International Monetary Fund

Romania and the IMF

Press Release:
IMF Executive Board Approves €12.9 Billion Stand-By Arrangement for Romania
May 4, 2009

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Romania: Letter of Intent and Technical Memorandum of Understanding

April 24, 2009

The following item is a Letter of Intent of the government of Romania, which describes the policies that Romania intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Romania, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Bucharest, April 24, 2009

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

Dear Mr. Strauss-Kahn:

1. Economic conditions in the region have worsened sharply in recent months as a result of the global financial crisis. These events were aggravated by underlying imbalances in our economy, and have resulted in sharply deteriorating prospects for Romania. In response, the government and the National Bank of Romania (NBR) have developed a comprehensive strategy to firmly anchor macroeconomic policies and reduce financial market stress. We request that the Fund support our program through a Stand-By Arrangement (SBA) for a period of 24 months in the amount equivalent to SDR11.443 billion (€12.95 billion). In conjunction with support of €5 billion under the EU's balance of payment financing facility and other multilateral commitments of some €2 billion, this arrangement will signal the international community's support for our policies. We view this package as essential to protect the Romanian economy from the worst effects of the worldwide crisis, and to put us in a position for a strong return to growth once the current difficulties ease.

2. We have discussed with IMF staff our economic program, which is outlined below. The program aims to cushion the effects of the sharp drop in private capital inflows while implementing policy measures to address the external and fiscal imbalances and to strengthen the financial sector. The immediate objective is to facilitate an orderly adjustment of the external deficit, thus easing excessive pressures on the exchange rate which could otherwise cause severe balance sheet effects on the corporate and household sectors, resulting in a sharper recession and strains in the banking sector. To attain this objective, our program intends to: (i) strengthen fiscal policy further to reduce the government's financing needs and improve long-term fiscal sustainability, thus preparing Romania for eventual entry into the euro zone; (ii) maintain adequate capitalization of banks and liquidity in domestic financial markets, (iii) bring inflation within the NBR's target range and maintain it there; and (iv) secure adequate external financing and improve confidence.

3. The government has already made important efforts to bring about the needed adjustment to stabilize the economy. We approved a 2009 budget with important spending cuts and revenue increases yielding around 3 percent of GDP. As prior actions under the program, another 1.1 percent of GDP in fiscal consolidation measures will be implemented.

An anti-crisis plan has been launched, including efforts to reorient public spending toward investment and to encourage private investment. Social measures to protect vulnerable groups are also being undertaken. The NBR has expanded its liquidity support to bank and several banks have boosted their capital adequacy while others are in the process of doing so.

4. The program will be monitored through quantitative performance criteria and indicative targets, structural benchmarks and consultation clauses, during quarterly reviews. Table 1 below sets out specific quarterly targets that are to be observed under the SBA for the overall general government balance, the change in arrears for the general government, CPI inflation, and net foreign assets, as well as for the issuance of new government contingent liabilities on behalf of the nonfinancial private sector and public enterprises. In addition, there will be indicative targets on the primary expenditure of the general government, net of disbursements of pre- and post-accession EU structural funds. We will have approved by emergency ordinance and sent to the parliament for ratification a package of fiscal measures designed to yield 1.1 percent of GDP RON 5.9 billion before consideration of our program by the IMF's Executive Board. Final approval of these measures will be required for the first review. The NBR will complete by April 30 (as a prior action) stress testing of all banks with more than 1 percent share (by assets) in the Romanian market, plus selected smaller banks, according to risk parameters agreed with IMF staff. The first review of the program will take place by September 15, 2009 and the second review by December 15, 2009. We believe that the policies set forth in this letter are adequate to achieve the objectives of our economic program, but the Government stands ready to take additional measures as appropriate to ensure the achievement of its objectives. Romania will consult with the IMF on the adoption of these measures and in advance of revisions to the policies contained in this letter in accordance with the IMF's policies on such consultations.

Recent economic performance and macroeconomic framework for 2009–10

5. Romania experienced an economic boom from 2003-08 that led to overheating and unsustainable imbalances. GDP growth averaged over 6½ percent per year, as foreign direct investment and capital inflows helped finance high consumption and investment growth. Robust export growth to EU countries reflected a process of increasing economic integration with western European economies. However, import growth was even faster, generating increasing current account deficits that peaked at 13½ percent of GDP in 2007. The overheating economy and rapid capital inflows complicated monetary policy, resulting in credit growth averaging 50 percent per year in 2006-7, and impairing NBR's ability to achieve its inflation target notwithstanding increases in interest rates and reserve requirements together with other measures to slow credit growth. Fiscal policy was strongly procyclical, with the government deficit rising from under 1 percent of GDP in 2005 to near 5 percent of GDP by 2008.

6. In recent months financial stress has increased, reflecting external factors and the downturn in the economy. The extreme shift in investors' risk preferences, which spilled

over from difficulties in global financial markets, has negatively affected the exchange rate, equity prices, and the government securities market. Capital inflows have slowed sharply, and NBR reserves have begun to decline. The effects in Romania have not been especially pronounced compared with elsewhere in the region, but due to the weak fiscal position and high current account deficit, the vulnerability to a sudden drop in capital flows is higher.

7. The economy turned sharply down in the fourth quarter of 2008, and prospects for 2009 are negative. GDP fell by 3.9 percent (q-on-q seasonally adjusted) in the last quarter, and indicators suggest the decline is continuing in early 2009. At this time, the outlook is particularly uncertain, as it depends on global events and on restoring consumer and investor confidence. We anticipate a sharp drop in GDP this year, but are hopeful that the measures proposed in this program will limit the fall. A recovery is expected to begin in 2010, but growth is likely to remain near zero due to the lingering effects of the global downturn on Romania. The risks to the baseline scenario are mostly on the downside, reflecting uncertainty about the speed with which financial markets will stabilize and the depth of the global economic slowdown. Inflationary pressures are expected to abate as the economy turns downward, and we anticipate that CPI inflation will move to within the NBR target band by late 2009 and remain there throughout 2010.

8. A current account correction appears well underway, but receding capital inflows are opening a significant external financing gap. Gross external financing needs will decline in 2009, due to the smaller current account deficit, and will be partly covered by pre- and post-accession EU structural funds (a stable source of inflows) and already committed foreign direct investment inflows. We cautiously assume net outflows from the non-financial private sector. Our IMF- and EU-supported program will strike a balance between balance of payments adjustment and financing support. Once the program takes effect, we expect foreign banks to largely maintain their exposure, stemming the decline experienced early in the year. At the same time, we aim to gradually increase the NBR's foreign reserves as a precaution against unexpected outflows. The resulting external financing need of some €20 billion over the period 2009-2011 can be covered by drawing on resources from the IMF, support under the EU's balance of payment facility, and from other official creditors.

Fiscal Policy

9. Government spending doubled between 2005 and 2008 in nominal terms, pushing the public share of economic activity from 32 percent of GDP to 37 percent. The public sector wage bill also more than doubled these three years due to high wage increases combined with a large increase in government employment. The fiscal deficit rose in 2008 to about 5 percent of GDP. In the final months of 2008, further expenditure increases in the run-up to the elections were financed on a very short-term basis, as the government found itself unable to borrow on longer maturities at reasonable cost. As the economy enters recession in 2009, an easing of fiscal policy to cushion the downturn is unfortunately no longer possible. Spending

has become too high and financing conditions leave the government unable to finance a large deficit.

10. The current government, which took office in late December, has already taken significant steps to reverse the fiscal imbalance. The fiscal policies of 2008 would have produced a deficit of nearly 9 percent of GDP in 2009, but measures already approved in the 2009 budget will reduce the deficit by about 3 percentage points of GDP. These budget measures include: (i) an increase of 3.3 percentage points in social contributions; (ii) adjusted property taxes due to an increase in appraisals; (iii) significant cuts in the public wage bill through reductions of bonuses and other benefits, and the elimination of 137,000 vacancies (previously used to grant higher salaries to existing staff); and (iv) substantial reductions in goods and services spending, as well as in subsidies.

11. Under the proposed IMF-supported program, the government will undertake additional fiscal adjustment efforts as a prior action, designed to bring the deficit down another 1.1 percent of GDP to 4.6 percent of GDP in 2009. Primary government expenditure (which excludes interest payments) will be reduced by an additional 0.85 percentage point of GDP compared to the 2009 budget. This will be achieved by (i) foregoing public sector wage increases (totaling 5 percent) scheduled for 2009 or equivalent further cuts in employment; (ii) reducing public employment, including by replacing only 1 of 7 departing employees; (iii) reductions in capital spending on items like vehicles and office equipment, plus a more realistic timetable for EU supported investment projects; (iv) additional cuts in spending on goods and services; and (v) further reductions in subsidies to public entities. Parliamentary ratification of these measures will be completed by the first review of the program (structural benchmark) Within the government's expenditure envelope, we will give priority to investment projects cofinanced by EU funds. We will also allocate an additional RON 250 million in spending to improving social protection for the most vulnerable groups during the economic downturn. On the revenue side, measures to eliminate certain tax deductions and allowances (in particular on company cars, and depreciation of revalued assets) are expected to generate an additional 0.25 percent of GDP.

12. The program will be primarily monitored through the cash balance of the general government (as defined in the accompanying technical memorandum, TMU) (a quarterly performance criterion). In the event that nongrant revenues exceed those foreseen under the program, the deficit target will be adjusted downward by one half the surplus, allowing for additional capital spending while reducing the deficit further. We will consult IMF staff on adjustments to the target and on eventual corrective measures in the event of a shortfall in government financing. A performance criterion will be established on the change in domestic payments arrears (as defined in the TMU) that will contemplate a full repayment of 2008 arrears under the program. In case of need, the government will take corrective measures to prevent the accumulation of new spending arrears. An indicative target will also be established on the primary expenditure of the general government, net of reimbursements

from pre- and post-accession EU structural funds, which will be subject to the same adjustor as applied to the deficit target.

13. The government is committed to maintaining fiscal discipline in the long-term, recognizing that this is a key element in reducing the external imbalance and in retaining investor confidence. We therefore intend to continue budget consolidation in 2010. We envisage a further reduction in the general government deficit to around 3⅔ percent of GDP. Fiscal efforts will continue to be concentrated on the expenditure side. Specific quarterly targets for 2010 will be set at the time of the second program review (to be concluded by December 15, 2009). For 2011, we plan to move the general government deficit below 3 percent of GDP (under both national and ESA 95 definitions). Passage of a 2011 budget designed to achieve this objective will be a structural benchmark for the sixth review of the program (scheduled by December 15, 2010).

14. Sustainable achievement of lower budget deficits will require important changes in the budget process, as well as reforms in revenue and expenditure policies. A key component of our medium-term strategy will be a new fiscal responsibility law that will, among other things: (i) set up, in coordination with the IMF and the World Bank, procedures for improved multiyear budgeting; (ii) establish limits on budget revisions during the course of the year; (iii) lay out fiscal rules on expenditures, public debt and the primary deficit; (iv) create a fiscal council to provide independent and expert scrutiny; and (v) set up a framework for the issuance and management of guarantees and other contingent liabilities. We plan to submit this law to parliament and prepare an implementation plan by end-November 2009 (a structural benchmark).

15. We have requested technical assistance from the IMF, the World Bank, and the European Commission in 2009 to assist in improving public financial management, tax administration, and the efficiency of public expenditures. Implementation of recommendations from this assistance will be undertaken in 2009 and 2010, including comprehensive reviews of the fiscal code and the fiscal procedures code in line with European Commission deadlines and procedures. We will implement an improved system of financial monitoring of decentralized fiscal entities (including public enterprises) and will move to increase the net revenue from these entities through tighter control on their expenditures and reduced subsidies. In 2010, once the enhanced monitoring is in place, an indicative target on the financial balance of the largest public enterprises will be included in program conditionality. Public enterprises will not be allowed to accumulate new arrears, but they will have to restructure to reduce existing arrears. During the program period, public enterprises making losses will not be allowed to raise compensation; those earning profits will only be allowed to increase compensation in line with inflation and productivity growth. We will step up efforts to improve the absorption of EU funds, while ensuring they target the right growth priorities. Improving the efficiency and effectiveness of the public administration will be instrumental to this goal.

16. We currently face major problems in the public sector wage system. Bonuses comprise too much of total compensation, there is no unified wage scale, and there is a large numbers of laws regulating wages in different parts of the system. To permanently eliminate these problems, we will approve during 2009 legislation to restructure the public compensation (structural benchmark). Under this legislation, we will establish a unified, simplified pay scale, and reform the current system of bonuses. A ceiling of under 30 percent will be phased-in on the share of all non-wage personnel expenditures as a share of total public compensation. Creation of non-monetary bonuses will be prohibited. Monetary bonuses will be consolidated—eliminating the large majority of bonuses or rolling them into the base wage. For any given public servant, total bonuses would be legally capped. All bonuses will continue to be fully taxable. The law could provide for a phasing-in period of the reforms of up to 3 years, and efforts will be made to safeguard the real incomes of the lowest paid workers during this process. Further attributes of this legislation will be coordinated with the Fund and the World Bank.

17. A significant source of fiscal pressure over the medium term is the cost of future pension obligations. To address this, we will reform key parameters of the pension system, in coordination with the World Bank (structural benchmark). Changes will include moving toward indexing public pensions to consumer prices rather than to wages and limiting the scope for discretionary pension increases. Groups of public employees currently excluded from pension contributions will have such contributions phased-in. We will also continue gradual adjustment of the retirement age beyond the currently agreed schedule (particularly for women) taking into account the evolution of life expectancies, to allow for greater financial stability of the system, as well as to ensure that retirement parameters are more in line with EU practices. To protect vulnerable pensioners, we will make efforts to boost targeted poverty support programs that would improve their living standards. We will continue to phase in the second pillar of the pension system, with regularly scheduled increases in contributions as originally envisaged. Together, we hope that the pillars of the pension system will allow us to eventually attain our objective of a 45 percent replacement ratio for retirees on average.

Financial Sector

18. The Romanian banking system entered the period of global financial turbulence with a strong solvency position. All 32 banks are in compliance with the capital adequacy requirement of 8 percent, and the average capital adequacy ratio was 12.3 percent at the end of 2008. Most banks are foreign owned (with 87 percent of assets), and most of the parent banks are based in the Euro area, with access to liquidity through the ECB facilities. The parents of the main banks operating in Romania have pledged any support necessary for their subsidiaries, committing to maintaining their global exposures to Romania over the program period, and to recapitalizing their subsidiaries as needed. This was reaffirmed in their joint statement issued in Vienna on March 26, 2009. The NBR, in conjunction with home country banking supervisors, will monitor this commitment closely.

19. While the banking system as a whole is currently well-capitalized, it now faces more difficult macroeconomic and global financial circumstances than in recent years and exceptionally uncertain prospects. In these circumstances it is prudent for banks to maintain strong capital buffers. To this end, the program will take advantage of the high standards of stress testing capability developed by the NBR. Stress tests of individual bank balance sheets and lending portfolios under different scenarios will be used to assess the potential increases in own funds needed to ensure that solvency ratios remain above 10 percent throughout the program period (prior action).

20. Once stress tests are completed, banks will be required to secure, by the end of September 2009, sufficient resources to cover any potential shortfalls revealed by the stress tests. These resources could be provided either in the form of increases in share capital or through subordinated long-term (at least 5-year) loans and similar instruments, qualifying as tier 2 capital and convertible into ordinary share capital at the holders' discretion or at the request of the NBR. These resources should in the first place come from the owners of the banks, but we will encourage bank owners to actively explore opportunities for cofinancing the increase in stable funding offered by the IFIs in the framework of their February 2009 Join Action Plan in support of banking systems in the CEE region.

21. A temporary preferential regime will be established for banks whose majority owner signs a commitment to (i) maintain overall exposure to Romania throughout the period of the program; and (ii) increase the capital of its bank in Romania in line with the potential needs, as assessed under the stress-testing exercise. For these banks, any new subordinated debt subscribed either by the owners or by the IFIs would be exempt from the NBR's reserve requirements. For the purposes of monitoring compliance with (ii), this subordinated debt and similar instruments would be counted as tier 1 capital, while existing capital adequacy rules will still apply. This preferential regime will expire at the end of the program period. In line with EU principles, it will be available to all banks established in Romania, regardless of the nationality of the owners. Banks' commitment to maintain or increase exposures and to enhance capital as needed is a key element in improving financial stability and monetary conditions. If monetary conditions evolve favorably, the NBR will be prepared to gradually ease reserve requirements, which in turn will promote bank stability.

22. Although the banking system is currently stable and sound, we will amend our banking and winding-up laws, in consultation with the IMF, to be able to respond in a timely and effective fashion in the event of bank distress. A key objective of the amendments will be to strengthen the special administrator's ability to deal with banks in weak financial positions (end-November 2009 structural benchmark). Beyond bank resolution, the NBR's remedial powers will be strengthened with provisions allowing it as part of its assessment of suitability to request that significant shareholders increase their share capital and financially support the bank, and to prohibit or limit profit distributions (end June 2009 structural benchmark). We are cognizant of the need to streamline and strengthen our court-based

proceedings for winding-up of banks and intend to pursue further work in this area at a future stage.

23. A further crucial ingredient in ensuring confidence in the banking system is the system of deposit insurance. In 2008, governments across Europe, including Romania, acted to strengthen their deposit insurance systems by raising the level of deposit coverage to at least €50,000. To further strengthen the RDGF, and to bring it more closely into alignment with international best practice and prospective requirements under EU directives, the RDGF will supplement its existing funding with access to government privatization receipts held in the Treasury account in the NBR (currently RON 11.6 billion). Additionally, procedures for the activation of deposit insurance will be modified to simplify and accelerate payouts. Under modified legislation, deposit insurance will be paid within the 20 working day period authorized in the EU directive on deposit guarantee schemes (structural benchmark).

24. The NBR will continue to improve the banking supervisory and regulatory framework, and will consult with Fund staff prior to the introduction of any new or revised prudential regulations for banks. This will include more detailed reporting requirements on liquidity and, at an appropriate time, raising the minimum level of the capital adequacy ratio from 8 percent to 10 percent. We are also committed to bringing Romanian financial accounting standards into line with international practice, as reflected in the International Financial Reporting Standards (IFRS). Adopting IFRS will reduce regulatory burdens on cross-border banks and corporations, and provide a more transparent framework for FDI. In the current circumstances, however, a rapid transition could be disruptive, particularly in the financial sector. In view of this, the adoption of IFRS will take place on a timetable to be determined by the NBR.

25. We will seek an agreement with commercial banks to facilitate the restructuring of household debt contracted in foreign currency by adjusting the maturity and repayment schedule of the debt, including offering the option to voluntarily convert it in domestic currency. Banks will also be allowed to continue to rely on their own in-house expertise for the collection of their claims

Monetary and Exchange Rate Policy

26. The NBR is determined to gradually bring inflation down to the official target of 3.5 percent (plus or minus 1 percent). Under the program, progress towards this goal will be monitored using an inflation consultation clause (see TMU). Monetary policy was tightened in 2007 and the first half of 2008 in response to a rise in underlying inflationary pressures. Looking forward, the economic slowdown in Romania and the rest of the world will likely put downward pressure on inflation, but any further depreciation of the exchange rate could boost inflation. Therefore, monetary policy will remain vigilant, with any easing of reserve requirements or of the policy interest rate calibrated to assure attainment of the inflation

objective by end-2009, and with due consideration of the possible effects on capital flows and the exchange rate.

27. Under the program, we plan for an increase in Gross International Reserves of 0 in 2009 (implying a recovery of all reserves lost in the months before the program takes effect), and of €3.0 billion in 2010. This will provide improved confidence in the economy and allow for greater reserve coverage of short-term liabilities. A performance criterion will be established on Net Foreign Assets that is consistent with gross reserves accumulation objective. Within the inflation targeting framework, the NBR's intervention policy will be applied consistently with the target for net foreign assets under the program. Reserve losses exceeding €2 billion in any 30-day period during the program will trigger consultation with IMF staff. The NBR will widen the range of assets acceptable as collateral for its facilities. The NBR stands ready to further expand its toolkit as needed.

28. During the period of the Stand-by arrangement we will not, without Fund approval, introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement. Moreover, we will not introduce or intensify import restrictions for balance of payments reasons.

29. We recognize the importance of completing a safeguards assessment by the first review under the Stand-By Arrangement. The National Bank of Romania will provide the information required to complete the assessment by the first review and will receive as safeguards mission from the IMF as necessary.

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Gheorghe Pogea	Mugur Isarescu
Minister of Finance	Governor of the BNR

Attachments

Table 1. Romania: Quantitative Program Targets

	2008	2009				2010
	Dec	March	June	Sept	Dec	Dec
	Actual	Proj.	Prog	Prog	Proj	Proj
I. Quantitative Performance Criteria						
1. Cumulative change in net foreign assets (mln euros) 1/	25,532	-3,500	-7,600	-8,720	-9,000	-500
2. Cumulative floor on general government overall balance (mln lei) 2/	-24,655	-8,300	-14,508	-18,612	-24,363	-20,583
3. Cumulative change in general government arrears (bn lei) 1/	0.3	…	0.0	0.0	-0.15	-0.15
4. Ceiling on general government guarantees issued during the year (face value, bn lei)	0.0	…	6.0	6.0	6.0	…
II. Continuous Performance Criterion						
5. Nonaccumulation of external debt arrears	0	0	0	0	0	0
III. Inflation Consultation						
6. 12-month rate of inflation in consumer prices						
Outer band (upper limit)	8.3	8.7	8.4	7.7	6.5	4.5
Inner band (upper limit)	7.3	7.7	7.4	6.7	5.5	3.5
Center point	*6.3*	*6.7*	*6.4*	*5.7*	*4.5*	*2.5*
Outer band (lower limit)	5.3	5.7	5.4	4.7	3.5	1.5
Inner band (lower limit)	4.3	4.7	4.4	3.7	2.5	0.5
IV. Indicative Target						
7. General government primary spending (excluding EU funds; mln lei) 2/	182,411	44,120	87,505	132,356	182,723	191,468

1/ The December 2008 figure is a stock.
2/ The December 2008 figure is for the whole year.

Table 2. Romania: Proposed Structural Conditionality Under the Program in 2009

Measure	Conditionality 1/	Timing
Fiscal policy		
1. Passage of 1.1 percent of GDP in fiscal measures to ensure achievement of fiscal targets (¶4, 11)	Prior Action	
2. Ratification by parliament of fiscal measures equivalent to 1.1 percent of GDP (¶4, 11)	SB	August 31, 2009
3. Passage of revised public compensation legislation (¶16)	SB	October 30, 2009
4. Presentation of fiscal responsibility legislation and implementation plan to parliament (¶14)	SB	November 30, 2009
5. Passage of revised pension legislation (¶17)	SB	December 31, 2009
Financial Sector		
6. Conducting stress-tests on banks with >1% of system assets and certain smaller banks to assess the need for additional capital (¶19)	Prior Action	
7. Passage of amendments to the banking law to strengthen NBR's power to request bank shareholders an increase in their share capital and limit profit distribution (¶22)	SB	June 30, 2009
8. Passage of amendments to deposit insurance legislation to broaden grounds for activation of deposit insurance, expedite payouts and provide a line of credit from the government (¶23)	SB	August 30, 2009
9. Passage of amendments to the banking and winding-up laws to enhance the bank resolution framework, in consultation with the IMF (¶22)	SB	November 30, 2009

1/ SB = structural benchmark.

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

April 1, 2009

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

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

3. For the purposes of the program, the *general government* includes the entities as defined in the 2009 budget. These are: the central government (state budget, treasury, self-financed state entities included in the budget, etc.), local governments, social security funds (pension, health, and unemployment), road fund company, and administration of the property fund. This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform IMF staff of the creation of any such new funds or programs immediately.

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

A. Floor on the Net Foreign Assets of the NBR

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

5. **Gross foreign assets** are defined to include the NBR's holdings of SDRs, the country's reserve position at the Fund, holdings of cash, securities and deposits abroad in convertible foreign currencies. Excluded from reserve assets are: (i) gold and other precious

metals; (ii) assets in nonconvertible currencies; (iii) illiquid assets; (iv) any assets that are pledged, collateralized, or otherwise encumbered; (v) claims on residents; and (vi) claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

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

Floor on cumulative change in NFA from the beginning of the year (in mln. euros) 1/

	2008	2009				2010
	December	March	June	September	December	December
	(stock)	(est)	PC	PC	IT	IT
Cumulative change in NFA	25,532	-3,500	-7,600	-8,720	-9,000	-500
Memorandum Item:						
Gross Foreign Assets	26,220	-3,500	-2,300	-1,200	0	3,000

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

7. NFA targets will be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as external disbursements from official creditors (World Bank and the EC) that are usable for the financing of the overall central government budget. The NFA targets will also be adjusted upward by the increase in commercial bank reserve requirements held with the NBR relative to end-December, 2008 (€13,038 million), measured at program exchange rates.

External Program Disbursements – Baseline Projections (in mln. euros)

	2009				2010
	March	June	September	December	December
Cumulative flows from end-December 2008	0	0	1,500	3,000	2,350

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

8. The quarterly consultation bands for the 12-month rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the Romanian Statistical Institute), are specified below. Should the observed year-on-year rate of CPI

inflation fall outside the outer bands specified above, the authorities will complete a consultation with the Fund on their proposed policy response before requesting further purchases under the program. In addition, the NBR will conduct discussions with the Fund staff should the observed year-on-year rate of CPI inflation fall outside the inner bands specified for the end of each quarter in the table above.

	2008	2009				2010
	December	March	June	September	December	December
Outer band (upper limit)	8.3	8.7	8.4	7.7	6.5	4.5
Inner band (upper limit)	7.3	7.7	7.4	6.7	5.5	3.5
Center point	*6.3*	*6.7*	*6.4*	*5.7*	*4.5*	*2.5*
Outer band (lower limit)	5.3	5.7	5.4	4.7	3.5	1.5
Inner band (lower limit)	4.3	4.7	4.4	3.7	2.5	0.5

C. Performance Criterion on General Government Balance

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

Cumulative floor on general government balance

	(In millions of lei)
December 31, 2008 (actual)	-24,655
End-March 2009 (actual)	-8,300
End-June 2009 (performance criterion)	-14,508
End-September 2009 (performance criterion)	-18,612
End-December 2009 (indicative target)	-24,363

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

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

11. If the difference between the general government deficit measured from above the line and from below the line is larger than lei 200 million each quarter during 2009, and to be determined for 2010 during the second review, the Ministry of Public Finance will consult with IMF staff.

12. In the event that non-grant revenues exceed those projected under the program, the deficit target will be adjusted downward by one half of the surplus to allow for additional capital spending while reducing the deficit further. The following table shows the accumulated projected non-grant revenue for 2009, to which the actual non-grant revenue will be compared.

Cumulative projected revenue of general government, net of EU funds	(In millions of lei)
December 31, 2008 (actual)	161,650
End-March 2009 (actual)	36,951
End-June 2009 (forecast)	77,351
End-September 2009 (forecast)	120,145
End-December 2009 (forecast)	166,722

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

13. The issuance of general government guarantees to the non-financial private sector and public enterprises will be limited during the program period.

	(In billions of lei)
Ceiling on new general government guarantees issued from end-2008 until:	
End-March 2009 (actual)	…
End-June 2009 (performance criterion)	6.0
End-September 2009 (performance criterion)	6.0
End-December 2009 (indicative target)	6.0

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

14. The performance criterion established on the change in domestic payments arrears of the general government contemplates no accumulation of new arrears and their elimination during the program period. In case of need, the government will take corrective measures to

prevent the accumulation of new spending arrears. For the purpose of the program, arrears mean accounts payable past due date by 90 days (in line with ESA95 definitions for expenditures).

Cumulative change in general government arrears	(In billions of lei)
December 31, 2008 (stock, actual)	0.3
End-March 2009 (projected)	0.0
End-June 2009 (performance criterion)	0.0
End-September 2009 (performance criterion)	0.0
End-December 2009 (indicative target)	-0.15
End-December 2010 (indicative target)	-0.15

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

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

G. Indicative Target on General Government Primary Spending

16. The indicative target on primary expenditure of the general government, i.e. overall spending excluding interest payments, net of disbursements of pre-accession and post-accession EU funds, will be subject to the same adjustor as applied to the deficit target.

Cumulative change in general government primary expenditures, net of EU funds	(In millions of lei)
December 31, 2008 (actual)	182,411
End-March 2009 (actual)	44,120
End-June 2009 (indicative target)	87,505
End-September 2009 (indicative target)	132,356
End-December 2009 (indicative target)	182,723

H. Monitoring of Public Enterprises

17. The Ministry of Public Finance, the Ministry of Labor and Social Protection, and other pertinent institutions will provide information to document that a monitoring system of public enterprises is in place by the time of the first review. During the program period, information will be provided to document that sanctions—decline in remuneration and dismissal of management according to Ordinances 37/2008 and 79/2008—are imposed if the budgets and company targets for restructuring are not observed.

18. During the second review, after the monitoring system of the Ministry of Public Finance has been refined, quarterly indicative targets for 2010 will be established on the operating balance (earnings before interest and tax), net of subsidies, of the 30 largest enterprises by total expenditures (as of 2009).

I. Reporting Requirements

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

Table 1. Romania: Data Provision to the IMF

Item	Periodicity
To be provided by the Ministry of Finance	
Preliminary monthly data on general government accounts	Monthly, on the 25th day of the following month
Quarterly final data on general government accounts	Quarterly cash data, on the 35th day past the test date. Quarterly accrual data, on the 55th day past test date.
The budget deficit of the general government using ESA95 definition	Quarterly, with a lag of three months
Preliminary data on below-the-line financing for the general government	Monthly, with a lag of no more than 35 days past the test date
Final quarterly data on below-the-line financing for the general government	Quarterly, no later than 45 days past the test date
Total accounts payable and arrears of the general government	Quarterly, within 55 days
Total accounts payable and arrears of the central government and social security funds	Monthly, within the next month
Stock of the central government external arrears	Daily, with a lag of not more than seven days
Public debt and new guarantees issued by the general government	Monthly, within one month
Preliminary monthly data on general government primary spending, net of EU disbursements	Preliminary monthly data will be reported to the IMF staff within 25 days
Final quarterly data on general government primary spending, net of EU disbursements	Quarterly, within 35 days from the test date
From 2010, the operating balance, profits, arrears, and personnel expenditures of 30 largest public enterprises by total expenditures	Quarterly, within three months of the test date
Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month
To be provided by the National Bank of Romania	
NFA data, by components, in both program and actual exchange rates	Weekly, each Monday succeeding the reporting week and with a 3 working day lag in the case of end-quarter data
Monetary survey data in the format agreed with IMF	Monthly, within 30 days of the end of the month

staff	
The schedule of contractual external payments of the *banking sector* falling due in the next four quarters, interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The schedule of contractual external payments of the *corporate sector* falling due in the next four quarters interest and amortization (for medium and long-term loans)	Monthly, 45 days after the end of each month
The stock of short-term external debt of banks and corporates	Monthly, 45 days after the end of each month
Balance of payments in the IMF format currently used to report	Monthly, 45 days after the end of each month
Exposure (deposits, loans, subordinated loans) of (i) foreign parent banks to their subsidiaries in Romania; (ii) IFI and (iii) other creditors to banks in Romania (by national and foreign currency).	Monthly, 20 days after the end of each month

II. Structural Conditionality: Specifications

A. Capital adequacy and stress testing

20. The stress tests involved in the assessment of capital adequacy of banks will include the following features:

- The tests will be applied to all banks with assets greater than 1 percent of total bank assets plus a number of smaller banks selected on basis of the quality and vulnerability of loan portfolios; the evolution of non-performing loans over the past year; and the current level of bank solvency;
- Two macroeconomic scenarios will be developed, including a baseline scenario consistent with the main features of the program assumptions, and a more severe scenario reflecting the potential for an even sharper weakening of growth and the external value of the leu. The NBR macroeconomic forecasting model will be used to generate internally consistent scenarios for the evolution of all key macroeconomic variables;
- The stress tests will be conducted by the NBR, using stress testing methods employed in the context of the IMF FSAP update in 2008. The tests will employ the results of the macroeconomic scenarios, together with the most recently available data on bank and corporate balance sheets, to project the evolution of bank balance sheets over the program period under the two scenarios;

- The results of the analyses will used to assess the level of additional own funds required at the outset to ensure that each bank's solvency ratio would remain above 10 percent throughout the program period.
- The stress tests and assessment of prudential increases in own funds on a bank-by-bank basis will be completed by end-April. The intention is to share with banks the general approach to the stress testing analysis at by late March. It is expected that the detailed assessment of needed increases in own funds would be able to be communicated to banks by end-April.
- The stress testing analysis and assessment of prudential capital needs will be carried out in consultation with IMF staff. In particular, IMF staff will be consulted on the final selection of banks included in the analysis and the assessment of appropriate increases in own funds. Additionally, the NBR staff will provide a note detailing the design of the stress testing exercise, including the macroeconomic scenarios, key assumptions, data employed, and key findings.

B. Bank Resolution

21. The legal amendments enacted by Parliament to the banking and winding-up laws will include the following elements:

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

b. Supplementing its existing authority, the special administrator will be granted new authority to implement promptly a broad range of restructuring measures, which shall include purchase and assumptions, sales of assets, transfer of deposits, and write downs of capital to absorb losses.

c. The law will provide authority for the appointment of the special administrator with the powers of all of the banks' decision-making bodies, including the bank's general assembly of shareholders

d. The law will carve out the application of burdensome provisions, including under the general companies law, to the extent that they are inconsistent with the prompt implementation of restructuring measures (i.e., in particular, the prompt implementation of the transfer of substantial assets and of the reduction of capital to absorb all existing losses)

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

f. The law will provide greater legal certainty for bank resolution measures during special administration so that these measures may not be suspended or reversed by litigation (i.e., such as by means of avoidance powers under the winding-up or insolvency proceedings). It will also clarify that restructuring measures are not subject to creditors' consent.

g. Initiation of winding up proceedings under the winding-up law and of liquidation proceedings under the companies law will require the NBR's prior approval.

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

C. Deposit insurance

22. Legislation will be modified by Parliament to extend the existing grounds for activation of the deposit insurance, which shall also be activated upon the NBR's determination that a credit institution, due to its financial circumstances, appears unable to repay a deposit and to have no current prospect of being able to do so. The conversion of foreign currency denominated deposits into lei will be determined as of the date of the activation of the deposit insurance.

23. The time limit for beginning payouts will be cut from the current 3 months, which can be extended to 9 months, to 20 working days consistent with the March 2009 amendments to the EU directive on deposit guarantee schemes.