3.8	2.7	4.7	4.2	3.6	3.3	3.3	3.3	3.3	
GDP deflator in Euros (change in percent)	4.0	-0.4	4.3	1.1	2.9	4.7	7.8	0.2	2.4	2.8	2.4	2.5	2.6	
Nominal external interest rate (in percent)	3.9	3.3	3.8	3.1	2.9	4.1	1.0	5.0	3.6	3.5	3.5	3.5	3.5	
Growth of exports (Euro terms, in percent)	20.3	2.0	15.1	8.0	6.4	13.8	13.6	-0.6	7.3	8.0	7.2	7.5	7.1	
Growth of imports (Euro terms, in percent)	16.1	0.1	3.3	6.8	7.0	10.8	18.4	2.3	9.2	8.1	7.7	8.0	7.3	
Current account balance, excluding interest payments	-2.2	-2.3	1.6	1.6	0.6	-3.6	4.8	1.0	-0.5	-0.8	-1.3	-1.8	-2.0	
Net non-debt creating capital inflows	1.4	2.1	1.9	1.7	1.6	3.4	2.6	1.7	1.8	1.8	1.8	1.8	1.8	

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

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

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

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

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

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

Annex IV. External Sector Assessment

Staff's overall assessment is Romania's external position in 2015 was broadly in line with fundamentals.

1. **Foreign Assets and Liabilities**. Romania's net international investment position (IIP), as a share of GDP, has improved since 2012. The IIP was -50.2 percent of GDP in 2015, a 6.7 percentage points improvement since 2014 due to the decrease in foreign liabilities. Going forward, the IIP is expected to continue to improve due to mainly the continued reduction in external liabilities.

Romania: Estimated Policy Contributions to Current Account Gap, 2015
(percent of GDP)

EBA-Lite CA Method	
Cyclically-adjusted CA	-1.0
Cyclically-adjusted CA (removing temporary factors)	-2.0
Cyclically-adjusted CA norm	-3.0
Model estimated CA gap	2.0
Of which:	
World fiscal deficits	0.7
Domestic fiscal deficits	-0.2
Policy gaps, other	0.4
Residuals	1.2
Adjusted CA gap (removing temporary factors)	1.0
EBA-Lite REER Index Model	
REER Gap 1/	-2.0
EBA-Lite External Sustainability Model	
CA Gap	0.9
REER Gap 1/	-3.6

1/ Negative value implies REER is below levels consistent with fundamentals and desirable policies.

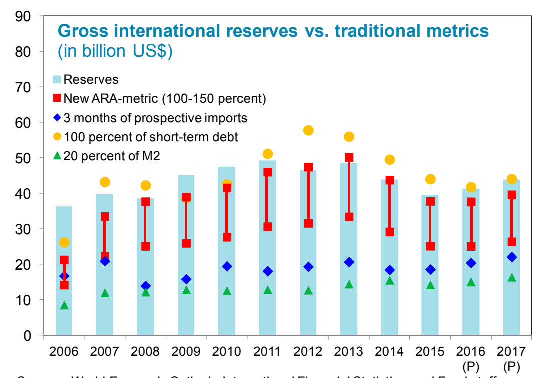
2. **Current Account**. Romania's current account deficit has narrowed remarkably since the global financial crisis, from 11.8 percent of GDP in 2008 to 1.1 percent in 2015, primarily on the back of strong exports (both goods and services) and import compression. Exports of goods and services comprise around 40 percent of GDP (compared to the pre-crisis level of 25 percent of GDP). The current account deficit has modestly deteriorated last year, primarily due to the increase in goods deficit and the almost doubling of primary income deficit. The Fund's recently developed EBA-lite tool[1] estimates that a cyclically-adjusted CA norm of -3.0 percent of GDP is consistent with medium-term fundamentals. The estimated CA gap of 2.0 percent includes policy gap of 0.9 percent, mainly due to the fiscal gap in the rest of the world. The EBA-lite model does not completely capture the temporary factors responsible for the sharp adjustment of the current account in Romania since 2007. The large compression in imports and the strong exports since 2007 is likely to be partly temporary and reverse to some extent, and the current account deficit is expected to gradually widen to 3.5 percent in the medium term. Hence, staff assesses that

[1] The External Assessment (EBA) methodology has been developed by IMF as a successor to the former CGER exercise. There are two important differences. First, EBA makes a sharper distinction between positive (descriptive) understanding of current accounts and real exchange rates and making normative evaluations. Second, EBA takes into account a much broader set of factors—including policies, cyclical conditions, and global capital market conditions—that may influence the current account and real exchange rate. For more details, see "The External Balance Assessment (EBA) Methodology," IMF Working Paper, WP/13/272. EBA-Lite model has been developed using the same methodology for countries not included in EBA. For more details, see "Methodological Note on EBA-Lite" at http://www.imf.org/external/pp/longres.aspx?id=5017.

the cyclically-adjusted CA, removing all temporary factors predominantly related to imports, would be around -2 percent of GDP, implying that the underlying cyclically-adjusted current account deficit is lower than the cyclically-adjusted norm.[2]

3. **Real Exchange Rate**. The real exchange rate has depreciated by around 4 percent in 2015. Assuming that exchange rate changes would be the primary driver for a current account adjustment, the EBA-Lite CA model estimates that an appreciation of around 8 percent would be needed to close the gap between the underlying cyclically-adjusted current account and the norm. However, staff assessment, incorporating the temporary factors in the current level of the cyclically-adjusted current account, implies that an appreciation of around 4 percent of the currency would be required to close the CA gap. The EBA-Lite REER index model suggests a modest undervaluation of 2 percent, while the EBA-Lite External Sustainability Approach suggests an undervaluation of around 3.6 percent. Overall, staff assesses that the real exchange rate is broadly in line with its equilibrium level. However, caution is needed to ensure that the recent wage pressure, an average increase of 8 percent in 2015, due to the rise in public wages and minimum wages do not undermine competitiveness.

4. **Reserve Adequacy**. Reserve coverage in Romania is broadly adequate according to most reserve adequacy metrics. The reserve level of €35.5 billion at end-December 2015 was above the level recommended by the standard rules of thumb (three months coverage of prospective imports and 20 percent of broad money). It was also in line with the new reserve adequacy metric for emerging markets developed by Fund staff. Reserves fell slightly short of the 100 percent short-term debt (at remaining maturity) benchmark, but this metric has improved recently due to the reduction in short-term external liabilities. Nevertheless, in light of continued downside external risks, a prudent stance with moderate reserve accumulation remains appropriate.



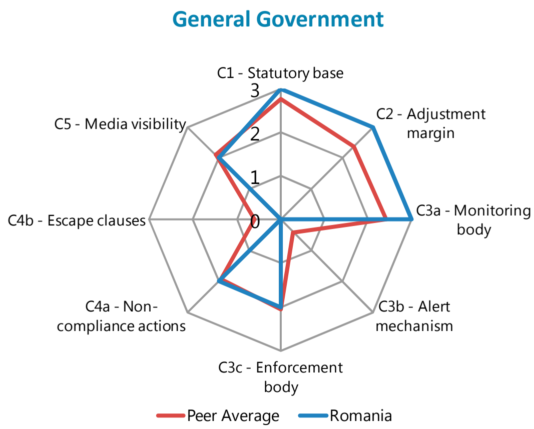
Sources: World Economic Outlook, International Financial Statistics; and Fund staff calculations.

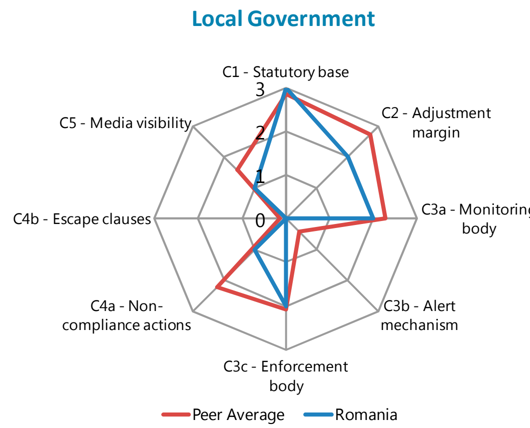
[2] The EBA-lite model includes two variables to capture temporary components of the CA (the output gap and temporary terms of trade changes), but in some instances these may not capture other temporary phenomena. The contraction in investment/imports during and after crises is generally much larger than what can be explained by linear specifications for the output gaps.

Annex V. Fiscal Institutions

1. **Romania's national and sub-national fiscal rules follow the EU model**. In 2013, the 2010 Fiscal Responsibility Law (FRL) was amended in line with EU requirements to include structural fiscal targets and specify corrective actions in case of deviations. Currently, the MTO for Romania is 1 percent of GDP deficit, to be achieved through structural annual adjustments of 0.5 percent of GDP. Also following EC provisions, the annual increase of expenditures should not exceed the projected nominal GDP growth for the next three years until the budget balance is in surplus. Public debt should not exceed 60 percent of GDP. Municipalities' budgets, excluding loans to finance investment and debt refinancing, have to be balanced. Municipalities cannot contract or guarantee loans if their annual public debt service (principal payment, interest, and commissions) including the loan they want to contract, is higher than 30 percent of their own revenue.

2. **A Fiscal Council was established in mid-2010**. This was one of the main objectives of the 2010 FRL. The council issues opinions and recommendations on official macroeconomic and budgetary forecasts, the annual budget laws, and assesses the compliance of the medium-term fiscal strategy with the principles and rules specified in the FRL.





Source: European Comission *Fiscal Rules Database*.

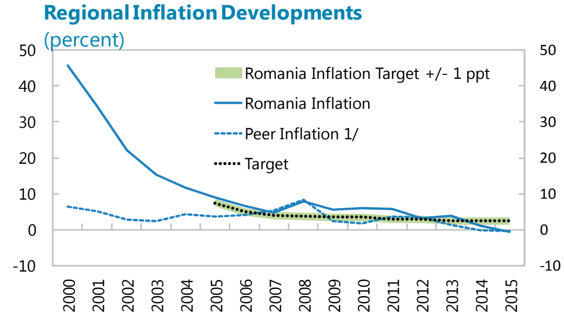
3. **On paper, Romania's fiscal rules fare well in comparison with the rest of the EU**. The EC periodically assesses the quality of European countries' fiscal rules. The last available assessment was done in 2014 and it is organized around five main indicators for both the local and the general governments (figure): (i) the legal basis of the rule (such as constitution or law); (ii) the room for revising the objectives; (iii) the institutions in charge of enforcement, monitoring and alerting (such as independent authority or the parliament); (iv) the enforcement mechanisms (such as an automatic sanction mechanism in case of non-compliance); and (v) media visibility (triggering public debate).

Based on these indicators, the general government rules fare well on the whole. At the local level, enforcement mechanisms and media visibility are area with margins for improvement.

4. **However, the actual enforcement of the rules is weak**. The fiscal rules have been repeatedly circumvented in the recent past. A recent example of non-compliance relates to the 2016 budget law that breaches the fiscal rule but contained specific provisions to waive the FRL (in this way also avoiding triggering the automatic sanctions foreseen by the FRL). The effectiveness of the rules should be strengthened through increasing the public awareness of the rules, ensuring proper tracking of risk of breaching them, and strengthening automatic sanctions to incentivize responsible parties to apply the rules.

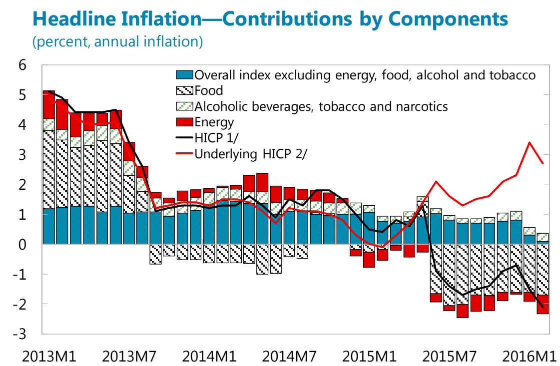
Annex VI. Inflation Outlook in Romania

1. **Headline inflation has come down markedly in Romania over recent years**. Romania experienced elevated levels of inflation in early 2000s which it was able to bring down on account of the increasingly successful stabilization of the economy and the improving structural factors, including successful wage policies, and relying on exchange rate as a nominal anchor to contain depreciation. Direct inflation targeting was introduced in August 2005 and since then inflation has been close to, though mostly slightly above, the target range. In the very recent period, headline inflation has declined in Romania in line with regional peers; it fell below the target in 2014 before entering the negative territory in June 2015.



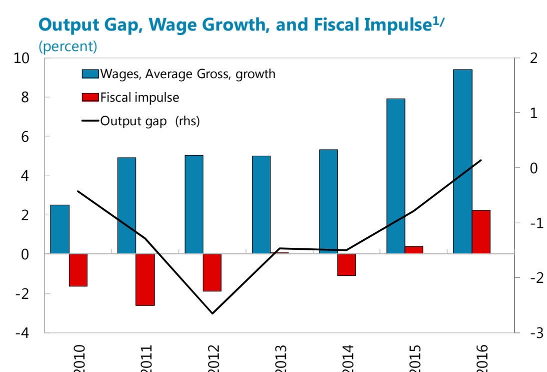
Sources: IMF *World Economic Outlook.*
1/ Peer countries include BGR, CZE, EST, HRV, HUN, LTA, LTU, POL, and SVK.

2. **Key factors behind the fall in inflation were oil and food price developments, but especially the recent reduction in the VAT rate**. Three episodes of a noticeable fall in inflation can be identified. The first in mid-2013 was largely due to lower food prices following an abundant harvest and a reduction in VAT on some food products. The second episode, since autumn 2014, was mainly the result of declining international energy prices. And most recently, the key reasons why the inflation rate turned negative were the VAT rate reduction on food items from 24 to 9 percent in mid-2015 and the standard VAT rate reduction from 24 to 20 percent in January 2016.



1/ Harmonized Index of Consumer Prices (HICP).
2/ HICP at constant tax rates.
Sources: Eurostat; and IMF staff calculations.

3. **Despite the fall in headline inflation, underlying inflation is positive, and inflation expectations are close to target**. Headline inflation in the first half of this year is expected to fall lower, following the recent standard VAT rate reduction (from 24 to 20 percent), lower import prices, and the decrease of tariffs for electricity. Underlying inflation—adjusted for the VAT cut but



Source: IMF staff calculations.
1/ Measured as the annual change in the primary structural general government fiscal deficit.

nevertheless incorporating lower international food and energy prices—has been rising in recent months and reached 2.3 percent in December 2015 (HICP at constant tax, Eurostat estimate). Based on the latest projections by the NBR, underlying inflation is projected to reach 3.7 percent by end-2017. So far, consensus forecasts for 2017 and 2018 have stayed close to the target.

4. **Going forward, a number of domestic factors point to a potential buildup of inflationary pressure that should be carefully monitored**. The output gap is projected to turn positive this year, as the Romanian economic growth is set to accelerate; wage pressure is growing, following the announced, large-scale upward adjustment in minimum wages and public wages; moreover, the fiscal impulse of about 2 percent of GDP is likely to drive up inflation expectations. Besides the pressures from demand factors, inflation is expected to rise as a number of supply shocks would likely reverse or phase out over the next 12 months.

Annex VII. Minimum Wage Policy in Romania

1. **Minimum wage policy in Romania has been increasingly active in recent years**. Minimum wages will be raised in May 2016, resulting in about 78.6 percent increase compared to end-2012. Minimum wage in Romania also showed the sharpest rise among EU countries, although the increase could partly indicate the progressive convergence with peers. With the planned increase in 2016, the minimum wage in Romania would leap to approximately 45.3 percent of mean wage and 65.4 percent of median wage which is high by international standards. In 2013, there were approximately 430,000 workers in Romania with wages at or below the minimum wage, accounting for about 11.2 percent of total workers registered. Minimum wage workers are largely concentrated in construction, trade, manufacturing, hotels and restaurants. The majority of these workers are among working-age group and about two-thirds of minimum wage workers are male. There was only 0.5 percent of government employees who received minimum wage in 2013, and a large increase in public sector wage in 2016 would lift the monthly salary for all government employees above the minimum wage.

2. **The increase in minimum wage is aimed at reducing poverty**. The Romanian government introduced the active minimum wage policy as part of measures to tackle poverty as committed in the Europe strategy 2020. A rise in minimum wage would reduce the number of low-paid workers—the share of workers at or below the minimum wage rose to 11.3 percent after the first hike in 2013, from around 4 percent in 2012. However, minimum wage is a poorly targeted instrument and may not be effective in reducing poverty as the effects would depend largely on the extent to which the population of minimum wage earners and that of the working poor are overlapped (IMF Country Report No. 14/221 and OCED (2015)).

3. **Sharp increases in minimum wage may nevertheless have undesirable economic effects**. Several studies find that high minimum wage to gross average wage ratio could undermine external competitiveness and export performance, while hampering potential foreign direct investment that could benefit low-skilled labor. Minimum wage is, in principle, a wage floor. If the floor is set too high, it could affect firms' profitability and discourage employers from hiring. Studies generally find negative labor demand elasticity to the change in minimum wage, particularly among young or low-skilled workers. But, the net effect on the total employment may be varied, depending on the overall economic conditions and labor market structures across countries. Sharp and sudden minimum wage increases are more often associated with sizeable employment effects, particularly if the initial level of minimum to average wage ratio is already at high level.

4. **Future decisions on minimum wage need to be carefully crafted**. The International Labor Organization (ILO) Convention on Minimum Wage Fixing (1970) suggests several elements to be taken into consideration in determining the level of minimum wages: (a) the needs of workers and their families and (b) economic factors including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment. Minimum wage in Romania is determined at the national level by the government after consulting trade unions and employers' organizations. As minimum-to-average wage ratios in Romania are already higher than its peers, the economic effects could weigh on Romania's perceived competitiveness in the region. Hence, future minimum wage adjustments could usefully be based on a transparent and clear mechanism and avoid unsustainably rapid increases to avoid adverse effects. Finally, periodic assessments of the impact of labor market policy including minimum wages by labor market expert committees could usefully inform future policy decisions.

INTERNATIONAL MONETARY FUND

ROMANIA

April 22, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

CONTENTS

FUND RELATIONS

As of February 29, 2016

Membership Status	Joined 12/15/72	Article VIII
General Resources Account	SDR million	% Quota
Quota	1,811.40	100.00
Fund holdings of currency	1,811.40	100.00
Reserve Tranche Position	0.00	0.00
SDR Department	SDR million	% Allocation
Net cumulative allocation	984.77	100.00
Holdings	8.25	0.84
Outstanding Purchases and Loans	SDR Million	% Quota
Stand-By Arrangements	0.00	0.00

Financial Arrangements

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

Projected Payments to Fund (Expectations Basis)[1]

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/interest	0.45	0.6	0.6	0.6	0.6
Total	0.45	0.6	0.6	0.6	0.6

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

Exchange Rate Arrangement

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

Technical Assistance

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

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

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

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

Article IV Consultations

Romania is on a 12-month consultation cycle. The previous Article IV consultation was concluded by the Executive Board on March 25, 2015.

Safeguards Assessment

An update of the 2011 safeguards assessment, completed on January 10, 2014, found that overall governance at the NBR remains robust, although the legal framework is in need of update to strengthen the NBR's financial autonomy. Accountability and transparency practices are strong; annual financial statements are independently audited and published. Robust controls are maintained over foreign reserves management, government banking, and vault operations. Romania fully repaid the Fund on January 11, 2016 and therefore will no longer be subject to monitoring under the safeguards policy.

FSAP and ROSC

A joint IMF-World Bank mission conducted an update assessment of Romania's financial sector as part of the Financial Sector Assessment Program (FSAP) during November 3–14, 2008. The Financial Sector Assessment Report (FSSA) was discussed at the Board in April 2009.

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

Resident Representative

The Fund has had a resident representative in Bucharest since 1991. Mr. Alejandro Hajdenberg assumed the post of regional resident representative in April 2016.

RELATIONS WITH THE WORLD BANK

The current World Bank Group Country Partnership Strategy (CPS) for Romania, covering the period 2014–17, was presented to the Board on May 22, 2014. The strategy aims at reducing poverty and promoting shared prosperity. The CPS is built on three pillars: (i) *Creating a 21st Century Government*, with focus on a well-functioning public administration, effective in its service delivery and with an improved quality of public expenditure; (ii) *Growth and Private Sector Job Creation*, seeking sustainable poverty mitigation and shared prosperity through improvements in the business environment and SOE governance (especially in energy and transport), promoting innovation, and furthering the digital agenda and competitiveness; and (iii) *Social Inclusion*, a key to the EU's Europe 2020 Agenda, with a special focus on the Roma community.

i. International Bank for Reconstruction and Development (IBRD)

Romania's portfolio consists of six active investment projects that amount to US$1.6 billion and one Development Policy Loan (DPL), which are complemented by four country-executed trust funds over US$10 million and 11 (Bank-funded) analytical pieces. The ongoing five Reimbursable Advisory Services (RAS) are worth US$12.29 million and support the Roma Education Fund, the Chancellery of the Prime Minister, the Ministry of Education and National Agency of Public Procurement. Since 2010, 47 RAS agreements totaling US$75.75 million have been signed.

- The six active investment projects include the recently approved Additional Financing for Integrated Nutrient Pollution Control (US$120.5 million), the Romania Secondary Education Project (US$243 million), the Health Sector Reform Project (US$339 million), the Results-Based Project for Social Assistance System Modernization (US$710 million), a Judicial Reform Project (US$130 million), and a Revenue Administration Modernization Project (US$92 million).

- The Second Fiscal Effectiveness and Growth DPL is the only loan under preparation for approval by the Bank's Board of Directors in FY2017. It is the second DPL in a programmatic series of two, which supports structural reforms in the areas of: cash and debt management; centralized procurement for health; public investment prioritization; SOE corporate governance; social assistance; energy; cadaster; and capital markets.

- The country-executed trust funds focus on (i) afforestation; (ii) nutrients pollution control; (iii) policymaking for people with disabilities; and (iv) strengthening financial accountability.

- The Bank advisory services program covers key areas of engagement. Under the programming period 2007–13, the Bank has been providing guidance on policy formulation and strategy development in agriculture, competition, climate change, early school leaving, tertiary education, life-long learning, active ageing, social inclusion, Roma integration and transport. Among the 47 RAS that have been signed since 2010, a few provided support to the government in improving the public sector management for efficient and effective service delivery by: (i) shifting towards a results-driven culture, improved policy prioritization, implementation, and coordination, (ii) strengthening public investment management, (iii) introducing performance management systems for EU funds, and (iv) supporting the strategic activities to meet the EU funding conditions for education, social inclusion, active aging (EU 2014–20 program budget).

- Analytical work (Bank-funded ASA) provides diagnostics and policy recommendations in key areas and stimulate cross sector synergy. Typical examples are the Public Expenditure Reviews and Financial Sector Assessments. Other ASAs delivered in the past include Rural Land Registration, Irrigation Prioritization, Roads Safety, Partnerships for Marginalized Roma, and Decentralization.

ii. International Finance Corporation (IFC)

Since the start of operations in Romania in 1990 through FY2015, IFC has invested approximately US$2.5 billion in long-term finance in 81 projects, including US$556 million in mobilization. As of February 29, 2016, IFC's Committed Portfolio stood at US$565 million (US$463 million outstanding). At present, Romania is IFC's fourth-largest country exposure in the Central and Eastern Europe region after Turkey, Russia, and Ukraine, accounting for 1.2 percent of its outstanding global portfolio. IFC has played an active crisis response role in Romania. From FY2009 to FY2014, IFC invested approximately US$933 million of its own funds and mobilized an additional US$277 million in 30 projects in various sectors. Particular support was provided to the financial, renewable energy, and health sectors.

STATISTICAL ISSUES

As of January 14, 2016
I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance. The quality of the national accounts, price, fiscal, and balance of payments data is adequate.
National accounts: Quarterly and annual national accounts statistics are produced by the National Institute for Statistics (INS) using the *European System of Accounts 2010 (ESA 2010)*. Estimates are methodologically sound and are reported to the Fund on a timely basis for publication in the *International Financial Statistics (IFS)*. Provisional and semi-final versions are disseminated in the Statistical Yearbook and other publications, as well as on the web (www.insse.ro).
Prices: The Consumer Price Index is subject to standard annual reweighting, and is considered reliable. In January 2004, the INS changed the coverage of the Producer Price Index to include the domestic and export sectors.
Labor market: Labor market statistics are broadly adequate. The definition used for employment is consistent with *ESA 2010*.
Public finances: Annual GFS data for the general government sector, including public corporations operating on a non-market basis, are reported on an accrual basis derived from cash data using various adjustment methods. Tax revenues are adjusted using the time-adjusted cash

method; expense data are adjusted using due-for-payments data; and interest payments are calculated on an accrual basis. Accrual data are also available on a quarterly basis three months after the end of each quarter. EUR receives monthly cash budget execution data. Consolidated data on general government operations are reported for inclusion in the *GFS Yearbook*.	
Monetary and financial statistics: The National Bank of Romania (NBR) reports monetary and financial statistics on a monthly basis for publication in the *IFS*. Since December 2004, the NBR reports monetary data to STA using the Standardized Report Forms (SRFs), including data for Other Financial Corporations (OFCs). The data are published beginning September 2006. **Financial Soundness Indicators (FSIs)**: The NBR reports all core and most encouraged FSIs for Deposit Takers on a quarterly basis, beginning in 2010 Quarter 1. In addition, the NBR reports FSIs for the nonfinancial corporations (NFCs) and households (HHs) sectors, as well as those concerning real estate markets.	
Balance of payments: The NBR routinely reports quarterly and annual external sector statistics to the Fund in a timely fashion. Since September 2014 the authorities implemented the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*), in line with other European countries. Romania also participates in the IMF's Coordinated Portfolio Investment Survey (CPIS) and Coordinated Direct Investment Survey (CDIS).	
II. Data Standards and Quality	
Romania is a subscriber to the Fund's Special Data Dissemination Standard (SDDS) since August 4, 2005.	IMF Reports on the Observance of Standards and Codes (ROSC) have been published as Country Report No. 01/206, 02/254 and 03/389.

Romania: Table of Common Indicators Required for Surveillance
(As of January 14, 2016)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	May 2014	Jun 2014	D and M	D and M	D and M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov 2015	Jan 2016	D and M	W and M	M
Reserve/Base Money	Nov 2015	Jan 2016	D and M	W and M	M
Broad Money	Nov 2015	Jan 2016	M	M	M
Central Bank Balance Sheet	Nov 2015	Jan 2016	M	M	M
Consolidated Balance Sheet of the Banking System	Nov 2015	Jan 2016	M	M	M
Interest Rates[2]	Nov 2015	Jan 2016	M	M	M
Consumer Price Index	Oct 2015	Dec 2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Nov 2015	Jan 2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Apr 2014	Mar 2014	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4 2013	Mar 2014	Q	Q	Q
External Current Account Balance	Q3 2015	Dec 2015	M	M	Q
Exports and Imports of Goods and Services	Q3 2015	Dec 2015	M	M	M
GDP/GNP	Q1 2014	May 2014	Q	Q	Q
Gross External Debt	Q4 2013	Mar 2014	Q	Q	Q
International Investment Position[7]	Q3 2015	Dec 2015	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic non-bank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds), and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by Menno Snel, Executive Director for Romania and Serban Matei, Senior Advisor to the Executive Director May 9, 2016

Within the framework of the programs supported by the IMF, the European Union and the World Bank, Romania has registered remarkable progress across its macroeconomic fundamentals in the last decade. As staff well noted, prudent policies, reduced vulnerabilities, and the fiscal and current account deficits improved markedly. After reentering the positive GDP growth territory in 2011, the economy continues to expand for the fourth consecutive year, the current account deficit dropped and a sharp fiscal consolidation process led to a reduction in the public deficit. Inflation has continued to come down, entering the negative territory in June 2015. Romania has maintained a resilient banking system, NPL ratios significantly decreased, adequate buffers were kept in place and no public funds have been necessary to support the banking sector during the global financial crisis. The Romanian authorities are aware of existing vulnerabilities and remain committed to continue on the path of reform and to further improve resilience and make the economic growth more structural.

Despite a challenging environment, Romania's economic recovery continues. Romania significantly reduced its internal and external imbalances through an important fiscal consolidation and prudent monetary and financial sector policies. In 2015, real GDP posted a swift annual growth rate, resulting in a 3.8 percent growth of Romania's economy as a whole. Private consumption noted an annual increase of 6.1 percent, marking a new post-crisis record high. This was underpinned by households' higher purchasing power, as a result of the lower consumer prices, on the one hand, and of the uptrend in the nominal income, on the other hand. In addition to private consumption growth, gross investments increased by 8.8 percent. The inflation rate had a positive evolution during the last years. Since 2013, when the central bank brought inflation back within the target range, it has been on a descending path. At the end of 2015, the annual CPI inflation rate continued to stay under the lower bound of the ±1 percentage point variation band of the 2.5 percent flat target. Under the current baseline scenario, the annual CPI inflation is projected to remain negative but later this year would return to positive levels, below the lower bound of the variation band of the target. The inflation rate is expected to reenter the variation band at the beginning of 2017 and stay there until the projection horizon, when it is seen reaching 3.4 percent.

The external position has improved markedly. The current account deficit adjusted remarkably since the global financial crisis (1.1 percent) and registered a modest widening in 2015. Romania continued and improved its presence on international capital markets, thus generating significant buffers. FDI inflows improved moderately due to the reinvestment of earnings and the economic recovery. As staff notes, despite large repayments to the Fund and the EU, gross reserves of €35.5 billion at end-2015 are broadly adequate by most reserve adequacy metrics. Despite the achieved progress, the economy remains vulnerable to adverse developments in international markets. However, the authorities will remain vigilant, act proactively, and take the necessary steps to contain these risks.

Significant progress continued in the fiscal sector but challenges remain. Since the start of the first program, Romania improved its fiscal position and reduced fiscal imbalances. In 2015, the fiscal deficit went below 1.5 percent of GDP, from almost 9 percent in 2008. Following the legislation adopted in late 2015, a package of tax cuts costing 1.4 percent of GDP in 2016 and a further 0.8 percent of GDP in 2017 poses significant fiscal challenges. The new Fiscal Code involves a welcome simplification of taxation legislation and has measures with positive revenue effects, including base broadening of social security contributions. These measures are aimed at stimulating the economy and incentivizing shifts from the informal to the formal sector. In addition, the authorities are committed to continued improvement of the revenue collection, while maintaining the fiscal deficit at 2.8 percent for 2016, as well as continuing sound fiscal policies and stronger public financial management. Recently, the authorities have made progress with prioritization of large public investment projects and significant steps have also been taken to enhance transparency of spending of public entities and the government plans to widen the use of centralized procurement. The authorities are aware of the existing challenges and are committed to pursue measures for fiscal sustainability and good public financial management.

The monetary authorities will continue to appropriately respond to economic developments. The National Bank of Romania (NBR) continued the rate-cutting cycle, lowering the policy rate to 1.75 percent, measures accompanied by a narrowing of the interest rate corridor and lowering the rate of minimum reserve requirement on both local and foreign exchange denominated liabilities. The central bank will ensure adequate liquidity conditions in the banking system, while underpinning the good functioning of money markets. The monetary authorities consider that a consistent implementation of an adequate macroeconomic policy mix and the step up in structural reforms, along the lines of the external financing arrangements, together with sustainable financial intermediation and an appropriate remuneration of bank deposits, are pivotal to consolidating the Romanian economy and enhancing its resilience to external shocks.

The financial sector in Romania has strengthened in recent years. In 2015, banks' profitability reverted to positive territory, high solvency and liquidity ratios were reported, and the non-performing loan ratio was stuck on a downward path. Contagion risks also kept declining, as the reliance of banks in Romania on parent bank funding was on the wane. The comprehensive action plan of the central bank consisting of NPLs sales, write-offs and higher provisioning helped NPLs to further decline to 11.65 percent at end-2015. Moreover, total prudential provisions at the end of 2015 were sufficient to cover over 58 percent of NPLs while the IFRS provisioning ratio stood at 68.94 percent. The capitalization of the banking sector stays above 18 percent. The NBR will continue to closely monitor and supervise the banking system and take any necessary measures to ensure that banks maintain sufficient capital and liquidity. Moreover, in close coordination with the IMF and EC, the NBR will continue to regularly conduct top-down and bottom-up solvency stress tests as well as liquidity stress tests of the banking industry. However, like staff, we consider that new systemic risks have emerged: one is of a domestic nature and features maximum intensity, i.e., the risk of an uncertain and unpredictable legislative framework in the financial and banking field, and the other is of an external nature and features high intensity, namely a possible exit of the United Kingdom from the European Union.

The government is determined to adopt, as soon as possible, the draft legislation and to pursue a steadfast implementation of reforms aimed at improving corporate governance of SOEs. Progress with the implementation of the structural reform agenda continued but experienced limitations. Governance problems have received more attention recently as the authorities are aware of the key challenges to improve the corporate governance of state-owned enterprises, restructure those that have sustained long-standing problems and pose a drain on the budget, raise EU-funds absorption, and improve the investment climate.

Progress with reform of the administration and improvement of the business environment is necessary and important. The efforts made by the authorities in this area were recognized in the 2016 flagship report of the World Bank, Doing Business. Romania is now ranked 37th from previously 48th, especially thanks to the achievements in paying taxes, enforcing contracts and improving the insolvency system. However, the Romanian authorities are aware that reforms aimed at making the public administration more efficient and transparent should be sped up. Therefore, the authorities are aiming their focus on addressing further progress with prioritization of public investment projects, strengthening targeting of social protection schemes, extending centralized procurement to generate savings, and passage of the public procurement law.

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