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IMF Executive Board Approves €12.9 Billion Stand-By Arrangement for Romania

The Executive Board of the International Monetary Fund (IMF) today approved a 24-month SDR 11.4 billion (about €12.9 billion or US$17.1 billion) Stand-By Arrangement for Romania to support an economic program designed by the Romanian authorities and intended to cushion the effects of the sharp drop in capital inflows while addressing the country's external and fiscal imbalances and strengthening the financial sector. The approval makes SDR 4.37 billion (about €4.9 billion or US$6.6 billion) immediately available and the remainder will be available in installments subject to quarterly reviews. The Stand-By Arrangement entails exceptional access to IMF resources, amounting to 1,111 percent of Romania's quota.

The Stand-By Arrangement will be combined with other multilateral financial support to fill the country's 2009-2010 financing gap. The total international financial support package will amount to €19.9 billion (about US$26.4 billion), with the European Union providing €5 billion (or about US6.6 billion), the World Bank €1 billion (or about US$1.3 billion), and the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the International Finance Corporation (IFC) a combined €1 billion (or about US$1.3 billion).

Following the Executive Board discussion on Romania, Mr. John Lipsky, First Deputy Managing Director and Acting Chairman, said:

"The Romanian authorities are to be commended for seeking early international support to assist them with an orderly correction of the large external imbalances and vulnerabilities built up during recent boom years, and leaving the country highly exposed to global financial turmoil and exchange rate volatility. Excessive public spending in recent years also produced sizeable fiscal deficits which, in the current tight financing environment, are destabilizing. With the global downturn increasingly spilling over to Romania, a rebalancing of the economy is unavoidable.

“The Romanian authorities have launched a comprehensive program to respond to the current challenges. The program aims at reversing the deteriorating fiscal path with significant expenditure cuts and additional revenues. Planned fiscal reforms are designed to contain future expenditures pressures, improve the budgeting process, and enhance the efficiency of tax collections and government operations over the medium-term. An action plan is being implemented to maintain confidence in the banking system, including by preemptive bank recapitalization, agreements to maintain foreign banks’ exposure in the country, and efforts to strengthen bank supervision and resolution. This program, combined with significant external financial support, should ease short-term funding pressures and enhance medium-term economic prospects.

“The joint financial assistance being provided by the IMF, the European Union, and the World Bank will help cushion the economic downturn and will provide reassurance to markets that Romania’s external obligations will be met. It sends a strong signal of the international community’s confidence that, with the consistent implementation of the program, Romania will weather the current difficulties and emerge with a better-balanced and more flexible economy,” Mr. Lipsky said.

ANNEX

Recent Economic Developments

Romania experienced an economic boom over the past five years that led to overheating and unsustainable imbalances. GDP growth averaged over 6½ percent per year from 2003-08, as foreign direct investment and capital inflows, in part through subsidiaries of foreign banks in Romania helped finance high consumption and investment growth. The rapid increase in borrowing that fueled the boom left Romania highly exposed to global financial difficulties and to exchange rate volatility. Loose fiscal and incomes policies also contributed to the overheating of the economy and to its current vulnerabilities, with excessive spending, especially on wages and pensions, as the main culprit.

Economic activity turned down sharply in late 2008 and has fallen further in 2009. Growth is projected at about 4 percent in 2009 on account of a sharp contraction in domestic demand, which in turn will set off a correction in the current account deficit from 12½ percent of GDP in 2008 to 7½ percent in 2009. Foreign direct investment and capital inflows will drop sharply. Increased financial stress, tightening credit standards and limited access to external funding will inhibit lending to the private sector. Once confidence is restored, domestic demand is expected to slowly rebound, but growth will remain near zero in 2010, before recovering to 5 percent in 2011. Inflation is expected to fall in 2009 to within the official target (3.5 percent, plus or minutes 1 percent) and remain there in 2010.

Program Summary

The IMF-supported program combines strong policy measures with sizable financial support. Key to restoring confidence is a reversal of the sharp increase in public spending, which caused a large deficit to accumulate even during a period of strong economic growth. Short-term budget cuts will be combined with fiscal policy reforms to place the public finances on a more sustainable path. The effects of the fiscal adjustment and budget reforms will be cushioned by boosting social safety net spending and safeguarding capital spending. Banking sector measures will also be implemented to ensure that banks remain sufficiently strong to weather the economic downturn.

Specific program objectives include:

- Reduce the fiscal imbalance to bring the deficit back under 3 percent of GDP by 2011.
- Maintain adequate capitalization of banks and liquidity in domestic financial markets.
- Bring inflation within the target range of the National Bank of Romania (NBR) by end-2009 and maintain it there.

- Secure adequate external financing and improve confidence.

Romania joined the IMF on December 15, 1972, and its quota is SDR 1.03 billion (about €1.16 billion or US$1.54 billion). Its latest arrangement with the IMF was a Stand-By Arrangement that expired on July 6, 2006.

Romania: Selected Economic and Social Indicators, 2005–11

	2005	2006	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.
Output and prices			(Annual percentage change)				
Real GDP	4.1	7.9	6.2	7.1	-4.1	0.0	5.0
Domestic demand	8.3	12.8	14.3	8.9	-8.2	-2.7	5.7
Net exports (contribution)	-6.1	-10.2	-16.6	-6.3	7.8	3.9	-2.6
Consumer price index (CPI, average)	9.0	6.6	4.8	7.8	5.9	3.9	3.5
Consumer price index (CPI, end of period)	8.6	4.9	6.6	6.3	4.5	3.5	3.5
Unemployment rate	5.8	5.4	4.3	4.0	8.9	9.7	7.7
Nominal wages	17.0	18.9	22.6	23.6	5.9	3.8	5.2
Public sector wages	25.9	27.3	18.5	31.0	5.1	3.9	3.5
Private sector wages	14.7	16.5	23.2	21.2	6.2	3.8	5.7
Saving and Investment			(In percent of GDP)				
Gross domestic investment	23.3	26.5	31.1	31.4	30.8	29.9	31.9
Gross national savings	14.4	16.1	17.3	19.0	23.2	23.4	25.7
General government finances							
Revenue	31.4	32.3	32.5	32.6	33.0	33.4	33.1
Expenditure	32.1	33.7	35.6	37.5	37.5	37.0	35.8
Fiscal balance	-0.7	-1.4	-3.1	-4.9	-4.6	-3.6	-2.7
Privatization proceeds	1.3	0.4	0.1	0.1	0.0	0.0	0.0
External financing	0.5	0.2	0.1	0.5	2.8	1.1	0.2
Domestic financing	-1.1	0.7	2.9	4.4	1.8	2.4	2.5
Structural fiscal balance 1/	-0.6	-2.1	-4.2	-6.7	-3.8	-1.7	-1.2
Gross public debt (direct debt only)	15.6	15.4	17.5	20.1	23.6	25.7	25.7
Money and credit			(Annual percentage change)				
Broad money (M3)	36.5	28.1	33.7	17.6	6.6	6.5	11.5
Credit to private sector	-	54.5	60.4	33.7	16.5	5.2	3.1
Interest rates, eop			(In percent)				
Euribor, six-months	2.79	3.23	4.79	3.52	-	-	-
NBR policy rate	7.50	8.75	7.50	10.25	-	-	-
NBR lending rate (Lombard)	14.00	14.00	12.00	14.25	-	-	-
Interbank offer rate (1 week)	7.00	7.42	7.81	15.95	-	-	-
Balance of payments			(In percent of GDP)				
Current account balance	-8.9	-10.4	-13.8	-12.4	-7.5	-6.5	-6.2
Merchandise trade balance	-9.9	-12.0	-14.4	-13.3	-7.1	-6.3	-6.4
Capital and financial account balance	15.6	15.7	17.3	13.7	-2.3	3.2	7.4
Foreign direct investment balance	6.6	8.9	5.8	6.6	2.9	3.5	3.5
International investment position	-29.2	-35.3	-39.8	-52.9	-55.6	-54.6	-53.0
Gross official reserves	22.9	23.2	23.2	21.5	24.6	27.3	26.7
Gross external debt	39.0	42.9	47.1	53.4	64.2	68.5	64.0
Exchange rates							
Lei per euro (end of period)	3.7	3.4	3.5	4.0	-	-	-
Lei per euro (average)	3.6	3.5	3.3	3.7	-	-	-
Real effective exchange rate							
CPI based (depreciation -)	17.9	7.6	9.0	-4.2	-	-	-
Memorandum Items:							
Nominal GDP (in bn RON)	289.0	344.7	412.8	504.0	531.3	568.5	634.1
Nominal GDP (in bn euros)	79.7	97.8	123.6	136.8	119.7	118.8	130.7

Social Indicators (reference year in parentheses)

Per capita GNI (Atlas method, 2005)**:** US $4445; **Income distribution** (GINI index, 2000): 30.3**; Poverty rate** (2005): 13 p.c.;
Primary education completion rate (2004): 94 percent; **Gender pay gap** (2003): 18 percent;
Life expectancy at birth (2004): 71.3; **Infant mortality per 1000 live births** (2004): 16.8.

Sources: Romanian authorities; IMF staff estimates and projections; and World Development Indicators database.
1/ Actual fiscal balance adjusted for the automatic effects of the business cycle.