FOR AGENDA

SM/08/167

June 12, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Romania—Staff Report for the 2008 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2008 Article IV consultation with Romania, which is tentatively scheduled for discussion on **Wednesday, June 25, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Romania indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Jaeger, EUR (ext. 35643).

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Central Bank forthwith; to the WTO Secretariat on Friday, June 20, 2008; and to the European Bank for Reconstruction and Development, the European Commission, the European Investment Bank, and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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ROMANIA

Staff Report for the 2008 Article IV Consultation

Prepared by the Staff Representatives for the 2008 Consultation with Romania

Approved by Juha Kähkönen and Matthew Fisher

June 12, 2008

Executive Summary

Background: A capital-inflow-driven absorption boom has underpinned rapid catch-up growth but also fuelled macroeconomic imbalances. In particular, the external current-account deficit has risen to unsustainable levels. And, since mid-2007, headline CPI inflation has surged well above the central bank's target, in part reflecting the first-round effects of food and energy price shocks. Rapid credit growth has raised risks to financial stability, although the largely foreign-owned banking system remains well-placed to absorb shocks. In this setting, fiscal policy has been highly procyclical and lacked medium-term orientation. Monetary policy, also faced with a depreciating exchange rate since international financial tensions erupted in mid-2007, has tightened its stance. However, and notwithstanding unfavorable global economic headwinds, the economy has yet to show signs of slowing.

Staff views: The main short-term challenge is to tighten fiscal policy, putting less of the stabilization burden on the fledgling inflation-targeting framework, while also avoiding the need to shift to a procyclical stance once boom conditions dissipate. Moreover, fiscal policies should be anchored within a more medium-term framework, also to address looming structural bottlenecks to catch-up growth in a forward-looking manner. The quality of credit portfolios needs careful monitoring, and additional preemptive measures to contain financial stability risks are warranted.

The authorities' views: The authorities broadly shared the staff's diagnosis and policy proposals, but noted that the fiscal deficit had remained well below 3 percent of GDP, while pressing investment needs and political constraints had made it difficult to adopt a less procyclical fiscal stance.

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I. Overview

1. **Large capital inflows have put Romania on a fast-growth track, but, amid uncoordinated policy responses, macroeconomic imbalances are widening.** Propelled by EU accession and massive capital inflows, Romania has enjoyed a stretch of strong economic performance, combining brisk catch-up growth with, until mid-2007, disinflation. But economic tensions have built up. The current-account deficit has surged to unsustainable levels. And, with booming absorption increasingly running up against binding supply constraints, procyclical fiscal policies have clashed with the National Bank of Romania's (NBR) inflation-targeting framework (Box 1). Nominal exchange rate volatility and large adverse shocks to food and energy prices have further complicated inflation control.

Box 1. Romania's Response to IMF Advice

With capital inflows surging, the Fund advised that automatic fiscal stabilizers should be allowed to operate, while public wage and employment policies should avoid aggravating private-sector labor shortages. The government, however, argued that fiscal policies foremost need to boost the economy's supply capacity, including by increasing investment spending, and that fiscal procyclicality may well be a price worth paying for this. There has been broad agreement on the appropriate monetary framework and policy requirements.

2. **Romania's fragmented politics is integral to concerns about economic prospects.** The minority government controls little more than twenty percent of parliamentary seats and has to rely on ad hoc coalitions to adopt key legislation. With parliamentary elections due in late-2008 or early-2009, proactive policy making, particularly as regards politically-difficult structural reforms, is largely on hold. However, new election rules, which include raising the voter threshold to 5 percent, could result in future coalition governments with a stronger mandate and purpose.

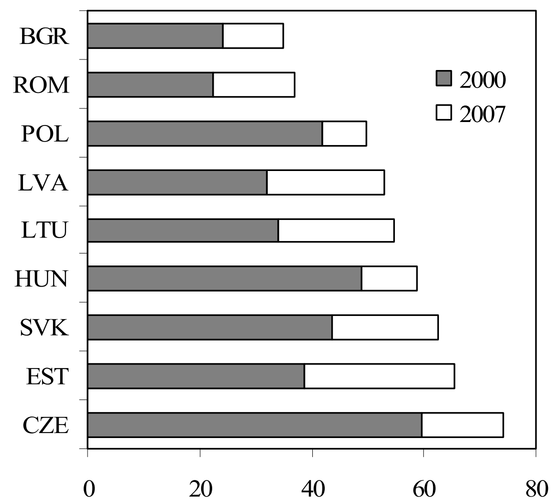
3. **Romania envisages entering the ERM II mechanism in 2012 and adopting the euro in 2014.** The authorities hope that this plan will allow time for the capital-inflow-driven macroeconomic imbalances to normalize, while anchoring policies to a clear, ambitious, but achievable euro-adoption calendar.

II. Background

A. Real and Nominal Convergence

4. **Fast but sustainable real catch-up growth requires stability-oriented policies.** Romania's per-capita income based on purchasing-power parities (PPP), while still at the tail end of the EU's income league, has caught up at an impressive speed over recent years. However, sustained fast real convergence will require stabilization policies that keep nominal convergence at a sustainable pace, while containing and managing risks from financial convergence. In particular, EU cross-country data strongly suggest that nominal convergence of price levels and labor costs—in common currency—is subject to tight speed limits (Figure 1). Thus, to safeguard real convergence, monetary, fiscal, and incomes policies need to contain external and internal imbalances. At the same time, Romania's financial deepening starts from very low levels, calling for regulation and supervision policies that preserve, and, if needed, restore financial stability along the real convergence path.

Selected EU Countries: Per Capita GDP in PPP, Euro Area=100

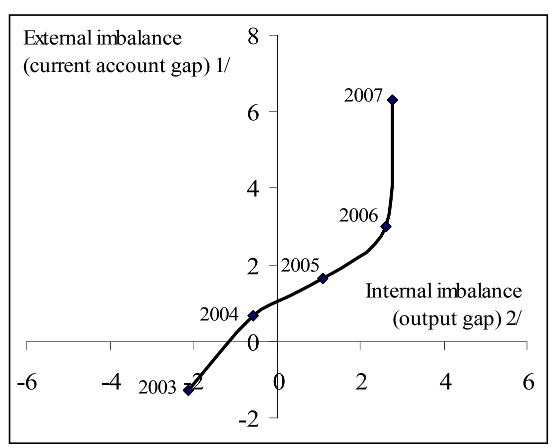


Sources: Eurostat; and Fund staff estimates.

B. External and Internal Balance

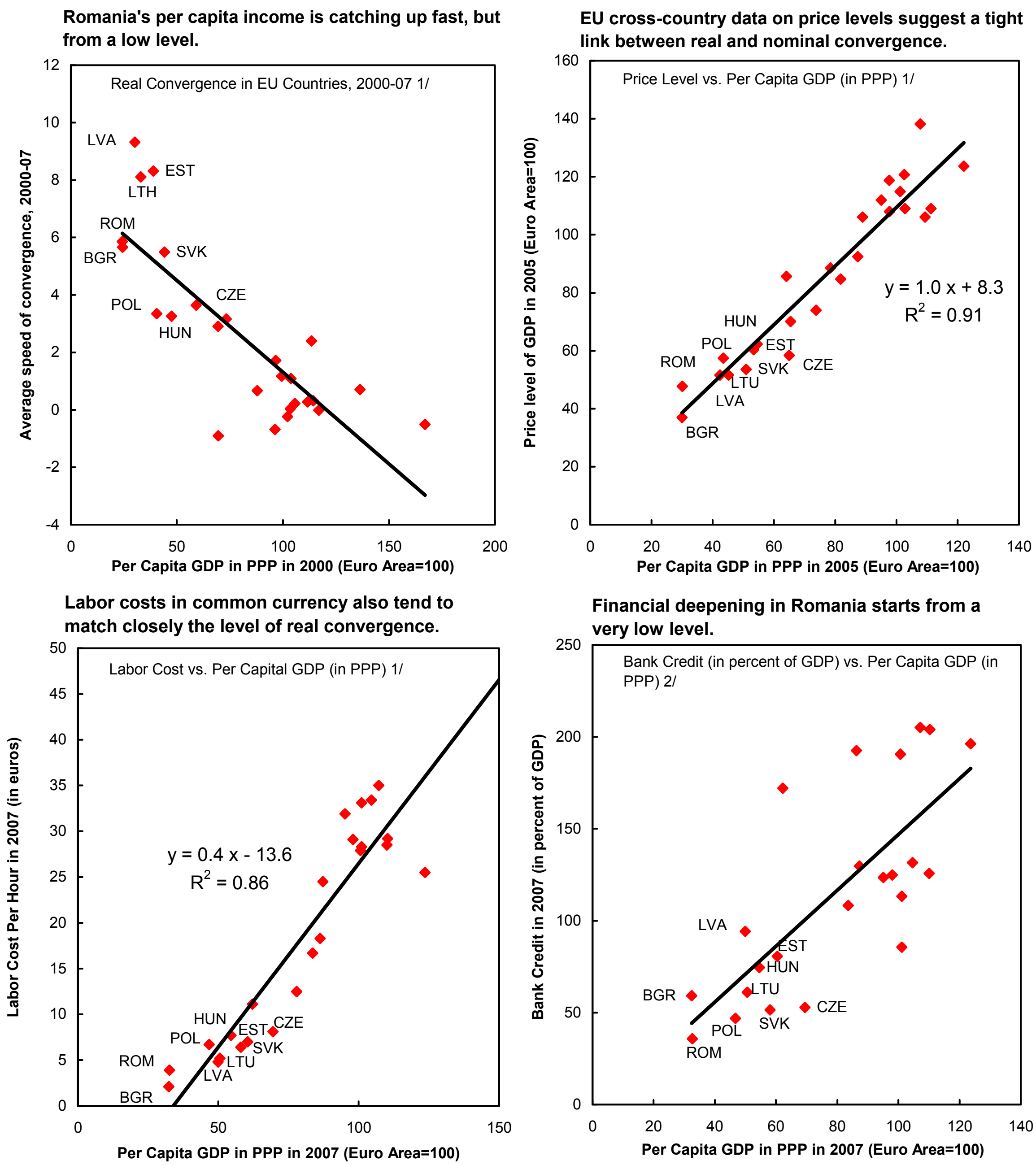
5. **An absorption boom, propelled by a surge in capital inflows, is at the root of growing macroeconomic imbalances.** Since 2003, absorption growth has outpaced income growth by large margins (Tables 1-2). A rapidly growing economy-wide spending-income gap was, however, overfinanced by capital inflows, which added to foreign-exchange reserves (text table). The absorption boom was mirrored by a ballooning current-account deficit, which reached 14 percent of GDP in 2007 (Table 3).

Romania: Internal and External Imbalances, 2003-07
(In percentage of potential GDP)



Source: Fund staff estimates.
1/ Deviation between actual and equilibrium current account.
2/ Deviation between actual and potential GDP.

Figure 1. Romania: Real, Nominal, and Financial Convergence



Sources: 2005 International Comparison Program; Eurostat; WEO; and Fund staff estimates.

1/ EU countries excluding Luxembourg.
2/ EU countries excluding Luxembourg, Cyprus, Malta, and Slovenia.

Romania: Absorption, Income, and Capital Flows, 2003-07
(In percent of GDP)

	2003	2004	2005	2006	2007
Absorption (domestic demand)	107.5	109.1	110.2	112.0	114.3
Consumption	85.7	85.3	87.5	85.6	84.7
Investment	21.8	23.8	22.6	26.5	29.6
= Gross disposable income 1/	101.7	100.7	101.3	101.7	100.3
+ Net capital inflows	6.7	15.7	15.7	15.7	17.7
+ FX Reserves (- is accumulation)	-0.9	-7.3	-6.8	-5.3	-3.7

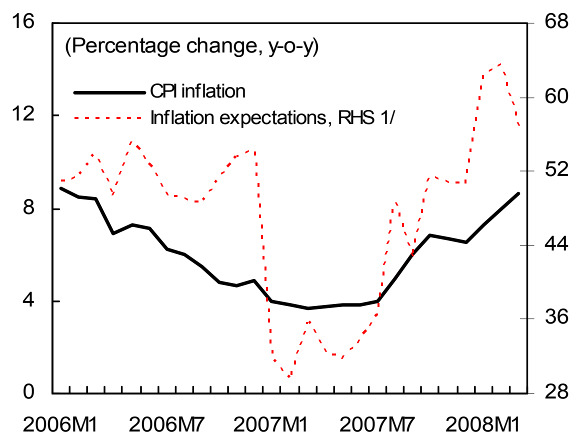
Sources: Romanian authorities; and Fund staff estimates and projections.

1/ GDP plus net factor income and transfer balance from abroad.

6. **As elsewhere in the region, private investment was the absorption boom's main driver (Figure 2).** Capital inflows were facilitated by capital account liberalization and high global risk appetite. But, with EU accession prospects secure, capital flows, particularly foreign direct investment (FDI), were also attracted by perceptions of lower investment risk, triggering a re-assessment of Romania as an investment location. Skyrocketing asset prices, easy capital gains, and rising collateral values added self-reinforcing momentum to the absorption boom. As in other countries, Romania's private consumption-GDP ratio remained remarkably stable, suggesting that consumption smoothing was not a principal boom driver.

7. **Inflation has re-emerged as a serious worry.** Real GDP growth (excluding agricultural production) has been robust, but is increasingly running up against capacity bottlenecks (Figure 3). Large-scale emigration, notably to Italy and Spain, and high demand for workers, especially in construction, have resulted in tight labor market conditions. As a result, real wage growth has outpaced productivity growth, with buoyant public-sector wages adding to private-sector wage pressures. With core inflation picking up, headline inflation has surged, partly owing to the first-round effects of shocks to energy and food prices, the latter also reflecting

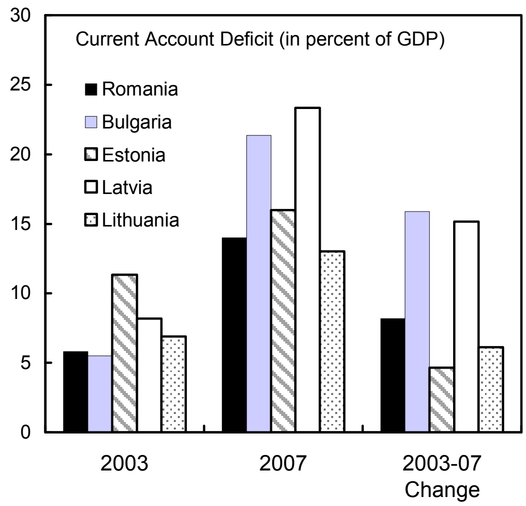
Inflation expectations seem to have risen along with actual inflation.



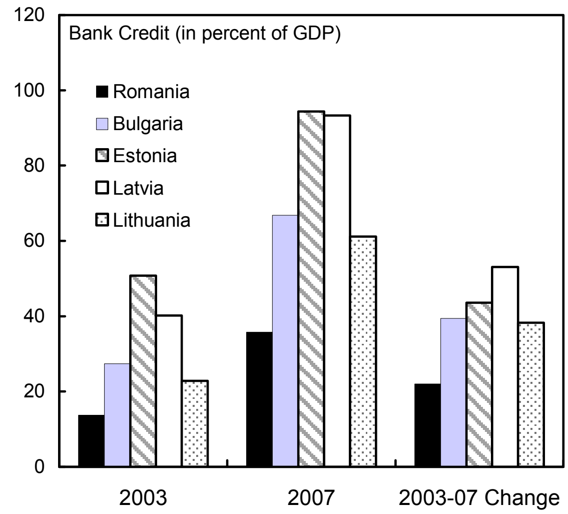
Sources: WEO; Eurostat; and Fund staff estimates.
1/ Consumer survey measure of expected price trends over next 12 months.

Figure 2. Selected EU Countries: A Regional Perspective on Absorption Booms, 2003–07

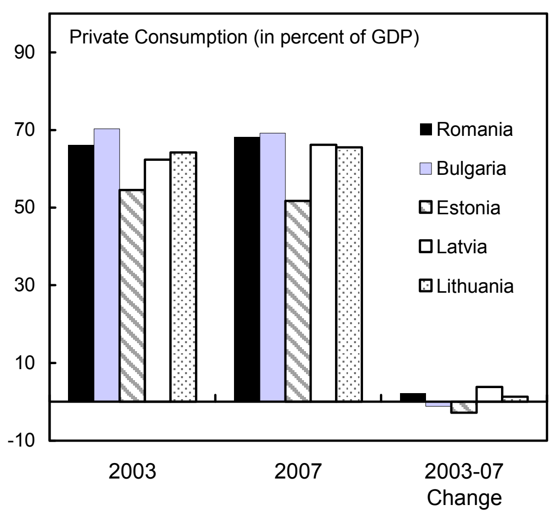
Romania's surging current account is not unique in the region ...



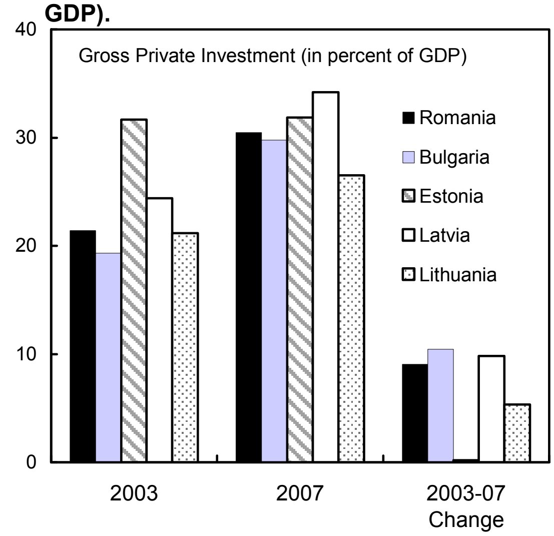
… although it was accompanied by a more moderate credit boom.



Private consumption remained remarkably stable (as a percent of GDP) in most countries ...

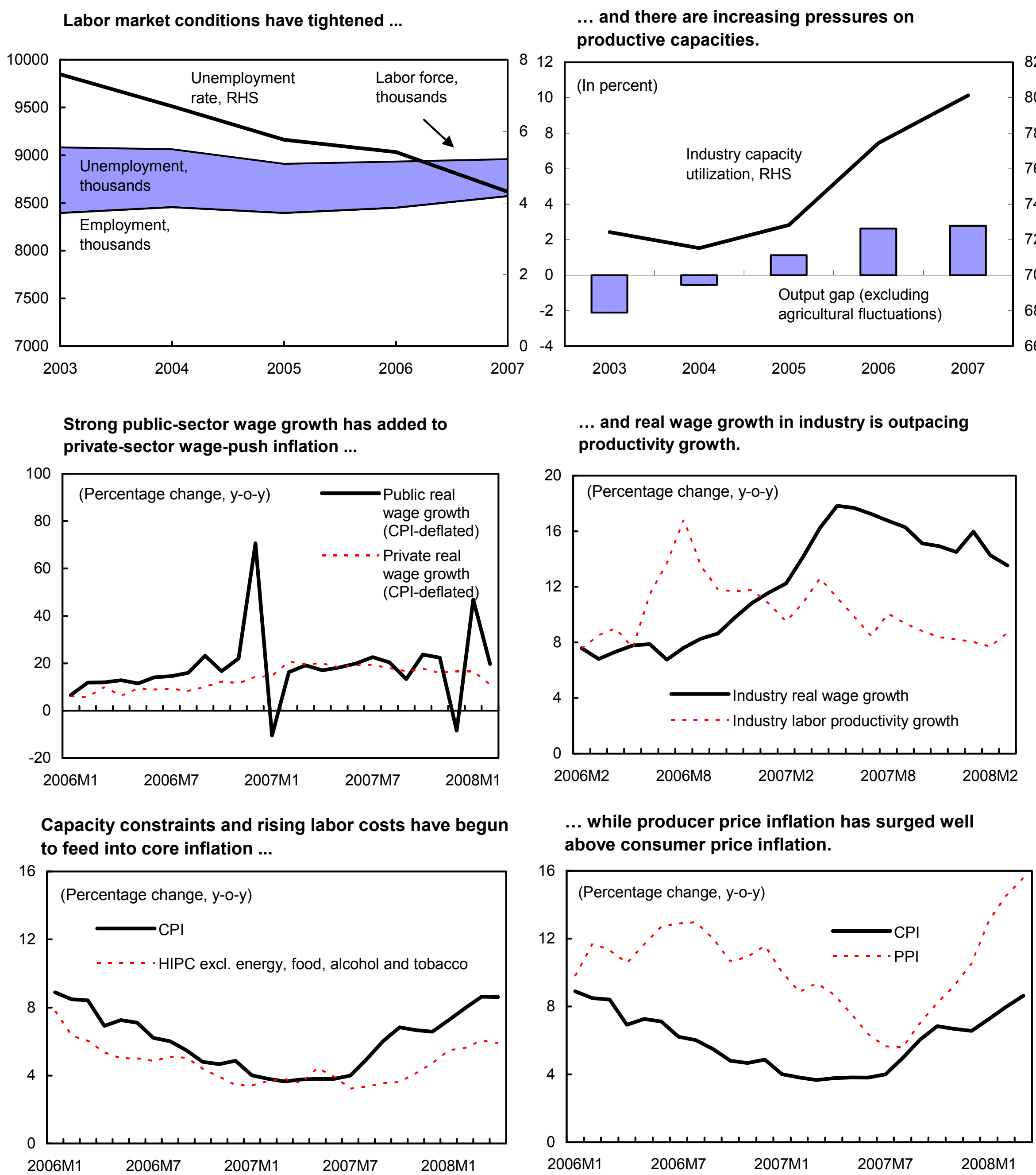


... while the absorption booms mainly boosted private investment (as a percent of GDP).



Sources: WEO; IFS; and Fund staff estimates.

Figure 3. Romania: Capacity Pressures and Inflation Indicators, 2003–08

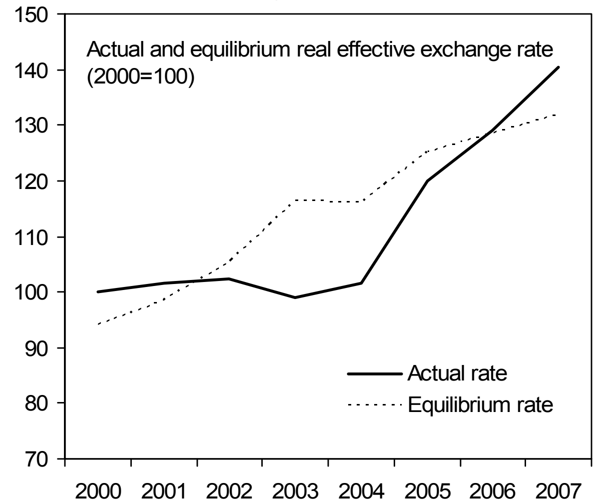


Sources: WEO; Eurostat; and Fund staff estimates and projections.

the 2007 drought. Price setters, faced with higher unit labor and other input costs, have been trying to maintain their markups, as also indicated by surging producer-price inflation.[1] Available sketchy survey data suggest that inflation expectations may be creeping upward.

8. **The exchange rate has been on a rollercoaster, but, at present levels, does not raise significant external stability concerns.** Following the shift to an inflation-targeting regime in August 2005, Romania adopted a managed float with no predetermined path. During the first half of 2007, the leu appreciated sharply against the euro, outperforming other regional floating currencies (Figure 4). However, with global risk appetite tanking in mid-2007, the leu abruptly reversed course, depreciating by over 15 percent. Estimates of the leu's common region-wide and country-specific components indicate that most of this recent volatility was specific to Romania. While the external deficit exceeds sustainable levels, there is no strong evidence that real effective exchange rate levels are significantly out of line with fundamentals, although some margin of overvaluation can not be ruled out (Box 2).

Estimates of the equilibrium real exchange rate point to a small margin of overvaluation in 2007. 1/



Source: Fund staff estimates.
1/ For details, see *Selected Issues* Chapter I, "Romania External Stability Risks."

9. **Romania's external net exposure remains contained, but rising short-term debt has raised external stability risks.** Although it has deteriorated sharply, the net IIP compares favorably with that in other regional economies (Figure 5, Table 4). However, a significant increase of debt at shorter maturities has raised the risk of abrupt shifts in capital flows, although foreign-exchange reserve coverage of short-term debt remains satisfactory.

C. Financial Stability

10. **Direct and indirect credit risks are rising, and the banking system is increasingly dependent on foreign funding.** Real private credit expanded by some 50 percent in 2007, and has increasingly been funded by foreign borrowing, mainly through parent banks, rather than domestic deposits (Figure 6, Table 5). Particularly strong growth in domestic foreign-currency credit—including a surge in Swiss-franc denominated credits from a low base—and heavy direct foreign borrowing abroad have increased currency mismatches in corporate and household balance sheets. While financial soundness indicators for the largely foreign-owned

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[1] See *Selected Issues* Chapter II "Wage-Price Setting in Romania and Other New EU Member States."

Box 2. Romania: Exchange Rate Assessment[1/]

Overall, staff's various approaches do not point to strong evidence of a significantly overvalued real exchange rate at present that could result in future external instability.

As a general caveat, it is difficult to pinpoint the equilibrium real exchange rate or the equilibrium current account for an EU convergence economy like Romania because the economy has generally operated in out-of-equilibrium mode, starting convergence from significantly undervalued real exchange rate levels.

This said, the **macroeconomic-balance approach** suggests that Romania's current-account deficit norm, taking account of about 1½ percent of GDP capital transfers, is 10¼ percent of GDP, but with considerable margins of uncertainty (Box Figure). This compares with an estimate of the underlying current-account deficit of 12½ percent, taking account of Romania's output gap as the only temporary factor. The difference between norm and underlying current-account deficit indicate an overvaluation margin of about 11 percent.

The **external-sustainability approach** also points to a sustainable external deficit norm of about 10 percent of GDP, assuming Romania's negative net international investment position (IIP) will stabilize at some 65 percent of GDP, consistent with a 13 percent overvaluation margin.

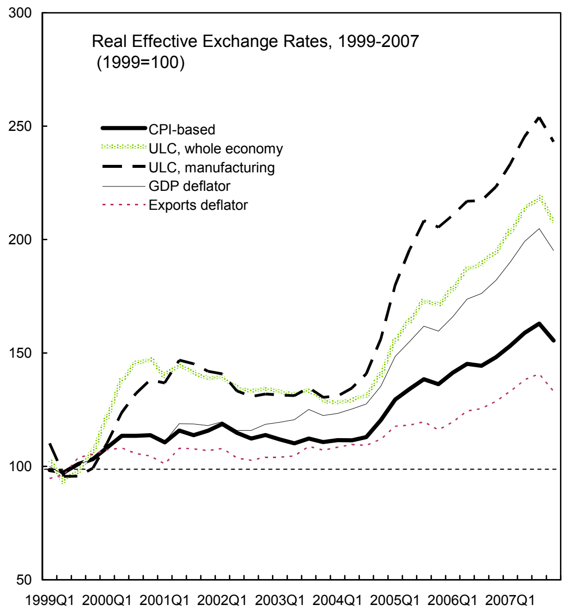
However, the **equilibrium real-exchange-rate approach** based on panel data suggests real exchange rate overvaluation of only about 7 percent in 2007. Reflecting the sharp nominal depreciation since mid-2007, the level of the real exchange rate in March 2008 was already some 4 percent lower than the 2007-average, indicating that any remaining margin of overvaluation would likely be small.

Turning to **external price and cost competitiveness indicators**, Romania's export market shares have steadily increased for all major export destinations. While nominal unit labor costs (ULC) in manufacturing have risen particularly sharply, profitability remains intact, and Romania's euro-denominated wages are still among the lowest in the EU; foreign-investor interest in re-locating production to Romania remains also strong.

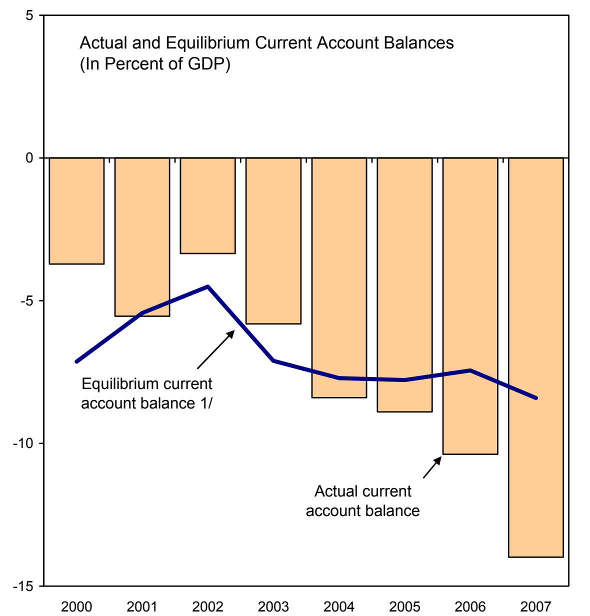
[1/] For details, see *Selected Issues* Chapter I "Romania's External Stability Risks."

Box 2. Figure 1. Romania: Exchange Rate Assessment

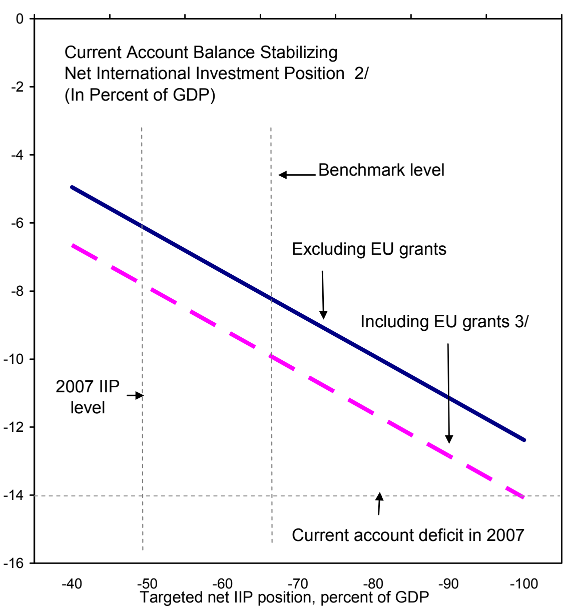
Different measures of the real effective exchange rate have all appreciated significantly since 2004.



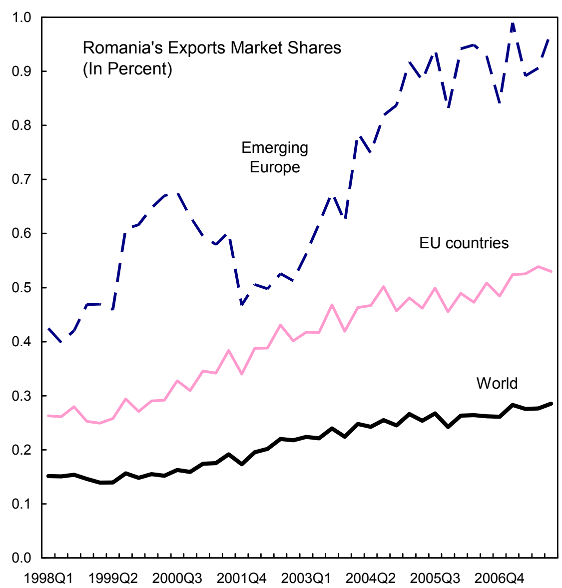
Since 2006, the current account balance has significantly diverged from the level consistent with its fundamental determinants...



...and stabilizing the net IIP at, for example, -65 percent of GDP would require a significant reduction in the current account deficit.



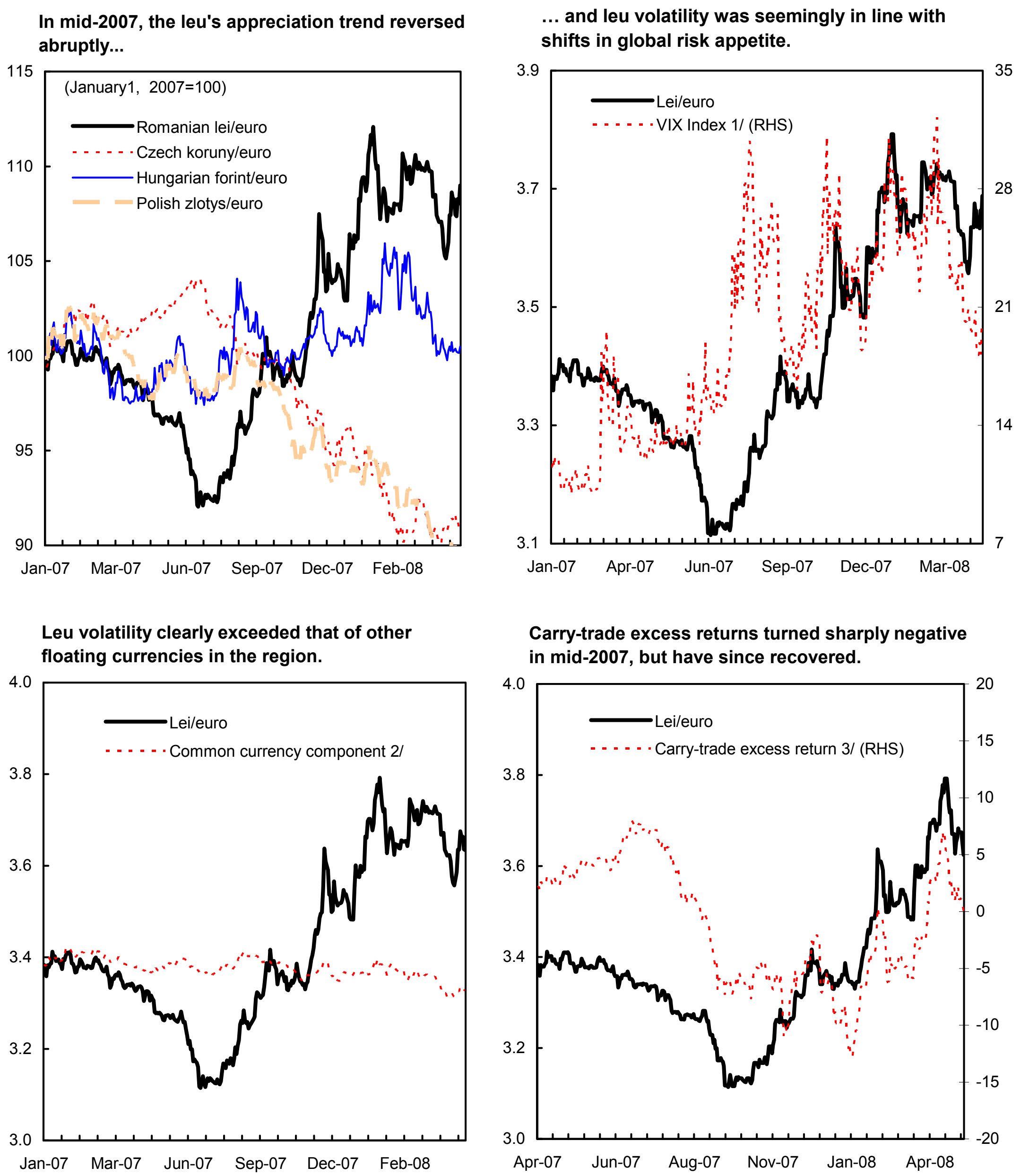
Nonetheless, external competitiveness indicators are inconsistent with the notion of marked overvaluation.



Sources: NBR, EU Commission, IFS, DOTS, and IMF staff calculations detailed in *Selected Issues* Chapter I "Romania's External Stability Risks."

1/ The equilibrium current account balance is estimated using fiscal balance, demographics, NFA, oil trade balance, PPP per capita income, GDP growth, and FDI.
2/ The IIP-stabilizing current account position is computed assuming real GDP growth (6 percent) and GDP deflator inflation (8 percent).
3/ The IIP-stabilizing current account is adjusted by the full amount of EU capital grants (about 1.7 percent of GDP).

Figure 4. Romania: Exchange Rate Developments, 2007–08

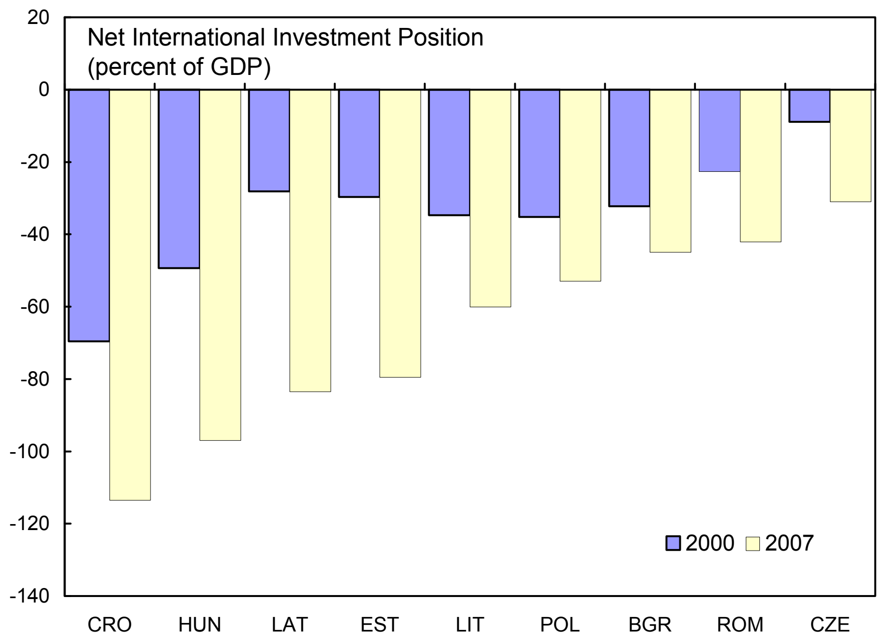


Sources: National Bank of Romania and Fund staff estimates.

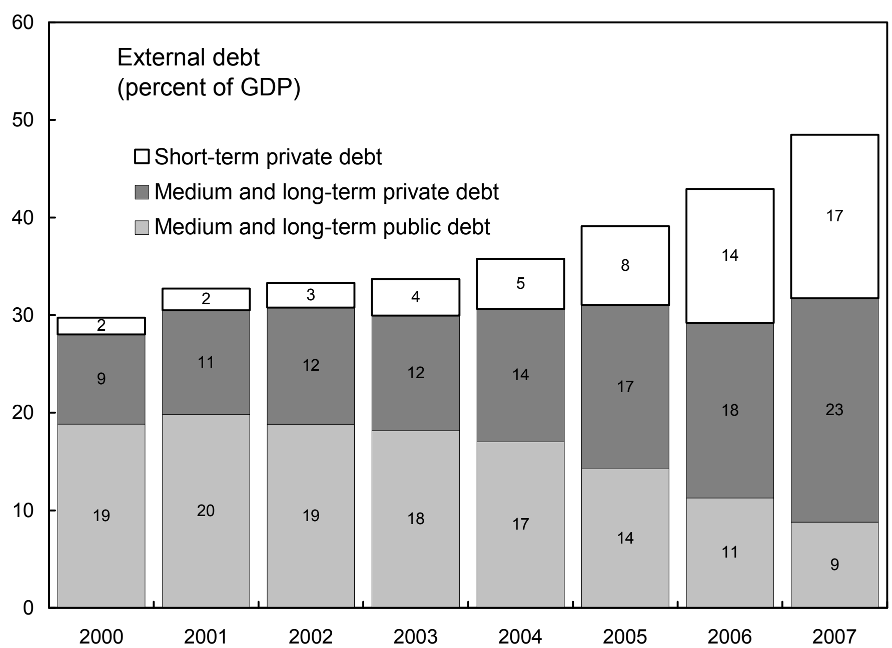
1/ Chicago Board Options Exchange Volatility Index, measuring the implied volatility of S&P 500 index options.
2/ The country sample includes Czech Rep., Hungary, Poland, and Romania.
3/ Differential (in percentage points) between three-month interbank market rate and three-month EURIBOR net of actual change in lei/euro exchange rate.

Figure 5. Romania: External Balance Sheet Indicators, 2000–07

Romania's net external balance position remains relatively strong...

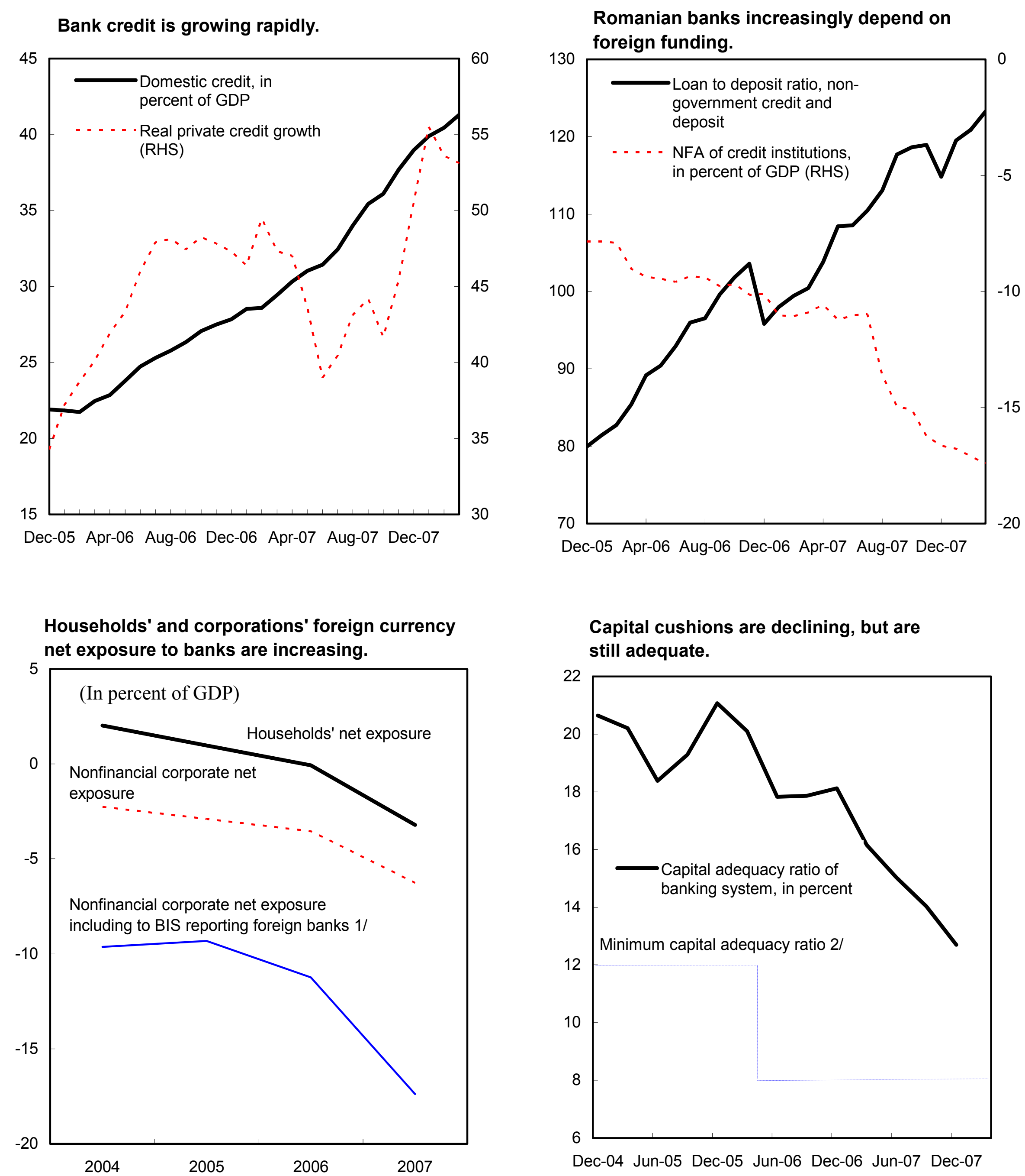


...but the structure of private external debt has shifted to shorter-term maturities.



Sources: National Bank of Romania; IFS; and Fund staff calculations.

Figure 6. Romania: Financial Sector Vulnerabilities, 2004–07



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

1/ BIS reporting banks' exposure to Romanian nonbanks is assumed to be to non-financial corporations.
2/ The NBR amended the capital adequacy requirements effective January 1, 2007 to be consistent with EU minimum requirements.

banking sector as a whole look still relatively solid, capital buffers have declined and non-performing loans have increased, amid strong competition among banks to gain market share (Table 6).

11. **Romania is vulnerable to adverse spillovers from global financial tensions.** In line with the growing external deficit and short-term debt, gross external financing requirements soared to about 28 percent of GDP in 2007 (Table 3). Financial markets have reacted with palpable concern: in addition to the recent sharp leu depreciation, a substantial correction took place in the stock market, and sovereign-bond spreads and credit-default swap rates widened substantially (Figure 7). Two rating agencies have downgraded Romania's outlook to negative.

D. Policy Developments

12. **The fiscal policy stance in 2007 was highly procyclical (Figure 8).** The cash-based fiscal deficit increased to 2¼ percent of GDP, up from ½ percent of GDP in 2006 (Table 7). Adjusted for the automatic effects of the booming economy on the fiscal position, the mission estimates that the 2007 structural deficit rose to almost 4 percent of GDP. As a result, the fiscal stance was highly expansionary, adding an estimated net fiscal stimulus of 2 percent of GDP to an already overheating economy. However, the general government balance sheet is strong: end-2007 gross public debt, excluding public guarantees, amounted to only 12 percent of GDP, and net financial worth was positive.

Romania: General Government Operations, 2004–07
(In percent of GDP)

	2004	2005	2006	2007 Budget	2007 Est.
Revenue	30.0	30.2	31.0	35.1	31.4
Expenditure	31.1	31.0	31.6	37.5	33.7
Fiscal balance (cash basis)	-1.0	-0.8	-0.6	-2.4	-2.3
Structural fiscal balance 1/	-0.9	-1.3	-1.8	...	-3.9

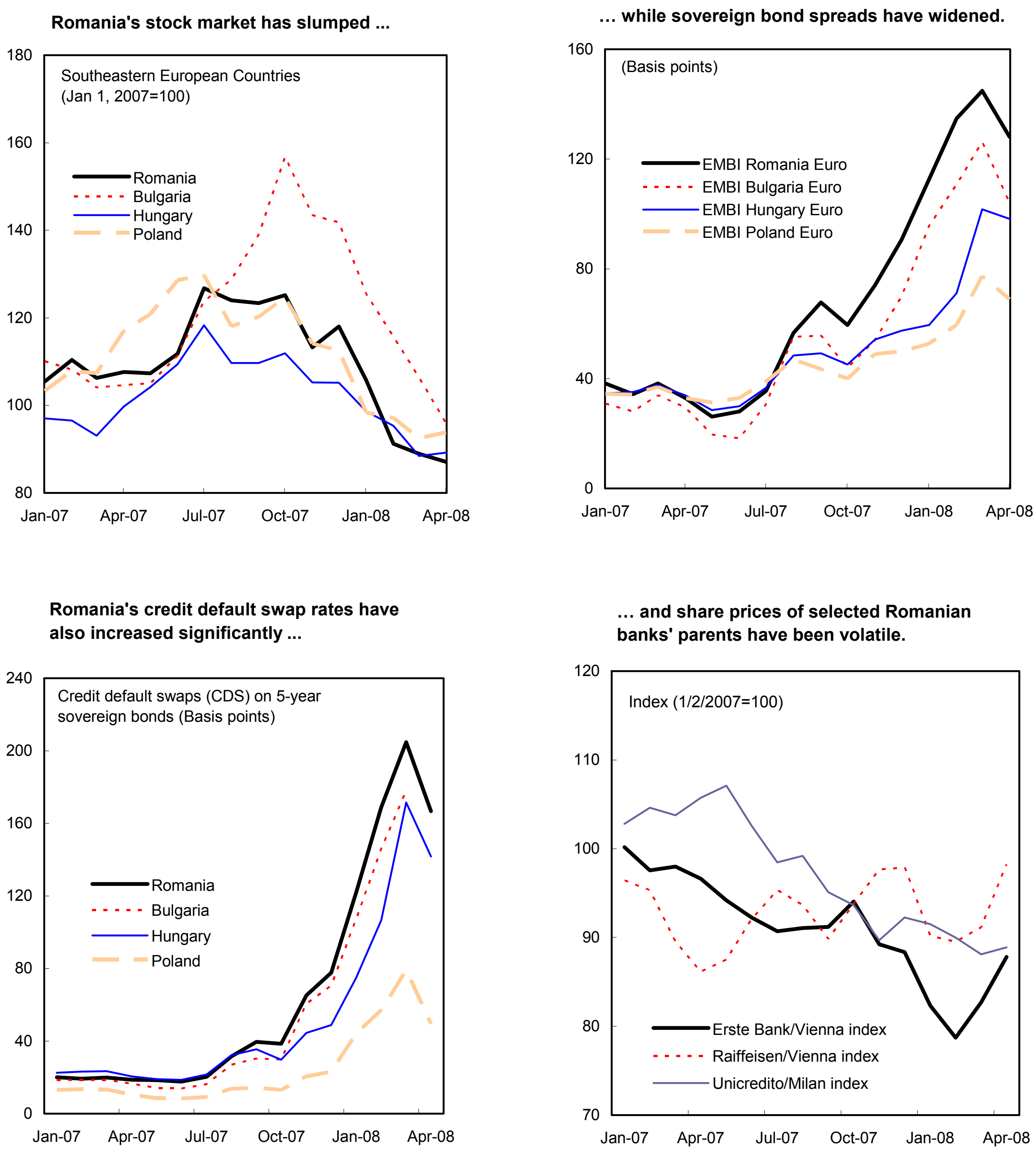
Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Actual fiscal balance adjusted for the automatic effects of both output gap and absorption gap on fiscal position. See IMF Country Report No. 07/390, Chapter III for details.

13. **Fiscal policy management remained short-term oriented.**[2] The originally approved 2007 budget was revised four times, leaving little time or resources for more medium-term budget planning. The traditional end-year spending surge could not be contained, despite control efforts by the Ministry of Finance. Moreover, in its first accession year, Romania had limited success in tapping EU grants, indicating weak capital-budget

[2] For details, see *Selected Issues* Chapter III "Retooling Romania's Budget Culture."

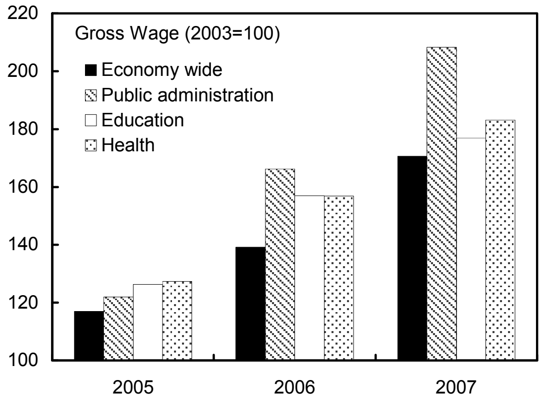
Figure 7. Romania: Selected Asset Prices, 2007–08



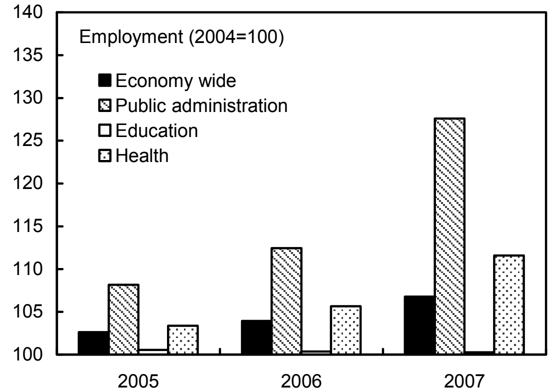
Sources: National Bank of Romania; Bulgaria National Bank; and Bloomberg.

Figure 8. Romania: Fiscal and Incomes Policy, 2005–07

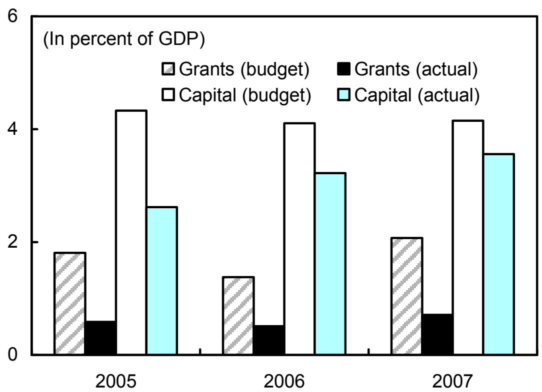
A loose public-sector wage policy ...



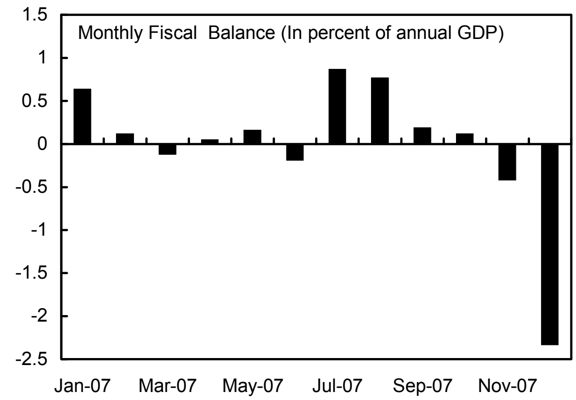
... was accompanied by higher government employment.



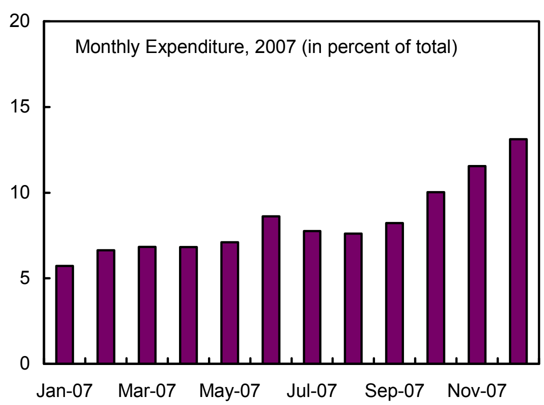
Capital budget implementation has been weak.



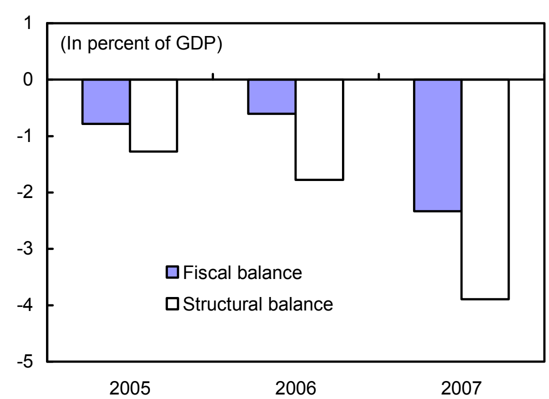
Despite a tight fiscal stance maintained until October, ...



... an end-year splurge in expenditures ...



... led to a procyclical fiscal stance in 2007.



Sources: WEO; and Fund staff estimates.

planning and implementation capacities. Finally, in mid-2007, a proposal to hike pensions in two steps during 2008–09 passed unanimously on a fast-track basis, although there was little clarity on the financing of the second-stage hike or the implications for the medium-term financial integrity of public pensions.

14. **Monetary policy responded proactively to the fluid macroeconomic environment.** During the first half of 2007, the NBR reacted to the sharply appreciating currency and declining inflation with policy-rate easing. While booming domestic demand and growing capacity pressures raised some questions about the wisdom of this easing course, the NBR also had countervailing concerns that the nominal exchange rate might have become overvalued. However, starting in July 2007, surging food and energy prices as well as the sharply depreciating exchange rate pushed inflation well above the target band (Figure 9). The NBR responded by hiking its policy rate in several steps to 9.75 percent.

15. **The NBR also took measures to contain banking system vulnerabilities.** Additional provisions for foreign-currency denominated loans to unhedged borrowers took effect in March 2008. Moreover, with structural excess liquidity in the banking system tightening, a new regulation has been issued requiring banks to strengthen their liquidity management.

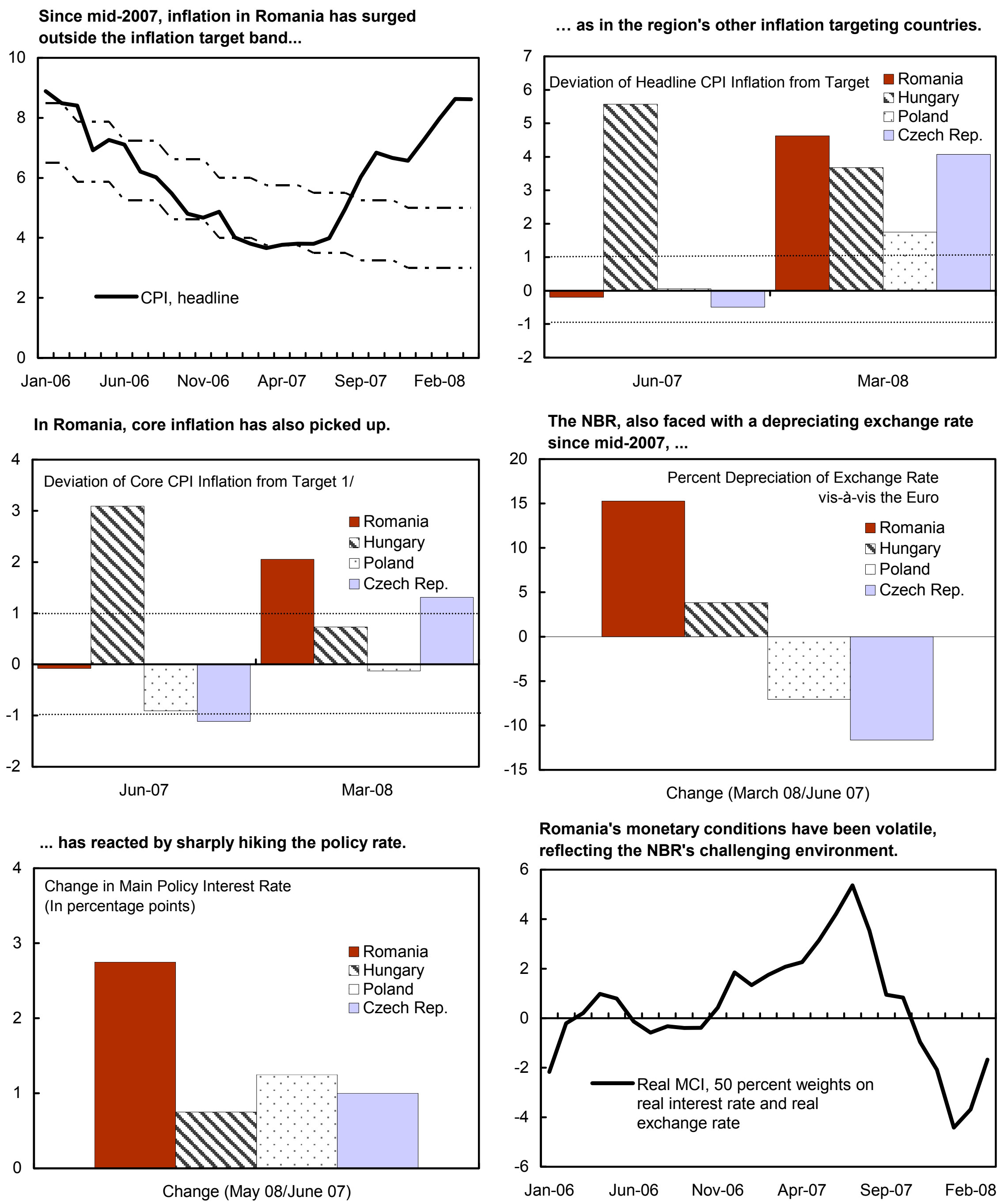
16. **In part reflecting political gridlock and post-EU-accession fatigue, the pace of structural reforms has slowed down.** The future speed of sustainable real convergence will largely depend on advancing structural reforms. Looming structural growth bottlenecks include Romania's exceptionally large and inefficient agricultural sector, inflexible labor markets, an education system insufficiently focused on marketable skills, an underdeveloped public infrastructure, and low energy efficiency. Romania continues to trail best-performing new EU member peers on most structural reform indicators, lagging particularly in the areas of business licensing, ease of employing workers, registering property, public infrastructure, and control of corruption (Table 8).

III. Policy Discussions

17. **The Article IV discussions focused on the policies best suited to achieve sustainable real and nominal convergence**:

- What is the outlook for a soft landing over the medium term, especially under different fiscal and incomes policies?
- What changes in fiscal policy management could help underpin less procyclical and more proactive fiscal policies?
- How should the NBR implement its fledgling inflation-targeting framework given high inflation but also concerns about rising financial vulnerabilities?

Figure 9. Romania: Monetary Policy, 2007–08
(in percent)



Sources: National authorities; Eurostat; IFS; and Fund staff estimates.

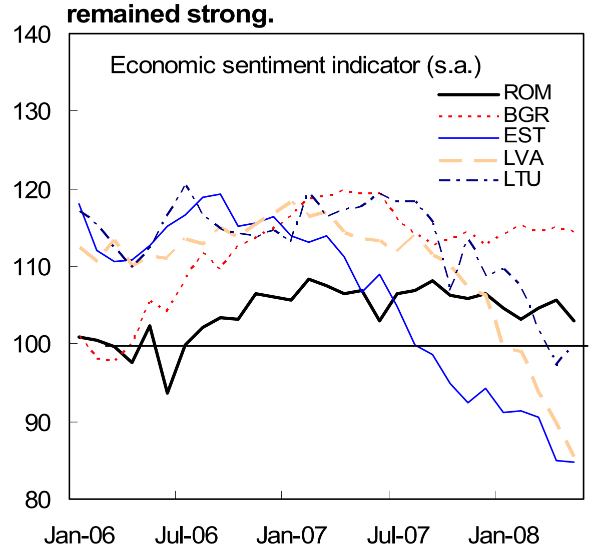
1/ HICP inflation rate excluding food, energy, and tobacco.

- What are the main financial vulnerabilities and how should financial-sector policies insure against a potential hard landing?

A. Outlook

18. **Romania's economic sentiment remains robust, but both global and regional leading indicators point to strong cyclical headwinds.** In the latest *World Economic Outlook*, global and EU growth is projected to cool during 2008–09, and economic sentiment in some other regional absorption-boom economies has already declined sharply. Although the timing of an eventual slowdown in Romania remains quite uncertain, especially with the construction sector still booming, there was broad agreement that the push forces behind Romania's absorption boom are likely to lose momentum.

Romania's economic sentiment has remained strong.

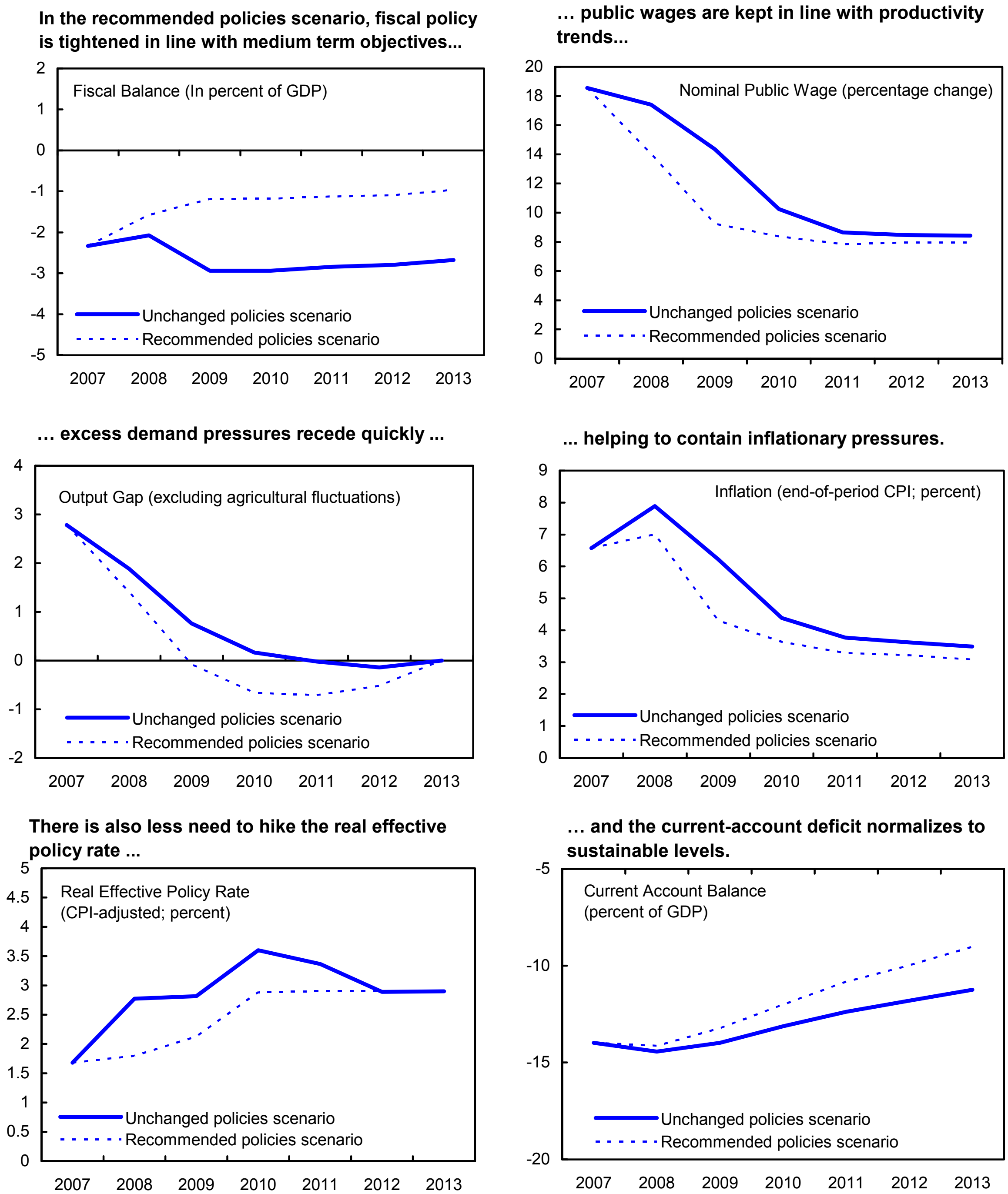


Source: Eurostat.

19. **Under unchanged fiscal policies, staff argued that it could be quite difficult to keep inflation expectations anchored and to achieve external balance over the medium term.** The staff baseline scenario assumes that the authorities will meet their presently planned 2008 fiscal deficit target (2 percent of GDP), while fiscal deficits beyond 2008 would revert to close to 3 percent of GDP, as envisaged in the *2007-10 Convergence Program*. Although a tight monetary policy is assumed to counter excess-demand pressures, the uncoordinated policy mix would make it difficult to bring inflation back into target range by 2009, potentially undermining the credibility of the inflation-targeting framework (Figure 10, Table 9a). Moreover, relatively loose fiscal policies over the medium term could also—by lowering public and private savings—frustrate external adjustment to a more sustainable current-account deficit, although the external imbalance would narrow relative to the present level, and external debt would stabilize at about 50 percent of GDP by 2013 (Appendix I). This scenario could, however, also reach a tipping point, where a sudden adverse shift in market sentiment may result in a sharp slowdown of capital inflows. A resulting slump in output combined with an abrupt depreciation could adversely affect the debt-servicing capacity of households and enterprises, thus putting the banking system under strain.

20. **Against this backdrop, the mission suggested that a soft landing would need to be underpinned by a more prudent policy mix.** In the staff's recommended policies scenario, fiscal policy would be tightened during 2008–09, reducing the deficit in two steps

Figure 10. Romania: Macroeconomic Prospects Under Different Policies, 2007–13 1/



Source: Fund staff projections.

1/ The recommended scenario assumes a tighter fiscal and income policy relative to the unchanged policies scenario. Specifically, compared with the unchanged policies scenario, average fiscal expenditure is lower by 1½ percent of GDP during 2008-13, mainly reflecting lower pensions, wages, and capital spending.

close to what is broadly agreed to be a reasonable medium-term fiscal deficit target for Romania (1 percent of GDP). With absorption growth moderating faster than under the baseline, this facilitates more rapid disinflation and a gradual reduction in the current-account deficit to sustainable levels (Figure 10, Table 9b). In fact, the authorities' own medium-term scenario, while somewhat more optimistic on short-term growth, had broadly similar features, although it did not elaborate on the assumed policy mix. Staff noted that even a prudent policy mix might not suffice to prevent a sharp slowdown given financial exposures and external uncertainties, and financial sector policies especially would need to be prepared for a potential hard landing. On the other hand, there would also be the upside risk that favorable external developments continued to underpin a boom for some time, widening the current-account deficit further, and rendering controlling underlying inflation pressures by tightening the policy mix even more challenging.

21. **Thus, going forward, Romania's external stability risks will be contingent on future policies and shocks.** However, under a more-balanced policy mix, external stability risks should remain contained, particularly if financial-sector buffers are also strengthened further. Conversely, given accumulated financial vulnerabilities, the risk of disruptive future exchange rate movements would increase under less-balanced policies or large adverse shocks.

B. Fiscal Policy

22. **There was broad agreement on the desirable features of a stability- and growth-oriented fiscal framework:**

- A medium-term fiscal deficit target of about 1 percent of GDP would be appropriate to maintain fiscal sustainability and to allow unimpeded symmetric operation of automatic fiscal stabilizers.

- To help stabilize the economy, fiscal policy should avoid procyclicality as the economy moves through different growth phases.

- And to support fast real convergence, while also attending to the population's social protection needs, fiscal policy should use budget resources, including EU funds, more efficiently to strengthen the economy's supply side.

23. **The mission argued that recent budgets were not in line with these requirements.** In particular, given the absorption boom, a cyclically-neutral fiscal stance would have resulted in a small 2007 budget surplus, rather than the 2¼ percent of GDP deficit actually registered. As regards the 2008 budget, a recent budget rectification and measures to control spending have reduced the deficit target to close to 2 percent of GDP, clearly steps in the right direction (Table 7). However, staff considered that a still lower 2008 deficit target of 1½ percent of GDP, while not first best given past years' large procyclical fiscal impulses, would provide a more balanced policy mix. The mission also expressed concern that revenue

projections seemed overoptimistic (by ¾ percent of GDP). At the same time, the mission saw scope to curtail the large budgeted hikes in spending on capital as well as maintenance and operations in line with the advocated tighter fiscal stance, while also relieving overheating pressures in the booming construction sector.

24. **The government authorities noted that massive investment needs and political constraints account for a perhaps less-than-ideal cyclical fiscal stance.** While recognizing the nub of the procyclicality problem, the government authorities viewed Romania's low debt and the 3 percent Maastricht deficit ceiling as providing fiscal space to boost investment spending. The mission noted that EU fiscal norms, properly interpreted, militate against procyclical fiscal behavior, and also pointed out that other regional absorption-boom economies have behaved much less procyclically than Romania during 2003–07, while broadly matching Romania's achieved increases in public investment (Figure 11).

25. **Owing to populist pressures ahead of elections, both the mission and the authorities saw significant upside risks to the 2008 fiscal deficit, which would need to be strongly resisted.** The upper house had already approved a cut in the VAT rate on food items from 19 to 5 percent, with full-year fiscal cost amounting to up to ½ percent of GDP, depending on implementation details. Some political parties had suggested to bring forward the already approved pension increase from January 2009 to an earlier date. And there could be potentially significant overruns in the public-sector wage bill, which the 2008 budget aims at broadly stabilizing at the 2007 level as a ratio to GDP.

26. **There was also broad agreement that progress toward better fiscal policies would need to be underpinned by changes in Romania's "budget culture."** The mission highlighted cross-country evidence for EU countries suggesting that sound budgetary procedures and the effective use of medium-term fiscal frameworks are associated with lower deficits and debts, less procyclical fiscal policies, and increased efficiency of government spending.[3] Key steps to improve fiscal institutions should include: upgrading fiscal expertise and capacity at the executive and legislative levels; modifying rules and procedures to alleviate the present short-term policy orientation, including by reducing the scope for multiple budget revisions; and using independent expert panels to provide macroeconomic and revenue forecasts, insulating the budget process from politically motivated biases.

27. **The 2009 budget would provide a good testing ground for a more forward-looking fiscal policy approach.** In staff's view, besides the need to implement a stability-oriented fiscal stance consistent with a deficit target close to 1 percent of GDP, the 2009 budget needs to be based on a review of the sustainability of the public pension system,

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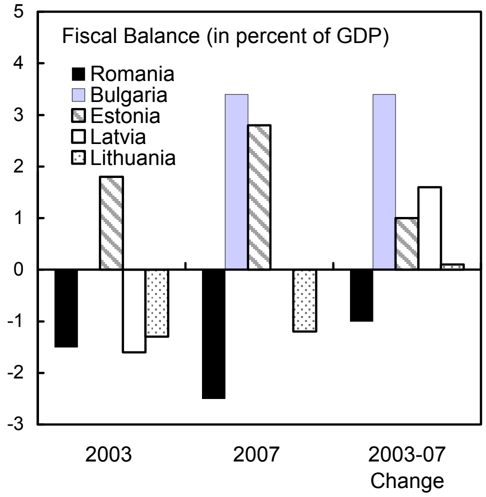
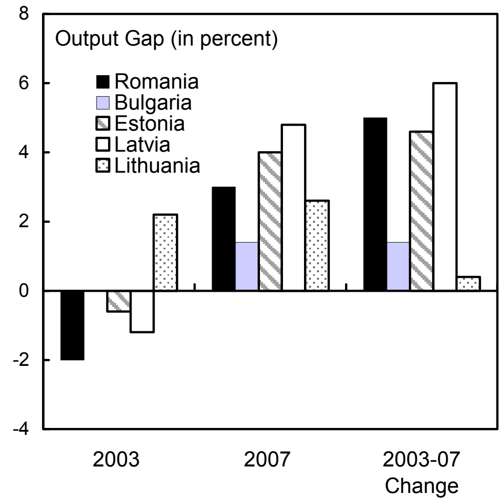
[3] See *Selected Issues* Chapter III "Retooling Romania's Budget Culture."

Figure 11. Selected EU Countries: Fiscal Policy Responses to Absorption Booms, 2003–07 1/

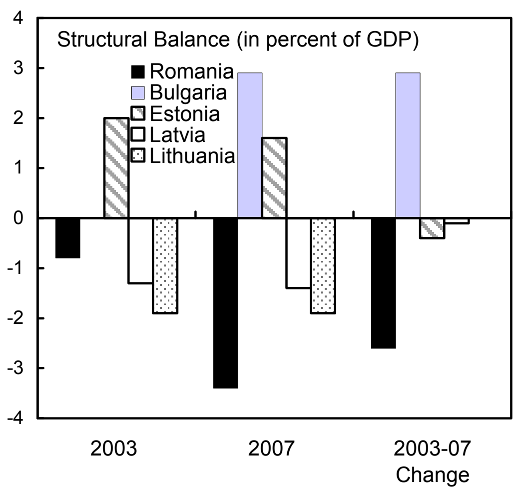
Actual fiscal balances improved during 2003-07, except for Romania ...



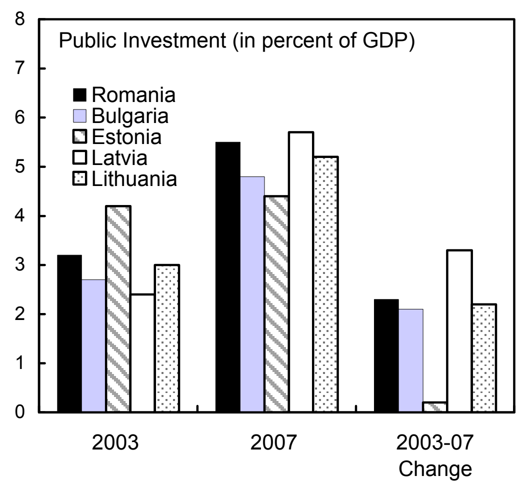
… while all countries' cyclical positions switched into overheating mode ...



… Romania's fiscal stance turned highly procyclical ...



… and Romania's public investment increased only in line with other countries.



Sources: Economic Forecasts Spring 2008, European Commission.

1/ To ensure cross-country data consistency and comparability, data are based on the European System of Accounts 1995, and taken from the European Commission's Spring 2008 Economic Forecasts.

address concerns about the efficiency of public spending, including on education and health care, and improve the capital budget's absorption of EU funds.[4]

C. Monetary Policy

28. **The monetary stance going forward will need to remain clearly focused on lowering inflation in line with the announced target path.** While the macroeconomic outlook is likely to remain fluid, there was agreement that, absent a sharp-slowdown scenario, additional policy tightening may be needed to keep inflation expectations anchored, while bringing inflation back into the end-2009 target range. Without prejudice to its primary objective, the NBR also intended to give continued consideration to the impact of further policy rate increases on financial vulnerabilities, but expressed confidence that price and financial stability considerations complement each other at this point. There was also broad agreement that NBR communication needs to try to avoid fostering impressions in the markets that it would be strongly averse to allowing either the policy rate or the lei/euro exchange rate to cross certain unconditional threshold values.

29. **Although inflation now exceeds the target range by an uncomfortable margin, there was agreement that the inflation-targeting framework has proven its mettle in a difficult external and domestic environment.** In particular, the mission and the authorities saw little merit in raising the inflation target or widening the band, as such accommodating steps could only add to the difficulty of keeping inflation expectations anchored. However, with inflation likely to remain significantly above the target range before re-entering it in 2009, implementation and communication of the inflation-targeting framework would remain a difficult challenge. The NBR plans to continue upgrading its implementation capacity. The mission also noted that, following the lead of selected best-practice inflation-targeting central banks, an independent expert review of the framework might also be useful to take stock of the NBR's accumulated experience.

D. Financial Sector Policies

30. **With financial vulnerabilities rising, the NBR plans to further intensify financial sector surveillance.** There was agreement that risks to financial stability, foremost direct and indirect credit risk, but also liquidity risk, had increased and needed close monitoring. The NBR, while recognizing that capital buffers had shrunk considerably, took comfort from stress tests—which included exchange rate, interest rate, and liquidity shocks—indicating that existing buffers remain adequate. The mission noted that the NBR's *Financial Stability Report* testified to its greatly enhanced capacity to monitor and assess financial sector trends and risks. At the same time, stress testing methodologies could be refined further, including

[4] The analysis and detailed proposals in World Bank, 2006, "Romania: Public Expenditure and Institutional Review" on these and other spending issues remain largely apposite.

by allowing stronger feedback effects between the real economy and banking soundness indicators. The recent initiative to remedy the lack of reliable statistics for real estate prices, while overdue, was also welcome.

31. **There was broad agreement that additional preemptive measures were warranted to contain risks to financial stability.** To contain credit risk, the mission advised higher capital requirements for riskier exposures, including real estate ones. The mission also urged to complement the new regulation for liquidity risks with on-site inspections and to consider broadening the range of eligible collateral for its overdraft facility. With many banks seemingly still focused on aggressively gaining market share, including by promoting exotic credit products, it would also be important that the NBR continued to encourage monitoring and containing operational risks. The authorities stressed that they were ready to take additional measures as necessary. The NBR also underlined that it will only allow banks to fully exploit the flexibility in Basel II after having carefully vetted banks' internal models.

32. **As part of EU commitments, the authorities are strengthening their crisis preparedness arrangements.** A crisis management group has been established, and a crisis contingency plan is being prepared. The key elements of a safety net—lender of last resort rules, deposit insurance, bank resolution framework—are in place, but remain largely untested. The most recent memorandum of understanding on cross-border financial crisis preparedness, signed by all EU countries, has again highlighted the need to coordinate regulatory and prudential actions with pertinent foreign regulators.

IV. Staff Appraisal

33. **Romania has made significant strides in catching up with EU income levels, but fast real convergence has gone hand-in-hand with growing macroeconomic imbalances.** Once EU accession prospects looked secure, foreign capital flooded into Romania to take advantage of perceived improvements in investment risks and returns, triggering an absorption boom. This boom has been mirrored by a widening current-account deficit, although the present level of the exchange rate does not raise significant external stability concerns. With labor market conditions tightening and fiscal policies in procyclical mode, the absorption boom has also raised underlying inflation pressures. Food and energy price shocks have pushed headline inflation well above the NBR's target range, while global financial market turbulence so far has been mainly reflected in somewhat higher external funding costs and increased exchange rate volatility.

34. **While the economic outlook is quite uncertain, with a better policy mix macroeconomic imbalances should gradually normalize over the medium term, in line with Romania's ambition to adopt the euro by 2014.** The economy has yet to show signs of slowing to a more sustainable pace; at the same time, lingering global financial market tensions hold the risk of a sharp slowdown. However, under any scenario, a key challenge for

Romania will be to adopt more stability-oriented fiscal and incomes policies that complement, rather than counteract, the NBR's monetary policy. But Romania's policy-making challenges go well beyond plain policy coordination problems in an overheating economy. In particular, the sustainable speed of real convergence will ultimately depend on the ability of policies to address growth bottlenecks in a forward-looking manner, calling for fresh efforts to catch up with best-performing new EU member peers on structural reforms.

35. **Fiscal policy should be tightened.** Romania's fiscal position—particularly as indicated by low public debt levels—is relatively sound. Nevertheless, it would have been appropriate to respond to the private-sector absorption boom by allowing automatic fiscal stabilizers to operate around the broadly agreed medium-term fiscal deficit target of 1 percent of GDP. As illustrated by the experience of other regional economies, a less procyclical fiscal stance does not need to conflict with increased spending on capital. In this vein, and building on the recent welcome budget rectification, the fiscal stance in 2008 should be tightened further to achieve a deficit of about 1½ percent of GDP. A tighter fiscal stance would relieve the burden on monetary policy, but also put the deficit on a credible consolidation path toward its medium-term target and avoid the need to adopt a procyclical fiscal stance when the economy shifts to a slower-growth phase. While upcoming elections will make achieving this more ambitious deficit target politically difficult, there is considerable scope to restrain budgeted spending on maintenance and operations as well as on capital, and such spending restraint could help mitigate overheating pressures in the booming construction sector. It will also be important to maintain wage discipline in the public sector, and resist populist pressures to increase social spending or cut taxes during the run-up to the elections.

36. **A more proactive fiscal policy will need to be underpinned by a less myopic budget culture.** The present short-term focus of fiscal policies may well have been aligned with the demands of an early stage of transition. At this point, such a policy culture has become counterproductive, as illustrated by Romania's so far limited success in tapping and absorbing EU funds. Improving fiscal policy management requires increasing fiscal expertise and capacity at all government levels, modifying the rules and procedures that underpin the present short-term orientation, and establishing a role for independent expert panels to mitigate biases in macroeconomic and fiscal forecasts.

37. **Monetary policy is facing a difficult environment in its efforts to restore low and stable inflation.** An absorption boom, a highly volatile exchange rate, and procyclical fiscal policies would already constitute considerable challenges for a central bank still building its inflation-targeting credentials. However, adverse supply shocks have aggravated headline inflation pressures, and inflation expectations may no longer be fully anchored. The NBR appropriately responded by tightening the monetary stance through several policy rate hikes, and additional tightening may be needed to bring inflation back into target range by 2009. Concurrently, the NBR should continue to strengthen its capacity to implement its framework, including by taking stock of its inflation-targeting experience since 2005.

38. **Given rising financial stability risks, continued vigilance and additional preemptive measures are warranted.** Financial deepening has progressed at a rapid clip, and private-sector currency mismatches are increasing. Moreover, banks' non-performing loans are rising, and previously large capital and liquidity buffers are being eroded, although financial soundness indicators remain relatively healthy. Admittedly, it is difficult to identify, motivate, and implement preemptive measures in a setting where financial fragilities are rising but not yet acute. The recent preemptive measures addressing foreign-exchange risks of unhedged borrowers and improving banks' liquidity management are commendable steps in the right direction. However, larger capital cushions for more risky exposures, including real-estate exposures, are advisable, while additional measures to contain liquidity and operational risks should also be considered. The envisaged update of the *Financial Sector Assessment Program* later in the year will provide a good opportunity for reviewing the strengths and vulnerabilities of Romania's financial system.

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

Table 1. Romania: Selected Economic and Social Indicators, 2005–09

	2005	2006	2007	2008 Proj.	2009 Proj.
Output, prices, and labor market			(Annual percentage change)		
Real GDP	4.2	7.9	6.0	6.8	5.8
Real GDP excluding agricultural sector	6.4	7.6	7.4	6.5	5.6
Real domestic demand (absorption)	8.8	14.5	16.4	9.3	9.9
Consumer price index (CPI, average)	9.0	6.6	4.8	8.2	6.6
Consumer price index (CPI, end of period)	8.6	4.9	6.6	7.9	6.2
Employment	-0.7	0.7	1.4	0.9	0.6
Nominal wages	17.0	18.9	22.6	20.5	16.9
Public sector wages	25.9	27.3	18.5	17.4	14.4
Private sector wages	14.8	16.6	23.7	21.4	17.6
Nominal unit labor cost	11.5	11.0	17.2	13.8	11.2
General government finances			(In percent of GDP)		
Revenue	30.2	31.0	31.4	34.7	35.2
Expenditure	31.0	31.6	33.7	36.8	38.2
Fiscal balance	-0.8	-0.6	-2.3	-2.1	-2.9
Structural fiscal balance 1/	-1.3	-1.8	-3.9	-3.4	-3.8
Gross public debt	15.8	12.4	12.1	11.4	11.5
Net financial worth	16.2	12.4	8.2	8.2	8.6
Money and credit			(Annual percentage change)		
Broad money (M3)	36.5	28.1	33.5	36.4	25.7
Domestic credit	43.7	52.0	64.5	32.8	24.9
Interest rates			(In percent)		
Euro, six-month LIBOR	2.2	3.1	4.3	4.2	4.0
Interbank rate	…	8.2	7.6	…	…
Lending rate	21.0	14.8	13.3	…	…
Real lending rate (CPI adjusted)	12.0	8.3	8.5	…	…
Balance of payments			(In percent of GDP)		
Current account balance	-8.9	-10.4	-14.0	-14.4	-14.0
Merchandise trade balance	-9.9	-12.0	-14.6	-14.9	-14.4
Capital and financial account balance	15.6	15.7	17.6	16.1	16.8
Foreign direct investment balance	6.6	8.9	5.9	5.6	5.0
Net international investment position	-29.2	-35.3	-42.1	-49.3	-53.5
Gross official reserves	18.4	18.6	16.2	14.2	13.7
Gross external debt	39.1	42.9	48.5	49.4	49.7
Exchange rates					
Lei per euro (end of period)	3.66	3.41	3.53	…	…
Lei per euro (average)	3.63	3.52	3.34	…	…
Real effective exchange rate					
CPI based (percentage change)	17.9	7.6	9.0	1.3	6.5
GDP deflator based (percentage change)	21.4	11.9	15.2	5.9	10.5

Social Indicators (reference year in parentheses)

Per capita GNI (Atlas method, 2006)**:** US $4,850; **Income distribution** (GINI index, 2003): 31.1; **Poverty rate** (2005): 13 percent; **Primary education completion rate** (2005): 99.4 percent; **Life expectancy at birth** (2005): 71.7; **Infant mortality** per 1000 live births (2005): 16.

Sources: Romanian authorities; Fund staff estimates and projections; and World Development Indicators database.

1/ Actual fiscal balance adjusted for the automatic effects of output gap and absorption gap on the fiscal position. See IMF Country Report No. 07/390, Chapter III for details.

Table 2. Romania: Real GDP Components and Implicit Deflators, 2003–09

	2003	2004	2005	2006	2007	2008 Proj.	2009 Proj.
	(Real growth rate by expenditure category, in percent)						
GDP	5.2	8.5	4.2	7.9	6.0	6.8	5.8
Domestic demand (absorption)	8.7	12.7	8.8	14.5	16.4	9.3	9.9
Private demand 1/	8.7	16.6	9.0	16.6	17.6	8.1	10.2
Public demand 1/	8.6	-6.0	7.4	2.4	8.4	18.2	8.4
Final consumption	8.3	11.2	9.7	10.1	10.3	7.6	8.7
Private consumption	8.4	14.6	9.9	12.4	11.0	7.6	9.1
Public consumption	7.7	-4.9	8.5	-3.1	5.6	7.4	6.1
Gross fixed investment	8.6	11.1	12.7	19.3	28.9	12.3	6.8
Private investment	7.7	15.3	14.3	17.7	30.2	6.5	5.4
Public investment	13.2	-11.3	1.5	32.3	19.7	56.3	13.9
Change in inventories 2/	0.1	1.9	-2.3	1.5	-1.2	-0.8	0.2
Net exports 2/	-3.6	-4.5	-4.4	-6.2	-8.7	-2.6	-3.7
Exports of goods and services	8.4	13.9	7.7	10.6	8.7	10.6	7.7
Imports of goods and services	16.0	22.1	16.0	22.4	26.1	12.9	13.4
	(Contribution to real GDP growth by expenditure category, in percent)						
Domestic demand (absorption)	8.8	12.9	8.6	14.0	14.8	9.4	9.4
Private demand 1/	7.3	14.3	7.2	13.7	13.2	6.2	7.6
Public demand 1/	1.6	-1.3	1.4	0.3	1.6	3.2	1.8
Final consumption	6.9	8.7	8.2	8.1	8.5	6.4	7.0
Private consumption	5.8	9.7	6.8	8.7	7.6	5.2	6.0
Public consumption	1.2	-1.0	1.4	-0.6	0.9	1.2	1.0
Gross fixed investment	1.8	2.4	2.8	4.5	7.4	3.8	2.2
Private investment	1.4	2.8	2.7	3.6	6.8	1.8	1.5
Public investment	0.4	-0.4	0.0	0.8	0.6	2.0	0.7
Change in inventories	0.1	1.9	-2.3	1.5	-1.2	-0.8	0.2
Net exports	-3.6	-4.5	-4.4	-6.2	-8.7	-2.6	-3.7
Exports of goods and services	3.0	4.8	2.8	3.5	2.8	3.2	2.4
Imports of goods and services	6.6	9.3	7.2	9.7	11.5	5.8	6.0
	(Contribution to real GDP growth by production category, in percent)						
Gross value added	4.7	7.4	3.2	7.0	5.9	6.5	5.2
Agriculture	0.6	2.2	-2.2	0.3	-1.3	0.3	0.2
Industry	1.2	1.6	0.6	1.7	1.2	1.1	0.9
Construction	0.4	0.5	0.6	1.6	2.5	1.8	1.2
Services	2.5	3.2	4.2	3.5	3.5	3.3	2.9
Net taxes on product	0.8	1.0	0.9	0.8	0.2	0.6	0.5
	(Percentage change in implicit deflators)						
GDP deflator	24.0	15.0	12.2	10.8	10.8	13.1	10.5
Domestic demand (absorption)	22.0	12.3	8.6	6.1	2.9	10.6	5.8
Final consumption	22.8	11.7	9.5	6.1	5.4	9.9	7.8
Private consumption	15.2	13.9	7.3	5.2	4.7	8.2	6.6
Public consumption	58.0	7.8	19.2	14.7	10.3	17.2	13.8
Gross fixed investment	20.7	14.6	9.6	11.2	8.4	14.3	9.8
Exports of goods and services	17.9	13.4	0.2	5.1	1.9	9.5	3.3
Imports of goods and services	15.4	8.9	-2.9	-0.2	-5.9	7.4	-1.7

Sources: National Institute of Statistics (INS); staff estimates and projections.

1/ Private and public sector components are based on staff estimations and are not officially reported by the INS.

2/ Contributions to GDP growth.

Table 3. Romania: Balance of Payments, 2005–13
(In billions of euros, unless otherwise indicated)

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
Current account balance	-7.1	-10.2	-17.0	-20.3	-23.5	-25.7	-28.1	-30.6	-33.3
Merchandise trade balance	-7.9	-11.8	-17.7	-20.9	-24.2	-26.4	-28.9	-31.6	-34.7
Exports of goods	22.3	25.9	29.4	33.7	38.0	43.3	49.4	56.9	65.5
Imports of goods	-30.2	-37.6	-47.1	-54.6	-62.2	-69.7	-78.4	-88.5	-100.3
Services balance	-0.4	0.0	0.2	0.5	0.7	1.1	1.5	2.1	2.9
Exports of non-factor services	3.9	5.5	7.6	9.3	11.1	13.2	15.7	18.9	22.7
Imports of non-factor services	-4.4	-5.5	-7.4	-8.9	-10.4	-12.2	-14.2	-16.8	-19.8
Income balance	-2.3	-3.2	-4.4	-5.1	-6.0	-7.3	-8.6	-10.1	-11.8
Receipts	1.2	1.7	2.4	2.5	3.0	3.5	4.1	4.7	5.3
Payments	-3.6	-5.0	-6.8	-7.6	-9.0	-10.8	-12.7	-14.8	-17.1
Current transfer balance	3.6	4.8	4.9	5.2	5.9	6.9	7.9	9.1	10.4
Capital and financial account balance	12.4	15.4	21.4	22.7	28.3	32.2	34.1	37.2	40.8
Capital transfer balance	0.6	0.0	0.8	2.1	2.7	3.3	3.6	3.8	4.1
Foreign direct investment balance	5.2	8.7	7.2	7.9	8.4	8.8	9.1	10.4	11.8
Portfolio investment balance	0.8	-0.3	0.0	0.0	0.4	0.9	1.6	1.8	2.0
Other investment balance	5.8	6.9	13.4	12.7	16.7	19.2	19.9	21.3	22.9
General government	0.4	-0.1	-0.1	1.1	2.0	2.6	3.0	3.7	3.9
Domestic banks	2.6	3.8	6.0	4.8	5.7	6.7	7.7	7.5	8.6
Other private sector	2.8	3.3	7.5	6.8	9.0	9.9	9.2	10.1	10.4
Errors and omissions	0.3	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	5.6	5.3	4.6	2.4	4.8	6.5	6.0	6.6	7.6
Financing	-5.6	-5.3	-4.6	-2.4	-4.8	-6.5	-6.0	-6.6	-7.6
Gross international reserves (increase: -)	-5.4	-5.2	-4.5	-2.4	-4.8	-6.5	-6.0	-6.6	-7.6
Use of Fund credit, net	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities, net	-0.1	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	-8.9	-10.4	-14.0	-14.4	-14.0	-13.1	-12.4	-11.8	-11.3
Merchandise trade balance	-9.9	-12.0	-14.6	-14.9	-14.4	-13.5	-12.7	-12.2	-11.7
Exports of goods	28.0	26.4	24.3	24.0	22.6	22.1	21.8	22.0	22.2
Imports of goods	-37.9	-38.5	-38.8	-38.9	-36.9	-35.6	-34.5	-34.2	-33.9
Services balance	-0.5	0.0	0.2	0.3	0.4	0.5	0.7	0.8	1.0
Income balance	-2.9	-3.3	-3.6	-3.6	-3.5	-3.7	-3.8	-3.9	-4.0
Current transfer balance	4.5	5.0	4.0	3.7	3.5	3.5	3.5	3.5	3.5
Foreign direct investment balance	6.6	8.9	5.9	5.7	5.0	4.5	4.0	4.0	4.0
Gross external financing requirement	16.6	20.2	28.2	35.4	35.9	36.8	37.4	38.1	38.1
				(Annual percentage change)					
Merchandise export volume	6.1	6.8	8.7	9.0	6.4	8.5	8.5	9.2	9.3
Merchandise import volume	15.0	22.3	26.1	12.4	12.9	12.1	12.1	12.3	12.7
Merchandise export prices	9.6	8.5	4.6	5.2	5.8	5.2	5.2	5.4	5.4
Merchandise import prices	7.0	2.2	-0.8	3.2	0.8	0.1	0.3	0.5	0.5
Terms of trade (merchandise)	2.8	6.4	5.4	1.9	5.0	5.1	4.9	4.8	4.8
GDP	79.5	97.8	121.2	140.4	168.4	196.1	227.1	259.0	295.8

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

Table 4. Romania: External Financial Assets and Liabilities, 2005–13

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
	(In billions of euros, unless otherwise indicated)								
Net international investment position	-23.2	-34.6	-51.0	-69.2	-90.0	-112.5	-137.0	-163.8	-192.9
Foreign direct investment	-21.7	-30.6	-37.8	-45.7	-54.1	-62.9	-72.0	-82.4	-94.2
Portfolio investment	-3.8	-3.6	-3.6	-3.5	-3.9	-4.9	-6.4	-8.2	-10.2
Other investments	-16.0	-23.3	-36.6	-49.3	-66.0	-85.2	-105.1	-126.3	-149.2
Gross international reserves	18.2	22.9	26.9	29.3	34.0	40.5	46.5	53.2	60.7
Financial assets	25.7	30.6	34.6	37.1	42.2	48.9	55.2	62.2	70.2
Foreign direct investment	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3
Portfolio investment	0.6	0.9	1.0	1.0	1.1	1.1	1.2	1.3	1.3
Other investments	6.7	6.6	6.5	6.7	6.9	7.1	7.3	7.5	7.8
Gross international reserves	18.2	22.9	26.9	29.3	34.0	40.5	46.5	53.2	60.7
Financial liabilities	48.9	65.2	85.6	106.4	132.2	161.4	192.2	226.0	263.1
Foreign direct investment	21.8	30.8	37.9	45.9	54.3	63.2	72.3	82.7	94.5
Portfolio investment	4.4	4.5	4.5	4.6	5.0	6.0	7.6	9.5	11.6
Loans	17.4	22.3	30.6	41.0	54.7	70.3	86.7	104.1	123.0
NBR	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government	7.2	6.9	6.9	8.0	10.0	12.7	15.7	19.3	23.2
Banks	3.7	6.6	12.6	17.5	23.4	30.2	38.2	45.9	54.8
Other sectors	6.3	8.7	11.2	15.6	21.3	27.4	32.9	38.8	45.0
Other liabilities	5.3	7.6	12.5	14.9	18.2	22.0	25.6	29.7	34.0
Memorandum items:	(In percent of GDP, unless otherwise indicated)								
Gross international reserves	22.9	23.4	22.2	20.8	20.2	20.7	20.5	20.5	20.5
In percent of short-term debt 1/	179.8	124.1	104.1	84.2	77.9	75.2	71.8	69.5	68.8
In months of next year's imports	5.1	5.0	5.1	4.8	5.0	5.3	5.3	5.3	5.3
Gross external debt	39.1	42.9	48.5	49.4	49.7	50.8	50.9	51.5	51.4
Public	8.7	7.4	6.3	6.2	6.3	6.6	6.7	7.0	7.1
Private	30.4	35.5	42.2	43.2	43.3	44.2	44.2	44.5	44.3
Of which: short-term	8.1	13.7	16.7	18.3	19.1	20.1	20.7	21.2	21.5
Net international investment position	-29.2	-35.3	-42.1	-49.3	-53.5	-57.3	-60.3	-63.2	-65.2

Sources: Romanian authorities and Fund staff estimates and projections.

1/ At remaining maturity.

Table 5a. Romania: Monetary Survey, 2005–09
(In billions of lei, unless otherwise indicated)

	2005	2006	2007	2008	2009
	December	December	December	December Proj.	December Proj.
Net foreign assets	41.5	38.7	29.1	32.6	38.1
In billions of euros	11.3	11.5	8.1	9.7	11.1
Of which: Commercial banks	-7.1	-11.9	-18.7	-21.7	-24.8
NBR	18.4	23.4	26.7	31.4	35.9
Net domestic assets	45.0	72.1	118.9	169.2	215.5
Domestic credit	63.1	95.9	157.8	209.4	261.6
Private sector credit	59.8	92.4	148.2	197.4	247.5
Of which in foreign currency (In percent)	54.7	47.4	54.3	...	...
Other items net	-18.1	-23.8	-38.8	-40.2	-46.0
Broad money (M3)	86.5	110.8	148.0	201.8	253.6
Currency in circulation	11.4	15.1	21.3	29.5	39.0
Deposits from non-government clients	74.8	96.4	129.1	172.3	214.5
Of which in foreign currencies (In percent)	34.6	32.3	32.1	…	…
Memorandum items:					
Domestic credit growth (In percent)	43.7	52.0	64.5	32.8	24.9
Private sector credit growth (In percent)	45.8	54.5	60.4	33.2	25.4
Broad money (M3) growth (In percent)	36.5	28.1	33.5	36.4	25.7
Net foreign asset contribution (In percentage points)	9.7	-3.2	-8.7	2.4	2.7
Net domestic asset contribution (In percentage points)	26.8	31.3	42.3	34.0	22.9
Growth of currency in circulation (In percent)	52.5	32.9	40.9	38.5	32.2
Real broad money growth (In percent)	25.5	22.1	25.3	26.4	18.3
CPI inflation (In percent)	8.6	4.9	6.6	7.9	6.2
Exchange rate (Lei/euro, e.o.p.)	3.66	3.41	3.53	…	…
M3 velocity	3.3	2.8	2.7	2.4	2.3
Money multiplier	3.9	3.2	3.0	3.1	2.9

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

Note: Starting January 2007, monetary indicators are calculated based on NBR Norms No 13/2006. Only some time series have been restated back to 2004.

Table 5b. Romania: Balance Sheet of the National Bank, 2005–09
(In billions of lei, unless otherwise indicated)

	2005	2006	2007	2008	2009
	December	December	December	December Proj.	December Proj.
Net foreign assets	67.5	79.1	96.5	105.4	122.9
In billion of euros	18.4	23.4	26.7	31.4	35.9
Net domestic assets	-45.3	-44.5	-47.7	-40.4	-34.6
Total credit	-25.4	-21.1	-15.4	-21.1	-19.5
Net credit to government 1/	-3.9	-9.6	-8.5	-4.7	-3.7
Other items net	-20.0	-23.5	-32.3	-19.4	-15.1
Reserve money	22.2	34.6	48.7	65.0	88.2
Currency	12.7	17.4	25.3	36.9	51.0
Deposits with the NBR	9.5	17.2	23.4	28.1	37.2
Memorandum items:					
Real reserve money growth (In percent)	49.1	48.5	32.3	23.5	27.9
Nominal reserve money growth (In percent)	62.1	55.7	41.0	33.3	35.8
Net domestic asset contribution (In percentage points)	-94.5	3.5	-9.1	14.9	9.0
Net foreign asset contribution (In percentage points)	156.6	52.2	50.1	18.4	26.8
CPI inflation (In percent)	8.6	4.9	6.6	7.9	6.2
Inflation target range (In percent)	6.5 - 8.5	4 - 6	3 - 5	2.8 - 4.8	2.5 - 4.5
Policy interest rate (Percent p.a.)	7.50	8.75	7.50	...	...
Effective policy interest rate (Percent p.a.) 2/	7.2	8.2	7.5	...	...
Real effective policy interest rate (Percent p.a.)	-1.4	3.2	0.9	...	...
Money market rate, deposits, monthly average (Percent p.a.)	...	8.2	7.6	...	...
Lending rates of credit institutions (Percent p.a.) 3/	21.0	14.8	13.3	...	...
Deposit rates of credit institutions (Percent p.a.) 3/	8.3	6.5	6.7	...	...

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

Note: Starting January 2007, monetary indicators are calculated based on NBR Norms No 13/2006. Only some time series have been restated back to 2004.

1/ Treasury's deposits with the NBR. The NBR is not allowed to provide direct credit to the government.
2/ The effective policy rate is calculated as the average of the interest rate of the daily flows of CDs, deposit auctions, and the deposit facility.
3/ Average rates for local currency denominated transactions of non-financial corporations and households.

Table 6. Romania: Selected Financial Soundness Indicators, 2003–07

	2003	2004	2005	2006	2007
	(In percent, unless otherwise indicated)				
Capital buffers:					
Capital adequacy ratio 1/	21.1	20.6	21.1	18.1	12.6
Own capital ratio 1/	10.9	8.9	9.2	8.6	6.7
Credit risk:					
Assets, percent of GDP	31.2	37.1	45.2	50.9	64.2
Domestic credit, percent of GDP	15.2	17.8	21.9	27.8	39.0
Lending for real estate purchase, percent of GDP 2/ 3/	1.2	1.9	2.7	3.9	6.5
Medium and long term credits, percent of private credit	...	58.4	63.9	68.4	76.0
Non-performing loans, percent of loans 4/	8.3	8.1	8.3	7.9	9.7
Specific provisions, percent of non-performing loans 4/	12.6	16.1	14.4	18.2	25.3
Foreign exchange risk:					
Net open position in foreign exchange	1.6	-2.0	-0.6	0.6	0.3
Lending in foreign exchange, percent of private credit	64.8	61.8	54.7	47.4	54.3
Foreign currency liabilities, percent of total liabilities	45.0	46.8	44.3	44.1	42.5
Net foreign assets of credit institutions, percent of GDP	-1.9	-3.7	-7.9	-10.1	-16.7
Liquidity risk:					
Liquidity ratio 5/	3.0	2.3	2.6	2.3	2.2
Liquid assets, percent of total assets	62.7	63.6	61.8	54.4	48.3
Liquid assets, percent of short term liabilities	210.8	193.9	245.7	207.2	171.7
Loan to deposit ratio 6/	...	77.2	84.4	99.5	108.9
Profitability and concentration:					
Return on average assets	2.7	2.5	1.9	1.7	1.3
Return on average equity	20.0	19.3	15.4	13.6	11.5
Market share (assets) of five largest banks	63.9	59.2	58.8	60.3	56.4
Memorandum items:					
Number of credit institutions	39	40	40	39	39
Stock market capitalization, percent of GDP 7/	10.2	17.1	22.3	24.4	27.3

Sources: National Bank of Romania, Romanian National Institute of Statistics, and Fund staff estimates.

Note: On January 1, 2007, the NBR introduced the ESCB's statistical methodology. Only some time series have been recalculated back to December 2004.

1/ The NBR amended the capital adequacy requirements effective January 1, 2007 to be consistent with EU minimum requirements. The former 12 percent capital adequacy ratio and 8 percent Tier I were substituted by a new 8 percent solvency ratio.

2/ Refers to loans and commitments to a single debtor above RON 20,000 according to the Central Credit Register, which covers about 82 percent of total loans and commitments granted.

3/ During 2007, the share of credit to households for house purchase has remained relatively constant around 19–20 percent.

4/ Non-perfroming loans reflect unadjusted exposure to non-performing loans classified as "loss", "doubtful" and "substandard", according to the NBR's loan classification regulations, as percent of total loans.

5/ Effective liquidity over required liquidity, the mandatory ratio is thus one.

6/ Loan-to-deposit ratio (domestic credit to domestic deposits, including government).

7/ Covers the regulated market at Bucharest Stock Exchange, including SIFs, and RASDAQ. Derivatives, which are traded at SIBEX, are excluded.

Table 7a. Romania: General Government Operations and Balance Sheet, 2005–13
(In billions of lei)

	2005	2006	2007 Budget	2007	2008 1/ Budget	2008	2009	2010	2011	2012	2013
						Projections, unchanged policies					
Revenue	87.0	106.9	142.1	127.1	172.9	169.6	201.3	230.8	256.6	288.5	324.7
Taxes	78.4	96.8	121.4	115.2	143.8	143.3	168.7	193.8	219.6	248.0	280.2
Taxes on profits	7.8	9.3	12.8	11.9	14.5	14.7	17.6	20.6	23.6	26.8	30.5
Taxes on income	6.9	9.8	14.1	14.4	17.6	18.3	21.9	25.6	29.4	33.6	38.4
Value-added taxes	22.5	27.8	35.5	31.2	41.0	41.0	48.4	55.5	63.1	71.0	80.1
Excises	9.1	10.6	13.9	12.5	15.1	14.0	15.1	16.2	17.5	18.9	20.4
Customs duties	2.2	2.6	1.6	0.9	1.1	1.0	1.2	1.3	1.5	1.7	1.9
Social security contributions	27.0	33.0	38.0	38.8	47.9	47.6	56.7	65.7	74.6	84.8	96.4
Other taxes	2.9	3.7	5.4	5.4	6.6	6.7	7.8	8.9	10.0	11.2	12.5
Nontax revenue	6.5	7.4	11.7	8.1	16.6	13.8	16.1	18.4	21.3	23.8	26.6
Capital revenue	0.4	0.9	0.7	0.9	1.0	1.0	1.2	1.4	1.6	1.7	2.0
Grants	1.7	1.8	8.4	2.9	11.4	11.4	15.3	17.2	14.1	15.0	15.9
Expenditure	89.2	109.0	151.6	136.5	183.0	179.7	218.1	250.1	277.4	311.5	349.3
Current expenditure	81.6	97.8	134.1	122.1	155.0	153.2	185.0	210.8	233.5	261.4	292.6
Compensation of employees	15.5	21.0	26.2	25.6	28.7	28.7	33.8	38.8	43.7	49.3	55.6
Maintenance and operations	21.5	22.1	28.4	25.8	35.6	33.8	40.1	46.0	52.1	58.6	65.5
Interest	3.0	2.7	3.1	2.7	3.8	3.8	4.4	4.7	5.1	5.6	6.2
Subsidies	6.5	7.4	6.8	6.9	6.7	6.7	7.2	7.7	8.0	8.5	9.9
Transfers	34.3	43.4	67.4	59.0	78.4	78.4	97.2	111.2	121.7	136.2	151.9
Pensions	16.7	18.5	22.9	22.6	31.6	31.6	43.0	49.9	56.0	63.2	70.6
Other social transfers	9.9	12.3	16.9	15.7	18.1	18.1	20.9	23.8	26.5	29.5	32.9
Contribution to EU budget	...	...	4.0	3.8	4.2	4.2	4.0	4.4	4.3	4.6	4.7
Other transfers 2/	7.7	12.6	23.6	16.9	24.5	24.5	29.2	33.1	34.8	38.9	43.8
Other spending	0.9	1.2	2.2	2.1	1.9	1.9	2.2	2.5	2.8	3.1	3.5
Capital expenditure	7.6	11.1	16.8	14.4	27.2	25.7	32.2	38.2	42.8	48.8	55.3
Reserve fund	0.0	0.0	0.6	0.0	0.5	0.5	0.6	0.7	0.7	0.8	0.9
Net lending	0.0	0.0	0.1	0.0	0.3	0.3	0.3	0.4	0.4	0.5	0.5
Fiscal balance (cash basis)	-2.3	-2.1	-9.5	-9.4	-10.1	-10.1	-16.8	-19.2	-20.9	-23.0	-24.6
Financing	2.3	2.1	9.5	9.4	10.1	10.1	16.8	19.2	20.9	23.0	24.6
Privatization proceeds	3.7	1.5	0.6	0.6	0.6	0.6	0.3	0.1	0.0	0.0	0.0
External	1.5	0.3	0.2	0.2	…	0.5	0.0	0.0	0.0	0.0	0.0
Domestic	-2.9	0.3	8.7	8.6	…	9.0	16.6	19.2	20.9	23.0	24.6
Financial assets	104.4	101.0	...	98.0	...	111.8	130.6	153.6	175.5	199.3	224.6
Financial liabilities	57.8	58.4	...	64.8	...	71.7	81.5	94.6	105.0	115.5	125.5
Gross public debt 3/	45.6	42.6	...	49.0	...	55.9	65.7	78.8	89.2	99.7	109.7
External	25.2	25.6	...	25.3	...	30.5	36.2	43.1	49.4	57.3	65.4
Domestic	20.4	17.0	...	23.7	...	25.4	29.5	35.7	39.8	42.4	44.2
Net financial worth	46.6	42.6	...	33.2	...	40.1	49.2	58.9	70.5	83.8	99.2

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

1/ First budget rectification approved in March 2008.
2/ Includes co-financing of EU projects.
3/ Excluding public debt guarantees.

Table 7b. Romania: General Government Operations and Balance Sheet, 2005–13
(In percent of GDP)

	2005	2006	2007 Budget	2007	2008 1/ Budget	2008	2009	2010	2011	2012	2013
						Projections, unchanged policies					
Revenue	30.2	31.0	35.1	31.4	35.4	34.7	35.2	35.3	34.9	35.1	35.4
Taxes	27.2	28.1	30.0	28.5	29.4	29.3	29.5	29.6	29.9	30.2	30.5
Taxes on profits	2.7	2.7	3.2	3.0	3.0	3.0	3.1	3.1	3.2	3.3	3.3
Taxes on income	2.4	2.8	3.5	3.6	3.6	3.7	3.8	3.9	4.0	4.1	4.2
Value-added taxes	7.8	8.1	8.8	7.7	8.4	8.4	8.5	8.5	8.6	8.6	8.7
Excises	3.2	3.1	3.4	3.1	3.1	2.9	2.6	2.5	2.4	2.3	2.2
Customs duties	0.8	0.8	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social security contributions	9.4	9.6	9.4	9.6	9.8	9.7	9.9	10.0	10.2	10.3	10.5
Other taxes	1.0	1.1	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Nontax revenue	2.2	2.2	2.9	2.0	3.4	2.8	2.8	2.8	2.9	2.9	2.9
Capital revenue	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	0.6	0.5	2.1	0.7	2.3	2.3	2.7	2.6	1.9	1.8	1.7
Expenditure	31.0	31.6	37.5	33.7	37.4	36.8	38.2	38.2	37.8	37.9	38.0
Current expenditure	28.3	28.4	33.1	30.2	31.7	31.3	32.4	32.2	31.8	31.8	31.9
Compensation of employees	5.4	6.1	6.5	6.3	5.9	5.9	5.9	5.9	5.9	6.0	6.1
Maintenance and operations	7.5	6.4	7.0	6.4	7.3	6.9	7.0	7.0	7.1	7.1	7.1
Interest	1.0	0.8	0.8	0.7	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Subsidies	2.2	2.2	1.7	1.7	1.4	1.4	1.3	1.2	1.1	1.0	1.1
Transfers	11.9	12.6	16.7	14.6	16.0	16.0	17.0	17.0	16.6	16.6	16.5
Pensions	5.8	5.4	5.7	5.6	6.5	6.5	7.5	7.6	7.6	7.7	7.7
Other social transfers	3.4	3.6	4.2	3.9	3.7	3.7	3.7	3.6	3.6	3.6	3.6
Contribution to EU budget	...	...	1.0	0.9	0.9	0.9	0.7	0.7	0.6	0.6	0.5
Other 2/	2.7	3.7	5.8	4.2	5.0	5.0	5.1	5.1	4.7	4.7	4.8
Other spending	0.3	0.3	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Capital expenditure	2.6	3.2	4.1	3.6	5.6	5.3	5.6	5.8	5.8	5.9	6.0
Reserve fund	0.0	0.0	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net lending	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Fiscal balance (cash basis)	-0.8	-0.6	-2.4	-2.3	-2.1	-2.1	-2.9	-2.9	-2.8	-2.8	-2.7
Financing	0.8	0.6	2.4	2.3	2.1	2.1	2.9	2.9	2.8	2.8	2.7
Privatization proceeds	1.3	0.4	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
External	0.5	0.1	0.1	0.1	…	0.1	0.0	0.0	0.0	0.0	0.0
Domestic	-1.0	0.1	2.1	2.1	…	1.8	2.9	2.9	2.8	2.8	2.7
Financial assets	36.2	29.3	...	24.2	...	22.9	22.9	23.5	23.9	24.3	24.5
Financial liabilities	20.1	16.9	...	16.0	...	14.7	14.3	14.5	14.3	14.1	13.7
Gross public debt 3/	15.8	12.4	...	12.1	...	11.4	11.5	12.0	12.1	12.1	11.9
External	8.7	7.4	...	6.3	...	6.2	6.3	6.6	6.7	7.0	7.1
Domestic	7.1	4.9	...	5.9	...	5.2	5.2	5.5	5.4	5.2	4.8
Net financial worth	16.2	12.4	...	8.2	...	8.2	8.6	9.0	9.6	10.2	10.8
Memorandum items:											
Structural fiscal balance 4/	-1.3	-1.8	...	-3.9	...	-3.4	-3.8	-3.5	-3.2	-3.1	-2.9
Conventional structural fiscal balance	-1.1	-1.4	...	-3.2	...	-2.7	-3.2	-3.0	-2.8	-2.7	-2.7
Output gap 5/	1.1	2.6	...	2.8	...	1.9	0.8	0.2	0.0	-0.1	0.0
Absorption gap 6/	2.6	5.8	...	9.1	...	8.0	5.8	4.4	3.5	2.8	2.3
Fiscal balance (ESA95 basis) 7/	-1.4	-2.2	...	-2.5	-2.4	...	...	...	...	...	...
Nominal GDP (in billions of lei)	288.2	344.5	...	404.7	...	488.9	571.5	654.7	734.6	821.4	918.3

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

1/ First budget rectification approved in March 2008.
2/ Includes co-financing of EU projects.
3/ Excluding public debt guarantees.
4/ Actual fiscal balance adjusted for the automatic effects of output gap and absorption gap on the fiscal position. See IMF Country Report No. 07/390, Chapter III for details.
5/ Percentage deviation of actual from potential GDP.
6/ Percentage deviation between actual absorption and the level consistent with external balance.
7/ The significant difference between cash-based and ESA95 fiscal balances in 2006 is mainly due to cancellation of Iraq debt and accrued spending commitments (including by the property compensation fund and local governments).

Table 8. Romania: Rankings of Selected Competitiveness and Structural Indicators 1/

	Romania		Best NMS performers 2/				Distance 3/	
	2006	2007	2006		2007		2006	2007
World Bank *Doing Business* survey								
Starting a business	93	86	Romania	93	Estonia	89	0	-3
Dealing with licenses	51	49	Estonia	94	Estonia	93	-43	-44
Employing workers	24	17	Bulgaria	67	Czech Rep.	69	-43	-52
Registering property	36	30	Lithuania	98	Lithuania	98	-62	-68
Getting credit	82	93	Slovakia	94	Slovakia	97	-11	-3
Protecting investors	82	82	Slovenia	90	Slovenia	90	-7	-8
Paying taxes	23	24	Estonia	82	Latvia	89	-59	-66
Trading across borders	78	79	Estonia	97	Estonia	97	-18	-18
Enforcing contracts	79	79	Latvia	99	Latvia	99	-20	-20
Closing a business	38	54	Lithuania	82	Lithuania	83	-44	-29
World Economic Forum								
Infrastructure	44	37	Estonia	67	Estonia	63	-23	-26
Health and primary education	91	80	Slovenia	98	Slovenia	88	-6	-8
Higher education and training	62	59	Estonia	75	Estonia	74	-13	-15
Goods market efficiency	58	58	Estonia	71	Estonia	71	-14	-13
Labor market efficiency	…	59	…	…	Estonia	68	…	-9
Financial market sophistication	56	58	Czech Rep.	71	Estonia	73	-15	-15
Technological readiness	51	47	Estonia	76	Estonia	72	-24	-25
Transparency international								
Corruption Perception Index	31	37	Estonia	67	Slovenia	66	-36	-29
EBRD transition indicators	76	79		92		92	-16	-14
Large scale privatization	85	85		92		92	-8	-8
Small scale privatization	85	85		100		100	-15	-15
Enterprise restructuring	62	62		85		85	-23	-23
Price liberalization	100	100		100		100	0	0
Trade and foreign exchange system	100	100		100		100	0	0
Competition policy	62	62		85		85	-23	-23
Banking reform	69	77		92		92	-23	-15
Non-bank financial institutions	46	62		92		92	-46	-31
Overall infrastructure reform	77	77		85		85	-8	-8

Sources: EBRD; World Bank; World Economic Forum; Transparency International; and Fund staff calculations.

1/ For comparability, all indices normalized so that they range from 0 (lowest) to 100 (best).

2/ Country name and index of best performers among New Member States (NMS) that joined since May 2004 other than Malta and Cyprus. Country names are not shown for EBRD transition indicators due to the presence of multiple entries.

3/ Distance of Romania from NMS best performer for each index.

Table 9a: Romania: Macroeconomic Framework, Baseline, Unchanged Policies Scenario, 2005–13

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				Unchanged policies scenario					
GDP and prices (annual percent change)									
Real GDP	4.2	7.9	6.0	6.8	5.8	5.6	5.7	5.8	6.0
Real domestic demand (absorption)	8.8	14.5	16.4	9.3	9.9	8.7	8.8	8.5	8.7
GDP deflator	12.2	10.8	10.8	13.1	10.5	8.5	6.2	5.7	5.4
Domestic demand deflator	8.6	6.1	2.9	10.6	5.8	4.5	2.4	2.4	2.3
Consumer price index (CPI, average)	9.0	6.6	4.8	8.2	6.6	5.5	4.0	3.7	3.5
Consumer price index (CPI, end of period)	8.6	4.9	6.6	7.9	6.2	4.4	3.8	3.6	3.5
Nominal wages	17.0	18.9	22.6	20.5	16.9	13.7	11.5	11.3	11.3
Public sector wages	25.9	27.3	18.5	17.4	14.4	10.3	8.7	8.5	8.4
Private sector wages	14.8	16.6	23.7	21.4	17.6	14.6	12.3	12.0	12.0
Real effective exchange rate, CPI based	17.9	7.6	9.0	1.3	6.5	5.5	5.5	4.0	4.0
Real effective exchange rate, GDP deflator based	21.4	11.9	15.2	5.9	10.5	8.4	7.7	6.0	5.9
Monetary aggregates (annual percent change)									
Broad money	36.5	28.1	33.5	36.4	25.7	23.2	20.6	20.3	20.2
Domestic credit	43.7	52.0	64.5	32.8	24.9	22.2	20.0	20.1	19.5
Saving and investment (in percent of GDP)									
Foreign saving	8.9	10.4	14.0	14.4	14.0	13.1	12.4	11.8	11.3
Gross national saving	13.7	16.1	15.6	17.1	16.7	17.6	18.1	18.2	18.3
Government	1.8	2.6	1.2	3.2	2.7	2.9	3.0	3.1	3.3
Private	11.9	13.5	14.4	13.9	14.0	14.7	15.1	15.1	14.9
Gross domestic investment	22.6	26.5	29.6	31.5	30.7	30.7	30.5	30.1	29.5
Government	2.6	3.2	3.6	5.3	5.6	5.8	5.8	5.9	6.0
Private	20.0	23.3	26.0	26.2	25.1	24.9	24.6	24.1	23.5
General government (in percent of GDP)									
Revenue	30.2	31.0	31.4	34.7	35.2	35.3	34.9	35.1	35.4
Expenditure	31.0	31.6	33.7	36.8	38.2	38.2	37.8	37.9	38.0
Fiscal balance	-0.8	-0.6	-2.3	-2.1	-2.9	-2.9	-2.8	-2.8	-2.7
Structural fiscal balance 1/	-1.3	-1.8	-3.9	-3.4	-3.8	-3.5	-3.2	-3.1	-2.9
Gross public debt	15.8	12.4	12.1	11.4	11.5	12.0	12.1	12.1	11.9
Balance of payments (in percent of GDP)									
Current account	-8.9	-10.4	-14.0	-14.4	-14.0	-13.1	-12.4	-11.8	-11.3
Merchandise trade balance	-9.9	-12.0	-14.6	-14.9	-14.4	-13.5	-12.7	-12.2	-11.7
Services balance	-0.5	0.0	0.2	0.3	0.4	0.5	0.7	0.8	1.0
Income balance	-2.9	-3.3	-3.6	-3.6	-3.5	-3.7	-3.8	-3.9	-4.0
Transfers balance	4.5	5.0	4.0	3.7	3.5	3.5	3.5	3.5	3.5
Capital and financial account balance	15.6	15.7	17.6	16.1	16.8	16.4	15.0	14.4	13.8
Foreign direct investment, balance	6.6	8.9	5.9	5.7	5.0	4.5	4.0	4.0	4.0
Memorandum items:									
Gross international reserves (in billions of euros)	18.2	22.9	26.9	29.3	34.0	40.5	46.5	53.2	60.7
Gross international reserves (in months of next year's imports)	5.1	5.0	5.1	4.8	5.0	5.3	5.3	5.3	5.3
Net international investment position (in percent of GDP)	-29.2	-35.3	-42.1	-49.3	-53.5	-57.3	-60.3	-63.2	-65.2
External debt (in percent of GDP)	39.1	42.9	48.5	49.4	49.7	50.8	50.9	51.5	51.4
Short-term external debt (in percent of GDP)	8.1	13.7	17.0	18.5	19.3	20.2	20.8	21.3	21.6
Merchandise export volume (percent change)	6.1	6.8	8.7	9.0	6.4	8.5	8.5	9.2	9.3
Merchandise import volume (percent change)	15.0	22.3	26.1	12.4	12.9	12.1	12.1	12.3	12.7
Terms of trade (percent change)	2.8	6.4	5.4	1.9	5.0	5.1	4.9	4.8	4.8
Nominal GDP (in billions of lei)	288.2	344.5	404.7	488.9	571.5	654.7	734.6	821.4	918.3

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

1/ Actual fiscal balance adjusted for the automatic effects of output gap and absorption gap on the fiscal position. See IMF Country Report No. 07/390, Chapter III for details.

Table 9b: Romania: Macroeconomic Framework, Recommended Policies Scenario, 2005–13

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				Recommended policies scenario					
GDP and prices (annual percent change)									
Real GDP	4.2	7.9	6.0	6.5	5.0	5.2	5.5	5.8	6.0
Real domestic demand (absorption)	8.8	14.5	16.4	7.9	7.6	7.0	7.2	7.7	7.8
GDP deflator	12.2	10.8	10.8	12.1	7.9	6.3	5.2	5.1	4.8
Domestic demand deflator	8.6	6.1	2.9	10.4	4.3	3.3	2.4	2.4	2.3
Consumer price index (CPI, average)	9.0	6.6	4.8	7.9	5.2	4.1	3.4	3.3	3.1
Consumer price index (CPI, end of period)	8.6	4.9	6.6	7.0	4.3	3.6	3.3	3.2	3.1
Nominal wages	17.0	18.9	22.6	18.7	12.3	11.2	10.4	10.6	10.6
Public sector wages	25.9	27.3	18.5	14.0	9.2	8.4	7.8	8.0	8.0
Private sector wages	14.8	16.6	23.7	20.1	13.2	11.9	11.1	11.3	11.3
Real effective exchange rate, CPI based	17.9	7.6	9.0	-1.1	3.9	3.7	3.2	3.0	3.0
Real effective exchange rate, GDP deflator based	21.4	11.9	15.2	2.8	6.6	5.9	5.0	4.8	4.7
Monetary aggregates (annual percent change)									
Broad money	36.5	28.1	33.5	36.8	22.1	22.0	19.9	19.8	19.7
Domestic credit	43.7	52.0	64.5	36.5	27.0	22.3	20.3	19.1	18.5
Saving and investment (in percent of GDP)									
Foreign saving	8.9	10.4	14.0	14.1	13.2	12.0	10.8	10.0	9.0
Gross national saving	13.7	16.1	15.6	17.3	17.8	18.6	19.3	19.8	20.2
Government	1.8	2.6	1.2	3.2	4.1	4.3	4.4	4.6	4.7
Private	11.9	13.5	14.4	14.1	13.8	14.3	14.9	15.2	15.5
Gross domestic investment	22.6	26.5	29.6	31.4	31.1	30.6	30.1	29.8	29.2
Government	2.6	3.2	3.6	4.7	5.3	5.5	5.5	5.7	5.7
Private	20.0	23.3	26.0	26.7	25.8	25.1	24.6	24.1	23.6
General government (in percent of GDP)									
Revenue	30.2	31.0	31.4	34.7	35.3	35.4	35.0	35.2	35.5
Expenditure	31.0	31.6	33.7	36.3	36.5	36.6	36.2	36.3	36.4
Fiscal balance	-0.8	-0.6	-2.3	-1.6	-1.2	-1.2	-1.1	-1.1	-1.0
Structural fiscal balance 1/	-1.3	-1.8	-3.9	-2.7	-1.6	-1.3	-1.1	-1.0	-1.0
Gross public debt	15.8	12.4	12.1	11.2	10.8	10.5	10.2	9.9	9.5
Balance of payments (in percent of GDP)									
Current account	-8.9	-10.4	-14.0	-14.1	-13.2	-12.0	-10.8	-10.0	-9.0
Merchandise trade balance	-10.0	-12.0	-14.6	-14.5	-13.4	-12.1	-11.0	-10.3	-9.6
Services balance	-0.5	0.0	0.2	0.3	0.4	0.6	0.7	0.9	1.1
Income balance	-2.9	-3.3	-3.6	-3.7	-3.8	-3.9	-4.0	-4.1	-4.0
Current transfer balance	4.5	5.0	4.0	3.7	3.5	3.5	3.5	3.5	3.5
Capital and financial account balance	15.6	15.7	17.6	14.7	15.5	14.3	13.0	12.1	11.2
Foreign direct investment, balance	6.6	8.9	5.9	5.7	5.0	4.5	4.0	4.0	4.0
Memorandum items:									
Gross international reserves (in billions of euros)	18.2	22.9	26.9	27.7	31.3	35.4	39.7	44.5	50.0
Gross international reserves (in months of next year's imports)	5.1	5.0	5.2	4.8	4.8	4.9	4.8	4.8	4.7
Net international investment position (in percent of GDP)	-29.2	-35.3	-42.1	-50.1	-55.1	-58.8	-61.2	-62.6	-62.9
External debt (in percent of GDP)	39.1	42.9	48.5	49.3	50.0	49.9	49.2	48.0	46.0
Short-term external debt (in percent of GDP)	8.1	13.7	17.0	18.5	19.6	20.2	20.7	20.7	20.4
Merchandise export volume (percent change)	6.1	6.8	8.7	10.1	7.5	9.2	9.4	9.5	9.6
Merchandise import volume (percent change)	15.0	22.3	26.1	10.6	10.1	10.5	10.6	11.8	12.1
Terms of trade (percent change)	2.8	6.4	5.4	1.9	5.0	5.1	4.9	4.8	4.8
Nominal GDP (in billions of lei)	288.2	344.5	404.7	483.3	547.8	613.1	680.9	756.5	840.6

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

1/ Actual fiscal balance adjusted for the automatic effects of output gap and absorption gap on the fiscal position. See IMF Country Report No. 07/390, Chapter III for details.