



NATIONAL
BANK OF
ROMANIA

Annual Report 2016

Annual Report 2016

NOTE

The Annual Report for 2016 was examined and approved by the National Bank of Romania Board on 27 June 2017 and was submitted to the Parliament of Romania pursuant to Law No. 312/2004 on the Statute of the National Bank of Romania.

Some of the data for the period covered are provisional and will be updated as appropriate in the subsequent publications of the National Bank of Romania. Totals may not add up and minor differences from the percentage changes in charts and tables may occur, due to rounding.

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Overview

At international level, 2016 saw a slowdown in economic growth – both worldwide and in the European Union overall –, but the Romanian economy expanded at its fastest pace after the outbreak of the global crisis, i.e. 4.8 percent. The chief driver was consumer demand, fuelled by labour market improvements and, additionally, by the fiscal and budgetary easing measures approved in the latter half of 2015.

The step-up in economic growth was, however, accompanied by emerging tensions surrounding macroeconomic equilibria, reflected by a widening of the fiscal and external deficits. Thus, the general government deficit reached the 3 percent of GDP reference value set forth in the Stability and Growth Pact, due to structural causes alone. According to estimates by the European Commission, the structural deficit of 2016 stood at 2.6 percent of GDP, 2 percentage points above the year-earlier reading. Such a sizeable stimulus provided to the economy at a time when most (domestic and international) available assessments on the cyclical position of the economy showed a return to potential keeps fiscal policy on pro-cyclical coordinates, thereby containing its future room for manoeuvre. Furthermore, the current account deficit widened to 2.3 percent of GDP, which is a sustainable level per se, covered entirely by foreign direct investment and non-repayable European funds, but places Romania in a rather unique position across the EU, as most of the Member States reported surpluses or lower and decreasing deficits.

Low inflation continued to be a feature of the domestic economic landscape in 2016 as well. Given that its path was substantially influenced by the VAT rate changes in June 2015 and January 2016, namely the broadening of the scope of the 9 percent reduced VAT rate to all food items and the cut in the standard VAT rate from 24 percent to 20 percent, the annual inflation rate ended the year at a slightly negative value of -0.5 percent. In the absence of these fiscal measures, this indicator would have run in positive territory (0.9 percent at year-end), with the drop in imported inflation offsetting to a large extent the latent pressures from the shift in the cyclical position of the economy and the uptrend in unit labour costs. Even though – amid the global supply-side disinflationary shocks in the form of large and persistent declines in prices of international raw materials, especially energy and agri-food commodities –, the annual inflation rate (net of the first-round effects of VAT rate cut) ran below the lower bound of the ± 1 percentage point variation band of the 2.5 percent target, its level may be deemed as compatible with the widely-accepted definition of price stability.

Romania's international reserves increased in 2016 to EUR 37.9 billion at year-end. This evolution has strengthened Romania's external credibility, thus enhancing the capacity of the economy to absorb potentially adverse shocks on financial markets and helping reduce the government's and local companies' financing costs. Also in 2016, the loan taken from the IMF in 2009 (under the multilateral financing arrangement signed

by the Romanian government with international financial institutions) was repaid in full, the entire repayment process ending without affecting the forex market or eroding the adequacy indicators of international reserves, which at end-2016 stood EUR 9.6 billion higher than in 2008, the year prior to taking the loan.

After a considerable adjustment effort that enabled Romania to overcome the fall-out from the global crisis and to achieve economic growth for six successive years, the joint consequences of a number of measures already implemented or envisaged for boosting consumer demand in particular could affect the sustainable growth pattern. Putting the economy onto a lasting growth path calls for a coherent economic policy mix so that macroeconomic equilibria and financial stability should not be deteriorated.

From the perspective of reinforcing the coherence and effectiveness of the institutional framework for managing economic convergence and macroprudential supervision of the financial system, notable developments took place in 2016 and the first part of 2017. Thus, in order to promote the necessary reforms paving the way for the Romanian economy to adopt the euro, in December 2016, the Inter-ministerial Committee for Changeover to the Euro (chaired by the Prime Minister of Romania and having the National Bank of Romania Governor as vice-chair) was set up via a Government decision. The first meeting of this advisory body was held in April 2017. In the same month, the meeting on the operationalisation of the National Committee for Macroprudential Oversight took place. This committee was established in virtue of Law No. 12/2017 on the macroprudential oversight of the national financial system as an inter-institutional cooperation structure without legal personality and bringing together representatives of the National Bank of Romania, the Financial Supervisory Authority and the Government. The mission of the newly-established entity is to ensure coordination in the field of macroprudential supervision over the national financial system by designing the macroprudential policy and the appropriate instruments for its enforcement.

As for the central bank's part within the economic policy mix, the best contribution it can make to the achievement of lasting economic growth is to maintain price stability and financial stability, two objectives for the accomplishment of which the National Bank of Romania has taken consistent action. The recent global crisis underscored the fact that price stability and financial stability are strongly interlocked, which substantiates central banks' elevated concern over the latter. Goal-specific policies are, however, required for the efficient provision of these two public goods that the society expects from central banks fulfilling, similarly to the NBR, the double role of monetary and prudential authority. Thus, the imperative of preserving and consolidating financial stability calls for an adequate macroprudential toolkit so that monetary policy retains enough degrees of freedom to attain the overriding goal of ensuring price stability.

In 2016, monetary policy sought to ensure the return over the medium term of the annual inflation rate to the flat target, in a manner supportive of economic growth by boosting confidence and lending. Nevertheless, monetary policy was implemented in a challenging environment, marked by the divergence between the near- and the longer-term outlook for inflation. Specifically, the annual inflation rate was stuck at negative values in the course of 2016, under the impact of a string of transitory disinflationary shocks, while its longer-term projected level stood in the upper half of

the variation band of the target, amid the build-up of latent inflationary pressures. In the first part of 2016, several supply-side shocks drove inflation rate deeper into negative territory, down to an all-time low of -3.5 percent in May. The most relevant shocks were the successive VAT rate cuts (in June 2015 and January 2016) and the year-on-year decline in international agri-food and energy commodity prices, which continued to exert strong disinflationary effects, despite the turning point seen in their dynamics at the beginning of 2016. With regard to the prospects of a fast rise in inflation rate over the projection interval, they emerged mainly from increases in labour costs and the reversal of the economy's cyclical position.

Against this backdrop, the NBR left unchanged the parameters of its key monetary policy instruments: the policy rate was kept at a historical low of 1.75 percent and the width of the symmetrical corridor defined by interest rates on the NBR's standing facilities around the policy rate remained unchanged at ± 1.5 percentage points.

The gradual alignment of the monetary policy operational framework to the European standard is an ongoing concern for the NBR, which over the past years has focused on minimum reserve requirement ratios (whose high levels had been used in the pre-crisis years to cap credit expansion) and on the corridor of interest rates on the NBR's standing facilities around the policy rate (whose relatively large width had helped reduce speculative capital inflows). Capitalising on the windows of opportunity provided by the economic and financial environment, the central bank gradually narrowed in 2013-2015 the corridor defined by interest rates from ± 4 percentage points to ± 1.5 percentage points, the current level nearing those in place at its peers in the region. Moreover, the minimum reserve requirement ratios were repeatedly lowered (down to 8 percent on leu-denominated liabilities and 12 percent on foreign currency-denominated liabilities in December 2015). In 2016 and the first half of 2017, the persistent and large contraction in forex loans to the private sector and the consolidation of international reserves provided favourable conditions for further cutting the reserve ratio on foreign currency-denominated liabilities (to 8 percent in May 2017).

Adequate liquidity management in the banking system was a feature of monetary policy in 2016 as well, thereby reinforcing the accommodative nature of real broad monetary conditions amid the persistence of a net liquidity surplus.

The EUR/RON exchange rate displayed a stable behaviour in 2016 as a whole, despite some episodes of heightened volatility on the international financial market or reverberations from the legislative initiatives targeting the banking sector and the fiscal and budgetary easing proposals bandied about domestically in an election climate. Thus, the annualised historical volatility of the EUR/RON exchange rate came in at about 2.5 percent, well below that seen on other forex markets across the region (4.8 percent in Hungary, 7.2 percent in Poland).

Over the period ahead, the NBR will continue to calibrate its monetary policy so as to ensure and maintain price stability in the medium term, in line with achieving the multi-annual flat target; over a longer horizon the NBR will aim to steer the annual inflation rate to levels compatible with the ECB's quantitative definition of price stability.

As for financial stability, it stayed solid, and risks thereto subsided in the latter half of 2016, yet continuing to be significant. The risk of fast deterioration in investor sentiment in emerging economies has remained elevated, as an abrupt shift in sentiment could put pressure on financial system stability in Romania. On the domestic front, the risk of an unpredictable legislative framework abated after the Constitutional Court's rulings in 2016 Q4 and early 2017 concerning the legislative initiatives on debt discharge and the conversion of CHF-denominated loans into leu-denominated loans based on historical exchange rates. On the whole, the banking sector is able to withstand potential headwinds, with the key prudential indicators posting adequate levels.

From a macroprudential perspective, it is essential that credit institutions' own funds are high enough to cover, aside from the minimum requirements, the capital buffers established by the NBR consistent with the recommendations of the inter-institutional structure of coordinating the macroprudential oversight of the national financial system. All such recommendations issued in 2016 were implemented by the NBR, which also ensures – in its capacity as supervisory authority for credit institutions – the regular monitoring of their exposures to the EU Member States and third countries, putting forward the necessary steps should these exposures become significant.

The local banking sector, one of the best capitalised in the European Union, consolidated its resilience to shocks in 2016. Key prudential indicators (on liquidity, solvency) stood above the reference levels and the results of (microprudential and macroprudential) stress tests did not reveal liquidity shortages, identifying only limited vulnerabilities of credit institutions. Although deleveraging carried on in 2016, it further unfolded in an orderly fashion, in line with developments across the region, as the parent banks' reduction in exposures was fully offset by funds raised on the domestic market, thus mitigating contagion risk.

Bank asset quality has improved substantially, with the drop in non-performing loan ratio at end-2016 to single-digit levels (9.6 percent from 13.5 percent in December 2015) pinpointing the considerable progress in balance sheet clean-up, to which the set of recommendations and measures the NBR implemented in 2014 made a decisive contribution. As a matter of fact, the post-programme monitoring missions by the European Commission and the consultations with the International Monetary Fund (under Article IV of the IMF's Articles of Agreement) showed that Romania's efforts to cut the non-performing loan ratio are a relevant experience for other countries as well, with the NBR holding a high-level regional seminar on this topic in June 2016.

The year 2016 saw also positive developments in terms of banks' profitability indicators, namely the return on assets and return on equity stood higher than the EU average levels, whereas the market share of loss-making credit institutions narrowed sizeably to 7.7 percent against 14.3 percent at the end of 2015. Besides the strengthening of the local deposit base and the resolution of a substantial amount of non-performing loans, the increase in the relative weight of leu-denominated loans also played a role in consolidating the structural stability of aggregate balance sheet. Against this background, the main vulnerabilities associated with the adjustment of external financing and credit risk arising from the foreign currency-denominated loan stock no longer pose significant macroprudential risks.

On the whole, credit to the private sector rose by a real 1.8 percent in 2016 (December versus December), driven mainly by a further fast-paced increase in new business to households, given that the banks' business model still targeted mostly retail customers and households' income expanded sizeably. The first part of 2017 witnessed, however, signs of banks turning to better account companies' borrowing potential, with April recording a halt in the downward trend of corporate loans. Nonetheless, putting these loans onto a sustainably upward path is conditional on both supply- and demand-side factors. On the supply side, special attention should be paid to improving the training of staff involved in lending and risk management, while on the demand side a considerably positive impact could come from an improved management of corporate finance and from a careful selection and sizing of investment projects.

The substantial rise in the share of leu-denominated credit to the private sector to a 20-year high of 57.2 percent in December 2016 was one of the positive features of 2016, as a result of diverging developments in its two components: fast-paced growth in leu-denominated loans (up 15 percent in real terms) and declining foreign currency-denominated loans (down 12.5 percent; values expressed in euro). The cut in interest rates on leu-denominated loans (to similar rates on EUR-denominated credit and even lower) played a major part in reducing foreign currency substitution, which is also beneficial from the standpoint of improving the monetary policy transmission mechanism. In the same direction acted the macroprudential measures aimed at foreign currency-denominated loans, the new conversion operations, albeit less sizeable than a year earlier, for such loans, and the larger share of forex credit in total loan sales.

In keeping with its mandate and with the principles of transparency and institutional accountability, the NBR acted, in 2016 too, as a supplier of high-quality economic information, encompassing both statistical data that the institution produces in compliance with the legal framework and the published research works and papers, which were related not only to the monetary and financial area, but also to various real economy segments. The recourse to standard communication means, i.e. NBR publications, scientific seminars and conferences, public presentations by Board members, was accompanied by enhanced resort to the online media, especially the dedicated website and the forum platform where central bank professionals share their views on current topics. In this context, particular attention was attached to tailoring communication to the specifics of social media by transposing and simplifying the technical content, introducing multimedia and visual elements, as well as using summarised materials to highlight key developments or information.

A top priority of communication and public relations activity was to ensure transparency and an as high as possible level of understanding by the general public of monetary policy decisions, of the measures meant to safeguard price stability and financial stability, of the role and functions of the central bank, in a challenging domestic and external environment marked by heightened uncertainty. By approaching the transparency-enhancing process in line with the legal provisions, the public interest and European central bank practice, in its meeting of 3 August 2016 the NBR Board decided to disclose the minutes of the monetary policy meetings and the income earned by Board members.

With a view to supporting financial education, the NBR continued to perform such activities in 2016 under the Cooperation Protocol signed with the Ministry of National Education and the partnerships launched with economic universities and other institutions and organisations promoting financial education at national and international level. The events organised under the projects “Let’s Talk about Money and Banks”, “NBR – Open Doors for Economics Students” and “Academica BNR” targeted about 40,000 pupils, students and teaching staff in educational establishments from across the country. Similarly to previous years, participants attended presentations and interactive sessions and were handed out educational materials regarding central bank-specific activities and basic concepts in the financial and banking field.

The National Bank of Romania maintains an ongoing dialogue with the Parliament of Romania, with institutional relationships unfolding via multiple ways: (i) providing legal opinions on draft laws that can be prepared and submitted to parliamentary committees either directly or indirectly, upon request of some initiators (Government, the National Authority for Consumer Protection, other public institutions); (ii) supplying information, advisory services or/and participating in discussions on specific issues within the NBR scope of activity (financial stability, European relations, statistics); (iii) interpellations on topical issues that MPs submitted to the central bank. The central bank’s interaction with the Parliament intensified in 2016, amid the debates on a number of legislative initiatives targeting the banking sector (law on debt discharge, law on converting CHF-denominated loans into leu-denominated loans) and the establishment of the National Committee for Macroprudential Oversight, with senior executives and experts of the NBR participating on repeated occasions in the meetings held by the committees of both the Senate and Chamber of Deputies.

As in previous years, in 2016 the National Bank of Romania acted to ensure price stability and financial stability and to fulfil any other tasks by law, without imposing a cost on the society. Furthermore, following the concern for efficiently managing available resources, the NBR posted a positive financial result as at 31 December 2016, transferring lei 100.2 million to the government budget.



The background of the slide features a photograph of a classical building with prominent columns and arches, overlaid with a pattern of thin, wavy, golden-brown lines. The text is positioned on the right side of the slide.

Chapter 1

Global environment and domestic macroeconomic developments

1. Global environment

In 2016, economic activity worldwide slowed down, to reach the lowest growth rate after the crisis outbreak (3.1 percent, according to the IMF). The evolution was accompanied by a slowdown in international trade expansion, in the context of a new contraction in China's export volume. The main influence came from advanced economies, which saw modest economic growth (of 1.7 percent on average), way below pre-crisis levels (circa 3 percent). In the absence of an upturn in investment, their advance continued to be supported by consumption, boosted, *inter alia*, by central banks' accommodative policies. Apart from the influence of persistent factors, such as the difficulties concerning the sustainability of the financial sector and sovereign debt in some EU countries, escalating uncertainties worldwide played a major part in curtailing or postponing some investments in 2016. The worsening perception on risks occurred mainly amid concerns about the likelihood of contagion effects becoming manifest worldwide following the slowdown in China's economic growth and especially the UK's vote to leave the European Union. However, the weaker-than-expected performance of advanced economies shows also the presence of some structural factors, among which the slowdown in labour productivity and ageing population (Box 1).

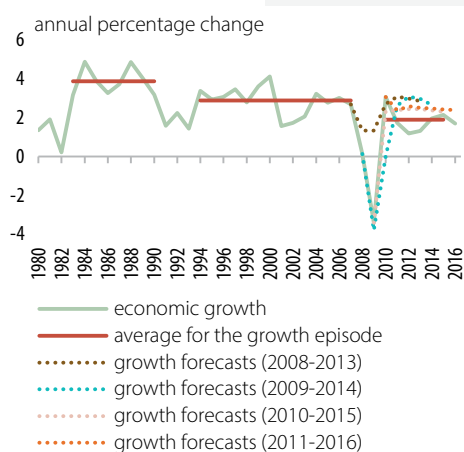
Box 1. The slow economic growth in advanced countries: a cyclical or a structural phenomenon?

Following the recession associated with the global financial crisis, advanced economies (mainly the USA and the euro area) posted modest growth rates, in general, compared to historical values. Thus, while in 1994-2007 the average

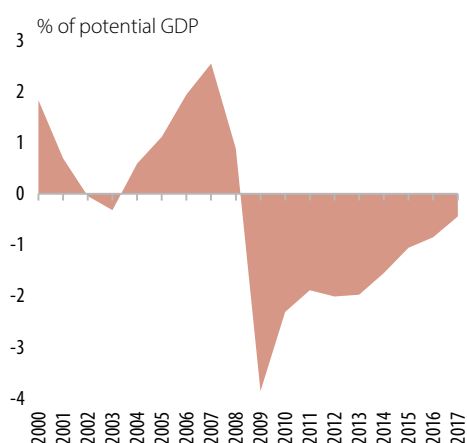
increase was of approximately 3 percent, it subsequently fell to circa 2 percent. The recovery pace was steadily below analysts' expectations, in this respect a case in point being the successive downward adjustments in the economic growth forecasts made by the international financial institutions for this group of countries (Chart A). According to the IMF's estimates, advanced economies continue to report a negative output gap for the eighth straight year, the forecast for the GDP dynamics remaining reserved for 2017 too (Chart B).

The debates over the drivers of this evolution are still underway, with the arguments the most often put forth focusing, on the one hand, on financial factors, and, on the other hand, on structural influences, such as demographic trends or the pace of technological progress.

Chart A
Economic growth and forecasts
in advanced economies



Source: IMF



Source: IMF

Chart B
Negative output gap
in advanced economies

Relevant to the first category are: the financial cycle hypothesis (Borio *et al.*, 2012), the debt supercycle hypothesis (Rogoff, 2016), and the balance sheet recession hypothesis (Koo, 2011) respectively. According to the first hypothesis, the frail economic growth in industrialised economies owes to the financial cycle drag, with the economy taking a lengthy period of time to unwind the ensuing adverse effects (deep and protracted recessions, weak recoveries, sluggish productivity dynamics) and hence regain its balance. The wider amplitude of the financial cycle (the simultaneous excessive increases in credit and asset prices, especially real estate prices) in the pre-crisis period is deemed to be ascribable to the cumulative influence of: the inherent sources of instability in financial markets, the poor risk management, monetary policies focused on near-term price stability objective (Borio, 2017).

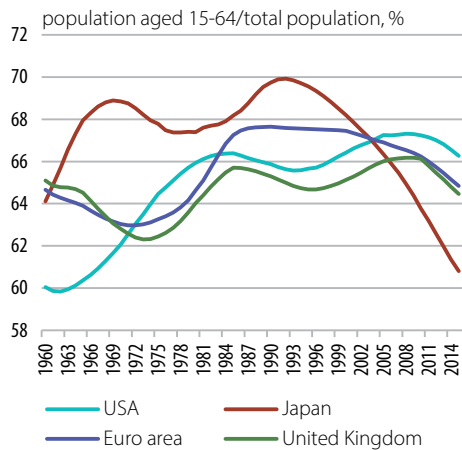
As low and stable inflation rates became the rule, the economic environment started to feature low interest rates, favouring a higher risk appetite of investors in search of higher yields. The behaviour was also fostered by the loose regulation of the financial system, which allowed for the emergence of speculative bubbles and the build-up of systemic risks. The materialisation of these risks actually marked the outbreak of the financial crisis. Afterwards there was a radical change in the risk tolerance of economic agents that became extremely prudent, with consumption and investment shrinking simultaneously, alongside an advance in deleveraging and saving.

A similar hypothesis was put forward by Rogoff (2016) who views the sluggish economic growth as a post-financial crisis phase of the debt supercycle. In his opinion, despite some peculiarities (especially the sovereign debt crisis in the euro area which exacerbated the difficulties), the pre- and post-crisis periods share many common features with the previous experiences associated with deep financial crises – the magnitude of the housing boom and bust phases, the massive indebtedness accompanying the bubble, the behaviour of asset prices before and after the crisis outbreak, then the severe recession, the slow recovery in income per capita, the much more pronounced persistence of high unemployment compared to an ordinary recession, the dramatic expansion of public debt.

Koo (2011) provides a similar reasoning, ascribing the persistence of the recession to the effects on the economy stemming from the economic agents' effort to reduce indebtedness. Thus, the outbreak of the crisis caused a sudden plunge in the value of assets, while the size of liabilities remained relatively constant. Subsequently, in order to cover net liability expansion, economic agents changed their behaviour in favour of saving, with direct contractionary effects on consumer demand. The impact of this phenomenon is persistent, the economic agents' cautiousness with regard to indebtedness leading to a slower recovery of aggregate demand.

Relative to the second category of determinants, the most often cited is the secular stagnation hypothesis that assumes that the downward trend of the potential GDP growth had been a characteristic of advanced economies long before the crisis

Chart C
Working age population

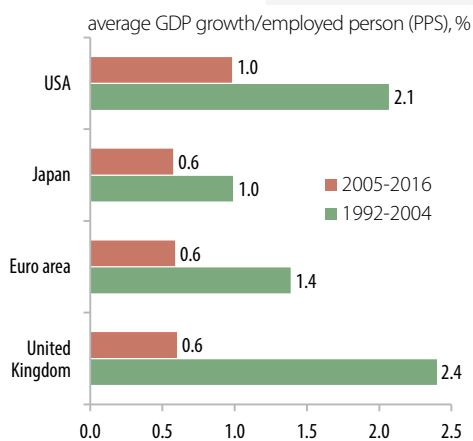


Source: World Bank

broke out, with the satisfactory dynamics of economic activity in the previous period owing solely to unsustainable financial conditions. The reasons behind this evolution pertain to the structural area and refer to the significant change in the saving-investment equilibrium, which generated a steadily downward path of the real natural interest rate to the negative values in the recent years (Summers, 2016).

Ageing population provides a first explanation for the increase in the marginal propensity to save and, implicitly, for the slowdown in capital accumulation. The rising trend in average age, along the pick-up in life expectancy and the decline in birth rates in advanced economies, favours a more cautious behaviour during the active period, as saving needs for keeping the same consumption habits throughout life went up (Eggertsson and Mehrotra, 2014). Moreover, the increase in income inequality, following the hike in high-end incomes, associated with individuals showing a higher marginal propensity to save, additionally reduces investment and puts downward pressure on interest rates (Gordon, 2014; Chart C).

Acting in the same direction is the considerable slowdown in the dynamics of the working age population compared to the historical average, the effect of which was partly offset by the increase in the labour force participation rate, especially among women, until the beginning of the 2000s.



Source: World Bank

Chart D
Labour productivity

Similar influences are associated with the marginal productivity of technological progress, whose level currently stands below that previously seen. Over the last centuries, three important technological jumps took place with profound economic and social effects, building initially on the steam engine and the cotton gin (the first industrial revolution, 1750-1830), then electricity and the internal combustion engine (the second industrial revolution, 1870-1900), and starting with the 1960s, computers and access to the Internet. However, unlike the first two episodes which span around 100 years each, the third episode was relatively rapidly implemented in advanced countries, the fastest pace of automation being reported in the last two decades of the past century (Gordon, 2012). Later on, innovation and new technologies concentrated with predilection on communication and the general improvement in life quality, with a lower impact on productivity, while the larger part played in the economy by companies in these sectors, having lower needs of physical capital, led to a decline in the demand for investment goods (Chart D).

Apart from the critiques formulated by the supporters of the financial cycle hypothesis, the secular stagnation hypothesis was increasingly contested over the last years in the professional literature. For instance, Bernanke (2015) deems that, with real interest rates sticking persistently to -2 percent, it is hard to imagine a

constant shortage of profitable investment. Moreover, Eichengreen (2015) deems that the relatively stable evolution (slightly on the upside, perhaps) in global saving over the last 15 years does not support the hypothesis of its major contribution to the persistently low level of interest rates and to the sluggishness of economic growth. In addition, Eichengreen calls into question the exhaustion of the room for productivity growth on account of technological progress, holding the view that some innovations' productive potential is in its early materialisation phase.

Last, but not least, Hamilton *et al.* (2015) deem as unfounded the assertion that, for several decades prior to the crisis, behind the advanced economies' performance stood solely a succession of financial bubbles, pointing out that the bubbles either occurred too late to account for the expansion phase of the business cycle (the dot.com bubble of the 1990s) or were offset in terms of their influence on consumer demand by other factors (the housing bubble of the 2000s).

The late return of economic activity to robust growth rates in advanced countries after the outbreak of the international crisis is most likely accounted for by a combination of cyclical and structural factors that affected, *inter alia*, the standard monetary policy transmission mechanism. In response to these developments, non-conventional policies were designed and implemented, generally translating into asset purchase programmes conducted by central banks or implying the conveyance of signals on the future interest rate stance (*forward guidance*). These measures partly succeeded in boosting aggregate demand, contributing to the gradual reduction of the negative output gap in the last years. Nevertheless, the growth potential stands much below that seen in the pre-crisis period, which favours maintaining real interest rates at lower levels for a longer period of time and calls for the use of a mix of economic policies, with a focus on structural ones, that would have a durable influence on aggregate supply by raising both the amount and the efficiency of production factors. Such policies are aimed at making labour market more flexible, stimulating competitiveness and the research and development activity, increasing birth rates, improving the reallocation of resources among the economic sectors.

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Across emerging market and developing economies, the discrepancies in growth among commodity importers and exporters persisted, abating, however, in the course of the year, once with the reversal of the downward trend in international commodity prices. Overall, this group of countries had a positive impact on the dynamics of world economy, the 4.1 percent pace of increase estimated by the IMF for 2016 exceeding by far the performance of advanced countries (Chart 1.1).

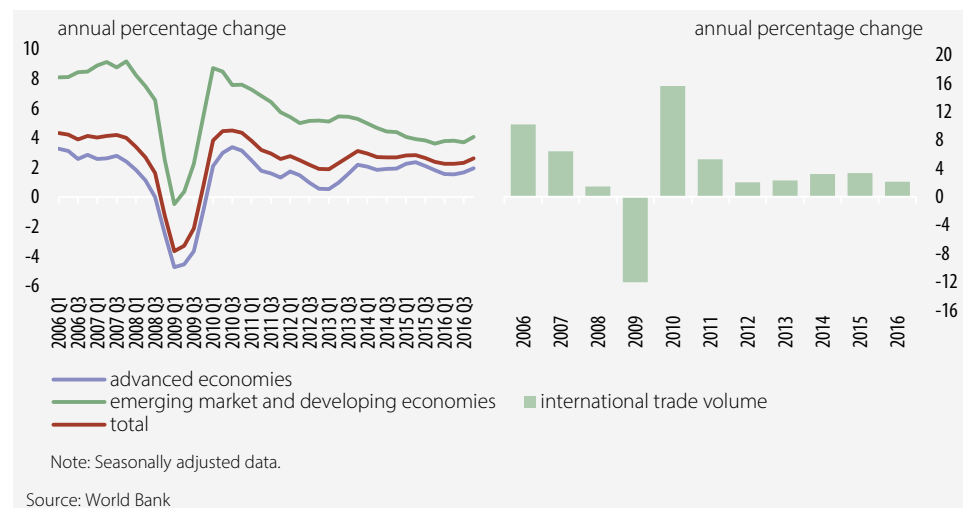


Chart 1.1
Global economic growth

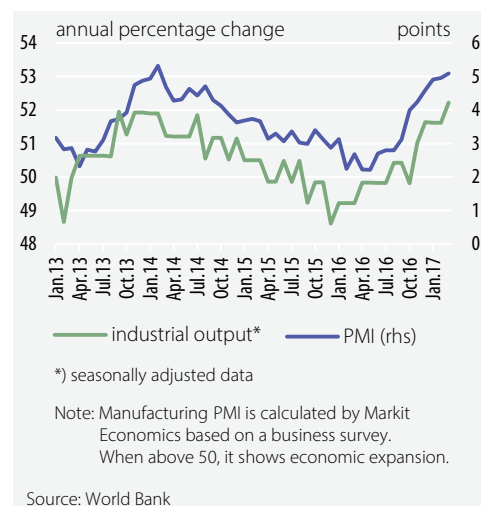


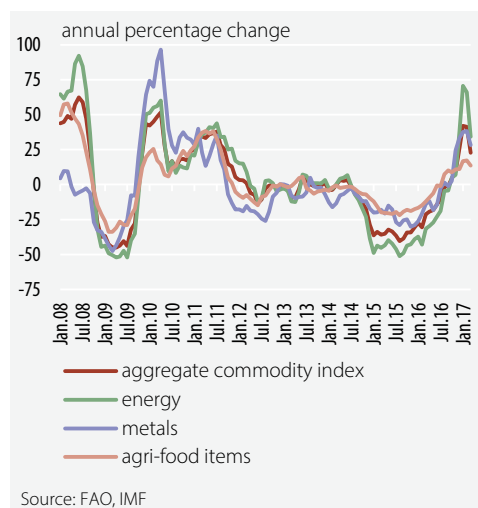
Chart 1.2
Economic growth outlook

The prospects for 2017 are relatively more optimistic, with signs of a step-up in global economic activity being visible ever since the end of the previous year (Chart 1.2). Thus, the IMF's most recent forecasts indicate an advance by almost 0.4 percentage points in the dynamics of global economy in 2017 to 3.5 percent.

In terms of producer prices and costs, the year 2016 saw a halt in the downward trend of international commodity prices. After having

contracted for four years in a row, the annual dynamics of prices saw a turning point in the first quarter, before strongly entering positive territory in December. The trend carried on in the first part of 2017, with the annual changes in prices indicating marked increases in all segments in March (36.3 percent for energy, 28.3 percent for metals and 13.4 percent for agri-food products; Chart 1.3).

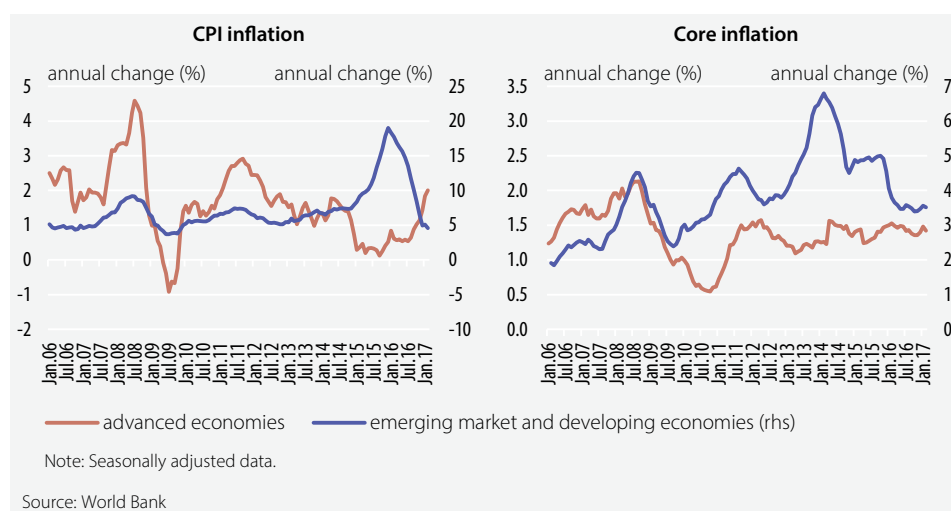
Chart 1.3
Prices of main
international commodities



The evolution owed largely to fundamentals, namely the drop in excess supply on the metal market (following the shutdown of production capacities and further relatively high demand) and energy market; a significant impact on the latter had the OPEC producers' agreement at end-2016 to cut oil production, which was also signed by other non-OPEC members. As for agri-food prices, the rise occurred in the processed food segment, with a large contribution being made by the considerable fall in oversupply in this segment (meat, milk

and dairy produce) at European level, following, *inter alia*, the measures adopted in this respect by the European Commission (providing easier access to new markets, granting financial aid for farmers to reduce production). Cereal prices made an exception, as they continued to post negative annual changes throughout the year, against the backdrop of good agricultural crops worldwide and already large stocks.

Chart 1.4
International consumer prices



The trend reversal posted by energy prices triggered upward movements in consumer prices in advanced economies, with the average annual inflation rate in 2016 nearing 2 percent. At the same time, however, core inflation remained relatively stable at 1.4 percent for the third consecutive year, reflecting in most cases the persistent negative output gap. In emerging market and developing economies, developments

were mixed: the annual inflation rate in net commodity importers showed the reversal in the price trend, while in exporting countries, the base effects associated with the significant depreciations in national currencies in the previous years caused the indicator to enter a downward trend (Chart 1.4).

From the standpoint of the monetary policy stance of the world's major central banks, the diverging evolutions became more pronounced in 2016. In the euro area, in the context of a lower-than-expected economic performance and especially of persistent low core inflation, monetary policy easing measures were further implemented. At the beginning of 2016, the European Central Bank (ECB) cut the key interest rates and decided to expand the asset purchase programme. Therefore, the interest rate on the main refinancing operations and that on the marginal lending facility were lowered by 5 basis points each to 0 percent and 0.25 percent respectively, whereas the interest rate on the deposit facility moved deeper into negative territory, losing another 10 basis points to -0.40 percent. In addition, the ECB decided to raise the monthly asset purchases from EUR 60 billion to EUR 80 billion, while also enlarging the list of eligible assets. Subsequently, at end-2016, the implementation of the programme was extended until December 2017 and the monthly volume of asset purchases was to be cut to EUR 60 billion starting April 2017. At the same time, the ECB reaffirmed its commitment to rescale the volume of purchases or prolong the implementation of the programme if the economic growth prospects became less favourable or the financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation.

The Bank of England pursued a similar monetary policy stance. After the referendum on the UK's EU membership that resulted in the decision to leave the Union, thus adding significantly to uncertainty, also on international level, while considerably worsening the economic prospects of the United Kingdom, the Bank of England adopted a set of stimulative measures. The policy rate was cut by 0.25 percentage points to 0.25 percent, while the asset purchase programme was extended by including corporate bonds in amount of GBP 10 billion on the list of eligible

assets and by raising the stock of purchases of government securities by GBP 60 billion.

The Federal Reserve System pursued an opposite stance and further tightened the monetary policy, by increasing at end-2016 the target range for federal funds rate by 0.25 percentage points to 0.5-0.75 percent. The decision was substantiated by the recovery trend in the US economy, albeit at a relatively slower pace than in the pre-crisis period, alongside the marked improvement in labour market

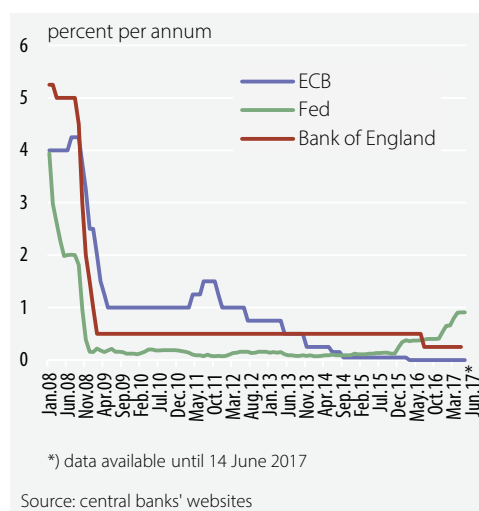


Chart 1.5
Policy rates

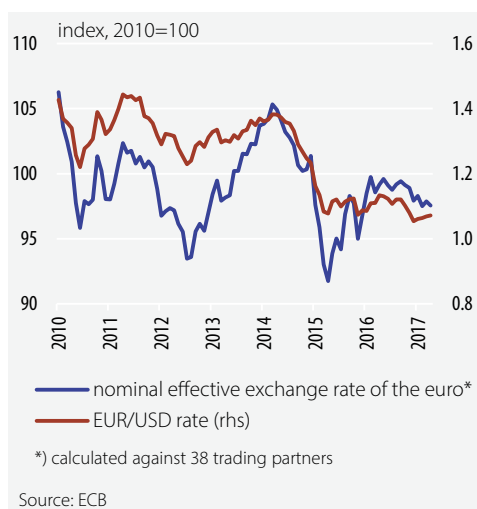


Chart 1.6
Euro exchange rate

conditions, reflected by the creation of jobs, the cut in unemployment and the advance in employment. In the context of these trends becoming stronger in the first half of 2017, Fed implemented two new rate increases (by 0.25 percentage points), with a new hike being expected by year-end (Chart 1.5).

In the course of 2016, the euro appreciated slightly in nominal effective terms (+3.7 percent). The trend moderated, however, towards the end of the year (Chart 1.6),

the market expectations on Fed's decision to raise the federal funds rate – which materialised in December – leading to the strengthening of the US dollar.

2. Domestic macroeconomic developments

2.1. Economic activity

Economic growth

In 2016, economic growth posted the fastest pace of the post-crisis period (4.8 percent), with consumer demand strengthening its dominant position amid the fiscal and income policy easing measures, as well as against the backdrop of favourable labour market conditions. Exports also made a positive contribution, as their swifter growth rate mitigated considerably the erosion effect of net external demand on real GDP change.

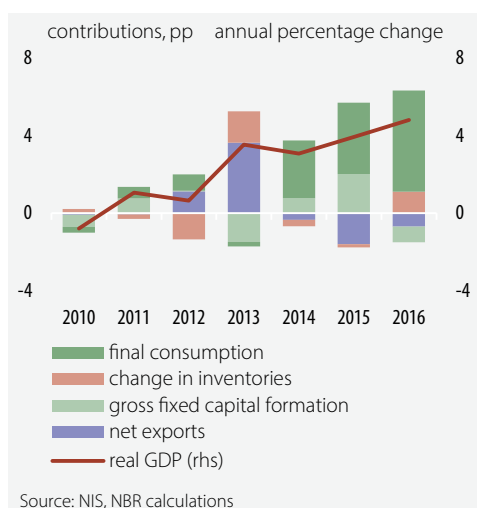


Chart 1.7
Demand

The strong advance in private consumption (by 7.3 percent) was backed by both households' higher purchasing power and improved lending conditions (Chart 1.7). The pick-up in real disposable income owed to wage rises induced by the gradual tightening of labour market, in the context of the change in the economy's cyclical position, as well as to the step-up in productivity in certain sub-sectors. These factors overlapped with new income policy measures, namely raising the minimum wage

economy-wide and granting pay rises in the public sector. The same as in the previous year, households' purchasing power was favourably influenced by the drop in consumer prices, although the intensity of this factor diminished progressively, mainly following the fading-out of the statistical effects associated with the broadening, in June 2015, of the scope of the 9 percent reduced VAT rate to all food items and food service activities.

Investments failed to post the same performance as in 2015, their volume shrinking by 3.3 percent (versus +8.3 percent), mainly on account of the contraction in civil engineering works. In 2016 too, this component of aggregate demand continued to feature high volatility, primarily owing to the asymmetry of budget execution (namely the step-in in expenditures over the last months of the year), the election calendar, as well as the timing of receiving EU grants. Thus, in H1, the volume of infrastructure works expanded by circa 8 percent, being spurred by the local elections in June and the deadline extension up to mid-year for some EU-funded projects related to the 2007-2013 financial framework. Subsequently, the fading-out of the two stimuli, to which added the delays in taking EU funds under the new financial framework (2014-2020), led to a severe reversal in the trajectory of such investments, which caused them to shrink by more than 11 percent in 2016 as a whole. Modest results were also reported by equipment purchases, which gradually lost momentum – a visible path in both own and borrowed funds. Construction of buildings was the only component to post a positive evolution, the upturn in residential investments being supported by the increase in household incomes, as well as by the further easing of bank lending cost (also following the unfolding of the “First Home” programme).

Given a marked improvement in the annual rate of increase of the export volume (+2.9 percentage points, to 8.3 percent), the year 2016 saw a smaller negative influence exerted by net external demand on economic growth. Amid a stronger pace of increase of exports and the pick-up in consumer demand, imports recorded a 0.6 percentage point faster advance in annual terms to 9.8 percent.

Although behind the step-up in export growth stood also incidental factors, namely the good crops of wheat and oil-yielding plants, ongoing integration in global value chains has been the main determinant. A limited number of industries have been undergoing this process, namely manufacture of rubber, of plastic products, electrical equipment and road transport means industries, which have remained attractive for foreign direct investment, mainly due to the comparative advantage provided by labour force cost¹. Looking at the road transport means industry, the dynamic evolution of exports owed solely to motor parts and accessories, while exports of motor vehicles posted a new decline, the rise in external demand notwithstanding². The competitive position of local production on the latter segment has been eroded by labour market tightening, to which added the absence of investments in road infrastructure, which has contained the expansion of production capacities to other regions of the country. Consequently, over the last years, producers' efforts have

¹ Deloitte, “Central Europe as a Focal Point of the Automotive Industry”, 2016.

² Dacia motorcar registrations on the EU market rose by 9.6 percent in 2016.

concentrated on the automation of manufacturing process, the launch of more expensive models, and the relocation of part of the production to other, more competitive states. Other sub-sectors that reported higher exports refer to the crude oil processing industry (amid the expansion of operations at regional level by an important local company that invested in its refining capacity in the course of time) and furniture industry (selling abroad largely premium brands, the demand for which focuses first and foremost on quality). By contrast, in other consumer goods industries, such as food or wearing apparel industries, exports saw new contractions in terms of volume.

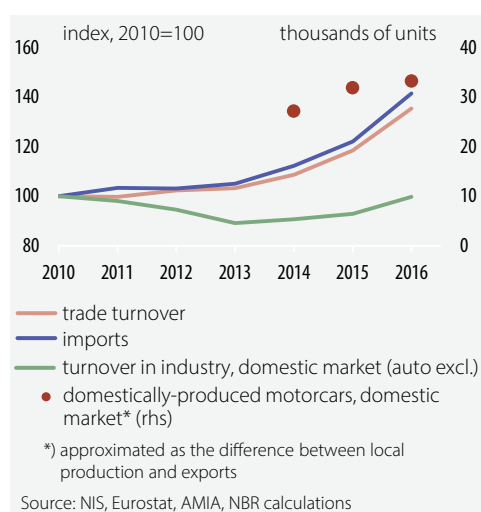


Chart 1.8
Demand for and supply
of consumer goods

The effect of the overall modest competitive position of the consumer goods production was best visible in the domestic market (Chart 1.8), the boost in demand being reflected by a significant step-up in the growth rate of relevant imports (15.9 percent compared to 8.8 percent in 2015). The competitiveness deficit can be ascribed, on the one hand, to the widening price differential versus competitors, once with the hike in unit labour costs and, on the other hand, to the insufficient investments in the non-price component, especially the

human capital. Other relevant non-price factors refer to: (i) Romanian producers' low capacity to integrate in value chains associated with modern retailers and (ii) the relatively poor range of domestically-produced goods amid consumers' continuously diversifying preferences.

External position

The outbreak of the global financial crisis marked the beginning of a rapid rebalancing of external positions in all the countries having reported high current account deficits in the economic boom. One of such countries was Romania, which adjusted its external imbalance at values below 1 percent of GDP in 2014 from a peak of almost 14 percent of GDP in 2007; the trend was supported by changes in the saving-investment balance across both the non-government sector and the government sector (Box 2).

Amid the cyclical recovery of the economy, enhanced by the fiscal easing measures, the year 2015 saw a turning point in the strengthening path of external accounts. The deepening trend of the current account deficit carried on in 2016 too, with the level reached remaining, however, within sustainable limits (2.3 percent of GDP). Nevertheless, it is worth mentioning that the evolution is relatively unique at European level, considering that over the past years most EU economies saw either surpluses or lower and decreasing deficits (Chart 1.9).

Chart 1.9
Current account balance
in EU-28 countries

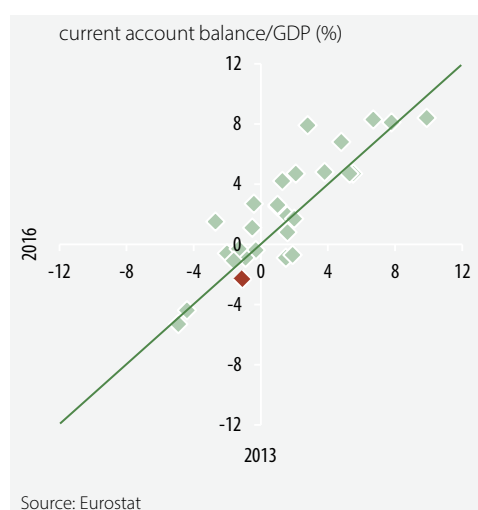
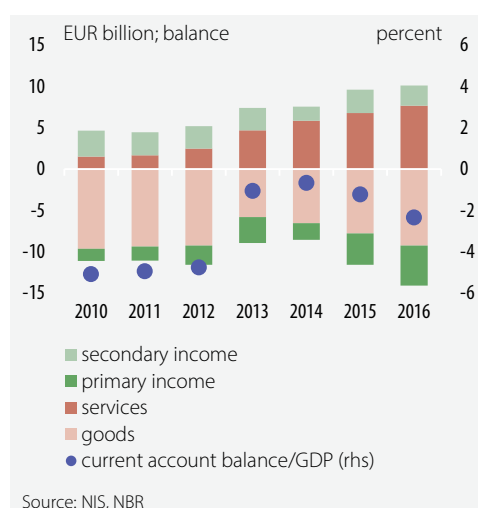


Chart 1.10
Current account



Similarly to the previous years, net receipts from international services offset more than 80 percent of the deficit in trade in goods (Chart 1.10). The largest contribution was made by international transport companies, which further generated almost half of the services surplus. The step-up in foreign trade over the last years and the increasing attractiveness of the local market, given the saturation of proximity markets and the advantage of stability in a volatile regional environment, continued to spur investments in the fleet renewal and expansion, as well as in the increase in warehousing capacities. However, the sector has not reached its full potential yet, large companies in the field mentioning the poor quality of transport infrastructure and the shortfall of skilled personnel (heightened by attractive working conditions for similar jobs in the EU) among the headwinds. The most dynamic segment was, however, “ICT and other business services”, which remained on a strongly upward trend, the high competitiveness of the local labour market drawing

further the interest of foreign investors and raising external demand.

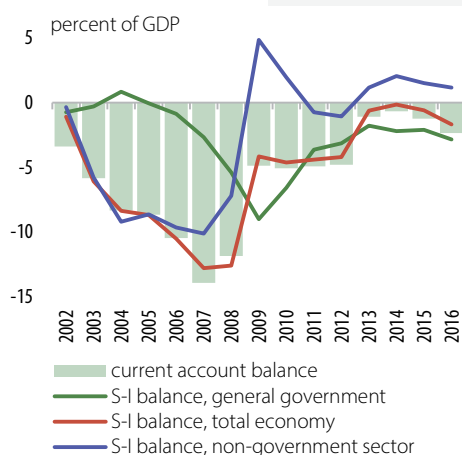
Box 2. Analysis of the saving-investment balance in the non-government sector and general government sector³

The identity between the saving-investment balance in the economy and the current account balance is one of the key relationships in macroeconomic analysis⁴. In order to capture the connection between fiscal aggregates and balance-of-payments data, the saving-investment (S-I) balance in the economy may be decomposed into that of the non-government sector and that of the general government sector.

³ The analysis of developments presented in this box draws on nominal series expressed as a share in nominal GDP. The data used herein are from the Quarterly Sector Accounts (unadjusted series; by categories of uses and resources and by transactions; current prices; ESA 2010); source: NIS.

⁴ As the data sources for the two balances are different – National Accounts (NIS) and Balance of Payments (NBR) –, there are differences in practice, but they cannot distort the validity of results.

Chart A
Saving-investment balance
and current account deficit



Source: NIS, NBR

$$(\text{Saving} - \text{Investment})_{\text{Total economy}} \equiv \text{Current account balance}$$

$$(\text{Saving} - \text{Investment})_{\text{Non-government sector}} + (\text{Saving} - \text{Investment})_{\text{General government}} \equiv \text{Current account balance}$$

In Romania, the significant adjustment of the current account deficit in the period 2008-2014 (by about 13 percentage points as a share in GDP) entailed changes in the saving-investment balance in both non-government and general government sectors, with a sizeable part of these corrections occurring amid the fall-out from the global financial crisis (Chart A).

During the pre-crisis years, against the background of a low level of domestic saving (below 20 percent of GDP between 2001 and 2007), non-government sector investment, supported also by the expansion of lending, brought about a relatively swift worsening of the current account deficit. In 2008, when the effects of the global financial crisis hit Romania's economy, the negative differential between savings and investment of the non-government sector embarked on a narrowing path, while that of general government continued to widen.

Behind these developments stood: (i) in the non-government sector, the slight increase in disposable income, along with falling final consumption and relatively flat investment, and (ii) in general government, the contraction of disposable income (owing mainly to larger expenditure on social contributions and social benefits), coupled with an increase in final consumption and investment (Chart B). As a result, the current account deficit first narrowed only slightly. It contracted sizeably – by approximately 7 percentage points as a share in GDP – no sooner than 2009, amid a significant adjustment in the non-government sector (where the saving-investment balance turned positive), given the rise in disposable income, together with declines in final consumption and investment.

From 2009 to 2012, current account deficit held relatively steady amid fiscal consolidation underpinned by two financial assistance programmes signed with international institutions (EU, IMF and the World Bank), and by the modest recovery in non-government sector investment⁵. The current account deficit saw further adjustment in 2013-2014 (by a cumulated 4.1 percentage points as a share in GDP), in the context of the developments in the saving-investment balance in both non-government and general government sectors, concurrently with better conditions of the business cycle in Romania. Starting 2015, the closing trend in the external deficit reversed, due chiefly to the wider gap between savings and investment of the general government, amid multiple fiscal and wage stimuli impacting the economy. At the same time though, the positive saving-investment balance in the non-government sector was somewhat stable.

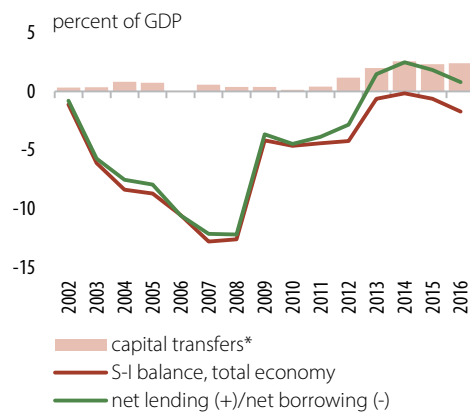
⁵ Averaging roughly 21.6 percent, compared with a high of 24.6 percent in the pre-crisis years.



Chart B
Key aggregates in
non-financial national accounts

Source: NIS

Chart C
Developments in
net lending (+)/net borrowing (-)



*) mostly European funds for investment

Source: NIS, NBR

In this analysis, particular attention is also attached to the assessment of net lending or borrowing of the total economy (Chart C). In this respect, along with the developments in the saving-investment balance in the economy, capital transfers are also of interest, as they are primarily non-debt-creating inflows in the form of EU funds for investment. As from 2012, Romania has benefitted from significant capital transfers from the EU, with the funds being allocated mainly to repay the costs of investment projects launched in both public and private sectors. These inflows of European funds helped decrease Romania's net borrowing in 2012 and, starting 2013, generated a resource surplus that the economy has made available to the rest of the world (translating into net lending). In order to better grasp the importance of absorbing the European funds for investment, the following counterfactual exercise can be run: the case where Romania had not benefitted from these funds or could not have succeeded in receiving them from the EU. Under this scenario, net borrowing of the Romanian economy from external sources would have risen and the gap would have been covered

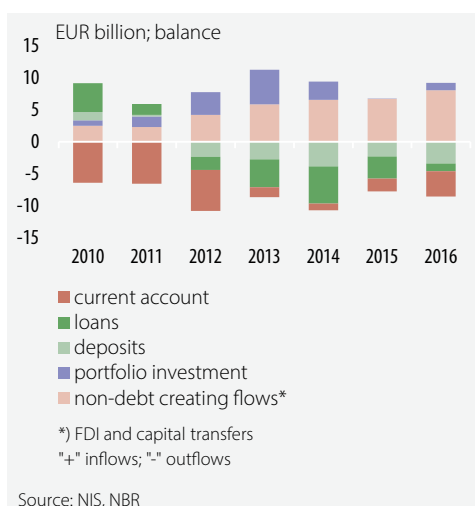
either by attracting debt-creating flows – via larger EUR- or USD-denominated bond issues on international markets and/or increased foreign borrowings – or by diminishing reserve assets.

With a view to clarifying the concepts used herein, below are the main definitions of non-financial national accounts based on the ESA 2010 methodology.

Gross disposable income is the balancing item of the secondary distribution of income account and shows the part of the value created in the economy which is allocated between final consumption and gross saving.

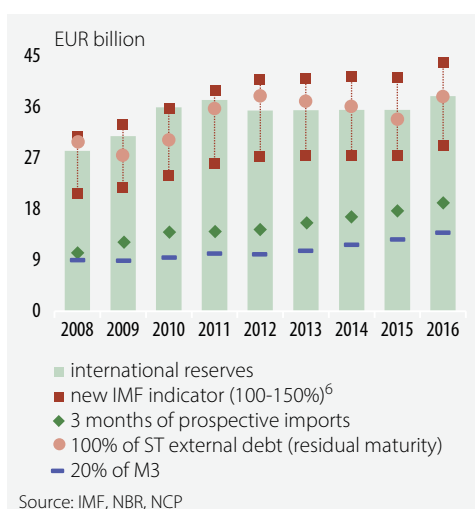
Net lending (+) or borrowing (-) is the balancing item of the capital account and shows the net resources that the total economy makes available to the rest of the world (if it is positive) or receives from the rest of the world (if it is negative).

Chart 1.11
Main sources of financing
for the current account deficit



Although virtually double in size versus the previous year (nearing EUR 4 billion), in 2016, the balance-of-payments current account deficit was fully covered by non-debt creating capital flows (Chart 1.11). Their volume expanded to circa EUR 8 billion, being accounted for to similar proportions by net flows in the form of capital transfers (mainly, inflows of EU grants – Box 3) and direct investment (EUR 3.9 billion, EUR 1 billion above the average for 2012-2015).

Chart 1.12
International reserve
adequacy indicators



Highly volatile capital flows, portfolio investment in particular, also saw a satisfactory evolution. Thus, Eurobond issues in 2016 featured historically low yields and extended maturities, Romania benefiting by the extremely low interest rates worldwide, as well as by a favourable investor perception of the local macroeconomic context. Relative to deposit flows, non-residents' short-term deposits saw a trend reversal, with net outflows amounting to EUR 1.5 billion, whereas long-term deposits reported visibly lower outflows.

⁶ When a flexible exchange rate arrangement is in place, the denominator is calculated as follows: 30 percent of ST external debt (residual maturity) + 10 percent of Other liabilities + 5 percent of Prospective exports of goods and services + 5 percent of M3.

Pressure from external debt followed a downward trend in 2016 too, with both its share in GDP (54.5 percent) and the long-term debt service ratio (27.4 percent of exports of goods and services) reaching post-crisis lows. During the last years, the gradual reduction in external indebtedness owed largely to the repayment of the loan taken by Romania in 2009 under the Stand-By Arrangement with the IMF (the process was completed in early 2016). The financial efforts made in that period, albeit significant, affected neither the dynamics of the foreign exchange market nor the forex reserve adequacy indicators. On the contrary, international reserves consolidated to reach EUR 37.9 billion in December 2016, i.e. one third above the December 2008 level, thus fully covering short-term external debt at residual maturity, as well as around 6 months of prospective imports of goods and services (Chart 1.12).

Box 3. Financing through European funds

European funds are grants from the European Union budget that focus on two major objectives: the reduction of regional disparities and the promotion of sustainable agriculture. With a view to achieving these goals, the cohesion policy and the common agriculture and fisheries policy of the EU were developed, each of them working through three types of funding instruments or funds (Figure 1). These funds are channelled to each Member State and region respectively based on a set of economic and social criteria expressed in the form of development and employment gaps versus the EU average.

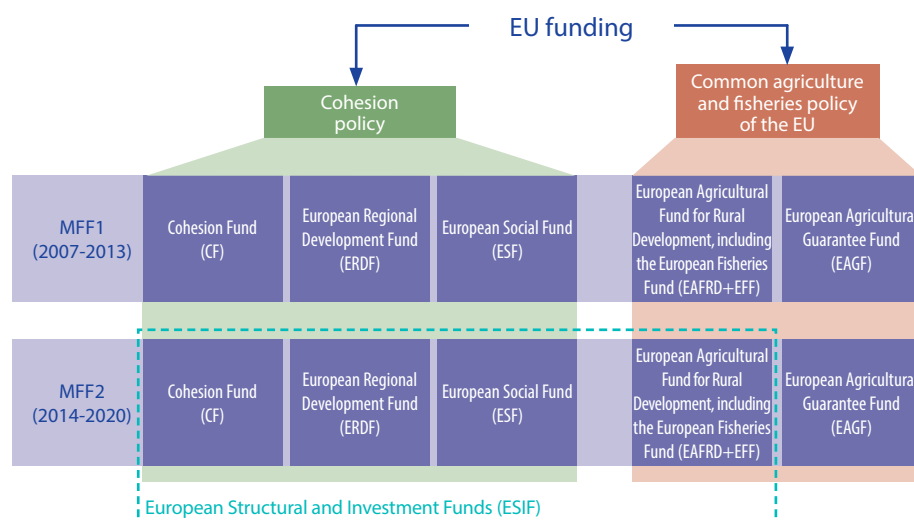


Figure 1
EU funding instruments

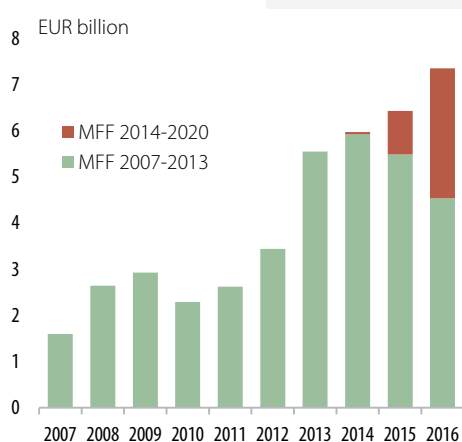
The translation into financial terms of the two policies is carried out through a Multiannual Financial Framework (MFF), which is virtually a spending plan over a period of at least five years. An annual budget is set for each Member State and the amounts are allocated gradually, given that transfers in the first years are usually lower. The start of projects with a certain delay is explained, among others, by the need to take several steps between the initial allocation of funds and the actual

payments (submission of the project application, of the related expenditure declaration, assessment and certification of expenditure by the managing authorities, etc.). Given the specifics of such financing, managing authorities with a fund allocation for year N must submit the claim application for payments from the funds of N within a set deadline – two years at most (the so-called N+2 rule, applied for MFF 2007-2013) or three years at most (the N+3 rule, adopted for the current programming period, i.e. 2014-2020). Nevertheless, in practice, these deadlines may be extended where the circumstances require it – for instance, in the context of the difficulties caused by the financial crisis.

Romania benefited from EU funding in two Multiannual Financial Frameworks, starting with its joining the European Union in 2007. However, the first programming period was marked by the lowest absorption rate across the EU, probably on the back of the slow development in the necessary administrative infrastructure, with less than half of the allocated amounts having been absorbed by the end of 2013. In fact, 2013 was the first year when the absorption rate in Romania, calculated as the ratio of amounts received (advances and reimbursements) to total allocation⁷, neared the levels posted by the other European countries (around 15 percent per year). Apart from the challenge related to the management of two overlapping programming periods, starting with 2014

the absorption of EU funds was hindered by the time needed for the preparation of a new institutional framework, which was actually a common factor among several EU Member States, as well as by the local administrations running out of money for co-financing. Previous experience at the EU level shows that, usually, in the first two years after the start of a new MFF, funding under the preceding programming period actually prevails (Bubbico and De Michelis, 2011). In the case of MFF 2007-2013, the deadline for the submission of project applications was extended until end-2015. As far as Romania is concerned, actual reimbursements were made also in 2017. As expected, fund inflows corresponding to the previous programming period were prevalent during 2014-2016, the absorption rate for MFF 2014-2020 being low so far (Chart A).

Chart A
Amounts received from
the EU budget



Source: MPF (Net Financial Balance)

The flows of EU funds are recorded in the balance of payments when the actual transfer occurs, so that the inflows in a given period may refer to different financial programmes that proceed at the same time. The payments are either advances provided to Member States during the first years of a programming period or reimbursements for projects in various stages of implementation (Chart B). Thus, the increase in EU fund absorption reported in 2016 owed particularly to the reimbursements from structural and cohesion funds in the 2007-2013

⁷ The choice of this calculation method employed by the European Commission is warranted by the need to ensure comparability with other EU Member States. According to the Ministry of European Funds, the stage of absorption may be assessed also via other methods: based on actual payments (excluding advances) or using the values in the statements of expenditure submitted to the European Commission at a certain point in time.

programming period. As far as the new MFF is concerned, fund absorption was limited and represented mostly subsidies to agriculture (the European Agricultural Guarantee Fund – EAGF), to which access is easier, not being conditional upon project approval, but referring, for instance, to the payments to active farmers depending on the farmed area, based on payment claims.

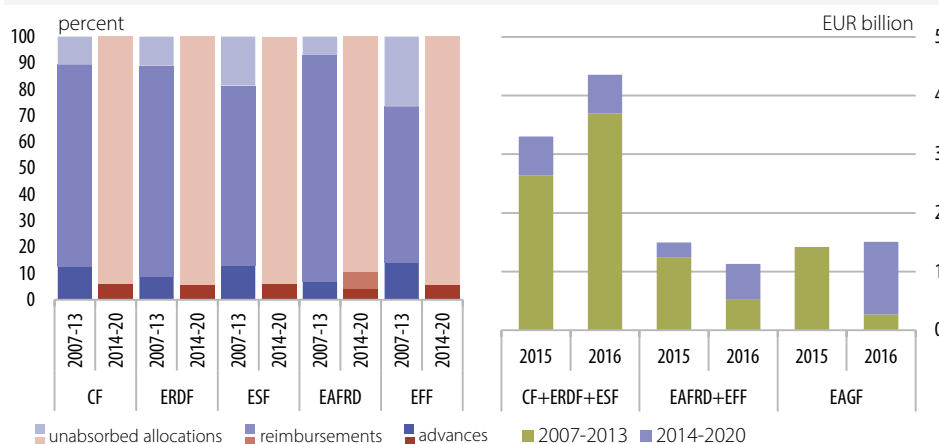
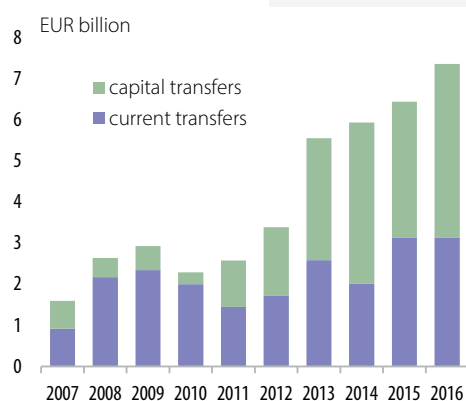


Chart B
EU fund absorption
in the two MFFs

Source: MPF (Net Financial Balance)

Chart C
Breakdown of EU funds received*
by type of (capital or operational)
expenditure



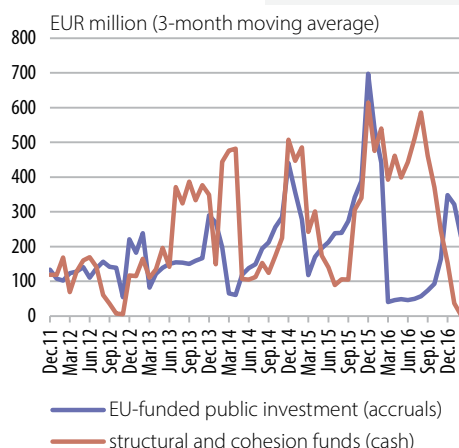
*) reimbursements and advances

Source: NBR (Balance of payments)

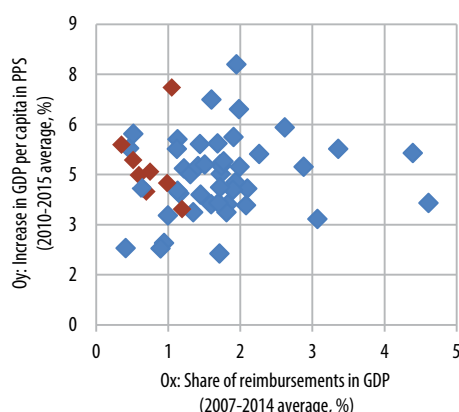
European funds mostly cover investment spending, recognised in the capital account of the balance of payments. However, there is also operational financing, recorded under (primary and secondary) income in the current account (Chart C). The largest share of funds mobilised under the common agricultural policy is operational, taking the form of subsidies to farmers (EAGF) and payments to

support semi-subsistence farms. Nonetheless, a substantial part of the amounts in the European Agricultural Fund for Rural Development (EAFRD), namely about half, is earmarked for investment purposes. In MFF 2007-2013, total funds for agriculture amounted to EUR 15.4 billion and a quarter was capital expenditure (with the EAFRD absorption rate standing at 93.4 percent at end-2016). As concerns the latter, satisfactory results were observed for agri-environment measures (for the wider appeal to environmentally friendly agricultural practices), investment for increasing the economic value of forests, improvement of standards in livestock farms and the setting-up of young farmers. In the current programming period, the funds for rural development totalled over EUR 800 million at end-2016, corresponding to an absorption rate of approximately 10 percent.

The cohesion policy focuses chiefly on investment in transport and environment infrastructure, and regional development, the allocated funds (European Regional Development Fund – ERDF and Cohesion Fund – CF) accounting for more than 70 percent of total capital account inflows during 2013-2016. By contrast, fund

Chart DStructural and cohesion funds
and public investment

Source: MPF

Note: NMS10 regions are defined at NUTS-2 level;
regions in Romania are marked in red.

Source: EC, Eurostat

Chart EDistribution of EU funds received
and increase in GDP per capita
at regional level – NMS10

inflows supporting the social component (the European Social Fund – ESF) are recognised particularly in the current account, being channelled especially to projects in education and workforce training, with a view to increasing employment, also for disadvantaged groups. The government plays a crucial role in the efficient management of the resources mobilised under structural and cohesion funds, given that around 70 percent of them target public investment (Chart D).

By end-2016, Romania received about EUR 17 billion of EUR 18.8 billion worth of funds allocated in MFF 2007-2013, thus posting the lowest absorption rate⁸ (90.4 percent), around 5 percentage points below that recorded by the other countries in the NMS10 group⁹. Approximately two thirds of these amounts were relatively evenly distributed (almost EUR 4 billion in each case) for funding projects in three major areas: (i) development of transport infrastructure, (ii) environment protection (mainly expansion and modernisation works for water systems and development of integrated waste management systems), as well as (iii) development of education infrastructure, of that for continuing vocational training and of micro-enterprises. The remainder of funds received were channelled to delivering workforce education and vocational training (including in rural areas), developing social inclusion, and increasing the efficiency of economic activity (also through the funding of R&D projects) respectively. In the new MFF, fund inflows have consisted only in advances so far, no information being available on the use of these amounts.

The low absorption of structural and cohesion funds entailed an opportunity cost in terms of the convergence of the Romanian economy, as it was noticed that the regions with higher absorption rates during 2007-2014¹⁰ usually posted a faster pace of development (Chart E).

The programmes for physical capital accumulation and human capital development, the pillars for increasing the potential of the economy, witnessed the lowest absorption rates (87 percent at end-2016). This can be partly attributed to the modest performance of the public sector, where EU-funded investment accounted for 1.0 percent of GDP in 2007-2014 (compared with an almost 2 percent average in the other NMS10 countries).

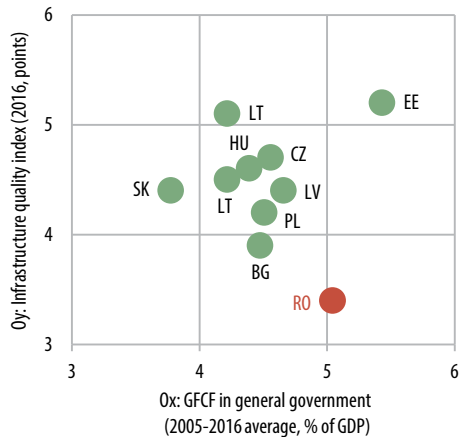
⁸ Calculated as a ratio of the amounts collected from the European Commission (reimbursements and advances) to the allocations under the MFF respectively.

⁹ Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

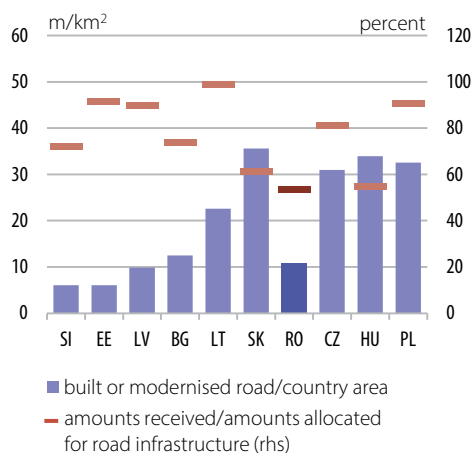
¹⁰ The choice of the 2007-2014 period is warranted by data availability.

Chart F

Public investment as a share of GDP and quality of infrastructure in NMS10



Source: Eurostat, WEF (2017)



Source: EC

Chart G

EU funding for road infrastructure in 2007-2014

A higher absorption rate of funds for public investment would be advantageous not only in quantitative but also in qualitative terms; public investment

expenditure as a percent of GDP is higher than that in the other new Member States, without translating however into a similar ranking with respect to the quality of road infrastructure (Chart F).

A larger contribution of EU funds to financing such projects (from approximately 25 percent in 2007-2016) could also yield positive effects in terms of efficiency, given that EU-funded investment limits the discretion in selecting the projects, requires strong feasibility studies, and is subject to *ex-ante* conditionality (IMF, 2017). In fact, according to IMF estimates, a 95 percent absorption rate in the current programming period (a rate achieved by the economies in the region in the previous programming period) would increase potential GDP growth by 1 percentage point compared with the baseline scenario (which assumes an 80 percent absorption rate).

The lack of progress in infrastructure development (Chart G) is probably one of the most important deterrents to both overall economic growth and the reduction of interregional disparities. Equally important for raising the growth potential of the economy are the ESF programmes, which focused particularly on the vocational training of the economically inactive population and the unemployed; nevertheless, generally modest progress was made in this case as well – the structural unemployment rate remains above 6 percent and the employment rate of the population aged 20-64 (66.3 percent) is markedly below the EU average and the 70 percent target set in the Europe 2020 Strategy.

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Labour market

In 2016, the step-up in economic activity led to a faster pace of hiring, the number of employees nearing the pre-crisis peak (Chart 1.13). At the same time, the expansion of hiring opportunities, reflected by the rise in the job vacancy rate, favoured the significant decline in unemployment rates, thus leading to a gradual tightening of labour market conditions.

The number of employees in Romania went up by 3.4 percent in annual terms, at end-2016 coming in at a level similar to that seen in 2008 (circa 4.8 million); more than

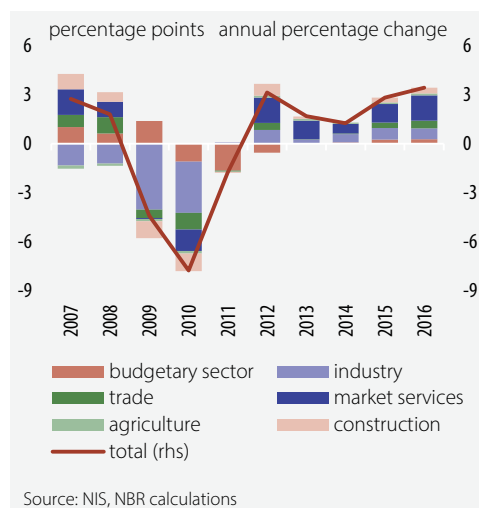


Chart 1.13
Sectoral contributions
to the annual dynamics
of the number of employees

half of this increase owed to hiring in market services, which currently account for the largest share of total payrolls (40 percent). Within this sector, large contributions to labour force absorption were made by trade, which was expanding rapidly, support services, and hotels and restaurants; although still taking a modest share of market services payrolls (about 8 percent), ICT services are also a fast growing sector which reports both price and quality competitiveness at a time when demand rises swiftly worldwide. Changes also occurred in industry (which held only 30 percent of

total employees at end-2016), with the only sub-sectors making a larger contribution to employment versus the pre-crisis period being the auto industry and related sub-sectors (in the context of investments made in this field) and food industry (spurred by the stimuli on demand for food items over the last years); at the opposite pole is light industry, whose personnel almost halved (Chart 1.14).

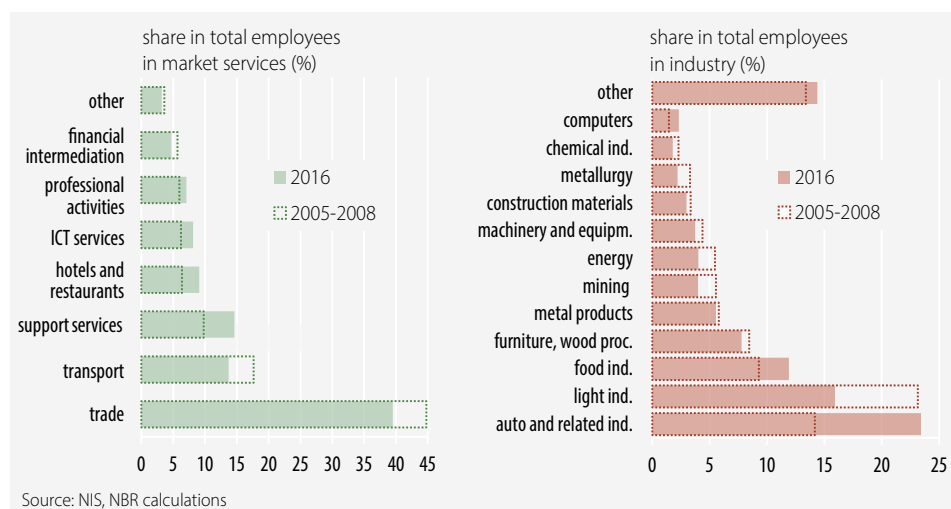


Chart 1.14
Composition of employees
in market services and industry
by sub-sector

The change in the structure of employment showing a rise in the share of labour intensive sectors with low productivity (trade, support services), alongside the advance in demand from medium- and high-tech industries (ICT services, the auto industry and related sub-sectors) was, actually, a characteristic of the Romanian economy over the last decade, in line with global trends. However, the phenomenon had social implications, as the labour income share narrowed steadily – a trend also visible worldwide (Box 4).

Box 4. Labour income share: level, trend, determinants

Given the economic, social and even political consequences associated with the downward trend in the labour income share, interest in this subject has grown among economic researchers in the post-crisis period. Apart from the implicit effect in terms of welfare, the level of the labour income share impacts the structure of aggregate demand, influencing not only the development of consumption (labour compensation has a higher propensity to consume), but also economic agents' investment decisions. Amid a downward trend of the labour income share, an improvement in an economy's performance is not found in the population's welfare to the same extent, higher inequality in the distribution of income eroding support for market economy and fuelling opposition to globalisation (OECD, 2015).

Despite theoretical approaches pointing to the steady long-term relationship between capital income and wage income, the past decades were characterised by a decrease in the labour income share, especially in advanced economies, where the lowest level seems to have been reached just prior to the outbreak of the financial crisis and no material recovery has been visible ever since (OECD, 2012; IMF, 2007 and 2017). In the literature, globalisation and technological progress are considered to be the determinants of this trend, tilting the balance of income distribution in favour of capital. Specifically, a possible substitution between labour and capital is brought into question, amid the relative decline in the cost of capital compared with that of labour. This may be associated with the automation of production and significantly reduced transaction and relocation costs, as well as with labour's diminished bargaining power, resulting from the relative increase in the labour supply worldwide, concurrently with the weaker demand for low-skilled workers (Arpaia *et al.*, 2009). Against this background, Box 4 aims to assess the level of the labour income share in the value added generated by the Romanian economy, while also looking at the extent to which the evolution of this indicator has been in line with the trend already observed globally and at the possible causes that affected its trajectory.

Calculation method

Although the assessment seems easy at first (by dividing compensation of employees to a measure of economy-wide income – value added, domestic product or national income), the literature gives careful consideration to the selection of the appropriate measure for each item of the ratio. One reason would be that the use of unadjusted data underestimates the share of labour by overlooking income from self-employment. A second reason refers to the relevance of the income measure used for the denominator – gross or net of depreciation.

As for the numerator, it is universally acknowledged that labour compensation in an economy regards not only company employees, but also self-employed individuals. Therefore, total labour costs were computed by summing up

compensation of employees – made up of gross wages and income in kind received by employees and of employers' social contributions – and gross income of the self-employed. However, the latter is not directly observable, international institutions (ILO, OECD, European Commission) and other studies dedicated to this topic using two methods of estimation. The first is based on the assumption that each self-employed individual is earning the average wage economy-wide, and the second uses (partially or fully) households' mixed income (Guerriero and Sen, 2012; De Nederlandsche Bank, 2016).

As regards to the denominator, the literature is much more limited in terms of considerations about the relevance of various measures of economy-wide income, the indicators (gross or net value added, gross domestic product or net national income) being generally deemed interchangeable, especially when the focus is less on the level and more on identifying long-term trends and their determinants. Cho *et al.* (2017) argues however that the trajectory of the labour income share depends on the perspective adopted when calculating it, i.e. on the chosen basis of calculation. If the purpose of the analysis is to identify the role of labour or capital in the production process (the production perspective), the adequate calculation basis is the gross value added (GVA). If, instead, the assessment is focused on the way in which the labour income share and the capital share influence households' income distribution (the income perspective), it should refer to the net value added (NVA).

For EU Member States, the European Commission calculates the labour income share using the GVA as a reference while attributing self-employed individuals the same cost as employees (I_0). In order to assess labour compensation in terms of welfare as well, this analysis calculates two alternative measures (I_1 and I_2), corresponding to the two aforementioned methods of estimating self-employed income, the NVA being the basis of calculation in both cases.

Taking the net value added as denominator is not the only difference between I_0 and the alternative measures I_1 and I_2 , the latter containing a series of adjustments meant to improve the accuracy of the calculation, mainly for Romania. Specifically, in determining the I_1 measure, the number of self-employed is reduced by the number of those individuals who are at the same time employers, the latter's income being actually in the form of capital income. In addition, the average income attributed to the self-employed is limited to the average gross wage economy-wide, excluding employers' contributions. The reason for this last correction stems from the fact that, in Romania, this category of workers is not liable to pay the said contributions.

Moreover, while the European Commission uses value added at basic prices, in determining I_1 and I_2 this is taken into account at factor prices, eliminating the elements with no relevance to the income that factors generate (other net taxes).

$$I_0 = \frac{(GW+C) \times (N_1 + N_2)}{GDP - TP_n} \quad (1)$$

$$I_1 = \frac{(GW+C) \times N_1 + GW \times (N_2 - N_e)}{GDP - TP_n - OT_n - C_{kf}} \quad (2)$$

$$I_2 = \frac{(GW+C) \times N_1 + I_{mixed} \times \frac{N_2 - N_e}{N_2}}{GDP - TP_n - OT_n - C_{kf}} \quad (3)$$

where:

GW – gross average wage economy-wide

C – employers' social contributions (health insurance, social security and unemployment);

I_{mixed} – self-employed income which cannot be separated from entrepreneurial income;

N_1 , N_2 and N_e – the number of employees economy-wide, the number of self-employed, the number of self-employed who are also employers respectively;

GDP – gross domestic product;

TP_n and OT_n – net taxes on products and other net taxes respectively (subsidies received are subtracted in both cases);

C_{kf} – consumption of fixed capital economy-wide.

It is worth mentioning that, due to different economic characteristics (for example, in terms of labour taxation or composition of the self-employed), no method of calculation of the labour income share ensures perfect international comparability. Specifically, the I_1 measure allocating the average gross wage to each self-employed underestimates labour compensation in the countries where these people also pay an equivalent to employers' contributions (e.g. Czech Republic and Slovenia), but overestimates the value of the compensation in those economies where the income of this type of employed person is far below the average gross wage economy-wide (such as Bulgaria). In fact, this last observation is also valid for the I_0 indicator calculated by the European Commission.

Results

Table 1.1 shows the labour income share in value added economy-wide in Romania and EU-28 Member States for 2015, the changes in this indicator compared with 2005, as well as the lowest, average and highest levels recorded during 2005-2015. The relatively short period of time used in the analysis was conditional on data availability and quality.

	I ₀						I ₁						I ₂				
	2015	2015/ 2005	Min.	Max.	Average 2005- 2015		2015	2015/ 2005	Min.	Max.	Average 2005- 2015		2015	2015/ 2005	Min.	Max.	Average 2005- 2015
	%	pp	%	%	%		%	pp	%	%	%		%	pp	%	%	%
IE	40	-12	40	58	53	IE	51	-8	51	66	60	IE	49	-10	49	64	59
SK	50	2	46	50	48	PL	57	-5	57	62	59	MT	60	-4	60	67	65
RO	51	-15	51	66	58	LT	60	0	55	64	59	LT	62	-1	57	66	61
CZ	52	0	51	54	52	MT	60	-3	60	66	64	LU	64	3	64	68	66
PL	53	-4	53	57	55	SK	60	2	54	60	58	BG	64	-3	62	68	65
LT	53	-1	49	57	53	RO	60	-17	60	77	68	RO	67	-8	67	75	70
MT	54	-2	54	58	57	LU	63	-4	62	70	65	HU	67	-4	67	72	70
HU	54	-5	54	59	57	CZ	64	1	61	67	63	CZ	69	-1	68	73	70
LU	57	-3	56	62	58	GR	64	2	60	66	63	CY	70	4	66	70	68
GR	57	-3	56	61	59	HU	64	-3	64	68	66	PL	70	-6	70	76	73
LV	58	6	50	59	54	CY	67	0	66	70	68	HR	73	-5	73	82	77
CY	59	-6	59	65	62	IT	69	5	64	70	67	IT	73	4	69	74	72
PT	59	-8	59	67	63	PT	69	-7	69	76	72	EE	73	8	66	78	69
EE	61	7	54	63	58	EE	71	11	60	74	66	PT	73	-7	73	80	77
IT	61	2	60	62	61	ES	71	2	70	72	71	UK	74	1	72	76	74
ES	61	-1	61	63	62	BG	72	8	58	72	64	ES	74	-3	73	77	74
SE	62	2	59	64	62	DE	74	2	69	75	72	GR	75	2	72	75	74
DE	63	1	59	63	62	LV	74	9	65	74	70	SK	75	2	69	75	73
AT	63	2	60	63	62	UK	74	2	73	77	75	NL	76	0	73	77	75
FI	64	3	59	65	63	AT	75	4	69	75	73	SE	76	3	71	78	75
BG	64	9	51	64	57	NL	75	2	72	76	74	FI	76	4	70	79	75
DK	64	0	64	68	65	SE	76	3	71	78	75	DE	77	2	72	77	75
NL	66	2	63	66	65	HR	77	1	75	84	79	AT	77	4	70	77	74
UK	66	2	65	68	67	FI	77	5	69	79	75	DK	77	-1	77	84	79
BE	67	1	65	68	67	DK	77	0	76	83	78	BE	78	2	75	80	78
FR	67	3	64	67	66	BE	79	3	75	81	78	LV	78	5	73	82	77
HR	68	-5	68	74	72	FR	80	4	74	80	78	FR	80	3	77	81	79
SI	71	1	68	73	71	SI	88	3	80	91	86	SI	87	1	82	89	86

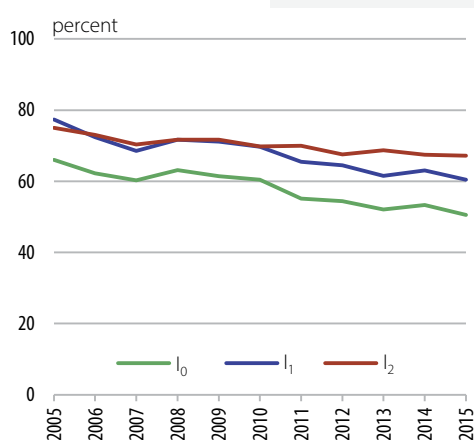
Note: (i) In the case of HR and LU, no other taxes were deducted (taxes on construction and other fixed assets, etc.); (ii) For I₂, the period taken into account in the case of BG and HR was 2005-2014, with 2005-2013 for CY and 2010-2015 for LU respectively.

Source: AMECO, Eurostat, NBR calculations

Table 1.1
Labour income share in EU-28

In terms of level, the labour income share heavily depends on the calculation method used, namely on dividing by the gross or net value added, the significant contribution of depreciation to the share of capital reducing the I₀ indicator to levels markedly below those of the I₁ and I₂, corresponding to a different perspective (the income perspective).

Chart A
Labour income share
developments in Romania
during 2005-2015



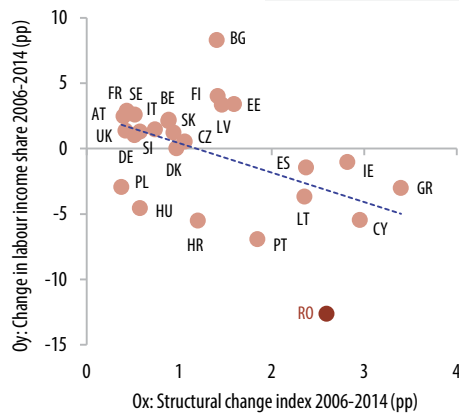
Source: AMECO, Eurostat, NBR calculations

As for Romania, at the end of the period under review, I₁ and I₂ stood by 9 percentage points and 16 percentage points respectively above the I₀, the levels reached in all three cases being, however, around those recorded by peer countries in the region (Czech Republic, Bulgaria, Poland, Hungary).

Regarding the dynamics of the indicators, the results are less diverging: all measures (yet more visibly in the case of I₁) show that the labour income share was relatively stable in most EU countries between 2005 and 2015, without however invalidating the downtrend seen in the advanced economies in the last decades. A notable exception is Romania, which posts the most sizeable declines in the labour income share over the past decade (Chart A).

Chart B

Index of structural change
in the economy and labour
income share dynamics in EU-28*



*) excluding Luxembourg and Malta

Source: AMECO, Eurostat, NBR calculations

A noteworthy contribution to the downtrend in labour income share made the decrease in employers' contributions by over 10 percentage points during 2005-2015 (annual changes between 2005 and 2008, followed by a 5 percentage point drop in October 2014). However, the key influencing factor was the structural change in the economy, along with higher economic efficiency (increased total factor productivity – TFP, also due to technological progress). Using a structural indicator such as the one below:

$$I_{str} = \sum_{i=1}^k \Delta s_i^2 \times \frac{s_{i,t-1}}{100} \quad (4)$$

where Δs_i illustrates the change in the share of the GVA of sector i in 2014 versus 2006 and $s_{i,t-1}$ is the share of the GVA of sector i in 2006, shows that Romania is among the countries with the sharpest structural shifts in the past ten years, the value recorded (2.59) exceeding by far not only the EU average (0.43), but also the new Member States' average (1.16). Significant structural changes are usually associated with a more pronounced decline in labour income share in

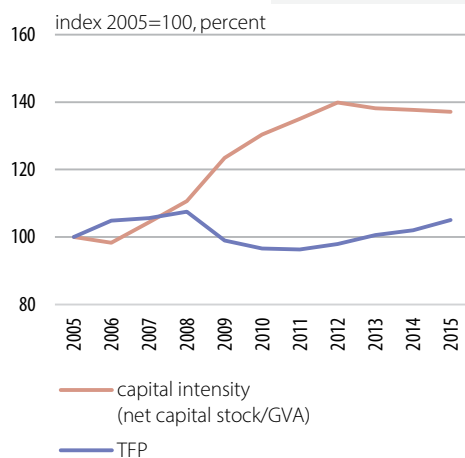
the period under review (Chart B).

The structural changes Romania has gone through since 2000 essentially reflect the rescaling of some oversized activities in terms of employment, in an effort to become a functional market, and therefore a more competitive economy. The process gathered momentum after the outbreak of the global financial crisis probably due to a higher degree of integration in global value chains. Also visible in other emerging economies (IMF, 2017), this led to a significant increase in the capital intensity of the economy, albeit from very low levels in 2005 (Chart C). Moreover, the reduced labour costs gave the local economy a competitive advantage. This corresponds to higher skills at lower costs compared

with other EU states only for narrow segments of economic activity, while mostly referring to low-skilled labour, with a reduced capacity of creating value added. In fact, the value added per hour worked in Romania stands at around 30 percent of the EU average, below that in other new Member States (e.g. Czech Republic, Hungary or Poland). To the downward trend of the labour income share also contributed some companies' higher concern with automating production processes, given that vast migration, limited internal labour mobility, the failure of the education system to accommodate the needs of the economy (not only in terms of the type of qualifications required, but also of the quality of training) made it more difficult for employers to recruit personnel.

Chart C

Capital intensity and TFP



Source: AMECO, NBR calculations

In the absence of active policies directed at increasing the quality of education and developing transport infrastructure (which would facilitate investment penetration and the access to labour force available in areas outside the current industrial clusters), the automation trend might come to have a more important contribution in the following years. Specifically, a labour force structure with a relatively high share of low-skilled employees performing low-complexity routine tasks fosters a replacement of labour with automated production lines.

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The increase in the capacity of the Romanian economy to create jobs in 2016 led to the contraction of unemployment rates, with the ILO unemployment rate dropping to 5.8 percent (-0.9 percentage points), whereas the registered unemployment rate fell to 4.8 percent (-0.3 percentage points). The decrease in the two indicators is rather ascribable to the cyclical factor, as it was not accompanied by an improvement in the number of longer-term unemployed (according to ILO definition, the long-term unemployment rate remained at 3 percent for the sixth year in a row, while the number of unemployed not receiving unemployment benefits exceeded 75 percent of total for the second straight year). The youth saw no recovery either – in their case the employment rate fell to 22.3 percent (in spite of a drop in the unemployment rate to readings close to the pre-crisis average), while the school dropout rate remained among the highest in the EU, way above the 10 percent ceiling advanced in the *Education and Training 2020 Report*¹¹. Besides, the employment rate of the population aged above 55 remained at around 43 percent in the last 10 years, in contrast to the sizeable progress across the EU (up from 44 percent to 55 percent). All these difficulties indicate the persistence – and even the worsening – of labour market structural problems, generated by the increase in emigration, population ageing, and the mismatch between job seekers’ skills and employers’ requests.

¹¹ Report that presents the priorities in education and vocational training identified in EU countries, within Europe 2020 strategy.

The annual dynamics of average gross wage earnings sped up significantly in 2016, outpacing the 10 percent threshold (+4.4 percentage points to 12.8 percent)¹².

The evolution reflects the joint influence of a series of factors – the labour market tightening (the influence of cyclical factors being heightened by the persistence of

structural rigidities), a new hike in the minimum wage economy-wide (with a higher impact than in 2015), as well as a number of wage increases in some sub-sectors in the context of previous productivity gains.

The wage dynamics saw a strong advance in construction and market services, especially trade, hotels and restaurants, being associated with the important share of minimum-wage earners. In addition, given the swift development in fields such as ICT and administrative and support services, wages continued to rise by more than

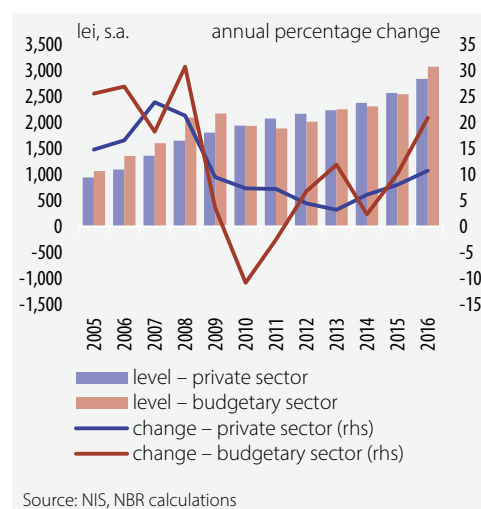


Chart 1.15
Gross wage earnings

10 percent in annual terms. Although below the economy-wide average, a significant wage growth was also visible in industry (+1.2 percentage points to 8.1 percent), posting swifter paces in expanding sub-sectors (electronic products). Faster dynamics were also seen in food and light industries, which – in the absence of productivity gains – impacted competitiveness; in the latter case, layoffs stepped up, amid the contraction across the sector, in line with external trends to relocate production in more cost-efficient Asian countries. On the other hand, the average wage growth economy-wide was influenced by hikes in the budgetary sector (circa 5 percent, on average, for low-wage earners in public institutions, in August 2016, and 15 percent in the health sector, in December 2016) (Chart 1.15).

In addition, the substantial step-up in the wage dynamics in public services (+21 percent in annual terms) has not come without repercussions on the private sector, as demonstration effects heighten the upward pressures associated with the progressive tightening of the labour market.

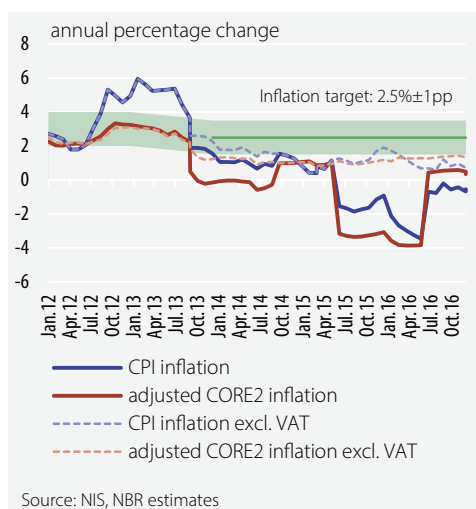
2.2. Prices and costs

Consumer prices

The trajectory followed by the annual CPI inflation rate in 2016 was largely influenced by the VAT changes in June 2015 and January 2016: the broadening of the scope of the 9 percent reduced VAT rate to all food items and the cut in the standard VAT rate from 24 percent to 20 percent, respectively. Their overlapping in the first part of the year pushed the indicator deeply into negative territory (below -3 percent), while

¹² In real terms, however, the annual growth rate of the gross wage accelerated to 15 percent, similarly to the pre-crisis level, therefore spurring consumer demand.

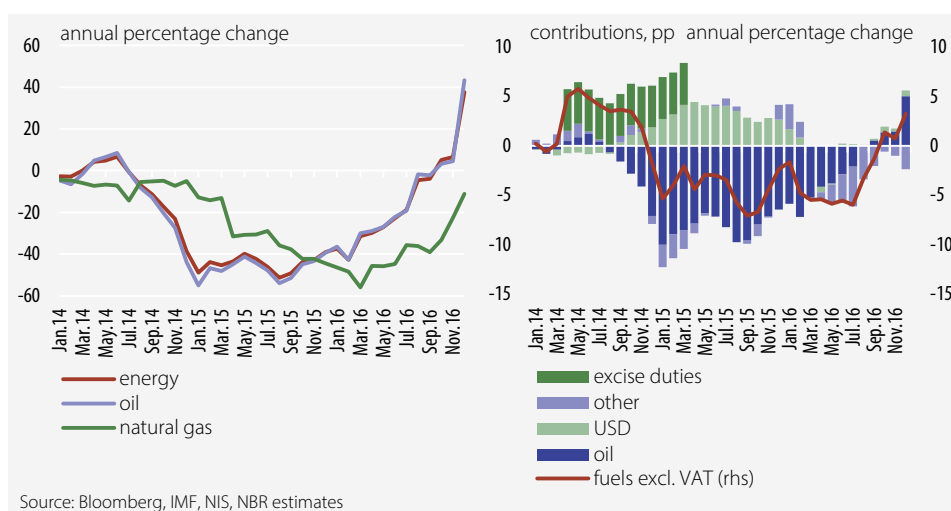
Chart 1.16
Annual inflation rate



the fading-out of the effect of the first measure caused a trend reversal in H2 (-0.54 percent at year-end, on a slight increase compared to December 2015). The annual inflation rate would have nevertheless stood below the lower bound of the ± 1 percentage point variation band of the 2.5 percent flat target even in the absence of the mentioned fiscal measures, the indicator adjusted with the first-round impact of VAT changes shedding 1 percentage point in 2016 to 0.9 percent in December (Chart 1.16). The explanation refers

essentially to developments in commodity prices, especially energy prices, strongly reflected by the volatile component of the CPI basket and, to some extent, by the administered one too. Thus, the severe decline posted by the crude oil price in early 2017 (approximately 50 percent) was quickly mirrored by the dynamics of domestic fuel prices and subsequently passed through, to different extents, to other price sub-indices (Chart 1.17). At the same time, the temporary oversupply of fruit and vegetables at European level caused the annual growth rate of domestic prices for these items to follow a steadily downward path in the first half of the year. Afterwards, the influences on the two segments of the volatile group offset each other, with the positive impact from the upward movement in the oil price being fully counterbalanced by a favourable agricultural year in Romania.

Chart 1.17
Energy commodity prices
and domestic fuel prices



In 2016 as a whole, the main contribution to the decrease in the annual CPI inflation rate (net of the first round impact of the VAT rate cut) was made by administered prices (-0.9 percentage points; Chart 1.18), with the drop in energy prices (to larger extents in May and July) reflecting – apart from the influence of the election cycle – the change in market conditions. Thus, the very low level of international energy prices (crude oil and natural gas) warranted, on the one hand, the suspension of

Chart 1.18
Contributions to annual CPI rate
(net of the direct effect
of VAT rate cuts)

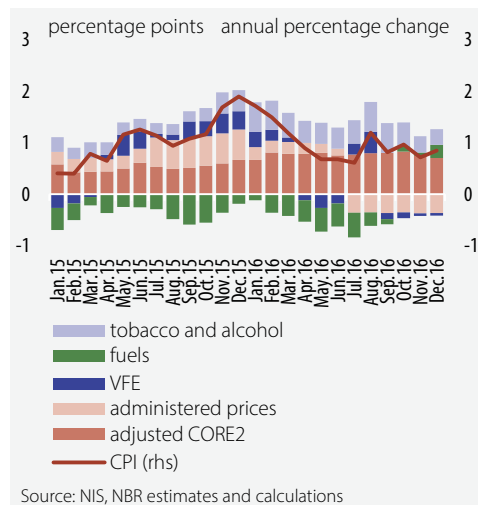
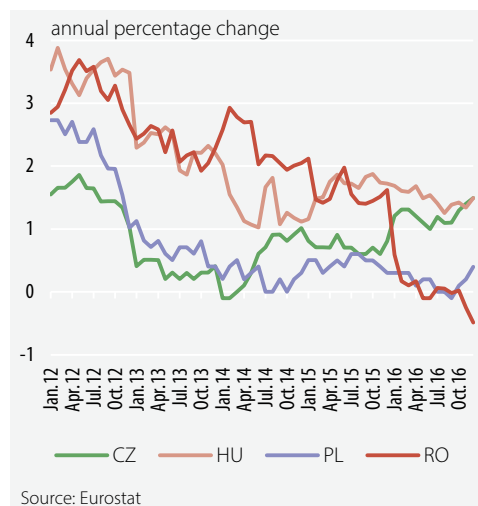


Chart 1.19
A core inflation measure
(HICP inflation excluding
alcoholic beverages, tobacco,
energy and food)



the natural gas market deregulation calendar until March 2017, and, on the other hand, contributed to the fall in electricity prices on the competitive market; in the latter case, the higher relative importance of renewable sources also played a part therein.

In 2016, adjusted CORE2 inflation stood low as well, ranging from 1.2 to 1.4 percent when adjusted by the first-round impact of the VAT rate cut (Chart 1.16). This indicator also reflected the influence of the external environment, with empirical evidence showing two transmission mechanisms: the pronounced contraction in some production costs (on commodities and energy) and transport costs, and the step-up in imports of consumer goods at more competitive prices. These developments, alongside stronger competition among the main modern retailers, counterbalanced domestic inflationary pressures, leading to a weaker relationship between inflation and output gap¹³. Under the circumstances, the changes in net core inflation in the course of the year were absolutely marginal,

although the economy changed its cyclical position ever since the first quarter and unit labour costs went up considerably. Relatively benign developments in core inflation¹⁴ were posted by other countries in the region too, including on account of the flattening-out of the Phillips curve (Hungary and Poland; Chart 1.19).

Output gap: definition
and estimation methods

The output gap is a synthetic measure of the gap between aggregate supply and aggregate demand in the economy. It is computed as the difference between actual GDP (showing short-term developments in aggregate demand) and potential GDP (showing long-term developments in aggregate supply). Potential GDP is the level of output that an economy could produce if actual capital stock and labour force were efficiently used and that does not exert inflationary pressures. Values of aggregate demand exceeding potential production capacities (excess demand) generate, *ceteris paribus*, inflationary pressures; similarly, a negative output gap (spare capacity) induces disinflationary pressures. The output gap is an important indicator for an inflation-targeting central bank as it is a key determinant of consumer price developments (especially of core inflation dynamics). By definition, monetary policy can

¹³ See Box "The relationship between economic activity and inflation", included in the *Inflation Report*, National Bank of Romania, May 2017.

¹⁴ A measure harmonised at European level that is calculated by excluding food, energy, tobacco and alcoholic beverages from the consumer basket.

influence only the output gap, as, in the long run, aggregate supply depends mainly on structural or institutional factors that are beyond the scope of the monetary authority (such as demographic developments, technological progress, the stance of the other economic policies).

The estimation of the output gap – an unobservable variable – poses many challenges, especially in emerging countries undergoing frequent regime changes or large economic policy reversals. Estimation can be performed by employing various methods, ranging from univariate statistical filters (such as Hodrick-Prescott or band-pass) to multivariate filters. The latter consider the interactions between output gap and a series of observable macroeconomic variables such as inflation rate, interest rate, exchange rate or unemployment rate. The main advantages associated with multivariate methods stem from using large information sets and from imposing relationships that are consistent with economic theory¹⁵. Given that the output gap is an unobservable variable and that there are various alternative estimation methods, a certain degree of uncertainty is associated with the size of the output gap. Uncertainty is higher when assessing recent values of the output gap, due both to statistical filtering issues (for instance, the end-of-sample problem) and the provisional nature of the most recent data sets.

Producer prices

The start of 2016 saw the largest contraction in producer prices on the domestic market (-3.8 percent in annual terms in March). The main drivers of this evolution were the developments in prices of energy and intermediate goods, correlated with

the drop in oil and metal prices to 12-year lows (Chart 1.20). Significant contributions to the strongly negative dynamics of energy prices had the competent authority's decision to lower electricity distribution tariffs starting with 1 January 2016 and cut the electricity prices on the deregulated market in the first months of the year.

After the lows seen in January 2016, commodity prices followed an upward trend in most cases¹⁶, due to the drop in excess supply. In correlation with this trend, industrial producer prices

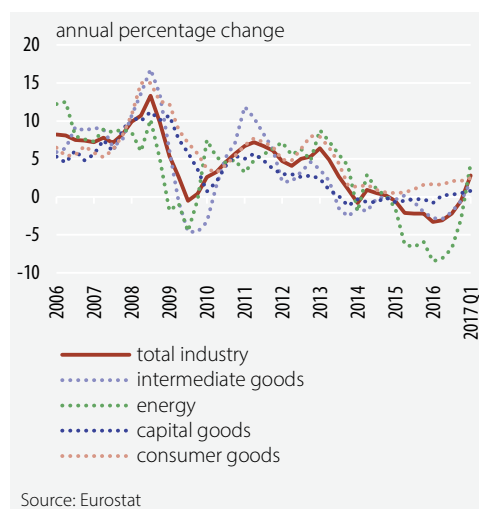


Chart 1.20
Producer prices on
the domestic market

on the domestic market posted a gradually slower rate of decrease and, in early 2017, their dynamics saw a strong return into positive territory, posting the greatest advance in the last three years and a half (3.2 percent in March 2017).

¹⁵ For instance, the link between output gap and inflation rate can be modelled by means of a Phillips curve type equation. Thus, in economic modelling, one can ensure the correspondence between the estimation method and the theoretical concept of the output gap (that level of GDP corresponding to the lack of inflationary pressures).

¹⁶ Except for cereal prices which, starting with the second half of the year, began to decrease again following the emergence of the first signs on a favourable agricultural crop worldwide, which afterwards came to materialise.

On the consumer goods segment, the annual rate of change of producer prices saw a gradual increase in 2016 to reach 3 percent in March 2017. The evolution reflects higher pressures from production costs (material and wage costs), as well as a further fast-paced growth of consumer demand, boosted by the fiscal and income policy easing measures and by the improvement in labour market conditions (in terms of both wages and employment).

Unit labour costs

In 2016, the annual dynamics of unit labour costs economy-wide returned to positive territory (5.5 percent), posting the fastest growth in the post-crisis period. However, the potential of this factor to bring about a build-up of upward pressures on end-user prices is contained by an increasingly competitive environment, in view of a higher contribution of imports to meeting consumer demand (in a context of low external inflation) and the aggressive expansion of large retailers. The faster dynamics of unit labour costs owe entirely to the stronger increase in the compensation of employees¹⁷, while labour productivity continued to advance in 2016 too (5.8 percent in annual terms, +0.9 percentage points from the previous year). This productivity gain can be, however, largely attributed to cyclical factors, considering that neither the labour market nor the net capital stock per person employed shows any signal indicating support from structural factors. On the one hand, deficiencies continued to

persist in terms of internal mobility and of the alignment of labour force skills to employers' requirements. On the other hand, the unfavourable evolution of gross fixed capital formation owed to the very components that could generate long-term productivity gains – technology and infrastructure.

At sectoral level, the step-up in the annual dynamics of unit labour costs was almost broad-based, with the trade sector (the main recipient of the fiscal stimuli on consumption) making the only notable exception. In industry, the mismatch between the growth rates of

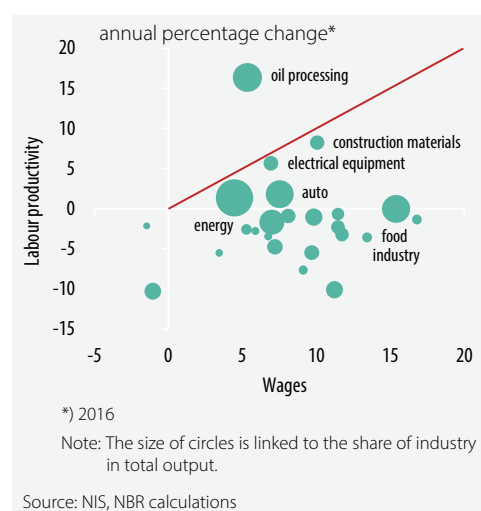


Chart 1.21
Productivity and wages
in industry

compensation and productivity grew visibly, with crude oil processing being the only manufacturing sub-sector generating productivity gains higher than wage dynamics, on account of the decline in commodity costs, as well as of a considerable demand both domestically and from abroad (Chart 1.21). Moreover, only a few industrial sectors reported labour productivity gains compared to the previous year, namely the auto and electrical equipment industries (further benefiting from significant foreign direct investment flows), the energy sector (in the context of restructuring the large power plants), and the manufacture of construction materials (reflecting booming residential construction works).

¹⁷ The step-up was primarily induced by the hike in gross minimum wage, as well as by pay rises in both the public and the private sectors.

2.3. Fiscal developments

The general government deficit (ESA 2010 methodology) widened substantially in 2016 to reach 3 percent of GDP, versus 0.8 percent of GDP at the end of the previous year. The deficit (ESA 2010) exceeded slightly the 2.9 percent-of-GDP target set in the 2016-2019 Convergence Programme, despite the higher-than-expected economic growth (4.8 percent, compared with the projected 4.2 percent under the aforesaid Programme) and a significantly lower-than-anticipated widening of the cash-based deficit (national methodology). The latter, projected in the budget construction to rise up to 2.8 percent of GDP, reached only 2.4 percent of GDP at year-end, amid lower-than-planned spending. The explanation for the substantially positive differential of 0.6 percent of GDP (in contrast to previous years) between the ESA 2010 general government deficit and the deficit calculated based on national methodology lies mainly with the influence of temporary factors: the recognition as fiscal expenditure according to the first classification of the entire amount of lei 3.8 billion in wage differences owed to teaching staff to be paid in 2016-2020 pursuant to Law No. 85/2016 (actual payments in 2016 ran at about lei 910 million) and of lei 2.1 billion in compensation titles issued by the National Authority for Property Restitution in accordance with the provisions of Laws Nos. 165/2013 and 164/2014 (to be paid out gradually).

	percent of GDP						
	2012	2013	2014	2015	2016	2017	2018
General government balance (cash, national methodology)*	-2.5	-2.5	-1.8	-1.4	-2.4	-2.96	-2.96
General government balance (ESA 2010)	-3.7	-2.1	-1.4	-0.8	-3.0	-3.5	-3.7
Primary general government balance**	-1.9	-0.3	0.3	0.9	-1.5	-2.0	-2.0
Structural general government balance***	-2.5	-1.0	-0.6	-0.6	-2.6	-3.9	-4.0
*) according to data included in the 2017-2019 Fiscal Strategy							
**) the primary deficit is the general government deficit (ESA 2010) excluding interest payable							
***) the structural deficit is the general government deficit adjusted for the cyclical component (estimated based on potential output)							
Source: MPF, Eurostat, European Commission							

Table 1.2
General government deficit

Occurring against the background of the 2015-approved changes to the Tax Code and successive public sector wage hikes, the fiscal deficit widening had a structural nature. The most recent estimates by the European Commission point to the closing of the negative output gap as a result of economic growth well above the potential GDP dynamics, together with a widening of the structural deficit (determined as a share in potential GDP at current prices) from 0.6 percent in 2015 to 2.6 percent in 2016 (Table 1.2). Against this background, the fiscal impulse, measured as the change in primary structural deficit, was strongly expansionary at 2.2 percentage points of GDP (Box 5); the provision of such a stimulus at a time when the economy was operating in fact at its potential is tantamount to fiscal policy remaining trapped in a pro-cyclical stance, which would inherently limit its room for manoeuvre in the event of adverse cyclical conditions in the future. Furthermore, from the perspective

of the obligations incumbent on Romania pursuant to the preventive arm of the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact), 2016 saw a wide deviation (1.6 percentage points) of the structural deficit from the medium-term objective, at odds with the developments seen between 2013 and 2015.

Structural balance
of the general government:
concept and relevance

Given that the base of tax revenues and social contributions of the general government consists of various incomes or expenditures of economic agents, most of the revenues to the general government fluctuate in line with swings in economic activity. Unlike revenues, general government expenditure, with the notable exception of unemployment benefits, does not depend on the cyclical position of the economy. To sum up, *ceteris paribus*, the general government balance tends to improve during an upturn and to worsen during a downturn.

For this reason, in analysing fiscal developments it is important to identify their nature and to assess the so-called structural (underlying) fiscal position. Determining the general government structural balance implies the decomposition of the actual fiscal position in the automated response of the budget to the swings in economic activity (cyclical component) and the discretionary component of fiscal policy. To assess the size of the cyclical component of the budget balance means to estimate the output gap relative to the potential or trend level and to quantify how the various types of revenues or expenditure respond to the swings in economic activity. The cyclical component should be interpreted as that part of the fiscal surplus/deficit that tends to correct itself over time as a result of the impact of the business cycle, while the structural balance corresponds to the fiscal surplus/deficit expressed as a percentage of GDP that would prevail if the economy operated at its potential. An improvement/a worsening of the structural balance reflects a certain combination of higher/lower tax rates and a trajectory of non-cyclical fiscal expenditure involving lower/higher growth rates than potential economic growth.

The general government structural balance plays a major part in assessing the sustainability of public finance, for which purpose, e.g. it is compared to the fiscal balance (expressed as a share in GDP) that ensures stabilisation of the public debt-to-GDP ratio. The relevance of the structural balance is also highlighted by its importance in the European fiscal policy surveillance mechanism for both preventive and corrective arms of the Stability and Growth Pact.

The preventive arm requires that the fiscal position of every Member State fulfil the so-called Medium-Term Objective (MTO), defined in terms of the structural deficit (or cyclically-adjusted deficit net of temporary measures). To set the fiscal target in structural terms implies to ensure medium-term sustainability of public finance and to allow automatic stabilisers to work fully. As for the corrective arm of the Stability and Growth Pact, if entry into/exit from the excessive deficit procedure is based on nominal concepts (budget deficit lower than 3 percent of GDP, public debt-to-GDP ratio below 60 percent), the concept of effective action in correcting the excessive deficit, which entails possible financial sanctions, implies the formulation of fiscal consolidation requirements in terms of the change in structural balance (the benchmark is 0.5 percentage points of GDP per annum).

Both general government revenues and expenditures expressed as a share in GDP contracted in 2016 compared with a year earlier (from 35 percent to 31.7 percent and from 35.8 percent to 34.7 percent respectively), reflecting largely the sharp reduction

in EU funds transferred via the budget (from 2.5 percent to 0.5 percent of GDP¹⁸), given the end of the absorption period for the 2007-2013 financial framework and the slow start of absorption of funds under the new financial framework.

Following the adjustment of aggregates by EU funds, the developments in revenues and expenditures become divergent: the former shrank from 32.6 percent to 31.2 percent of GDP and the latter went up from 33.3 percent to 34.2 percent of GDP. The decline in the overall revenue ratio was prompted by tax revenues (including social contributions), down from 28 percent of GDP in 2015 to 25.9 percent of GDP in 2016, on the back of tax cuts introduced in those two years; among these cuts worth noting is the broadening of the scope of the reduced VAT rate in June 2015 and the 4 percentage point reduction in the standard VAT rate as of 1 January 2016 that caused related tax receipts to narrow as a share in GDP by 1.6 percentage points to 6.5 percent. On the expenditure side, compensation of employees and capital transfers¹⁹ saw increases as a share in GDP versus the previous year (up 0.56 percentage points and 0.46 percentage points respectively), which were partly offset by the 0.35 percentage point drop in intermediate consumption. The impact of lower EU funds was visible particularly on public investment, which accounted for 3.6 percent of GDP, down from 5.2 percent of GDP in 2015.

The increase in public debt (by lei 15.9 billion) was well below the ESA 2010 general government deficit (up lei 23.1 billion), reflecting the considerable volume of expenditure in the form of accrued liabilities, not actual payments (which explains the size of the differential between the ESA 2010 deficit and the cash-based deficit), and the high level of EU funds inflows in 2016, representing settlements of applications

for reimbursement submitted a year earlier (and recorded as revenues upon submission). The large negative stock-flow adjustment, together with the favourable interest-economic growth differential, explains the decline in the public debt-to-GDP ratio to 37.6 percent, from 38 percent at end-2015 (Chart 1.22), despite a primary deficit of 1.5 percent of GDP, compared to a 0.9 percent of GDP surplus in the year before (Chart 1.23).

Fiscal deficit financing was covered mostly from domestic sources, as reflected by the increase in

lei-denominated public debt by lei 12.2 billion, way above that in foreign currency-denominated debt, up lei 3.6 billion. Bonds issued on the international

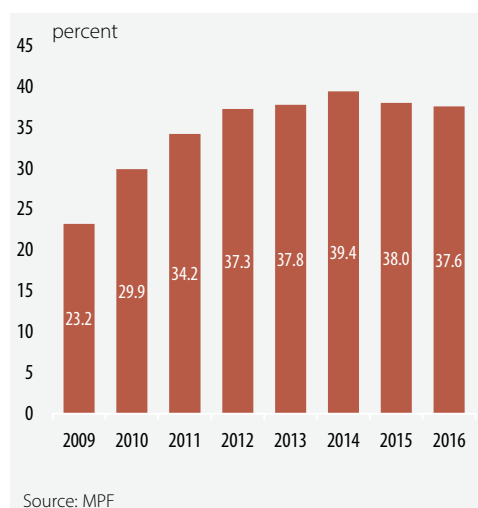
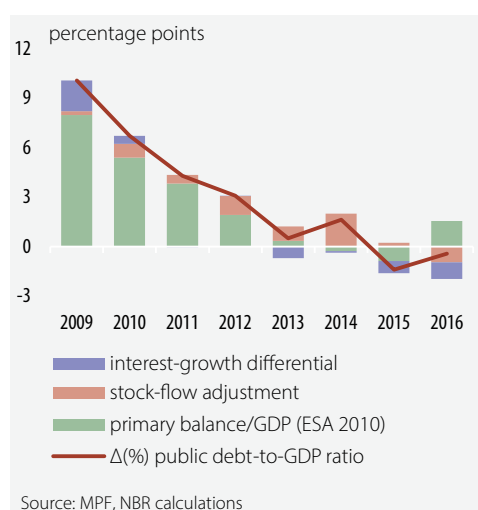


Chart 1.22
Public debt-to-GDP ratio

¹⁸ In 2016, budgetary execution in accordance with national methodology shows EU funds worth lei 6.86 billion (0.9 percent of GDP), yet this amount includes funds for farmers of around lei 3 billion that are not treated as transfers to general government in accordance with ESA 2010.

¹⁹ Due to the above-mentioned temporary factors representing the source of the positive differential between the ESA 2010 general government deficit and that calculated based on national methodology.

Chart 1.23
Decomposition of the change
in public debt-to-GDP ratio



markets amounted to EUR 3.25 billion, of which EUR 750 million and EUR 500 million came from the reopening of the 2015 issues maturing in 2025 and 2035 respectively, while EUR 2 billion were raised via a fresh 12-year issue. Adding to these was the local market issue of 5-year bonds worth a nominal EUR 775 million. Turning to the leu-denominated issues, even though short-term debt increased slightly its weight in total debt to 6.9 percent, from 6.3 percent, the average maturity of bond issues continued to grow, thus underpinning

the ongoing uptrend in the average residual maturity of the entire public debt stock (from 5.4 years to 5.7 years).

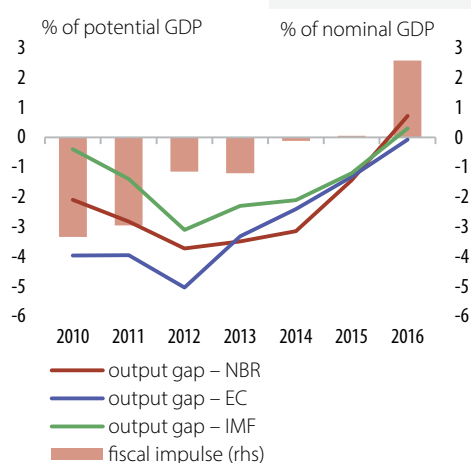
Box 5. Effects of the 2016 fiscal easing on key macroeconomic variables

In 2016, economic activity was significantly influenced by a number of fiscal easing measures implemented in this period, the most notable being the standard VAT rate cut from 24 percent to 20 percent starting January, and new raises in public sector employees' pay. This box presents an assessment of the effects of the said stimuli on economic growth, inflation rate and the current account deficit.

Fiscal position and the business cycle

From a broader perspective, subsequent to the outbreak of the global economic and financial crisis, in Romania, as in other countries, fiscal consolidation measures were needed to correct the major imbalances that had built up prior to that point, also as a result of the expansionary fiscal stance. Specifically, the general government deficit-to-GDP ratio fell from 9.5 percent in 2009 to 6.9 percent in 2010, with the tight fiscal stance remaining in place, as a matter of fact, for most of the post-crisis period. The shift to an expansionary drive has become manifest since 2016 (following an almost neutral position in the previous two years), the rise in the fiscal deficit to 3 percent being caused by its structural component, which is equivalent to a stimulative fiscal impulse²⁰ to the economy (Chart A). Considering that this shift overlapped the reversal in the cyclical position of the economy, which is estimated

Chart A
Output gap and fiscal impulse



²⁰ The fiscal impulse is defined as the change from one period to another in the structural fiscal balance, with an inverted algebraic sign (for further details, see www.bnr.ro, Monetary policy, Transmission mechanism, Fiscal projections and macroeconomic forecast).

to have occurred during 2016, fiscal policy retained its pro-cyclical nature all through the post-crisis period, contributing to widening the business cycle fluctuations, instead of diminishing them.

Assessment of fiscal policy effects on key macroeconomic variables in 2016

GDP and the current account

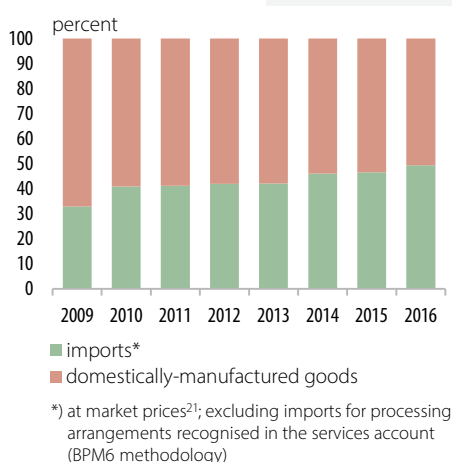
Households' purchasing power improved considerably in the course of 2016, to this contributing the rise in their income (both in public and private sectors, the latter income also in the context of a demonstration effect of public sector wage hikes), on the one hand, and the impact of indirect tax cuts on the general price level, on the other hand. Against this background, final consumption of households picked up to 7.3 percent, being the primary driver of the strong economic growth in 2016. It should be pointed out, however, that repeated provision of fiscal stimuli with positive effects mostly on consumption and relatively less traction on investment in the national economy does not warrant economic growth sustainability over the medium term, having limited benefits in terms of growth potential.

As a matter of fact, this evolution favoured particularly the trade sector (inherently characterised by limited productivity and, hence, by low capacity to positively

influence the growth potential of the economy), while the stimulative effects on the domestic industrial sector producing consumer goods were rather subdued in terms of both output expansion and employment. If prior to the outbreak of the crisis domestically-manufactured goods covered about 60 percent of local demand, their share narrowed steadily in the following years to approximately one half at present (Chart B); the trend has become sharper since 2014, with the recovery of domestic consumption emerging in a global low-price environment and being additionally fostered by the keener domestic competition (illustrated both by the aggressive expansion of large chain stores and high levels of the aggregate index of competitive pressure on market segments representative for the CPI basket).

Chart B

Purchases of consumer goods:
domestic output vs. imports



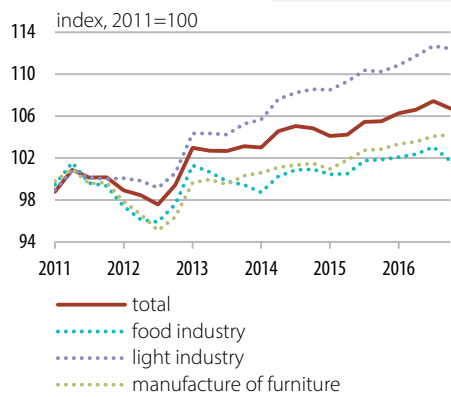
Source: NIS, Eurostat, NBR calculations

The difficulty of the local industrial sector to accommodate most of the consumption growth driven by the above-mentioned stimuli is due to several factors, some of them being common to all sectors and others having a specific nature. As regards the former factors, particularly important has been the swift rise in unit labour costs, which significantly sapped the competitive position of consumer goods sectors (on both local and foreign markets), given the intensive use of labour in these fields and, therefore, the weight of staff costs in the cost

²¹ Actual data on trade and transport margin, customs duties and taxes on products excluding customs duties, necessary to calculate imports at market value, refer to the period until 2014 only. For 2015-2016, the first two items were approximated based on their rates (applied to base prices) in 2012-2014, whereas for the third item different VAT rates in the reference years were used.

Chart C

Real effective exchange rate –
consumer goods, competition
on the domestic market²²



Source: Eurostat, WIOD, national statistics offices,
NBR calculations

structure (Chart C). As for the specific influences, the following deserve mention: (i) weak efficiency along the domestic production chain in the food industry; (ii) the significant share of economic agents in the light industry producing goods under processing arrangements, which increases the sector's sensitivity to

developments in unit labour costs, on the one hand, and leads to limited reception of positive domestic demand impulses, on the other hand; and (iii) the consumers' preference for imported used cars.

In quantitative terms, the use of estimates on the fiscal impulse as an input variable in the NBR's model for macroeconomic analysis and medium-term forecast (MAMTF) reveals a 1.1 percentage point impact of the stimuli provided in 2016 on economic growth in the same period. The effects became manifest both directly, via the fiscal impact multiplier, and indirectly, via the persistence effects induced by the inertial component of the output gap²³. In the context of the boosting effect that the increase in individual consumption of households had on imports of goods and services, the fiscal impulse caused the current account deficit-to-GDP ratio

to widen by about 0.8 percentage points in 2016, which explains the rather weak stimulative effect that fiscal easing exerted on the GDP.

Inflation

As for inflation rate, the influence of the fiscal expansion is two-sided. Firstly, there is the impact of the cut in indirect taxes (VAT, excise duties), whose first-round effect persisted in the annual inflation rate throughout the year and was estimated at -1.2 percentage points. Besides, second-round effects of indirect tax changes on CPI inflation were assessed as well. These were associated with the downward revision of economic agents' inflation expectations that was favoured also by the prevailing backward-looking nature of those expectations. Second-round effects of these measures fade away gradually and were found, in the cited episode, to be significantly lower than first-round effects.

Secondly, within the hybrid new Keynesian Phillips curve based on which developments in core inflation are modelled, a determinant is the output gap, which approximates the inflationary pressures exerted by the real sector. This type of assessment reveals that the demand surplus generated in the economy following the implementation of fiscal easing measures may be accountable for a 0.5 percentage point rise in the annual CPI inflation rate at end-2016.

²² For further details on how these indicators were calculated, see the Box titled "Price competitiveness of main industrial groupings and sub-sectors" in the May 2017 *Inflation Report*.

²³ The term "persistence" in the aggregate demand equation is based on the theory of habit formation in consumption.

The background of the slide features a photograph of classical architectural columns, likely from a bank building, with a series of thin, wavy, golden lines overlaid on the left side.

Chapter 2

Monetary policy of the National Bank of Romania

1. Policy objective

The primary objective of the National Bank of Romania, in compliance with its Statute²⁴, is to ensure and maintain price stability. By fulfilling this objective, monetary policy – i.e. the key task of the monetary authority – can serve best to achieve sustainable economic growth. The NBR's monetary policy is designed and implemented in the context of inflation targeting²⁵, characterised by a flat inflation target of 2.5 percent ± 1 percentage point²⁶, compatible with the definition of medium-term price stability for the Romanian economy.

In the specific context of 2016, monetary policy was geared towards ensuring the return over the medium term of the annual inflation rate to the flat target, in a manner supportive of economic growth, also by boosting confidence and lending. This specific objective stemmed from the institutional features of monetary policy, on one hand, and from the particulars of the macroeconomic and financial framework in which monetary policy was implemented, on the other hand. Moreover, this objective met the requirement to bring the annual inflation rate, in the medium to long run, at levels in line with the European Central Bank's quantitative definition of price stability.

2. Policy decisions

From the perspective of monetary policy conduct, the macroeconomic and financial environment of 2016 was characterised by deeply divergent developments. It was marked, on one hand, by the transitory disinflationary effects of a multitude of significant supply-side shocks and, on the other hand, by the reversal of the cyclical position of the economy – amid the pick-up in economic growth – and by the increase in unit wage costs, also due to labour market tightening, implying the prospective build-up of increasingly stronger inflationary pressures. Against this background, the annual inflation rate moved considerably deeper into negative territory in the first part of the year, whereas the forecasts updated during that period indicated and reconfirmed the outlook for inflation to return into the upper half of the variation band of the flat target over the longer time horizon.

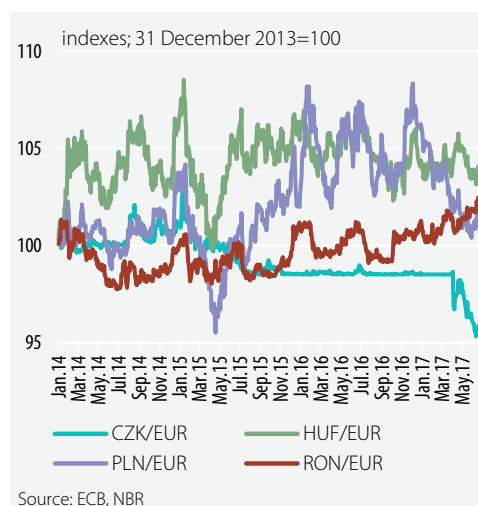
²⁴ Law No. 312/2014.

²⁵ The NBR moved to inflation targeting in August 2005.

²⁶ The NBR shifted to a multi-annual flat inflation target of 2.5 percent ± 1 percentage point in December 2013.

Behind these divergences stood the set of fiscal and wage measures implemented/scheduled in the period from 2015 to 2016, also in line with the new Tax Code²⁷, conducive to a heightening of the pro-cyclical nature of the fiscal and income policies. In 2016, major influences were exerted by the reduction, as of 1 January, in the standard VAT rate²⁸ and other indirect taxes, by the hikes in wages²⁹ and other household income starting in the latter half of 2015, as well as by the rise in the minimum gross wage economy-wide. Two-way effects, albeit much more modest, yet chiefly disinflationary over the short term, also had the performance of administered prices and the unexpected decline, towards year-end, in tobacco product prices and in the prices of compulsory motor third-party liability insurance policies. By contrast, a stronger impact came from global supply-side shocks consisting in large decreases in international commodity prices, particularly of energy and agricultural produce; the magnitude and length of their disinflationary effects exceeded the initial expectations, also amid higher imports of goods, leading to a widening of the trade deficit.

Chart 2.1
Exchange rate developments on
emerging markets in the region



The external environment was also a source of both uncertainty and two-way risks to domestic inflation, sporadically compounded by the slowdown of the Chinese economy and of other major emerging economies, thereafter by the Brexit vote and, towards the end of the year, by the US elections and their unexpected outcome. Thus, global economic growth remained subdued and the euro area recovery slowed, yet their prospects improved in the latter half of the year. At the same time, inflation was further affected by low

oil prices and the persistence of excess production capacity, although trending upwards towards the end of the period under review. This context prompted a more accommodative monetary policy stance³⁰ on the part of the ECB and other EU central

²⁷ The new version of the Tax Code adopted by the Parliament of Romania on 3 September 2015 essentially set forth: (i) the cut in the standard VAT rate from 24 percent to 20 percent as of 1 January 2016 and to 19 percent as of 1 January 2017; (ii) the removal of the special excise duty on fuels as of 1 January 2017; (iii) the scrapping of the tax on special constructions and the cut in the tax on dividends from 16 percent to 5 percent as of 1 January 2017. The Code was subsequently amended and supplemented via Government Emergency Ordinance No. 50 of 27 October 2015, which approved the implementation, as of 1 January 2016, of the following additional measures: the cut in the tax on dividends, the broadening of the scope of the reduced 9 percent VAT rate to potable water delivery services, and the reduction of the income tax for micro-enterprises with hired workers.

²⁸ Its impact overlapped that exerted by the broadening of the scope of the reduced VAT rate to all food items starting 1 June 2015; the VAT rate applicable to these products was lowered from 24 percent to 9 percent.

²⁹ The latter part of 2015 had seen pay rises in local public institutions (12 percent), healthcare and social security (25 percent), for teaching and auxiliary teaching staff in the education sector (in two stages, by 5 percent and 15 percent respectively), as well as for other categories of public sector employees, excluding healthcare, education and social security (10 percent). Moreover, in August 2016, low-wage earners in public institutions (mainly in the health sector) benefited from wage hikes of around 5 percent.

³⁰ The package of measures adopted by the ECB in March included further lowering the key policy rates, expanding the monthly purchases under the asset purchase programme (APP) from EUR 60 billion to EUR 80 billion, purchasing corporate bonds for the first time, as well as launching a new series of targeted longer-term refinancing operations.

banks, while the Fed postponed the resumption in monetary policy normalisation, raising the policy rate as late as December 2016. In its turn, the international financial market witnessed several volatility spikes, with limited knock-on effects in the local market. Conversely, stronger influences were exerted by the legislative initiatives regarding the banking sector³¹, as well as by the fiscal and wage measures on the domestic agenda, also in an electoral context, perceived by investors as generating risks to domestic fundamentals. Against this backdrop, the EUR/RON exchange rate saw successive swings, before running at relatively higher readings in the closing part of the year³² (Chart 2.1); the USD/RON was more volatile, reflecting the considerable fluctuations of the EUR/USD on international markets³³.

In this context, the prudent tailoring of the monetary policy stance with a view to ensuring medium-term price stability called for keeping the policy rate at the historical low of 1.75 percent³⁴. Additionally, the NBR kept unchanged the width of the corridor of interest rates on the central bank's standing facilities around the policy rate at ± 1.5 percentage points and the minimum reserve requirement ratio on leu-denominated liabilities of credit institutions. The monetary authority also pursued adequate liquidity management in the banking system, fostering – amid the persistence of banks' net liquidity surplus – the accommodative nature of real broad monetary conditions. The central bank's actions and approach were aimed at bringing, on a lasting basis, the annual inflation rate back in line with the flat target in a manner supportive of economic growth, against the background of enhanced monetary transmission and also relative compatibility with the monetary policy cycles of central banks in the region and in the euro area. A secondary objective was the further harmonisation of the reserve requirement mechanism with the relevant standards and practices of the ECB and other central banks in the EU Member States. In particular, the NBR cut the minimum reserve requirement ratio on forex-denominated liabilities of credit institutions to 10 percent from 12 percent, given the steady contraction in annual terms in foreign currency lending.

Furthermore, the monetary authority continued to extensively use and to diversify its specific tools and means of communicating and detailing the rationale behind the monetary policy decisions, starting to publish, as of 2016, the minutes of the NBR Board monetary policy meetings³⁵; in the minutes, the central bank has repeatedly underlined that a balanced macroeconomic policy mix, along with the progress in structural reforms and with EU funds absorption, is essential for preserving macro-stability, ensuring lasting economic growth, enhancing the domestic economy's resilience to potential adverse developments worldwide, and hence for furthering convergence with the euro area.

³¹ Law on debt discharge and that on converting CHF-denominated loans into leu-denominated loans at the historical exchange rate.

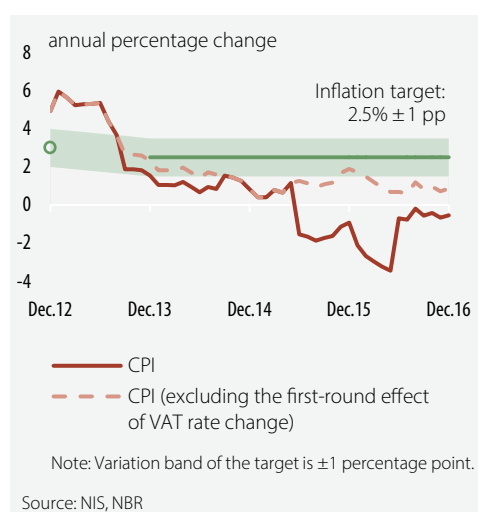
³² In 2016 as a whole, the average EUR/RON depreciated by 1.0 percent in nominal terms.

³³ The USD/RON exchange rate hit a historical high on 20 December 2016, given that the US currency continued to strengthen quickly against the euro on international markets, with the EUR/USD rate posting the lowest reading since December 2002.

³⁴ Reached in May 2015.

³⁵ Starting with the monetary policy meeting of September 2016.

Chart 2.2
Inflation rate



The action steps taken by the NBR and the prudent tailoring of the monetary policy stance proved decisive in the solid anchoring of longer-term inflation expectations – a key prerequisite for ensuring and preserving medium-term price stability –, while also contributing to the step-up in economic growth, which peaked in 2016 at a post-crisis high of 4.8 percent. However, under the transitory impact of the strong disinflationary supply-side shocks, the annual inflation rate remained in negative territory, averaging out at a historical low of -1.5 percent in

2016. Nonetheless, it ended the year slightly above the December 2015 reading (-0.54 percent versus -0.93 percent; Chart 2.2) and, in the absence of the transitory effects of the VAT rate cut, it would have stood at 0.85 percent (1.9 percent in December 2015).

The NBR Board's approach in the first part of the year under review was warranted by the widening divergence between short-term developments in inflation and its medium-term outlook, as highlighted by the central bank's forecasts updated in February and May 2016 and broadly confirmed by subsequently-released statistical data. Equally essential was the nature of the drivers of the expected inflation pattern, as well as of the associated uncertainty and risks.

Thus, in line with the NBR's previous forecasts, the annual inflation rate moved deeper into negative territory in the first months of 2016³⁶, under the transitory impact of the cut, starting 1 January, in the standard VAT rate³⁷ and other indirect taxes, overlapping the same-way effects exerted by the broadening of the scope of the reduced VAT rate to all food items³⁸ and by the sharper decline in international oil prices, as well as by the decrease in administered prices and the decelerating euro area inflation. To these added the outlook for the annual inflation rate to remain in negative territory beyond mid-2016 and well below the lower bound of the variation band of the flat target until end-2016, amid the relatively stronger disinflationary action expected from supply-side shocks over the short time horizon.

At the same time, however, the medium-term forecasts updated during 2016 H1 reconfirmed the prospects for the annual inflation rate to witness a large upward correction at the beginning of 2017 – given the fading out of the transitory impact exerted by the first round of the standard VAT rate cut³⁹ –, followed by a relatively fast

³⁶ Annual inflation rate dropped to -3.0 percent in March 2016 from -0.93 percent in December 2015.

³⁷ From 24 percent to 20 percent.

³⁸ The VAT rate applicable to these products was lowered from 24 percent to 9 percent starting 1 June 2015.

³⁹ The base effect was anticipated to be somewhat counterbalanced by the opposite influences from the new indirect tax cuts scheduled starting 1 January 2017, consisting mainly in the lowering of the standard VAT rate to 19 percent and the removal of the special excise duty on fuels.

pick-up to values in the upper half of the variation band of the flat target⁴⁰. Behind these prospects stood the rising inflationary pressures anticipated to emerge from the reversal of the cyclical position of the economy in the second half of 2016 and from the subsequent advance in excess aggregate demand – amid the forecasted economic growth rate remaining above potential –, as well as from the sustained increase in unit wage costs. These had as major premises and assumptions the recent and expected easing of fiscal and income policy stances⁴¹ and the ensuing rise in household real disposable income, also underpinned by the low oil price, as well as the preservation of stimulative real monetary conditions and the consolidation of lending.

Forecasts were still marked by significant uncertainties and two-way risks stemming, on one hand, from the potential fiscal and income policy stance in the context of the electoral year and, on the other hand, from the legislative initiatives in the banking field, as well as from the uncertainty about economic growth globally and in the euro area/EU, also fuelled by the weakening of the Chinese economy and of other major economies and, subsequently, by the Brexit referendum. Highly uncertain was the future performance of oil and other commodity prices as well.

Subsequent statistical data and assessments pointed to the annual inflation rate falling deeper into negative territory in the first part of 2016 Q2⁴², almost entirely due to the stronger direct and indirect effects exerted, via multiple channels⁴³, by supply-side global disinflationary shocks consisting in large and persistent declines in international commodity prices, particularly of energy and agricultural produce⁴⁴; as for the latter, a major role also played the build-up of excess supply of agri-food products on the EU market⁴⁵. Under the circumstances, the short-term prospects for the annual dynamics of exogenous CPI components – fuel prices, volatile food prices, as well as administered prices – witnessed sizeable downward adjustments.

At the same time, however, there was evidence of faster-than-expected pick-up in economic growth in the first two quarters of 2016 – with annual GDP dynamics standing at 4.3 percent and 6 percent respectively⁴⁶, primarily due to the expansion in private consumption, boosted by higher household income, the implemented fiscal measures, and favourable financial conditions – implying an early reversal of the cyclical position of the economy⁴⁷ and a swifter build-up of demand-driven inflationary pressures.

⁴⁰ In the May forecasting round, the annual inflation rate was seen at 3.3 percent at the end of the projection horizon, i.e. in 2018 Q1.

⁴¹ The minimum gross wage economy-wide was raised by 19 percent in May. Furthermore, pursuant to Government Emergency Ordinance No. 20/2016 (June), it was decided to increase the wages for some categories of public sector employees in August.

⁴² The 12-month inflation rate hit a historical low of -3.46 percent in May.

⁴³ Including through imports of consumer and intermediate goods, leading to a widening of the trade deficit.

⁴⁴ Major commodity prices on international markets hit record lows for the past years at the end of 2015/beginning of 2016. Thereafter they tended to recover gradually, but their annual dynamics remained strongly negative in the first part of the year.

⁴⁵ The oversupply generated ever since 2014 H2 following the import restrictions imposed by Russia expanded as a result of the import ban being extended to Turkey as well starting January 2016.

⁴⁶ As a general rule, statistical data on economic growth are the provisional ones available at the time of the assessment underlying the monetary policy decision.

⁴⁷ In 2016 Q1.

Against this backdrop, the quarterly forecasts updated during 2016 H2 showed a lower-than-previously-anticipated path of the forecasted annual inflation rate over the short term, yet at least as divergent in nature as in the earlier projection rounds. Specifically, the annual inflation rate was seen remaining in negative territory until end-2016⁴⁸ and below the lower bound of the variation band of the flat target in 2017 H1, before climbing to the upper half of the band in 2018 and reaching levels comparable to those anticipated previously at the end of the projection horizon.

Apart from the base effects associated with indirect tax cuts, the upward trajectory of the forecasted annual inflation rate reflected primarily the stronger inflationary pressures anticipated to emerge over the projection horizon from the positive output gap and from unit wage costs, also amid the gradual labour market tightening under the influence of cyclical factors, compounded by structural rigidities. The prospects for a relatively wider opening of the positive output gap stemmed both from the faster-than-expected pick-up in economic growth in 2016 H1 and from the upward revision of the projected GDP dynamics for 2016 H2, as well as for 2017 and 2018. In addition to the gradual recovery in the euro area and global economies, the relative step-up in economic activity was expected to be underpinned by the recent/planned fiscal easing measures, hikes in wages for some categories of public sector employees and higher income in the form of social security benefits, as well as by the further accommodative real monetary conditions, conducive – also via the historically low interest rates during this period – to the consolidation of private sector credit and to higher liquidity in the economy (Box 6).

Box 6. Credit to the private sector and liquidity in the economy – developments and determinants

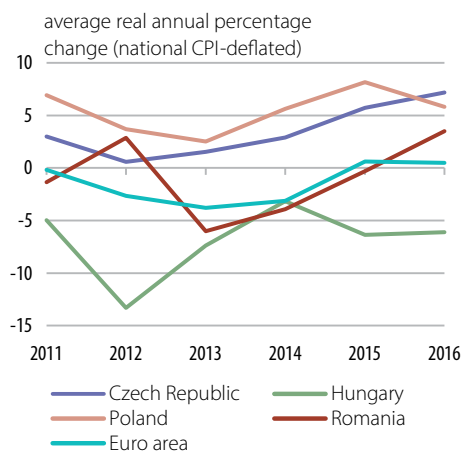
The major changes seen in 2015 in the dynamics and composition of private sector credit and liquidity in the economy – relevant in terms of monetary transmission – consolidated in 2016, spurring structural convergence with monetary developments in the euro area and other countries in the region. Specifically:

1. The average annual rate of change of credit to the private sector⁴⁹ re-entered positive territory for the first time in four years (3.5 percent against -0.3 percent in 2015 – Chart A).

The continued rebound in credit to the private sector was mainly driven by the further swift growth of new loans to households and, to a lower extent, by the advance in credit to non-financial corporations (Chart B). The ensuing effects on the stock of private sector credit were, however, partly offset by those related to the strong pick-up in net sales of non-performing loans. Against this background,

⁴⁸ Coming in at -0.4 percent in December. Recalculated net of the one-off impact of the standard VAT rate cut to 20 percent, the annual inflation rate was forecasted to end 2016 at 1.0 percent.

⁴⁹ For a clearer picture, changes in dynamics during this period were analysed, as a rule, in the form of indicators calculated as average real annual growth rates, an approach warranted primarily by the strong asymmetry of influences exerted by some of the key determinants, as well as by the presence of statistical effects stemming from the shifts in the annual inflation rate and/or exchange rate of the leu.



Source: NCBs, Eurostat

Chart A
Credit to the private sector

the real annual growth rate of private sector credit followed an unsteady path; in particular, it saw its upward trajectory come to a halt and witnessed, at the end of 2016 H1, a sizeable downward adjustment, before fluctuating around readings below those reached at end-2015. Moreover, the share of private sector credit in GDP continued to shrink in 2016 – a trend manifest in recent years in other countries of the region as well.

2. The prevailing share of the leu-denominated component in total credit to private sector consolidated.

The share of domestic currency credit continued to widen at a somewhat fast pace, comparable to that recorded a year earlier, hitting a post-1996 high of 57.2 percent

in December 2016. Behind these developments stood the relatively stronger divergence between the positive annual dynamics of leu-denominated loans (an annual average of 18.6 percent compared with 13.4 percent in 2015) and the negative rate of change of forex loans (-12.6 percent versus -10.9 percent in 2015, based on outstanding values expressed in euro), under the joint impact of: (i) the ongoing robust rise in the flow of domestic currency credit (Chart C); (ii) additional conversion of foreign currency loans (albeit of a lower magnitude than in the previous year), and (iii) the larger share of forex credit in total loan sales.

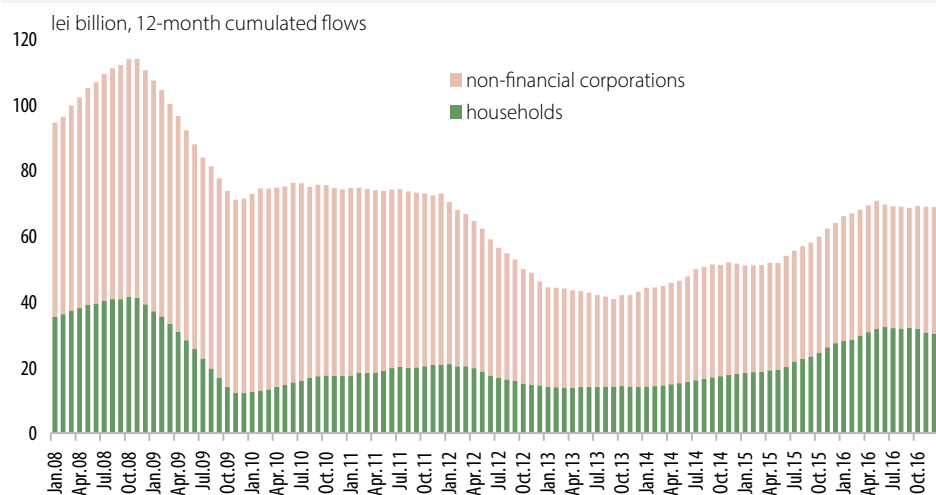
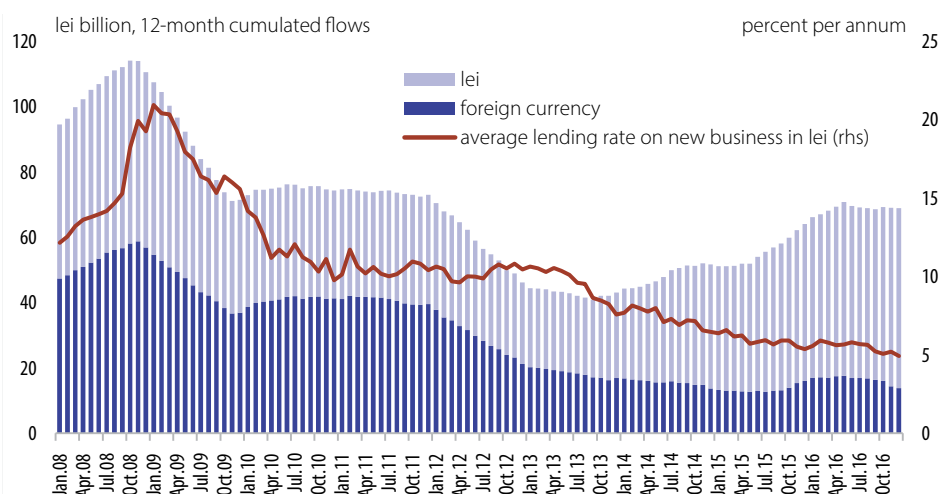


Chart B
New loans to households and non-financial corporations

The ongoing adjustment was underpinned both by the non-financial corporations sector and especially by households, with the share of leu-denominated loans in total household credit exceeding that of forex loans for the first time in nine years (58.5 percent at end-2016 from 48.7 percent in the same year-earlier period)⁵⁰, due both to the faster rise in new business in lei and to the advance in net sales of foreign currency loans.

⁵⁰ Domestic currency credit had last prevailed on this segment in October 2007.

Chart C
New loans to the private sector
in lei and foreign currency



3. The share of household credit became prevalent again for the first time since 2009, while also peaking at a historical high.

The upward path of this share steepened in 2016 (51.4 percent against 49.7 percent in December 2015), as a result of the faster-paced rise in the stock of household credit (7.1 percent on average in 2016 versus 3.2 percent a year earlier), particularly on account of the quick advance in the flow of loans. New consumer credit played the key role, its stronger performance in the first part of the year pointing to its partial use for covering the higher down-payment on housing loans. New loans for house purchase also continued to grow in annual terms, albeit at a slower pace, owing to the disruptions in implementing the “First Home” programme⁵¹, as well as to the effects of the Law on debt discharge.

At the same time, the average annual dynamics of credit to non-financial corporations stayed in negative territory (-1.4 percent versus -4.0 percent in 2015), given the step-up in corporate loan sales and the slower increase in the credit flow, amid: (i) these entities’ higher reluctance to take a loan⁵²; (ii) the possible continuation of the balance sheet adjustment process; as well as (iii) the persistence of a somewhat higher risk attributed by banks to some non-financial corporations, especially SMEs – which further recorded the highest NPL ratio. A relative recovery was visible as late as in the latter part of the year, also due to an improvement trend in companies’ confidence.

In terms of international comparisons, the share of household loans in private sector credit is higher than in the euro area and places Romania third in the region, after Poland and the Czech Republic.

⁵¹ The guarantee ceiling for loans under the “First Home” programme had initially been set at lei 1,600 million and was raised by lei 500 million in both May (via Government Decision No. 366/2016) and September 2016 (Government Decision No. 703/2016) and by lei 250 million in November (Government Decision No. 899/2016).

⁵² According to the *NBR Survey on the access to finance of non-financial corporations in Romania and their capacity to withstand adverse financial conditions*, the year under review saw a larger share of companies contemplating recourse primarily to internal sources for financing their daily activity, for investment or other projects.

4. The share of housing loans in total credit to households prevailed for the first time.

The further widening of this share – supportive of the catching-up process with the euro area and regional peers in terms of household credit composition – was mainly the effect of the ongoing “First Home” programme⁵³, in an environment marked by the unfavourable influences of the Law on debt discharge. Against this backdrop, the average annual growth rate of housing loans continued to

expand (17.6 percent from 13.8 percent in 2015), albeit at a slower pace – solely on account of the leu-denominated component⁵⁴ –, thus exceeding markedly that of consumer credit and other loans. In fact, the annual dynamics of consumer credit and other loans remained in negative territory during the year as a whole, the slower decline notwithstanding, the effect of the relatively faster rise in the annual flow of these loans being largely offset by the impact of NPL sales.

The consolidation of changes in the dynamics and composition of private sector credit reflected the favourable effects exerted on loan demand and supply by: (i) the continued decline in lending rates on new leu-denominated business to households and non-financial corporations, influenced by the NBR’s monetary policy measures, thus closing in on the corresponding interest rates on new loans in euro or even falling below them⁵⁵; (ii) faster increase in household income, especially in wages; (iii) further high private sector confidence⁵⁶ for the post-2008 period; (iv) the ongoing softer strain put on credit institutions’ balance sheets by non-performing loans (with the NPL ratio dropping from 13.5 percent to 9.6 percent), amid the larger volume of loan sales; (v) the continued decline in the loan-to-deposit ratio, which fell to an 11-year low of 80.3 percent at end-2016; (vi) the further uptrend in housing prices⁵⁷.

However, opposite influences continued to come, in 2016 as well, from the high level of indebtedness of some borrowers and the protracted adjustment of certain entities’ balance sheets, as well as from the further high risk that banks associated with some types of debtors. To these

Chart D
Demand for loans

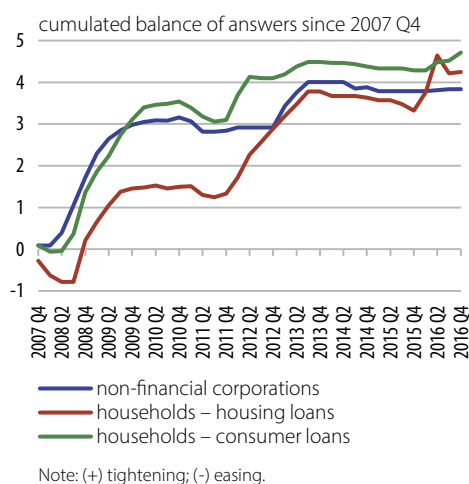
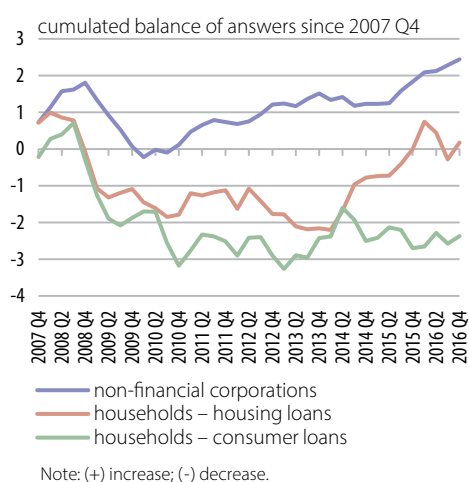


Chart E
Credit standards

⁵³ The total guarantee ceiling earmarked for this programme exceeded slightly the year-earlier reading.

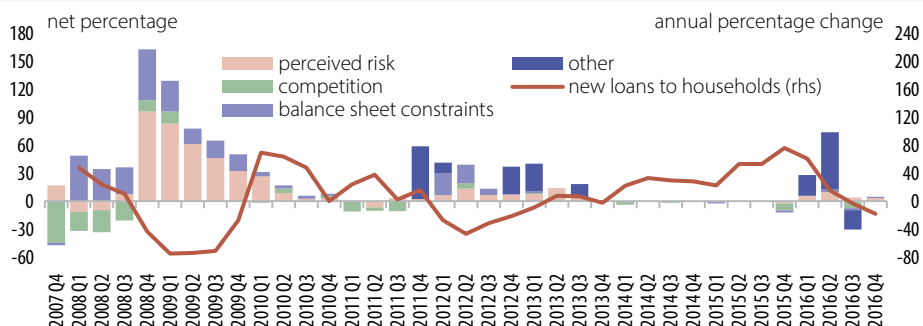
⁵⁴ Whose share in total housing loans tended to prevail, widening to 49.2 percent at end-2016 from 35.9 percent in December 2015.

⁵⁵ In the case of leu-denominated housing loans and large-value corporate loans.

⁵⁶ According to the successive DG ECFIN surveys.

⁵⁷ According to NIS data, the annual dynamics of housing prices peaked at a post-2008 high.

added the unfavourable effects of the Law on debt discharge and that on converting CHF-denominated loans into leu-denominated loans at the historical exchange rate⁵⁸.



*) quarterly flow – weighted averages

Note: Perceived risk includes expectations on the economic and financial standing, collateral risk, industry risk, expectations on the real estate market. Competition refers to competition among banks, non-banks or other sources of funding. Balance sheet constraints refer to the situation of the bank's capital, developments in non-performing loans, the NBR's monetary policy or prudential decisions.

Chart F

The drivers of changes in credit standards on household loans*

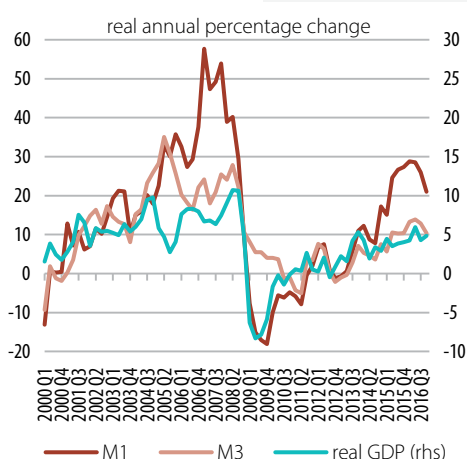
In this context, the successive issues of the *Bank Lending Survey* conducted by the NBR pointed to a quasi-steady rise in credit demand from non-financial corporations, as well as in the demand for consumer loans (Chart D); by contrast, demand for housing loans fluctuated, shrinking in Q2 and Q3, highly likely due to the adoption of the Law on debt discharge. The latter also prompted a considerable tightening of credit standards applicable to housing loans in the first two quarters of the year, which was partly reversed thereafter (Charts E and F); in turn, credit terms and conditions witnessed a temporary increase in restrictiveness, with credit institutions adjusting for a certain period the maximum loan-to-value requirement and, to a

lower extent, that on the maximum loan maturity. At the same time, credit standards remained broadly unchanged for loans to non-financial corporations, whereas those on consumer loans were slightly tightened in 2016 Q2 and Q4.

Looking at the economy-wide liquidity, the consolidation of some changes in dynamics/composition was also accompanied by shifts in direction of other changes. The main developments consisted in:

1. The degree of monetisation of the economy continued to increase, reaching 41.3 percent at end-2016 from 40.3 percent at end-2015.

The advance in this process – which had resumed in 2013 (Chart G) – was the result of the step-up in the annual growth rate of broad money (M3) to an average of 13.2 percent in 2016 (versus 8.5 percent



Source: NIS, NBR

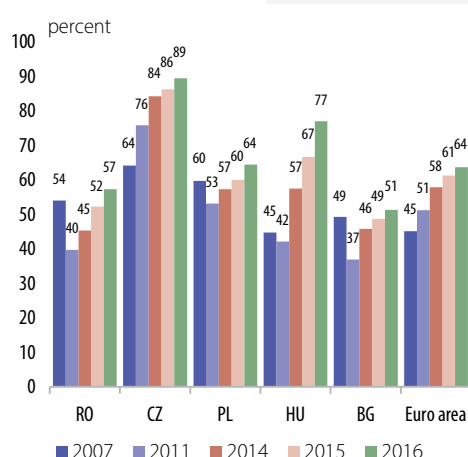
Chart G

Broad money and GDP

⁵⁸ The Constitutional Court ruled as unconstitutional some provisions of the Law on debt discharge as well as the Law on converting CHF-denominated loans into leu-denominated loans at the historical exchange rate (in October 2016 and February 2017 respectively).

a year earlier), *inter alia* amid the relative increase in EU fund inflows. Hence, from the perspective of broad money counterparts, monetary expansion was chiefly ascribable to banks' net foreign assets, as well as to private sector credit; contractionary effects, albeit of a lower magnitude, were exerted by the decline in net credit to the central public sector, reflecting the rise in central government deposits in foreign currency and the somewhat slower growth of credit institutions' government security holdings.

2. The majority share of narrow money (M1) in M3 consolidated.



Source: NCBs

Chart H
Share of M1 in M3,
international comparisons

The share of M1 in broad money remained on the uptrend witnessed over the past five years – similarly to the upward path seen in the euro area and other countries in the region, yet steeper (Chart H) –, peaking at a 22-year high of 57.3 percent at the end of the period under review. Behind this stood the pick-up in the growth rate of M1 (27.8 percent as annual average compared with 22.1 percent in 2015), mainly due to the faster dynamics of overnight deposits, corporate ones in particular, but also from households⁵⁹, with the latter's share in total ON deposits peaking at a six-year high of 44.3 percent; the rate of increase of currency in circulation also stepped up, although at a slacker pace, with the share of this component in M3 reaching record post-1996 highs⁶⁰. By contrast, the annual average rate of change of time deposits with a maturity of up to two years remained in negative territory (-0.3 percent from -1.7 percent in the previous year), owing solely to the declining dynamics of household deposits (-0.5 percent versus 0.4 percent in 2015).

The developments reflected, aside from the further lower opportunity cost of holding liquid monetary assets, the keener money demand for current transactions, in correlation with the pick-up in economic activity and especially with the faster growth of private consumption, spurred *inter alia* by the considerable rise in wage income.

3. The narrowing of the share of household deposits in total deposits of the non-bank sector came to a halt (59.6 percent compared with 57.9 percent at end- 2015).

The change occurred after three years of decline, amid the ongoing step-up in the pace of increase of household deposits to an annual average of 10.3 percent (from 7.7 percent in 2015). However, this growth momentum trailed behind that seen in 2015 and was almost exclusively brought about by developments on the overnight segment, hinting at a somewhat larger share of the extra income being earmarked for consumption, also in the period ahead, given the ongoing improvement trend in household expectations on their financial standing/employment prospects, to which added the low interest rates on time deposits.

⁵⁹ Household overnight deposits grew at an annual average rate of 36.6 percent against 26.4 percent in 2015.

⁶⁰ 17.6 percent (July, October and November).

Deposits from non-financial corporations witnessed a swifter advance (annual average pace of 16.0 percent versus 9.7 percent in 2015), which materialised however in a somewhat lower increase in volume. This most likely reflected higher inflows from EU funds, larger expenditures by households for purchases of goods and services, and relatively lower net repayments on companies' external loans; an opposite impact had the higher imports of goods and developments in profits – potentially affected by the rise in wage-related costs.

The latter part of the year also saw the considerable heightening of uncertainties and two-way risks associated with the medium-term inflation forecast, the most significant ones stemming from the fiscal and income policy prospects amid the still pending 2017 budget construction; their relevance was increased, on the one hand, by the budget execution January through September 2016 posting a deficit of merely 0.5 percent of GDP⁶¹ and, on the other hand, by the multitude and nature of fiscal measures initiated in the legislative area – referring to tax cuts, pay rises in the

budgetary sector, and higher income in the form of social security benefits –, whose materialisation was, however, uncertain. Equally relevant continued to be the uncertainty surrounding global economic growth and euro area recovery, in the context of the slow upturn in the major emerging economies, the issues facing the European banking system, and the outcome of the Brexit vote.

Against this background, in its meetings of June, August, September and November, the NBR Board decided to keep the monetary policy rate

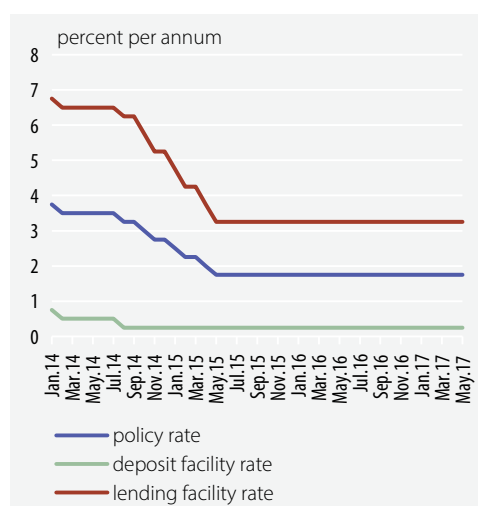


Chart 2.3
NBR rates

unchanged, to maintain the characteristics of the symmetrical corridor of interest rates on the central bank's standing facilities around the policy rate (Chart 2.3), as well as to preserve the existing level of the minimum reserve requirement ratio on leu-denominated liabilities of credit institutions and to pursue adequate liquidity management in the banking system. At the same time, the ongoing sizeable contraction in annual terms in foreign currency loans prompted the NBR Board to cut, in the September meeting, the minimum reserve requirement ratio on forex-denominated liabilities of credit institutions to 10 percent from 12 percent⁶²; the measure was aimed at continuing the harmonisation of the reserve requirement mechanism with the relevant standards and practices of the ECB and of the major central banks in the EU.

The NBR Board extended the status-quo of the monetary policy rate in its January 2017 meeting as well, given that recent developments in inflation and especially in economic growth had been below expectations, yet their implications on inflation

⁶¹ Compared with a targeted deficit of 2.8 percent for the entire year.

⁶² Starting with the 24 October – 23 November 2016 maintenance period.

prospects looked set to be relevant only in the near run. In particular, according to statistical data and the assessments carried out, the annual inflation rate had further slipped in November to -0.67 percent⁶³ – primarily due to the slower annual dynamics of tobacco product prices⁶⁴, as well as to the price cuts for compulsory motor third-party liability insurance policies –, standing slightly below the forecasted level. Data also pointed to a stronger-than-anticipated deceleration in third-quarter economic growth (to 4.4 percent year on year), but also to prospects for a slight step-up in GDP quarterly growth in 2016 Q4, implying only a mild slowdown – vis-à-vis the previous forecast – in the widening of the positive output gap over the short term. Under the circumstances, the new assessments reconfirmed the outlook for the annual inflation rate to re-enter positive territory in 2017 Q1, amid the fading out of the transitory effect of the standard VAT rate cut to 20 percent, although running lower than the levels projected in the medium-term forecast of November 2016. At the same time, the assessments revealed prevailing upside risks to this forecast, related to post-election developments during that period; however, fiscal and income policy prospects remained uncertain until the 2016 budget execution features were released and, more importantly, the 2017 budget construction became available.

3. Use of monetary policy instruments

During 2016, tailoring real broad monetary conditions for attaining the inflation target of 2.5 percent ± 1 percentage point over the medium term called for extending the status-quo of the parameters of the key policy instruments by the NBR. Nonetheless, the central bank continued the harmonisation of the reserve requirement mechanism with the relevant standards and practices of the ECB and other central banks in EU Member States, by lowering the minimum reserve requirement ratio on forex-denominated liabilities of credit institutions. The NBR's approach was warranted/underpinned by:

- (i) the ongoing improvement in monetary transmission, especially in the functioning of the credit channel⁶⁵ – amid the consolidation of domestic currency lending –, although disrupted temporarily by the uncertainty and risks stemming from the Law on debt discharge; nevertheless, the degree of financial intermediation declined due to the step-up in NPL sales;
- (ii) the rise in the structural liquidity surplus across the banking system, and hence in the positive value of credit institutions' net liquidity position, on account of the injections carried out by the Treasury from its leu- and foreign currency-denominated accounts at the NBR; however, the level of banks' excess reserves fluctuated during the year

⁶³ After having picked up to -0.43 percent in October (from -0.57 percent in September), in line with projections.

⁶⁴ Reflecting, *inter alia*, a base effect.

⁶⁵ Given the decline in lending rates on new business, the rise in income from wages and the relative improvement in household expectations on their future financial standing and employment prospects, the further narrowing of the NPL share, and the continued increase in property prices.

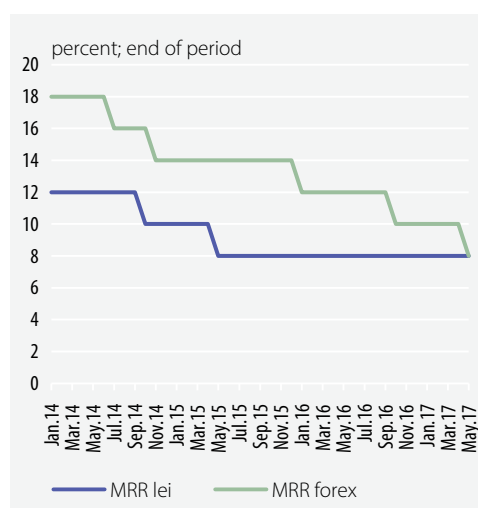
under review, influenced by the asymmetric pattern of budget execution⁶⁶ and by the characteristics of public debt financing/refinancing, as well as of the use of EU funds;

- (iii) the prevailing calmness on international financial markets – also amid the more accommodative monetary policy stance of the ECB and other EU central banks and the relative slowdown in the pace of Fed policy normalisation –, interrupted only by short-lived spikes in volatility, triggered by the temporary weakening of the Chinese economy, the Brexit vote, and later on by the outcome of the US elections;
- (iv) the continued sizeable decline in annual terms in foreign currency credit to the private sector and the low risk of a recovery thereof, due to: (a) the prudential measures previously taken by the NBR; (b) the narrowing of the interest rate differential between leu- and EUR-denominated new loans (or even the closing/reversal thereof for some types of loans); (c) the dampening effects exerted by the increasing awareness of risks associated with these loans; as well as (d) the carrying out of further forex loan conversions;
- (v) the ongoing improvement trend of indicators on international reserve adequacy, including of the coverage of the external debt service at residual maturity, given the larger inflows of EU funds and the MPF's new bond issues on the international financial market⁶⁷.

Against this backdrop, in addition to keeping the monetary policy rate unchanged at 1.75 percent, the central bank preserved the symmetrical corridor of interest rates on standing facilities around the policy rate at ± 1.5 percentage points. In correlation with current and prospective developments in the structural liquidity

surplus across the banking system, as well as with the manner of managing liquidity, the NBR also left unchanged the minimum reserve requirement ratio on leu-denominated liabilities of credit institutions at 8 percent. However, the central bank continued the harmonisation of the reserve requirement mechanism with the relevant standards and practices of the ECB and of the major central banks in the EU as regards the foreign currency component; specifically, given the persistent contraction in foreign currency credit, the consolidation of

Chart 2.4
MRR ratios



⁶⁶ The general government budget posted positive monthly balances in four months of 2016. In cumulated terms, the budget execution ended the first ten months of the year on a deficit of merely 0.2 percent of GDP, while generating a deficit of 2.4 percent of GDP at end-2016.

⁶⁷ The MPF tapped external markets in February, May and September, raising EUR 3.25 billion over maturities of 10, 12 and 20 years respectively.

forex reserves above the adequate level and their improved composition, the minimum reserve requirement ratio on forex-denominated liabilities of credit institutions was lowered to 10 percent from 12 percent⁶⁸ (Chart 2.4).

The central bank continued to assign a major role in tailoring real broad monetary conditions to the adequate liquidity management in the banking system. This approach, warranted *inter alia* by a relatively stable exchange rate of the leu, implied mopping up the net liquidity surplus in the banking sector throughout the year under review exclusively via the NBR's deposit facility – a beneficial approach in terms of consolidating the monetary transmission mechanism, domestic currency credit included, thereby strengthening the accommodative nature of real monetary conditions. The volume of mopped-up liquidity expanded significantly in 2016, amid the rise in reserve injections generated by autonomous factors, particularly by Treasury operations in lei and foreign currency; hence, during the reported year, the average balance of the deposit facility accounted for around 63 percent of the average level of banks' current account with the NBR and approximately 1.2 percent of GDP – almost double the year-earlier figures.

Against this background, overnight rates on the interbank money market stayed almost incessantly during 2016 in the vicinity of the NBR's deposit facility rate. At the same time, longer-term (3M-12M) ROBOR rates, relevant for setting lending rates on new business to non-bank customers, remained in the first two months of the year on the downtrend seen since end-2015, in the context of the significant loosening of liquidity conditions on account of Treasury injections. Afterwards they were quasi-stable⁶⁹, before re-embarking on a slightly downward path in the wake of the NBR releasing its medium-term inflation forecast in August, hitting new historical

lows⁷⁰ at end-Q3 and fluctuating around them for a short while (Chart 2.5). However, the behaviour of ROBOR rates tended to change towards the end of the year, when slightly upward shifts were brought about by the weaker-than-expected performance of excess liquidity in the banking system⁷¹, by the heightened volatility on international financial markets following the US presidential elections, and by the revision of credit institutions' outlook on very short-term interest rates in the interbank money market. Nevertheless, the average

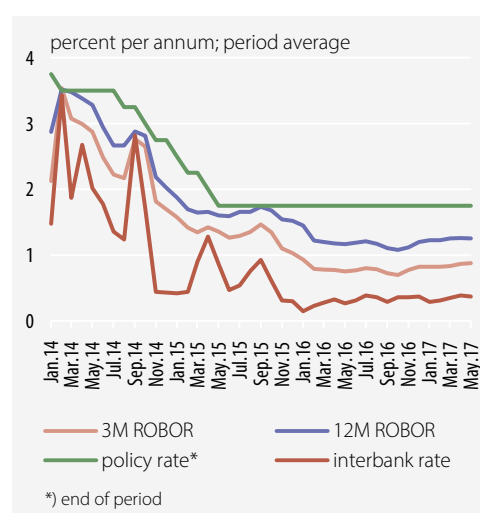


Chart 2.5
Policy rate and ROBOR rates

⁶⁸ The measure was taken in the September meeting of the NBR Board and became effective starting with the 24 October – 23 November 2016 maintenance period.

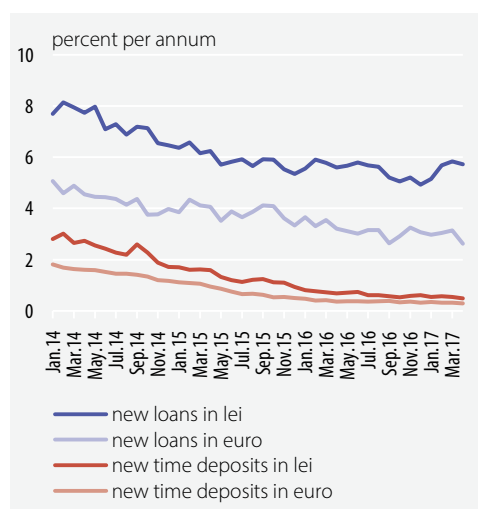
⁶⁹ The only fluctuation worth mentioning during this period was the temporary rise witnessed at end-June, amid tensions on international markets in response to the outcome of the UK referendum, largely corrected thereafter.

⁷⁰ Data series available since August 1995.

⁷¹ Larger-than-expected drop in banks' excess liquidity in November and its lower-than-anticipated rise towards year-end, both as a result of Treasury operations.

longer-term ROBOR rates recorded in December 2016 remained below the readings in the same year-earlier period⁷², ranging between 0.83 percent (3M ROBOR) and 1.20 percent (for the 12M rate).

Chart 2.6
Lending and deposit
rates on new business



These influences fed through to lending rates on new business to non-bank customers, which also dropped to new historical lows. Looking at non-financial corporations, the decline (-0.64 percentage points, to 3.72 percent) persisted until towards year-end, probably also as an effect of keener competition in the banking system (Chart 2.6). Behind this stood both major types of loans – i.e. up to and above EUR 1 million equivalent respectively – whose interest rates shed 0.62 percentage points (to 4.05 percent) and 0.67 percentage

points (to 3.3 percent) respectively; the former thus neared the upper bound of the values posted in other countries in the region, whereas the latter fell below it. The average lending rate on new business to households declined only marginally (to 6.57 percent), as the effect of the change in composition⁷³ partly offset that exerted by the drop in interest rates on both consumer credit (down 0.26 percentage points to 8.92 percent) and housing loans (down 0.31 percentage points to 3.52 percent). The level of these rates remained in the median range of values recorded regionally.

The yields on leu-denominated government securities posted mixed developments across the maturity spectrum. In particular, the yields at maturities of 6 to 12 months broadly replicated the performance of ROBOR rates at similar maturities, while the yields on 5 to 10-year bonds – which are more sensitive to the influence of global factors – witnessed uneven developments. Specifically, they resumed a downward path at the beginning of the year, in tandem with similar yields in the US and the euro area⁷⁴, before shifting higher in Q2, owing *inter alia* to domestic uncertainty surrounding the fiscal and income policy stance, as well as the Law on debt discharge. These yields posted an abrupt rise in the wake of the UK referendum, followed by a quick correction, the same as yields in developed markets. The decline continued at a fast pace July through August, under the influence of the improved global financial market sentiment due to the major central banks' more accommodative monetary policy stance/forward guidance on extending monetary stimulus. It was followed by an increase during 2016 Q4, largely correlated with the performance of similar yields in the US and the euro

⁷² With declines ranging between 0.20 and 0.33 percentage points.

⁷³ Following an increase in the share of new consumer credit.

⁷⁴ Prompted by heightened investor concerns over the global economic slowdown and, thereafter, by the additional easing of the ECB's monetary policy and by the Fed's cautious approach to monetary policy tightening.

area⁷⁵. A potential driver also consisted in the concerns about the legislative initiatives regarding the banking sector (in particular, the Law on the conversion into lei of CHF-denominated loans) and about the fiscal and wage measures adopted/discussed during that period. As a result of these developments, benchmark rates⁷⁶ on the secondary market for government securities at the 6-month, 12-month, 3-year, 5-year and 10-year maturities averaged out in December 2016 at 0.71 percent, 0.86 percent, 1.55 percent, 2.45 percent and 3.55 percent respectively, relatively close (for all maturities) to the levels seen in the year-earlier period.

4. Policy outlook

The monetary policy pursued by the NBR will remain firmly geared towards ensuring and preserving price stability over the medium term, in line with the flat inflation target of 2.5 percent ± 1 percentage point, thus marking the best contribution that it can make to sustainable economic growth. Over the medium to long horizon, monetary policy will further aim to bring down and consolidate the annual inflation rate at levels compatible with the ECB's quantitative definition of price stability.

From this perspective, ensuring an adequate monetary policy stance in the early months of 2017 entailed the extension of the status-quo of the monetary policy rate, as well as of the parameters of the key policy instruments. In particular, during its meetings held February through May 2017, the NBR Board kept unchanged both the monetary policy rate – at 1.75 percent – and the characteristics of the corridor of interest rates on the standing facilities⁷⁷. Moreover, the central bank further pursued adequate liquidity management in the banking system and maintained the existing level (8 percent) of the minimum reserve requirement ratio on leu-denominated liabilities of credit institutions. At the same time, the minimum reserve requirement ratio on forex-denominated liabilities of credit institutions was lowered by another 2 percentage points⁷⁸, the measure – aimed to continue the harmonisation of the reserve requirement mechanism with the relevant standards and practices of the ECB and the major central banks across the European Union – being warranted by the ongoing contraction in foreign currency credit, the consolidation of forex reserves above the adequate level and their improved composition.

The decisions were taken considering that the return of the annual inflation rate to positive territory in 2017 – amid the base effect associated with the standard VAT rate cut to 20 percent⁷⁹ – was at slightly lower-than-previously-anticipated levels⁸⁰, while

⁷⁵ Expectations on the future stance of monetary policy were reinforced in the context of the Fed policy meeting of 13-14 December 2016, where it was decided – as anticipated – on an interest rate hike, while the federal funds rate path forecasted by FOMC members was revised upwards.

⁷⁶ Bid/ask average.

⁷⁷ The width of the symmetrical corridor of interest rates on the central bank's standing facilities around the policy rate was maintained at ± 1.50 percentage points.

⁷⁸ To 8 percent from 10 percent starting with the 24 May – 23 June 2017 maintenance period.

⁷⁹ Largely offset, among others, by the impact of lowering the standard VAT rate to 19 percent and of removing the special excise duty on fuels as of 1 January 2017.

⁸⁰ The annual inflation rate climbed to 0.18 percent in March 2017, from -0.54 percent in December 2016.

the upward path of the forecasted annual inflation rate saw two successive downward revisions during the February and May rounds. The first of these adjustments – owing to the unexpected new disinflationary supply-side shocks manifest January through February⁸¹ – spanned only the short term, implying the postponement for 2017 Q4 of the return of the projected 12-month inflation rate into the variation band of the flat target⁸². Conversely, the second adjustment was almost entirely attributable to the weaker relationship between core inflation and the output gap. The opening of the positive output gap was, however, expected to be relatively wider than previously anticipated throughout the forecast horizon, given the faster-than-expected pick-up in economic growth in 2016 Q4⁸³, as well as the upward revision of the projected GDP dynamics for 2017 and 2018; moreover, rising inflationary pressures, or at least comparable to those in the previous forecast, were anticipated to stem from unit wage costs, prices of imports – against the backdrop of the likely increase in their volume –, as well as from the uptrend in short-term inflation expectations.

The main assumption underlying the outlook for the faster dynamics of economic activity was the relative strengthening of the pro-cyclical stance of the fiscal and income policies across the projection horizon⁸⁴; furthermore, the outlook implied an accommodative nature of real monetary conditions comparable to that in the earlier forecast and sturdier economic growth in the euro area/EU and globally. Under the circumstances, the forecasted trajectory of the annual inflation rate retained its strongly upward profile, with inflation seen climbing into the upper half of the variation band of target at mid-2018 H1 and then standing at 3.1 percent in December 2018 (compared with the previously-forecasted figure of 3.4 percent). At the end of the projection horizon (March 2019), the annual inflation rate was expected to come in at 3.4 percent, a similar level to that indicated in the previous medium-term forecast.

The inflation outlook was still marked by uncertainties and two-way risks. They stemmed primarily from the future fiscal and income policy stance and the likely composition of public spending, particularly in the context of the uncertainty regarding the new unified wage law and the possible corrective fiscal measures meant to ensure compliance of the fiscal deficit with the 3 percent-of-GDP reference value in 2017. The external environment also continued to pose two-way risks to the inflation forecast, given, on the one hand, the balancing trend of the risks to the outlook for economic growth and inflation in the euro area/EU and globally⁸⁵ and, on the other hand, the persistence of significant downside risks arising from the elections scheduled in the euro area, the Brexit talks, as well as from the economic policies implemented by the new US Administration.

⁸¹ The additional price reduction in compulsory motor third-party liability insurance policies in January and the scrapping of non-tax fees and charges.

⁸² According to the February forecast, the annual inflation rate was expected to reach 1.7 percent at end-2017 (2.1 percent in the November 2016 projection).

⁸³ To 4.8 percent year on year, against 4.3 percent in the previous quarter.

⁸⁴ The updated projections in February and May 2017 incorporated, alongside the measures laid down in the new Tax Code, the following: further pay rises across the budgetary sector (by 15 percent in the healthcare sector in December 2016, 15 percent in education in January 2017, and by 20 percent in local public administration in February 2017), the lei 200 increase in the gross minimum wage economy-wide starting February 2017, the scrapping of non-tax fees and charges, the hike in the minimum pension to lei 520 as of March 2017 and the raise in the pension point to lei 1,000 as of July 2017.

⁸⁵ Also amid the ongoing accommodative monetary policy stance, especially in developed countries, and the anticipated fiscal stimulus to the US economy.

Over the period ahead, the NBR will further gear monetary policy towards bringing the annual inflation rate back into line with the flat target and keeping it there over the medium term, in a manner supportive of economic growth.

Both in the short run and over the longer horizon, the calibration of parameters of the monetary policy tools, the NBR's policy rate level included, in the context of ensuring adequate real broad monetary conditions, will be mainly correlated with the intensity of inflationary pressures prospectively stemming from the positive output gap and with the behaviour of medium-term inflation expectations. A major role in the analyses underlying monetary policy decisions will continue to play the uncertainties and the configuration of the balance of risks associated with the medium-term inflation forecast, including the likelihood of materialisation thereof – particularly relevant at the current juncture being the uncertainty and the risks surrounding the outlook for the fiscal and income policy stance. In addition, the characteristics of the monetary policy transmission mechanism, especially of lending to the private sector and of the saving behaviour, will further be duly considered when policy decisions are taken.

Moreover, the NBR will resume/continue the normalisation/adjustment of the features of some components of the monetary policy operational framework, in correlation with the prevailing and/or anticipated macroeconomic developments, as well as with the specifics of the functioning of different financial market segments. This is meant to enhance the degree of harmonisation of these instruments with the relevant standards and practices of the ECB and of the major central banks in the EU Member States, and especially to consolidate the transmission of the policy rate signal and the monetary transmission overall. The latter is expected to be further underpinned by: (i) the narrow interest-rate differential between leu- and euro-denominated new loans; (ii) the influence of the NBR's prudential measures of 2011-2012⁸⁶ – conducive to a shift towards lending in domestic currency to the detriment of forex credit; as well as by (iii) the favourable effects on credit supply exerted by the improvement in bank asset quality. However, the sustainable consolidation of growth in private sector credit – also implying a probable halt in 2017 in the downward trajectory of its share in GDP⁸⁷ – and the ongoing improvement trend in its currency composition are further conditional on the private sector's confidence and expectations vis-à-vis the outlook for the domestic economy, as well as on the borrowing capacity of economic agents, non-financial corporations in particular. Looking at small- and medium-sized enterprises, equally essential are the legislative framework on corporate governance quality and the implementation mechanisms thereof, as well as the restructuring of economic agents that prove to be fundamentally viable, yet face temporary difficulties in relation to creditors.

Particularly important in terms of the monetary policy stance and implementation remain the characteristics of structural reforms and of EU fund absorption as well, given that a balanced macroeconomic policy mix and enhancing the growth potential of the economy are of the essence for fulfilling the medium-term price stability objective, thus paving the way for sustainable and lasting economic growth.

⁸⁶ With a view to capping the growth in forex loans to households and other non-financial entities.

⁸⁷ Amid the probable alleviation of the contractionary impact exerted on the stock of loans by the ongoing clean-up of credit institutions' balance sheets (via loan sales/write-offs).



Chapter 3

Financial stability

1. The NBR's role in implementing macroprudential framework

The National Bank of Romania, in its capacity as competent authority responsible for the supervision of credit institutions, has implemented capital buffers in the Romanian banking sector as of 1 January 2014. Pursuant to the legislation in force⁸⁸, credit institutions shall hold own funds high enough to cover, aside from the minimum capital requirements, the capital buffers imposed by the NBR consistent with the recommendation of the inter-institutional structure coordinating the macroprudential oversight of the national financial system, namely the capital conservation buffer, the countercyclical capital buffer, the systemic risk buffer and the buffer for other systemically important institutions (O-SII buffer). The National Committee for Financial Stability (NCFS)⁸⁹ fulfilled this role until the operationalisation of the National Committee for Macroprudential Oversight (NCMO)⁹⁰. Specifically, the NCFS had been empowered to adopt recommendations and advisory opinions during the transition period until the inter-institutional structure for coordinating the macroprudential oversight of the national financial system, i.e. the NCMO (in compliance with Article X of Government Emergency Ordinance No. 113/2013), became operational.

The macroprudential measures for 2017 with regard to capital buffers were decided in the NCFS ordinary meeting of 13 December 2016. Additionally, during the meeting, the NCFS took decisions on the reciprocation of macroprudential policy measures adopted by other EU Member States and made the materiality assessment of third countries for the Romanian banking sector in terms of recognising and setting countercyclical buffer rates in line with the ESRB Recommendation.

A. As concerns capital buffers, the NCFS recommended the National Bank of Romania to impose on credit institutions the following requirements:

- a) to keep the countercyclical capital buffer rate at 0 percent (a level that was implemented as of 1 January 2016); this recommendation took account of the fact that developments did not highlight significant pressure from private sector indebtedness, according to the data available at 30 June 2016.

⁸⁸ Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as approved, amended and supplemented by Law No. 227/2007.

⁸⁹ The NCFS was established on 31 July 2007 based on the Memorandum of Understanding for cooperation in the field of financial stability and financial crisis management signed by the Ministry of Economy and Finance, the National Bank of Romania, the National Securities Commission, the Insurance Supervisory Commission, the Private Pension System Supervisory Commission (the last three institutions were taken over by the Financial Supervisory Authority); in 2012, the Memorandum of Understanding was extended, being also signed by the Bank Deposit Guarantee Fund.

⁹⁰ The NCMO was established by Law No. 12/2017 on the macroprudential oversight of the national financial system, which was published in *Monitorul Oficial al României* on 17 March 2017.

The latest assessments (at 30 September 2016) showed that total indebtedness had risen further, exceeding the indicative threshold in the case of household lending, but remaining below the threshold overall. Therefore, on 10 March 2017, the NCFS recommended that the central bank should maintain the countercyclical capital buffer rate at 0 percent and closely monitor developments in household indebtedness;

- b) to implement a buffer of 1 percent of the total risk exposure amount for all credit institutions identified as systemically important based on data available as at 30 June 2016: Banca Comercială Română S.A., BRD – Groupe Société Générale S.A., UniCredit Bank S.A., Raiffeisen Bank S.A., Alpha Bank România S.A., Bancpost S.A., Piraeus Bank S.A., Banca Transilvania S.A., CEC Bank S.A., Garanti Bank S.A., and OTP Bank S.A. As compared with the 2015 assessment, the group of systemically important banks grew larger, after adding two more entities, i.e. Piraeus Bank and OTP Bank, as of 1 March 2017. The buffer relating to systemically important institutions has been applied since 1 January 2016;
- c) to deactivate the systemic risk buffer established to ensure protection against risks that could have been posed by parent banks registered in a country with low investment rating (non-investment grade). Taking into account the mitigation of risks for which this buffer had been established (also due to the fact that some credit institutions with parent banks in such countries were required to implement an additional buffer of a different kind), the NCSF recommended the National Bank of Romania to deactivate the systemic risk buffer (set at 1 percent) as of 1 March 2017.

B. Regarding the reciprocity for macroprudential measures adopted by other EU Member States, the following decisions were formulated:

- a) it is not necessary to reciprocate the macroprudential policy measure adopted by Estonia (Recommendation ESRB/2016/4), given that credit institutions in Romania have non-material exposures to this jurisdiction. The macroprudential measure implemented by Estonia consists in a 1 percent systemic risk buffer rate applied to the domestic exposures of all credit institutions authorised in Estonia;
- b) to postpone a decision on the voluntary reciprocation of the macroprudential policy measure adopted by Belgium (Recommendation ESRB/2016/3) until after the Law on the macroprudential oversight of the national financial system has been adopted and the NCMO has become operational. Belgium adopted a macroprudential measure consisting of a 5 percentage point increase in the risk weights applied to the Belgian mortgage loan exposures of credit institutions using the internal-ratings based approach for determining capital requirements for credit risk. The postponement was warranted by the fact that: (i) in December 2016, there was no designated authority in Romania for the purposes of Article 458 of Regulation (EU) No 575/2013 (CRR) and (ii) the voluntary recognition of this measure may be carried out solely pursuant to Article 458 of the CRR.

C. Pursuant to the Recommendation on recognising and setting countercyclical buffer rates for exposures to third countries (ESRB/2015/1), the NCFS defined the methodology for identifying the material third countries⁹¹ for the Romanian banking sector. In order to achieve harmonisation with the EU methodology, the local methodology is based on the ESRB procedure, being supplemented with additional indicators to ensure the robustness of results. The NBR's assessments did not identify any material third countries in terms of recognising countercyclical buffer rates for the Romanian banking sector, but more thorough assessments will be made once new, more in-depth statistical data are available.

The National Bank of Romania has implemented all the NCFS recommendations on capital buffers. Furthermore, the NBR regularly assesses credit institutions' exposures to EU Member States and third countries and will recommend the measures to be imposed where such exposures become material.

Law No. 12/2017 on the macroprudential oversight of the national financial system was published on 17 March 2017 in *Monitorul Oficial al României*, Part I, providing for the establishment of the National Committee for Macroprudential Oversight (NCMO) as an inter-institutional structure, without legal personality, for coordinating the macroprudential oversight at national level by setting the macroprudential policy and the appropriate instruments for its implementation. The NCMO comprises the authorities that play an important part in ensuring financial stability in Romania, namely the National Bank of Romania, the Financial Supervisory Authority (FSA) and the Government of Romania. The NCMO may issue warnings and recommendations (soft law), which are based on an "act or explain" mechanism and addressed to the NBR or the FSA, in their capacity as national authorities responsible for sectoral financial oversight.

According to the law, the NCMO is: (i) a macroprudential authority within the meaning of the Recommendation on the macro-prudential mandate of national authorities (ESRB/2011/3); (ii) a designated authority according to the capital buffer provisions of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV) and (iii) a designated authority pursuant to Article 458 of Regulation (EU) No 575/2013.

The NBR ensures the NCMO Secretariat and participates in the NCMO General Board with 3 out of its 9 Board members, the NBR Governor being also the Chairman of the NCMO. Additionally, the NBR plays a leading role in the macroprudential oversight of the national financial system, due to its contribution in its capacity as supervisory authority for the banking sector.

⁹¹ According to the ESRB, material third countries are third countries to which the banking sector has material exposures.

2. Main assessments on financial stability

Financial stability remained solid in 2016. Risks to the stability of the financial system subsided in the latter half of 2016, yet continuing to be significant. The risk of fast deterioration in investor sentiment in emerging economies has remained the most important risk factor, as an abrupt shift in sentiment could put pressure on financial system stability in Romania. On the domestic front, the risk of an unpredictable legislative framework abated after the Constitutional Court's rulings in 2016 Q4 and early 2017 concerning two of the legislative initiatives with implications on the banking sector. In addition, the banking sector continued to strengthen and the non-performing loan ratio remained on a downward trend. Moreover, no public funds were used for the capitalisation of credit institutions. On the whole, the local banking sector is able to withstand headwinds, with the key prudential indicators posting adequate levels.

2.1. Indebtedness of non-financial corporations and households

Corporate and household debt⁹² owed to financial institutions decreased marginally in 2016 to EUR 69.2 billion (Chart 3.1). The decline in private external debt, together

with a contraction in foreign-currency denominated loans from local sources, entailed lower corporate risks arising from foreign financing (specifically, the risk of withdrawal of funds and the currency risk). However, the decline in external debt owed to non-resident financial institutions cannot be ascribed to non-financial corporations' deleveraging efforts, but rather to a substitution effect, with foreign debt being replaced with loans taken either from the non-financial sector (i.e. parent companies or trading partners) or from local banks.

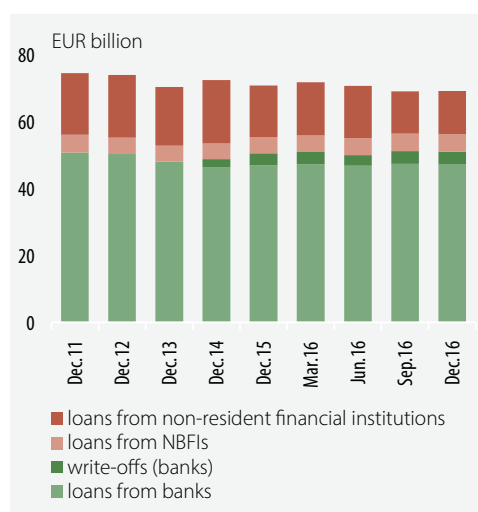


Chart 3.1

Total corporate and household debt by creditor

Indebtedness continued to post divergent developments across sectors. Total debt of non-financial corporations fell by 6.9 percent in 2016, while total household debt posted positive dynamics (2.3 percent⁹³). As for the loans granted by local banks, mention should be made that the business model of the banks has further targeted mainly households, despite non-financial corporations' sustainable borrowing potential. The low dynamics of corporate lending owed to both supply- and demand-side factors. On the supply side, measures at banking sector level may be considered, also by improving the training of employees involved in granting loans and managing risks. By contrast, on the demand side, companies must focus more

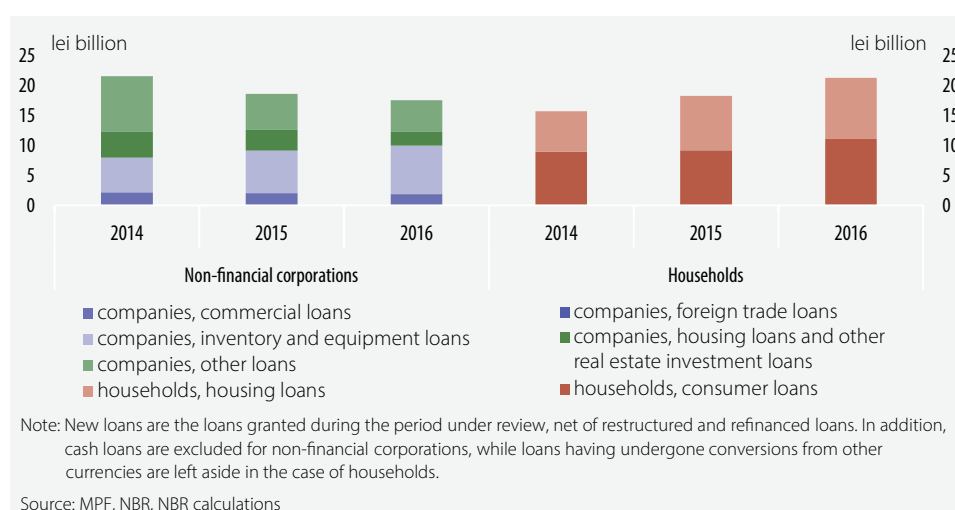
⁹² Total debt covers loans taken from resident or non-resident banks and NBFIs, including loans written-off by banks.

⁹³ The lending dynamics are calculated taking into account the exchange rate effect by adjusting the nominal stock of foreign currency-denominated loans for exchange rate changes.

on improving their financial management, on making appropriate use of working capital (and therefore involving other financing sources in carrying out investments), on appropriately selecting and sizing investment projects, as well as on effectively managing firm's liquidities.

The borrowing potential of non-financial corporations and SMEs, in particular, is significant. An assessment of financial results recorded over the latest business cycle points to 12,200 small and medium-sized enterprises that can be deemed economically viable, namely they further ranked among the best-performing companies economy-wide in at least 7 of the past 9 years. Among these companies, more than 6,600 SMEs report a debt-to-equity ratio below 1 and can service a significant loan volume (lei 36.3 billion in December 2015). By economic activity, this borrowing potential comes from sectors such as industry (27.8 percent), trade (25.5 percent) and services and utilities (20.4 percent). Given the quite restrictive conditions for identifying performing companies, the sustainable borrowing potential of companies may be higher than that estimated.

Chart 3.2
New loans to non-financial corporations and households by purpose



Nevertheless, in 2016, local banks channelled new loans mainly to households⁹⁴ (Chart 3.2). Specifically, in the course of 2016, roughly 55 percent of new loans extended to the non-financial private sector went to households, their value rising by 17 percent compared to the previous year, while loans to non-financial corporations remained on a downward trend (-5 percent versus 2015). New corporate loans accounted for less than half of the new loans granted in the peak period of the previous credit cycle, while new household loans amounted to roughly 60 percent of the level recorded during the expansion phase of lending. The further strong upward trend in household loans, along with the rise in individuals' level of indebtedness, amid historically low interest rates, may lead to heightening vulnerabilities in the banking sector, with significant negative effects on financial stability and economic growth over the medium term. These developments call for a recalibration of macroprudential tools at borrower level (such as caps on debt

⁹⁴ Based on the information provided by the Central Credit Register.

service-to-income and loan-to-value ratios). Such measures ensure that the level of indebtedness remains within manageable limits, even in the context of adverse developments in interest rate or income.

Non-financial corporations further recorded positive developments in profitability, liquidity and solvency ratios in 2016 H1, reflecting the favourable economic conditions. Nevertheless, the structural analysis shows considerable asymmetries. A significant share of companies reported negative net results (32 percent), with a quarter of these companies incurring losses for the third year in a row (according to the semi-annual financial statements). In addition, the analysis of the level of indebtedness reveals two distinct categories of SMEs: (i) companies that do not access external sources of financing (the debt-to-equity ratio is below 1) and (ii) over-indebted companies (the debt-to-equity ratio is well above 2, representing an alert threshold for credit risk). Another important characteristic of the non-financial corporations sector is the high degree of concentration of performance (the first 100 companies in terms of net profit accounted for 42 percent of total), while companies' involvement in high-tech and knowledge-intensive activities can be enhanced. Other challenges facing the corporate sector in the period ahead stem from pressures on wage costs and from the availability of labour force.

Insolvency continued to abate in 2016 (particularly as regards the number of newly-insolvent firms), playing, however, a significant part in both the deterioration of payment discipline in relation to trading partners and the losses incurred by the banking sector. These companies generated approximately 44 percent of non-performing loans in local banks' portfolios in December 2016 and 72 percent of total loans past due for more than 90 days.

Non-financial corporations' debt servicing capacity to local banks continued to improve in 2016, the dynamics reflecting both the sector's positive financial results

and the loan stock adjustments following the measures taken by credit institutions to resolve their non-performing exposures. The NPL ratio stood at 19.3 percent in December 2016, down from 26.2 percent at end-2015 (Chart 3.3).

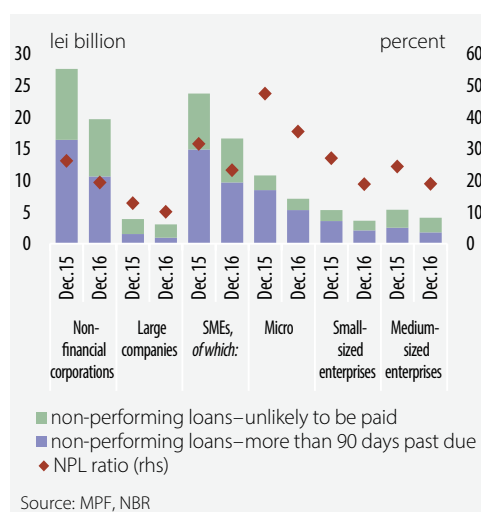


Chart 3.3
Non-performing loan ratio
by company size

The persistent structural vulnerabilities such as (i) the large number of firms with a net worth below the minimum required level; (ii) high level of indebtedness of certain segments and (iii) divergent results of companies call for close monitoring of the risks posed by firms to the local banking

sector. In 2015, the equity of 275.5 thousand firms (45 percent of total) was lower than 50 percent of the share capital, thus standing below the threshold set forth by

Law No. 31/1990 on commercial companies⁹⁵. Most of these, i.e. 268.7 thousand, are firms with negative equity. A significant share of firms with negative equity at end-2015 (75 percent) were in this situation in 3 out of the past 5 years. The persistence of this issue is also revealed by the fact that nearly half of the firms with negative equity in 2015 (48.5 percent) were in this circumstance in each of the past 5 years. This indicates that the sector has been facing a chronic problem and the developments in the liability structure of firms are not sustainable. This evolution cannot be solely accounted for by challenges encountered during economic recession, as the resumption of economic growth did not come with a solution to this problem or even help reduce its magnitude.

A large number of undercapitalised companies is a vulnerability in the context in which these entities can pass through the difficulties they are facing to both credit institutions and other trading partners. These companies are constantly responsible for a significant share of banks' non-performing loans and the overdue payments to other economic agents. In addition, the materialisation of a potential adverse economic scenario will substantially reduce the survival chances of these firms, given their precarious situation.

These aspects, along with the forecasted macroeconomic developments and financial conditions, contribute to a prudent assessment of future default rate dynamics. Specifically, the probability of default estimated⁹⁶ at end-2016 on a 12-month horizon reveals a notable increase in the default rate up to 4.9 percent as compared with 3.6 percent in 2016.

Developments in households' balance sheets point to a strengthening of their favourable position recorded in 2015, amid the positive dynamics of the disposable income. Bank savings followed an upward trend concurrently with a higher degree of diversification of financial assets. In this context, households' net creditor position vis-à-vis the financial system strengthened, amounting to lei 42.9 billion in December 2016. Moreover, the non-performing loan ratio for household loans declined further to reach 7.1 percent in December 2016 versus 9.1 percent in the same year-ago period. This was also due to banks' keener efforts to come up with loan restructuring solutions for borrowers facing difficulties in servicing debt.

Microeconomic analysis shows the persistence of vulnerabilities related to the asymmetry of borrowers' level of indebtedness, which may heighten risks stemming from the current low interest rate environment. Specifically, microeconomic data show that, over the past years, the indebtedness level of debtors has been on a rise, the median debt service-to-income ratio (DSTI) reaching 30 percent in 2016. DSTI was higher particularly in the case of borrowers who took new loans (Chart 3.4), for both housing loans (up to 46 percent) and consumer loans (up to 33 percent) in 2016.

⁹⁵ Pursuant to Art. 153²⁴ and Art. 228 of the law.

⁹⁶ The probability of default was calculated on a 12-month horizon for companies with outstanding bank loans reporting no payments overdue for more than 90 days over the last 12 months. The individual probability of default (PD) is calibrated by using the annual default rate (the percentage of newly-defaulted companies in the last 12 months).

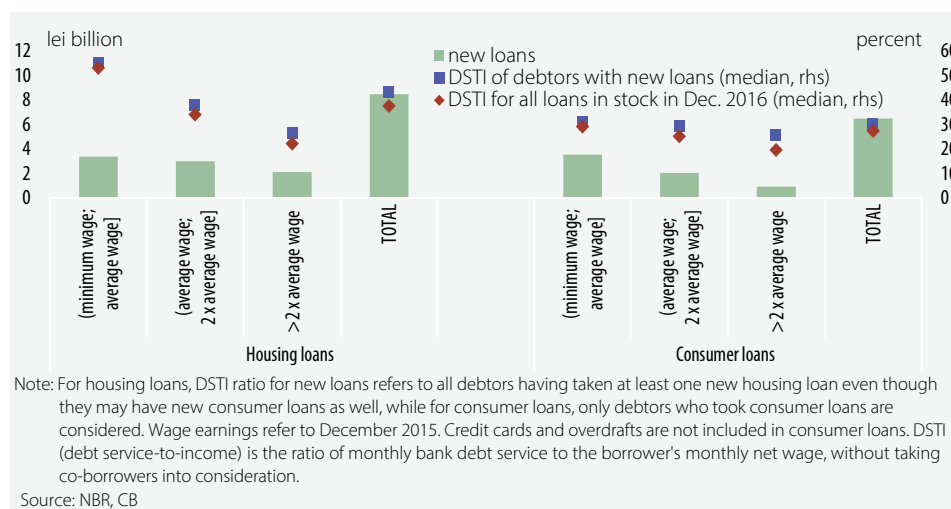


Chart 3.4
Level of indebtedness by loan
type and net monthly wage
(December 2016)

By income, the level of indebtedness of individuals earning below-average net wages remains higher than that for the household sector, and the asymmetry is stronger for housing loan borrowers. Moreover, in the latter case, debtors took loans worth, on average, more than the housing loans taken in 2015 and 2014, in the context of keeping the median maturity high (about 30 years). Against this background, the NBR, by assuming the macroprudential objective of reducing and preventing excessive credit growth and leverage, committed to regularly monitor the need to recalibrate the macroprudential instruments related to risks pertaining to households' borrowing capacity, including those arising from a potential interest rate hike.

2.2. Banking sector

The banking sector is experiencing good times, as shown by the higher-than-minimum-required bank prudential indicators, the decline in the vulnerabilities associated with the balance sheet structure, the gradual improvement in asset quality, the rise in operating profit and the tendency to keep impairment charges at levels significantly lower than those recorded, on average, since the financial crisis broke out. The brighter macroeconomic picture, as well as the resolution efforts targeting the reduction of non-performing loan stock contributed to the improvement in credit institutions' asset quality.

In 2016, the local banking sector continued to consolidate the structural stability of the aggregate balance sheet by: (i) strengthening the local deposit base, particularly the deposits of households; (ii) resolving a large part of the volume of non-performing loans; and (iii) maintaining the high dynamics of leu-denominated loans. In this context, the main vulnerabilities stemming from the adjustment in foreign funding and the credit risk pertaining to foreign currency-denominated loans do no longer generate significant risks from a macroprudential perspective.

The current business model of banks – focused on asset financing by taking deposits from the residents and on granting mostly retail loans (particularly denominated in lei), as well as on the concentration of sovereign exposures and loans secured by real estate – is likely to continue in the near future. The main challenges to this business

model are: (i) enlarging the customer base by including non-financial corporations from sectors featuring sustainable growth and innovative high technology; (ii) close monitoring of the risks associated with a possible interest rate increase, considering the significant share of fixed-interest bearing assets (including government securities) in the balance sheet; (iii) the potential effects of implementing the new accounting standard IFRS 9 and of the amendments expected to be made in the European regulatory framework for capital requirements.

Bank assets (gross) totalled lei 428.9 billion at end-December 2016, standing 2.9 percent higher than a year earlier, in the context of the substantial growth of the local deposit base, the ongoing orderly reduction in foreign financing from parent banks and the non-performing loan resolution.

	percent of total assets						
	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014	Dec. 2015	Dec. 2016
Domestic assets, of which:	96.8	97.7	97.2	97.0	95.3	95.2	94.4
Claims on the NBR and credit institutions, of which:	16.5	15.3	13.4	14.9	13.1	12.6	12.1
Claims on the NBR	14.2	13.7	11.9	12.9	11.6	11.6	10.6
Claims on the domestic non-bank sector, of which:	70.1	74.5	75.2	73.2	73.2	73.6	73.1
Claims on the government sector	15.7	17.7	19.5	19.7	21.1	21.5	21.7
Claims on companies	27.9	30.3	30.0	28.2	26.9	26.3	25.0
Claims on households	26.5	26.5	25.8	25.3	25.2	25.9	26.4
Other assets	10.3	7.9	8.6	9.0	9.0	9.0	9.3
Foreign assets	3.2	2.3	2.8	3.0	4.7	4.8	5.6

	percent of total liabilities						
	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014	Dec. 2015	Dec. 2016
Domestic liabilities, of which:	73.2	73.5	76.8	79.5	82.3	84.5	88.3
Interbank deposits	3.4	3.4	4.6	2.3	1.5	0.9	1.5
Government sector deposits	1.7	1.4	1.3	1.3	1.5	1.6	2.6
Corporate deposits	19.0	19.0	18.5	21.0	23.5	25.6	25.8
Household deposits	27.0	28.7	30.2	31.7	34.1	35.2	38.1
Capital and reserves	14.2	16.2	18.0	19.4	18.0	17.4	15.7
Other liabilities	7.9	4.8	4.2	3.8	3.8	3.9	4.5
Foreign liabilities	26.8	26.5	23.2	20.5	17.7	15.5	11.7

Note: Totals may not add up due to rounding.

Source: NBR – Monetary balance sheet of credit institutions

Table 3.1
Balance sheet composition
of credit institutions
operating in Romania

The balance sheet composition (Table 3.1) shows the strengthening of trends identified in 2015:

- (i) loans to the private sector prevail in the balance sheet of credit institutions; the most important of these loans are domestic currency exposures to the retail segment;
- (ii) the share of exposures to the central government rose further; the credit risk associated with such exposures is low, given that the public debt-to-GDP ratio is moderate and the average duration of domestic debt is short;

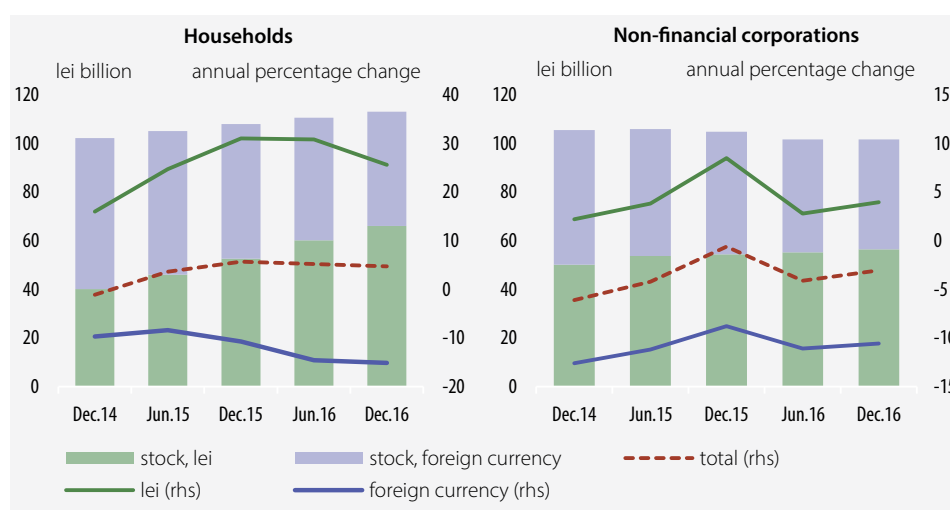
- (iii) the share of claims on the central bank in total assets is significant, i.e. 10.6 percent in December 2016, yet on a strongly downward trend over the past years, against the backdrop of diminishing foreign currency-denominated deposits taken from non-residents and lower minimum reserve requirement ratio⁹⁷, also amid the continued harmonisation of the required reserve mechanism with the standards and practices of the ECB and of the major central banks in EU Member States;
- (iv) foreign assets further hold a small share (5.6 percent of total assets in December 2016), following however a steeper uptrend over the past three years. Among these, deposits with maturities of up to 1 year, held with euro area credit institutions, are prevalent. Sovereign risk exposure related to securities issued by euro area governments is limited;
- (v) deposits from the private sector increased significantly as a share in total liabilities (reaching a historical high of 64 percent in December 2016), mainly on account of domestic currency-denominated funds raised from households;
- (vi) foreign financing continued to decline in an orderly manner (down by 11.7 percent in total liabilities in December 2016), insofar as the maturing loans were no longer renewed. The contraction was visible across the entire maturity spectrum.

Bank lending to the real economy remained modest in terms of current liquidity in the banking sector, the substantial capital reserves and the favourable macroeconomic conditions. The loan stock dynamics were broadly influenced by the non-performing loan resolution (initiated in April 2014 at the recommendation of the NBR) and, in the first part of 2016, by the legislative measures concerning debtors (individuals), which caused a temporary contraction of loan supply. The Constitutional Court's ruling in 2016 Q4 with regard to the constitutionality of the new legal provisions set forth in Law No. 77/2016 on the discharge of debt obligations assumed through credit agreements and the Law supplementing the Government Emergency Ordinance No. 50/2010 on credit agreements for consumers contributed to restoring lending conditions to levels similar to those recorded in the period preceding these initiatives.

Leu-denominated loans further posted high nominal growth rates (14.3 percent, December 2016), household loans in particular, due to robust demand (Chart 3.5). Foreign currency loans continued to report a negative rate of change (-12.2 percent in December 2016 versus -9.9 percent in December 2015), their stock hitting a 9-year low. The evolution was visible for exposures to both non-financial corporations and households. Behind the contraction in foreign currency-denominated loans stood: (i) the macroprudential measures for foreign currency lending; (ii) the stronger growth of leu-denominated deposits; and (iii) the decline in the costs of leu-denominated loans as compared with those of foreign currency loans. Against this background, the share of leu-denominated loans to the private sector expanded further, reaching a 20-year high of 57.2 percent in December 2016.

⁹⁷ In 2016, the NBR cut the minimum reserve requirement ratio on foreign currency-denominated liabilities on two occasions, i.e. in January (from 14 percent to 12 percent) and in October (from 12 percent to 10 percent), also amid a slowdown in foreign currency-denominated lending.

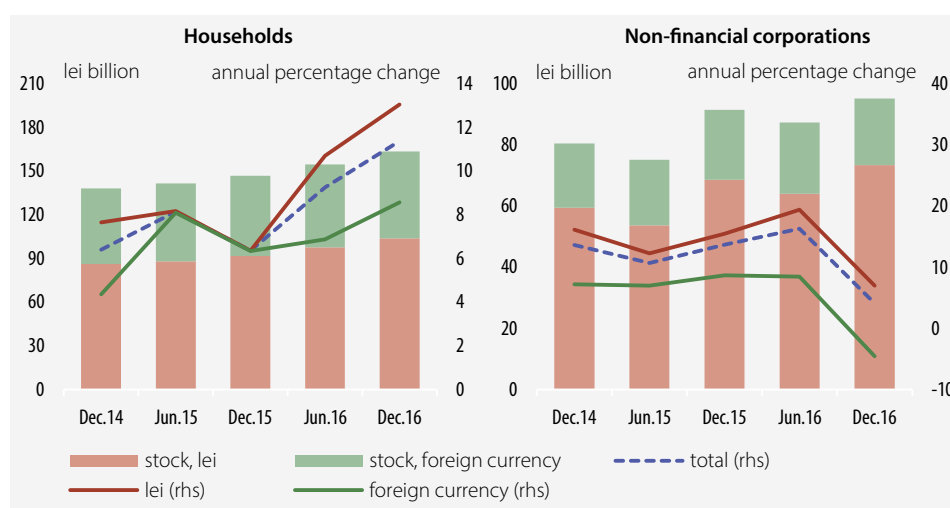
Chart 3.5
Loans to the private sector



From the perspective of institutional sectors, the growth pace of loans to households slowed down towards year-end (4.7 percent in December 2016 versus 5.7 percent in December 2015), given that the stock of consumer credit and other loans contracted further (-2.5 percent in December 2016 versus -2.6 percent in December 2015), while the dynamics of mortgage loans kept decelerating, as a result of the enforcement of Law No. 77/2016 (12.5 percent in December 2016 as compared with 16.5 percent in December 2015).

Corporate lending remained low (-3.0 percent in December 2016), despite the fall in interest rates on new loans to all-time lows. These developments caused the widening of the differential between the shares of credit institutions' exposures by main category of borrowers in favour of households (51.4 percent in December 2016) for the first time since 2009.

Chart 3.6
Deposits from the private sector



Residents' deposits consolidated their role as the main source of funding for the banking sector and continued to support, at all-time low costs, the repayment of loans from parent banks, while adequate liquidity levels were preserved. The positive annual dynamics of these deposits were visible for all components (Chart 3.6), except

the foreign currency-denominated deposits of non-financial corporations. By institutional sector, households further had the largest contribution (80 percent) to the significant rise in private sector deposits in 2016. The latter's stock totalled lei 274.3 billion at end-2016, standing lei 20.8 billion higher than the level recorded in 2015, which is the equivalent of an 8.2 percent increase.

This feature provides good stability to the composition of deposits, given the overall precautionary purpose of these placements. By currency, the major contribution to deposit growth (82 percent) came from leu-denominated deposits.

The correlated analysis of loans and deposits shows that the foreign currency position turned to balance in the case of exposures to households and moderated visibly for exposures to non-financial corporations. In this context, the loan-to-deposit ratio for the private sector stayed on the downtrend that had begun in 2012, reaching 66.8 percent for the leu-denominated component in December 2016 (64.3 percent, December 2015) and 109.7 percent (as compared with 130.6 percent in December 2015) for the foreign currency component, according to monetary statistics. The indicator improvement is in line with regional developments. The continuation of this trend could prove counterproductive in the medium run for the business model of banks.

While posting a pick-up in 2016, the deleveraging undertaken by parent banks carried on in an orderly manner and is in line with regional developments. The withdrawals made by parent banks were fully offset by resources raised from the domestic market, thus mitigating contagion risk. Despite this positive aspect, the replacement of these mostly medium- and long-term funding sources with local resources having mainly maturities of up to 1 year could contribute to the increase in certain vulnerabilities

to financial stability. A solution to prevent this from occurring would be the development of the domestic capital market, also by issuing debt instruments.

At end-2016, total capital ratio at system level was 19.7 percent, while Tier 1 capital ratio stood at 17.5 percent, which placed the Romanian banking sector in a low risk bucket, as defined by the European Banking Authority (EBA). Moreover, total capital ratio is close to the EU average (18.5 percent in December 2016, Chart 3.7).

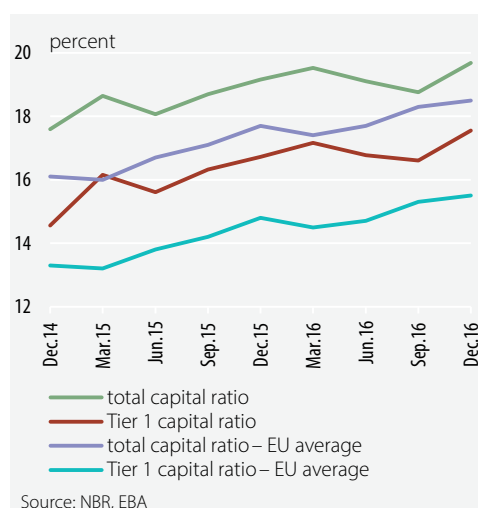


Chart 3.7

Capital adequacy indicators in Romania and the EU (average)

The high loss absorption capacity of banks in Romania stems also from the structure of own funds, which are primarily made up of Common Equity Tier 1 capital. Credit risk contributes most to total capital requirements (81.3 percent), operational risk takes around 15 percent of total requirements and market risk generates moderate requirements (3.5 percent). The leverage ratio was 8.9 percent at end-2016, thus

confirming the high level of capital held by credit institutions in relation to the balance sheet size and the traditional business model of banks, focused on lending (retail loans, in particular).

At individual level, the asymmetry of the total capital ratio grew over the past years. Most banks hold capital in excess of the overall capital requirement⁹⁸, with a median value of 6.7 percentage points in December 2016.

The positive impact of the gradual phasing-out of the prudential filters deducted from own funds on the capital adequacy waned as a result of the significant reduction in the volume of non-performing loans (which affected own funds by nearly 3 percent in December 2016) and will fade out from 2018 onward. Prudential filters, which had been introduced in 2012 in order to reflect a prudent level of own funds following the IFRS adoption, adjusted capital for the difference between the volume of prudential valuation adjustments (the former RAS provisions) and the loan impairment charges (IFRS). Prudential filters have been gradually phased-out in the period from 2014 to 2018, following the adoption of the transitory provisions of the CRD IV/CRR regulatory framework.

In 2016, banking sector liquidity remained at an adequate level, as shown by stress testing results and the relevant liquidity indicators. The results of (micro and macroprudential) stress tests did not reveal liquidity shortages, with limited vulnerabilities being identified at bank level.

The liquidity coverage ratio (LCR) stood at around 230 percent on average (December 2016), whereas the calendar for the implementation of this indicator set a minimum requirement of 80 percent for 2017.

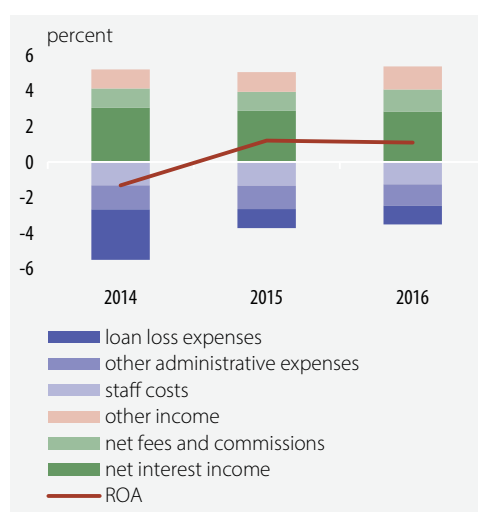
The Romanian banking sector recorded a net profit of lei 4.2 billion at end-2016, as a result of the continued favourable dynamics of net expenses for provisions and further low funding costs. The 2016 financial results were favourably influenced by a one-off gain, recorded as operating income by banks that sold their stakes in Visa Europe. The main profitability indicators of the Romanian banking sector, ROA (1.1 percent) and ROE (10.4 percent), are above EU averages. The market share of loss-making banks shrank to 7.7 percent from 14.3 percent at end-2015, with most credit institutions, Romanian legal entities, reporting positive financial results. The substantial decline in interest expenses on deposits from households and non-financial corporations led to the rise in operating profit and its main component, net interest income (56.3 percent of total operating income). High interest rate spreads⁹⁹, arising particularly from credit risk, remained however a key characteristic of the business model of the Romanian banking sector. The volume of cash and

⁹⁸ Excess capital at individual level was calculated as the difference between the actual total capital ratio of the credit institution and the sum of capital requirements provided by: (i) the minimum required level (8 percent); (ii) additional microprudential requirements under Pillar 2, which were introduced once the Basel II Accord came into force; (iii) the combined buffer, in respect of which requirements for the capital conservation buffer and those specific to the buffer for systemically important institutions are currently imposed, subject to verifying the compliance with the minimum requirements for each component of own funds.

⁹⁹ The average interest rate spread is calculated as the difference between the weighted average interest rate on outstanding loans and deposits respectively of households and non-financial corporations.

deposits taken by banks increased, despite the falling interest rates offered, on the back of factors such as (i) low elasticity of deposits to a decrease in interest rates; (ii) depositors' risk aversion; and (iii) the imperfection of alternative products as substitutes for deposits in terms of liquidity, guarantee level and payment services. Net fee and commission income (19.8 percent of operating income) rose due to income from bank transactions (i.e. customers' payment orders and cash transfers). The positive dynamics recorded in recent months by gains from sales of securities from the portfolios of available-for-sale financial instruments made this item the third-largest component of operating profit in 2016 (11.3 percent).

Chart 3.8
Share of income and
expenses in average assets



The dynamics of operating expenses have returned to negative territory as of the latter half of 2016. This may be attributed to the continued efforts aimed at increasing operational efficiency by cutting the number of personnel and branches or by reducing other administrative expenses and depreciation expenses.

Net impairment charges as a share of assets remained unchanged at 1.1 percent, a level similar to that seen in the previous year, after the peak of 2.8 percent recorded in 2014, due to

balance sheet clean-up operations and collateral revaluations (Chart 3.8). The impact of net impairment charges on profitability is relevant. The ratio of net impairment charges to net assets exceeded 2 percent in years with negative net financial results (2010-2012, 2014), as well as in years with low levels of profitability (2009, 2013).

The high ratio of impairment charges to the volume of non-performing loans sped up the resolution of non-performing exposures in the Romanian banking sector. In fact, the non-performing loan resolution is an important concern at EU level (Box 7).

Box 7. Non-performing loans – a macroprudential issue at EU level

Reducing non-performing loans is a priority at European level¹⁰⁰. At the end of 2016 Q3, the volume of non-performing loans in the EU totalled about EUR 1.2 trillion, accounting for around 5 percent of total loans granted by credit institutions and 4.1 percent of EU GDP. Non-performing loan issues are not specific just to a certain country or region in Europe, yet they are more pronounced in countries with higher volatility in economic activity.

In the absence of a macroprudential framework in place in the credit boom period, which would have currently ensured a lower level of non-performing loans, their significant volume can be efficiently resolved solely with the help of a number of

¹⁰⁰ Several initiatives on non-performing loan resolution were developed at EU level, such as the ECB guide issued in 2016 (*Draft Guidance to Banks on Non-performing Loans*) or the NPL initiative under the Vienna Initiative, coordinated by the EBRD.

both microprudential and legal or fiscal measures. Facilitating the creation of a secondary market for non-performing exposures would also enable the step-up in NPL resolution.

The alternatives to address the non-performing loan issue include: (i) internal management practices applied by each bank via various forms of debt restructuring. In general, due to the long duration and low level of recovery of this approach, credit institutions prefer alternative solutions. In Romania, the efficiency of debt restructuring is low, as most restructured loans are NPLs; (ii) hybrid solutions, such as asset protection schemes, which imply that assets are kept in the balance sheet and banks establish lower provisions than those

warranted by market conditions, due to government guarantees granted to banks, or true-sale securitisations and synthetic securitisations; (iii) solutions that entail the removal of exposures from the balance sheet. Among these solutions, mention should be made about direct sales to investors, where there is a sufficiently liquid market, and the establishment of companies specialised in asset management (Asset Management Companies – AMC¹⁰¹).

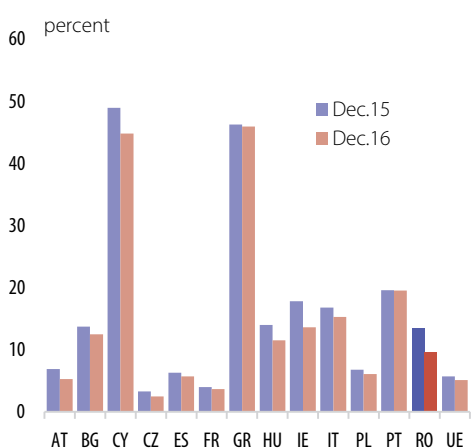
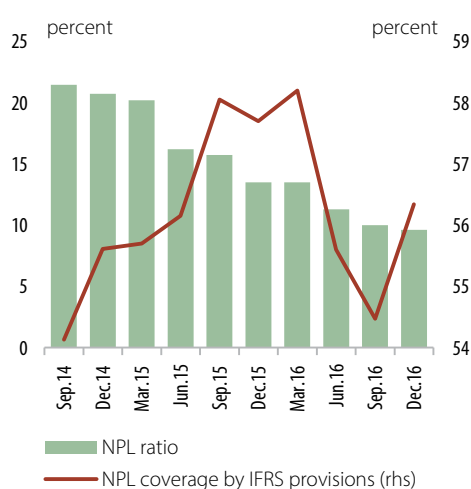
At EU level, several factors hinder the NPL resolution by way of non-performing loan sales. The main demand-side obstacles are: (i) the cumbersome legal framework and the long duration of insolvency proceedings; (ii) investors' uncertainty concerning the fair value of purchased assets; (iii) the legislative framework in favour of borrowers for certain classes of exposures; and (iv) strict conditions that purchasers of non-performing loans have to fulfil. The non-performing loan supply is affected by: (i) credit institutions' capacity to withstand the potential loss measured as the difference between the asset's sale price and its carrying amount; (ii) the relative benefits of NPL sales (release of capital and human resources, more favourable funding conditions); and (iii) fiscal aspects that could generate additional costs for credit institutions. Additionally, macroeconomic developments are essential for fostering the creation of a secondary market for non-performing loans.

Romania witnessed a significant rise in non-performing loan ratio after the 2008 financial crisis. Due to the supervisory and regulatory measures implemented by the NBR, the NPL ratio has recently decreased markedly, reaching 9.6 percent at

end-2016 (in September 2014, the NPL ratio stood at 21.5 percent, Chart A). These measures proved to be efficient and caused one of the fastest NPL ratio

Chart A

Asset quality indicators
in Romania



Source: EBA, NBR

Chart B

Non-performing loan ratio
in EU countries

¹⁰¹ Over the past years, several AMC were created in the EU: (i) Ireland – NAMA, set up in 2009 (with an initial size of EUR 74 billion); (ii) Italy – GACS, established in 2016 (EUR 5 billion); (iii) Slovenia – DUTB/BAMC, created in 2013 (EUR 2 billion); (iv) Spain – SAREB, set up in 2012 (EUR 107 billion); (v) Hungary – MARK, established in 2015 (EUR 1 billion).

declines among EU countries (Chart B). However, every country's experience in dealing with non-performing loan issues depends on the structural characteristics of its own banking sector and economy.

The efficient resolution of non-performing loans in Romania was favoured by a series of specific features: (i) high NPL coverage by provisions; (ii) adequate capitalisation of banks; (iii) the consensus among credit institutions about carrying out the NPL resolution exercise. Starting 2013, the NBR has promoted several initiatives for stimulating the resolution process that focused in particular on adequate provisioning and guaranteeing. First, the revaluation of loan collateral by external auditors was required (2013). The collateral revaluation exercise was reiterated in 2014 and 2015. Second, in 2014, a regulation was issued for the separate recognition in the off-balance sheet accounts of fully-provisioned non-performing loans. As a result, loans were removed from the balance sheets without banks' waiving their contractual rights on future flows from those loans, thus avoiding the moral hazard generated by borrowers' expectations to be exempted from payments. Third, 2014 saw the implementation of supervisory measures, such as (i) removal of uncollected, fully-provisioned non-performing loans; (ii) full provisioning of loans over 360 days past due in which case judicial proceedings were not initiated; (iii) provisioning of at least 90 percent of all exposures to insolvent borrowers; (iv) conducting an external audit of the accounting methodologies used to determine the value of provisions and the manner of collateral evaluation. Fourth, in 2016, the NBR recommended banks to fully cover by provisions the unsecured NPLs overdue for more than 180 days, followed by their write-off.

The NBR will make further efforts to boost the non-performing loan resolution in order to improve the quality of the loan portfolio held by the banking sector in Romania. Moreover, the NBR promotes a macroprudential framework for preventing the build-up of non-performing loans in the future. Responsible lending, which relies on the prudent assessment of customers' creditworthiness (also in the context of adverse macroeconomic developments) and the prevention of successive debt restructuring episodes are current concerns of the central bank. The early altering of capital in order to reflect loan losses, amid the deterioration of asset quality, will also be stimulated in the future by the adoption of the new IFRS 9 accounting standard.

The aggregate analysis of operational efficiency based on the cost-to-income ratio¹⁰² shows an improvement in this indicator (53 percent in December 2016, a significantly better value than the average of the EU banking sector), on the back of the positive dynamics of operating income, correlated with the cut in operating expenses. The trend is amplified by one-off items and some regulatory amendments. However, the low operating profitability of most small- and medium-sized banks¹⁰³ is indicative

¹⁰² The cost-to-income ratio is calculated as a ratio of operating expenses to operating revenues. It is volatile as its denominator depends on interest rate movements.

¹⁰³ Medium-sized banks have a market share in terms of assets between 1 percent and 5 percent and small banks have a market share below 1 percent.

of possibilities to increase efficiency, by enhancing financial intermediation on a sustainable basis, using the benefits of technology and fostering ongoing staff training.

The NBR performs regularly stress tests of credit institutions' capital adequacy based on macroeconomic scenarios. The latest stress test was conducted based on the 2015 financial and prudential data and used the methodology and macroeconomic scenarios developed for the 2016 EU-wide stress test coordinated by the EBA. The NBR's stress test envisaged a baseline scenario and an adverse scenario. According to the baseline scenario (in normal macroeconomic conditions), throughout the reviewed period, at the banking sector level, both total capital ratio and Common Equity Tier 1 capital ratio follow an uptrend, staying, on average, above the minimum requirement. The adverse scenario takes into account the rise in default rates to levels similar to or higher than the all-time peaks, as well as the contraction in net interest income as a result of larger NPL volume and increased funding costs of credit institutions. In this case, total capital ratio at system level could drop by up to 8 percentage points by the end of 2018. The results confirm the local banking sector's resilience to severe shocks. The NBR regularly monitors the prudential standing of credit institutions in order to ensure that they have an adequate capacity to manage the main risks to financial stability.

Another major challenge to financial stability is cyber security. Recent developments in financial technological innovation are of concern due to their complexity, the absence of harmonised regulations and/or standards in the field and the difficulties to assess the risks they imply. The National Bank of Romania started monitoring potential risks to financial stability in Romania following the development of technologies and/or products in the financial field (Fintech), as well as cyber security risks (including those stemming from new technologies).

2.3. Non-bank financial sector

The non-bank financial sector grew further, at a moderate pace, in 2016, on the back of favourable economic conditions. The share of non-bank financial assets in total assets of the financial sector moved ahead to 23.5 percent in December 2016, due mainly to the increase reported by pension funds and insurance companies.

A look at the breakdown shows that investment funds hold the largest share of total non-bank financial assets, with closed-end equity funds and open-end bond funds being the most representative categories of this sector. The vulnerabilities emerging from the balance sheet analysis of investment funds refer to the high concentration of investments in market risk-sensitive assets and the lack of diversification of the funding structure, from the perspective of both instruments and nationality of investors (92 percent of fund units are held by Romanian investors).

The favourable economic conditions were also mirrored by the 13.2 percent advance in loans granted by non-bank financial institutions in 2016 versus 2015. The pick-up in lending activity of NBFIs was visible in the case of loans to both households and

non-financial corporations. The composition of NBF lending remained unchanged in 2016, loans to non-financial corporations holding a 75 percent share in total loans. The NBFs' ratio of loans overdue for more than 90 days¹⁰⁴ kept decreasing, yet it remained higher than that seen by the banking sector at end-2016 (8.6 percent as compared with 6.9 percent).

The insurance sector is small as compared with the other sectors in what concerns the share of assets in total assets. The level of intermediation, calculated as the share of gross premiums written in GDP, stayed on an overall downward trend, falling to 0.9 percent in September 2016, from 1.23 percent in 2015. The year 2016 brought about notable amendments to the legislative framework due to the implementation of the new risk-based supervisory regime (Solvency II), which has as objective the harmonisation with the new rules concerning the level of prudential financial requirements (32 insurance companies fell within the scope of this Directive in January 2016). Moreover, in 2016, the European Insurance and Occupational Pensions Authority (EIOPA) conducted a stress test of EU insurance companies' vulnerabilities and resilience. Romania participated in this exercise with 3 undertakings which obtained favourable results.

Private pension funds continued to grow in 2016, due to both Pillar II and Pillar III, amid (i) the higher number of participants (up 3.9 percent to 7.2 million persons) and (ii) the further low monthly payments to recipients. Nevertheless, regional comparisons show that Romania has the lowest level of intermediation (assets to GDP) in the region, the situation being similar for the number of pension funds. Government securities hold the largest share in the portfolio of private pension funds (65 percent in December 2016). Returns were lower for all categories of investments made by pension funds, except for those made with investment funds. The low interest rate environment may lead to additional risk-taking associated with investments in higher-yield, higher-risk assets.

2.4. Financial markets

The main high-volatility episodes, which were seen on the local financial markets in 2016 Q1, were caused by corrections in international commodity prices, as well as by plunges in stock market indices in China, which increased the concerns over global economic growth fragility and the uncertainty about the future monetary policy stance in the USA (Table 3.2). Nevertheless, market volatility remained at a manageable level, yet the domestic framework calls for a prudent approach to coordinating the economic policy mix, with a view to maintaining positive prospects on the evolution of the government bond and sovereign debt markets.

The financing cost of Romania's sovereign debt moved in line with the developments witnessed by other countries in the region. In this vein, the spread between the yields on Romanian government bonds and German Bunds moved slightly up April through June 2016, but following the United Kingdom's decision to leave the EU, it contracted

¹⁰⁴ The ratio was calculated as the share of loans to non-financial corporations and households more than 90 days past due in the total loans granted to them by NBFs.

sizeably. The yield curve for government bonds has shifted significantly upwards starting September 2016, with longer-term bonds recording more pronounced rises. The positive trend in the term spread may be ascribed to global developments, as well as to domestic factors, such as the fiscal easing and pay rise measures.

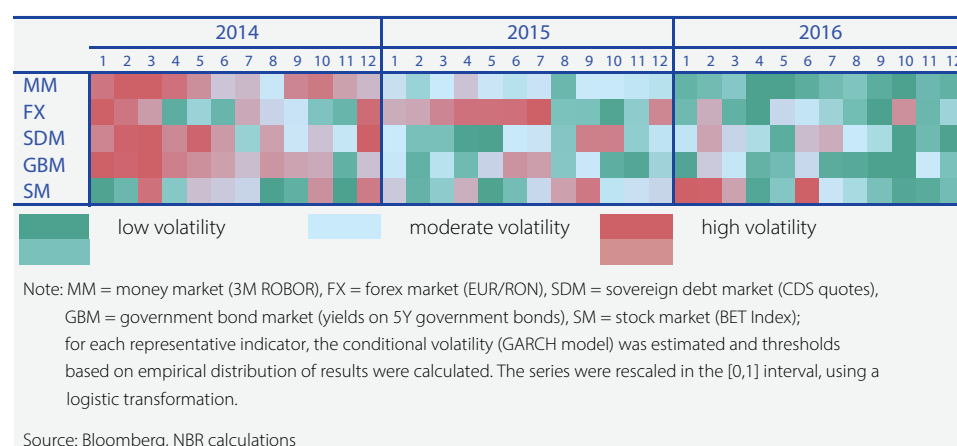


Table 3.2
Dashboard of Romania's financial
market volatility in 2014-2016

The local factors that caused the short-lived increase in yields did not have a similar impact on developments in CDS (credit default swaps) quotes. In the course of 2016, CDS quotes across the emerging economies in Central and Eastern Europe, Romania included, posted relatively stable dynamics compared with the evolution of indices for countries such as Spain or Italy. The effects of the June 2016 Brexit vote faded out towards the end of 2016 Q3. In absolute terms, CDS quotes for Romania saw the largest change in early November 2016 (by about 6 basis points), when the US election results were announced.

In 2016, the EUR/RON exchange rate posted a relatively steady evolution and showed a close connection to the movements in money market rates. In the course of October however, the leu decoupled itself not only from the money market trends, but also from developments in foreign exchange markets in the region, showing a fast-paced depreciation versus the euro. This episode could be attributed to a number of domestic factors, such as the legislative initiatives targeting the banking sector in Romania or the fiscal initiatives promoted as policy options for 2017. Nevertheless, the magnitude of EUR/RON exchange rate swings from January to December 2016 was, on the whole, lower than that observed for other currencies in the region (such as the Hungarian forint or the Polish zloty).

The capital market in Romania exhibited relatively mixed developments in the first half of 2016, with the key index moving in line with its peers in Central and East European countries. The increase seen in the latter half of 2016 was largely due to investors' stronger demand for higher yields, being also fuelled by the low interest rate environment and the improvement in listed companies' fundamentals. The temporary volatility episodes, triggered by some short-lived, albeit sharp, drops in indices, emerged broadly as a result of escalating tensions in the short run on the international markets: in June 2016 as a result of the Brexit vote and in November 2016, following the US presidential election results. Such tensions were also manifest on the region's capital markets.

3. Instruments supportive of prudential supervision and financial stability

3.1. Central Credit Register (CCR)

The Central Credit Register (CCR) conducts its activity in compliance with NBR Regulation No. 2/2012 on the organisation and functioning of the Central Credit Register operated by the National Bank of Romania, as subsequently amended. In 2016, the Regulation was amended by NBR Regulation No. 4/2016 to include new information in the CCR database. The data collected starting with 1 October 2016 refer to credit agreements in relation to which foreclosure proceedings were initiated, credit agreements subject to currency conversion as a result of restructuring, the type of institution to which the credit agreement was sold and, respectively, from which the loan was purchased, information that the debtor is living in the mortgaged property, the occupational status of individuals and information about the loan closure via debt discharge. The largest part of this information is required for the analysis purposes of the National Bank of Romania and is not disclosed to the reporting entities.

Pursuant to the provisions of NBR Regulation No. 2/2012, as subsequently amended, the reporting institutions to the CCR are credit institutions, non-bank financial institutions (NBFIs) enlisted in the Special Register opened at the NBR, electronic money institutions and payment institutions with significant lending activity. At end-2016, 75 reporting institutions, of which 36 credit institutions, 38 NBFIs (as compared with 36 credit institutions and 42 NBFIs at end-2015) and one payment institution reported to the CCR.

The NBFIs and the payment institution hold relatively small shares of the indicators used in the CCR: number of borrowers – 8.77 percent; number of loans and commitments – 10.39 percent; total amounts due – 6.65 percent; overdue amounts – 6.25 percent. These shares were higher than in December 2015.

In 2016, the number of CCR database queries declined from a year earlier, reaching 1.5 million queries (as compared with 1.7 million in 2015), of which 76.7 percent with the consent of potential borrowers. The queries concerned and provided data on overall risk, loans and overdue amounts of borrowers.

The same as in the previous years, the number of small-value consumer loans held a significant position in 2016 as well. Thus, at year-end, given that the reporting threshold was left unchanged at lei 20,000, the CCR database comprised 19.6 percent of the number of borrowers and 26.0 percent of the number of loans granted and commitments assumed by the reporting institutions (on a rise as compared with a year earlier). By contrast, the CCR database comprised 90.4 percent of the value of loans granted and commitments assumed by reporting institutions (down slightly from 2015). The coverage ratio by reporting institution stood at 91.3 percent for credit institutions and at 80.5 percent for NBFIs and the payment institution. The shares were similar to those recorded a year ago.

The developments in main indicators used by the CCR are presented in the tables below, being shown separately for credit institutions and the NBFIs enlisted in the Special Register.

Table 3.3
Main indicators used
by the CCR – credit institutions

	31 December 2015	31 December 2016	percentage change Dec. 2016/Dec. 2015
Number of borrowers (thou.)	991	1,071	8.1
Individuals	892	973	9.1
Legal entities	98	98	0.0
Number of borrowers with overdue loans (thou.)	186	170	-8.6
Number of loans and commitments (thou.)	1,724	1,889	9.6
Number of overdue loans (thou.)	259	233	-10.0
Total amount due (lei mill.)	275,954	284,505	3.1
Individuals	97,012	103,950	7.2
Legal entities	178,942	180,555	0.9
Overdue amount (lei mill.)	31,428	25,227	-19.7

Source: CCR

For credit institutions, the overdue amount decreased significantly, i.e. by 19.7 percent year on year (Table 3.3), whereas the amount due increased by 3.1 percent, which caused the share of overdue amount in total amount due to go down to 8.9 percent. At the same time, declines were reported for the numbers of overdue loans and borrowers with overdue amounts (10.0 percent and 8.6 percent respectively).

Table 3.4
Main indicators used by the CCR
– non-bank financial institutions
and payment institutions

	31 December 2015	31 December 2016	percentage change Dec. 2016/Dec. 2015
Number of borrowers (thou.)	87	103	18.4
Individuals	36	46	27.8
Legal entities	51	57	11.8
Number of borrowers with overdue loans (thou.)	15	16	6.7
Number of loans and commitments (thou.)	184	219	19.0
Number of overdue loans (thou.)	33	35	6.1
Total amount due (lei mill.)	17,486	20,259	15.9
Individuals	1,501	1,894	26.2
Legal entities	15,992	18,365	14.8
Overdue amount (lei mill.)	1,913	1,682	-12.1

Source: CCR

Individuals accounted for 90.9 percent of total borrowers in the CCR database as at 31 December 2016. The share of loans to individuals in total amount due rose slightly from end-2015 to reach 36.5 percent. The currency breakdown of loans to individuals is as follows: 52.8 percent were denominated in lei, 41.2 percent in euro, 5.7 percent in Swiss francs and 0.2 percent in US dollars. The share of leu-denominated loans grew from a year ago, to the detriment of loans denominated in euro and Swiss francs.

Most indicators monitored for NBFIs and the payment institution saw increases versus 2015 (Table 3.4), i.e. the number of borrowers in the CCR database by 18.4 percent, the number of loans and commitments by 19 percent and the number of overdue loans by 6.1 percent. The overdue amount decreased by 12.1 percent in the same period. The share of overdue amount in total amount due was 8.3 percent, down from a year ago.

In the case of NBFIs and the payment institution, the structure of borrowers is different from that corresponding to credit institutions, as legal entities hold the larger share (55.3 percent at end-2016).

The reporting institutions reported more groups of connected clients from a year ago, so that the CCR database comprised 775,427 groups at 31 December 2016. Unlike the previous year, when no information on card frauds was reported, in 2016, the reporting institutions reported information about 4 borrowers who committed card frauds, the value of the fraud totalling about lei 23 thousand.

In the year under review, 422 petitioners requested information on the CCR database entries in their name, compared with 555 petitioners in 2015.

As regards the cross-border exchange of information based on the Memorandum of Understanding on the exchange of information among National Central Credit Registers for the purpose of passing it on to reporting institutions, the information flows remained unchanged from 2015.

In 2016, the NBR further cooperated with the ECB on the project concerning the establishment of a database containing granular credit data. In May 2016, the ECB's Governing Council approved Regulation ECB/2016/13 on the collection of granular credit and credit risk data. The Regulation is available on the website of the European Central Bank and applies to all euro area countries, encouraging also non-euro area countries to take part in this project.

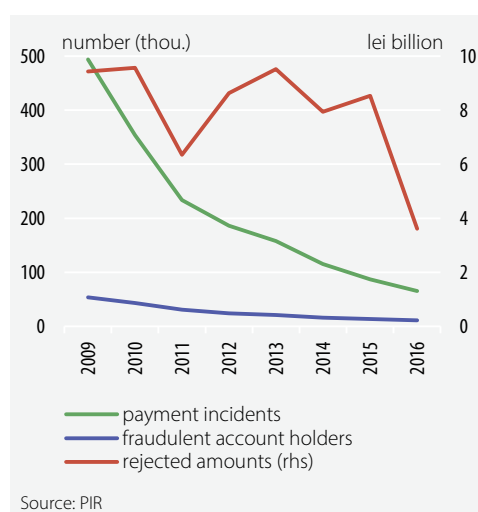
Until then, the provisions of Decision ECB/2014/6 on the organisation of preparatory measures for the collection of granular credit data by the European System of Central Banks (applicable to euro area countries) and of Recommendation ECB/2014/7 on the organisation of preparatory measures for the collection of granular credit data by the European System of Central Banks (applicable to non-euro area countries) remain in force, the NBR continuing to submit the information required from the CCR database.

3.2. Payment Incidents Register (PIR)

The Payment Incidents Register (PIR) conducts its activity in compliance with NBR Regulation No. 1/2012 on the organisation and functioning of the Payment Incidents Register operated by the National Bank of Romania.

According to the PIR database, in 2016, the numbers of payment incidents and account holders who generated payment incidents, as well as rejected amounts dropped significantly. These declines occurred as a result of a fall in the

Chart 3.9
Main indicators of payment
incidents during 2009-2016



average rejected amount related to a payment instrument (down to lei 55 thousand versus lei 98 thousand in 2015).

Compared to 2015, the number of fraudulent account holders reported with payment incidents fell by 17.0 percent to reach 11,352 in 2016, while the number of payment incidents dropped by 24.7 percent to 65,682. Moreover, the average number of incidents perpetrated by one account holder was lower, while the number of account holders with

suspended cheque-writing privileges went down by 29.6 percent (from 1,071 in 2015 to 754 in 2016). In the reviewed year, 196 individuals who caused payment incidents (related mostly to promissory notes) were reported to the PIR, as compared with 180 in 2015.

The value of rejected amounts diminished by 57.7 percent to lei 3,609 million in 2016, versus lei 8,539 million in 2015 (Chart 3.9).

The concentration of payment incidents reported by reporting institutions reveals that, in the year under review, 15 credit institutions accounted for 93 percent of the total number of payment incidents and 89.2 percent of the total rejected amounts, the figures being similar to those seen a year ago. The most frequent reason for payment refusal was the complete or partial lack of funds (59.1 percent of total payment refusal reasons), the same as in 2015.

Over the reported period, credit institutions expressed interest in the PIR database information, sending 6.9 million queries (up 0.4 percent), in their own name or in their customers' name. The answers to these queries provide information about whether the account holders committed any payment incidents.

In 2016, 61 petitioners requested information about the data reported to the PIR in their own name, compared to 68 petitioners in 2015.

4. Developments in the field of bank recovery and resolution

Law No. 312 of 2015 on the recovery and resolution of credit institutions and investment firms, as well as on amending and supplementing some normative acts in the financial field, which transposes into domestic law Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD), entered into force on 14 December 2015.

The new legislative framework makes possible the rapid intervention of the NBR, in its capacity as resolution authority, in the case of institutions that are failing or are likely to fail and which cannot be liquidated under normal insolvency proceedings, in order to ensure the continuity of critical functions, to avoid significant adverse effects on financial stability, as well as to protect public funds, depositors, investors, client funds and assets.

Resolutions actions are taken to fulfil the aforementioned objectives, only if, under normal insolvency proceedings, the liquidation of the credit institution is neither credible (from the viewpoint of the potential impact on financial markets and market confidence, on financial market infrastructures, other financial institutions and real economy) nor feasible (in terms of the institution's capacity to provide the information required by the deposit guarantee scheme and conduct the related operations).

Specifically, the NBR, in its capacity as resolution authority, can take resolution actions, which imply the implementation and/or exercise, as appropriate, of one or more resolution tools or resolution powers, by observing the principles set forth by Law No. 312/2015.

The resolution tools that can be implemented are the sale of business, the bridge institution, the separation of assets and the bail-in. Resolution tools may be applied individually or in any combination, except for the separation of assets, which can be used solely together with another resolution tool.

The resolution powers refer to those powers necessary to apply the resolution tools (for instance, the power to take control of an institution, the power to transfer the shares or any other instruments of ownership, rights, assets or liabilities, the power to cancel debt instruments, to write down/convert into common shares or other instruments of ownership the eligible liabilities of an institution under resolution. The power to write down or convert relevant capital instruments can be exercised, either independently or in combination with a resolution action. Furthermore, the provisions concerning the bail-in, as well as those on the implementation of government financial stabilisation tools stipulated by Law No. 312/2015 have been entirely implemented as of 1 January 2016. This ensures the legal framework necessary for the efficient crisis management in the public interest and for preserving market confidence.



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Chapter 4

Licensing and regulation of financial institutions

1. Licensing and notification of financial institutions

Authorisation of credit institutions

The National Bank of Romania's prerogative powers in relation to the authorisation of credit institutions are set out in Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as amended and supplemented by Law No. 227/2007, as subsequently amended and supplemented. In 2016, the NBR granted no authorisation to any credit institution.

In the course of 2016, the branch in Romania of a credit institution based in another EU Member State was registered with the Credit Institutions Register: Alior Bank S.A. Warsaw – Bucharest Branch.

Authorisation of payment institutions

By virtue of its powers in the area of regulation, authorisation and prudential supervision of payment institutions under Government Emergency Ordinance No. 113/2009 on payment services, as approved and amended by Law No. 197/2010, as subsequently amended and supplemented, and NBR Regulation No. 21/2009 on payment institutions, as further amended and supplemented, the National Bank of Romania entered 40 agents of Meridiana Transfer de Bani S.R.L., a payment institution, in the Payment Institutions Register, as well as 1 agent of Westaco S.R.L. At the same time, the NBR erased from the above-mentioned register 5 agents of Meridiana Transfer de Bani S.R.L.

Notification of non-bank financial institutions

In 2016, the notification and registration of the newly-established non-bank financial institutions carried on. In compliance with Law No. 93/2009 on non-bank financial institutions, as subsequently amended and supplemented, the notification and registration procedure was carried out to enter 15 NBFIs in the General Register, 2 other such institutions in the Special Register and 125 entities in the Entry Register.

In addition, 10 NBFIs were erased from the General Register, 7 NBFIs from the Special Register and 100 NBFIs from the Entry Register.

2. Regulatory framework for credit institutions

Regulation of lending conditions

With a view to transposing into national law the provisions on the creditworthiness assessment of applicants for a residential loan and the remuneration policies of creditors in Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010 and in EBA Guidelines EBA/GL/2015/11 on creditworthiness assessment, the National Bank of Romania issued Regulation No. 5/2016 amending and supplementing NBR Regulation No. 17/2012 on certain lending conditions. Moreover, the piece of legislation envisaged the alignment of the consumer loan regulatory and supervisory regime to the regime governing real estate investment loans with regard to the creditworthiness assessment of loan applicants and to the establishment of remuneration policy by the creditor.

Deposit guarantee regulatory framework

Considering the National Bank of Romania's obligation to set, regularly review and publish on its website a higher coverage limit provided for at Article 62 (1) of Law No. 311/2015 on deposit guarantee schemes and the Bank Deposit Guarantee Fund, Circular No. 24/2016 was issued on the guarantee level set forth at Article 62 (1) of Law No. 311/2015 on deposit guarantee schemes and the Bank Deposit Guarantee Fund, by which the National Bank of Romania set a higher coverage limit at the equivalent in lei of EUR 100,000. The additional level is different from that laid down by Article 61 (3) of Law No. 311/2015 and applies to the aggregate amount of deposits provided for at Article 62 (1) of Law No. 311/2015, in determining their compensation according to Article 63 of the same law.

At the same time, the National Bank of Romania notified of its considering the EBA Guidelines on the cooperation agreements between deposit guarantee schemes under Directive 2014/49/EU – EBA/GL/2016/02 of 8 June 2016, in the activity carried out in its capacity as designated authority, as well as EBA Guidelines on stress tests of deposit guarantee schemes under Directive 2014/49/EU – EBA/GL/2016/04 of 19 October 2016, in the activity performed in its capacity as designated authority and, as the case may be, as competent or resolution authority. The National Bank of Romania disclosed its decision to consider these guidelines in the releases posted on its website.

Regulatory framework governing prudential banking and bank resolution

In 2016, the main progress seen in the regulatory framework applicable to credit institutions resulted from:

- Regulation No. 1/2016 on the issuance of covered bonds. The Regulation was drafted in line with the duties of the National Bank of Romania under Law No. 304/2015 on covered bond issues and provides an in-depth description of the approval

procedure of the covered bond issue, the approval procedure of the cover pool monitor, keeping the internal cover register, the structure of the cover pool, the assessment and management of the liquidity risk, the calculation of the coverage and overcollateralisation indicators, conducting stress tests, reporting requirements, transparency requirements;

- Regulation No. 9/2016 amending NBR Regulation No. 5/2013 on prudential requirements for credit institutions. With a view to ensuring legal certainty relative to the calculation of the maximum distributable amount, the regulation establishes the priority in which capital buffer requirements are applied in respect to the requirements imposed by the competent authority as Pillar II measures. In order to ensure convergence of prudential supervision tools and practices used nationwide with the best European practices, the national regulatory framework continued to incorporate the guidelines released by the European Banking Authority (EBA) in the area of prudential banking and credit institution resolution. To this end, instructions were issued to inform credit institutions that the specifications and details laid down in the mentioned guidelines must be considered when applying the regulatory framework. Furthermore, for those provisions in the guidelines including compliance requirements for competent authorities, the National Bank of Romania, in its capacity as competent authority or resolution authority, as the case may be, disclosed its decision to apply these provisions via releases published on its website, thereby informing about considering the provisions of the relevant guidelines during its activities in its capacity as competent and/or resolution authority.

In 2016, the National Bank of Romania analysed and incorporated in its regulatory framework the following guidelines:

- Guidelines for complaints-handling for the securities (ESMA) and banking (EBA) sectors – JC/2014/43 of 27 May 2014 and EBA Guidelines on product oversight and governance arrangements for retail banking products – EBA/GL/2015/18 of 22 March 2016, incorporated in the Instructions of 29 December 2016 on the governance framework for retail banking products and complaints in the banking and financial sector;
- Guidelines on disclosure of encumbered and unencumbered assets – EBA/GL/03/2014 of 27 June 2014, incorporated in the Instructions of 23 May 2016 on the disclosure of information on encumbered and unencumbered assets;
- Guidelines on sound remuneration policies in line with Article 74 (3) and Article 75 (2) of Directive 2013/36/EU and the information published in line with Article 450 of Regulation (EU) No. 575/2013 – EBA/GL/2015/22 of 27 June 2016, incorporated in the Instructions of 29 December 2016 on sound remuneration policies;
- Guidelines on the provision of information in summary or collective form for the purposes of Article 84 (3) of Directive 2014/59/EU – EBA/GL/2016/03 of 19 July 2016, incorporated in the Instructions of 19 January 2017 on the provision of confidential information in summary or collective form;
- Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No. 575/2013 – EBA/GL/2015/20 of 3 June 2016, incorporated

in the Instructions of 29 December 2016 on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework;

- Guidelines on the range of scenarios to be used in recovery plans – EBA/GL/2014/06 of 18 July 2014, incorporated in the Instructions of 14 November 2016 on the range of scenarios to be used in recovery plans;
- Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU – EBA/GL/2015/07 of 26 May 2015, incorporated in the Instructions of 5 August 2016 on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail;
- Guidelines on the minimum list of qualitative and quantitative recovery plan indicators – EBA/GL/2015/02 of 23 July 2015, incorporated in the Instructions of 14 November 2016 on the range of scenarios to be used in recovery plans;
- Guidelines on specifying the conditions for group financial support under Article 23 of Directive 2014/59/EU – EBA/GL/2015/17 of 8 December 2015, incorporated in the Instructions of 4 March 2016 on the conditions for group financial support provided for in letters b), d), f), g) and h) of Article 137 of Law No. 312/2015 on the recovery and resolution of credit institutions and investment firms, as well as on amending and supplementing some normative acts in the financial field.

3. Accounting regulatory framework for institutions within the regulatory scope of the National Bank of Romania¹⁰⁵

In 2016, the NBR adopted new accounting regulations, pursuing the following objectives:

- a) to update reporting regulations so as to meet the information requirements of the Ministry of Public Finance (NBR Orders No. 1/2013 and No. 10/2012) via the issue of NBR Orders No. 3/2016 and No. 6/2016, with a view to ensuring a uniform reporting system economy-wide;
- b) to update the accounting regulations compliant with EU Directives (NBR Order No. 6/2015) and with the International Financial Reporting Standards – IFRS (NBR Order No. 27/2010) applicable to entities within the National Bank of Romania's regulatory scope via the issue of NBR Order No. 7/2016, with a view to ensuring the transposition into national law of Directive 2014/95/EU¹⁰⁶;

¹⁰⁵ Credit institutions, NBFIs, payment institutions and electronic money institutions granting payment services-related loans and whose activity is limited to the provision of such services, namely issuance of e-money and provision of payment services, as well as the Bank Deposit Guarantee Fund. These entities are listed under Article 4 (3) letter a) of Law No. 82/1991 – the Accounting Law (republished), as subsequently amended and supplemented.

¹⁰⁶ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

- c) to update the FINREP reporting framework at solo level (NBR Order No. 6/2014) via the issue of NBR Order No. 3/2017 for including the amendments made by the EBA in 2016 to the consolidated FINREP reporting framework, as approved by Regulation (EU) No. 680/2014¹⁰⁷;
- d) to update the regular reporting framework for financial and accounting statistical information applicable to branches in Romania of credit institutions having their head offices in other Member States (NBR Order No. 5/2014) via the issue of NBR Order No. 3/2017, aiming to ensure comparability between the information required by this regulation and similar information reported by credit institutions, in compliance with the FINREP reporting framework at solo level.

The National Bank of Romania, via its representatives in the EU institutions and bodies, has played an active part, by formulating positions, in both the preparation of EU prudential regulation strategies and the drafting of new directives, regulations or guidelines within its scope of activity.

The NBR provided technical assistance to the National Bank of Moldova under the Twinning Arrangement “Strengthening the NBM’s Capacity in the Field of Banking Regulation and Supervision in the Context of EU Requirements” that was signed between the European Union and the consortium made up of the National Bank of Romania and De Nederlandsche Bank, with a view to enacting the CRD IV legislative package.

4. Regulatory guidelines in 2017

In the field of prudential regulation

- to prepare secondary regulation concerning deposit guarantee schemes;
- to analyse EBA guidelines and prepare the regulatory framework for their implementation into national law;
- to draft proposals to review the regulatory framework applicable to non-bank financial institutions – Law No. 93/2009 on non-bank financial institutions, given the need to comply with practical and temporary requirements;
- to formulate technical positions during the negotiations on the legislative package (aimed at amending Directive 2013/36/EU (CRD), Regulation (EU) No. 575/2013 (CRR) and Directive 2014/59/EU (BRRD) including risk reduction measures (RRM package);
- to contribute, via participation in EBA working groups, to the drawing up of draft regulatory and implementing technical standards, as well as of guidelines to prudential banking;

¹⁰⁷ Regulation (EU) No. 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No. 575/2013 of the European Parliament and of the Council, as subsequently amended and supplemented.

- to supplement/review the regulatory framework applicable to credit institutions in areas such as licensing and corporate governance;
- to complete providing technical assistance to the National Bank of Moldova with a view to enacting the CDR IV legislative package under the above-mentioned Twinning Arrangement;
- to assess the provisions of the national legislative framework for securitisation transactions in terms of compliance with the European draft regulations in the simple, transparent and standardised (STS) securitisation package with a view to identifying the needs to adjust the national regulatory framework;
- to update the regulatory framework applicable to credit institutions in line with the provisions of Law No. 12/2017 on the macroprudential oversight of the national financial system.

In the field of regulation of financial activities

- to take part, in compliance with the central bank's legal powers, in transposing into national law Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC;
- to participate, in compliance with the central bank's legal powers, in transposing into national law Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No. 1093/2010, and repealing Directive 2007/64/EC.

In the field of accounting regulation

- to update the reporting regulations so as to meet the information requirements of the Ministry of Public Finance, with a view to ensuring a uniform reporting system economy-wide;
- to update the accounting regulation applicable to the entities within the NBR's regulatory scope, other than credit institutions, with the aim of implementing the changes brought to the national and EU accounting regulatory framework;
- to update the IFRS-compliant accounting regulations applicable to credit institutions so as to include the changes in the IFRS provisions adopted across the EU, as well as the possible proposals generated by the actual application of the IFRS, as received from credit institutions and audit firms;
- to update the regulation on the regular financial statements of NBFIs, with a view to correlating the reporting framework applicable to such entities with amendments to accounting regulations;

- to update the regulation on the FINREP reporting framework at solo level, following the revision by EBA of the consolidated FINREP reporting framework, given the adoption of the new IFRS 9 Financial instruments at European level;
- to update the regular reporting framework for financial and accounting statistical information applicable to branches in Romania of credit institutions having their head offices in other Member States, aiming to ensure comparability between the information required by this regulation and similar information reported by credit institutions, in compliance with the FINREP reporting framework at solo level.

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Chapter 5

Prudential supervision of financial institutions

1. Supervision of credit institutions

According to the mandate set forth in Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, approved and amended by Law No. 227/2007, as subsequently amended and supplemented, the National Bank of Romania shall carry out the prudential supervision of credit institutions, Romanian legal persons, and of their branches established in other Member States or in third countries, on an individual basis, as well as on a consolidated or sub-consolidated basis, as appropriate.

The National Bank of Romania monitors compliance by credit institutions, Romanian legal persons, with prudential requirements and other requirements laid down by Government Emergency Ordinance No. 99/2006, as well as by the regulations applicable to it, based on reports submitted by credit institutions and via inspections conducted at credit institutions' head offices and their branches in Romania and abroad.

From a microprudential perspective, supervision involves monitoring possible risks to credit institutions by means of instruments in the form of capital, liquidity and governance requirements used at the level of each credit institution. In 2016, the scope of banking supervision covered 29 credit institutions, Romanian legal persons, whose aggregate net assets totalled lei 350,746.2 million at 31 December 2016. These included 2 credit institutions with fully or majority state-owned capital (CEC Bank and Banca de Export-Import a României – Eximbank), 3 credit institutions with majority domestic private capital (Banca Centrală Cooperatistă CREDITCOOP, Banca Română de Credite și Investiții and Banca Comercială Feroviara) and 24 credit institutions with majority foreign capital.

As regards the 8 branches of credit institutions having their head offices in other EU Member States, which perform banking activity on the territory of Romania, the supervisory task falls within the remit of the competent authority in the home country of the parent credit institution. In the case where the home country is a euro area Member State and the credit institution is significant¹⁰⁸, the supervision is carried out through an integrated architecture combining a supranational authority – the European Central Bank – and national supervisory authorities, cooperating closely in accordance with a single set of high-level standards and requirements.

¹⁰⁸ Banks subject to direct supervision are those which have assets of more than EUR 30 billion or which account for at least 20 percent of their home country GDP. At present, there are around 120 such banks in the euro area, representing almost 85 percent of its total banking assets.

1.1. Size and structure of the banking system

The banking consolidation process continued in 2016, albeit at a smaller scale compared to the previous year, as a natural consequence of the measures for strengthening credit institutions operating in a competitive market. Banks' classification in terms of asset size shows that the share of credit institutions with a market share in excess of 5 percent in total net assets of the banking system widened from 71.3 percent as at 31 December 2015 to 73.3 percent at end-2016, and that of medium-sized banks, with a market share in the range of 1 to 5 percent, narrowed to an almost similar extent, from 22.4 percent to 20.4 percent, while banks holding assets less than 1 percent further made up 6.3 percent.

However, the Herfindahl-Hirschman index, whose value rose slightly from the previous year to 894.3 at 31 December 2016, points to a still moderate market concentration according to international standards for this indicator.

In terms of size of the territorial network, the banking system continued to shrink also in 2016. Specifically, 168 branches and bank agencies ceased operations and the number of banking sector employees declined by 532 persons. Digitalisation, albeit less dynamic on the domestic front than externally, is expected to gain ground on the local market and make a certain contribution to territorial restructuring.

Looking at mergers and acquisitions in the banking sector, in January 2016, Nextebank S.A. became a shareholder of Banca Comercială Carpatica S.A. through the acquisition of a direct qualifying holding in the latter's share capital. At end-November 2016, the merger by absorption between Banca Comercială Carpatica S.A., the absorbing bank, and Patria Bank S.A.¹⁰⁹ (former Nextebank S.A.), the absorbed bank, received the prior approval of the National Bank of Romania.

UniCredit Bank S.A. also witnessed a change in its shareholding, with UniCredit S.p.A., the indirect shareholder, becoming direct shareholder of the credit institution, having a qualifying holding of 98.3 percent in the former's share capital, as a result of UniCredit Group completing its reorganisation process in Central and Eastern Europe.

Table 5.1
Credit institutions by ownership

number of credit institutions, end of period		
	2015	2016
Credit institutions, Romanian legal entities, of which:	29	29
Fully or majority state-owned capital	2	2
Majority private capital, of which:	27	27
– with majority domestic capital	4	3
– with majority foreign capital	23	24
Branches of foreign credit institutions	7	8
Total credit institutions	36	37

¹⁰⁹ Patria Bank operated under the name of Nextebank S.A. until 10 March 2016.

In July 2016, the Bucharest branch of Alior Bank S.A. Varşovia notified the NBR of starting operations on the Romanian market. With its entry on the market, the number of foreign bank branches rose to 8, while that of credit institutions, Romanian legal entities, remained unchanged at 29 (including 1 credit cooperative) – Table 5.1.

Aggregate net assets of the said 37 credit institutions amounted to lei 393,647.9 million at end-2016 (Table 5.5), up by 4.4 percent against the previous year.

The market share of credit institutions with majority foreign capital (including branches of foreign credit institutions) saw a slight increase from 90.4 percent in December 2015 to 91.3 percent in December 2016 (Table 5.2). After the acquisition of a direct qualifying holding in a credit institution with domestic capital by a bank with foreign capital, followed by the start of the merger between the two, the share of credit institutions with majority domestic capital narrowed from 9.6 percent to 8.7 percent. The market share of banks with majority state-owned capital remained relatively unchanged (8.2 percent at end-2016).

	end of period			
	Net assets			
	2015		2016	
	lei mill.	%	lei mill.	%
Credit institutions with domestic capital, of which:	36,342.7	9.6	34,375.4	8.7
– with majority state-owned capital	31,360.7	8.3	32,466.7	8.2
– with majority private capital	4,982.0	1.3	1,908.7	0.5
Credit institutions with majority foreign capital	300,204.8	79.6	316,370.8	80.4
I. Credit institutions, Romanian legal entities	336,547.5	89.2	350,746.2	89.1
II. Branches of foreign credit institutions	40,639.8	10.8	42,901.7	10.9
Total credit institutions with majority private capital, including branches of foreign credit institutions	345,826.6	91.7	361,181.2	91.8
Total credit institutions with majority foreign capital, including branches of foreign credit institutions	340,844.6	90.4	359,272.5	91.3
Total credit institutions (I+II)	377,187.3	100.0	393,647.9	100.0

Table 5.2
Market share of credit institutions

Amid changes in the shareholding structure, the market share of credit institutions in terms of capital adjusted accordingly. The share of credit institutions with majority foreign capital in aggregate capital of the banking sector expanded from 85.9 percent to 86.7 percent, while that of credit institutions with a majority domestic capital narrowed from 14.1 percent to 13.3 percent (Table 5.3).

By 25 May 2017, the NBR received notifications from competent supervisory authorities in other EU Member States regarding the intention of 747 institutions to provide direct banking services on the territory of Romania¹¹⁰, of which 294 banks, 7 non-bank financial institutions, 114 electronic money institutions, and 332 payment institutions.

¹¹⁰ Pursuant to Article 49 of Government Emergency Ordinance No. 99/2006, a credit institution authorised and supervised in another Member State may directly provide services upon the notification sent to the National Bank of Romania by the competent authority of the home Member State; the notification shall include the activities which the credit institution intends to carry on in Romania.

Table 5.3
Credit institutions as a share
in aggregate capital

	end of period			
	Share/Endowment capital			
	2015		2016	
	lei mill.	%	lei mill.	%
Credit institutions with domestic capital, of which:	3,539.6	14.1	3,415.9	13.3
– with majority state-owned capital	3,081.0	12.3	3,081.0	12.0
– with majority private capital	458.6	1.8	334.9	1.3
Credit institutions with majority foreign capital	21,281.3	84.6	21,986.3	85.3
I. Credit institutions, Romanian legal entities	24,820.9	98.7	25,402.2	98.6
II. Branches of foreign credit institutions	321.9	1.3	355.1	1.4
Total credit institutions with majority private capital, including branches of foreign credit institutions	22,061.8	87.7	22,676.3	88.0
Total credit institutions with majority foreign capital, including branches of foreign credit institutions	21,603.2	85.9	22,341.4	86.7
Total credit institutions (I+II)	25,142.8	100.0	25,757.3	100.0

1.2. Performance of the banking sector

In general terms, trends in key indicators further paint the picture of a profitable Romanian banking system, with adequate capital and liquidity levels. The notable performance of 2016 consisted in the NPL ratio falling below the 10 percent threshold, while differences between credit institutions in terms of the value of this indicator narrowed significantly. However, compared to the average of the European banking system, the NPL ratio is still high, despite clear improvements reported as of 2014. The implementation in 2018 of a new financial reporting standard, i.e. IFRS 9 – Financial Instruments, that will replace IAS 39 – Financial Instruments: Recognition and Measurement, is bound to bring new changes in the level of loan quality indicators, particularly due to higher provisioning requirements for impairment of financial assets. The provisioning methodology will become more complex and involve a shift from the incurred loss impairment model to an expected loss model, i.e. monitoring and identifying significant changes in credit risk throughout the life of financial assets. Hence, mechanisms for early monitoring of credit risk will aim at preventing a significant worsening of credit quality, rather than target the non-fulfilment of obligations by the client, as it is currently the case.

The lower reliance on funds raised from parent banks, along with the fewer possibilities for accessing new credit lines from them, reduced the cross-border contagion risk and, at the same time, paved the way for a shift towards domestic funding sources. Deposits taken from non-bank clients increased at the same pace as in 2015, despite the relatively weak remuneration of this saving option. The majority of credit institutions strengthened their deposit base, making this type of instruments account for the bulk of funding sources, with a roughly 75 percent share of total balance sheet liabilities.

The banking system remained profitable throughout 2016 and, despite the lower aggregate net profit compared to 2015¹¹¹, the number of credit institutions reporting positive results at end-2016 increased. The breakdown by component shows that

¹¹¹ Against the background of one-off influences exerted by merger operations carried out in 2015.

the financial result reported in 2016 mirrored however a rise in the operating profit. Another positive aspect refers to the Romanian banking system ranking among the most profitable compared to the average of the European banking system.

The solvency level points to an adequate capitalisation, in line with the applicable regulatory prudential requirements, witnessing a slight improvement from end-2015, by approximately 0.5 percentage points, due to a more rapid increase in own funds than in risk-weighted assets. Behind the positive adjustment in the volume of own funds stood primarily the gradual phasing-out of prudential filters by another 20 percent, while the increase in share capital also impacted the composition and dynamics of own funds. In fact, in order to prevent the deterioration of the capital adequacy ratio, the National Bank of Romania took measures constantly after 2008 in order to preserve a comfortable solvency level capable to offset the build-up of non-performing loans in the asset portfolio, as well as the risks that may arise in an unpredictable economic environment and legal framework. The notable measures imposed by the supervisory authority that had a major contribution to the ongoing positive developments included, *inter alia*, the increase in own funds by new cash contributions to the share capital, the capitalisation of profit and taking subordinated loans.

In order to preserve their equilibrium, banks must undergo continuous restructuring of their business, all the more so since, given the shift to IFRS 9, the classification and measurement of financial instruments will be aligned to the management model applicable to these tools. Moreover, the indicators reflecting the soundness of a credit institution cannot be maintained at prudent values if credit institutions are not aware of the importance of a viable business model, adapted to the current market coordinates. It is their task to find ways to optimise their business, pursuing careful cost control, a prudent risk approach and an efficient cost/income ratio.

Monitoring of own fund requirements. Capital adequacy

According to the prudential framework in place at EU level, directly applicable at national level, credit institutions shall at all times meet the following own funds requirements¹¹²: 8 percent for total capital ratio, 6 percent for Tier 1 capital ratio and 4.5 percent for Common Equity Tier 1 capital ratio.

General prudential requirements are supplemented by individual arrangements that the National Bank of Romania, in its capacity as competent authority, may decide as a result of its ongoing supervisory review of credit institutions, specific requirements having to be tailored to the specific risk profile of institutions. Additional own fund requirements must cover risks of unexpected losses and any expected losses not covered by provisions, the risk of underestimation of risk associated with model deficiencies and the risk arising from deficiencies in internal governance. In setting additional own fund requirements, the competent authority takes into consideration the internal capital requirements determined in the internal capital adequacy assessment process (ICAAP), the outcomes of the stress tests performed by the credit

¹¹² In line with Article 92 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

institution, including at the request of supervisors, and of the NBR's stress tests, as well as the adjustment mechanism for total capital requirements that can be applied by the National Bank of Romania depending on the reliability of the calculations made by credit institutions under the internal capital adequacy assessment process and on the outcome of the supervisory review and evaluation process.

Specifically, the supervisory authority determines the Total Supervisory Capital Requirements (TSCR) for each credit institution as the sum of own funds requirements for covering risks the bank is exposed to.

Moreover, the Overall Capital Requirement (OCR) is determined based on TSCR, to which add the capital buffer requirements provided for in Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and set forth by NBR order.

Thus, for 2016, the National Bank of Romania introduced additional capital requirements consisting in: (i) a capital conservation buffer of 0.625 percent of the total risk exposure amount for all credit institutions, Romanian legal entities; (ii) a countercyclical capital buffer of 0 percent¹¹³; and (iii) an O-SII buffer of 1 percent of the total risk exposure amount for all credit institutions identified as systemically important¹¹⁴.

While the first two buffers cover all credit institutions authorised by the National Bank of Romania, the requirement on the O-SII buffer applies solely to those institutions identified by the National Bank of Romania under Article 267(1) of NBR Regulation No. 5/2013 as "other systemically important institutions" (O-SII). According to the assessment made on the basis of data for 2015, the requirement on the O-SII buffer applied as of 1 January 2016 to the following credit institutions: Banca Comercială Română S.A., BRD – Groupe Société Générale S.A., UniCredit Bank S.A., Raiffeisen Bank S.A., Banca Transilvania S.A., Alpha Bank România S.A., Garanti Bank S.A., CEC Bank S.A. and Bancpost S.A.

Starting 1 January 2017, the capital conservation buffer increased to 1.25 percent of the total risk exposure amount, calculated pursuant to Article 92(3) of Regulation (EU) No 575/2013, and shall stand at 1.875 percent in the period from 1 January to 31 December 2018. Moreover, the list of O-SII credit institutions changed with the inclusion of OTP Bank S.A. (consolidated level) and Piraeus Bank S.A. (individual level) as of 1 March 2017¹¹⁵.

According to data reported in line with EBA's directly applicable technical standards¹¹⁶, most credit institutions have an appropriate level of capitalisation, given that solvency indicators exceeded capital requirements during the entire period under review.

¹¹³ NBR Order No. 12/2015 on the capital conservation buffer and the countercyclical capital buffer.

¹¹⁴ NBR Order No. 111/2015 on the buffer for credit institutions authorised in Romania and identified by the National Bank of Romania as other systemically important institutions (O-SII).

¹¹⁵ NBR Order No. 1/2017 on the buffer for credit institutions authorised in Romania and identified by the National Bank of Romania as other systemically important institutions (O-SII).

¹¹⁶ Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council, as subsequently amended and supplemented.

At end-2016, total own funds stood at lei 37,595.6 million, up 8 percent from a year earlier. Tier 1 capital and Common Equity Tier 1 capital reported a 10.4 percent rise, from lei 30,371.1 million to lei 33,523 million. A major influence on own funds dynamics was also exerted by the removal of another 20 percent of existing prudential filters, which have been gradually phased out once with the implementation of the CRD IV/CRR package, contributing to the positive adjustment of own funds.

The total capital ratio stood above the level reported at previous year-end, i.e. at 19.7 percent in December 2016 versus 19.2 percent in December 2015, as a result own funds rising at a faster pace than the total risk exposure amount (8 percent versus 5.2 percent; Table 5.4). In the context of the entry into force of the Law on the discharge of mortgage-backed debts through transfer of title over immovable property, the National Bank of Romania required credit institutions to properly assess the resulting credit risk and to cover it adequately by capital requirements tailored to the specific situation of each credit institution.

Moreover, Tier 1 capital ratio and Common Equity Tier 1 capital ratio exceeded prudential requirements in December 2016, both standing at 17.5 percent versus the required thresholds of 6 percent and 4.5 percent respectively. In fact, the two indicators stand above the European banking system average of 15.4 percent and 14.2 percent respectively as at December 2016, thus falling into the lowest risk bucket according to thresholds set by EBA in the quarterly assessment of a set of key risk indicators (EBA Risk Dashboard)¹¹⁷.

It should be noted that Tier 1 capital, along with Common Equity Tier 1 capital account for 89.2 percent of total own funds.

Apart from the three capital ratios, the monitoring of solvency includes the leverage ratio. After several years of monitoring and calibrating it, the minimum requirement for this indicator, namely 3 percent, will be applicable as of January 2018.

At end-2016, the level of this indicator, calculated based on the provisional definition of Tier 1 capital, was 8.9 percent for credit institutions registered in Romania, higher than the 8.2 percent level reported in December 2015.

With the changes to the regulatory framework regarding the leverage ratio, introduced by Commission Delegated Regulation (EU) 2015/62 amending Regulation (EU) No 575/2013, the indicator was revised in order to lead to a more accurate measure of leverage and serve as a proportionate constraint on the accumulation of leverage in credit institutions. In this context, EBA amended the implementing technical standards on leverage ratio reporting¹¹⁸, so as to ensure consistency between amended legislation and the relevant information to be provided by credit institutions to supervisory authorities. As of September 2016, data reporting is based on the methodology used for calculating the leverage ratio as indicator at end-quarter.

¹¹⁷ <http://www.eba.europa.eu/risk-analysis-and-data/risk-dashboard>.

¹¹⁸ Commission Implementing Regulation (EU) 2016/428 of 23 March 2016 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions as regards the reporting of the Leverage Ratio.

Monitoring of asset quality

During the period under review, the main asset quality indicators generally strengthened their positive trend. Credit institutions further pursued the balance sheet clean-up by resorting to write-offs of non-performing loans, in particular fully-provisioned NPLs, and to loan sales. Repayment of outstanding loans, as well as application of restructuring measures impacted also the size and trend of indicators.

Specifically, the non-performing loan ratio¹¹⁹ fell below the 10 percent threshold to stand at 9.6 percent at end-December 2016, down by 3.9 percentage points against end-2015.

Indicators	percent	
	2015	2016
Capital adequacy		
Total capital ratio (previously solvency ratio)	19.2	19.7
Tier 1 capital ratio	16.7	17.5
Common Equity Tier 1 capital ratio	16.7	17.5
Leverage ratio	8.2	8.9
Asset quality		
Loans to customers (gross) / Total assets (gross)	56.0	56.6
Interbank loans and investments (gross) / Total assets (gross)	15.9	16.5
Impaired loans to non-bank customers (net) / Total loan portfolio to customers (net)	7.0	4.9
Impaired loans to non-bank customers (net) / Total assets (net)	3.8	2.7
Impaired loans to non-bank customers (net) / Total liabilities	4.3	3.0
Non-performing loan ratio ¹ (EBA definition)	13.5	9.6
Profitability		
ROA (Net income / Total assets, average)	1.2	1.1
ROE (Net income / Total equity, average)	11.8	10.4
Liquidity		
Immediate liquidity	40.8	40.3
Liquidity ratio ² (effective liquidity / required liquidity):		
– MB ≤ 1 month	1.7	1.6
– 1 month < MB ≤ 3 months	5.5	6.3
– 3 months < MB ≤ 6 months	7.9	7.3
– 6 months < MB ≤ 12 months	10.1	7.7
– 12 months < MB	4.9	6.4
(1) Pursuant to the EBA definition, implemented at national level by NBR Order No. 6/2014, non-performing exposures are those that satisfy either of the following criteria: (i) material exposures which are more than 90 days past-due; (ii) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due. In June 2015, the methodological notes on the FINREP framework at solo level were amended so as to include cash balances with the central bank and other demand deposits with credit institutions in the non-performing exposure report.		
(2) The liquidity ratio is expressed in units.		

Table 5.4
Key indicators of
the banking system

Behind the lower NLP ratio stood solely the numerator effect, given the drop in the volume of non-performing loans and advances by 29 percent (from lei 35,799.2 million in December 2015 to 25,415.4 million in December 2016). Exposure from loans and

¹¹⁹ Pursuant to the EBA definition, a loan is considered a non-performing exposure if it is more than 90 days past due and/or the debtor is assessed as unlikely to pay its credit obligations in full without the realisation of the collateral, regardless of the existence of any past due amount or of the number of days past due.

advances witnessed a slight decrease of 0.3 percent, from lei 265,057.1 million in December 2015 to lei 264,150.2 million in December 2016. The types of debtors whose exposure is covered by this indicator include central banks, public administrations, credit institutions, other financial corporations, non-financial corporations and households.

Given the large volume of non-performing loans and the persistent restructuring measures, the NPL ratio (9.6 percent) and the restructured loans ratio (6.4 percent) remained in the red bucket, as described by the European Banking Authority, surpassing the EU banking system average of 5.2 percent and 3.2 percent respectively. However, the vulnerabilities reflected by these two indicators are offset by the NPL coverage by provisions, calculated based on the EBA definition, which remained at a high level of 56.3 percent, placing the Romanian banking system way above the EU average of 44.7 percent.

The resolution of NPLs and adequate provisioning were boosted by the prudential measures that the NBR has taken since 2013, related to successive collateral revaluations, loss recognition in case of uncollectible non-performing loans, full provisioning of NPLs overdue for more than 360 days, where banks did not initiate legal proceedings, as well as of unsecured NPLs overdue for more than 180 days, followed by their write-off.

Lending was also impacted by the changes in the housing loan market following the entry into force in May 2016 of Law No. 77/2016 on the discharge of mortgage-backed debts through transfer of title over immovable property. The implementation of the said law generated uncertainties surrounding the payment behaviour of mortgage loan borrowers, with possible effects on the evolution of NPLs and, implicitly, on the setting-up of provisions by credit institutions, as well as on capital requirements for credit risk.

Given that the Constitutional Court declared unconstitutional some of the provisions of Law No. 77/2016, its implementation is expected to have a significantly lower impact on banks than initially estimated.

Mention should be made that, as of January 2018, the banking sector will shift from the incurred loss impairment model (provided for in the International Accounting Standard IAS 39) to that based on expected losses (established by the International Financial Reporting Standard IFRS 9). The application of IFRS 9 will have a significant impact on risk management, as well as on the banking business model, generating also an increase in the importance of professional judgement and in the complexity of the reporting activity.

The main estimated impact of the IFRS 9 implementation on risk management consists in a more prudent credit risk management, by monitoring and identifying significant changes in this type of risk throughout the life of financial assets. Early monitoring mechanisms will aim mainly at preventing a significant worsening of credit quality – an approach different than that used so far, which targets the non-fulfilment of contractual obligations by the client (default).

Monitoring of liquidity requirements

According to the transitional provision for the introduction of the liquidity coverage ratio (LCR), the minimum liquidity requirements were 70 percent in 2016 and 80 percent in 2017, before reaching 100 percent as of January 2018. The calibration of this indicator and the calculation methodology were included in a delegated act adopted by the European Commission, i.e. Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions¹²⁰.

Following the entry into force of the delegated act, EBA amended the implementing technical standards with regard to LCR reporting¹²¹, so as to introduce new reporting templates and instructions, in line with specifications laid down in Delegated Regulation (EU) 2015/61, respectively to include all the necessary elements for the ratio calculation.

According to reports submitted on 31 December 2016, LCR for each credit institution stood comfortably above the minimum level of 70 percent required for 2016.

Pursuant to Article 412 of Regulation (EU) No 575/2013, institutions shall hold liquid assets, the sum of the values of which covers the liquidity outflows less the liquidity inflows under stressed conditions so as to ensure that institutions maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of 30 days. If they hold adequate liquidity buffers, credit institutions may use their liquid assets to cover their net liquidity outflows during times of stress.

Across the banking system, the liquidity coverage ratio stood at 229.4 percent on 31 December 2016, significantly above the level of EU banks, which came in at 140.7 percent on the same date, pointing to sufficient high-quality liquid assets in a 30-day stress scenario. Moreover, the immediate liquidity ratio remained at around 40 percent.

As for the prudential liquidity indicator regulated by the National Bank of Romania, calculated as a ratio of effective liquidity to required liquidity, the level reported at end-2016 was double the minimum required (1). Despite the mismatches between total assets and total liabilities by maturity buckets 1M-3M, 3M-6M and 6M-12M, stemming from the low maturity of funds raised and the high share of loans with medium- and long-term maturities, no imbalances occurred. Specifically, the distribution of cash flows associated with assets and liabilities by maturity buckets resulted in a financing surplus for each bucket. In order to prevent liquidity risk, an appropriate correlation between assets and liabilities is needed with regard to the duration of mobilisation and use of resources.

¹²⁰ On 1 October 2015, when the Delegated Regulation (EU) 2015/61 entered into force, the liquidity coverage requirement was 60 percent.

¹²¹ Commission Implementing Regulation (EU) 2016/322 of 10 February 2016 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions of the liquidity coverage requirement.

The breakdown by component shows that the Romanian banking system financing relied on funds raised from the local market, mainly on the short term, while total foreign financing, namely funds raised from parent banks, continued to decline, resulting in lower cross-border contagion risk. If the stock of deposits taken from non-bank clients expanded by 9.8 percent compared to the previous year (from lei 269,240.3 million to lei 295,530.5 million), funds raised from parent banks dropped by approximately 21 percent versus end-2015 (from lei 44,028 million in December 2015 to lei 34,761.5 million in December 2016).

Profitability¹²²

Profitability is an important indicator of banks' competitiveness level and management quality. Banks conduct their business based on the profitability criterion, looking to make a net profit depending on the specific risks they take, the restrictions imposed by the legislative framework, the overall economic developments, etc.

The Romanian banking system reported a net profit of lei 4,153.2 million at end-2016, despite challenging external and domestic developments, with over two thirds of local credit institutions recording positive net results at year end.

Aggregate net profit during 2016 fell by approximately lei 322 million as compared with 2015, amid one-off influences seen in 2015, despite the much better operating financial performance. Behind the positive dynamics of operating profit (roughly 20 percent) stood the rise in operating income (by 6.6 percent, from lei 18,165.7 million in 2015 to lei 19,355.5 million in 2016), accounted for mainly by net interest income, as well as the fall in operating expenses (by 3.2 percent, from lei 10,604.2 million in 2015 to lei 10,264.2 million in 2016).

The adjustment in operating expenses owed also to the Romanian banking system restructuring, following the closure of bank units and the drop in the number of employees. Hence, staff costs and other administrative expenses went down by 2 percent and 4.6 percent respectively versus 2015. Moreover, the higher operating income was significantly driven also by the revenues collected in 2016 H1 by credit institutions that are shareholders in Visa, following the acquisition of payment processor Visa Europe by American Visa Inc. In this context, the cost-to-income ratio stood at 53 percent, better in terms of performance than the 2015 level (58.4 percent) and the EU banking system average (65.7 percent).

As for profitability indicators, despite reporting slightly lower readings than in 2015, their values exceeded the EU banking system average as at 31 December 2016.

Specifically, return on assets (ROA) reached 1.1 percent at end-2016, marginally down by 0.1 percentage points versus 2015, against the background of a 6.6 percent rise in average total assets (from lei 361,536.8 million to lei 385,417.6 million), along with lower net profit in 2016.

¹²² This section covers credit institutions, Romanian legal entities, and branches of foreign credit institutions.

	Net assets		Own funds*	
	lei mill.	%	lei mill.	%
1. Credit institutions with majority domestic capital, of which:	34,375.4	8.73	3,295.6	8.25
1.1. State-owned credit institutions, of which:	32,466.7	8.25	2,903.4	7.27
1. CEC Bank	28,194.8	7.16	1,881.7	4.71
2. Banca de Export-Import a României – Eximbank	4,271.9	1.09	1,021.7	2.56
1.2. Credit institutions with majority private capital, of which:	1,908.7	0.48	392.2	0.98
1. Banca Centrală Cooperatistă Creditcoop	1,111.9	0.28	268.2	0.67
2. Banca Comercială Ferroviară	646.9	0.16	39.4	0.10
3. Banca Română de Credite și Investiții	149.9	0.04	84.6	0.21
2. Credit institutions with majority foreign capital, of which:	316,370.8	80.37	34,300.0	85.87
1. Banca Comercială Română	64,068.2	16.28	7,655.9	19.17
2. Banca Transilvania	51,776.1	13.15	5,529.8	13.84
3. BRD – Groupe Société Générale	50,657.6	12.87	5,212.0	13.05
4. Raiffeisen Bank	33,419.8	8.49	3,540.2	8.86
5. UniCredit Bank	32,687.2	8.30	3,029.2	7.58
6. Alpha Bank	14,732.5	3.74	1,893.9	4.74
7. Bancpost	11,656.9	2.96	1,315.1	3.29
8. Garanti Bank	8,959.7	2.28	883.0	2.21
9. OTP Bank	8,215.3	2.09	824.7	2.06
10. Piraeus Bank	6,572.5	1.67	834.3	2.09
11. Banca Românească Grupul National Bank of Greece	6,383.2	1.62	737.5	1.85
12. Credit Europe Bank	4,292.6	1.09	618.4	1.55
13. Banca Comercială Intesa SanPaolo	4,088.5	1.04	435.2	1.09
14. Libra Internet Bank	3,392.1	0.86	275.3	0.69
15. BCR Banca pentru Locuințe	3,109.7	0.79	117.4	0.29
16. Banca Comercială Carpatica	2,603.5	0.66	135.2	0.34
17. Marfîn Bank	2,032.0	0.52	300.9	0.75
18. Idea Bank	1,521.2	0.39	108.9	0.27
19. ProCredit Bank	1,383.7	0.35	188.7	0.47
20. Bank Leumi	1,263.9	0.32	160.5	0.40
21. Crédit Agricole Bank	1,249.4	0.32	165.8	0.42
22. Patria Bank	1,138.0	0.29	137.6	0.34
23. Raiffeisen Banca pentru Locuințe	745.9	0.19	71.6	0.18
24. Porsche Bank	421.3	0.11	128.9	0.32
I. Total credit institutions, Romanian legal entities (1+2)	350,746.2	89.10	37,595.6	94.12
II. Branches of foreign credit institutions, of which:	42,901.7	10.90	2,350.4	5.88
1. ING Bank N.V., Amsterdam	27,869.7	7.08	1,894.8	4.74
2. Citibank Europe plc, Dublin	6,815.2	1.73	571.0	1.43
3. Veneto Banca Spa Italia Montebelluna	4,111.2	1.04	-256.5	-0.64
4. Bank of Cyprus Public Company Limited Nicosia	1,624.7	0.41	-78.6	-0.20
5. BNP Paribas Fortis SA/NV Bruxelles	1,066.5	0.27	21.0	0.05
6. Blom Bank France Paris	799.4	0.20	195.9	0.49
7. TBI Bank EAD Sofia	608.1	0.15	-3.5	-0.01
8. Alior Bank Varșovia	6.9	0.002	6.3	0.02
Total credit institutions (I+II)	393,647.9	100.00	39,946.0	100.00
*) own capital for branches of foreign credit institutions				

Table 5.5

Net assets and own funds
as at 31 December 2016

Moreover, return on equity (ROE) came in at 10.4 percent at end-2016, pointing to good returns on shareholder investment against the European average, of 3.3 percent. However, compared to 2015, the return on equity was slightly lower (by 1.4 percentage points), amid both a drop in net profit and a rise in average total equity (by 4.8 percent).

1.3. Assessment of banking risks

As of 1 January 2016, the NBR Board approved the implementation into national supervisory practices of EBA Guidelines on Common procedures and methodologies for the supervisory review and evaluation process (SREP). The objective of the supervisory review and evaluation process of credit institutions is to promote a sound banking system, which is essential for ensuring the sustainable financing of the economy.

In the supervisory review and evaluation process, the NBR classifies credit institutions based on their size, structure and internal organisation, and on the nature, scope and complexity of their activities. Additionally, the central bank continuously assesses the risks to which the institution is or might be exposed, the risk profile and viability of the institution through the overall assessment of capital and liquidity. At the same time, the annual assessment establishes if the credit institution's own funds ensure the sound coverage of the risks assessed as significant, as well as the structure of additional own funds, and if there is an appropriate coverage of liquidity and funding risk.

According to the SREP methodology, the supervisory authority assigns to each credit institution an overall score reflecting the overall viability of the institution, which is based on a scale of 1 to 4, where 1 means no discernible risk, 2 – low risk, 3 – medium risk and 4 – high risk. Moreover, when the institution is considered to be 'failing' or 'likely to fail', it is assigned a score of 5 and the interaction procedure with the resolution authority is activated.

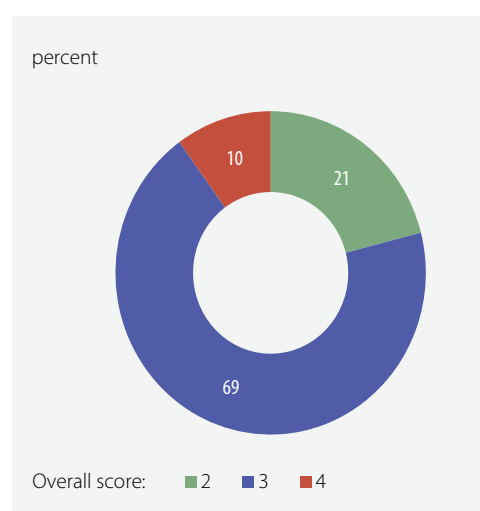


Chart 5.1
Distribution of credit institutions
subject to SREP by overall score

The conclusions of this assessment are communicated to each credit institution, together with the measures it should implement in the period ahead. Credit institutions are applied minimum capital requirements known as Pillar 1 and capital requirements commensurate with their risk profiles resulting from the supervisory assessment (known as Pillar 2) are communicated to them based on the SREP decision. Pillar 2 capital

requirements may trigger a capital increase only when they are higher than minimum requirements.

After conducting the SREP, overall scores of 2, 3 and 4 were assigned to 21 percent, 69 percent and 10 percent respectively of the 29 credit institutions (Chart 5.1).

At system level, average and median of total SREP capital requirements (TSCR) were of about 12 percent.

The distribution of credit institutions by including SREP elements in risk categories shows that a score of 2 was assigned in most cases to liquidity adequacy (59 percent of the assessed institutions) and a score of 3 was applied to capital adequacy, business model and internal governance (69 percent, 65 percent and 59 percent respectively, Chart 5.2).

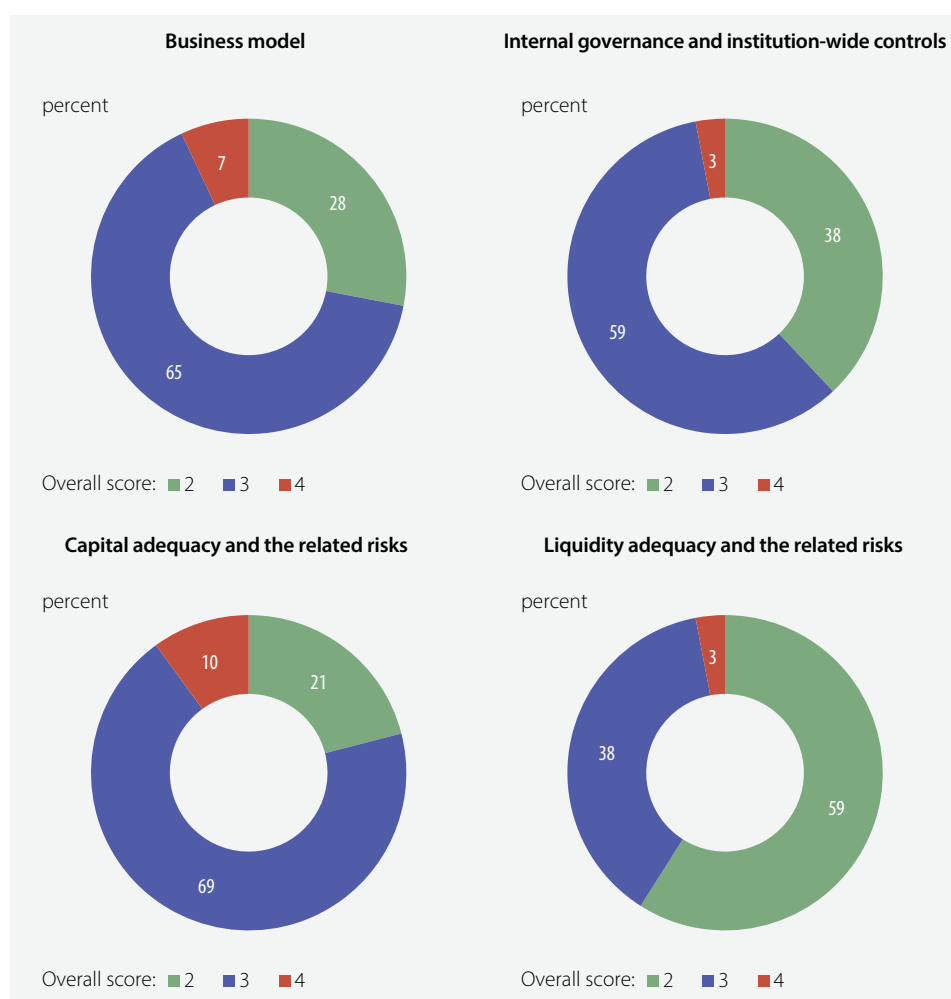


Chart 5.2
SREP elements
by the score assigned

The individual SREP decision also contributes to the planning of the supervisory cycle, of the frequency and depth of on-site and off-site supervisory activities.

Under the 2016 assessment and verification programme, approved by the Supervisory Committee, 30 inspections were conducted, of which 29 at the head-offices of credit institutions, Romanian legal entities, and one at the branch in Romania of a credit institution having its head office in another Member State.

The supervisory activities conducted under the annual assessment and verification programme focused on the viability and sustainability of the business model, internal governance and institution-wide controls, the assessment of capital adequacy and the related risks, the assessment of liquidity adequacy and the related risks, verifying the implementation of the measures imposed by the NBR and of the set of measures prepared by the credit institution.

In addition to the scheduled inspections, 24 narrowly-targeted thematic inspections were also conducted (Table 5.6).

Table 5.6
Themes of narrowly-targeted
inspections

No.	Themes	No. of inspections
1	The manner in which own funds ensure the prudent management and appropriate coverage of risks in relation to the profile risk of the credit institution (TSCR rates)	5
2	Compliance with the prudential regulatory framework relevant for the limits of large exposures	3
3	Internal rating model used by the credit institution to assess corporate customers in order to determine the capital requirement for credit risk, based on the internal ratings-based approach	1
4	Credit risk, in light of NBR Regulation No. 17/2012 on certain lending conditions	1
5	Setting-up impairment losses on restructured loans	2
6	Management framework for debt restructuring	2
7	Erasure from the Land Register of mortgages on real estate properties accepted as collateral for loans granted through the "First Home" programme	1
8	Using the advanced measurement approach for operational risk	1
9	Regulatory and reporting framework for suspicious operations and fraud incidents	1
10	Management of risks arising from outsourced services and activities	1
11	Annual reports submitted to the NBR according to Article 676 of NBR Regulation No. 5/2013 on prudential requirements for credit institutions	1
12	Erroneous reporting of data in the FINREP statements at solo level	1
13	Implementation of measures imposed by the NBR	5

Based on the supervisory reports prepared for both scheduled and narrowly-targeted thematic inspections, the NBR imposed supervisory measures generally regarding the business management framework and the internal capital adequacy assessment process (Table 5.7) or imposed sanctions, of which 29 written warnings and 29 fines (Table 5.8).

Table 5.7
Supervisory measures imposed
pursuant to Government
Emergency Ordinance No. 99/2006
on credit institutions,
as subsequently amended
and supplemented

No.	Measures	No. of cases
1	Strengthening the provisions on governance and internal capital management	32
2	Maintaining own funds at a level higher than the minimum capital requirements	27
3	Reducing the risk inherent to activities, products and systems	11
4	Implementing a specific provisioning policy or treatment of assets	5
5	Submitting a plan for restoring compliance with supervisory requirements	1
6	Reducing/limiting activities or operations	1
	Total	77

Table 5.8

Sanctions imposed in 2016

Type of sanction	No. of cases, of which:	Banks	Board members	Executives	Directors
Written warning	29	7	15	4	2
Fine	29	1	9	13	6
Total	58	8	24	17	8

The deficiencies for which sanctions were enforced are detailed under the legal transparency requirements applicable to supervisory authorities on the NBR website in the 'Supervision' section.

Specifically, pursuant to Article 234(4) of Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, amended and supplemented by Law No. 227/2007, as subsequently amended and supplemented, the National Bank of Romania shall publish on its website, as soon as possible, the sanctions imposed in accordance with Article 229(1), that were not challenged under Article 275 and those for which objections were definitively rejected, as well as information regarding the type and nature of the breach and the identity of the sanctioned natural or legal person, after their notification of the imposed sanction.

Table 5.9

Number of persons in the category of those referred to in Article 108 of Government Emergency Ordinance No. 99/2006, subject to the NBR's approval in 2016

Number of persons subject to the NBR's approval	Rejected following the NBR's assessment made pursuant to Article 109 of Government Emergency Ordinance No. 99/2006				
	TOTAL, of which:	Approved	Rejected for non-compliance with the conditions stipulated by the special law*	Request for approval withdrawn by the credit institution	
Executives	35	31	-	1	3
Board members	32	26	-	2	4
Middle management	78	69	-	5	4
Total	145	126	-	8	11

*) Government Emergency Ordinance No. 75/1999 on financial audit, republished

In 2016, in the process of prior approval conducted by the National Bank of Romania via the Supervision Department, pursuant to the legal framework in force (Article 108 of Government Emergency Ordinance No. 99/2006), 145 requests for prior approval were processed related to credit institutions' board members, executives and persons designated to ensure the management of particularly important structures (risk management and risk control, internal audit, compliance, treasury, lending, as well as any other activities that may expose the credit institution to significant risks), including individuals who were assigned new responsibilities (Table 5.9).

2. Supervision of guarantee schemes

Directive 2014/49/EU of the European Parliament and of the Council on deposit guarantee schemes, transposed into national legislation by Law No. 311/2015 on deposit guarantee schemes and the Bank Deposit Guarantee Fund, assigns a series of prerogative powers to the National Bank of Romania with regard to the administration and supervision of deposit guarantee schemes.

In light of the said prerogative powers, the National Bank of Romania is the competent administrative authority for classifying deposits as unavailable, as well as the designated authority in charge of deposit guarantee schemes in place at national level. At present, the only guarantee scheme officially recognised on the territory of Romania is the Bank Deposit Guarantee Fund (FGDB), which operates as a statutory scheme under Government Ordinance No. 39/1996 on the establishment and operation of the Bank Deposit Guarantee Fund, republished, as subsequently amended and supplemented.

Credit institutions' deposits covered by the Bank Deposit Guarantee Fund amounted to lei 158,619.3 million at end-2016, up by 6.6 percent versus the same year-ago period.

3. Supervision of non-bank financial institutions, payment institutions and electronic money institutions

In 2016, the stabilising trend that had started in the previous year in the sector of non-bank financial institutions (NBFIs), payment institutions and electronic money institutions continued in terms of both number and key aggregate financial indicators.

3.1. Non-bank financial institutions

The number of NBFIs in the General Register increased to 177 at end-2016 from 172 at end-2015, following the erasure of 10 institutions, concurrently with the registration of other 15 institutions. Erasures were performed largely upon request (8 cases), one was made for other legal grounds and another following the imposition of sanctions on the institution.

By type of lending activity, according to sections in the General Register, 142 institutions (80 percent) were recorded under 'Multiple lending activities', a share similar to that reported at end-2015 (77 percent).

Moreover, compared to end-2015, the number of NBFIs registered with the Special Register at end-2016 dropped from 44 to 39 (Table 5.10).

Table 5.10Breakdown of NBFIs by activity
as at 31 December 2016

Activity	Special Register		General Register*		General Register	
	No.	%	No.	%	No.	%
Multiple lending activities	34	87.2	108	78.3	142	80.2
Financial leases	4	10.3	18	13.0	22	12.4
Issuing guarantees and assuming commitments, including credit guarantee	1	2.6	4	2.9	5	2.8
Consumer loans	0	0.0	4	2.9	4	2.3
Micro loans	0	0.0	2	1.4	2	1.1
Financing of commercial transactions	0	0.0	1	0.7	1	0.6
Factoring	0	0.0	1	0.7	1	0.6
Housing and/or mortgage loans	0	0.0	0	0.0	0	0.0
Discounting	0	0.0	0	0.0	0	0.0
Forfeiting	0	0.0	0	0.0	0	0.0
Other financing means in the form of loans	0	0.0	0	0.0	0	0.0
Total	39	100.0	138	100.0	177	100.0

*) excluding NBFIs in the Special Register

The share capital of NBFIs contracted by 6.9 percent compared to the end of the previous year, running at lei 2,813.2 million at end-2016, whereas their aggregate assets (net) followed an upward trend to reach lei 28,084.0 million, up 11.3 percent year on year.

The aggregate level of loans and commitments equalled lei 42,657.3 million, up 11.5 percent from the prior year. The breakdown shows that financial leases amounted to lei 10,852.0 million (25.4 percent), other loans came in at lei 10,313.4 million (24.2 percent), while the balance on commitments assumed and guarantees issued stood at lei 21,491.9 million (50.4 percent).

Other loans followed a sharply upward path compared to the end of 2015, up 26.6 percent. Financial leases reversed their past years' downtrend, rising by 13.9 percent, whereas commitments assumed and guarantees issued stayed on an upward trend, albeit at a slower pace (4.4 percent).

Overdue and doubtful claims (net) dropped in 2015-2016 both in absolute terms, to lei 759.6 million from lei 791.6 million (down 4.0 percent) and as a share in total assets (net), to 2.7 percent from 3.1 percent. In the course of 2016, overdue and doubtful loans followed an uptrend (from lei 482.8 million to lei 537.6 million), which was steeper for the NBFIs in the Special Register (15.1 percent) than in the case of NBFIs entered only in the General Register (0.7 percent).

Nevertheless, the level of provisions for overdue and doubtful loans shrank from lei 3,270.8 million to lei 2,682.1 million, pinpointing an improvement in the debt service relative to these borrowings. This inference is upheld also by the compression of non-performing loans and commitments from lei 4,022 million to lei 3,271.2 million.

Moreover, during 2016, the NBFIs improved their profitability significantly, with the financial result standing in positive territory for both the entities entered in the Special Register and those only in the General Register.

The aggregate profit of the NBFIs registered with the Special Register equalled lei 459.4 million and that of the NBFIs entered only in the General Register stood at lei 288.6 million, with total profit of the system amounting to lei 748.0 million (Table 5.11).

lei million**			
Indicator	Special Register	General Register***	General Register
Share/endowment capital	2,126.2	687.0	2,813.2
Total assets (net)	25,675.5	2,408.5	28,084.0
Total loans and commitments (net), of which:	40,436.9	2,220.4	42,657.3
– financial leases	10,600.9	251.1	10,852.0
– other loans	9,147.4	1,166.0	10,313.4
– commitments	20,688.6	803.3	21,491.9
Overdue and doubtful claims (net), of which:	602.6	157.0	759.6
– overdue and doubtful loans	410.2	127.4	537.6
Provisions for overdue and doubtful claims, of which:	2,769.9	431.2	3,201.1
– provisions for overdue and doubtful loans	2,351.2	330.9	2,682.1
Non-performing loans and commitments****	2,781.6	489.6	3,271.2
Retained earnings/Loss carried forward	248.4	-63.7	184.7
Profit for the year 2016	459.4	288.6	748.0
ROA (Net income/Total assets; %)	1.8	12.0	2.7
ROE (Net income/Total equity; %)	8.8	26.2	11.8
Number of contracts	1,167,917	1,129,650	2,297,567
Number of customers, of which:	1,023,835	916,256	1,940,091
– individuals	938,672	906,790	1,845,462
– legal entities	85,163	9,466	94,629
*) including data reported by NBFIs that are also payment institutions			
**) excluding "ROA", "ROE", "Number of contracts" and "Number of customers"			
***) excluding NBFIs entered in the Special Register			
****) overdue for more than 90 days and/or in which case legal proceedings have been initiated to recover the assets (with debtor contagion)			

Table 5.11
Key indicators of the NBF sector
as at 31 December 2016*

Key profitability indicators (return on equity – ROE and return on assets – ROA) of the NBFIs listed only in the General Register posted significantly higher values (ROE: 26.2 percent and ROA: 12 percent) compared with the NBFIs registered also with the Special Register (ROE: 8.8 percent and ROA: 1.8 percent), reflecting higher profitability of small-sized NBFIs. Compared to previous years, the profitability of NBFIs entered in the General Register was more volatile, while the NBFIs registered also with the Special Register saw greater stability.

Total number of financing agreements and the number of customers of NBFIs stayed on the upward paths seen in 2015.

Table 5.12 sets out the breakdown of the share/endowment capital by country of origin for the NBFIs registered with the Special Register at end-2016.

Table 5.12
Share/endowment capital
by country of origin
as at 31 December 2016

Country of origin	Share/Endowment capital		percent
	in total capital	in total foreign capital	
Romania	68.9		
Germany	8.0	25.9	
France	7.7	24.6	
Sweden	4.7	15.0	
Netherlands	4.0	12.8	
Italy	3.5	11.2	
Austria	1.2	3.7	
Cyprus	1.0	3.2	
Poland	0.8	2.7	
Greece	0.3	0.9	

In 2016, capital from certain countries holding a small share in total foreign capital tended to exit the market, the same as in the previous year. At the same time, the share of domestic capital continued to widen, from 67.4 percent to 68.9 percent.

As for the other countries holding stakes in the share/endowment capital of the NBFIs listed in the Special Register, at end-2016 Germany was in the lead (25.9 percent in total foreign capital), ahead of France (24.6 percent) and Sweden (15.0 percent), the three EU Member States accounting for 65.5 percent of foreign capital.

Foreign capital was tantamount to lei 661.2 million, down lei 95.6 million versus 2015.

3.2. Prudential supervision and oversight of NBFIs

Prudential supervision and oversight of NBFIs translated into monitoring the drafting and submission of regular reports and changes in their standing, as well as into the conduct of on-site inspections by the dedicated NBR staff. The actions resulted in supervision reports and sanctions enforced, as appropriate, in accordance with the legal provisions in force.

The on-site inspections, carried out in compliance with the annual inspection programme, focused on checking the operating activity of 15 NBFIs listed in the Special Register and 2 NBFIs entered only in the General Register.

Based on the reports compiled by the on-site inspection teams, sanctions in the form of 7 written warnings were imposed on 7 institutions. In addition, 6 NBFIs were required to draft and submit remedial action plans.

3.3. Payment institutions

At end-2016, 9 payment institutions and 87 agents through which they performed payment services in Romania and abroad were listed in the Payment Institutions Register.

Moreover, 5 authorised payment institutions are also NBFIs, entered in the General Register.

In 2016, the prudential supervision of payment institutions was conducted based on the analysis of the reports they submitted, in compliance with NBR Regulation No. 21/2009 on payment institutions, as subsequently amended and supplemented, and of the changes in their standing, as well as based on the on-site inspections by the dedicated NBR staff. The on-site inspections were carried out according to the annual inspection programme and focused on checking the operating activity of 3 payment institutions, other than those that are also NBFIs, ending without enforcement of sanctions and measures.

3.4. Electronic money institutions

At end-2016, 3 such institutions were listed in the Register of Electronic Money Institutions.

During the period under review, the prudential supervision of electronic money institutions was conducted based on the analysis of the reports they submitted, in compliance with NBR Regulation No 8/2011 on electronic money institutions, as subsequently amended and supplemented, and of the changes in their standing, as well as based on the on-site inspections by the dedicated NBR staff. The on-site inspections were carried out according to the annual inspection programme, focused on checking the operating activity of all 3 electronic money institutions and ended with the enforcement of a measure for meeting prudential requirements.

4. Monitoring the application of international sanctions, prevention of money laundering and terrorist financing

The National Bank of Romania oversees the application of international sanctions, checks and controls the enforcement of the legal framework regulating the prevention of money laundering and terrorist financing at the level of credit institutions and Romanian branches of foreign credit institutions, non-bank financial institutions, payment institutions and electronic money institutions.

Against this background, in 2016, 39 inspections were conducted at the head offices of entities supervised by the central bank, in compliance with the programme and subjects for their assessment and verification, as approved by the Supervisory Committee. In addition to the scheduled inspections, one narrowly-targeted thematic inspection was also conducted.

For the non-compliance with special legal provisions governing the prevention and sanctioning of money laundering and terrorist financing, as well as the implementation of international sanctions, orders were imposed with regard to

remedial action plans and letters of recommendation were sent to improve the framework for managing the risk of money laundering and terrorist financing; 38 sanctions for offences committed, i.e. 19 warnings and 19 fines (the latter totalling lei 335,000), were applied to 20 institutions.

Specifically, the institutions supervised by the NBR were sanctioned for breaching the provisions of Article 5(1), 5(7), 5(8) and 5(10), Article 6(2) and 6(3), Article 7(2), Article 11, Article 13, Article 14, Article 18(1)(c), Article 19, Article 20 and Article 21 of Law No. 656/2002 on the prevention and sanctioning of money laundering, as well as on enforcing some measures to prevent and combat terrorism financing, republished, as subsequently amended and supplemented, of Article 30a(1)(b) of Council Regulation (EU) No 267/2012 of 23 March 2012 concerning restrictive measures against Iran and repealing Regulation (EU) No 961/2010, as subsequently amended and supplemented, and of Article 9(1) and 9(2) of Regulation (EC) No 1781/2006 of the European Parliament and of the Council of 15 November 2006 on information on the payer accompanying transfers of funds.

Sanctions were imposed pursuant to Article 28 and Article III(3)(b) of Law No. 656/2002, republished, as subsequently amended and supplemented, and to Article 26 of Government Emergency Ordinance No. 202/2008 on the enforcement of international sanctions, as approved and amended by Law No. 217/2009, as subsequently amended and supplemented.

Moreover, for the enforcement of the same legal framework, 6 notifications concerning suspicious transactions of money laundering identified by inspection teams were submitted to the National Office for Prevention and Control of Money Laundering and another notification to a public institution with competencies in this field.

An important objective for the period covered by this *Report* was the research and identification of legal solutions specific to the scope of activity of entities supervised by the NBR, in order to transpose into national law the provisions of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

At the same time, the participation of the NBR representative in the Interinstitutional Council meetings¹²³, established for the purpose of providing the general cooperation framework for the application of international sanctions, ensured the documentation and expertise in the financial and banking area necessary for: (i) drafting the mandates and position documents of Romania, submitted to the international bodies with responsibilities in the field of international sanctions, particularly during the meetings of the RELEX working party – “Sanctions” formation – of the EU Council;

¹²³ The Interinstitutional Council was established in compliance with Article 13 of Government Emergency Ordinance No. 202/2008, approved by Law No. 217/2009, as subsequently amended and supplemented.

(ii) drafting and issuing advisory opinions in order to substantiate decisions on applying international sanctions; (iii) formulating observations on and/or proposals for the EU draft regulations and decisions regarding the application of international sanctions in this field; (iv) drafting the *Annual Report* on the measures taken by Romania with a view to enforcing the internationally established sanctions regimes in the financial and banking area (the *Report* is submitted to the Parliament and the Supreme Council of National Defence by the Prime Minister); (v) submitting for review certain aspects concerning the enforcement of international sanctions with a view to their clarification and uniform implementation; (vi) formulating proposals for amending and supplementing Government Emergency Ordinance No. 202/2008, approved by Law No. 217/2009, as subsequently amended and supplemented.

Another important permanent component of the activity was to inform with celerity the credit institutions about: (i) the adoption, amendment or supplementation of the sanctions to be applied in the financial and banking field; (ii) the adoption/update of guidelines and good practices in the field and (iii) the risk of money laundering and/or terrorist financing considering the vulnerabilities identified by the Financial Action Task Force (FATF), in order to take appropriate measures.

Furthermore, ongoing communication with the supervised institutions was ensured with regard to the way of applying the legislation on international sanctions, preventing and combating money laundering and terrorist financing, which referred particularly to notifications and drafting of some opinions with a view to clarifying and uniformly enforcing the appropriate legislation.

Based on the mandate granted by the NBR Board, the dedicated department ensured cooperation with: (i) the supervisory authorities, particularly the National Office for Prevention and Control of Money Laundering and the Financial Supervisory Authority, in what concerns the enforcement of regulations on preventing money laundering and terrorist financing, for providing information on a mutual basis while observing the professional secrecy requirements stipulated by law and (ii) the other national and international authorities tasked with the application of international sanctions, in compliance with the provisions of the legal cooperation framework.

Another line of action consisted in the NBR's participation, as a member, in the meetings of the Subcommittee on Anti-Money Laundering within the Joint Committee of the European Supervisory Authorities, as well as in the meetings of the European Commission's Expert Group on Money Laundering and Terrorist Financing (EGMLTF).



Chapter 6

Currency issue

Throughout 2016, the National Bank of Romania fulfilled its tasks as a currency issuing bank by providing the currency necessary to ensure smooth money circulation in terms of quantity, value and denomination composition. Moreover, the central bank steadily concerned itself with improving the quality of the notes and coins in circulation.

1. Developments in currency in circulation outside banks

In 2016, the currency in circulation outside banks continued its upward course, the pace of increase (+17.6 percent to lei 58,221.8 million¹²⁴) being 2.5 percentage points faster than that recorded in 2015.

Throughout 2016, February and March were the only months when the value of currency outside banks fell in monthly terms (up to 1.2 percent), before embarking in 2016 Q2 on a strong upward path visible until the end of the year. The same as in previous years, seasonal factors determined the sharpest changes: (i) April (up 4.3 percent), under the impact of Easter and (ii) December (up 3.6 percent), as a result of winter holidays and increased public expenditure. Currency outside banks reached a record high for the year under review, i.e. lei 59,338.7 million, on 23 December 2016, due to increased demand for currency specific to the winter holidays.

At end-2016, the number of banknotes outside banks was 1,200.2 million, up 13.6 percent year on year (Chart 6.1).

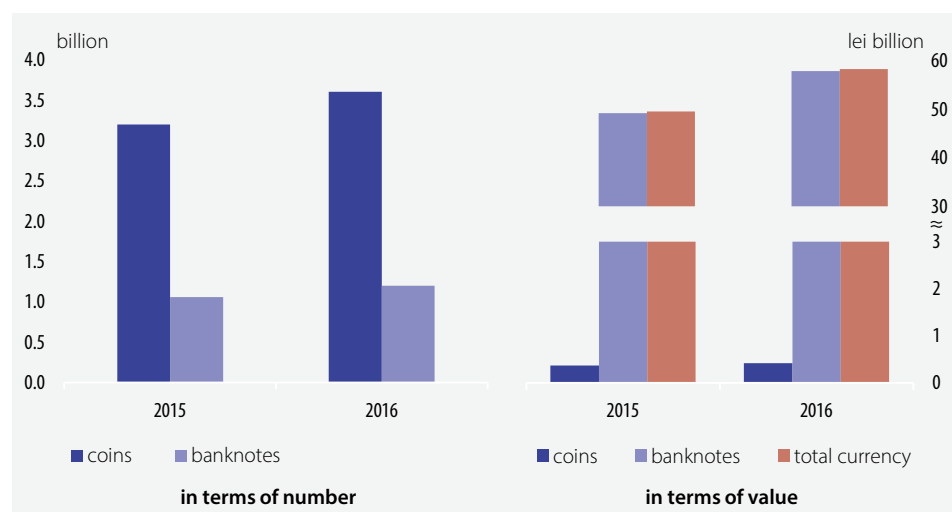


Chart 6.1

Composition of currency outside banks in 2015 and 2016

¹²⁴ Lei 55,680.3 million, excluding the cash in automated teller machines and automated exchange teller machines.

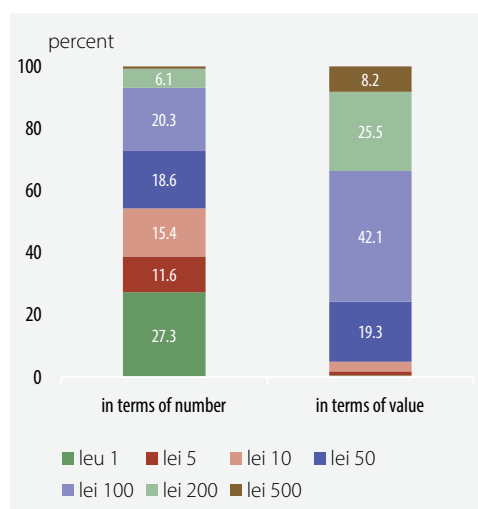
Banknotes outside banks reported rises in terms of number irrespective of denomination, with the lei 200 banknote posting the largest hike, i.e. 24.4 percent.

As at 31 December 2016, in terms of quantity, the lei 1 denomination maintained the largest share in total banknotes outside banks (27.3 percent), ahead of the lei 100 banknote (20.3 percent) and the lei 50 banknote (18.6 percent). Similarly to previous years, the lei 500 note took the lowest share of the total number

of banknotes outside banks, i.e. 0.8 percent. However, the number of lei 500 banknotes went up 16.3 percent from end-2015, which was higher than the average increase of the total number of banknotes.

The banknotes most frequently used for loading ATMs, namely the lei 100, the lei 200 and the lei 50 denominations, continued to take the highest shares of the total value of currency outside banks, i.e. 42.1 percent, 25.5 percent and 19.3 percent respectively (Chart 6.2).

Chart 6.2
Denomination composition of banknotes in circulation in 2016



At end-2016, the number of coins outside banks was 3,602.5 million, up 12.7 percent year on year, their value standing 12.6 percent higher than the same year-ago period.

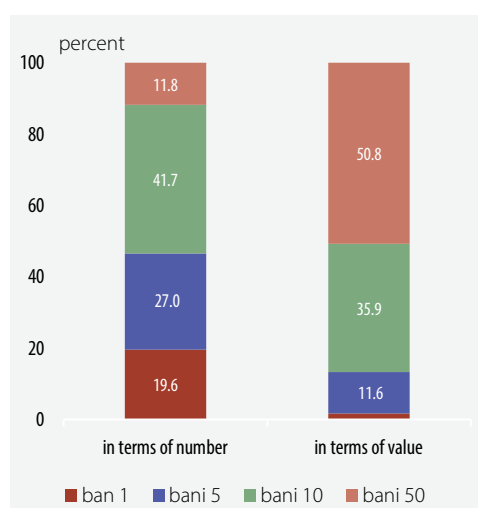
The same as in the previous years, demand for coins was high, which led to an increase in the quantity of coins outside banks for all denominations: ban 1

(12.8 percent), bani 5 (11.4 percent), bani 10 (13.8 percent) and bani 50 (12 percent).

The bani 10 coin accounted for the largest share of the total number of coins outside banks, i.e. 41.7 percent, with the bani 5 coin ranking second with a share of 27.0 percent (Chart 6.3).

In terms of value, the bani 50 coin held the highest share, i.e. 50.8 percent, ahead of the bani 10 coin (35.9 percent).

Chart 6.3
Denomination composition of coins in circulation in 2016



At end-2016, out of the total number of currency outside banks, the number of notes and coins per capita amounted to 61 and 182, respectively, i.e. 7 notes and 18 coins more than at end-2015.

2. NBR's cash payments and collections in its relation with credit institutions/the State Treasury

Payments

In 2016, the total value of currency used for NBR's payments to credit institutions/the State Treasury stood at lei 20,433.5 million, up 7.4 percent from 2015.

The number of banknotes put in circulation via payments was 555.3 million, up 4.7 percent year on year, and their value, i.e. lei 20,370.3 million, increased by 7.5 percent.

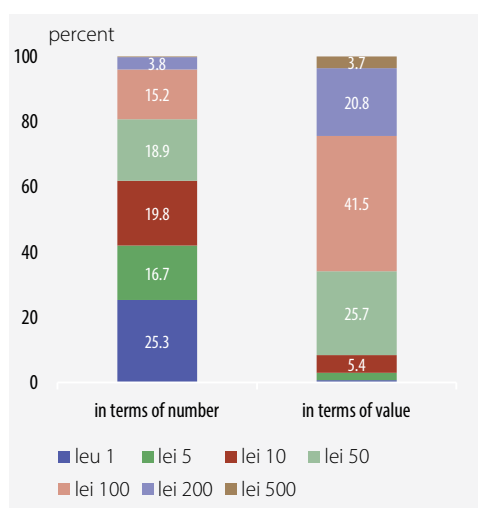


Chart 6.4
Denomination composition
of banknotes used
for payments in 2016

The only denomination witnessing a fall in the number of banknotes used for payments was the lei 50 note, down 7.7 percent from 2015. All the other denominations recorded an increase in the number of notes issued, the steepest being for the lei 500 (15.8 percent), lei 200 (15.0 percent), lei 100 (14.7 percent) and lei 5 (12.4 percent), while the lei 1 banknote recorded only a 2.2 percent rise. Under these circumstances, the cumulative share of the lei 100, lei 200 and lei 500 banknotes in the total number of notes put in circulation via

payments grew up to 19.3 percent in 2016, from 17.6 percent in 2015 (Chart 6.4).

In terms of value, the denomination composition of banknotes used for payments in 2016 was similar to that in 2015, the only notable changes being the drop in the share of the lei 50 note from 30.0 percent to 25.7 percent and the increase in the share of the lei 100 note to 41.5 percent and of the lei 200 note to 20.8 percent.

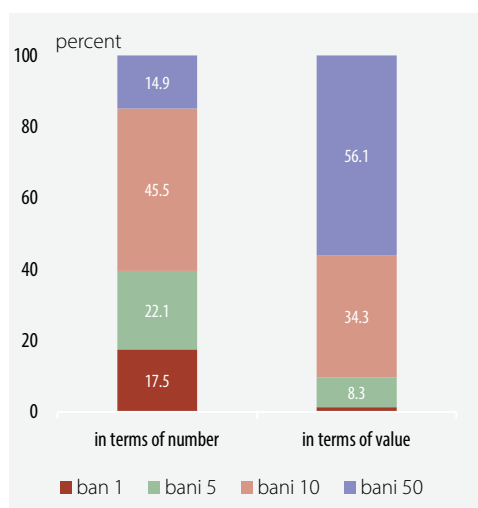


Chart 6.5
Denomination composition of
coins used for payments in 2016

The number of coins withdrawn by credit institutions/the State Treasury from the central bank in 2016 was lower by 4.6 percent than the previous year, the most notable decline, by 15 percent, being reported by the ban 1 coin, followed by the bani 50 coin, with a 11.7 percent decrease. By contrast, the bani 5 coin recorded a 2.5 percent rise. The bani 10 coin

continued to hold the highest share in the total number of coins used for payments, namely 45.5 percent, ahead of the bani 5 coin, which held a 22.1 percent share (Chart 6.5).

In terms of value, the share of denominations used for payments to credit institutions/the State Treasury were very close to those in 2015, most frequently used being the bani 50 coin (56.1 percent of payments), followed by the bani 10 coin, holding a 34.3 percent share.

Collections

In 2016, the NBR's cash collections amounted to lei 11,007.5 million, down 6.6 percent against the previous year.

The deposits of credit institutions/the State Treasury returned to the NBR 406.5 million banknotes, 13.9 percent more than in 2015.

In 2016, all denominations reported increases in the number of banknotes collected, except for the lei 50 and lei 100, where the number of notes deposited with the NBR dropped by 16.0 percent and 7.8 percent respectively. The number of banknotes returned to the NBR increased significantly for low-value denominations (lei 1, lei 5 and lei 10), with growth rates of up

to 37.4 percent compared with 2015, while high-value denominations, lei 200 and lei 500, witnessed rises of only 3.0 percent and 4.2 percent respectively.

The largest share in the total number of notes collected from credit institutions/the State Treasury was held by the lei 1 denomination (32.3 percent), ahead of the lei 10 note, with a 20.3 percent share (Chart 6.6).

As regards the share taken in the total value of banknotes collected, the

lei 100 denomination accounted for 46.1 percent, followed by the lei 50 note, with 30.7 percent.

In 2016, 55.6 million coins were returned to the central bank, down 37.7 percent from the year before.

The bani 50 coin posted a considerable decline in the number of coins collected, i.e. 40.1 percent, while the bani 10 and bani 5 coins recorded smaller decreases, i.e. 37.9 percent and 21.1 percent respectively.

Chart 6.6
Denomination composition
of banknotes collected in 2016

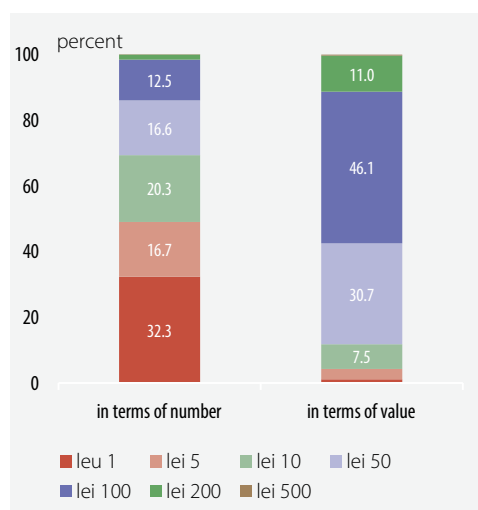
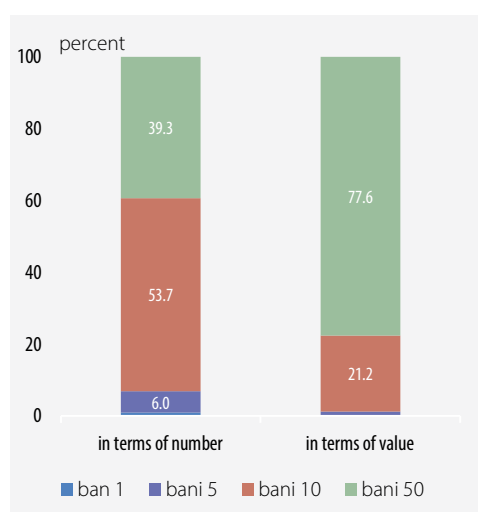


Chart 6.7
Denomination composition
of coins collected in 2016



The only denomination showing an increase in the number of cash collections from credit institutions/ the State Treasury was the bani 1, up 21.8 percent from 2015.

The largest share in the total number of coins collected, namely 53.7 percent, was held by the bani 10 denomination, ahead of the bani 50 coin, with a 39.3 percent share (Chart 6.7).

In 2016, the value of coins deposited by credit institutions/ the State Treasury

with the NBR's regional branches amounted to lei 14.1 million (down 39.5 percent from 2015), the bani 10 and the bani 50 coins jointly accounting for 98.8 percent.

3. Currency processing and withdrawal from circulation of unfit currency

In 2016, 479.4 million banknotes were processed in the four processing centres of the National Bank of Romania. Some 44.9 million banknotes were sorted as unfit for money circulation out of the total number of notes processed, corresponding to an average unfit banknote rate of approximately 9 percent, 1 percentage point lower than that seen in 2015.

The unfit rate decreased from the previous year particularly for the leu 1 banknote and the lei 5 banknote, i.e. down 4 percentage points and 3 percentage points respectively, whereas that of the lei 10, lei 50, lei 100 and lei 200 notes declined by less than 1 percentage point. The only denomination with a relatively constant unfit rate was the lei 500 banknote.

At the same time, in 2016, some 58.9 million coins were processed, with 665.7 thousand coins being sorted as unfit for money circulation.

4. Numismatic issues

In 2016, the National Bank of Romania launched 9 numismatic issues, including 13 coins, out of which 5 were of gold, 6 of silver and 2 of copper-plated tombac (Table 6.1). The mintage differed depending on the metal the coins were made of, namely 1,300 gold coins, 1,300 silver coins and 300 copper-plated tombac coins.

The central bank also put into circulation 250 mint sets to mark 80 years since the inauguration of the “Dimitrie Gusti” National Village Museum.

Numismatic issue	Metal and face value
150 years since Mihai Eminescu's literary debut in “Familia” magazine	silver coin with face value of lei 10
175 years since the birth of Petru Poni	silver coin with face value of lei 10
150 years since the establishment of the Romanian Academy	set of three coins (made of gold, silver and copper-plated tombac) with face values of lei 100, lei 10 and leu 1
575 years since John Hunyadi became Voivode of Transylvania	gold coin with face value of lei 100
Governors of the National Bank of Romania – Ion I. Câmpineanu, Mihail Manoilescu and Ion I. Lapedatu	set of three coins (made of gold, silver and copper-plated tombac) with face values of lei 100, lei 10 and leu 1
200 years since the birth of Constantin A. Rosetti	gold coin with face value of lei 100
210 years of industrial exploitation of the Borsec mineral natural waters	silver coin with face value of lei 10
150 years since the birth of George Coșbuc	silver coin with face value of lei 10
History of gold – The mace of King Ferdinand I	gold coin with face value of lei 10
80 years since the inauguration of the “Dimitrie Gusti” National Village Museum	a mint set comprising the Romanian coins in circulation of ban 1, bani 5, bani 10, bani 50 and commemorative coins of bani 50 (Aurel Vlaicu, Mircea cel Bătrân, Neagoe Basarab, Vladislav I Vlaicu, 10 years since the redenomination of the domestic currency and John Hunyadi), as well as a silver medal

Table 6.1
The 2016 numismatic issues

5. Detected leu counterfeits

In 2016, counterfeit Romanian banknotes checked by the National Bank of Romania totalled 6,985, up 56 percent from the previous year. The monthly distribution of counterfeits is shown in Table 6.2.

Table 6.2
Monthly distribution
of counterfeits

2016											
Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
789	654	322	1,150	642	524	584	152	1,093	377	438	260

Out of the total number of counterfeit banknotes, 60 were seized by specific police operations before entering circulation, while 6,925 were found in circulation, up 58 percent from 2015.

The lei 100 denomination recorded the highest number of counterfeits, i.e. 5,660 banknotes. The lei 10 note ranked second, totalling 1,084 counterfeits, ahead of the lei 50 banknote, with 150 counterfeits (Table 6.3).

Table 6.3
Counterfeits by denomination

Denomination	Number of counterfeits
leu 1	2
lei 5	1
lei 10	1,084
lei 50	150
lei 100	5,660
lei 200	78
lei 500	10

Some 5.2 counterfeits were found per 1 million authentic banknotes in circulation versus 3.7 counterfeits in 2015.



Chapter 7

Payment and settlement systems

According to its statutory tasks, the National Bank of Romania promotes the smooth functioning of payment systems with a view to ensuring financial stability and maintaining public confidence in the national currency. The main tool whereby this objective is achieved, aside from the regulation, authorisation and oversight of the payment systems, consists in the facilities that the National Bank of Romania provides for ensuring the efficient operation of payment and settlement systems.

To this end, the National Bank of Romania operates ReGIS, a real-time gross settlement system for large-value or urgent payments in lei, and SaFIR, a central depository and settlement system for government securities and certificates of deposits issued by the National Bank of Romania, while equally managing TARGET2-România, the national component of the real-time gross settlement system for payments in euro, on behalf of the Eurosystem. The National Bank of Romania manages ReGIS and SaFIR, whereas the technical operation services were outsourced to TRANSFOND¹²⁵.

1. ReGIS

General aspects

ReGIS ensures the real-time gross settlement of large-value or urgent payments in lei made by participants, on their own behalf and account or on the customers' account, as well as of net positions arising from ancillary systems.

In 2016, ReGIS further contributed to the smooth operation of money market and forex market, playing a major part in the successful implementation of the National Bank of Romania's monetary policy, considering that central bank's monetary policy operations are processed solely through this system.

Participation in the system

At end-2016, the system counted 45 participants, out of which: 37 credit institutions, the National Bank of Romania, the State Treasury and 6 ancillary systems (SENT, SaFIR, RoClear, DSClear, VISA Europe and MasterCard International).

Payments in ReGIS

The volume and value of payments settled in ReGIS went up by 5.6 percent and 29.3 percent respectively in 2016 against the previous year (Table 7.1).

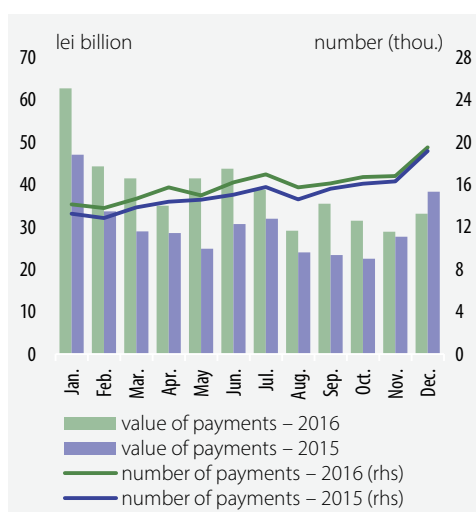
¹²⁵ TRANSFOND is a joint-stock company, having as shareholders the National Bank of Romania (33.33 percent) and credit institutions (66.67 percent).

Table 7.1
Payments traffic in ReGIS

	Volume (no. of transactions; thou.)		Value (lei bill.)		Average value per transaction (lei mill.)
	Total	Daily average	Total	Daily average	
2015	3,832	15.15	7,599	30.04	1.98
2016	4,045	15.93	9,829	38.70	2.43
Change (%)	+5.6	+5.1	+29.3	+28.8	+22.7

The maximum volume of payments daily settled through ReGIS was recorded in December 2016 (29,520 transactions/day), while the maximum value of payments daily settled in this system was posted in January 2016 (lei 81.8 billion/day) (Chart 7.1).

Chart 7.1
Large-value or urgent payments in 2016 versus 2015 (daily average)



The composition of payments in ReGIS in 2016 (Table 7.2) shows that payment transactions carried out by participants on customers' account (MT103 messages) prevailed (91.6 percent of the total volume of transactions settled in the system), their total value remaining, however, relatively low (only 12.8 percent of the value of settled transactions). By contrast, the volume of payment transactions carried out by participants on their own account (MT202 messages) was relatively subdued (6.7 percent of the volume of settled transactions), their value running, however, high (34.1 percent of the value of transactions settled via the system).

Table 7.2
Composition of payments in ReGIS in 2016

Payments	percent		
	MT103	MT202	Direct transfer
Total volume	91.6	6.7	1.7
Total value	12.8	34.1	53.1

Moreover, payment transactions involving direct debit/credit of participants' settlement accounts (direct transfer) posted a low volume (1.7 percent of the volume of transactions settled via the system), while reporting a relatively high value (53.1 percent).

Market concentration remained comparable to that in the previous year in terms of both the volume and value of payments settled through ReGIS (the top five credit institutions accounting for 59 percent and 75.9 percent, respectively, of the market).

In 2016, the average availability of ReGIS, i.e. the extent to which participants could use the system without any incidents during the operating days, was 99.99 percent.

In 2016, no gridlock situations occurred in the system due to the lack of funds in participants' settlement accounts, with only 0.4 percent of the volume of settled transactions having been queued. At the same time, the participants pursued an adequate and efficient liquidity management, with the value of the repo intraday liquidity provided by the National Bank of Romania accounting for 0.12 percent of the total value of transactions settled in the system.

2. SaFIR

General aspects

Securities depositories and settlement systems are key components of financial markets' infrastructure. In the central bank's view, the importance of SaFIR (the securities depository and settlement system) lies with the system's interaction with the other payment systems, as well as with the role played by such instruments in the settlement of monetary policy operations.

Participation in the system

At end-2016, SaFIR counted 37 participants, out of which: 33 credit institutions, the National Bank of Romania, the Ministry of Public Finance and 2 securities depository and settlement systems – the Central Depository and Clearstream Banking.

Face value of government security issues deposited with SaFIR

At end-2016, the overall face value of outstanding issues of lei-denominated government securities came in at lei 119,892.8 million, up 12.4 percent versus end-2015, while the overall face value of the issues of euro-denominated government securities amounted to EUR 1,703.6 million, down 31.8 percent versus end-2015.

Operations settled in SaFIR

SaFIR processes operations performed by participants in relation to the issuer (settlement of the primary market's results, interest and/or coupon payments, partial/optional/total redemption) and operations carried out by participants on the secondary market (sale/purchase transactions, financial collateral arrangements, repo transactions, portfolio transfers).

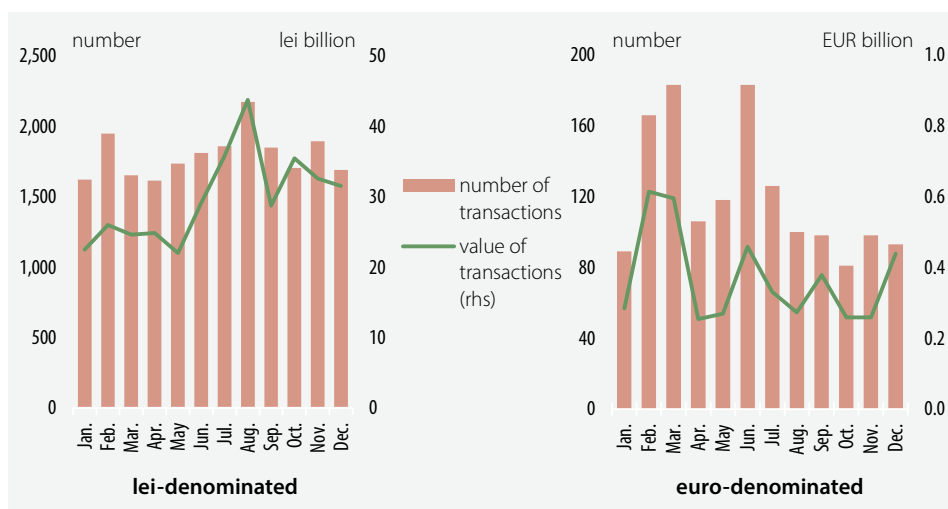
Chart 7.2 shows the number and value of sale/purchase transactions, while also including reverse transactions.

System upgrading in 2016

In 2016, SaFIR was adjusted ahead of broadening the range of assets eligible for central bank's operations, by taking in lei-denominated bonds issued by the Ministry of Public Finance as part of the FIDELIS programme.

Chart 7.2

Operations in government securities settled in SaFIR in 2016



In order to ensure compliance with the delivery versus payment (DvP) principle when settling in euro operations in securities through SaFIR, in 2016 Q4 steps were initiated to connect SaFIR to TARGET2, as an ancillary system.

3. TARGET2 system

General aspects

TARGET2 is a payment system made available by the Eurosystem for the real-time settlement of monetary policy operations, interbank transfers, payments on customers' account, as well as of payments related to the operations carried out by net settlement systems and by other financial market infrastructures in euro.

Central banks outside the euro area (connected central banks) can participate in TARGET2 on a voluntary basis by signing specific agreements with the central banks in the Eurosystem. The same as the other connected central banks (i.e. in Bulgaria, Denmark, Poland and Croatia), as of 2011, the National Bank of Romania has been connected to TARGET2, operating TARGET2-România, the national component.

Participation in the system

The participation in TARGET2-România is governed by the system rules set forth by National Bank of Romania Order No. 4/2015 on the operation of TARGET2-România, as subsequently amended and supplemented.

At end-2016, participating in TARGET2-România were: 22 credit institutions, the National Bank of Romania, an ancillary system (SENT – operated by TRANSFOND) and the Central Depository (in its capacity as dedicated cash account holder for transaction settlement via TARGET2-Securities). In 2016 Q4, first steps were taken to connect SaFIR to TARGET2, as an ancillary system.

TARGET2-România operations

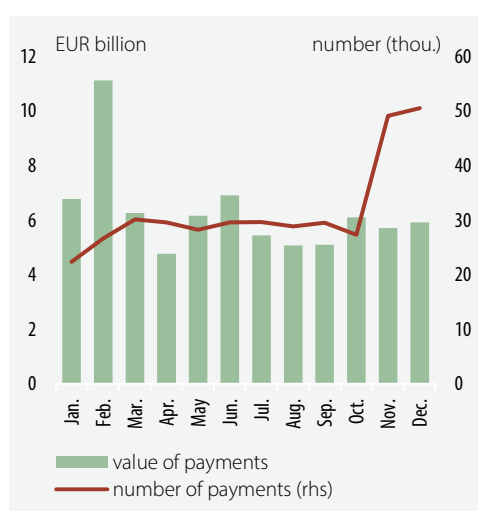
In 2016, the total volume of payments settled in TARGET2-România rose by 27.9 percent from 2015, while their value fell by 4.9 percent (Table 7.3).

Table 7.3
Payments traffic
in TARGET2-România

	Volume (no. of transactions)		Value of transactions (EUR mill.)	
	Total	Daily average	Total	Daily average
2015	298,372	1,170	79,202	311
2016	381,632	1,485	75,327	293
Change (%)	27.9	26.9	-4.9	-5.6

The monthly volume of payments settled in 2016 saw an uptrend until March, rising from 22,393 to 30,115 payments, before stabilising at around 30,000 payments per month. In the last two months of 2016, the volume of payments surged to reach 50,543 payments in December (Chart 7.3). This increase was due mainly to the temporary redirection of small-value payments through TARGET2.

Chart 7.3
Payments in
TARGET2-România in 2016



On the other hand, in 2016, the monthly value of payments rose significantly in February, when it peaked at EUR 11.1 billion, while hovering around EUR 6 billion per month in the course of the year (Chart 7.3).

The composition by category of payments settled through TARGET2-România in 2016 shows the prevalence of cross-border payments over national payments (79.6 percent of the total volume of payments settled through TARGET2-România and 92.2 percent of their value).

Most transactions in TARGET2-România were made with Germany, Austria, the Netherlands and Italy (Table 7.4).

Table 7.4
Geographical distribution
of payments/receipts related
to TARGET2-România in 2016

Outgoing payments		Incoming payments	
Volume	Value	Volume	Value
Germany	Germany	Germany	Germany
Italy	Austria	Netherlands	Austria
Netherlands	France	Italy	Belgium
Austria	Netherlands	Belgium	Netherlands
France	Greece	France	France

Furthermore, mention should be made that most payments performed by the participants in TARGET2-România were settled during the first part of the day, between 7:00 and 9:00 CET¹²⁶, with the participants in Romania frequently resorting to warehoused payments.

¹²⁶ Central European Time.

In 2016, participants pursued an adequate and efficient liquidity management and no gridlock situations occurred due to the lack of funds in the participants' settlement accounts.

TARGET2-Securities (T2S)

TARGET2-Securities is the European platform for the settlement of national and cross-border securities transactions, operated by the Eurosystem. The settlement is carried out through securities accounts opened and managed on T2S by central depositories also connected through Dedicated Cash Accounts (DCAs), opened and managed on the platform by national central banks.

T2S started operating on 22 June 2015, when participants' first migration wave took place. At that time, 5 depositories and 9 central banks, among which the Central Depository and the National Bank of Romania – in its capacity as operator of TARGET2-România –, migrated to the platform. According to the project timeline, by September 2017, 22 central securities depositories in Europe will have connected to T2S.

The year 2016 saw the second and the third migration waves, at year-end, 12 central depositories being connected to T2S.

Similarly to the other central banks operating TARGET2 national components, the National Bank of Romania opens and manages Dedicated Cash Accounts in euro on the T2S platform for credit institutions operating in Romania that want to act as settlement banks for the connected central depositories.

The activity carried out by the Romanian community on T2S in 2016 was extremely low, mainly owing to depositories' migration being expected to come to an end in 2017.

4. Authorisation and oversight of payment and settlement systems

Authorisation of payment systems and securities settlement systems

The National Bank of Romania performs its legal tasks concerning the regulation, authorisation and oversight of the payment systems and securities settlement systems in Romania, as well as of their operators, with a view to promoting the safe and efficient functioning of the systems and preventing the systemic risk from materialising.

Turning to settlement systems, in 2016, the NBR sanctioned the supplementation and amendment of the operating rules governing SaFIR (operated by the NBR), RoClear (operated by the Central Depository) and DSClear (operated by Sibex Depository).

Thus, in order to remove the credit risk that the participants may face, the NBR decided to connect SaFIR to TARGET2-România for settlements in euro, by observing the delivery versus payment principle of securities operations in SaFIR. The connection became functional in March 2017.

The Central Depository made a series of changes to the system rules relative mainly to the implementation of EU standards for processing corporate events (dividend payments, capital changes, reorganisations, etc.), while using the settlement via ReGIS for this purpose.

The changes operated by Sibex Depository referred to facilitating stock loans and the settlement of corporate events, as well as the increase in market liquidity and facilitating the settlement of stock transactions.

Relative to SENT, the small-value payment system operated by TRANSFOND, the NBR approved the introduction of a processing service for direct debit payment instructions in the SEPA format.

Measures adopted by the central bank for containing the risks to the functioning of payment and settlement systems and for boosting their efficiency

During 2016, payment and settlement systems continued to run normally and safely, with the monthly availability rate not falling below 99.97 percent. Operational incidents were minor.

According to its statutory tasks, the NBR monitored on a continuous basis the functioning of payment systems and securities settlement systems. This central bank-specific activity envisages meeting the following objectives: safeguarding financial stability, providing an adequate channel for monetary policy transmission, ensuring the systems' efficiency and effectiveness, system operators complying with the legal framework, as well as maintaining public confidence in payment systems, payment instruments and the domestic currency.

In the wake of the operational incidents reported by some credit institutions, which affected the smooth functioning of payment systems and electronic payment instruments, the NBR carried out a series of on-site inspections at the related processing centres and imposed remedial measures and implementation deadlines designed to strengthen the operational resilience of all payment service providers.

Developments in the electronic payment market

In 2016, the electronic payment market witnessed the following trends:

- the advance in the number of cards in circulation by 6.7 percent (1 million cards) versus end-2015;

- the pick-up in the share of contactless cards in total cards in circulation from 21 percent in December 2015 to 37 percent at end-2016, due to the gradual replacement of expiring cards by contactless cards;
- the 24 percent rise in the number of POS payments made on the national territory by cards issued in Romania in 2016 versus the previous year, concurrently with the 21 percent increase in the value thereof in the same period.

In 2016, the NBR issued NBR Regulation No. 2/2016 on credit transfers and direct debits performed in Romania. The Regulation was aimed at updating the national legal framework on this type of payment instruments/services and at harmonising it with the European legal framework for these operations.

At end-2016, payment services providers in Romania adopted the standards set forth by Regulation (EU) No. 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No. 924/2009. According to its tasks, the NBR is the competent authority for overseeing the compliance with the requirements of the EU regulation by payment services providers and small-value payment system operators and is involved in the SEPA project domestically, by coordinating and monitoring the implementation of SEPA standards.





Chapter 8

Management of international reserves

Romania's international reserves act as a fundamental mechanism for safeguarding the economy against adverse external shocks and provide credibility to the country on the international stage. At the same time, they are a key tool in implementing the NBR's monetary policy and exchange rate policy, as well as in managing Romania's external debt, both public and private. Furthermore, international reserves help ensure domestic financial stability.

Emerging market economies with access to capital markets at reasonable costs, Romania included, usually make recourse to foreign currency reserves for precautionary purposes, in order to tackle risks stemming from the current and capital account deficit. In countries with a managed float exchange rate regime, a factor playing a major role in setting the optimal reserve level is the volatility of the domestic currency, especially in times of financial market turmoil.

The recent global financial crisis has led to shifts in the perception of the optimal degree of reserve adequacy (even in the case of developed economies), due to countries' reduced access to liquidity – in acceptable conditions – during periods of heightened tensions on financial markets. Foreign currency reserves may ease access to funding during such times.

As part of its international reserve management activity, the NBR seeks to ensure an adequate level of reserves, so that they cumulatively fulfil several objectives. Liquidity and safety come first, ahead of profit-making, the management of international reserves by the NBR being carried out in an environment of high risk aversion. Thus, the value of international reserves is maximised while complying with prudent risk limits, so that reserves are always available when needed.

Over the recent period, the domestic economic fundamentals have improved significantly. Keeping international reserves at a relatively high level has helped consolidate Romania's external credibility and supported these trends. However, the soundness of the domestic macroeconomic and financial framework and the stock of reserves do not insulate the local economy from adverse domestic and external shocks.

1. Developments in Romania's international reserves in 2016

At end-2016, Romania's international reserves amounted to EUR 37,905 million (Chart 8.1), of which foreign currency reserves made up 90.3 percent and gold accounted for 9.7 percent. International reserves increased by EUR 2,420 million

from end-2015. The gold reserve remained unchanged at approximately 104 tonnes. Nevertheless, in terms of value, it went up EUR 416 million from end-2015 (to EUR 3,664 million), as a result of the rise in the gold price on the international market.

The most significant impact on the gold price trajectory in 2016 came from the higher investment demand, which exceeded the demand for physical metal in the first half of the year under review due to heightened risk aversion of investors and inflation expectations. In 2016 H2,

the outcome of the US presidential elections sparked investor optimism regarding US economic developments, amid the expansionary measures on the presidential agenda, with the increased attractiveness of stock markets entailing a weaker interest in gold investments and hence lower gold prices.

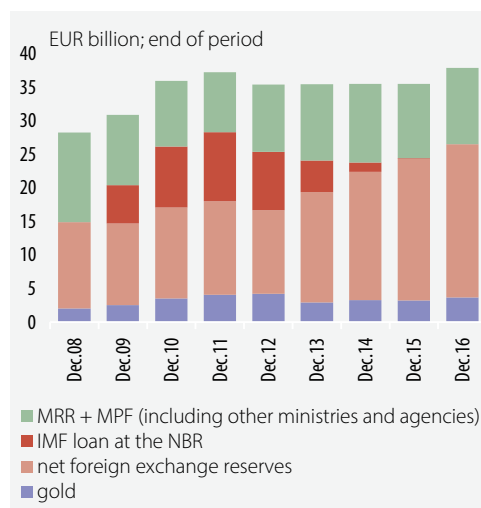


Chart 8.1
International reserves

Considerations on the gold reserve

Gold reserves are part of Romania's international reserves and provide a guarantee for the National Bank of Romania in carrying out its public functions.

Pursuant to Article 30, paragraph (1), letter a) of Law No. 312/2004, the NBR may hold, as part of international reserves, "gold either in a vault at home or deposited abroad". The central bank has gold holdings both in its own vault and in custody at the Bank of England. The NBR gold deposited with the Bank of England (a sound custodian from a financial and reputational point of view, providing a similar service to central banks throughout the world) is at the NBR's disposal at all times, with the Bank of England conducting operations through this account only as instructed by and on behalf of the NBR.

The gold reserve is meant, *inter alia*, to enhance confidence in the stability of the Romanian financial system and of the leu, being particularly useful in times of heightened economic turmoil (domestically or abroad) or geopolitical tensions. In such a situation, foreign creditors would most likely consider that only gold deposited abroad – whose existence and quality can be confirmed in real time by a third party – may serve as collateral for a potential loan.

Another reason for choosing the Bank of England as custodian is the fact that the main physical market for gold is the London-based one, where the metal is traded among members of the London Bullion Market Association (LBMA) and the gold fixing is done twice a day.

Moreover, the LBMA has set a number of specifications for gold bars to qualify as *London Good Delivery* (LGD – standard quality bullions). Thanks to these standards, market participants can trade, at any given time, gold bars without having to check their characteristics.

Unlike other asset types, gold has no solvency risk attached, because it is not “issued” by an authority (such as a government or a central bank).

Presently, interest rates on short-term gold deposits, quoted by the NBR’s potentially eligible counterparties, are in negative territory, the same as short-term interest rates for certain currencies. From a historical perspective, the interest rate level for gold has stood higher (for instance, the average remuneration of one-month gold deposits was 1.72 percent during 1999 and 0.50 percent in 2008).

Immediately after the 2008 crisis, many central banks in the ESCB suspended gold transactions, especially due to the credit risk. Some of these banks (in Poland, Bulgaria) have resumed gold trading, particularly over the short term.

Looking at the other ESCB members, it should be noted that none of the central banks that launched programmes to repatriate the gold deposited abroad intends to bring back the entire quantity – they all keep a part of the reserve abroad. The main purpose of repatriation programmes is to narrow the discrepancy between gold holdings abroad and those in the country of origin, depending on the specifics of each particular country. For example, there are banks in the ESCB that hold over 90 percent of the gold stock abroad.

The regular reviews conducted by the NBR on the appropriateness of resuming operations with private counterparties refer to gold as well.

In the reviewed period, foreign currency reserves rose by EUR 2,004 million, coming in at EUR 34,242 million at end-2016. The main sources of increase were the amounts paid by the European Commission, generally non-repayable funds, and those raised by the MPF via bond issues on the domestic and external markets. The main outflows related to the refunds occasioned by the cut in the minimum required reserves, as well as to the repayments on external debt and maturing bonds issued by the MPF domestically and abroad.

The rise in foreign currency reserves – to EUR 34,242 million at end-2016 compared with EUR 26,221 million at end-2008 – was ascribable to the component net of the Treasury’s foreign currency holdings and of credit institutions’ forex-denominated minimum required reserves, a component which almost doubled in the said period. These developments contributed, on one hand, to the downtrend in funding costs for the Romanian government and local companies, also paving the way for upgrades of the sovereign ratings, and, on the other hand, underpinned the monetisation of the economy.

The pecuniary costs entailed by the relatively high international reserves stemmed from the unfavourable differential between the returns on investments in foreign currency assets, given the developments in the global financial markets and the prudent investment policy conducted by the NBR, and the interest rates on the central bank’s foreign liabilities.

2. Management of international reserves in a tense global economic and financial environment, marked by a high degree of uncertainty

2.1. External economic and financial developments

The year 2016 was marked by two political events whose outcome – with relatively low *ex ante* probabilities of occurrence – triggered renewed waves of uncertainty worldwide: the vote in favour of the UK leaving the European Union and the winning of the US presidential elections by the Republican candidate.

Overall, the developments seen in 2016 confirmed that restoring the global economy onto a sustainable path is a complex and lengthy process, rife with challenges. According to the April 2017 *World Economic Outlook*, global GDP advanced in 2016 by 3.1 percent in real terms, at a pace below the previous year's reading of 3.4 percent. The growth rate of advanced economies slowed markedly (from 2.1 percent in 2015 to 1.7 percent in 2016), owing primarily to the US economy performing way below expectations in the first half of the year and to the Brexit effects. At the same time, emerging market and developing economies posted relatively steady dynamics of 4.1 percent. Global economic activity was underpinned by the exceptionally accommodative monetary policy pursued by the major central banks, with the ECB, Bank of Japan and Bank of England resorting to additional monetary easing. In addition, the Japanese government announced a fiscal plan for the sustainable growth of the domestic economy, while the Bank of Australia lowered, in turn, the monetary policy rate. The global economy was, however, constrained by the uncertainty associated with Brexit, by the deceleration of China's economic growth, as well as by political and geopolitical tensions.

January through October 2016, in a fragile economic and financial environment globally, marked by an elevated degree of uncertainty and increased risks, market participants' risk appetite generally stuck to a low level. In November, however, the unexpected outcome of the US presidential elections was met with surprising enthusiasm on international financial markets. Behind this stood the substantial package of measures proposed by the president-elect with a view to spurring economic activity, i.e. massive reduction in corporate taxation, deregulation in the area of environment protection and in the financial sector, investment in infrastructure. After the US elections, medium- and long-term yields trended sharply upwards, also prompted by expectations on the Fed raising the monetary policy rate in December.

The ECB's announcement on extending the horizon of its asset purchase programme, as well as scrapping the minimum yield requirement under this programme, even amid the reduction in the monthly pace of purchases starting March 2017, resulted in the slowing and even reversal of the uptrend in government bond yields.

During 2016 as a whole, the euro depreciated against most reserve currencies (particularly in relation to the Japanese yen), except for the pound sterling (versus which it appreciated considerably). The weakening vis-à-vis the currencies of oil-exporting countries was chiefly due to the significant rise in oil prices, largely following events such as the wildfires in Alberta, Canada and the OPEC decision to cut oil production. Globally-representative stock market indices recorded mixed developments.

2.2. The manner to achieve strategic goals

The period under review saw the pursuit of the key strategic parameters set by the NBR Board at end-2015 for the period 2016-2017 in terms of managing international reserves, in a bid to set up a framework conducive to the highest possible investment performance throughout the lifespan of the strategy¹²⁷ via the prudent and effective management of reserves, with a focus on diversifying the central bank's balance sheet risks, as well as on investment safety and liquidity:

- a currency composition in which the euro accounts for 55 to 85 percent of foreign currency reserves, the US dollar for 10 to 35 percent and other currencies for at most 20 percent;
- establishing an average duration of up to 1 year and 3 months for the foreign currency reserve as a whole;
- setting up investment tranches for improved results from international reserve management;
- categories of eligible issuers: (i) the US government; (ii) government agencies or agencies sponsored by the US government; (iii) the governments of EU Member States; (iv) government agencies or agencies sponsored by the governments of EU Member States; (v) the Government of Japan; (vi) other governments rated A- and above; (vii) supranational institutions; and (viii) private entities, issuers of covered bonds;
- the maximum exposure to private entities that are issuers of covered bonds: 10 percent of international reserves;
- the maximum exposure to private entities other than covered bond issuers: 10 percent of international reserves.

The NBR Board approved the resumption of foreign exchange operations with private entities and the acceptance, in conducting these transactions, of the least risky counterparties, provided strict exposure limits are observed.

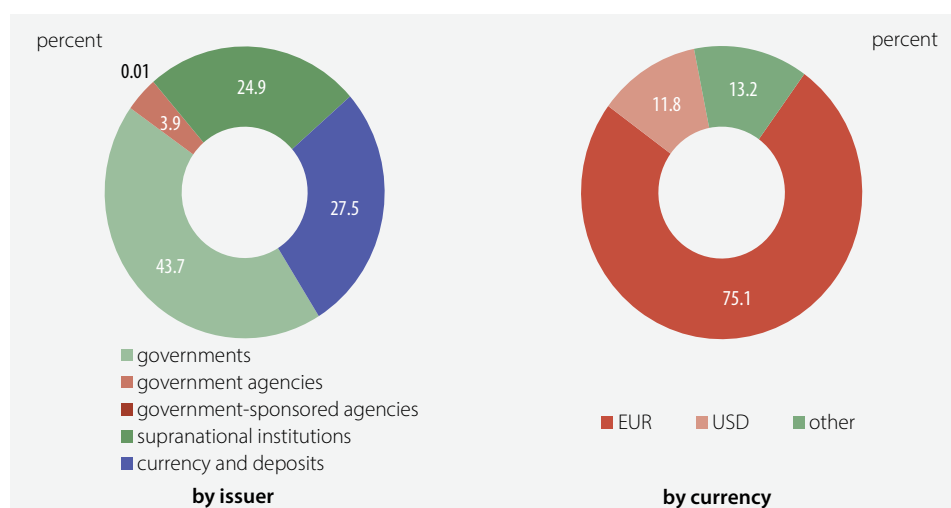
The surprise events of 2016 (the Brexit vote and the outcome of the US presidential elections) generated volatility and paved the way for lingering uncertainty in the period ahead, both from an economic perspective and at a political and geopolitical level.

¹²⁷ The goal was to reduce the strategic investment horizon.

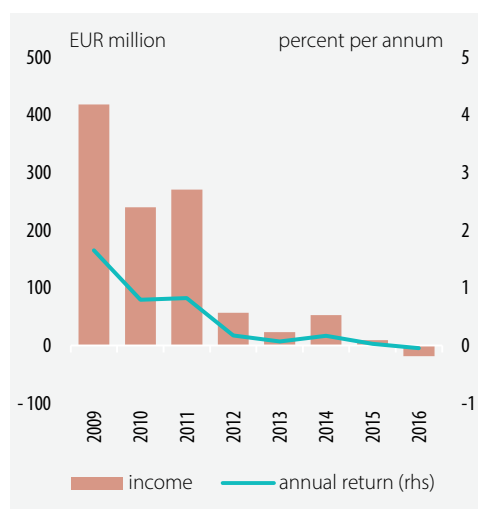
Against this background, the Foreign Reserve Management Committee and the Board deemed it appropriate to leave unchanged the parameters for the management of Romania's international reserves, given the degree of risk diversification and the previously-taken measures to increase the expected return on NBR portfolios. Foreign currency reserves were further managed dynamically and flexibly, with a focus on identifying and capitalising on new opportunities in the global financial markets, yet without prejudice to the NBR's investment safety and liquidity objectives. With a view to obtaining additional income, the NBR made adjustments in the currency composition of international reserves, as well as portfolio shifts by type of fixed-income issuer. Moreover, the NBR continued to favour a relatively dynamic management in terms of portfolio duration and exposures along the yield curves. Additional risks were taken in a cautious and effective manner, in accordance with the objectives and risk parameters defined by the multiannual strategy for international reserve management, as well as with other relevant provisions and considerations. Therefore, keeping in place the restriction on making investments with private counterparties was deemed appropriate.

Chart 8.2

Composition of Romania's foreign exchange reserves at end-2016

**Chart 8.3**

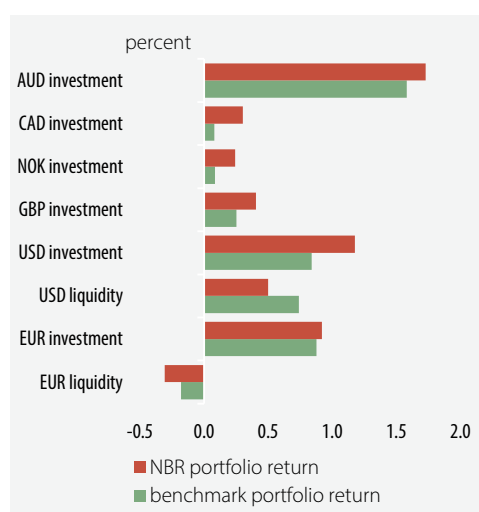
Returns on portfolio management



In line with the currency composition of the NBR's foreign liabilities, of Romania's public and publicly guaranteed debt service and of the country's international trade, the euro further held the largest share of foreign exchange reserves (75.1 percent) at end-2016 as well, ahead of the US dollar with 11.8 percent (Chart 8.2).

Given the unfavourable conditions of the investment environment, the annual returns on foreign exchange reserves decreased in the period

Chart 8.4
Comparative returns – NBR vs
benchmark portfolios



ranging between 0.24 percent and 1.72 percent (Chart 8.4).

under review, from 0.03 percent in the previous year to -0.04 percent (Chart 8.3). In 2016, income from portfolio management¹²⁸ dropped from EUR 9 million (euro equivalent) to EUR -18 million (euro equivalent). The annual returns on the NBR's EUR- and USD-denominated liquidity portfolios¹²⁹ stood at -0.31 percent and 0.5 percent respectively. The investment portfolios¹³⁰ – denominated in euros, US dollars, pound sterling, Norwegian crowns, Canadian dollars, and Australian dollars – posted positive annual returns

¹²⁸ It is only a component of income from international reserve management, which also includes income from gold holdings and from foreign currency positions.

¹²⁹ Holding the largest share in foreign exchange reserves and having the role of accommodating, at acceptable costs, unexpected foreign currency outflows from reserves.

¹³⁰ Aimed at improving the performance of international reserve management, with a return and risk profile that differs from that of liquidity portfolios.



Chapter 9

Romania's balance of payments
and international investment position

1. Current account and capital account

Current account

In 2016, the balance-of-payments current account deficit stood at EUR 3,966 million, accounting for 2.3 percent of GDP versus 1.2 percent of GDP a year earlier (Table 9.1).

	EUR million	
	2015	2016
Goods, net	-7,794	-9,254
Exports (FOB)	49,099	52,170
Imports (FOB)	56,893	61,424
Services, net	6,794	7,659
Primary income, net	-3,772	-4,830
Secondary income, net	2,794	2,459
Current account balance	-1,978	-3,966

Table 9.1
Current account

The widening of the current account deficit reflected the 28 percent increase in the primary income deficit and the 18.7 percent pick-up in the trade in goods deficit, as well as the reduction in the secondary income surplus by 12 percent. These developments were partly offset by the 12.7 percent rise in the services surplus.

The primary income deficit widened to EUR 4,830 million, compared with EUR 3,772 million in 2015, mainly on account of the advance in direct investment income (dividends and reinvested earnings).

The deficit on trade in goods widened 18.7 percent against the previous year, to EUR 9,254 million. Exports grew by 6.3 percent (4.9 percent in 2015), while imports moved ahead 8 percent¹³¹ (6.6 percent in 2015), with the trade in goods deficit as a share in GDP rising from 4.9 percent to 5.5 percent. The breakdown of the balance on trade in goods by group of goods shows the largest deficits under chemical and plastic products (EUR 5,950 million), base metals (EUR 1,908 million), mineral products (EUR 1,742 million), textiles, wearing apparel and footwear (EUR 1,053 million). Intra-EU trade (EUR -9,034 million) accounted for 97.6 percent of the deficit on trade in goods.

¹³¹ Source: the National Institute of Statistics – International trade in goods; NBR calculations. Imports (FOB) are calculated by the NBR based on the 1.0430 CIF/FOB conversion factor determined by the NIS.

The rate of coverage of imports by exports went down 1.4 percentage points to 84.9 percent, while the openness of the Romanian economy¹³² rose 0.7 percentage points to 67 percent.

Exports of goods came in at EUR 52,170 million¹³³, up 6.3 percent or EUR 3,071 million from the previous year, amid the strengthening of external demand from the European Union.

The breakdown of exports by group of goods shows an increase against 2015 in the share of machinery, apparatus, equipment and transport means (up 2.8 percentage points to 48.1 percent), textiles, wearing apparel and footwear (up 0.1 percentage points to 5.5 percent) and other goods (up 0.5 percentage points to 8.8 percent).

Imports of goods totalled EUR 61,424 million¹³⁴, up 8 percent, or EUR 4,531 million, versus 2015. The breakdown of imports by group of goods shows a rise in the share of machinery, apparatus, equipment and transport means (up 0.5 percentage points to 38.3 percent), agri-food items (up 0.7 percentage points to 11.1 percent), textiles, wearing apparel and footwear (up 0.5 percentage points to 6.3 percent) and other goods (up 0.3 percentage points to 7.1 percent).

The surplus on services trade amounted to EUR 7,659 million, compared to EUR 6,794 million in 2015, its rise being attributable to larger receipts from: manufacturing services on physical inputs owned by others, road haulage, computer services, construction services abroad, professional and management consulting services.

The surplus on secondary income equalled EUR 2,459 million, down 12 percent from a year earlier, amid the lower volume of miscellaneous current transfers, other than workers' remittances, and the current transfers of the general government sticking to the same level.

Capital account

In 2016, the positive capital account balance stood 8.6 percent above that recorded a year earlier (EUR 4,237 million versus EUR 3,901 million in 2015), fully covering the current account deficit for the fourth year in a row and easing the pressure on external borrowing requirements.

¹³² (Exports of goods + imports of goods)/GDP*100.

¹³³ In 2016, the share of exports of goods in GDP went up 0.1 percentage points against 2015 to 30.8 percent.

¹³⁴ In 2016, the share of imports of goods in GDP advanced 0.7 percentage points versus 2015 to 36.2 percent.

2. Financial account

In 2016, the positive financial account balance stood at EUR 1,577 million, showing lower net outflows than in the previous year (Table 9.2). The downward trend was induced both by the larger volume of financial inflows (direct and portfolio investment) and by the drop in outflows from other investment (lower repayments by the central bank and the general government on long-term loans from non-residents).

	EUR million	
	2015	2016
Financial account	2,280	1,577
Net acquisition of assets	1,539	4,627
Net incurrence of liabilities	-741	3,050
Direct investment	-2,955	-3,917
Net acquisition of assets	929	941
Net incurrence of liabilities	3,884	4,858
Portfolio investment	-5	-1,192
Net acquisition of assets	300	362
Net incurrence of liabilities	305	1,554
Financial derivatives	-24	29
Other investment	5,864	4,399
Net acquisition of assets	934	1,037
Net incurrence of liabilities	-4,930	-3,362
Reserve assets	-600	2,258
Net acquisition of assets	-600	2,258

Table 9.2
Financial account

Note: For the net acquisition of assets and the net incurrence of liabilities, "+" and "-" stand for an increase and a decrease respectively.

Direct investment comprised net inflows worth EUR 3,917 million, up 32.6 percent year on year, amid the rise in reinvestment of earnings. Investment by non-residents in Romania reached EUR 4,134 million, with equity¹³⁵ amounting to EUR 4,238 million, reduced by the negative net value of intercompany lending¹³⁶. The top-five investor countries¹³⁷ were: Germany (25.9 percent), France (15.9 percent), Italy (12.4 percent), the United Kingdom (8.2 percent), and Belgium (7.5 percent).

In 2016, portfolio investment recorded net inflows of EUR 1,192 million (EUR 5 million in 2015), in the context of a higher volume of bonds issued by the general government.

Other investment reported net outflows worth EUR 4,399 million (EUR 5,864 million in 2015), with the downward influence coming from long-term loans, which totalled EUR 1,125 million worth of net outflows, compared to EUR 3,586 million a year earlier.

¹³⁵ Including the estimated net reinvestment of earnings.

¹³⁶ Loans between the foreign investor and the resident company.

¹³⁷ In terms of the share in net inflows of direct investment by non-residents in Romania in 2016 (preliminary data). These five countries account for 70 percent of total investment.

3. Romania's international investment position – main components

International reserves

At end-2016, Romania's international reserves totalled EUR 37,905 million, up EUR 2,420 million from end-2015. Net transactions, exchange rate changes, and changes in international gold price made a contribution of EUR 2,703 million, whereas developments in prices of portfolio securities had a negative contribution of EUR 283 million. At the end of the period under review, Romania's international reserves covered 6.3 months of imports of goods and services, compared to 6.4 months at end-2015¹³⁸.

Gross external debt

At 31 December 2016, gross external debt came in at EUR 92.4 billion.

Long-term external debt¹³⁹ shed 2.2 percent from end-2015, running at EUR 69 billion, as a result of EUR 2.1 billion worth of net outflows, changes in debt security prices (EUR -0.4 billion), partly offset by other changes and exchange rate changes (EUR +1.0 billion).

Long-term external debt service equalled EUR 19.2 billion in 2016, of which EUR 17.4 billion worth of principal repayments and EUR 1.8 billion worth of payments of interest and commissions.

Long-term external debt by institutional sector shows that, at end-2016, the general government sector further held the largest share (46.5 percent), ahead of the non-bank sector (40.1 percent). Compared with the previous year, the banking sector (11.6 percent) and the monetary authority (1.8 percent) continued to post diminished readings, on the back of the lower stock of non-residents' deposits and the full repayment of the loan taken by Romania in 2009 under the Stand-By Arrangement with the IMF.

The analysis of the long-term external debt by creditor reveals the share held by international institutions following a further downward trend (from 23.1 percent at end-2015 to 22.0 percent at end-2016), as a result of the full repayment of the 2009 IMF loan, as well as the repayments on the external debt to other multilateral creditors – the EU, IBRD, EBRD, EIB (EUR 1.6 billion). The share of private financing sources kept rising (from 76.9 percent at end-2015 to 78.2 percent at end-2016) due to the access to private capital markets (via issues of securities).

¹³⁸ Import cover is calculated as a ratio of Romania's international reserves (foreign currency + gold) at the end of period to average monthly imports of goods and services in the period under review.

¹³⁹ Consisting of trade credits and external loans, bonds, deposits and SDR allocations.

Looking at the composition by maturity, at end-2016, external debt with a maturity of over five years further took the largest share in long-term external debt (86.3 percent).

The breakdown of long-term external debt by currency at end-2016 shows that the euro was in the lead (73.5 percent, down 0.3 percentage points versus 31 December 2015), ahead of the leu (12.2 percent, up 1.1 percentage points), the US dollar (10.5 percent, up 0.1 percentage points), SDR (1.8 percent, down 0.2 percentage points), the Swiss franc (1.2 percent, down 0.8 percentage points), and other currencies (0.8 percent).

At end-2016, long-term external debt held 40.7 percent of GDP, down 3.4 percentage points from end-2015. Long-term external debt service ratio fell by 11.1 percentage points to 27.4 percent at end-2016 from 38.5 percent at end-2015 (Table 9.3).

Table 9.3
Key external
indebtedness indicators

	percent	
	2015	2016
Gross external debt/GDP	56.5	54.5
Net external debt / GDP ¹⁴⁰	24.1	22.0
Long-term gross external debt/GDP	44.1	40.7
Long-term gross external debt/exports of goods and services	107.3	98.3
Long-term gross external debt service ratio	38.5	27.4

Short-term external debt ran at EUR 23.4 billion at end-2016, with its balance standing 17.7 percent higher against the previous year, due to net capital inflows and other changes from financial instrument adjustments. Short-term external debt service amounted to EUR 41.6 billion, with the corresponding debt service ratio reaching 59.2 percent at end-2016, 10 percentage points higher than at end-2015.

Net external debt¹⁴⁰

At end-2016, net external debt fell to EUR 37.2 billion from EUR 38.6 billion in 2015 amid the decline in the net external debt of deposit-taking corporations except the central bank, along with the increase in the net position of other sectors, as well of the general government sector and of the central bank (Table 9.4).

At end-2016, the general government sector posted a higher external debtor position, with net debt standing at EUR 30.2 billion, against EUR 29.3 billion in 2015, mainly as a result of funding via expanding the portfolio of securities issued.

The net debtor position of credit institutions amounted to EUR 5.8 billion, down from EUR 10.8 billion in 2015, on the back of shrinking deposits from parent banks (EUR 11 billion in 2016 versus EUR 14.2 billion a year earlier).

¹⁴⁰ According to the IMF's *External Debt Statistics: Guide for Compilers and Users*, 2013 edition, net external debt is equal to gross external debt less external assets in the form of debt instruments.

	EUR million		
	Gross external debt	External assets in the form of debt instruments	Net external debt
	(1)	(2)	(3) =(1)-(2)
General government	32,379	2,206	30,173
Cash and deposits	224	7	217
Debt securities	19,699	10	19,689
Loans	12,432	60	12,372
Trade credits and advances	2	2,047	-2,045
Other liabilities/assets	22	82	-60
Central bank	1,258	34,242	-32,984
Special drawing rights (SDR)	1,255	1,260	-5
Cash and deposits	3	8,168	-8,165
Debt securities	0	24,814	-24,814
Deposit-taking corporations except the central bank	11,162	5,365	5,797
Cash and deposits	10,984	4,372	6,612
Debt securities	152	168	-16
Loans	0	628	-628
Other liabilities/assets	26	197	-171
Other sectors	23,207	7,619	15,588
Cash and deposits	0	1,674	-1,674
Debt securities	14	1,746	-1,732
Loans	16,844	210	16,634
Trade credits and advances	6,161	3,916	2,245
Other liabilities/assets	188	73	115
Debt instruments under direct investment	24,371	5,705	18,666
Total	92,377	55,137	37,240

Table 9.4
Romania's external debt
at end-2016

The non-bank sector posted a net debtor position of EUR 15.6 billion, against EUR 10.7 billion in 2015, mainly following a rise in the stock of external liabilities in the form of trade credits.

The NBR's net creditor position of EUR 33 billion, up from EUR 30.7 billion in 2015, was prompted by an increase in external assets in the form of deposits and special drawing rights, as well as by the full repayment of the IMF loan under the Stand-By Arrangement of 2009.

Debt instruments under direct investment posted a slightly rising net debtor position worth EUR 18.7 billion, compared with EUR 18.5 billion in 2015, owing to a pick-up in intercompany lending by non-residents.





Chapter 10

International relations

1. The NBR's activity at EU level

1.1. The European context – developments in economic, financial and banking policies

a) Reform of the European Union banking sector – risk reduction measures

On 23 November 2016, the European Commission published a comprehensive package of reforms, meant to further strengthen resilience of EU banks. The proposals build on existing EU banking rules and aim to complete the post-crisis economic and financial regulatory framework so that it is able to address all outstanding challenges to financial stability, while ensuring that banks can continue to support the real economy.

The measures proposed are part of the European Commission's ongoing work to reduce risks in the banking sector, as set out in the Communication "Towards the Completion of the Banking Union"¹⁴¹ (November 2015). Moreover, they mirror the conclusions of the ECOFIN Council of 17 June 2017, where the European Commission was invited to put forward relevant proposals no later than the end of 2016. Also, the said proposals implement international standards into EU law – that have been only recently finalised by the international standardisation bodies¹⁴² –, while taking into account European specificities and preventing adverse impact of the new framework on the financing of the real economy.

The proposals amend the following pieces of legislation:

- The Capital Requirements Regulation (CRR)¹⁴³ and the Capital Requirements Directive (CRD)¹⁴⁴, which were adopted in 2013 and which set out prudential requirements applicable to credit institutions and investment firms and rules on governance and supervision;

¹⁴¹ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of Regions (COM(2015) 587 final).

¹⁴² Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB).

¹⁴³ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

¹⁴⁴ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

- The Bank Recovery and Resolution Directive (BRRD)¹⁴⁵ and the Single Resolution Mechanism Regulation (SRMR)¹⁴⁶, which were adopted in 2014 and which specify the rules on the recovery and resolution of failing institutions and establish the Single Resolution Mechanism.

The package of legislative proposals is discussed in the EU Council within a dedicated working party¹⁴⁷ attended *inter alia* by NBR representatives, along with representatives of the Ministry of Public Finance, the Financial Supervisory Authority and the Permanent Representation of Romania to the European Union.

b) Developments in the establishment of a European Deposit Insurance Scheme (EDIS)

Following the European Commission's proposal of 24 November 2015 to establish a European Deposit Insurance Scheme, an Ad Hoc Working Party on the Strengthening of the Banking Union¹⁴⁸ was created by the EU Council on 13 January 2016, with a mandate to examine the proposal for a regulation in order to prepare a political decision at EU level in that respect. EDIS is aimed only at Member States in the Banking Union, but the discussions within the working party are attended by all 28 EU member countries, given the existing possibility of other EU Member States joining the Banking Union in the future.

NBR representatives, along with representatives of the Ministry of Public Finance and of the Permanent Representation of Romania to the European Union also participate in the meetings of the Ad Hoc Working Party.

c) The European Semester

The European Semester 2016, an integral part of the EU economic governance concept, kicked off on 26 November 2015, when the European Commission released the "2016 Annual Growth Survey" (AGS) Communication.

Considering the priority actions identified by the EC in the AGS 2016 and the 2015 country-specific recommendations, the Romanian authorities prepared and submitted to the European Commission the 2016 National Reform Programme (NRP), along with the 2016-2019 Convergence Programme, based on which the EU Council adopted country-specific recommendations on 12 July 2016. Romania received four specific recommendations in the areas of public finance, labour market, healthcare system, and public administration. The first of the four recommendations was also circumscribed to the NBR's scope of activity

¹⁴⁵ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

¹⁴⁶ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

¹⁴⁷ Working Party on Financial Services on Risk Reduction Measures.

¹⁴⁸ Ad Hoc Working Party on the Strengthening of the Banking Union.

and responsibilities, namely “to ensure that legislative initiatives do not undermine legal certainty and do not put at risk financial stability. If necessary, adopt measures that mitigate such risks.”

Moreover, in the context of the European Semester 2016, a European Commission team conducted a fact finding mission in Bucharest on 8-9 November 2016, which included talks with the Romanian authorities, among which the NBR, regarding the country’s economic and financial developments in the prospect of preparing the country report for 2017.

The seventh European Semester started on 16 November 2016, with the launch of the Commission’s AGS for 2017. On the same date, the Commission published its opinions on the 2017 draft budgetary plans, the overall assessment of the budgetary situation and the fiscal stance in the euro area.

As regards the Macroeconomic Imbalance Procedure (MIP), the European Commission published the Alert Mechanism Report for 2017 on 16 November 2016. This document identifies the Member States for which it considers that developments warrant further analysis (in the form of an in-depth review) to substantiate whether imbalances exist and propose policy measures. The Commission carried out in-depth reviews for 13 Member States¹⁴⁹, excluding Romania.

On 22 February 2017, the European Commission published Romania’s Country Report for 2017¹⁵⁰. On the one hand, the report assesses the country’s economic policies, as well as the implementation of the country-specific recommendations by the Romanian authorities in 2016 and, on the other hand, it identifies the main challenges that must be addressed in the period ahead.

1.2. NBR participation in European structures

The NBR participates, through its representatives, in the meetings and procedures of various structures and working groups of European bodies.

Participation in the ECB General Council meetings

The NBR Governor attends the quarterly meetings and the teleconferences of the ECB’s General Council. This analysis and decision-making body had on the 2016 agenda topics covering: (i) regular macroeconomic analyses and reviews of key monetary, financial and fiscal developments both within and outside the euro area; (ii) the ECB report on competitiveness, imbalances and vulnerabilities of non-euro area EU Member States; (iii) compliance by the ESCB members with the provisions of Articles 123 and 124 of the Treaty on the Functioning of the European Union; and (iv) use of ESCB projections in stress-testing exercises carried out by EBA.

¹⁴⁹ Bulgaria, Cyprus, Croatia, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Slovenia, Spain and Sweden.

¹⁵⁰ <https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-romania-en.pdf>.

NBR participation in the enlarged meetings of ESCB structures and substructures

As regards the decision-making mechanism at operational level, NBR representatives attend the enlarged meetings of the 12+1 ESCB committees, contributing to formulating and implementing the decisions of the General Council and the Governing Council of the ECB. Along with the relevant ESCB substructures, these structures ensure a framework for assessment and decision-making according to their fields of competence. Both the NBR executive management and the NBR Board attach particular attention to the central bank's participation in ESCB structures and substructures by closely monitoring any related issues.

NBR participation in the ESRB

In 2016, the activity of the European Systemic Risk Board (ESRB) further focused on:

- identifying and assessing risks to financial stability;
- issuing warnings, when significant risks to financial stability in the Union are identified in the process of the macroprudential oversight of the EU financial system. In 2016, the ESRB issued warnings for eight Member States on medium-term vulnerabilities in the residential real estate sector;
- preparing new recommendations and following up on those issued in previous years.

In 2016, the ESRB issued:

- (i) Recommendation ESRB/2016/14 on closing real estate data gaps;
- (ii) Recommendation ESRB/2016/2 amending Recommendation ESRB/2012/2 on funding of credit institutions;
- (iii) Recommendations ESRB/2016/3 and ESRB/2016/4 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures.

Moreover, the ESRB continued to follow up on the implementation of the Recommendation on funding of credit institutions (ESRB/2012/2) and of the Recommendation on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1).

- drafting and improving the macroprudential policy framework for the EU financial sector.

The NBR was involved at decision-making level, with the NBR Governor, the Deputy Governor in charge of financial stability and a member of the NBR Board attending the quarterly meetings of the ESRB General Board, and at a technical level, via NBR experts' participation in the activity of ESRB working groups, including the Advisory Technical Committee.

NBR participation in the EBA working structures and relevant substructures

In the period under review, the NBR participated in a series of working structures and substructures of the European Banking Authority (EBA), as follows:

- in the Board of Supervisors and the Resolution Committee;
- in other structures and substructures, such as: the Standing Committee on Oversight and Practices, the Standing Committee on Regulation and Policy, the Standing Committee on Accounting, Reporting and Auditing, the Subcommittee on Anti-Money Laundering of the Joint Committee of the European Supervisory Authorities, the Subgroup on Own Funds, the Subgroup on Securitisation and Covered Bonds, the Subgroup on Governance and Remuneration, the Subgroup on Liquidity, the special Working Group on Stress Testing, the special Working Group on Impact Study, and the special Working Group on Information Technology Risk Supervision;
- in supervisory colleges.

NBR participation in structures of the EU Council and of the EC

Some of the most important structures and substructures of the EU Council and of the EC where the NBR is represented at various hierarchical levels include:

- the biannual participation in the informal ECOFIN Council meetings, which the NBR attends at executive management level;
- participation in the Economic and Financial Committee (EFC), whose meetings are attended by a NBR Deputy Governor. In 2016, the final report of the High-Level Working Group on the Regulatory Treatment of Sovereign Exposures¹⁵¹ was presented in the EFC, to its drafting contributing also the Deputy Governor in charge of coordinating financial stability, who is the NBR representative to the working group;
- participation in the meetings of various working structures/substructures of the EU Council and the EC whose agendas are closely connected with the central bank's fields of competence (the Financial Services Committee, the Committee on Monetary, Financial and Balance of Payments Statistics, the Expert Group on Money Laundering and Terrorist Financing, the Ad Hoc Working Party on the Strengthening of the Banking Union, the Experts' Group "Economic Forecasts", the Euro Counterfeiting Experts Group, etc.), along with representatives of the Ministry of Public Finance and/or other government institutions.

NBR participation in the joint working platform with government authorities on European affairs

In line with its statutory tasks on the *ex ante* advisory role played in the institutional relations with government authorities, the NBR is represented in the meetings of the interinstitutional Committee for European Affairs Coordination, which is in charge, at a national level, of preparing the decisions and formulating Romania's stance with

¹⁵¹ High-Level Working Group on the Regulatory Treatment of Sovereign Exposures.

regard to European affairs. As a result of the requests received and within the limits of its lawful tasks, the NBR submitted its comments on the topics and items included in the agenda of the meetings of the interinstitutional Committee for European Affairs Coordination.

Moreover, in the context of the national stage of the European Semester, the NBR was actively involved in the meetings of the inter-ministerial working groups responsible for preparing the National Reform Programme, where debates covered the actions/measures laid down in this document and the progress reports on their implementation.

NBR participation in the ECB's decision-making by means of written procedure

In line with the obligations under the Treaty on the Functioning of the European Union, the Protocol on the Statute of the ESCB and of the ECB and Council Decision 98/415/EC of 29 June 1998 on the consultation of the ECB by national authorities regarding draft legislative provisions, the NBR participated in the written consultation procedure on draft national legislation falling within the ECB's field of competence.

NBR participation in the process of transposing, implementing and notifying EU legislation

a) Transposing and implementing EU regulations

EU regulations are binding in their entirety and directly applicable in all Member States and thus do not have to be transposed into national law. The NBR, in its capacity as an institution with regulatory and supervisory tasks, checks the EC database (Eur-lex) on a regular basis so as to track any newly-adopted EU regulations applicable to its scope of activity. The list of these regulations is sent to the Ministry of Foreign Affairs and is posted on the central bank's website, with a view to properly informing the entities under the NBR's regulatory/supervisory scope.

b) Informing the EC about the transposition of EU legislation

During the period under review, the NBR submitted to the Ministry of Foreign Affairs – so that the latter may duly notify the Commission – the transposition notification and the compliance table related to all articles in several Directives within the NBR's field of competence.

The NBR and other competent institutions are currently involved in transposing the Directives on: markets in financial instruments; comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features; the prevention of the use of the financial system for the purpose of money laundering and terrorist financing; payment services in the internal market.

For the purpose of an easier collection of opinions/joint positions related to topics on the agendas of European institutions and international bodies that are of interest to the NBR's activity, in-house economic seminars have been organised on a regular basis as of

February 2016. In these seminars, the NBR representatives to the structures and working groups of the said institutions and bodies deliver presentations on significant aspects and issues related to the activity of external representation of the central bank.

1.3. Technical cooperation

In 2016, the NBR was mainly involved in the twinning project¹⁵² dedicated to the National Bank of Moldova (NBM), titled “Strengthening the NBM’s Capacity in the Field of Banking Regulation and Supervision in the Context of EU Requirements”. This project, worth around EUR 1.2 million in funding from the European Union, through the European Neighbourhood and Partnership Instrument (ENPI) for the Republic of Moldova, spans two years (June 2015 – June 2017). The aim of the project is to offer technical assistance to the NBM for strengthening the prudential supervision framework during the harmonisation with EU rules and standards for the banking supervisory authorities, and for enhancing the NBM’s institutional and administrative capacity in this area. The NBR provides assistance alongside De Nederlandsche Bank (DNB), in a consortium led by the former. Within the project, the NBM benefits from the expertise of a Resident Twinning Adviser seconded from the NBR to Chişinău for the duration of the project and of 44 short-term experts, of whom 37 from the NBR and 7 from NBM, in the areas of regulation and authorisation, supervision, financial stability and human resources. They provide assistance in more than 100 missions in Chişinău and study visits by NBM experts in Bucharest and Amsterdam.

1.4. EU medium-term financial assistance

Starting October 2015, the EC has begun the financial assistance post-programme surveillance aimed at assessing Romania’s repayment capacity that will have to be maintained at least until 70 percent of the loan amount received under the 2009-2011 programme is repaid, namely at least until May 2018.

In this context, two joint EC-ECB surveillance missions¹⁵³ were conducted in 2016 and in early 2017, where economic and financial developments in Romania were discussed with the country’s authorities, including the NBR.

1.5. NBR participation in external institutions and organisations

Starting 15 April 2016, the NBR has become an institutional member of Bruegel¹⁵⁴. In this context, NBR representatives participated in a series of meetings organised by Bruegel regarding key economic policy aspects. Moreover, given the central bank’s joining to Bruegel, French economist Nicolas Véron, senior fellow at Bruegel and

¹⁵² Twinning is an instrument for cooperation between Public Administrations of EU Member States and beneficiary countries (candidate countries and potential candidates to EU membership, as well as countries covered by the European Neighbourhood Policy). Twinning projects are aimed at sharing good practices and fostering long-term relationships between the public administrations of existing and future EU countries.

¹⁵³ In 23-26 May 2016 and 16-17 March 2017 respectively.

¹⁵⁴ Bruegel is a European think tank established in 2005 and headquartered in Brussels that specialises in economics and that is known and well-regarded among decision-makers, both at European and international level, being frequently invited to express its opinions on various current topics on the agenda of, for example, the Council of the European Union (ECOFIN), the European Parliament, the European Commission, as well as of some national assemblies, such as the German or French Parliament.

co-founder of the organisation, made a working visit to the NBR. On that occasion, he delivered a presentation on the topic “Banking Union and Beyond: Taking Stock of EU Financial Reform” in the in-house economic seminar of 10 June 2016.

In 2016, the NBR initiated the process of joining the Official Monetary and Financial Institutions Forum (OMFIF), which it estimated to complete in 2017. OMFIF is an independent platform for dialogue and research, promoting worldwide public-private sector exchanges in the field of economics, particularly in finance. OMFIF focuses on global policy and investment themes (mainly in asset management, capital markets and financial supervision/regulation) relating to central banks, sovereign funds, pension funds and regulators.

2. International financial relations

International Monetary Fund

Romania has been a member of the International Monetary Fund (IMF) since 1972. At present, Romania's quota subscription (subscribed and paid-up capital) is SDR 1,811.4 million, i.e. 0.38 percent of the Fund's total quota.

January 2016 saw the repayment to the IMF of the final instalment (in the amount of DST 96.125 million) of the loan taken under the 2009 Stand-By Arrangement, to which added SDT 0.5 million worth of net interest payments.

In the period from 13 to 15 January 2016, the new head of the IMF mission to Romania, Mr. Reza Baqir, together with Mr. Alejandro Hajdenberg, the new Resident Representative of the IMF in Romania, made an introductory visit to Bucharest.

During 1-15 March 2016, an IMF team visited Bucharest for discussions and consultations with the relevant Romania authorities as part of the surveillance procedure known generically as Article IV Consultations¹⁵⁵. The topics discussed included: the reduction in revenues amid low budget spending, the minimum wage in Romania, inflation and inflation expectations, and financial sector developments. The conclusions of the discussions were presented in a staff report approved by the IMF Executive Board and published on 11 May 2016.

A third IMF mission visited Romania from 11 to 19 October 2016 to assess the progress in structural reform implementation and the priorities ahead, the stage of 2017 budget construction and the medium-term fiscal framework, as well as the financial sector developments and prospects.

The 2017 consultations under Article IV Consultations were held from 8 to 17 March 2017. In this context, a seminar was organised at the NBR's head office on 13 March 2017, where discussions covered topics regarding the relation between

¹⁵⁵ Which allows the Fund to exercise its surveillance role over the international monetary system.

the exchange rate and economic growth, the monetary policy transmission mechanism in Romania and the link between the efficiency of public capital, European funds and economic growth in Romania.

World Bank Group

Along with the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), which together make up the World Bank, the World Bank Group also includes the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID). Romania is a member of all these institutions. IBRD and IDA are distinct, yet complementary institutions: while the former aims to reduce poverty in middle- and low-income countries, IDA's activity is particularly concerned with the poorest states.

International Bank for Reconstruction and Development

Romania joined the IBRD in 1972, an institution in which it currently holds 6,866 shares (0.31 percent of the bank's capital) and a voting power accounting for 0.32 percent of total.

The World Bank resumed its activity in Romania in 1991. Currently, the Country Partnership Strategy for the period 2014–2017 relies on three pillars: (i) modernising the governance system; (ii) supporting economic growth and job creation; (iii) boosting social inclusion.

The IBRD has provided approximately USD 11 billion in loans to Romania from 1991 to 2016.

International Development Association

Romania joined the IDA on 12 April 2014 and currently holds a voting power of 0.36 percent of total.

Financial institutions affiliated to the World Bank

Romania joined the IFC in 1990 and currently holds 4,278 shares worth USD 4.278 million and a 0.19 percent voting power within the organisation. In the fiscal year 2016, the IFC invested in Romania around USD 145 million.

Romania has been a member of the MIGA since 1992 and currently holds 978 shares representing SDR 9.78 million and a voting power of 0.55 percent. Over time, MIGA's cumulative exposure encompassed 13 guarantees tantamount to USD 438 million for supporting investment projects in Romania.

European Bank for Reconstruction and Development

Romania is a founding member of the European Bank for Reconstruction and Development (EBRD), where it currently holds 14,407 shares worth EUR 144.07 million, accounting for 0.49 percent of the bank's total subscribed capital.

According to the most recent Country Strategy for Romania, i.e. for 2015-2018, the EBRD will become involved in broadening access to financing by boosting lending and expanding capital markets, reducing regional disparities and encouraging social inclusion, as well as improving private sector competitiveness.

By the end of April 2017, the EBRD provided Romania with financial assistance totalling roughly EUR 7.5 billion by way of 392 projects, 56 percent of which were channelled to the private sector.

Black Sea Trade and Development Bank

The Black Sea Trade and Development Bank (BSTDB) was established in 1994 by the 11 member countries of the Organization of Black Sea Economic Cooperation, Romania included, with a view to supporting economic development and regional cooperation. The BSTDB's authorised capital currently stands at around USD 4.5 billion, with Romania holding 14 percent of the institution's capital, respectively of total votes.

In 2016, the BSTDB Board of Directors approved two projects for Romania, totalling EUR 14.5 million.

Bank for International Settlements

The NBR has been a member of the Bank for International Settlements (BIS) ever since the latter's establishment in 1930 and holds 8,564 shares in the BIS total capital, for which it received in 2016 approximately GBP 1.9 million in dividends for the financial year ended on 31 March 2016.

In 2016, the NBR took the steps to join the Financial Stability Board, Regional Consultative Group for Europe (FSB-RCGE). As a result, the NBR was invited to participate as an observer to the FSB-RCGE meeting of 24 October 2016, held in Lisbon, and Romania is expected to become a full member in 2017.

Organisation for Economic Cooperation and Development

One of Romania's key foreign policy objectives over the last decade has been to join the Organisation for Economic Cooperation and Development (OECD).

The NBR has supported this aim, within the limits of its tasks under the Statute, by participating in the relevant OECD working units. Specifically, the NBR attended as a guest the meetings of the Financial Markets Committee, held in April and October 2016.

At the same time, the NBR participated in the works of the Inter-ministerial Committee for Coordination of Romania's Relations with the OECD, which is coordinated by Government General Secretariat and is responsible for developing the strategy for promoting Romania's OECD membership application, by establishing a roadmap of actions, events and budget and coordinating the steps taken by the institutions involved in this process.



Chapter 11

The convergence
of the Romanian economy
and the new EU economic
governance framework

1. Romania's progress towards convergence

Romania's integration with the European Union involves the adoption of the European single currency and implicitly the fulfilment of the nominal convergence criteria. Joining the euro area entails the transfer of the responsibility for the formulation and conduct of monetary policy to the European Central Bank, which takes a "one-size-fits-all" approach for the whole euro area, whose homogeneity is assumed to be high. The nominal convergence criteria stipulated in the Maastricht Treaty refer to price stability, the sustainability of public finances and of indebtedness, the exchange rate stability and the level of long-term interest rates. In addition, the assessment of Romania's progress towards convergence also implies the analysis of some structural alignment indicators, with a view to determining the capacity of the economy to operate efficiently in the event of shocks materialising, without the support of an independent national monetary policy.

Romania has actually been complying with all the nominal convergence criteria since July 2015, without participating, however, in the ERM II (Table 11.1).

	Romania		
	Maastricht criteria	2016	May 2017
Inflation rate (HICP)¹ (%, annual average)	≤1.5 pp above the average of the three best-performing EU Member States	-1.1 (1.0: reference value)	0.1 (1.5: reference value)
General government deficit (% of GDP)	below 3 percent	3.0	...
Government debt (% of GDP)	below 60 percent	37.6	...
Exchange rate vs the euro (2-year maximum percentage change)	±15 percent	+1.4/-1.8 ²	+1.0/-2.6 ³
Long-term interest rates¹ (% p.a., annual average)	≤2 pp above the average of the three best-performing EU Member States in terms of price stability	3.3 (3.8: reference value)	3.5 (4.1: reference value)

1) The reference value for 2016 was calculated by taking into account Croatia, Slovakia and Spain, whereas that for May 2017 took into consideration Bulgaria, Cyprus and Ireland. 2) Maximum percentage changes in the exchange rate versus the euro during January 2015 – December 2016. Calculations are based on daily data series, by reference to the average for December 2014. 3) Maximum percentage changes in the exchange rate versus the euro during June 2015 – May 2017. Calculations are based on daily data series, by reference to the average for May 2015.

Source: Eurostat, NBR calculations

Table 11.1
Maastricht criteria
(nominal convergence indicators)

Over the last years, the inflation rate in Romania has followed a pronounced downtrend, supported, on the one hand, by the mainly downward path of core inflation, reflecting the persistent negative output gap until the end of 2015, the decline in core inflation sensitivity to the output gap, in spite of the reversal of the cyclical position of the economy, estimated to have begun in 2016 Q1, as well as the low inflation expectations of economic agents. On the other hand, the said trend

can be explained by the occurrence of repeated supply-side shocks, including the relatively low commodity prices. Starting in 2015 H2, amid the successive cuts in the VAT rates¹⁵⁶, the average annual HICP inflation rate fell significantly, reaching a historical low in May 2016 (Chart 11.1). Subsequently, there was a reversal of the downtrend in the average annual HICP inflation rate, which remained however in negative territory, becoming positive again in May 2017 (0.1 percent). Looking ahead, inflationary pressures stemming from the positive output gap, the higher unit labour costs and the projected strengthening of the uptrend in the main commodity prices are expected to contribute to a pick-up in the average HICP inflation rate in 2017. Nevertheless, the cut in the standard VAT rate by 1 percentage point as of January 2017 works in the opposite direction. Under the circumstances, the average annual HICP inflation rate is foreseen to further stand below the reference value of the criterion on price stability in 2017 as well.

Chart 11.1
Inflation rate (HICP)

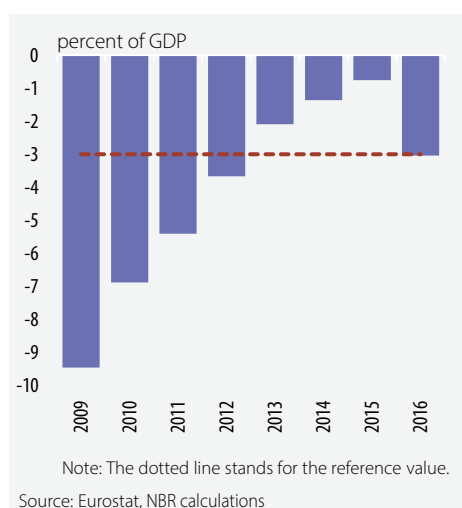
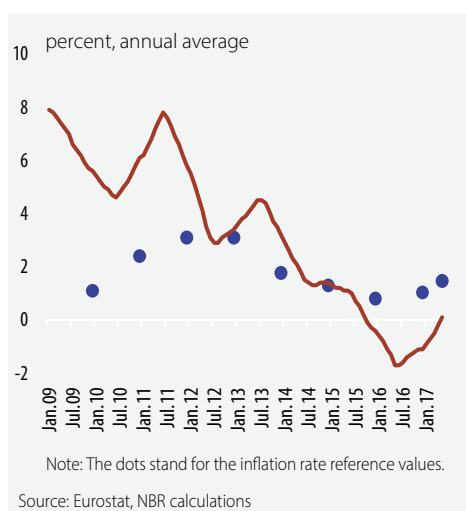


Chart 11.2
General government deficit
(ESA 2010 methodology)

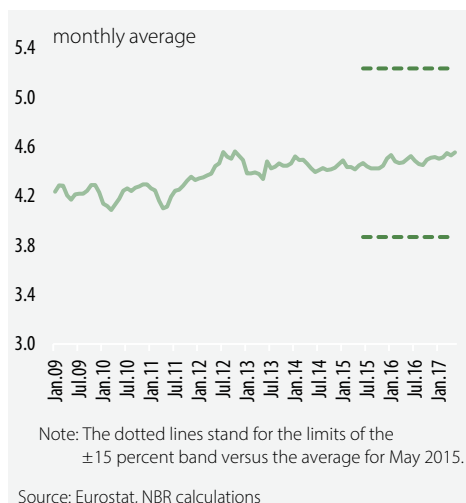


Chart 11.3
EUR/RON exchange rate

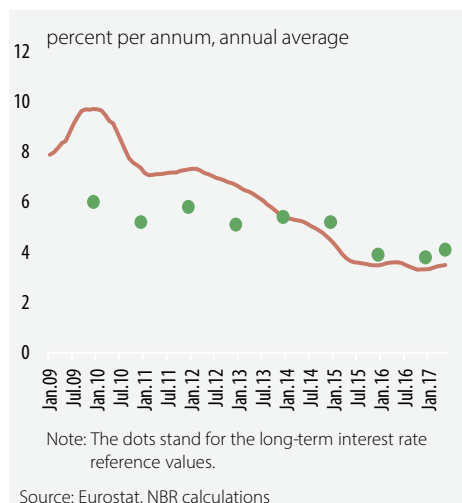


Chart 11.4
Long-term interest rates

¹⁵⁶ To 9 percent for all food items, non-alcoholic beverages and food service activities as of June 2015 and by 4 percentage points for the standard VAT rate as of January 2016.

The general government deficit (according to ESA 2010 methodology) saw a significant correction during 2010-2015 (Chart 11.2), its share in GDP running, as of 2013, below the reference value stipulated in the Maastricht Treaty. In 2016, this indicator witnessed a trend reversal and increased up to the 3 percent ceiling. The share of public debt in GDP stabilised below 40 percent and its sustainability profile saw an improvement over the last years due to a longer residual maturity and lower financing costs. Nonetheless, the capacity of the banking system to provide additional financing to the public sector is further limited, amid the high bank exposure to the latter.

Subsequent to the global financial crisis, the mitigation of domestic macroeconomic imbalances, in parallel with carrying out the agreements concluded with the international financial institutions, favoured the relatively stable evolution of the exchange rate of the leu against the euro (Chart 11.3). Owing to Romania's non-participation in the ERM II, the fluctuation of the exchange rate is not measured against a central parity, but against the average for the month preceding the period under review. The fluctuation of the leu ranged comfortably within the ± 15 percent standard band both in 2015-2016 and June 2015 through May 2017, even amid the anticipation of a stronger divergence between the monetary policy decisions of the major central banks (the Fed and the ECB) and the uncertainty surrounding the persistence of domestic macroeconomic balances.

Amid Romania's keeping its investment grade rating, the long-term interest rate ran below the reference value in 2016 and the first five months of 2017 (Chart 11.4). Given that the ongoing domestic structural rigidities and the fiscal and income policy coordinates could be viewed by investors as risk factors, there is a need for structural reforms to be further implemented while maintaining an adequate economic policy mix.

The progress towards real convergence may be assessed using a series of indicators such as GDP per capita, the sectoral structure of the economy, the openness of the economy and the share of trade with the EU in total foreign trade.

GDP per capita in Romania (calculated based on the purchasing power standard) remained on an upward trend. In the pre-crisis period from 2006 to 2008, it averaged at around 39 percent of GDP per capita in the euro area. Subsequently, the gap continued to shrink gradually, with the ratio of GDP per capita in Romania to the euro area GDP per capita coming in at 55.6 percent in 2016, up 2 percentage points from the level seen in 2015 (Chart 11.5). In 2012-2016, the sectoral structure of the economy (measured based on sectors' contribution to GDP formation) tended to converge to that in the euro area – especially due to the advance in the share of services –, which favours the mitigation of the effects of potential asymmetric shocks (Chart 11.6).

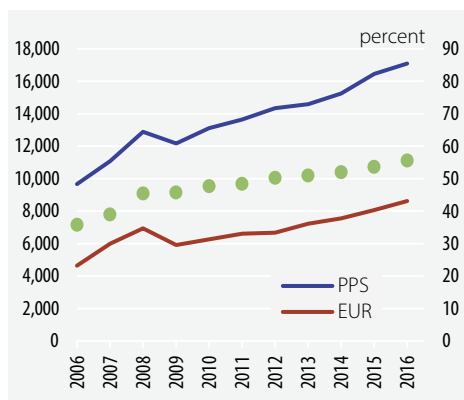
After the adjustment triggered by the global crisis, the openness of the economy¹⁵⁷ rose markedly, with the last three years' average reaching approximately 83 percent (Chart 11.7). Trade integration with the European Union, calculated based on the

¹⁵⁷ (exports of goods and services + imports of goods and services)/GDP*100.

share of trade with the other EU Member States in Romania's total foreign trade, has increased progressively since 2010 and is assessed to be high, exceeding 76 percent in 2016 (Chart 11.8).

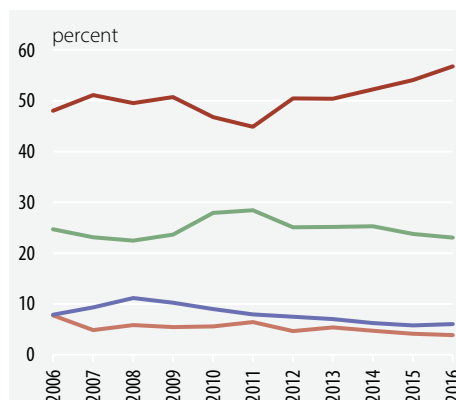
Given the multiple facets of economic convergence, its analysis framework may be expanded by also taking into account the sustainability of the external imbalance or the level of development of the banking and financial system.

Chart 11.5
GDP per capita in Romania



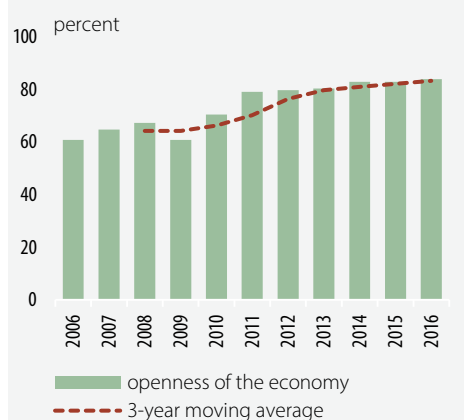
Note: The dots stand for the share of GDP per capita in Romania expressed based on the PPS in euro area average (rhs); PPS = Purchasing Power Standard.

Source: AMECO, NIS, NBR calculations



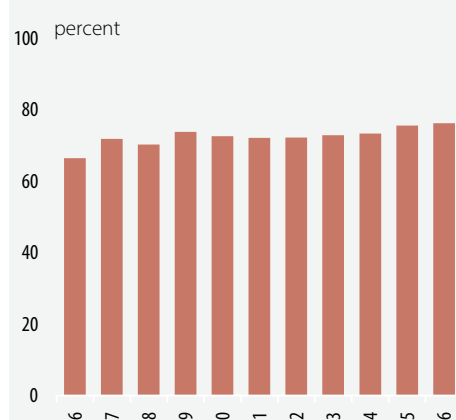
Source: NIS

Chart 11.6
Share of economic sectors in GDP



*) (imports+exports of goods and services)/GDP*100

Source: NIS, NBR



Source: Eurostat

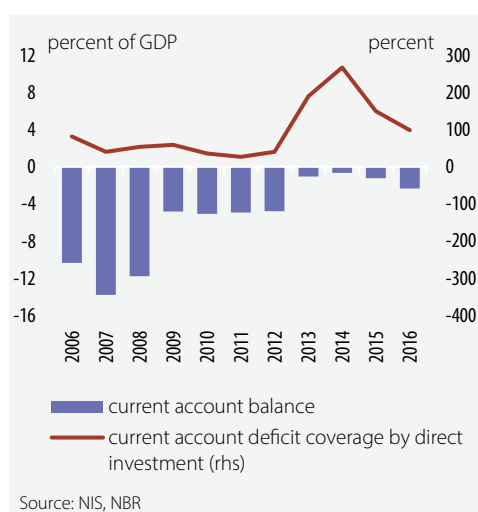
Chart 11.8
Share of trade with the EU-28
in total foreign trade

Chart 11.7
Openness of the economy*

In 2009 and 2013, the share of the current account deficit in GDP saw substantial adjustments, reaching a historical low of 0.7 percent in 2014. Starting in 2015, the trend reversed, chiefly amid the larger deficits on primary income and trade in goods, and the indicator rose to 2.3 percent of GDP at end-2016. The current account deficit financing through direct investment¹⁵⁸ witnessed successive declines in 2010-2011, in the context of the knock-on effects of the global financial crisis on the Romanian economy. Subsequently, the indicator reported a substantial improvement, posting a high average level of over 200 percent in 2013-2014,

¹⁵⁸ With that made by non-residents in Romania prevailing.

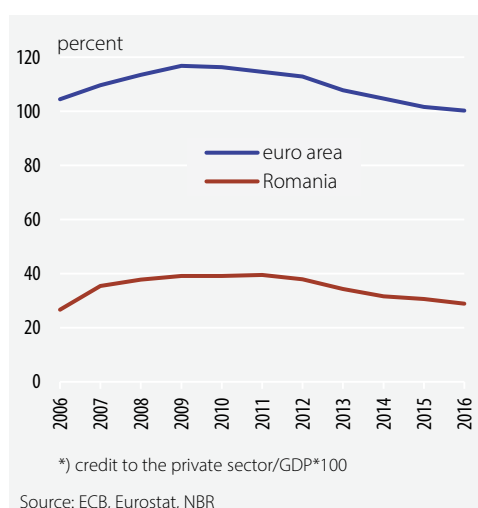
Chart 11.9
Current account deficit and deficit coverage by direct investment



mainly as a result of the significant current account deficit adjustment. Beginning with 2015, once this trend reverted, the indicator followed a downward path. Nevertheless, at end-2016 direct investment financed the current account deficit almost entirely (Chart 11.9).

The integration of the banking and financial sector in Romania with that in the euro area remains high, as shown by the prevalence of the capital originating in euro area countries in the shareholding structure of credit institutions operating in the Romanian market. In spite of the significant progress made by this sector concurrently with Romania's joining the EU, financial intermediation continues to be well undersized¹⁵⁹ (Chart 11.10).

Chart 11.10
Indirect financial intermediation*



An important step in terms of improving the institutional framework for carrying out the process of the single currency adoption was the setting-up, in December 2016, via a Government decision, of the Inter-ministerial Committee for Changeover to the

Euro. The first meeting of this advisory body, which is chaired by the Prime Minister of Romania and comprises also the Governor of the National Bank of Romania as vice-chair, took place on 10 April 2017.

As for Romania's prospects for joining the euro area, according to the "Convergence Programme 2017-2020", the government maintains its commitment in this respect, which is further an important anchor for the implementation of effective and coherent policies, with a view to ensuring sustainable real convergence, enhancing the competitiveness of the domestic economy, narrowing regional disparities and reducing labour market structural deficiencies. Nonetheless, setting an exact date for euro adoption implies the conduct of in-depth analyses, particularly with regard to real, structural and institutional convergence, areas where substantial progress needs to be made. At the same time, the sustainability of meeting the nominal convergence criteria should be taken into consideration.

¹⁵⁹ In Romania, indirect financial intermediation, calculated as a ratio of private sector credit to GDP, picked up in 2006-2011 from 26.6 percent to about 40 percent, the path of the indicator subsequently posting a reversal. Thus, in 2016, it stood at 28.9 percent, accounting for approximately a third of that in the euro area.

2. Developments in the European Union's economic governance

The recent period has been marked by heightened debates about the development of the European project as a whole, also in the context of the release of the "White Paper on the Future of Europe", which lays out five scenarios on the future cooperation within the European Union. Against the background of such discussions, at end-May 2017 the European Commission published a reflection paper that sets out the necessary steps to be taken for the completion of the architecture of the Economic and Monetary Union – in both the financial field and the economic and fiscal one –, aiming also at democratic accountability and effective governance. Specifically, the achievement of the Financial Union would involve focusing on the completion of the Banking Union and the achievement of the Capital Markets Union, as well as on making the European banking system more resilient to shocks. In the economic and fiscal field, the lines of action proposed cover a wide spectrum, envisaging, among others, better economic policy coordination under the European Semester, improved use of EU funding to support the domestic agenda of reforms, simplification of the rules of the Stability and Growth Pact, and implementation of a new assessment framework for economic convergence. As far as democratic accountability and effective governance are concerned, according to the EC's analysis, there is a need for strengthened cooperation with the European Parliament, improved external representation of the euro area or integration of the Fiscal Compact into the EU legal framework, with 2025 being the year by which objectives such as the setting-up of a euro area Treasury and of a European Monetary Fund respectively should be accomplished.

Similarly to the previous years, a new annual cycle of the Macroeconomic Imbalance Procedure (MIP), part of the European Semester, started in November 2016 via the publication by the European Commission of the Annual Growth Survey and the Alert Mechanism Report (AMR). These reports aim at identifying the macroeconomic developments that may jeopardise the smooth functioning of the Economic Union and will subsequently underlie the in-depth reviews undertaken for the Member States where significant imbalances are noticed. In order to assess these risks, the AMR uses a scoreboard of 14 headline indicators covering the external position, the level of competitiveness, domestic imbalances and the social and labour market situation, as well as an extended set of 25 auxiliary indicators that paint a more comprehensive picture of the overall economic situation of each EU Member State.

The parameters for the scoreboard in the Alert Mechanism Report released in 2016 are identical with those in the previous AMR with respect to both the indicators employed and their indicative thresholds. The report highlights the need to prepare in-depth reviews for 13 Member States (compared to 19 in the preceding year), six of which were identified with excessive imbalances. Alongside Austria, Belgium, Estonia, Hungary, and the United Kingdom, Romania was found to signal no major additional risks compared with the previous year, being thus no need to carry out an in-depth review in 2017 any longer.

Among the positive developments mentioned in the current issue of the AMR is the pick-up in exports in most EU Member States. Specifically, while in 2009 the current account balance was beyond the range of -4 percent to +6 percent of GDP recommended in the scoreboard for 16 countries, in 2015 this was the case for only five countries, three of which reported surpluses. Thus, the current account surplus of the euro area continued to increase at a fast pace in 2015, to 3.2 percent of GDP¹⁶⁰, mainly following the slower recovery of aggregate domestic demand compared with that of economic activity in the largest part of the euro area, which is also mirrored by the further negative output gap. Nevertheless, the sluggishness of consumption and investment risks creating an environment marked by modest prospects, fuelling thus a loop of slow GDP and productivity growth, in line with the secular stagnation hypothesis (Box 1). In fact, this development also affects the general government debt-to-GDP ratio, only the countries with no worrisome over-indebtedness making corrections in this respect in 2015.

In most cases, the net international investment position (NIIP), although reporting values beyond the scoreboard threshold, remained on a slow adjustment trend, underpinned by the favourable developments in the current account balance. In addition, no significant risks associated with values exceeding the indicative threshold for this indicator were identified, to the extent that these deviations are generated by foreign direct investment inflows or portfolio investment in the form of equity. Cost competitiveness did not see any notable progress throughout 2015, the room for adjustment in relative prices being limited in a low-inflation environment, with reduced dispersion in price developments across countries. Under the circumstances, the improvement trend in export market shares – translating into the relevant scoreboard indicator returning above the threshold for seven Member States and into a slowdown in negative rates of change for five of the 11 countries in whose case the said indicator was still below the threshold – owes rather to a base effect.

As far as private debt as a share of GDP is concerned, it further exceeds the threshold for 13 countries¹⁶¹, generally amid the over-indebtedness of both households and non-financial corporations. Elevated indebtedness renders the private sector vulnerable to potential shocks and amplifies their negative repercussions on the banking system should they become manifest. Such risks are heightened in the countries in which a large share of debt is denominated in foreign currencies, this being the case with Romania as well. Deleveraging continued, albeit at a slow and uneven pace, mirroring the weak economic activity: in some countries, there was either active deleveraging, based on negative credit flows, or passive deleveraging, through an increase in GDP (denominator effect), while in other states the already excessive level of indebtedness further rose.

¹⁶⁰ In 2016, the surplus reached 3.4 percent of GDP.

¹⁶¹ Following the revision, in one of the countries, namely Malta, the value for this indicator no longer exceeds the threshold.

Table 11.2. Macroeconomic imbalance procedure scoreboard

		Current account balance	Net international investment position	HICP-based real effective exchange rate	Market share of exports of goods and services	Nominal unit labour cost	House price index	Private sector credit flow
		% of GDP, 3-year average	% of GDP	3-year % change	5-year % change	3-year % change	annual % change	% of GDP
		-4%/+6% of GDP	-35% of GDP	±5% (EA) ±11% (non-EA)	-6%	+9% (EA) +12% (non-EA)	6%	+14% of GDP
Austria	2015	2.1	2.9	1.8	-9.5	6.1	3.5	2.1
	2016	2.0	5.2	1.4	-4.1	4.9	7.2	...
Belgium	2015	-0.2	61.2	-1.3	-11.2	1.5	1.3	6.2
	2016	-0.2	49.5	0.0	-1.8	-0.7	1.0	12.3
Bulgaria	2015	0.4	-63.5	-4.1	12.5	14.9	1.6	-0.3
	2016	1.4	-51.3	-4.5	6.3	7.2	7.5	...
Croatia	2015	2.7	-77.7	0.1	-3.4	-5.7	-2.4	-1.4
	2016	3.2	-71.2	0.0	10.3	-6.2	2.1	...
Cyprus	2015	-4.1	-130.3	-6.3	-16.7	-10.0	0.2	4.4
	2016	-4.2	-125.4	-6.6	-6.6	-5.6	0.3	...
Czech Republic	2015	0.0	-33.2	-8.0	-1.6	0.5	3.9	0.9
	2016	0.5	-24.9	-3.5	3.2	3.2	6.4	...
Denmark	2015	8.6	34.0	-1.5	-8.7	2.6	6.3	-1.2
	2016	8.7	56.1	-1.3	-4.7	4.0	4.2	...
Estonia	2015	0.9	-40.9	6.4	8.7	14.4	6.8	3.3
	2016	1.9	-37.3	5.1	0.0	14.3	3.9	...
Finland	2015	-1.2	0.5	2.2	-20.4	3.5	-0.4	8.8
	2016	-1.0	7.1	0.7	-15.1	2.2	0.1	2.8
France	2015	-0.7	-16.4	-2.7	-5.3	2.2	-1.3	4.4
	2016	-0.7	-15.8	-3.0	-2.1	1.4	1.0	...
Germany	2015	7.6	49.7	-1.5	-2.2	5.7	4.1	2.9
	2016	8.1	54.4	-2.0	3.3	5.4	5.1	...
Greece	2015	-1.2	-134.6	-5.5	-20.5	-11.1	-3.5	-3.1
	2016	-0.7	-136.5	-3.6	-18.7	-2.6	-1.8	-1.7
Hungary	2015	3.0	-64.4	-6.9	-7.5	3.4	11.6	-2.8
	2016	3.4	-58.9	-4.8	2.1	8.4	10.4	-4.3
Ireland	2015	4.7	-208.0	-6.0	37.3	-18.1	8.3	-6.7
	2016	5.5	-185.3	-6.2	55.1	-19.9	5.3	...
Italy	2015	1.4	-23.5	-2.2	-8.8	1.7	-2.6	-1.7
	2016	2.0	-14.9	-3.1	-2.3	1.8	-0.6	...
Latvia	2015	-1.8	-62.5	3.0	10.6	16.3	-2.7	0.7
	2016	-0.4	-58.2	5.3	6.3	15.9	7.8	...
Lithuania	2015	0.9	-44.7	3.9	15.6	11.6	4.6	2.2
	2016	0.1	-43.3	5.2	5.6	13.5	4.4	...
Luxembourg	2015	5.2	35.0	-0.5	23.1	0.0	5.9	23.7
	2016	5.0	23.2	-1.4	24.8	-1.2	5.8	...
Malta	2015	5.9	49.8	-0.2	-1.3	-0.2	4.6	5.1
	2016	7.6	47.4	0.0	9.9	-0.1	8.8	...
Netherlands	2015	9.2	64.7	-0.6	-8.2	0.2	3.6	-1.6
	2016	8.7	75.9	-2.0	-2.6	-0.3	4.3	...
Poland	2015	-1.3	-62.5	-1.1	9.9	0.3	2.9	3.3
	2016	-1.0	-61.9	-4.7	17.8	...	2.5	4.6
Portugal	2015	0.6	-112.0	-2.9	2.6	0.0	2.3	-1.9
	2016	0.3	-105.1	-1.7	6.1	-0.1	6.0	-2.0
Romania	2015	-1.0	-51.1	2.7	21.2	-0.2	1.9	0.2
	2016	-1.4	-48.9	-2.4	24.0	5.7	6.5	0.3
Slovakia	2015	1.1	-61.0	-0.7	6.9	2.2	5.5	8.2
	2016	0.2	-58.1	-1.1	9.2	2.8	7.0	...
Slovenia	2015	5.4	-38.7	0.5	-3.5	-0.6	1.5	-5.1
	2016	6.1	-34.5	-0.3	4.6	0.7	3.8	-0.8
Spain	2015	1.3	-91.3	-2.9	-3.4	-0.7	3.8	-1.9
	2016	1.5	-85.7	-4.0	2.5	-0.5	4.8	-1.1
Sweden	2015	4.9	3.3	-8.0	-8.9	3.7	12.0	6.7
	2016	4.7	16.7	-8.8	-7.5	3.0	7.5	8.1
United Kingdom	2015	-4.4	-4.6	11.1	2.8	2.1	5.6	0.8
	2016	-4.4	24.2	0.9	0.7	3.1	6.1	5.8

■ The indicators do not fall within the indicative thresholds

"..." not available

Source: Eurostat, NBR

Private sector debt	General government sector debt	Unemployment rate	Total financial sector liabilities	Activity rate – population aged 15-64	Long-term unemployment rate – % of active population aged 15-74	Youth unemployment rate – % of active population aged 15-24		
% of GDP	% of GDP	%, 3-year average	annual % change	pp, 3-year change	pp, 3-year change	pp, 3-year change		
133% of GDP	60% of GDP	10%	16.5%	-0.2 pp	0.5 pp	2 pp		
126.4	85.5	5.6	0.6	0.4	0.5	1.2	2015	Austria
...	84.6	5.8	...	0.7	0.6	1.5	2016	
175.0	106.0	8.5	-0.6	0.7	1.0	2.3	2015	Belgium
182.3	105.9	8.3	1.3	0.1	0.1	-3.6	2016	
110.5	26.0	11.2	7.0	2.2	-1.2	-6.5	2015	Bulgaria
...	29.5	9.4	...	0.3	-2.9	-11.2	2016	
114.4	86.7	16.9	2.1	3.0	0.0	0.1	2015	Croatia
...	84.2	15.5	...	1.9	-4.4	-18.8	2016	
353.7	107.5	15.7	2.8	0.4	3.2	5.1	2015	Cyprus
...	107.8	14.7	...	-0.5	-0.3	-9.8	2016	
68.6	40.3	6.1	7.7	2.4	-0.6	-6.9	2015	Czech Republic
...	37.2	5.1	...	2.1	-1.3	-8.4	2016	
210.0	39.6	6.6	-1.1	-0.1	-0.4	-3.3	2015	Denmark
...	37.8	6.3	...	1.9	-0.4	-1.0	2016	
116.6	10.1	7.4	8.1	1.9	-3.1	-7.8	2015	Estonia
...	9.5	6.8	...	2.4	-1.7	-5.3	2016	
154.8	63.7	8.8	1.3	0.6	0.7	3.4	2015	Finland
152.9	63.6	9.0	4.1	0.7	0.6	0.2	2016	
143.4	95.6	10.3	1.8	0.8	0.6	0.3	2015	France
...	96.0	10.3	...	0.6	0.3	-0.3	2016	
98.5	71.2	4.9	2.8	0.4	-0.4	-0.8	2015	Germany
...	68.3	4.6	...	0.4	-0.6	-0.8	2016	
126.4	177.4	26.3	15.7	0.3	3.7	-5.5	2015	Greece
123.3	179.0	25.0	-18.5	0.7	-1.5	-11.0	2016	
84.7	74.7	8.2	1.2	4.9	-1.9	-10.9	2015	Hungary
76.7	74.1	6.5	-0.9	5.4	-2.5	-13.7	2016	
303.4	78.7	11.3	9.5	0.8	-3.7	-9.5	2015	Ireland
...	75.4	9.5	...	0.7	-3.6	-9.6	2016	
116.8	132.1	12.2	1.7	0.5	1.3	5.0	2015	Italy
...	132.6	12.1	...	1.5	-0.2	-2.2	2016	
88.7	36.5	10.9	12.2	1.3	-3.3	-12.2	2015	Latvia
...	40.1	10.1	...	2.3	-1.7	-5.9	2016	
55.0	42.7	10.5	6.7	2.3	-2.7	-10.4	2015	Lithuania
...	40.2	9.2	...	3.1	-2.1	-7.4	2016	
335.8	21.6	6.1	15.5	1.5	0.3	-1.4	2015	Luxembourg
...	20.0	6.3	...	0.1	0.4	2.3	2016	
131.8	60.6	5.9	1.3	4.5	-0.7	-2.3	2015	Malta
...	58.3	5.3	...	4.0	-1.0	-1.9	2016	
228.8	65.2	7.2	3.2	0.6	1.1	-0.4	2015	Netherlands
...	62.3	6.8	...	0.3	0.0	-2.4	2016	
78.7	51.1	8.9	2.5	1.6	-1.1	-5.7	2015	Poland
81.8	54.4	7.6	9.2	1.8	-2.2	-9.6	2016	
180.3	129.0	14.4	-1.8	0.0	-0.5	-6.0	2015	Portugal
172.0	130.4	12.6	0.0	0.7	-3.1	-9.9	2016	
59.3	38.0	6.9	4.1	1.3	0.0	-0.9	2015	Romania
55.4	37.6	6.5	7.5	0.7	-0.2	-3.1	2016	
81.4	52.5	13.0	4.5	1.5	-1.8	-7.5	2015	Slovakia
...	51.9	11.4	...	2.0	-4.2	-11.5	2016	
87.3	83.1	9.6	-3.7	1.4	0.4	-4.3	2015	Slovenia
81.5	79.7	8.9	3.2	1.1	-0.9	-6.4	2016	
155.5	99.8	24.2	-1.0	0.0	0.4	-4.6	2015	Spain
147.3	99.4	22.1	1.3	-0.1	-3.5	-11.1	2016	
187.5	43.9	7.8	3.2	1.4	0.0	-3.3	2015	Sweden
186.5	41.6	7.4	8.9	1.0	-0.1	-4.7	2016	
157.7	89.0	6.3	-9.2	0.8	-1.1	-6.6	2015	United Kingdom
160.7	89.3	5.4	9.8	0.9	-1.4	-7.7	2016	

The stability of the European financial sector consolidated in 2015, mainly through the improvement in capital ratios as a result of the implementation of new prudential regulations. However, bank profitability was further affected by high NPL ratios and the low-yield economic environment. Nevertheless, real estate prices rose in almost all Member States, in a number of cases fuelling the risks associated with already overvalued housing markets, amid the rebound in credit to households.

The labour market witnessed favourable developments, reporting both declines in the unemployment rate and a decrease in disparities across countries with respect to this indicator. Specifically, the employment rate for the EU as a whole surpassed the 2008 peak for the first time, with encouraging developments across all vulnerable groups: a reduction in the long-term unemployment rate, a drop in the youth unemployment rate, as well as a fall in the share of people at risk of poverty or social exclusion. At the same time, labour mobility improved, with inflows of population from both inside and outside the EU particularly into the countries with low unemployment rates.

According to the AMR released in 2016, the indicators for Romania remain within the scoreboard thresholds except for the NIIP¹⁶², yet also in the latter case convergence towards the indicative threshold that had begun in 2013 continued, in correlation with the progress made with regard to the size of the current account deficit, the export market share and cost competitiveness. The European Commission reported a favourable assessment of the banking sector's stability too, against the background of the resumption of lending to the private sector. Nonetheless, the report signals the possibility of increases in the risks to the external equilibrium, amid the fast dynamics of domestic demand, as well as to the budget equilibrium and financial stability, following the loose fiscal stance and some legislative initiatives impacting the banking sector.

The manner in which Romania addressed the four sets of country-specific recommendations included in the 2016 in-depth review is assessed in the Country Report published in February 2017¹⁶³, which specifies the following to have been made:

- limited progress in fiscal policy adjustment (via strengthening tax compliance and collection) and some progress in ensuring financial stability;
- limited progress in establishing, in cooperation with social partners, objective criteria for setting the minimum wage economy-wide, some progress in tackling early school leaving and linking employment with social services, and substantial progress in strengthening the National Employment Agency's services;
- limited progress in strengthening the transparency of human resources management in the public administration, some progress in curbing informal payments in the healthcare system, but substantial progress in strengthening corporate governance of state-owned enterprises;

¹⁶² However, the data also point to the change in house prices exceeding the threshold in 2016 as a whole.

¹⁶³ The following categories are used to assess progress: no progress, limited progress, some progress, substantial progress, full implementation.

- some progress in improving infrastructure through the adoption of the General Transport Master Plan in September 2016, but only limited progress in public investment project prioritisation and preparation.

In the period after the onset of the global financial crisis, the EU implemented a substantial agenda of financial sector reforms. In this context, the legal framework applicable to banks was strengthened based on common rules, which thus ensure more consistent regulation, better supervision and enhanced resilience to shocks of financial institutions across the European Union.

As far as the blocs of the Banking Union are concerned, while 2015 was the first year when the ECB acted as the single prudential supervisor through the Single Supervisory Mechanism (SSM), in 2016 the Single Resolution Mechanism (SRM), the second pillar of the Banking Union, became fully operational, ensuring the uniform application of the resolution regime in the participating Member States.

In 2016, with a view to further strengthening the Banking Union, progress was also made in supplementing the EU regulatory framework for resolution with a number of European Commission regulations concerning Directive 2014/59/EU. These regulations set out in more detail and complement aspects with regard to, *inter alia*, *ex ante* contributions to resolution financing arrangements, the critical functions, content and assessment of recovery and resolution plans, the minimum elements of a business reorganisation plan or the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities (MREL).

Towards the end of 2016, the European Commission published an additional set of documents including the following proposals:

- amendments to Directive 2013/36/EU (CRD) and to Regulation (EU) No 575/2013 (CRR) concerning capital requirements;
- amendments to Directive 2014/59/EU (BRRD) and to Regulation (EU) No 806/2014 (the SRM Regulation) that refer to harmonising the treatment of minimum requirements for own funds and eligible liabilities at the EU level and to reviewing the insolvency creditor hierarchy.

These proposals, which make up the legislative package that includes measures to mitigate risks in the banking sector, are designed to update capital requirements for banks, to establish less complex and less burdensome rules for small banks and to improve the capacity of credit institutions to support the economy. At the same time, the legislative package proposed by the European Commission aims at aligning EU rules on the Banking Union with a number of elements agreed upon at the international level, particularly with the standards set by the Basel Committee on Banking Supervision and by the Financial Stability Board.

Given that on 24 November 2015 the European Commission put forward a legislative proposal on setting up a European Deposit Insurance Scheme (EDIS), which would become enforceable on 30 June 2017, in 2016 there was extensive debate about the necessity, appropriateness and possible structure of this third pillar of the Banking Union.

In Romania, the enforcement, in 2015, of Law No. 312/2015 on the recovery and resolution of credit institutions and investment firms marked the end of the enactment, in national legislation, of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD). Under this legal framework, the foundation was laid for the resolution activity within the National Bank of Romania by setting up a dedicated department. In the exercise of its tasks in this field, the NBR participated, in 2016, in the meetings of the Resolution Committee of the European Banking Authority (EBA) and appointed permanent members to the latter's structures and substructures such as the working group on resolution financing and the working group on preparing draft regulatory technical standards (RTS) on the criteria for assessing the institutions' eligibility for simplified obligations.

In addition, in 2016 the NBR took part in resolution colleges governed by the Single Resolution Board, as well as in a resolution college governed by a resolution authority of another Member State. These colleges were set up with a view to making common decisions on group level resolution plans.

In line with its tasks under Law No. 312/2015, the National Bank of Romania is the resolution authority, at individual level, for credit institutions, Romanian legal entities, and for branches in Romania of credit institutions from third countries (non-EU countries), as well as the resolution authority at group level when it is also the competent authority responsible for consolidated supervision of a group whose parent undertaking is a credit institution or, where the parent undertaking is a financial holding company or a mixed financial holding company, includes also a credit institution. In this capacity, the central bank prepared the resolution plans or, where appropriate, the set of simplified requirements for the credit institutions under its responsibility.

2016 was the first year when the contributions to the Bank Resolution Fund were set and collected, according to the mechanism laid down in Law No. 312/2015 and Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to *ex ante* contributions to resolution financing arrangements, as corrected by Commission Delegated Regulation (EU) 2016/1434.

From an organisational point of view, the procedural framework needed to optimise all the processes necessary for the NBR's planning and, where appropriate, intervention in case of resolution was developed.

At the same time, during 2016 further harmonisation efforts were undertaken with respect to the supervision of credit institutions, Romanian legal entities, by Romania's participating in a number of working groups of the European Banking Authority, whose objective is to ensure effective and consistent prudential regulation and supervision across the EU banking sector.

Turning to the responsibilities of the National Bank of Romania concerning the alignment with the new European regulatory and supervisory framework, steps were taken for certain EU regulations and guidelines to be implemented in the Romanian banking legislation and enforced. In addition, in 2016 the NBR carried out ongoing supervision in cooperation with the European authorities, namely the European Central Bank, which was assigned such prerogatives via the Joint Supervisory Teams (JSTs), comprising staff of the ECB and of the local competent supervisory authority.

Furthermore, as regards the supervision of cross-border banking groups, the National Bank of Romania works with the other supervisory authorities by means of supervisory colleges, which are structures that ensure optimum dissemination of information and the making of joint decisions on capital and liquidity adequacy and on credit institutions' recovery plans.

The background of the page features a photograph of classical columns, likely from a historical building, with a wavy, concentric line pattern overlaid in a light beige color. The pattern is more prominent on the left side and fades towards the right.

Chapter 12

External communication of the National Bank of Romania

1. Public relations

In 2016, the National Bank of Romania's activities in the area of communication and public relations were aimed at correctly and promptly informing the general public, experts, other institutions and the media of the measures and policies adopted by the central bank in pursuit of its tasks, in compliance with Law No. 312/2004 on the Statute of the National Bank of Romania.

In keeping with its mandate and with the principles of transparency and institutional accountability, the NBR proactively provides both the public and institutions with information resulting from reports and statistical data that the institution produces in compliance with the legal framework in force. These data are supplemented by analyses and assessments made in-house based on solid research, expertise and the thorough knowledge of area-specific issues.

The context in which the NBR carried out its activity throughout 2016, as reflected by the public messages of the central bank's officials, was defined not only by domestic economic developments, the fiscal and income policy stance and changes in the banking and financial legislation, but also by the evolution of international economy, risks associated with the economic growth of the euro area, the challenges to the European banking system, Brexit and the uncertainties regarding the monetary policies of the major central banks worldwide due to higher volatility on global financial markets. Last but not least, NBR officials and experts strived to offer substantiated explanations to a series of unfounded accusations set to damage the image of the central bank and create confusion among the public, a situation which the NBR faced in the second half of the year.

A top priority of the communication and public relations activity was to ensure an as high as possible level of understanding by the general public of monetary policy decisions, of the measures meant to safeguard price stability and financial stability, the role and functions of the central bank, in a challenging domestic and external environment, marked by heightened uncertainty. In this respect and approaching the transparency-enhancing process in line with the legal provisions, the public interest and European central bank practice, in its meeting of 3 August 2016, the NBR Board decided to disclose the minutes of the monetary policy meetings and the income earned by Board members.

In accordance with its statutory provisions, the NBR has always offered pertinent information and detailed explanations about its activity and decisions during briefings and press conferences dedicated to monetary policy measures and

presenting inflation and financial stability reports. Moreover, there was a great number of interviews to the media, as well as frequent participation in relevant public debates in 2016, i.e. approximately 50 such public appearances.

Along with the messages dedicated to its current activity, the central bank had a continuous public presence in order to provide information, analyses, reasoning and clarifications to the general public, as well as to the banking community, academics, financial analysts and journalists on important subjects under public debate. The European environment was given particular attention: analysis of the economic and geopolitical consequences post-Brexit, the state of the euro area, the conditions and effects of Romania possibly adopting the single currency. In addition, central bank officials and experts gave detailed explanations about the mechanisms and forecasted impact of the legal amendments in the economic and financial area. Over 20 interviews, conferences and articles discussed this theme between February and April 2016.

A considerable number of institutional messages focused on explanations, clarifications and analyses to debunk media attacks based on unfounded accusations and biased comments on Romania's international reserves, especially the gold reserve, the NBR's salary policy, the central bank's statute, the need for and the mechanisms underlying the functioning of the National Committee for Macroprudential Oversight, the loan taken from the IMF and the monetary policy from 2008 to 2015.

To this end, the blog *OpiniiBNR.ro* was used to ensure that the voice of the central bank is heard as quickly as possible by the public, articles being simultaneously sent to central and local media outlets. A significant aspect is the joint contribution of competent departments to the effort to provide accurate information. The NBR's territorial network was an important means for the dissemination of messages at the local level.

In the context of heightened public debate on the financial and banking sector, the NBR took steps to strengthen institutional communication and to revive some standard communication channels, by sending to the committees of the Romanian Parliament, the Government and other public institutions opinions and/or clarifications referring to amendments of the legal framework in the economic and financial area, as well as by increasing the public presentations related to its area of activity and to relevant issues for the central bank.

Long-established events for external communication (*Legal Colloquia, Banking History and Civilisation Symposium, Regional Seminar on Financial Stability Issues*) were accompanied by celebrations such as *25 years since the Reopening of the Romanian Foreign Exchange Market*, by seminars and conferences like *Regional NBR-EC-IMF High-level Workshop on NPLs Resolution, Romania's Development*

Strategy, Regionalization and Euro Convergence. The almost 30 events proved to be important vehicles for conveying the central bank's messages, with a positive impact on the accurate information of the general public (Table 12.1).

The central bank continued to open to the public by organising visits to its offices and the NBR Museum, thus raising awareness of its history, tradition, identity, patrimony, numismatics and bank architecture. Moreover, between 27-28 May 2016, the NBR took part in the *Your Money Expo 2016*, organised by the Bucharest Stock Exchange, alongside partner institutions involved in supporting financial education. During the two-day event, the almost 1,500 visitors of the NBR's booth were given information and presentations by the bank's representatives.

Between 7-21 November 2016, the travelling exhibition "Leul românesc" ("The Romanian Leu") presenting the history of money and the safety elements of the national currency was inaugurated at the Bucharest regional branch. In 2017, the exhibition is open to the public at the NBR's regional branches in Cluj-Napoca, Timișoara and Iași.

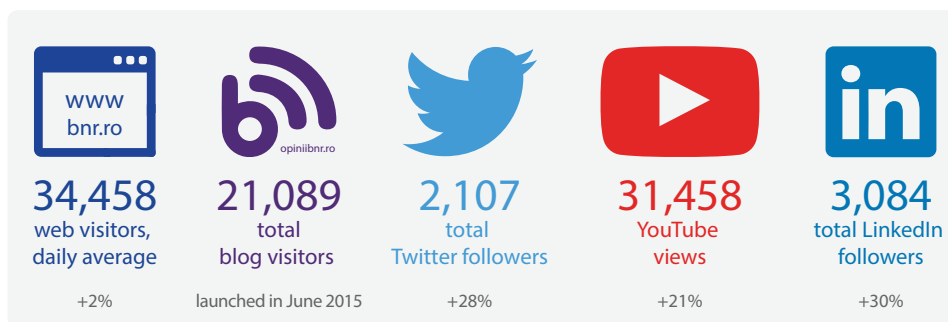
Concerning its relationship with the media, during 2016, the NBR published approximately 300 press releases, mainly referring to its decisions on monetary policy and macroprudential supervision, as well as the evolution of statistical indicators relevant to the banking sector and the national economy in general.

The NBR also responded to over 190 requests for information and clarifications received from journalists, the majority of which relating to banking system indicators, legislative amendments in the economic and financial area and the NBR's remuneration policy.

In 2016, the NBR's coverage in the relevant central and local media (written media, radio-TV and online) consisted of over 13,000 articles assessed. The analysis of these articles shows that almost 70 percent used a balanced tone, the same as in previous years, while over 20 percent of articles had a negative tone, more than in 2015.

In terms of number, most articles were published online (6,335), accounting for 48 percent of the total. The largest share of neutral articles appeared in written media, both central and local (75 percent of total), while televisions provided the widest negative coverage.

The most covered themes were the monetary policy decisions, credit policy developments, legislative amendments in the economic and financial area. Over 70 percent of the articles which discussed the Law on debt discharge used a balanced tone, 8 percent had a positive one and 22 percent employed a negative tone from the central bank's perspective. Monetary policy decisions were constantly covered by the media throughout the year, in 1,148 articles, mainly in a neutral manner (83 percent).

InfographicMain statistics on the NBR's
online communication in 2016

The NBR's image was most negatively impacted in 2016 Q3, July and August seeing a drop in balanced articles under 50 percent, as a result of the excessive media coverage of the unfounded accusations about the way international reserves are managed and how the monetary policy was implemented in the past.

In 2016, the NBR's online communication focused on constantly developing a portfolio of techniques and ways of addressing the general public, which included creating, launching and adapting its communication tools in line with digital progress and trends.

The NBR's website remains the institution's main communication tool, averaging over 30,000 visitors per day: financial and banking institutions in the country and abroad, entrepreneurs, researchers, media multipliers, the general public. Through prompt and high-quality services, the NBR's website contributes to increasing transparency and strengthening the institution's reputation and acts as a means for educating interested audiences.

InfographicThe number of downloads of the
„Leul Românesc” mobile app

In 2016, the development of digital communication was high on the agenda, especially that on mobile devices, in order to make information accessible to more and more user groups active on these channels. Current trends show Internet users gradually moving away from PCs towards mobile devices such as smartphones and tablets. Following this trend, the National Bank of Romania offers the possibility to explore

the website's contents using mobile devices. In October 2016, the NBR launched its first such application, "LeulRomânesc" ("The Romanian Leu"), aimed primarily at raising awareness about banknotes' security and design features among the general public and especially among young audiences, who easily access online resources. The application was developed in Romanian and English, for both Apple and Android devices, and was a real hit (over 2,300 downloads from both online stores).

The new social media channels are used more and more frequently by the central bank, not only to inform the general public in real time about the NBR's decisions, activities and initiatives, but also to allow feedback from audiences, through direct, unmediated interaction between the institution and the user.

The NBR is present on Twitter, YouTube, LinkedIn and its own blog, OpiniiBNR ("NBR Opinions"), used for publishing articles on economic and financial subjects. In welcoming the new trends, efforts were recently focused on adapting the manner of communication to the specifics of social media platforms, by transposing technical language and simplifying it, introducing visual and multimedia elements, adopting synthetic, intuitive materials for highlighting main developments and information (infographics, leaflets, banners).

NBR publications

The NBR's portfolio of publications remained unchanged in 2016, continuing to be one of the main communication tools via which various information is made available to financial and banking experts and the general public, accessible in several formats (printed, pdf and epub, respectively).

The NBR publishes a wide range of reports issued at different time intervals:

- (i) the *Annual Report* providing a detailed analysis of the international context and domestic macroeconomic developments, as well as of the activities carried out by the central bank in the previous year;
- (ii) the *Financial Stability Report*, published bi-annually starting with 2016 in order to reflect adequately and in a timely manner the domestic challenges to financial stability, as well as the rapid developments at EU level on prudential regulations;
- (iii) the *Inflation Report* detailing the analysis framework and, implicitly, the rationales behind the monetary policy decisions;
- (iv) publications intended for the external sector, namely the *Balance of Payments and International Investment Position of Romania – Annual report* and *Foreign Direct Investment*, also published annually;
- (v) *Financial Accounts*;
- (vi) *Central Bank Journal of Law and Finance*, comprising of scientific articles in the legal and financial fields in English;
- (vi) the *Monthly Bulletin*, containing a synthetic analysis of the main economic and monetary policy developments in the reference period, a detailed statistical section and, bi-annually, a feature on relevant economic themes;
- (viii) regular surveys conducted by the NBR – the *Survey on the access to finance of the non-financial corporations in Romania and their capacity to cope with adverse financial conditions* and the *Bank Lending Survey*.

The same as in the previous years, the results of the NBR's research activity were published in the *Caiete de studii* and *Occasional Papers* series respectively, in 2016 and in the first months of 2017, 5 papers in Romanian and 8 in English (4 of which were English versions of papers printed in the *Caiete de studii* series). The topics covered are briefly described in Chapter 13 – Statistics and economic research.

Public information activity

The public information activity is circumscribed to the legal requirements provided for by Law No. 544/2001 on free access to public interest information, as well as to those set forth by Government Ordinance No. 27/2002 on the regulation of the petition settlement activity, as amended and supplemented by Law No. 233/2002.

The NBR's external communication in the form of direct public information of individuals is carried out via a mix of tools, structured on various activities, namely:

- handling written requests based on the right to access public interest information regarding or resulting from the central bank's activity, by providing answers via post;
- securing the institutional framework for receiving and solving petitions, in order to answer written petitions addressed to the NBR;
- providing applicants with the information requested by telephone and verbally at the Information-Documentation Point.

The statistics of petitions and questions formulated by the public pursuant to the right to access public information, throughout 2016, highlights the registration and handling of around 2,800 written requests, received by post, fax or e-mail at both the NBR's head office (about 1,950 requests) and its territorial network (almost 850 requests), of which:

- 97 requests were grounded on Law No. 544/2001 on free access to public interest information, with 18 of these being received from media representatives. They were solved in compliance with the provisions of this piece of legislation, as follows: information was supplied for 62 of them, 26 requests were handled as petitions, given the fact that the information sought by the applicants was not subject to the expressly invoked law, relevant clarifications being made. The remaining 9 enquiries were declined, in line with the law, the rejections being justified by the fact that 4 of the requests pertained to the exceptions from the free access of the public, as provided by law, while the information requested via the other 5 was not available in the NBR's records.
- Around 2,700 written requests and notifications were assessed according to the provisions of Government Ordinance No. 27/2002 on the regulation of petition settlement activity, as amended and supplemented by Law No. 233/2002, and as such, in the handling process, approximately 2,500 enquiries were answered by

post or e-mail, while the rest were dismissed according to applicable legal provisions, as they were either anonymous or lacking the petitioners' identification data, or they were follow-ups to previously solved correspondence.

At the same time, in 2016, over 1,650 verbal requests made by telephone (approximately 1,300 enquiries) or directly addressed to the NBR's representatives at the Information-Documentation Point (more than 350 enquiries) were handled and settled.

The main themes of the petitions recorded in 2016 at the NBR's head office remained generally unchanged from previous years. The topics related primarily to the following areas of interest:

- notifications, complaints or opinions regarding the activity of certain credit institutions or non-bank financial institutions and the relationship with their own customers, also from the perspective of CHF-denominated loans;
- interpretations of the legal framework issued and/or administered by the NBR;
- enquiries on assessing the legality of some loans sale by banks;
- the evolution of the domestic currency exchange rate against other quoted or unquoted currencies;
- requests for the exchange of worn-out/deteriorated banknotes or banknotes which are no longer legal tender, a significant number of which were received from foreign citizens;
- the level of various interest rates applied by the central bank in relation to the entities under its scope of regulation and supervision or aggregated based on reports sent to the central bank;
- information on the tasks and activities specific to the NBR, the bank's publications and the banking system in general.

This specific public information activity is presented in detail in terms of the volume of petitions, the petition handling process and the petitioners' main topics of interest in the *Report on the access to public interest information and the handling of petitions in 2016*, drawn up each year consistent with the structure required by the applicable legal framework and published on the NBR website, in the dedicated section (<http://www.bnr.ro/Informare-publica-7672.aspx>) (Romanian version only).

2. Financial education

In 2016, the NBR continued to support financial education under the Cooperation Protocol signed with the Ministry of National Education and the partnerships launched with economic universities and other institutions and organisations promoting financial education at national and international level. The events

organised under the projects “Let’s Talk about Money and Banks”, “NBR – Open Doors for Economics Students” and “Academica BNR” addressed over 40,000 pupils, students and teaching staff in educational establishments across the country. Similar to previous years, participants attended presentations and interactive sessions and were handed out educational and information support materials related to central bank-specific activities, as well as to basic concepts in the financial and banking field.

Educational activities were conducted throughout the year, being more dynamic during the Global Money Week (in partnership with Child and Youth Finance International) and A Different Type of Learning: Learn More, Improve Yourself (“Școala altfel: Să știi mai multe, să fii mai bun”). The two programmes attracted around 20,800 primary, secondary and tertiary education participants, twice as many as in the previous year, many of whom came from rural areas. These activities, mainly organised by NBR branches and agencies, took place in the country and consisted in exhibitions and video projections related to the activity, functions and history of the central bank, the history of money and the domestic currency, in explaining basic economic and financial notions (credit, deposit, inflation), as well as in viewing educational videos, with a special focus on coins and banknotes in circulation and their security features.

For the first time ever, mixed teams made up of representatives of CFA Society Romania and the NBR delivered presentations on current financial and banking topics in educational institutions in Bucharest’s surrounding areas. At the same time, visits to the NBR’s head office and territorial units continued, including to the cash processing centres and the permanent exhibit of the NBR Museum.

Carrying on the tradition of participating in the national educational programme “Școala altfel”, the NBR Museum hosted over 2,000 pupils and teachers, who had the opportunity to find out relevant information about the central bank’s history, as well as Romania’s monetary past, while admiring the valuable numismatic collections on display.

All the participants in the educational programmes expressed their interest in continuing these activities.

From 27 to 29 June 2016, the NBR, in partnership with the Ministry of National Education and the Financial Supervisory Authority, hosted Child and Youth Finance International’s annual Summit. Over 50 countries took part in this event, among which central bank and government officials, representatives of the academia, foundations and professional associations, youth from Romania and abroad, participants to educational and financial inclusion programmes. The discussions during the conference focused on topics such as the importance of national strategies in increasing the level of economic and financial education, disseminating good practices, attracting the young generation in drawing up strategic plans, promoting programmes and institutionalised education.

As regards the higher education segment, the NBR hosted the 12th edition of the international summer school organised by the Bucharest University of Economic Studies – Bucharest Summer University 2016, where university lecturers and officials of the NBR spoke with approximately 60 Romanian and foreign students from over 30 countries, as well as the international conference *STRATEGICA*, with the theme “Values, policies and public management in the European Union”, in co-operation with the National School of Political Science and Public Administration, which brought together around 100 researchers from 25 countries.

In 2016, the “Academica BNR” organised meetings seeking to discuss relevant issues pertaining to the economic, financial and banking area, as well as to identify, alongside the rectors of partner universities and representatives of the Romanian Academy, a new format for the activities carried out under the aegis of this project.

In 2016, the NBR Archives continued its activity aimed at taking over and archiving documents created by and received from the NBR's structures, as well as preserving, processing and turning to account the institution's historical archive. Specifically: (i) the digital and analogue processing of documents in “Serviciul administrativ” stock was initiated; (ii) the documents whose conservation period had run out were selected.

The turning to account of the documents was done via the reading parlour of the NBR Archives and by presenting the research findings at scientific events on economic history, financial and banking issues, organised within the institution, as well as at national and international levels. In this vein, expert assistance was provided to Romanian and foreign researchers who studied in the reading parlour of the NBR Archives in order to prepare research papers on: Romania's monetary history (the Law of 1867, the printing of the 10-bani, 25-bani and 50-bani notes by the Ministry of Finance, the monetary reforms of 1947 and 1952), the history of the National Bank of Romania (relationship with the government during 1880-1900, the issue with Romania's Treasure in Moscow, the evolution of the Brăila branch, architecture in the interwar period, the production, processing, circulation, verification and marking of precious metals), important figures in Romania's economic and financial past (Iorgu Steriu, Ion Lapedatu, Ilie Mecu), Romania's history during World War Two and the communist era (the civilian population's support of the war effort, the situation of Jewish people during 1941-1944, the bases of socialist industrialisation, the connection between this process and urbanisation and social transformation, public debt in the communist era, Romanian-Soviet economic relations from 1945 to 1965).

The same as in previous years, the NBR organised the 24th edition of the “Cristian Popișteanu” Banking History and Civilisation Symposium, with the topic *The National Bank of Romania and World War One*, as well as the 11th annual conference of the South Eastern European Monetary History Network (SEEMHN), themed *Gaps and Economic Crises in South-East Europe: Present and Past*. Papers prepared based on the information in the NBR Archives were delivered in the conference *Poland and Romania in Central Europe in the 20th and 21st centuries*, organised by the Jagiellonian

University in Krakow, in the banking history section of the National Congress of Romanian Historians, prepared by the “Babeş-Bolyai” University in Cluj-Napoca and in the scientific session “Sibiu – Centre of Humanistic Research”, arranged by the Institute of Social Sciences and Humanities Sibiu.

The turning to account of NBR's documents materialised in: (i) papers on institutional and national history published in the *Magazin Istoric* magazine or in the volumes of scientific events (the *NBR Employees in World War One – Ştefan Constantinescu's War Diary, Daily Life, Money and Trade in Occupied Bucharest, The Public Philatelic Collections in Romania, between Moscow and Berlin during World War One, The Relations between the National Bank of Romania and Bank Polski in the Interwar Period, The Odyssey of Polish Gold in Romania (1939-1947), Romania and Poland – cooperation and rivalry in the Council for Mutual Economic Assistance, Banks' liquidity: legislation, institutions, mechanisms (1947-1953), The Treasure of the National Bank of Romania during 1944-1947*); (ii) presenting the importance of document preservation, the manner of organising the storage space of the General Archives and significant dates in the history of the central bank to students in Archival science and the NBR staff attending in-house seminars; (iii) IT support for preparing the texts underlying the NBR's numismatic issues.

In order to draw the public's attention to an important moment in national and institutional history, the Museum of the NBR Treasure in Tismana was inaugurated in 2016, reaching 10,000 visitors in less than half a year.

In 2016, 20,000 people visited the Museum of the National Bank of Romania, the increased number of visitors being the result not only of a permanent renewal of its cultural offer, but also of the diversification of the type of activities carried out within the museum – the organisation of new exhibitions and participation in national educational programmes.

The main event hosted by the NBR Museum in 2016 was the temporary exhibition of the sculpture of Constantin Brâncuşi “The Wisdom of the Earth”, between 15 June and 1 November. During this period, over 13,000 people visited the museum and admired Brâncuşi's work of art in the splendid decor of the Marble Hall of the Old Palace of the National Bank of Romania.

The museum's cultural offer diversified in 2016 thanks to a permanent exhibition section being redesigned. The museum's rich numismatic collections are brought into the spotlight by the showcase of more than 3,000 pieces of remarkable historic and artistic value, many of which have never been exhibited before. In a contemporary and eye-catching display, visitors can view ancient, medieval and modern monetary hoards and hoard fragments, as well as Romanian coins and medals which represent superlatives in Romanian monetary history. In addition, due to the remodelling of the vaults embedded in the pillars surrounding the Marble Hall, visitors discover anniversary Romanian gold issues from the first half of the 20th century.

The presentation of the NBR Museum on the institution's website was redesigned and detailed, the information published seeking to increase awareness of previously undisclosed or less known aspects regarding the history of the national currency and the role of the central bank in developing the modern Romanian state, as well as to stimulate visitors' curiosity for cultural projects and topics proposed. Moreover, in order to help promote the NBR Museum and its collections, a new brochure was released/published, with special graphics and updated contents.

As a result of the interest generated by the projects carried out by the NBR Museum, its activity was illustrated throughout 2016 in numerous press articles, news reports and filmed documentaries, reflected in the national media.

The assets of the museum were scientifically turned to account also through presentations and expert studies at conferences and scientific sessions, such as "Gold coins from a treasure discovered in Mihăiești (Suceava county)" at the *XVI Symposium of Numismatics* organised in Chișinău, or "The Gold Coins with the Effigy of King Ferdinand I", a study published in the volume *Moesica et Christiana: Studies in Honour of Professor Alexandru Barnea*.

In 2016 as well, the NBR Library activity remained mainly focused on increasing efficiency of staff information and documentation process. In this respect, throughout the year, the book stock was enriched, through purchases and donations by papers in the Romanian and foreign (especially English) dedicated literature on economic, financial and banking matters.

At the same time, the NBR Library continued entering the book stock into the online catalogue, so that at end-2016 it registered 26,839 bibliographic descriptions, including monographs, periodicals and studies from collective volumes. The online catalogue on the NBR's intranet website facilitated staff access to the library's entries, as reflected by the larger number of borrowed books, up 14.25 percent from 2015.

The evolution of the NBR Library throughout the institution's history was the subject of a series of presentations within the project Open Doors for Economics Students and in-house seminars delivered by the Library staff.

In 2016 the volume *Moesica et Christiana: Studies in Honour of Professor Alexandru Barnea* was co-edited, in which the study "Autour des palais de la Banque Nationale de la Roumanie: l'histoire d'une partie de Bucarest" was published. In addition, a broad-based scientific documentation activity in Bucharest's most prominent libraries and archives was completed, in order to draft the fifth volume of the series *Romania's Banknotes*, dedicated to the issue of mortgage notes.

Table 12.1. Events focusing on monetary, banking and financial issues, organised by the National Bank of Romania in 2016

Date	Event	Co-organisers
8 February 2016 9 May 2016 8 August 2016 8 November 2016	Press conferences presenting the <i>Inflation Report</i>	
7 April 2016 13 December 2016	Press conferences presenting the <i>Financial Stability Report</i>	
25 February 2016	Conference – <i>25 years since the Reopening of the Romanian Foreign Exchange Market</i>	
15-16 March 2016	Conference – <i>Romania's Development Strategy, Regionalization and Euro Convergence</i>	Profit.ro
3 April 2016	Anniversary Symposium – <i>150 years Since the Establishment of the Romanian Academy</i>	Romanian Academy
6 April 2016	The annual "Cristian Popișteanu" Banking History and Civilisation Symposium, 24th edition – "The National Bank of Romania and World War One"	"Magazin Istoric" Cultural Foundation
26-27 April 2016	Conference – <i>How Can the EU Generate a Virtuous Circle in the Black Sea Region – The Case of Food And Energy Security</i>	European League for Economic Cooperation
9 May 2016	IMF's Regional Economic Issues Report on Central, Eastern and Southeastern Europe	International Monetary Fund
20 May 2016	Conference – <i>Economic Perspectives for Europe: Challenges and Opportunities</i> delivered by Ewald Nowotny, Governor of the Österreichische Nationalbank	National Bank of Romania
10-11 June 2016	International conference – <i>Financial Innovation, Consumer Protection and Financial Stability in Emerging Markets</i>	Financial Supervisory Authority
15 June 2016	Regional NBR-EC-IMF High-level Workshop on NPLs Resolution	European Commission and International Monetary Fund
27-29 June 2016	World Summit and the launch of the CYFI 2016-2020 strategy for financial education	Child and Youth Finance International
25-26 July 2016	Symposium – <i>The Odyssey of the National Bank's Gold – Tismana 1944-1947</i> and the ceremony for the official inauguration of the NBR Treasure Museum at the Tismana Monastery	
1-4 September 2016	"Academica BNR" – Debate forum on financial education projects	Romanian Academy, Ministry of National Education, National Council of Rectors
19 October 2016	Anniversary event – 25 years since the establishment of the Romanian Banking Association	Romanian Banking Association
20-22 October 2016	"Strategica" – <i>Opportunities and Risks in the Contemporary Business Environment</i>	National University of Political Studies and Public Administration
20-21 October 2016	Annual regional seminar on financial stability – <i>Macro-stability: Central Banks in Uncharted Territories</i>	International Monetary Fund
14 November 2016	Conference – <i>20 Years of Bank Cards in Romania</i>	Nocash
15 November 2016	National conference of the Association of Financial-Banking Analysts – <i>Internal Equilibrium amid Geopolitical Tensions</i>	Association of Financial-Banking Analysts
16 November 2016	Debate – <i>Romania and the Accession to the Eurozone. Risks and Opportunities</i>	European Institute of Romania and the Romanian Society of Economics – SOREC
23-27 November 2016	International seminar – <i>European Union-Finance and Banking Lectures</i>	Alpha Bank, RBA
14-16 December 2016	Events dedicated to the First World War Centenary and the Great Union Centenary in Iași	Government of Romania





Chapter 13

Statistics and economic research

1. Statistical activity

In 2016, monetary, financial, and external sector statistics were further compiled and developed, in line with the requirements formulated by the European Central Bank and Eurostat, as these statistics are employed by the National Bank of Romania in monetary policy and financial stability analyses, as well as in the economic research activity.

The range of statistics prepared by the National Bank of Romania was extended with those on insurance companies. Specifically, the NBR collects statistical information on the assets and liabilities of insurance companies with a view to fulfilling the ECB's statistical reporting requirements and compiling the national financial accounts for this institutional sector.

Furthermore, in accordance with EU-wide recommendations concerning the collection of data on external sector statistics directly from economic agents, the NBR relinquished the information collection system for compiling external statistics indirectly, via credit institutions, and implemented a quarterly statistical survey – Financial Information in relation to Non-residents – starting in 2016 Q1. Data are reported in electronic format via the RAPDIR application and the results are used in compiling statistics on the balance of payments, international investment position and external debt.

Moreover, further development of NBR statistics takes into account the ECB's medium- and long-term approach on statistics, consisting in the development of granular databases on asset items in financial institutions' balance sheets. In this vein, several relevant projects in the context of the Single Supervisory Mechanism are already in progress, such as: RIAD, the Register of Institutions and Affiliates Database, and AnaCredit, the granular database for collecting credit and credit risk information.

Also in 2016, the legislation on statistical reporting to the National Bank of Romania was updated. Specifically, in October 2016, NBR Regulation No. 6/2016 amending NBR Regulation No. 4/2014 on reporting statistical data and information to the National Bank of Romania was published in *Monitorul Oficial al României*. The amendments were necessary to: (i) ensure harmonisation with the European regulatory framework, i.e. Regulation (EC) No 924/2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001, as subsequently amended and supplemented, which removes credit institutions' reporting obligations concerning their customers' cross-border payments for balance-of-payments purposes; and (ii) update the reporting requirements related to transactions in own name and own account reported by credit institutions, which are necessary for compiling balance of payments and international investment position statistics in keeping with the international methodology.

2. Economic research

Economic research activity within the National Bank of Romania focuses on applied topics, playing a major part in the substantiation of the decision-making process. In the course of 2016, high on the agenda were topics related to monetary analysis, macroeconomic modelling, financial stability, and real economy.

2.1. Monetary policy

Monetary analysis was one of the major research topics in 2016 as well. Research work continued in this field, seeking to estimate the equilibrium level of credit to the private sector by resorting to a variety of econometric methods and procedures. This included carrying out work to identify the trend component and, implicitly, the private sector credit-to-GDP gap and performing out-of-sample forecast exercises based on panel models, as well as building a disequilibrium model. The approach was aimed to surmount the difficulties specific to this endeavour in the emerging economies – stemming mainly from the short time span of data series and the frequent structural changes they were subjected to – and to identify an equilibrium level of credit consistent with the macroeconomic fundamentals, together with the purely statistical one resulting from the trend component.

Another line of research envisaged to deepen the previous analyses concerning credit developments by seeking to identify and highlight the influence of various types of shocks associated with its dynamics (mainly typical of the supply of and demand for loans) on economic activity. To this end, Bayesian vector autoregressive models were estimated, with both fixed and time-varying parameters and stochastic volatility and shocks were identified by imposing sign restrictions on impulse response functions, in line with economic theory. The results showed that lending-related shocks had a relatively limited contribution to domestic economy's fluctuations.

Research work also included relevant topics in terms of the international economic environment such as the complex interactions between the business cycle and the financial cycle and the issue of the prevalence of ultra-low interest rates. The starting point of the analyses is the fragility of the post-crisis recovery of the global economy, in the context of drivers of the financial cycle, as well as of structural factors (demographic trends, the pace of technological progress, income distribution). Approaching these topics is also useful for the emerging economies, whose attractiveness for speculative flows in search for high yields poses risks depending on how monetary policy normalises in the advanced economies. The results of these research endeavours were the papers titled "Domestic cycles, financial cycles and policies. What has gone wrong?" and "An Age of Ultra-low Interest Rates" published in the *Occasional Papers* series.

2.2. Macroeconomic modelling

One line of research sought to capture the transmission mechanism of fiscal stimulus (by category of government revenue and expenditure) to aggregate demand components such as actual individual consumption of households and gross fixed

capital formation. To this end, Bayesian vector autoregressive models were employed, allowing staff to remove the problem of over-parameterisation and, thus, reduce uncertainty surrounding estimated parameters. The results showed a relatively low impact of discretionary fiscal measures on aggregate demand components on revenue and expenditure sides¹⁶⁴, the government spending on wages being one of the most powerful instruments to stimulate consumption by raising the real disposable income of households.

Given the significant increases implemented over the past years for both public sector wages, affecting also private sector pays via demonstration effects, and the gross minimum wage economy-wide, a distinct research topic assessed the impact of the average gross wage dynamics on inflation rate. In order to test the robustness of results, the empirical analysis used a wider range of econometric models (linear regressions, vector autoregressive models, semi-structural models) and estimation techniques (the ordinary least squares method, the Kalman filter and Bayesian methods). Most of the results were statistically significant, pointing to a relatively low impact of average gross wage dynamics on inflation rate, its magnitude being, however, conditional on both the type of model and the sample of data used in the estimation. Furthermore, a number of asymmetries were found with regard to the pass-through of wage changes to prices (e.g. the pass-through is stronger when the economy is above potential compared to demand-deficit episodes).

Another line of research, which continued during 2016, was directed at further developing the methodology for assessing the forecasting activity of the NBR, especially in relation to the predictive performance of the model for analysis and medium-term forecasting (MAMTF). To this end, the assessment methodology for the forecast errors in the successive quarterly rounds was enlarged so as to cover, besides the annual CPI inflation rate¹⁶⁵, other relevant variables in the MAMTF such as economic growth or the ILO unemployment rate. By identifying the sources of forecast errors, useful insights are provided into the activity of recalibrating the macroeconomic model with a view to improving its predictive performance.

As in previous years, following the requests from ECB working groups, a number of simulations were run using the MAMTF in order to update and enlarge the set of elasticities to be employed also in formulating EU-wide scenarios for stress testing the resilience of credit institutions in adverse macroeconomic conditions. Specifically, the set of results in the case of Romania was extended with the addition of some fiscal elasticities allowing the MAMTF-based simulation of the impact of shocks deriving from direct and indirect tax changes on key macroeconomic variables of interest. Moreover, within the research project launched in 2014 by the ECB on the causes of low global inflation, a number of economic analyses were developed relative to the pass-through of wage/labour cost dynamics to core inflation in Romania's economy.

¹⁶⁴ These conclusions are in line with those of other papers on Central and East European countries – the size of fiscal multipliers is relatively low in small open economies, where a flexible exchange rate regime is in place.

¹⁶⁵ The results of the assessment of forecast errors for the end-2016 annual CPI inflation are presented in the February 2017 *Inflation Report*.

With a view to improving the analytical support underlying the monetary policy decisions, the analysis of peculiarities associated with the formation of inflation expectations of economic agents in Romania was high on the research agenda. In this vein, the project was designed to assess the implications of various formation mechanisms of inflation expectations on the macroeconomic forecast: exogenous expectations anchored to the NBR survey on inflation expectations of financial analysts versus endogenous expectations quantified on the basis of the quarterly MAMTF and consistent with its structure. The study underscored the properties and features specific to every mechanism and showed the usefulness of both approaches in checking the robustness of results of the NBR's analysis and forecast process.

The year 2016 saw the continuation of the research project that had been launched one year earlier on a business conditions index that encapsulates the information available in a wide range of macroeconomic and financial variables. This indicator, together with other relevant determinants, helps substantiate near-term forecasts on economic activity. The results of this study were published in the *Occasional Papers* series (No. 22).

In order to enhance the NBR's analysis and projection framework, resources were allocated to develop the methodology for evaluating and forecasting potential GDP via the production function. The research targeted: (i) the connection between potential GDP and the natural interest rate; (ii) contextualisation of multi-factor productivity dynamics via certain indicators such as European Innovation Scoreboard or the rate of absorption of structural and cohesion European funds; and (iii) the weights of production factors. In the third analysis, the specification of the production function was set based on particular features of Romania: an economy where the labour income share in GDP is significantly smaller (approximately 50 percent¹⁶⁶) than the most frequent value mentioned in the economic literature (65 percent).

In 2016, the flow-of-funds methodology was further improved by looking at the evolution of the net international investment position and of the financing sources, as well as by analysing the dynamics of foreign direct investment. The research on the evolution of Romania's net international investment position (NIIP) consisted in a detailed examination of its financing broken down by sector and instrument, but also of the regional environment. In this vein, attention was attached to assessing the impact of developments in the current account deficit on the international investment position and the manner in which pre-2008 significant capital inflows and, subsequently, the cross-border bank deleveraging or the external financing package altered the NIIP financing structure. At the same time, for a better understanding of the determinants of foreign direct investment, an in-depth analysis of its breakdown by key economic activity and country of origin was considered. Moreover, an analysis regarding the dynamics of items under direct investment by non-residents in Romania, i.e. equity versus intercompany lending, was conducted in order to investigate whether structural changes occurred and/or a post-crisis trend was taking shape. Bank staff also sought to monitor net direct investment inflows in relation to the outflows from the related income account.

¹⁶⁶ The 2006-2016 average, reflecting the developments in this indicator during a full business cycle.

In the course of 2016, work continued on integrating the Dynamic Stochastic General Equilibrium (DSGE) model into the quarterly cycle of macroeconomic analysis and forecast by running shadow forecast exercises (conducted in parallel with the formal one). They provided information on the forecasting performance and on some of the model properties. Resting on these assumptions, staff analysed and tested the appropriateness of re-specifying some structural elements, such as the monetary policy reaction function and the equation for sovereign risk premium within a model re-estimation exercise. This was required also for statistical reasons, since the available sample for the previous model estimation was rather small (40 observations, quarterly data) and was subsequently subject to substantial revisions. In a simplified model, oil was introduced as a factor of production with a direct bearing on the production of consumption goods, along with initiating the development of a fiscal sector. The theoretical structure of the model, the results of its estimation and some connected analyses, such as predictive performance testing, were published in the *Occasional Papers* series (No. 21).

Also related to the structural DSGE models was the tailoring to Romania's economy of a model with trade and financial interactions at global level, having a four-region structure, i.e. Romania, euro area, USA and the rest of the world. It was used first to assess the plausibility of the economy's response to a variety of shocks such as monetary policy shock, shocks affecting productivity in the tradables or non-tradables sector stemming from both domestic and foreign economies. Specifically, the shocks originating in foreign economies (e.g. euro area) benefit from analytical (trade, financial) spillovers on the other modelled economies, including on Romania, which particularises the innovative contribution of such a model in the central bank's day-to-day activity.

2.3. Economic papers and analyses

In 2016, the paper "Jobless recovery in Romania: the role of sticky wages and other frictions. Firm-level evidence from the WDN survey" was published in the NBR's *Occasional Papers* series. This paper makes an in-depth analysis of the factors under which influence the post-crisis economic recovery in Romania was not accompanied by a corresponding labour market upturn. The analysis starts from a unique and rich firm-level dataset stemming from the first labour market survey conducted in 2014 by the National Bank of Romania, in cooperation with the Wage Dynamics Network (WDN), an ESCB research group. The questionnaire was prepared so as to allow assessing Romania's labour market adjustments in the period 2010-2013 and the impact of reforms implemented in 2011 on the firms' activity. The economic environment, as perceived by respondent firms, was characterised by moderate demand swings in the period covered by the survey. Companies were relatively wary of cutting (nominal and real) wages of incumbent employees, which, according to probit model estimates, subsequently increased the likelihood for a firm to have laid off workers or to have frozen hiring. By contrast, the findings show that wages of newly-hired employees were more pro-cyclical than those of existing employees at least in the early recovery phase of the business cycle. Apart from wage stickiness, other labour market frictions that complicated the search for a new job and the

matching process may be associated with companies' perception of high payroll taxes, the whole-economy minimum wage policy, sectoral shifts in the economy, and especially the increasing skill mismatch. Even though steps were taken to enhance labour market flexibility, companies perceived reforms as having a subdued influence, with no significant changes in hiring/firing costs. However, estimates highlight a number of positive effects of reforms, namely the possibility to reduce working hours for economic reasons and the improvement in the framework for fixed-term and temporary contracts.

Another research project that approached a topic connected to the labour market referred to the relationship between public sector and private sector wages. Assessing the strength of the link between the two variables is relevant in terms of inflationary influences, as well as for the evaluation of the economy's competitive position, given that public-sector pay rises have the potential to pass through to wage earnings prevailing in the private sector (also referred to as demonstration effect), regardless of the developments in labour productivity. Econometric tests pinpointed a statistically significant long-run relationship between the average wage in industry and that in the public sector. Thus, a 10 percent increase in public sector wages leads to a roughly 3.5 percentage point pick-up in growth of the average wage in industry over a year. Hence, budgetary-sector wage increases implemented during 2015 exerted inflationary influences, along with worsening price competitiveness. The results of this research project were presented in the box titled "The demonstration effect – to what extent do public sector wage increases influence wage dynamics in industry?" in the February 2016 *Inflation Report*.

Given the broad set of variables that may be employed in conducting labour market analyses, which are often difficult to interpret on the whole as they may send out mixed signals, another study focused on building a synthetic indicator of labour market conditions. To this end, principal component analysis was used, as well as various specifications of models with latent variables. The results confirmed the tightening trend seen in the labour market over the recent years and also revealed the predictive power of the indicator for the short-term developments in the adjusted CORE2 inflation rate. This research work was published in the December 2016 *Monthly Bulletin*.

Another paper dealing with inflation featured an empirical research into the role played by external factors in consumer price developments on the domestic market. Specifically, the study revealed the presence of a "common factor" explaining, to a considerable extent, the path in price dynamics across some European economies, including Romania (euro area, Bulgaria, the Czech Republic, Poland, Romania and Hungary). In turn, this external influence was chalked up to developments in prices of major commodities (oil in particular), as suggested by the modelling of CPI dynamics (net of administered prices) and the adjusted CORE2 dynamics based on vector autoregressions. As a result, VAT rate cuts left aside, the low inflation readings over the past few years are attributable mostly to external factors. The results of this research work were included in the box titled "The relevance of external factors to domestic inflation dynamics" in the August 2016 *Inflation Report*.

Another study conducted during 2016 focused on developments in total factor productivity (TFP) and its contribution to economic growth, as well as on a microeconomic investigation into its determinants. Thus, it was shown that Romania experienced a considerable advance in TFP 2000 through 2014, compared with other EU economies, pointing to the rise in competitiveness and progress in terms of real convergence. The analysis based on information available at firm level and helped the shaping of the profile of the productive firm, which is a large, more recently-established, majority foreign-owned private company that is part of a group undertaking. These results come to underpin the significant part that foreign direct investment inflows played in increasing the efficiency of the production process. At the same time, aggregate productivity is influenced by both firm-specific efficiency and the extent to which resources are channelled towards more productive companies to the detriment of less efficient ones. By simultaneously analysing the dynamics of productivity and those of the number of employees in manufacturing companies, the study found that the reallocation of human resources helped support aggregate TFP both before and especially after the economic crisis broke out. The results of this research work were released in the box titled "Total factor productivity (TFP) from a macro- and a microeconomic perspective" in the May 2016 *Inflation Report*.

Among the research works on competitiveness conducted in 2016 was a comparative assessment of the extent to which the domestic output of consumer goods and imports thereof were influenced by the increase in local demand and the competitive position. Specifically, based on cointegration models, excess demand was shown to have had a positive impact on local output and imports, the latter also benefiting, however, by enhanced price competitiveness of foreign producers to the detriment of domestic ones. Given that imports outpaced the local output of consumer goods, the position of the former on the domestic market of such goods continued to strengthen. The results of this analysis were published in the June 2016 *Monthly Bulletin*.

The interest shown in the competitive position of the Romanian economy was also reflected by an analysis on how structural shifts across the real sector impacted current account adjustment. In this vein, empirical estimations highlighted the important part that the increase in energy efficiency played in narrowing the current account deficit in 2013. The downward path in the ratio of energy consumption to gross value added is ascribed to energy efficiency gains, on the one hand, and to shifts in the composition of industrial output towards industries with lower energy consumption, on the other hand. These results were included in the box titled "Structural factors behind the adjustment of the external imbalance" in the February 2016 *Inflation Report*.

2.4. Financial stability

In 2016, the main research topics approached in the field of financial stability were as follows:

- a) **Ready for the future? A new perspective on the Romanian economy.** The study aimed to map out the outlook for the Romanian economy by looking at three categories of companies foreseen as preserving their significant role in the economy even over one decade: (i) "veterans in power"; (ii) the leading firms and (iii) state-owned

enterprises. Authors considered these entities to make up the critical mass for shaping the future of the economy. The companies in the critical mass are capable of withstanding future challenges (such as a possible euro adoption) provided that the authorities become fairly active in correcting some weaknesses that had built up over the past decades. The study reveals that two elements, i.e. balance sheet prudence and creditors' more active role, are critical ingredients in the recipes for both longevity and performance. For want of in-depth structural shifts, the critical mass of companies will not be able to make significant progress in the catching-up with EU economies and will leave Romania trapped at the level of innovative, knowledge-based development close to that of the 2000's.

- b) **Real-estate market cycle.** The study investigated the construction of composite indices on real-estate market activity in an attempt to assess the cyclical developments these indices may show. According to the literature, the property price cycle is an important component in defining the financial cycle. This study was meant to add to property price analysis a tool for identifying the real estate market cycle by resorting to other available information on this market's activity. The analysis is focused on a number of European countries, both advanced and emerging economies, and explores the developments in these countries over the past two decades. First, the study reveals that composite indices have a cyclical evolution similar to that of property prices and the benefit of a longer data history than the latter. Second, the composite indices may be employed in signalling future financial crises, with the downturns in real estate cycle succeeding in capturing systemic financial crises in most countries that experienced such episodes in the reviewed period.
- c) **Stress-testing the household sector.** The study focused on developing a model to estimate the probability of default for households by using credit data. A logit model with fixed effects was employed, the factors explaining non-performance being the debtor's risk characteristics (indebtedness level, age, income) and the loan's risk characteristics (loan-to-value ratio – LTV, currency, maturity). The results show that the level of indebtedness, the currency of the loan and the lending rate at the origination date are the key determinants of the probability of default. The stress test implied building scenarios for the main explanatory factors and assessing the impact of changes on the probability of default.
- d) **Study of the interactions between government bond market and credit default swap (CDS) market.** The paper assesses the price-setting mechanism for government bonds and CDS contracts, given its relevance to policy makers, as it allows a better understanding of how changes in economic fundamentals and investor perception feed through to prices of these financial instruments. The analysis employs the estimation of a two-variable vector error correction model (VECM) based on daily data for the sample period spanning from August 2008 to August 2016. By applying the methodology proposed by Gonzalo and Granger (1995)¹⁶⁷, the results point to the fact that price setting on the two markets is interdependent (developments on a market contribute to price formation on the other market). Moreover, in a bid to capture direct and indirect interactions in a multivariate framework via a structural approach that allows establishing multiple interdependence relationships,

¹⁶⁷ Gonzalo, J. and Granger, C., "Estimation of Common-Long Memory Components in Cointegrated Systems", *Journal of Business and Economic Statistics*, 13(1), 1995.

the results suggest that the substantial changes posted by developments in long-term government bond yields could be ascribed to domestic factors, such as the uncertainty surrounding the real sector.

- e) **The analysis of home bias, crowding-out, and the implications on financial stability in case of the Romanian economy.** The study employs chiefly a general equilibrium model with a mechanism similar to that used by Traum and Yang (2010)¹⁶⁸. The results lead to the conclusion that government investment, albeit sending public debt higher, boosts private sector investment. The occurrence of crowding-in is highlighted in cases where public debt goes up on the back of the rise in government investment. The findings are in line with the conclusions formulated by Friedman (1978)¹⁶⁹, according to which the crowding-out is closely connected with the real sector, rather than with public debt financing.
- f) **Implications of balance sheet adjustments in the context of new equilibria.** This analysis investigated the effects of the new domestic and international equilibria on financial macro-stability. The economic and financial tensions that occurred starting 2008-2009 highlighted the non-linearities in the transition between the stages of business and financial cycles. The new equilibria emerge amid a macro-financial environment characterised by peculiarities such as low short-term rates, sharp and sizeable narrowing of fiscal space and precautionary saving. Against this background, the analysis shows that balance sheet adjustments in the private sector could generate a series of second-round effects on the macro-financial environment, with potentially adverse externalities on lending.
- g) **Developing a dashboard of Romania's financial market volatility.** The analysis was aimed at crystallising an overview of the stress episodes in local financial markets by taking an approach similar to that employed by the European Systemic Risk Board. The dashboard gives an overview of financial markets, in particular money market, foreign exchange market, the market for government securities and the capital market. The analysis summarises the risks through a visual method, namely a risk map, with data series representing estimates of volatility of financial instrument prices via GARCH models. The methodology allows identifying the presence of high volatility on several market segments simultaneously, thus developing the toolkit employed for systemic risk oversight on domestic financial markets.
- h) **The role of the capital market in corporate financing.** The analysis was meant to investigate capital market contribution to real sector financing, which is a currently debated issue at EU level as well. Specifically, the EU authorities have recently decided to implement the Capital Markets Union with a view to diversifying funding sources. The study shows that, in the case of Romania, market-based financing is relatively low. The share of capital market trades in new loans to local non-financial corporations peaked at 14 percent in 2013, on the back of both initial public offerings and a base effect, namely the record low in the volume of new loans to non-financial corporations that year. The capital market via its capital allocation function may be a viable alternative to bank financing.

¹⁶⁸ Traum, N. and Yang, S.-C. S., "When Does Government Debt Crowd Out Investment?", Center for Applied Economics and Policy Research Working Paper No. 006-2010, May 2010.

¹⁶⁹ Friedman, B. M., "Crowding Out or Crowding In? The Economic Consequences of Financing Government Deficits", NBER Working Paper, 1978.

i) **Assessment of term premia for the government bond market in Romania.**

The analysis sought to produce a time series for the term premium relating to the term structure of yields on debt instruments issued by the Romanian government. For this purpose, three approaches were employed: (i) the methodology based on a term structure model with three latent pricing factors, as proposed by Adrian, Crump and Moench (2008)¹⁷⁰; (ii) the methodology proposed by Joslin, Singleton and Zhu (2011)¹⁷¹ that estimates an affine term structure model by imposing no-arbitrage restrictions; and (iii) the methodology based on modelling the term structure with rational expectations via a Fama-Bliss factorial model (1987)¹⁷². The results prove a sensitivity of yields to external factors in the case of Romania that is similar to that observed for the US Treasury term premia. Starting in 2015 H2, a decoupling of the Romanian market from that in the US has been visible, amid the influence of domestic factors on the term structure of yields.

At the same time, staff examined topics such as the analysis of the dynamics and determinants of risk premia in the euro area, the relative ranking of credit institutions in Romania in terms of credit risk, stress-testing the non-financial corporations sector or an analysis of saving behaviour, these papers being presented at the Annual Regional Seminar on Financial Stability Issues titled "Macrostability: Central Banks in Uncharted Territories", organised jointly by the NBR and the IMF during 20-22 October 2016. An analysis on how Romania tackled non-performing loans and their evolution was presented at the Regional High-level Workshop on NPLs Resolution that took place on 15 June 2016 in Bucharest under the aegis of the NBR, the EC and the IMF.

2.5. Guidelines and objectives of the research activity in 2017

In order to enhance the analytical support for the substantiation of monetary policy decisions, a number of research projects are envisaged for 2017, as follows: (i) to develop and recalibrate the MAMTF with a view to improving its predictive performance; (ii) to implement the inflation forecast using ARIMA models, on the basis of NIS-released price indices at the most disaggregated level; (iii) to devise alternative methods to substantiate the current account deficit forecast; (iv) to improve the methodology for assessing potential GDP and the in-depth analysis of determinants behind total factor productivity (TFP); (v) to develop a structural model for assessing the impact of labour market changes; and (vi) to enlarge the framework for fiscal sector analysis and projection and for EU funds impact assessment.

In the course of 2017, the process of harmonising and integrating the DSGE model into the quarterly macroeconomic analysis and forecast cycle is envisaged to be completed. Other refinement directions include, based on the simplified structure of the DSGE model, the evolution of the fiscal sector and the labour market so as to better capture a number of characteristics of the Romanian economy.

¹⁷⁰ Adrian, T., Crump, R. and Moench, E., "Pricing the Term Structure with Linear Regressions", *Fed Staff Reports* No. 340, August 2008.

¹⁷¹ Joslin, S., Singleton, K. and Zhu, H., "A New Perspective on Gaussian Dynamic Term Structure Models", *Review of Financial Studies* 24.3, 2011.

¹⁷² Fama, E. and Bliss, R., "The Information in Long-Maturity Forward Rates", *American Economic Review*, 77, 1987.

As for the DSGE model that captures Romania's trade and financial interactions with its economic partners at global level, its structure is expected to be developed by including public investment and the complementarity of private and public consumption. Thus, it will be possible to quantify the impact of EU funds inflows (especially structural and cohesion funds) on key macroeconomic variables. For example, increases in EU funds allocation for infrastructure act as a favourable productivity shock on private-sector enterprises, with beneficial consequences on their production costs. In the context of recent and prospective developments, it is also envisaged to add an energy sector (oil) with an impact both on the production of firms (as a production factor) and final consumption of households (as a determinant of end-user fuel prices included in the NIS-calculated consumer price index). Another development of the model is to include an additional source of real rigidities in the form of a distribution sector, which contributes to the output of final tradables via the provision of specific services such as transport, marketing, insurance, etc. These rigidities ensure an incomplete pass-through of changes in the nominal exchange rate on the domestic prices of goods (denominated in local currency) and deviations from purchasing power parity (including for prices of tradables), both in line with the empirical evidence detecting the presence of these phenomena.

An objective set for 2017 is to conclude the study aimed at the decomposition of yields on Romanian government bonds denominated in the local currency into two unobservable components reflecting: (i) market expectations on the short-term nominal interest rate over the relevant horizon and (ii) the risk premium demanded by investors to make long-term investments, instead of successively reinvesting in short-term instruments. With a view to attaining the above-mentioned decomposition, two Gaussian affine term structure models are estimated: Hamilton and Wu (2012)¹⁷³, and Adrian *et al.* (2013)¹⁷⁴. Preliminary results show that the drop in leu-denominated government bond yields starting in 2011 owed both to the downward adjustment in expectations on the short-term nominal interest rate and the term risk premium compression, amid structural factors at play, as well as to the correlation with developments in global financial markets. The paper, which is part of a research project aimed at extracting and assessing relevant information from leu-denominated government bonds, is to be published in the *Occasional Papers* series.

Yet another line of the research activity will be to expand the analyses on how the monetary transmission mechanism works by making a number of assessments of credit channel functioning, to this end employing the information in the NBR's Bank Lending Survey as well. The empirical methodology will be based on a Bayesian vector autoregressive model.

Research on competitiveness is to materialise in 2017 in a study on the role that real effective exchange rate (REER) plays in economic activity. Given the evidence seen in the national economy, as well as some results from the literature, according to which there is inter-sectoral heterogeneity in terms of both the trajectory of the REER and

¹⁷³ Hamilton, J. D. and Wu, J. C., "Identification and Estimation of Gaussian Affine Term Structure Models", *Journal of Econometrics*, 168, 2012, pp. 315-331.

¹⁷⁴ Adrian, T., Crump, R. and Moench, E., "Pricing the Term Structure with Linear Regressions", *Journal of Financial Economics*, 110, 2013, pp. 110-138.

the intensity of its influences, the research work focuses on substantiating certain indicators and analysing their impact on economic activity (exports, jobs) at the level of NACE division and main industrial groupings.

Another direction of analysis refers to exploring the area of non-price determinants of competitiveness by assessing the quality of exported products based on a set of assumptions that allow the separation of “objective” quality-related influences from “subjective” influences associated with consumer preference.

In the context of research concerning labour market developments, an analysis of the relationship between wage dynamics and labour productivity dynamics will be carried out in the course of 2017, amid the differential between the two indicators, which has widened since 2015 and has the potential to generate inflationary pressures. The study aims to assess the link between wages and productivity by taking a macroeconomic approach and resorting to firm-level information.

Turning to the research work in the area of financial stability, attention will be devoted to the improvement of the framework for assessing credit risk associated with non-financial corporations. This study is aimed at developing a microeconomic module for corporate sector stress testing, which allows investigating the impact of various scenarios on both performance and probability of default, implementing sub-models for estimating probability of default at sectoral level or recalibrating the current credit risk assessment model.

In 2017, a financial cycle analysis will also be carried out in a bid to identify the indicators defining it and to devise a composite indicator providing information on the stage the financial system is in at the time of the analysis (normal growth, strong growth or contraction). This assessment is expected to make possible the identification of adequate macroprudential tools to be employed in the future.



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Chapter 14

Legal activity of the
National Bank of Romania

In 2016, endorsement by the Legal Department of the National Bank of Romania involved 38 draft pieces of legislation, of which 28 external regulations and 10 internal regulations, as well as 28 draft pieces of legislation on financial and banking matters initiated by other institutions and submitted for review to the National Bank of Romania (Table 14.1).

Another key part of the legal activity consisted in the endorsement of 145 draft orders on the sanctioning of and imposition of measures on certain credit institutions and non-bank financial institutions, prepared by the relevant departments in the National Bank of Romania's head office, 66 orders on the sanctioning of the managers of some credit institutions, 5 documents representing Governor's orders on the erasure of some non-bank financial institutions from the General Register and/or the Special Register, as well as 1 decision on the erasure of one non-bank financial institution from the General Register and the prohibition of performing lending activity.

Moreover, the Legal Department: (i) endorsed 151 draft responses prepared by the relevant departments in the NBR's head office for the Ministry of Administration and Interior and the Public Ministry and 45 notes drawn up by the relevant departments in the NBR's head office on various issues related to central banking; (ii) provided 118 legal opinions on specific topics at the request of the relevant departments in the NBR's head office; (iii) analysed and endorsed two addenda to cooperation agreements/conventions signed by the National Bank of Romania and two institutions in Romania, as well as a memorandum of understanding between the National Bank of Romania and Banque du Liban; (iv) prepared draft responses for 67 petitions and 80 letters submitted to the National Bank of Romania by different legal entities or public institutions, and (v) drew up 82 notes and letters on various subjects.

In the course of 2016, legal advisors represented the central bank in the meetings of the relevant Committees of the Chamber of Deputies and of the Senate, as well as in the working groups organised by the Ministry of Public Finance, Ministry of Justice, Ministry of Economy, the National Authority for Consumer Protection and Ministry of Regional Development, Public Administration and European Funds.

As for disputed claims and contract assistance, the Legal Department: (i) provided legal opinions; (ii) represented the National Bank of Romania before the courts of law, the syndic judge, the prosecution authorities, notaries public, lodging statements/written conclusions, pursuing, when necessary, all remedies at law under the laws in force with a view to defending and enforcing the bank's rights on its own behalf or in a different capacity deriving from the law or the agreements concluded by the National Bank of Romania, cooperating with the bank departments

in the NBR's head office, as well as with the latter's territorial units to obtain the necessary data and information; (iii) completed the legal procedures concerning foreclosure, examining and responding to the documentation related to foreclosure requests through garnishment of bank accounts of credit institutions/wages of employees of the National Bank of Romania by court enforcement officers in accordance with the relevant legal regulations; (iv) granted legal assistance to NBR departments by providing legal opinions/points of view/recommendations; (v) compiled responses to courts of law, court enforcement officers, prosecutor's offices, police authorities, individuals, notaries public and the territorial units of the National Bank of Romania.

In this context, in 2016 the Legal Department prepared 5,182 papers, as follows: (i) 1,634 endorsements of documents, such as explanatory notes for establishing the public contract award procedure, draft orders issued by the NBR governor on certain issues, substantiation notes elaborated by relevant departments on specific topics, draft contracts to be concluded by the National Bank of Romania, orders concerning employment, amendments to, suspension or termination of employment contracts of employees working in the NBR's head office, as well as with the latter's territorial units, powers of representation signed by the Governor of the National Bank of Romania; (ii) 451 legal viewpoints/opinions; (iii) 613 papers (defence statements, writs of summons, notices of appeal or second appeal) for representing the National Bank of Romania before the courts of law in 296 cases, as well as in a conciliation procedure; (iv) 952 papers for foreclosure files; (v) 1,532 responses to competent resolution departments/institutions, as well as with NBR branches/agencies.

As part of the NBR's activity within the European System of Central Banks in the legal field, the Legal Department, *inter alia*, participated in the meetings of the Legal Committee, cooperated with the representatives of the ECB's Directorate General Legal Services and its peers in the national central banks of EU Member States, and examined the relevant documents sent by the European Central Bank via written procedure. Legal assistance was granted during the meetings held in the context of the IMF, World Bank and European Commission missions to Romania and for working out various topics that the aforementioned institutions brought to the attention of the NBR. Furthermore, opinions were prepared with respect to the legal issues in the questionnaires submitted to the National Bank of Romania by international institutions and views were expressed on the enactment in the national law of the regulatory documents drawn up by EU institutions, such as the European Banking Authority and the European Systemic Risk Board.

The NBR's legal activity also focused on providing expert assistance in order to settle issues related to the activity of payment systems, as well as to resolve other legal central banking matters, which resulted in the preparation of roughly 420 legal opinions.

As regards the relationship with the Ministry of Foreign Affairs, the Legal Department further represented the National Bank of Romania in the quarterly meetings of the EU Litigation Working Group (EULWG).

Table 14.1. Main pieces of legislation for which the National Bank of Romania submitted opinions and proposals in 2016

Piece of legislation	Subject matter
Law No. 77/28.04.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 330/28.04.2016)	on the discharge of mortgage-backed debts through transfer of title over immovable property
Law No. 146/12.07.2016 (<i>Monitorul Oficial al României</i> , Part, No. 542/19.07.2016)	amending Law No. 102/1992 on the coat of arms and the seal of Romania
Law No. 209/09.11.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 913/14.11.2016)	amending and supplementing Government Emergency Ordinance No. 193/2002 on introducing modern payment systems
Law No. 12/16.03.2017 (<i>Monitorul Oficial al României</i> , Part I, No. 192/17.03.2017)	on macroprudential supervision of the national financial system
Law No. 24/21.03.2017 (<i>Monitorul Oficial al României</i> , Part I, No. 213/29.03.2017)	on issuers of financial instruments and market operations
Law No. 29/24.03.2017 (<i>Monitorul Oficial al României</i> , Part I, No. 213/29.03.2017)	amending and supplementing Government Emergency Ordinance No. 32/2012 on undertakings for collective investment in transferable securities and investment management firms and amending and supplementing Law No. 297/2004 on capital market
Emergency Ordinance No. 52/14.09.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 727/20.09.2016)	on credit agreements for consumers relating to immovable property, as well as amending and supplementing Government Emergency Ordinance No. 50/2010 on credit agreements for consumers
Government Decision No. 169/16.03.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 222/25.03.2016)	approving the 2016 budget of the "Imprimeria Băncii Naționale a României" régie autonome subordinated to the National Bank of Romania
Government Decision No. 228/30.03.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 259/06.04.2016)	approving the 2016 budget of the "Monetăria Statului" régie autonome subordinated to the National Bank of Romania
Government Decision No. 677/19.09.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 766/30.09.2016)	setting forth measures for applying Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions
Government Decision No. 931/8.12.2016 (<i>Monitorul Oficial al României</i> , Part I, No. 1014/16.12.2016)	on the establishment of the Inter-ministerial Committee for changeover to the euro
Draft Law (with the Committees of the Chamber of Deputies since 10.10.2016)	amending and supplementing Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as subsequently amended and supplemented (PL-x 427/10.10.2016)
Draft Law (with the Committees of the Chamber of Deputies since 07.11.2016)	amending Article 71 of Government Emergency Ordinance No. 50/2010 on credit agreements for consumers (PL-x 527/07.11.2016)
Draft Law (with the Committees of the Chamber of Deputies since 07.11.2016)	approving Government Emergency Ordinance No. 52/2016 on credit agreements for consumers relating to immovable property, as well as amending and supplementing Government Emergency Ordinance No. 50/2010 on credit agreements for consumers (PL-x 511/07.11.2016)
Draft Law (with the Committees of the Chamber of Deputies since 09.11.2015)	on the development of crowdfunding (PL-x 801/09.11.2015)
Draft Law (the legislative procedure was terminated following its definitive rejection in the Plenary Assembly of the Chamber of Deputies on 14.02.2017)	repealing Article 120 of Government's Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as subsequently amended and supplemented (PL-x 616/28.09.2015)
Draft Law (the legislative procedure was terminated following its definitive rejection in the Plenary Assembly of the Chamber of Deputies on 14.02.2017)	repealing Article 52 of Law No. 93/2009 on non-bank financial institutions (PL-x 891/21.12.2015)
Draft Law (before promulgation, Constitutional Court Decision No. 62/2017 declared it unconstitutional in its entirety)	supplementing Government Emergency Ordinance No. 50/2010 on credit agreements for consumers (PL-x 345/23.06.2014)
Draft Law (Joint report for rejection of the Committee for industries and services, of 08.03.2017, and of the Committee for public administration and territorial development of the Chamber of Deputies, of 20.03.2017, on the agenda of the Chamber of Deputies)	amending and supplementing Government Emergency Ordinance No. 69/2010 on the thermal rehabilitation of residential buildings funded from government-backed bank loans (PL-x 80/01.02.2017)

continued

Piece of legislation	Subject matter
Legal proposal (submitted to the Plenary Assembly of the Chamber of Deputies with a proposal for rejection; Joint report for rejection of the Committee for budget, finance and banks and the Committee for Legal Matters, Discipline and Immunities, of 23.03.2017)	supplementing Article 5 of Law No. 70/2015 for strengthening financial discipline concerning cash collection and payment operations and for amending and supplementing Government Emergency Ordinance No. 193/2002 on introducing modern payment systems
Legal proposal (submitted to the Plenary Assembly of the Chamber of Deputies with a proposal for rejection; Joint report for rejection by the Committee for industries and services and the Committee for Legal Matters, Discipline and Immunities, of 28.03.2017)	on debt collection activity (Pl-x 522/07.11.2016)
Legal proposal (removed from legislative procedure by the Senate based on Article 63(5) of the Constitution of Romania on 27.12.2016)	amending and supplementing Government Emergency Ordinance No. 23/2009 regarding the setting-up of the Romanian Counter-Guarantee Fund (B429/2016)
Legal proposal (removed from legislative procedure by the Senate based on Article 63(5) of the Constitution of Romania on 27.12.2016)	on supporting housing construction for the youth (B492/2016)
Legal proposal (with the standing committees of the Senate)	on Statute of the National Authority for Consumer Protection (L468/05.09.2016)
Legal proposal (the legislative procedure was terminated following its definitive rejection in the Plenary Assembly of the Chamber of Deputies on 21.02.2017)	amending Article 5 of Law No. 70/2015 for strengthening financial discipline concerning cash collection and payment operations and for amending and supplementing Government Emergency Ordinance No. 193/2002 on introducing modern payment systems
Legal proposal (the legislative procedure was terminated following its definitive rejection in the Plenary Assembly of the Chamber of Deputies on 21.03.2017)	supplementing Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as subsequently amended and supplemented (Pl-x 381/26.09.2016)
Draft Government Decision (based on Note No. XX/6236/01.09.2016 and via Letter No. 872/FG/01.09.2016, the NBR delivered its response to the Ministry of Labour, Family, Social Protection and Elderly, specifying that the endorsement of the said draft decision falls outside the NBR's competence. Currently, Decision No. 579/10.08.2016, <i>Monitorul Oficial al României</i> , Part I, No. 623 of 12.08.2016)	approving the implementing regulations for Law No. 273/2004 on adoption procedure, amending and supplementing Government Decision No. 233/2012 on the services and activities that Romanian private bodies may carry out during domestic adoption proceedings, as well as the methodology for their authorisation and amending Government Decision No 1441/2004 on the authorisation of foreign private bodies to carry out inter-country adoption activities
Draft Law (the NBR Legal Department submitted its observations via Letter No. XX/1/3/5396/21.07.2016. The legislative procedure was terminated following its definitive rejection by the Senate on 28.04.2015)	on the cybersecurity of Romania (PL-x 263/27.05.2014)
Draft Law (based on Note No. XX/1/7764/31.10.2016, the NBR delivered its observations to the Ministry of Public Finance, in its capacity as proponent of the draft law, via Letter No. 1102/FG/01.11.2016. Submitted for additional report to the standing committees of the Chamber of Deputies on 19.03.2013)	amending and supplementing Government Emergency Ordinance No. 190/2000 on the regime of precious metals, alloys and precious stones in Romania (PL-x 445/06.09.2010)
Draft Law (based on Note No. XX/1/5302/ 19.07.2016 and via Letter No. 781/FG/27.07.2016, the NBR delivered its response to the Ministry of Administration and Interior)	amending and supplementing Law No. 535/2004 on preventing and fighting terrorism, as well as other pieces of legislation

continued

Piece of legislation	Subject matter
Legal proposal (removed from legislative procedure by the Senate on 27.12.2016)	repealing Article 25(3)(4) of Law No. 312/2004 on the Statute of the National Bank of Romania (L615/07.11.2016)
Draft Law	amending Law No. 312/2004 on the Statute of the National Bank of Romania (PL-x 36/01.02.2017)
Draft Law	establishing measures for the implementation of Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories
Draft Law	on the operation of Banca de Export și de Dezvoltare a României Eximbank S.A.
Draft Law	on the statutory audit of annual financial statements and consolidated annual financial statements, amending pieces of legislation
Draft Government Emergency Ordinance	on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features

The background of the page features a faded, high-angle photograph of several classical columns, likely from a grand building. Overlaid on this image is a pattern of thin, concentric, wavy lines in a light beige or gold color, creating a textured, ripple-like effect across the left and central portions of the page.

Chapter 15

The institutional framework
and the organisation
of the National Bank of Romania

The National Bank of Romania is the central bank of Romania and an independent public institution. Its activity is governed by Law No. 312/2004 on the Statute of the National Bank of Romania.

The primary objective of the NBR is to ensure and maintain price stability. The main tasks of the National Bank of Romania are:

- to design and implement the monetary policy and the exchange rate policy;
- to conduct the authorisation, regulation and prudential supervision of credit institutions, and to promote and oversee the smooth operation of the payment systems with a view to ensuring financial stability;
- to issue banknotes and coins as legal tender to be used on the territory of Romania;
- to set the exchange rate regime and to oversee its observance;
- to manage the international reserves of Romania.

1. Decision-making bodies and corporate governance

The National Bank of Romania is run by the Board of Directors, which is made up of nine members appointed by Parliament for a five-year mandate that may be renewed. According to the law, members of the Board may not be members of Parliament or of a political party and they may not be Court officials or public servants. Out of the nine members, four are senior executives of the NBR, i.e. the Governor, the first deputy governor, and the two deputy governors. The other five members of the Board are not on the payroll of the NBR. The chairman of the Board is the Governor of the NBR.

The Board of Directors is the decision-making body of the NBR with respect to: (i) setting the monetary and exchange rate policies; (ii) the authorisation, regulation and prudential supervision or, as applicable, oversight of credit institutions, payment institutions and non-bank financial institutions, as well as oversight of the payment systems authorised by the central bank; and (iii) the bank's internal organisation. Moreover, the Board assigns the tasks to the executives and staff of the NBR.

In order to ensure the effectiveness of the decision-making process, the following three operational bodies are responsible for the performance of the main tasks of a central bank: the Monetary Policy Committee, the Supervisory Committee, and the Foreign Reserve Management Committee. Adding to these is the Audit Committee that analyses and proposes the NBR's policy and strategies as regards internal control, risk management, internal and external audit. These standing committees have their own rules of procedure, which define in detail their composition and specific tasks and responsibilities.



Mugur Constantin Isărescu
Governor,
Chairman of the Board

Members of the National Bank of Romania Board



Florin Georgescu
First Deputy Governor,
Vice Chairman of the Board



Liviu Voinea
Deputy Governor,
Member of the Board



Eugen Nicolăescu*
Deputy Governor,
Member of the Board



Marin Dinu
Member of the Board



Daniel Dăianu
Member of the Board



Gheorghe Gherghina
Member of the Board



Ágnes Nagy
Member of the Board



Virgiliu Stoenescu
Member of the Board

* Appointed pursuant to Parliament Decision No. 42 of 24 May 2017, after the resignation of Mr. Bogdan Olteanu.

The Monetary Policy Committee (MPC) is a standing advisory and decision-making body. It is made up of 10 members¹⁷⁵ and is chaired by the NBR Governor.

The committee's tasks focus on the central bank's primary objective and relate mainly to the specifics of the monetary policy strategy and operational framework, monetary policy configuration and implementation, as well as the associated economic research. In particular, the MPC discusses and defines the content, structure and configuration of monetary policy analysis reports/papers, of the macroeconomic projections over various time horizons, as well as of proposals on the monetary policy stance, which are subsequently submitted to the NBR Board for review and approval. In addition, the MPC supports the monetary policy decision-making process by discussing, approving and making available to the NBR Board, on a regular basis, certain analyses/research papers prepared by the line departments on relevant topics in terms of monetary policy conduct. At the same time, the MPC discusses, analyses and proposes to the NBR Board, whenever needed, revisions to certain features of the monetary policy strategy (inflation target included) and of the monetary policy toolkit with a view to calibrating them in order to achieve the central bank's primary objective and bring them into line with the ECB standards in the field. According to the annual calendar of quarterly forecasting rounds approved by the NBR Board, the year 2016 saw 16 meetings of the MPC, with eight other meetings being held January through May 2017.

The Supervisory Committee is a standing decision-making body composed of 10 members and chaired by the NBR Governor. The Committee's tasks and responsibilities are related to the assessment and oversight of credit institutions' asset quality, financial performance and observance of the required levels of prudential indicators, as well as ensuring the regulatory framework according to the specific legislation and international practices in the field. Also within the scope of the Committee are non-bank financial institutions and payment institutions.

In 2016, the Supervisory Committee passed decisions in 24 meetings, while 7 meetings were held January through March 2017, the topics relating primarily to: (i) the notification of the intention on acquiring a qualifying holding in the share capital of a credit institution and/or on increasing such participations; (ii) applications submitted by credit institutions, Romanian legal entities, pursuant to prudential regulations, for approval of changes in their standing as concerns the Board members and/or executives, broadening their scope of activity, the financial auditor, operations on preferential terms set forth in the employee benefits and incentive packages, mergers, etc.; (iii) draft pieces of legislation to be issued by the central bank or other authorities concerning the activity of credit institutions and non-bank financial institutions; (iv) implementing EBA Guidelines in the national legal framework and/or in supervisory practices; (v) monitoring developments in terms of financial stability, identifying, monitoring and assessing systemic risks and those related to systemically-important credit institutions, specific analyses (monitoring the lending terms and conditions, overseeing the way in which the financial system contributes to the sustainable resumption of lending to the real economy, etc.), analyses on the activity of the Central Credit Register and of the Payment Incidents Register (the use of information in databases, submitting the information in the CCR database to the ECB in line with Recommendation ECB/2014/7); and (vi) other matters related to banking system functioning.

¹⁷⁵ As of 4 November 2014; the committee previously had nine members.

The Foreign Reserve Management Committee (FRMC) is a standing body whose tasks consist in achieving, via tactical decisions, the strategic objectives set by the NBR Board in the area of foreign reserve management. The Committee is made up of 11 members and is headed by the NBR Governor. In line with the tasks defined by the NBR Board, it analyses global economic and financial developments and formulates proposals for the reserve management strategy, assesses the performance of portfolios and examines their compliance with strategic and tactical guidelines, makes recommendations on introducing new financial instruments and draws up the list comprising eligible entities for transactions and bond issuers. The FRMC convenes and takes decisions whenever required by financial market developments, when summoned by the chairman or the vice-chairman acting as a substitute for the former, focusing primarily on ensuring liquidity, preserving the value of reserve assets and obtaining reasonable income over the medium and long term.

The Committee for Preparing the Changeover to the Euro set up at the NBR is an advisory body analysing the preparatory activities ahead of euro adoption. It is a formal discussion forum providing support to central bank decisions on the path to joining the Economic and Monetary Union. The Committee for Preparing the Changeover to the Euro convened six times during 2016, while two other meetings were held January through May 2017. Discussed during the meetings were topics such as: adopting the euro from the perspective of real economy, the planning, implementation and consequences of bank resolution at a national and cross-border level, the implications of the negotiations between the United Kingdom and the European Union, the major co-ordinates of the 2016-2019 issue of Romania's Convergence Programme, the risks and opportunities of Romania joining the euro area, the dynamics and determinants of the risk premium in the euro area, the Alert Mechanism Report 2016, the Future Financing of the EU Report (the Monti Report), parameters of the public pension scheme and long-term outlook.

Within the NBR also operates an **Audit Committee**, whose role is to strengthen the corporate governance framework in place. The Audit Committee is an independent body from the executive management, consisting of the five non-executive Board members.

The Audit Committee has an advisory role, supporting the NBR Board in supervising the bank's internal control, risk management and governance system, as well as in supervising the internal and external audit processes.

This committee convenes at least once every three months and whenever necessary. Senior representatives of the Internal Audit Department and the committee secretary are invited to its meetings on a continuous basis. In order to clarify certain issues under examination, the committee may invite to its meetings members of the executive management, senior representatives of the NBR's organisational structures and other specialists, including persons from outside the NBR. Through its tasks and activity, the Audit Committee supports the actual independence of internal audit within the central bank.

During 2016, the committee convened in five meetings, three of which focused on reviewing the financial statements submitted by the external auditor. In the other meetings, the Audit Committee reviewed the internal audit plan, discussed the outcome of the internal audit missions, and analysed the regular activity reports of the Internal Audit Department, its performance included.

In the first part of 2017, 2 meetings were held, in which the 2016 Activity Report of the Internal Audit Department was endorsed, and the external auditor submitted their progress with auditing of the NBR's financial statements for 2016.

In addition to the Audit Committee, the NBR's internal control system encompasses several control layers, lines of defence against any factors which might jeopardise the fulfilment of the bank's objectives.

External control layers

The NBR Statute provides for two external control layers, namely the external auditor, which is appointed to audit the annual accounts of the NBR, and the Court of Accounts, which conducts the subsequent audit of commercial operations carried out by the central bank.

Internal control layers

The National Bank of Romania takes a functional approach to risk management, meaning that each organisational unit has primary responsibility for identifying, assessing and managing the risks associated with its own activities and operations. The risk management process is an integral part of the NBR's internal control system and represents the bank's first line of defence against any factors that might jeopardise the fulfilment of the objectives and of the action plans. To this end, each organisational unit implements operational control procedures within its area of responsibility, in accordance with the levels of risk tolerance set in advance by the executive management. Furthermore, the NBR applies the approach known as the Chinese wall, which separates the departments in charge of monetary policy formulation and implementation respectively, on the one hand, and the aforementioned units from the departments entrusted with other statutory tasks, on the other hand.

The second line of defence is functional on certain business segments with high-risk financial exposure, e.g. international reserve management. It monitors compliance with the risk limits approved by the bank's executive management and reports any breach. The decision-making/advisory committees within the NBR, namely the Foreign Reserve Management Committee, the Monetary Policy Committee and the Supervisory Committee, play a major role in this line of defence.

Apart from the risk monitoring by the operational structures, the NBR's Internal Audit Department – which functions as a distinct line of defence – examines the overall controls in place and determines whether they are properly designed and functional so as to ensure the reliability and integrity of financial and operational information, the effectiveness of the activities carried out, asset protection, as well as compliance with applicable legal and contractual provisions.

The 35 audit missions finalised in 2016 included recommendations to improve processes of internal control, risk management and governance, helping streamline activity and increase the effectiveness of internal control system.

The advisory role of internal auditing was enhanced following requests by the executive management and heads of departments to carry out ten advisory missions during 2016.

The NBR's internal audit activity is carried out jointly with the ESCB, with two audit missions being carried out in 2016, coordinated by subunits of the Internal Auditors Committee, an ESCB unit responsible for internal audit.

In its activity, the Internal Audit Department applies the International Standards for the Professional Practice of Internal Auditing (from the International Professional Practices Framework), issued by the Institute of Internal Auditors, and the working methodology provided in the NBR's Internal Audit Manual and implements the best practices in the field on a regular basis, including those related to IT&C audit, cyber security and resilience.

2. The relationship of the NBR with the Parliament of Romania

As regards institutional communication, the National Bank of Romania maintains a steady dialogue with the Parliament of Romania, the cooperation consisting mainly in:

- (i) formulating opinions on draft pieces of legislation at the direct request of parliamentary committees, or indirectly, upon the request of some initiators, i.e. the Ministry of Public Finance, the National Authority for Consumer Protection or other public authorities, or of the Ministry for the Relation with the Parliament, with a view to finalising the Government's position on those draft laws. Pursuant to Article 3 of the NBR Statute, central public authorities ask for the central bank's opinion on the draft pieces of legislation related to areas falling within the NBR's competences;
- (ii) preparing and submitting materials during the parliamentary procedure to exert control in relation to the compliance of EU draft legal acts with the principles of subsidiarity and proportionality;
- (iii) delivering opinions and participating in the meetings of the specialised committees in the two Chambers of the Parliament during the parliamentary procedure to review the draft legal acts prepared by EU institutions;
- (iv) expressing opinions, preparing materials or participating in discussions on topics covered by the NBR's scope of activity, i.e. financial stability, bank resolution, European affairs, payment systems;
- (v) drawing up materials for the preparation of events organised by the Parliament or in which representatives of the Parliament take part;
- (vi) formulating answers to specific interpellations the NBR received from members of Parliament.

The interaction between the central bank and the Parliament grew stronger in 2016, amid discussions on several legislative initiatives regarding the banking sector (the law on debt discharge, the law on the conversion of CHF-denominated loans) and the establishment of the National Committee for Macroprudential Oversight, with members of the executive management and experts of the NBR being repeatedly invited to the meetings of the specialised committees of the Senate (Committee for Budget, Finance, Banking and Capital Market, Committee for Economy, Industry and Services) and of the Chamber of Deputies (Committee for Legal Matters, Discipline and Immunities).

During the debates on Law No. 77/2016 on the discharge of mortgage-backed debts through transfer of title over immovable property, the NBR highlighted the negative consequences that the enforcement of this law in the proposed form might have on lending conditions, financial stability, economy as well as on the decline in foreign investor confidence amid the increase in legal uncertainty. Moreover, the central bank underscored that the retroactive enactment of the law may generate moral hazard and may have a significant negative impact on financial stability and the smooth functioning of credit institutions.

Turning to the draft law supplementing Government Emergency Ordinance No. 50/2010 on credit agreements for consumers, the NBR formulated opinions on the legislative proposals concerning CHF-denominated loans. Specifically, the NBR presented the Committee for Budget, Finance, Banking and Capital Market of the Senate and the Committee for Legal Matters, Discipline and Immunities of the Chamber of Deputies the impact of loan conversion at various exchange rates from the perspective of potential losses at banking sector level, the effects on the foreign currency position and the increase in risk-weighted assets amid the rise in the short foreign currency position, as well as the influence of changes to these items on capital adequacy indicators.

Moreover, by way of documents submitted and the participation in the discussions held in the specialised committees of the Senate (Committee for European Affairs, Committee for Economy, Industry and Services, Committee for Legal Matters, Appointment, Discipline, Immunities and Validation, Committee for Budget, Finance, Banking and Capital Market) and of the Chamber of Deputies (Committee for Budget, Finance and Banks), the NBR contributed to the drafting of the final version of Law No. 12/2017 on the macroprudential oversight of the national financial system. The NBR's contribution referred to compliance with EU rules, harmonisation with the provisions of the CRD IV/CRR regulatory framework applicable in Romania, as well as clarification of the macroprudential oversight mechanism (soft law – “act or explain”), similarly with the ESRB's functioning. The above-mentioned law provided for the establishment of the National Committee for Macroprudential Oversight (NCMO) as an inter-institutional cooperation structure without legal personality, which comprises representatives of the National Bank of Romania, the Financial Supervisory Authority and the Government of Romania. The NCMO establishment ensures the implementation of Recommendation ESRB/2011/3 on the macroprudential mandate of national authorities.

Apart from the aforementioned areas, the draft legal acts on which the Parliament, the initiators or the Government asked for the NBR's opinions in 2016 and the first part of 2017 (including those concerning the transposition of some EU directives into national legislation) dealt with topics related to: (i) the NBR Statute; (ii) the introduction of modern payment systems; (iii) issuers of financial instruments and market operations; (iv) non-bank financial institutions; (v) strengthening of financial discipline in relation to cash payments and receipts; (vi) debt collection activity; (vii) credit institutions and capital adequacy; (viii) functioning of Banca de Export și de Dezvoltare a României – Eximbank S.A.; (ix) the statute of the National Authority for Consumer Protection; (x) development of crowdfunding; (xi) alternative resolution for disputes between consumers and traders; (xii) regulation

of sold loans; (xiii) comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features; (xiv) markets in financial instruments (Markets in Financial Instruments Directive – MiFID II); (xv) the statutory audit of annual financial statements and consolidated financial statements, and amending some pieces of legislation; (xvi) collective saving and lending for housing; and (xvii) prevention and combating of terrorism.

Another area of cooperation with the legislative body derives from Romania's capacity as an EU Member State, the Parliament requiring materials to be submitted during the parliamentary procedure to exert control with regard to the compliance of EU draft legal acts with the principles of subsidiarity and proportionality and during the procedure of reviewing the draft legal acts prepared by EU institutions, the topics approached in the period 2016-2017 concerning: (i) the Banking Union; (ii) the establishment of a European Deposit Insurance Scheme; (iii) the EC measures to mitigate risks in the banking sector ("Towards the completion of the Banking Union" Communication); (iv) the EC Communication on the "Annual Growth Survey 2017"; and (v) prospects for Romania's joining the euro area in the context of the White Paper on the future of Europe.

Moreover, the NBR was requested to formulate opinions on the pieces of legislation regarding dormant bank accounts, the legislative package comprising measures to mitigate risks in the banking sector and the European Framework regulation integrating business statistics.

The cooperation between the central bank and Parliament relies on formulating written opinions and answers to specific questions, submitting the requested informative documents or participating in discussions. In the latter case, participation is ensured at different levels of representation based on the relevant topics (Board members, chief economist, advisers, director/deputy director, experts).

3. Organisational developments

3.1. Human resources management

Changes in the organisation chart

In 2016, the National Bank of Romania Board approved a number of changes in the departments of the bank's head office, which were mainly aimed at: (i) strengthening and harmonising the risk management framework; (ii) enhancing and expanding public relations and optimising communication; and (iii) relieving the field of financial stability of ancillary activities.

The reorganisation process and the changes to the central bank's activity entailed the establishment of new organisational structures, the disbandment of certain existing structures and the merger of some divisions' activity, the main changes being as follows:

- a) Strengthening the risk management framework by setting up divisions focused on: (i) foreign reserves risk management, taken over from the Foreign Reserve Management Division of the Market Operations Department; (ii) information and IT security within the NBR Chancellery (IT&C Information Management and Security Division) and (iii) establishing a general regulatory framework for managing operational risks in the central bank within the Budget and Financial Analysis Department (Risk Monitoring Division). Moreover, in order to ensure an appropriate framework for a consistent and efficient monitoring of internal risks, the NBR Board approved the establishment of the Risk Committee, with similar responsibilities to those of other central banks, which will become operational in 2017.
- b) Grouping together public relations-specific activities (public information projects, external communication, financial education, museum, archives, library) into a single organisation structure – Secretariat and Public Relations Department. At the same time, the Online Communication Division, dedicated to developing online communication and highlighting the proactive communication activity, was established within the Communication and Multimedia Department.
- c) Relieving the organisational structure with responsibilities in the area of financial stability from non-specific duties by transferring: (i) the activities linked to the management of the Payment Incidents Register and the Central Credit Register to the Statistics Department (Credit Risk Statistics Division) and (ii) the activities related to formulating the NBR's policy in the field of payments and settlements, regulating and authorising instruments and infrastructures for settlements, supervision and continuous oversight of payment systems, and the setting up of a new separate structure – Payment and Settlement Systems Regulation and Oversight Unit.

Moreover, during 2016, the NBR continued to implement the ReGIS and SaFIR Systems Internalisation Programme started in July 2015, approving the establishment of a new structure (Business Continuity Division within the Payments Department) and the additional staffing of the divisions tasked with this activity with 42 positions.

The organisational changes and the revisions of the departments' tasks following the reorganisation process were reflected by Regulation No. 2/2016 on the organisation and functioning of the National Bank of Romania, approved by the NBR Board in its meeting in August 2016, which became effective on 1 September 2016.

Amid the significant revision of the central bank's activity starting with 1 September 2016, the job listing of the units concerned saw major changes.

The reorganisation process involved 12 units and affected 70 employees by moving to a new position, 12 of whom were previously part of the managerial ranks (director, head of division). Specifically, the reorganisation implied the disbandment of 14 divisions and the establishment of 12 divisions (9 new ones and 3 resulting from the merger of activities). The staff members of those units were redistributed across the new units, following the reallocation of activities and the newly-assigned tasks, and in the already existing ones.

The above-mentioned employees had the opportunity to choose the existing or the newly-established vacancies, insofar as their individual profile (educational background, experience) was compatible with the position's profile. The selection process unfolded on a competitive basis, including managerial positions, in accordance with the internal regulations and the legislation governing labour.

2016 saw a staff turnover rate of 4.6 percent, the National Bank of Romania reporting 1,902 employees as of end-December 2016, compared with 1,905 employees at end-2015.

With regard to promotions, 58 employees were promoted to executive positions and 32 employees advanced to managerial ranks.

Professional training of the NBR staff in 2016

Throughout 2016, there were 2,224 participations in professional training programmes – comprising 1,218 members of staff –, of which 2,002 in Romania (90 percent) and 222 abroad. These were organised as follows:

- a) Professional training programmes in Romania:
 - organised for the first time were seminars held by Romanian speakers teaching at prestigious universities abroad, on topics specific to a central bank's activity (*Estimation of Structural Macroeconomics Models, Techniques for Short-Term Macroeconomic Forecasting, Introduction to Macro Labour Economic*), in which 48 employees participated;
 - the series of in-house seminars continued with in-house speakers as well as guests from outside the bank, on the following topics: statistics, international economic and financial environment (in the context of the participation of NBR representatives in European structures), *NBR – History, Values, Perspectives*, attended by 528 members of staff. As for the participation in management development programmes, the Leadership Executive Programme was further organised and attended by 42 employees holding management and top executive positions;
 - other specialised seminars (statistics, budget, accounting, procurement, etc.) were organised as well, having 412 attendees.
- b) The professional training courses held abroad, consisting mainly of technical workshops offered by central banks' old-established training providers (ECB, IMF, Joint Vienna Institute, the Bank for International Settlements), as well as those organised by some central banks' professional training centres (Bank of England, Banque de France, Deutsche Bundesbank, Swiss National Bank), which covered areas such as financial stability, open market operations, supervision, payment systems, bank resolution, and were attended by 179 employees.
- c) A special place in the domestic professional training activity was taken by the 5 international seminars organised by the NBR together with the ECB, on topics aimed at developing behavioural and leadership skills, but also specific to the central banks' scope of activity, in which 79 employees from central banks in the ESCB and the National Bank of Romania took part. All the seminars were held in the NBR's Professional Training and Social Activity Centre.

3.2. Information technology

In 2016, several IT projects were completed with a view to rendering more efficient the activity carried out within the central bank and optimising performance in operating IT systems, as follows: (i) the go-live of the new DCT2EUR system, intended for calculating and processing interest to the euro accounts of participants in TARGET2-Romania and to the account opened at the ECB by the NBR, in its capacity as TARGET2-Romania operator; (ii) the upgrading of "Government Securities – Primary Market" software for implementing the provisions of NBR Regulation No. 7/2016 on the primary market for government securities managed by the National Bank of Romania; (iii) the expansion of EBA-ITS IT system to collect, validate and submit to the European Banking Authority the LCR data, in line with the Delegated Act (LCR DA); (iv) the upgrading of RAPDIR online reporting application with a view to collecting new financial indicators and the validation, processing and extraction of final reports based on the data collected; (v) the improvement in the performance of the integrated financial and accounting management system, procurement, HR and payroll, based on the Oracle E-Business Suite (Release 12) by migrating to a new hardware platform and shifting from single-node to multi-node architecture.

The activities in the internalisation programme of ReGIS and SaFIR systems continued throughout 2016, focusing on the National Bank of Romania resuming the technical operation of the two payment systems. The internalisation of ReGIS and SaFIR systems by the NBR requires the development of a technical platform able to meet the standards applicable to electronic payment systems in terms of performance, availability, security and cyber resilience.

In order to meet the requirements for the availability and secure operation which should characterise the technical infrastructure for payment systems, the hardware platform will be installed at two different locations, which will be capable to take over system operation for long periods of time and will regularly be used for running applications. With a view to ensuring technical and functional parameters suitable for taking over the traffic of ReGIS and SaFIR payment systems, the Interbank Communication Network operated by the National Bank of Romania will be developed as well.

Moreover, 2016 saw the initiation of activities related to designing and implementing an information security management system applicable to the payment and settlement systems operated by the National Bank of Romania. Information security will be ensured via specific policies and procedures and by implementing dedicated hardware and software systems, which will offer facilities for registration and access control, identifying vulnerabilities, monitoring and controlling intrusions, traffic filtering, anti-malware protection, reviewing and monitoring security incidents.

During 2016, the functionalities of the procurement planning and execution programme were developed and data entry into the NBR's visitor management application was optimised. In addition, replacement of obsolete hardware equipment and the standardisation of software versions for general use continued.

Organisation Chart of the National Bank of Romania as at 30 May 2017



Note:

Colour patterns show the departments' coordination.

DIRECTORS

Mugur Isărescu

Deputy Governor **Eugen Nicolăescu****STATISTICS DEPARTMENT**

- Monetary and Financial Statistics Division
- Balance of Payments Division
- Direct Statistical Reporting Division
- Statistical Data Processing Division
- SIRBNR Data Management Division
- Credit Risk Statistics Division

IT DEPARTMENT

- IT Systems Division
- Network Administration Division
- IT Support Division

TECHNICAL AND MAINTENANCE DEPARTMENT

- Buildings Maintenance Division
- Equipment and Installations Maintenance Division
- Administrative Maintenance and Utilities Division

PROCUREMENT DEPARTMENT

- General Procurement Procedures Division
- Methodology and Contracting Division
- Planning and Monitoring Division
- Direct Procurement Division
- Banking Procurement Procedures Division

LEGAL DEPARTMENT

- Legal Documentation and Advisory Opinion Division
- Contract Assistance and Disputed Claims Division
- European and International Law Division

TRAINING AND SOCIAL EVENTS FACILITY DEPARTMENT

- Training Support Division
- Social Events Division
- Auxiliary Activities Division
- Cafeteria Division
- Training and Social Events Units

REGIONAL BRANCHES AND AGENCIES

Audit Committee

CHANCELLERY

- The Executives' Offices and Document Management
- Strategic Projects Division
- Governor's Control Office
- Board Secretariat Division
- Information Management and Protection Division
- IT&C Information Management and Security Division
- Territorial Network Coordination Division

MONETARY POLICY DEPARTMENT

- Monetary Policy Analysis and Strategy Division
- Liquidity Management Division

MARKET OPERATIONS DEPARTMENT

- Monetary Policy Operations Division
- State Treasury Operations Division
- Foreign Reserve Management Division
- Back Office Division
- Foreign Reserves Risk Management Division

ECONOMICS DEPARTMENT

- Economic Analysis and Short-Term Forecasting Division
- Publications Division
- Translation and Editing Division

COMMUNICATION AND MULTIMEDIA DEPARTMENT

- Media Relations Division
- Intranet and Internal Communication
- Online Communication Division
- Multimedia Support Division

HUMAN RESOURCES DEPARTMENT

- Organisation and Planning Division
- Human Resources Management Division
- Training and Career Development Division

INTERNAL AUDIT DEPARTMENT

- General Audit Division 1
- General Audit Division 2

BUDGET AND FINANCIAL ANALYSIS DEPARTMENT

- Budget and Financial Analysis Division
- Preventive Financial Control Division
- Consumption Standards and Norms Division
- Risk Monitoring Division

SECURITY DEPARTMENT

- Crisis Management & Business Continuity Division
- Internal Protection Division
- Special Transport Division
- Security Systems Division
- Transport and Maintenance Division

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Chapter 16

Financial statements
of the National Bank of Romania
as at 31 December 2016

1. Overview

Pursuant to Law No. 312/2004 on the Statute of the National Bank of Romania, starting with the financial year 2005, the National Bank of Romania has been applying the International Accounting Standards used by the national central banks, which are acknowledged by the European Central Bank and for which it issued its own norms based on EU regulations¹⁷⁶.

The aforementioned Statute specifies that the primary objective of the central bank is to ensure and maintain price stability.

The National Bank of Romania implements the appropriate monetary policy so as to achieve its primary objective and fulfils the other tasks mentioned in the law, without focusing on business-related objectives such as profit maximisation. Nonetheless, in its activity, the NBR has shown a steady concern for the efficient management of the available resources, also by capping its administrative and staff costs. Thus, in 2016 the NBR carried out its statutory activities while cutting its net administrative and staff costs by 6 percent versus 2015 and by 8 percent against 2014 respectively. Compared with the budgeted figures, the said net expenses of the National Bank of Romania were 21 percent lower in 2016 (while in 2014 and 2015 they were 6 percent and 13 percent lower respectively).

As at 31 December 2016, the National Bank of Romania reported a profit amounting to lei 124,636 thousand, mainly as a result of:

- operating profit worth lei 771,997 thousand, down 14 percent from the previous year's figure (lei 895,164 thousand);
- unrealised losses arising from the revaluation of foreign currency assets and liabilities tantamount to lei 646,034 thousand, 5.8 times higher than those reported at end-2015 (lei 111,705 thousand);
- net losses arising from the revaluation of land and buildings equalling lei 1,327 thousand.

Equity, i.e. the NBR's net assets as at 31 December 2016, was further markedly positive (lei 17,802,595 thousand), up 10 percent from end-2015, reflecting the sustainable financial position of the central bank.

¹⁷⁶ Guideline ECB/2016/34.

2. Recognition of monetary policy operations

Throughout 2016, the National Bank of Romania had a debtor position vis-à-vis the banking system, the excess liquidity being mopped up via the deposit facility. The persistence of relatively high surplus reserves in the banking system implied the absence in 2016 of monetary policy operations designed to provide liquidity to credit institutions. Mirroring the costs of draining excess liquidity, in 2016 monetary policy operations led to a loss worth lei 53,415 thousand, down 16 percent from the level recorded in 2015 (lei 63,358 thousand).

The summary balance sheet as at 31 December 2016 (Table 16.1) shows the following:

- foreign assets accounted for 98.7 percent of total assets;
- deposits the NBR took from credit institutions as minimum required reserves held 18.7 percent of total liabilities (11.8 percent in lei, 6.88 percent in euro and 0.02 percent in US dollars);
- currency in circulation accounted for 33.2 percent of total liabilities;
- deposits of the State Treasury with the NBR made up 25.0 percent of total liabilities (4.7 percent in lei, 4 percent in US dollars and 16.3 percent in euro);
- 8.5 percent of total liabilities represented foreign liabilities.

ASSETS	Average annual return – % –	LIABILITIES	Average annual interest rate – % –
Foreign assets 98.7%	0.86	Minimum required reserves 18.7% (11.8% in lei and 6.9% in foreign currency: 0.02% in US dollars and 6.88% in euro)	lei: 0.12 USD: 0.07 EUR: 0.07
		Currency in circulation 33.2%	-
		Foreign liabilities 8.5%	0.08
		Deposits of the State Treasury 25.0% (4.7% in lei and 20.3% in foreign currency: 4.0% in US dollars and 16.3% in euro)	lei: 0.12 USD: 0.40 EUR: -0.33
		Capital, reserves a.s.o. 9.4%	-
Other assets 1.3%	-	Other liabilities 5.2%	-

Table 16.1
NBR balance sheet structure
as at 31 December 2016

In 2016, the NBR recorded a positive operating result while creating the necessary conditions to ensure price stability over the medium term, consolidating international reserves and maintaining financial stability. Table 16.1 shows the composition of the central bank's balance sheet as at 31 December 2016.

In 2016, foreign asset management resulted in an average annual return of 0.86 percent. Looking at liabilities (sources of foreign assets), the corresponding average annual interest rates (paid by the NBR) were lower than the annual return on assets (received by the NBR) or negative interest rates were recorded (generating a receivable interest), so that 2016 ended in an operating profit.

Consequently, the positive financial result reported by the NBR was directly and substantially influenced by the favourable difference between the net income from the management of foreign currency assets and liabilities and the net costs related to the use of monetary policy tools in the domestic market. In 2016, the net income from the management of foreign currency assets and liabilities totalled lei 1,303,417 thousand, while the net interest expenses associated with monetary policy operations amounted to lei 53,415 thousand. Interest expenses associated with monetary policy operations implicitly represent the cost of pursuing the primary objective of the central bank set by law, i.e. to ensure and maintain price stability.

3. Recognition of foreign currency asset/liability management operations

At end-2016, the lei value of foreign assets increased by lei 20,876,419 thousand or 12.5 percent in year-on-year comparison (Chart 16.1).

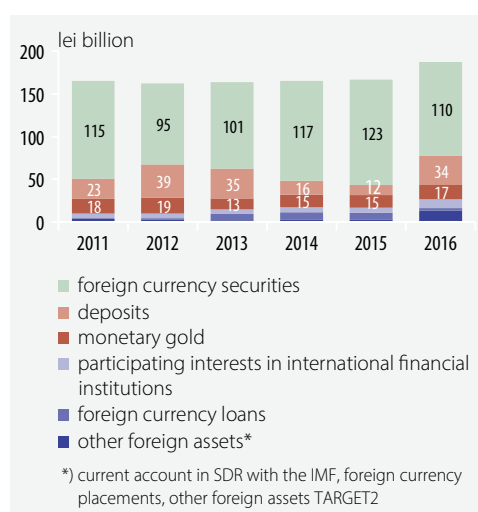


Chart 16.1
Foreign assets of the NBR

The management of foreign currency assets and liabilities included the full repayment (SDR 8,526,375 thousand) during 2012-2016 of the tranches drawn by the central bank in 2009, 2010 and 2011 from the loan granted by the IMF under the Stand-By Arrangement concluded in 2009. The loan was necessary to maintain an adequate level of international reserves so as to ensure Romania's external creditworthiness, a *sine qua non* for the country's financial and foreign exchange stability.

In 2016, the management of foreign currency assets and liabilities generated income equalling lei 1,651,344 thousand and expenses totalling lei 347,927 thousand, which entailed a profit amounting to lei 1,303,417 thousand (Table 16.2).

	lei thousand		
	Income	Expenses	Profit/Loss
Foreign currency securities	128,544	179,972	-51,428
Other foreign currency holdings and operations	1,522,800	167,632	1,355,168
Gold	-	323	-323
Total	1,651,344	347,927	1,303,417

Table 16.2
Result of transactions
conducted in 2016

4. Effects of changes in the exchange rates and in the market prices of international reserve assets

Given the objective need to preserve relatively high foreign exchange reserves and a diversified currency composition of reserves with a view to securing external creditworthiness, the exchange rate movements in international markets generated unrealised losses arising from the revaluation of some foreign currency positions.

At the end of the financial year, the effects of changes in the exchange rate of the leu versus the euro and of the currencies making up foreign currency reserves versus the euro are measured based on the difference between the revaluation rate¹⁷⁷ and the average cost of the foreign currency positions held by the central bank. In this context, mention should be made that the size of such effects is influenced by one-off events, which may impact movements in exchange rates on the last day of the year. In that case, the respective exchange rate levels are not likely to illustrate longer-term trends.

Moreover, the effects of the changes in the market prices of international reserve assets are measured based on the difference between the market price of assets (gold and foreign currency securities) and their average cost or net average cost. Thus, as at 31 December 2016 significant unrealised gains arising from the revaluation of foreign currency holdings, foreign currency securities and monetary gold tantamount to lei 15,502,902 thousand were registered in the "Special revaluation account". Unrealised losses (worth lei 646,034 thousand) arising from the revaluation of the pound sterling and the Japanese yen positions, as well as of some foreign currency securities were booked in the profit and loss account as expenses as at 31 December 2016 (Table 16.3).

Table 16.3
Revaluation differences
as at 31 December 2016

	lei thousand	
	Unrealised gains (recognised in the special revaluation account under liabilities)	Unrealised losses (recognised in the profit and loss account)
Foreign currency securities	139,579	110,231
Other foreign currency holdings	2,833,581	535,803
Gold	12,529,742	-
Total	15,502,902	646,034

5. Conclusions

The financial position of the National Bank of Romania as at 31 December 2016 was further sustainable, on the back of the markedly positive equity (lei 17,802,595 thousand; Table 16.4), up 10 percent from the end-2015 level

¹⁷⁷ The revaluation rate is the exchange rate on the last business day of the month. It is used for the revaluation of foreign currency positions.

(lei 16,185,574 thousand). The rise owed chiefly to significant unrealised gains arising from the revaluation of monetary gold holdings as at 31 December 2016 (recorded in the "Special revaluation account").

Table 16.4
Equity

	lei thousand	
	31 December 2016	31 December 2015
Capital	30,000	30,000
Reserves	2,259,905	2,252,385
Special revaluation account	15,502,902	13,840,608
Result for the year	124,636	783,449
Profit distribution	-114,848	-720,868
Total	17,802,595	16,185,574

The operating financial result for 2016, which actually reflects the outcome of the activity performed by the National Bank of Romania, was profit tantamount to lei 771,997 thousand, mainly following the positive result of the management of foreign currency assets and liabilities. The 16 percent lower loss related to monetary policy operations than in 2015 (Table 16.5) and the 6 percent smaller loss in other operations had a favourable influence as well.

Table 16.5
Operating result for financial
years 2015 and 2016

Activity	Operating result (lei thousand)		Annual change
	2016	2015	%
Monetary policy	-53,415	-63,358	-16
Management of foreign currency assets and liabilities	1,303,417	1,456,611	-11
Currency issue and payment settlement	-84,394	-78,618	7
Other operations	-393,611	-419,471	-6
Total operating result	771,997	895,164	-14

Profit distribution for the financial year 2016. Pursuant to Article 43 of Law No. 312/2004 on the Statute of the National Bank of Romania, the largest part of the said profit was the share of 80 percent of the bank's net income due to the state budget, amounting to lei 100,166 thousand. In addition, an amount of lei 14,682 thousand was allocated to increase the statutory reserves (60 percent of the profit remaining after deducting the share of 80 percent of the bank's net income owed to the state budget). The remaining profit is to be distributed in 2017, in line with the legal provisions.

To sum up, acting for the public good in order to ensure and maintain price stability over the medium term and to consolidate the foreign exchange position of the government, in 2016 the National Bank of Romania reported a profit, due to the positive contribution of the profit arising from the management of foreign currency assets and liabilities, as well as of the lower loss related to monetary policy operations and the smaller loss in other operations (represented mainly by the operating activity of the bank).

National Bank of Romania
Financial Statements
31 December 2016

(audited by Ernst & Young Assurance Services)



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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of the National Bank of Romania

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the National Bank of Romania ("the Bank"), which comprise the balance sheet as at December 31, 2016, the income statement for the year then ended and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at December 31, 2016 and of its separate financial performance for the year then ended in accordance with Norm 1/2007 for organizing and conducting the accounting of the National Bank of Romania ("Norm 1/2007"), with all subsequent modifications and clarifications.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to the audit of the financial statements in Romania, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The other information comprises the Annual Report, but does not include the financial statements and our auditors' report thereon. Management is responsible for the other information. The Bank's 2016 Annual Report is expected to be made available to us after the date of this auditor's report.

Our audit opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

The English version of the audit report represents a translation of the original audit report issued in Romanian language.



In connection with our audit of the financial statements, our responsibility is to read the other information when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the Norm 1/2007, with all subsequent modifications and clarifications, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

The English version of the audit report represents a translation of the original audit report issued in Romanian language.



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit

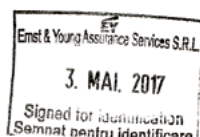
On behalf of

Ernst & Young Assurance Services SRL

Registered with the Chamber of Financial Auditors in Romania

No. 77/15 August 2001

Gelu Gherghescu



Registered with the Chamber of Financial Auditors in Romania

No. 1449/09 September 2002

Bucharest, Romania

3 May 2017

The English version of the audit report represents a translation of the original audit report issued in Romanian language.

BALANCE SHEET AS AT 31 DECEMBER 2016

		lei thousand	
	Note	31 December 2016	31 December 2015
Cash and other cash equivalents		46,662	45,120
Precious metals and stones,		204,416	179,401
<i>out of which:</i>			
Non-monetary gold		166,288	147,489
Other precious metals and stones		38,128	31,912
Foreign assets,		187,434,476	166,558,057
<i>out of which:</i>			
Current account in SDR with the IMF	4	5,717,560	49,312
Monetary gold	5	16,613,515	14,669,552
Demand deposits placed	6	25,509,958	2,432,894
Term deposits placed	7	8,816,507	9,648,409
Placements in foreign currencies	8	2,391,977	2,287,246
Securities in foreign currencies	9	109,775,122	123,092,434
Loans in foreign currencies	10	2,666,325	7,720,944
Quotas in international financial institutions:	11	10,629,419	6,070,705
<i>out of which the IMF</i>		10,479,061	5,921,166
Other foreign assets TARGET2		5,314,093	586,561
Loans to domestic credit institutions,	12	0	0
<i>out of which:</i>			
Loans in litigation		25,009	25,009
Provisions for credit risk – principal		(25,009)	(25,009)
Other assets		1,687,720	1,515,336
Loans to employees		38	51
Tangible and intangible fixed assets	13	1,327,822	1,383,748
Inventories		4,431	4,041
Participating interests	14	2,323	2,321
Settlement account with the State Budget	15	206,006	66,947
Accruals and prepaid expenses		144,908	36,453
Revaluation differences for off-balance-sheet items	16	-	19,016
Other assets		74,490	72,029
Provisions for other assets	17	(72,298)	(69,270)
Accrued interest receivable		510,643	635,062
Accrued interest receivable	18	516,711	641,130
Provisions for credit risk – interest	19	(6,068)	(6,068)
Total assets		189,883,917	168,932,976

Notes from page 255 to 286 are an integral part of these financial statements.

BALANCE SHEET AS AT 31 DECEMBER 2016

		lei thousand	
	Note	31 December 2016	31 December 2015
Currency in circulation	20	63,019,783	53,593,307
Foreign liabilities,		16,199,249	12,983,785
<i>out of which:</i>			
Due to international financial institutions	21	10,479,728	6,474,296
<i>out of which: borrowings from the IMF</i>		-	552,487
Demand deposits taken	22	21,199	845,324
Borrowings from banks and other financial institutions	23	1,380	4,125
Counterpart of special drawing rights allocated by the IMF	24	5,696,942	5,660,040
Due to domestic credit institutions,		45,350,812	48,454,589
<i>out of which:</i>			
Current accounts of the domestic banks		22,453,679	20,402,647
Amounts withheld at court disposition		5,467	4,834
Deposits of the credit institutions		4,489,480	10,098,915
Foreign currency minimum reserves		13,087,444	17,360,263
Accounts of bankrupt credit institutions		649	1,369
Other liabilities TARGET2		5,314,093	586,561
Current account of the State Treasury	25	47,449,207	37,675,320
Other liabilities		43,626	31,279
Sundry creditors		29,313	21,728
Salaries and other personnel-related liabilities		75	82
Settlement account with the State Budget		7,912	8,114
Accruals and income collected in advance		1,023	207
Revaluation differences for off-balance-sheet items		270	-
Other liabilities		5,033	1,148
Accrued interest payable	26	18,645	9,122
Capital and reserves,		17,802,595	16,185,574
<i>out of which:</i>			
Capital		30,000	30,000
Reserves	28	2,259,905	2,252,385
Special revaluation account	29	15,502,902	13,840,608
Profit for the year		124,636	783,449
Profit distribution for the year	42	(114,848)	(720,868)
Total liabilities and equity		189,883,917	168,932,976

The financial statements were approved by the Board of Directors on 3 May 2017 and were signed on its behalf by:

Governor

Mr. Mugur Isărescu

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2016

		lei thousand	
	Note	31 December 2016	31 December 2015
Interest income	30	121,425	51,414
Interest expense	31	(342,013)	(197,851)
Net interest expense		(220,588)	(146,437)
Fees and commissions income	32	124,408	111,138
Fees and commissions expense	33	(27,057)	(43,443)
Net income from fees and commissions		97,351	67,695
Net realized gains arising from foreign currency operations	34	1,343,154	1,481,780
Net realized gains arising from securities operations	35	125,364	72,320
Net realized losses arising from precious metals operations	36	(323)	(362)
Unrealized losses from revaluation differences	37	(646,034)	(111,705)
Net result of financial operations		822,161	1,442,033
Currency issue expenses	38	(180,149)	(161,044)
Expenses from provisions		(3,028)	(7,744)
Other expenses from specific operations		(1,529)	(2,186)
Other income from specific operations		2,328	2,700
Net result of specific operations		(182,378)	(168,274)
Other income		42,812	12,179
Staff costs		(279,688)	(273,833)
Administrative expenses		(43,172)	(41,671)
Depreciation of tangible and intangible fixed assets		(56,216)	(53,927)
Net unrealized losses from the revaluation of buildings, land and other assets	39	(1,327)	(10)
Other operating expenses		(54,319)	(54,306)
Net profit for the year		124,636	783,449

The financial statements were approved by the Board of Directors on 3 May 2017 and were signed on its behalf by:

Governor

Mr. Mugur Isărescu

Notes to the financial statements for the year ended 31 December 2016

1. General information

The National Bank of Romania (the “Bank” or “NBR”) was set up in 1880 as the central bank of Romania. The current registered headquarters are located at 25 Lipscani Street, Bucharest, Romania. In accordance with the legislation, the Bank is managed by a Board of Directors. The executive management of the Bank lies with the Governor, the First Deputy Governor and two Deputy Governors (currently, one Deputy Governor position is open). The Parliament appoints the members of the Board of Directors for a period of five years. The Bank is fully owned by the Romanian state. The actual number of employees as at 31 December 2016 is 1,902 (31 December 2015: 1,905 employees).

In 2016, the Bank’s operations were governed by the “Law on the Statute of the National Bank of Romania” (Law no. 312/2004), effective since 31 July 2004, except for a number of provisions related to statutory financial reporting that became effective commencing on 1 January 2005. The purpose of Law no. 312/2004 is to ensure the compliance of the NBR Statute with the European Union legislation and, particularly, with the provisions of the European Community Treaty regarding the independence of the central bank.

In accordance with the legislation in force, the primary objective of the Bank is to ensure and maintain price stability. Furthermore, the Bank has the exclusive right to issue banknotes and coins and the responsibility to regulate and supervise the Romanian banking system.

2. Significant accounting policies

a) Statement of compliance

The financial statements of the NBR are prepared in accordance with Norm no. 1/2007 for organizing and conducting the accounting of the National Bank of Romania, as subsequently amended and supplemented (no. 1/2008, no. 3/2008, no. 1/2010, no. 2/2010, no. 4/2011 and no. 1/2014), and include the balance sheet, the income statement and the explanatory notes. NBR Norm no. 1/2007, as subsequently amended and supplemented, lays down the basic accounting principles and rules, the structure and the content of the annual financial statements, having as general purpose the compliance with the provisions of the accounting standards applicable to central banks and recognized by the European Central Bank (i.e.: Guideline ECB/2016/34), except the formats which are mandatory only in case of reporting data to the ECB for Eurosystem financial reporting purposes.

b) Basis of preparation

The financial statements are prepared on a going concern basis and are presented in Romanian lei (RON), rounded to the nearest thousand. Income and expenses are recognized in the accounting period in which they are earned or incurred, according to the accruals principle.

c) The transfer of the Bank's net revenues to the State Budget

The Bank is exempt from paying income tax, but in accordance with Law no. 312/2004, it distributes a share of 80% of the net revenues to the State Budget on a monthly basis. This quota applies to the net revenues after deducting the expenses related to the financial year (except for other than credit risk provision expenses) and the loss related to previous financial years that remained uncovered by other available sources. In 2016 and 2015, on the basis of net revenues, the Bank booked the State's corresponding 80% share. The final adjustments related to the financial year are performed by the deadline for submission of the annual balance sheet, according to the law, based on a special rectifying statement.

d) Significant accounting principles

Substance over form: transactions are accounted for and presented in accordance with their substance and economic reality and not merely with their legal form.

Prudence: the valuation of assets and liabilities, as well as the revenues and expenses recognition are carried out prudently. However, prudence does not allow for a deliberate understatement of assets and income or overstatement of liabilities and expenses.

Going concern principle: the NBR, as the central bank of Romania, will operate in the foreseeable future.

Comparability: the criteria for the evaluation of the balance sheet items and for results recognition must be consistently applied in order to ensure the data comparability in the financial statements.

Events after the balance sheet date: assets and liabilities are adjusted for events that occur between the annual balance sheet date and the date on which the financial statements are approved by the Board of Directors, if these events affect the condition of assets or liabilities at the balance sheet date. No adjustment is made, but disclosure is required for those events occurring after the balance sheet date that do not affect the condition of assets and liabilities at the balance sheet date, but which are of such importance that non-disclosure would affect the ability of the stakeholders to make proper evaluations and to take economic decisions.

Materiality: deviations from the accounting rules, including those affecting the income statement, are allowed only if they can reasonably be judged to be immaterial for the overall context and for the presentation of the Bank's financial statements.

The accruals principle: income and expenses are recognized in the accounting period in which they are earned or incurred and not in the period in which they are collected or paid.

e) Estimates

In preparing the financial statements in accordance with the provisions of Norm no. 1/2007, as subsequently amended and supplemented, the management is required to make estimates and assumptions that affect the reported amounts for assets, liabilities, revenues and expenses for the reporting period. Actual results could differ from these estimates. The estimates are periodically reviewed and, if necessary, adjustments are recorded in the income statement of the period when they occur. Although these individual estimates carry a degree of uncertainty, their cumulative effect on the financial statements is deemed immaterial.

f) Recognition of assets and liabilities

Financial and other assets/liabilities are recognized in the balance sheet only when:

- it is probable that future economic benefits associated with the asset/liability will flow to or from the Bank;
- all the risks and benefits associated with the asset/liability have been effectively transferred to/ from the Bank; and
- the value of the asset/liability can be reliably measured.

Financial assets and liabilities are initially recognized at acquisition value, as presented hereinafter.

g) Foreign currency position

The currency position represents the net balance in a certain currency, determined as the difference between total receivables (balance sheet assets and off-balance-sheet accounts similar to assets) and total payables (balance sheet liabilities and off-balance-sheet accounts similar to liabilities) denominated in the respective currency, with some exceptions. Monetary gold is considered a foreign currency, representing the gold position.

Starting 31 December 2010, the Bank has applied Norm no. 2/2010 amending and supplementing Norm no. 1/2007 for organizing and conducting the accounting of the National Bank of Romania, as subsequently amended and supplemented, effective starting with the annual financial statements for the year 2010, which includes the following provisions:

- the SDR currency is considered a distinct currency; transactions that affect the net SDR position are either transactions denominated in SDR or transactions that follow the structure of the SDR basket;

- for the SDR hedging operation, the Bank designates the holdings denominated in each of the currencies composing the SDR basket, evaluated at the average cost existing prior to the annual revaluation (as at the end of the year);
- as at the end of the year, the net SDR position includes both the SDR holding and the designated holdings denominated in the individual currencies composing the SDR basket. The aforementioned holdings will be treated jointly as a single net foreign currency position;
- as at the end of the year, the Bank may perform the SDR hedging operation which consists in recording the SDR position revaluation result after cumulating it with the revaluation result of the individual holdings denominated in the currencies composing the SDR basket, designated according to the SDR basket structure.

The items that are not included in the foreign currency position are: cash in foreign currencies, foreign currencies in transit, sundry creditors, sundry debtors, settlement accounts and prepayments.

h) Average cost method

The average cost method applies to the following:

- the foreign currency position, including SDR;
- the monetary gold position;
- the foreign currency securities portfolio – for each ISIN/CUSIP (security series).

The average cost of the foreign currency holdings is calculated daily as an indirect foreign exchange quotation (RON/1 foreign currency unit). For the long foreign currency position, net purchases of currencies made during the day, considered at the average cost of the purchases made during the day, are added to the previous day's closing balance, in order to determine the new average cost of the position. In the case of net sales, the average cost of the foreign currency position remains unchanged. The same principles apply to the gold holdings.

The average cost of the foreign currency securities holdings is determined for each ISIN/CUSIP (security series) by dividing the transaction value of the entire holding to the nominal value of the holding. For each security series, all purchases made during the day are added to the previous day's holding to determine a new weighted average cost.

The net average cost of the foreign currency securities is determined for each security series by dividing the holding at average cost – adjusted with the cumulated premium or discount amortization – to the corresponding nominal value of the holding. Premiums or discounts resulting from the securities purchase are amortized over the remaining life of the securities using the internal rate of return method.

The gains or losses resulting from transactions in foreign currencies or monetary gold/silver and from transactions with foreign currency securities are determined based on the average cost of the respective holding (Note 2i and Note 2j).

In accordance with the revaluation procedure (Note 2p), at the end of the financial year, the revaluation rate and the revaluation price of the securities become the new average cost of the foreign currency holding and the new net average cost of the foreign currency securities, provided that unrealized losses for the respective foreign currency position or holding of ISIN/CUSIP were recorded as expenses as at 31 December.

i) Foreign currency transactions

The operations denominated in foreign currencies are converted into RON at the official exchange rate valid on the trade date. The monetary assets and liabilities denominated in foreign currencies at the balance sheet date are converted into RON at the exchange rate valid on that date.

Forward and spot foreign currencies purchases and sales performed as part of foreign currency/RON swaps are recognized in off-balance-sheet accounts from the trade date to the settlement date at the spot rate of the transactions, and recognized in balance-sheet accounts on the settlement date. The difference between spot and forward rates is treated as interest payable or receivable. The foreign currency position is affected by the accrued interest payable or receivable denominated in foreign currency.

In accordance with the average cost method for the long foreign currency position, any sale of foreign currency (outflow from the foreign currency position) generates a realized gain/loss calculated as follows:

- if the daily acquisitions exceed the daily sales, then the gain/loss arising from the daily sales is computed as the total sales multiplied by the difference between the average price of the daily sales and the average cost of the daily acquisitions;
- if the daily sales exceed the daily acquisitions, then the gain/loss arising from the daily sales is computed as the sum of the following:
 - the gain/loss arising from the sales covered by the daily acquisitions, computed as the total daily acquisitions multiplied by the difference between the average price of the daily sales and the average cost of the daily acquisitions;
 - the gain/loss arising from the sales covered by the previous day's foreign currency holdings, computed as the daily net sales multiplied by the difference between the average price of the daily sales and the average cost of the respective foreign currency position on the preceding day.

In the case of a short position for a foreign currency or gold, the reverse treatment to the above-mentioned approach is applied. Thus, the average cost of the liability position is affected by net outflows, while net inflows reduce the position at the existing average cost and generate realized gains or losses.

j) Foreign currency securities

Premiums/discounts arising from the securities acquisitions are amortized over the remaining life of the securities using the internal rate of return method.

The amortization of the discount/premium is booked daily based on the accruals principle and is disclosed as part of the interest income/expense. The accrued interest receivable on securities in foreign currencies is calculated and recorded on a daily basis, based on the accruals principle, being converted into RON at the Bank's exchange rate of the day.

The gain/loss arising from the sale of securities is determined as the nominal value of the securities sold multiplied by the difference between the sale price and the average cost of the respective security. The components of the aforementioned gain/loss are the following:

- the market price effect, representing the nominal value of the securities sold multiplied by the difference between the sale price and the net average cost of the respective security – booked in the income statement on the settlement date;
- the interest rate effect, representing the nominal value of the securities sold multiplied by the difference between the net average cost and the average cost of the respective security – booked in the income statement through the daily amortization of the related premiums/discounts on foreign currency securities.

The gain/loss from the mark-to-market revaluation is determined as the difference between the market price and the net average cost.

The Bank conducts securities lending under a securities lending program carried out by a European bank. The Bank records the income from commissions and books in the off-balance-sheet accounts the securities lent and the securities received as collateral.

k) Loans to domestic credit institutions and other entities

Loans are disclosed in the balance sheet at the value of the outstanding principal, adjusted with the provision for credit risk in order to reflect the recoverable amount. Likewise, this balance sheet item includes the loans granted to credit institutions based on securities transfers accompanied by a repurchase agreement.

l) Participating interests

In accordance with Norm no. 1/2007, as subsequently amended and supplemented, the participating interests, including those reflecting a significant influence, are booked at cost; these financial statements are not consolidated.

m) Tangible and intangible fixed assets

The tangible and intangible fixed assets are presented in the financial statements at cost or revalued cost, less any accumulated depreciation or amortization.

At least every three years, the fixed assets in the categories *Buildings* and *Land* are revaluated. The resulting favorable differences are booked as Reserves if no previous decrease was recognized as an expense; favorable differences are booked as income to compensate the previous expense representing a decrease in the asset value.

The resulting unfavorable differences are compensated with the previous favorable revaluation differences for each asset; the remaining unfavorable differences are booked as expenses.

All maintenance and current repair operations (which do not upgrade the initial characteristics of fixed assets), the periodical and occasional technical inspections, the service operations are recognized in the income statement, irrespective of their value; their value is not included in the value of the fixed assets.

Other repair costs are booked in the income statement if their individual value is lower than the threshold laid down in NBR Norm No. 1/2014; if the individual value of these operations is equal to or higher than the aforementioned threshold and the operations improve the technical parameters of the fixed assets, or if the operations are mandatory for securing a normal functioning of the assets, the costs increase the value of the fixed assets.

Any expenses related to the replacement at various times of components/parts are booked in the income statement if their individual value is lower than the threshold laid down in NBR Norm No. 1/2014; if their individual value is higher than the aforementioned threshold, the costs increase the value of the fixed assets.

Expenses related to construction of property are capitalized and depreciated once the assets are put in use.

The depreciation is calculated on a straight-line basis over the estimated useful life of each class of tangible assets. The depreciation is accounted for as a write-down of the value of the property and equipment items. Land is not depreciated. The legal useful life for each category is as follows:

Buildings	20-60 years
Equipment	5-20 years
Motor vehicles	5 years
Computer equipment	3 years

n) Adjustments for the impairment of assets

As part of its monetary and exchange rate policies, the Bank is entitled to grant loans to domestic credit institutions. The Bank makes provisions for the impairment of such loans, in accordance with its own norms, drawn up under the approval of the Board of Directors and the advisory approval of the Ministry of Public Finance.

Adjustments for the impairment of loans are charged to the income statement as specific expenses and are offset against the carrying value of the loans and accrued interest receivable.

Loans are written off and charged to the income statement as they become unrecoverable and all the legal procedures have been carried out for their recovery.

The adjustments for the impairment of assets, other than those for credit risk, are deducted from the profit remaining after transferring to the State Budget the share of 80% of the Bank's net revenues. Financial assets are reviewed to determine whether there is any indication of impairment.

If any such indication occurs, the asset's recoverable amount is estimated. An impairment loss is recognized whenever the carrying amount of an asset exceeds its recoverable amount.

The adjustments for the impairment of tangible and intangible fixed assets are fully/partially reversed if there has been a change in the estimates previously used to determine the recoverable amount of the respective assets. A provision for impairment is fully/partially reversed only to the extent that the asset's carrying amount does not exceed the net carrying amount that would have been determined if no impairment provision had been recognized in previous years.

o) Currency in circulation

The Bank draws up the program for banknote and coin issuance and provides the related printing, distribution and management services for the currency reserve, in order to meet the cash requirements in accordance with the real needs for currency in circulation.

Currency in circulation is booked at the nominal value of the banknotes and coins which are actually put into circulation.

The costs of printing banknotes and minting coins are booked as expenses on the date of reception in the reserve fund.

p) Revaluation

The revaluation of long and short currency positions is performed on a monthly basis and booked in the special revaluation account, as the difference between the revaluation exchange rate (the official rate calculated and published on the last working day of the month) and the average cost of the foreign currency position. The assets (quota at the IMF) and liabilities (allocations and deposit from the IMF) denominated in SDR are also revalued on 30 April and 31 December, based on the exchange rates communicated by the International Monetary Fund.

The mark-to-market is performed on a monthly basis both for the holdings of monetary gold/silver and for the foreign currency securities, with the exceptions listed below; the revaluation differences are recorded in balance-sheet adjustment accounts. The revaluation of gold is performed based on the price in RON per defined weight unit of gold, derived from the RON/USD exchange rate and the fixing price on the London Bullion Market. The revaluation of securities denominated in foreign currencies is performed by comparing the mid-market price at the end of the last working day of the month with the net average cost of the respective foreign currency security holding. Short-term securities in the form of commercial paper are booked at cost plus accumulated discount (these instruments are not traded on a secondary market).

Offsetting unrealized losses in securities, currencies or gold against unrealized gains in other securities, currencies or gold is not allowed.

At the end of the financial year, the unrealized losses resulting from the revaluation of assets and liabilities are charged to the income statement without the possibility of subsequent cancellation against new unrealized gains obtained in future financial years. Subsequently, if unrealized losses were recorded as expenses for a certain foreign currency position or holding of securities, the average cost of the respective foreign currency position and the net average cost of the foreign currency securities are written down to the revaluation exchange rate and the revaluation price respectively. The unrealized gains obtained at the end of the year are booked in the special revaluation account.

At the end of the financial year, the SDR revaluation differences are offset against revaluation differences for the foreign currency holdings designated for hedging against the SDR exchange rate risk (Note 2g) and the resulting net unrealized losses are booked as expenses.

q) Pension obligations and employee benefits

The Bank makes payments to the Romanian state funds for its Romanian employees for pension, healthcare and unemployment benefits. During 2016, as well as during the previous years, all the employees of the Bank were included in the state pension system. Also, starting with the year 2007, according to the legal framework, all eligible employees of the Bank have been included in the private pension system.

In compliance with the collective labor agreement currently in force, on the retirement of its employees, the Bank pays benefits based on the salary as at the date of retirement. The collective labor agreement is subject to the annual approval of the Board of Directors. The Bank recognizes the retirement benefits on the date on which the individual employment contracts of those employees terminate.

r) Income and expense recognition

Income and expenses are recognized in accordance with the accruals principle. The losses or gains arising from the sale of foreign currencies, gold or securities holdings are accounted for in the income statement. These realized gains/losses are determined as the difference between the sale price and the average cost of the respective asset.

The unrealized revaluation gains are not recognized as income, but booked directly in the special revaluation account.

At the end of the year, the unrealized losses are charged to the income statement if they exceed the revaluation gains previously recorded in the corresponding revaluation account. There is no netting of unrealized losses in securities, currencies or gold against unrealized gains in other securities, currencies or gold, except for the SDR hedging operation (Note 2g and Note 2p).

The commitment fees charged under the precautionary Stand-By Arrangement signed for the period September 2013 – September 2015 between Romania and the International Monetary Fund were accrued monthly and booked as expenses.

s) Capital and statutory reserves

The *capital* is fully owned by the Romanian state and is not divided into shares. As at 31 December 2016 and 31 December 2015, the Bank's capital amounted to RON 30,000 thousand.

The *statutory reserves* were set up on 1 January 2005 in accordance with Law No. 312/2004, incorporating the remaining balance of the reserve fund.

As at 31 December 2016 and 31 December 2015, the statutory reserves were increased by distributing 60% of the annual profit left after paying to the state its share of 80% of the Bank's 2016 and 2015 net revenues.

t) Profit distribution

The 2016 remaining profit is distributed in accordance with Law no. 312/2004 on the Statute of the National Bank of Romania (Note 42).

3. Risk management policies

The main risks associated with the activities of the Bank are financial and operational risks, arising from the responsibility of the Bank to ensure and maintain price stability. The main types of financial risks to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk and interest rate risk.

a) Credit risk

The Bank is exposed to credit risk as a result of its trading, lending and investment activities.

The credit risk associated with trading and investment activities is managed through the Bank's market risk management procedures. The risk is mitigated by selecting counterparties with the highest credit ratings, by monitoring their activities and ratings, as well as by using the exposure limits method.

The eligible issuers approved by the Board of Directors as part of the foreign reserves management strategy for 2016-2017 are: (i) the US government; (ii) government agencies or agencies sponsored by the US government; (iii) governments of the European Union Member States; (iv) government agencies or agencies sponsored by the European Union Member States governments; (v) the government of Japan; (vi) other governments rated at least A-; (vii) supranational institutions; (viii) private entities issuing covered bonds.

b) Liquidity risk

The Bank is the lender of last resort to credit institutions in Romania. The main objective of its daily operations is to ensure adequate liquidity on the domestic market.

The Bank also manages the foreign currency reserves, through planning and diversification, in order to ensure that foreign exchange obligations are timely met.

c) Interest rate risk

The Bank is exposed to interest rate risk mainly due to adverse changes in the market interest rates to the extent that the interest-earning assets and interest-bearing liabilities become due, the market value of assets/liabilities is affected by the interest rate fluctuations or to the extent that the interest rate changes periodically.

For financial assets and liabilities denominated in RON, the Bank endeavors to match the current interest rates available in the market. Obtaining a positive margin is not always possible given that the levels of these assets and liabilities are dictated by the objectives of the monetary policy. However, the Bank constantly monitors the costs of implementing this policy against the estimated benefits.

As part of the management of Romania's international reserves, the interest rate risk is managed both by setting target average durations for portfolios and deviation limits of these exposures and by diversifying maturities and issuers. The NBR also uses the VaR indicator (value at risk). For identifying the optimum strategic risk parameters, the following items are taken into consideration: the role of the international reserves, the NBR's objectives and risk tolerance, the NBR's assets and liabilities profile, interest rate perspectives and other relevant considerations. As part of the strategy for Romania's international reserves, approved by the Board of Directors of the Bank for 2016-2017, an average duration up to one year and three months (1.25 years) was established for the entire foreign currency reserve. The Board approved two additional duration limits as follows: aggregated for MMKT (Money Market) and liquidity tranches – one year; investment tranche – two years and four months (2.33 years).

d) Currency risk

The Bank is exposed to currency risk through its foreign currency transactions.

As at 31 December 2015 and 31 December 2016, the main net assets held by the Bank were denominated in EUR and USD. As at 31 December 2015, the main net liabilities held by the Bank were denominated in SDR; as at 31 December 2016, there were no net liabilities denominated in foreign currencies. Due to the volatility of the exchange rate and of the financial markets, there is a consequent risk of decrease/increase in the RON value of the monetary assets/liabilities denominated in foreign currencies. Open foreign exchange positions represent a source of currency risk.

Within the framework of its objectives for managing foreign currency reserves, in order to avoid losses arising from adverse changes in exchange rates, the Bank is currently pursuing a policy of diversifying its portfolio, so as to ensure a balanced foreign currency composition. Also, on 31 December 2015, the Bank performed the hedging operation for protection against the SDR currency risk (Note 2g).

The assets and liabilities denominated in EUR, USD and other foreign currencies as at the balance sheet date are presented in Note 40.

The revaluation exchange rates of the main foreign currencies at the end of the year were:

Currency	31 December 2016	31 December 2015	% increase
Euro: LEI/1 EUR	4.5411	4.5245	0.37
US dollar: LEI/1 USD	4.3033	4.1477	3.75
Special Drawing Rights: LEI/1 SDR	5.7868	5.7504	0.63

4. Current account in SDR with the IMF

Each IMF member state has an SDR current account with the International Monetary Fund (IMF) used for loan agreements and other related operations between member states and the IMF. This account bears the same interest rate as the IMF's SDR allocations. As at 31 December 2016, the SDR current account of the Bank held with the IMF amounted to RON 5,717,560 thousand representing the equivalent of SDR 988,035 thousand (31 December 2015: RON 49,312 thousand representing the equivalent of SDR 8,575 thousand). In 2016, in line with the risk diversification strategy for the management of international reserves and the relationship between assets and liabilities in foreign currency, the international reserves were diversified by increasing the current account in SDR with the IMF up to the level of SDR allocations.

5. Monetary gold

	lei thousand	
	31 December 2016	31 December 2015
Gold bullions in standard form	4,477,369	3,953,418
Coins	2,309,691	2,039,591
Deposits abroad	9,826,455	8,676,543
Total	16,613,515	14,669,552

As at 31 December 2016, the Bank has gold deposits abroad amounting to RON 9,826,455 thousand (31 December 2015: RON 8,676,543 thousand). As at 31 December 2016, the gold revaluation price was RON 160.4449 per gram and the Bank's total gold holdings amounted to 103,546.5 kg (as at 31 December 2015, the revaluation price was RON 141.6693 per gram and the Bank's gold holdings amounted to 103,547.8 kg).

6. Demand deposits placed

	lei thousand	
	31 December 2016	31 December 2015
Demand deposits		
– with international financial institutions	246,047	624
– with central banks	25,263,868	1,074,593
– with foreign banks	43	1,357,677
Total	25,509,958	2,432,894

As at 31 December 2016, the item “Demand deposits with international financial institutions” includes the demand deposit held with the BIS amounting to RON 246,047 thousand (31 December 2015: RON 624 thousand), representing the equivalent of USD 6 thousand (31 December 2015: USD 6 thousand), EUR 1.1 thousand (31 December 2015: EUR 0.2 thousand), NOK 60,125 thousand (31 December 2015: NOK 119 thousand), AUD 67,385 thousand (31 December 2015: AUD 45 thousand), and CAD 2,011 thousand (31 December 2015: CAD 136 thousand).

As at 31 December 2016, the item “Demand deposits with central banks” includes mainly the demand deposit held with a financial institution outside the European Union amounting to RON 5,660,174 thousand representing JPY 153,667,106 thousand (31 December 2015: RON 566,149 thousand representing JPY 16,432,503 thousand), the demand deposits held with financial institutions in the European Union amounting to RON 19,380,466 thousand representing EUR 4,267,791 thousand (31 December 2015: RON 271,349 thousand representing EUR 59,973 thousand) and to RON 212,404 thousand representing CHF 50,279 thousand (31 December 2015: RON 9,417 thousand representing CHF 2,253 thousand), the Bank’s balance as a direct participant in TARGET2 amounting to RON 4,591 thousand representing EUR 1,011 thousand (31 December 2015: RON 220,686 thousand representing EUR 48,776 thousand) and other deposits.

As at 31 December 2016, the item “Demand deposits with foreign banks” includes mainly the demand deposit held with an institution in the European Union amounting to RON 31 thousand representing GBP 6 thousand (31 December 2015: RON 1,357,296 thousand representing EUR 299,988 thousand).

On 4 July 2011, the Bank implemented the system TARGET2-România (Trans-European Automated Real-time Gross Settlement Express Transfer System). TARGET2 represents a channel for processing the interbank payments in euro performed by banks on their own behalf or on behalf of their customers.

The breakdown by currency of the other demand deposits is presented in Note 40.

7. Term deposits placed

	lei thousand	
	31 December 2016	31 December 2015
Term deposits		
– with central banks	6,970,589	6,741,505
– with international institutions	1,845,918	2,906,904
Total	8,816,507	9,648,409

As at 31 December 2016, the term deposits held with central banks include the deposits held with a central bank in the European Union amounting to RON 6,970,589 thousand representing EUR 1,535,000 thousand (31 December 2015: RON 6,741,505 thousand representing EUR 1,490,000 thousand). The term deposits held with international institutions include the deposits held with a non-European Union financial institution in amount of RON 1,845,918 thousand representing GBP 343,000 thousand and NOK 58,700 thousand (31 December 2015: RON 2,906,904 thousand representing GBP 40,000 thousand, AUD 347,670 thousand, CAD 243,285 thousand and NOK 1,866,890 thousand).

8. Placements in foreign currencies

	lei thousand	
	31 December 2016	31 December 2015
Placements with the World Bank, out of which:		
– demand deposits with the Fed	100,887	7,425
– securities	2,291,090	2,279,821
Total	2,391,977	2,287,246

In 2002, the Bank and the International Bank for Reconstruction and Development (IBRD) concluded an investment management agreement (renewed in 2007) providing the IBRD with the role of an investment advisor and agent for the Bank's foreign asset management, up to the limit of 20% of the foreign reserves of the Bank. As at 31 December 2016, the deposits managed by the IBRD are as follows:

- demand deposits amounting to RON 100,887 thousand – the equivalent of USD 23,444 thousand (31 December 2015: RON 7,425 thousand – the equivalent of USD 1,790 thousand);
- securities managed by the World Bank, in accordance with the investment management agreement, amounting to RON 2,291,090 thousand, the equivalent of USD 532,403 thousand (31 December 2015: RON 2,279,821 thousand, the equivalent of USD 549,659 thousand), and which are in compliance with the policies for international reserve management described in Note 3.

9. Securities in foreign currencies

	lei thousand	
	31 December 2016	31 December 2015
Discount Treasury bills issued by:		
– European Treasuries	28,560,449	44,699,089
– European government agencies	2,048,335	22,570,145
– foreign banks and international institutions	600,232	-
– international financial institutions (EIB, IBRD, NIB, EBRD)	8,063,005	207,005
Coupon Treasury bills issued by:		
– non-European Union Treasuries (USA, Canada, Australia, etc.)	12,131,467	10,026,261
– European Treasuries	25,293,777	31,665,805
– foreign banks and international institutions	24,571,715	
– European government agencies	781,808	8,369,743
– international financial institutions (EIB, IBRD, NIB, EBRD, BIS)	7,724,334	5,554,386
Total	109,775,122	123,092,434

As at 31 December 2016, the foreign currency securities portfolio amounts to RON 109,775,122 thousand (31 December 2015: RON 123,092,434 thousand), out of which securities borrowed under the “GC Access” agreement are in the amount of EUR 2,950,856 thousand (RON 13,400,133 thousand), USD 33,674 thousand (RON 144,908 thousand), NOK 20,475 thousand (RON 10,240 thousand) and AUD 28,623 thousand (RON 88,999 thousand). As at 31 December 2015: EUR 1,228,258 thousand (RON 5,557,257 thousand) and GBP 284,851 thousand (RON 1,750,866 thousand).

Coupon securities issued by European Treasuries, non-European Union Treasuries, foreign banks and other financial institutions bear fixed interest rates.

As at 31 December 2016, both categories of securities include securities in the form of commercial paper consisting of zero coupon bonds and short-term discount securities (maturity of less than one year) amounting to RON 39,272,020 thousand – the equivalent of EUR 8,129,225 thousand, USD 99,943 thousand, GBP 331,596 thousand and AUD 54,721 thousand (31 December 2015: RON 10,909,302 thousand – the equivalent of EUR 1,656,011 thousand, USD 749,699 thousand and GBP 49,971 thousand).

10. Loans in foreign currencies

As at 31 December 2016, the Bank’s placements with the FED amounted to RON 2,666,325 thousand – the equivalent of USD 619,600 thousand (31 December 2015: RON 7,720,944 thousand – the equivalent of USD 1,861,500 thousand).

11. Quotas in international financial institutions

	lei thousand	
	31 December 2016	31 December 2015
Romania's quota at the IMF	10,479,061	5,921,166
Participating interest in the Bank for International Settlements	102,385	101,742
Participating interest in the European Central Bank	47,973	47,797
Total	10,629,419	6,070,705

This item comprises the national funds representing the participating interests in other international financial institutions. No impairment adjustment is required. In accordance with Law no. 97/1997, the Bank exercises all the rights and obligations arising from Romania's membership of the IMF. As an exception, tranches II, III and IV of the IMF loan were equally divided in 2009 and 2010 between the Bank and the Ministry of Public Finance; the corresponding rights and obligations were assumed by each institution for its part of the loan, in accordance with the provisions of Law no. 72/16.04.2010¹⁷⁸.

At 31 December 2016, Romania's quota at the IMF amounted to SDR 1,811 million (the Bank acting as a depository for the deposits of the IMF related to the quota), due to the February 2016 increase of SDR 781 million (31 December 2015: SDR 1,030 million). The aforementioned increase was made to comply with Resolution 66-2/2010 on the fourteenth general review of quotas and reform of the Executive Board approved by the IMF Board of Governors.

12. Loans to domestic credit institutions

	lei thousand	
	31 December 2016	31 December 2015
Loans in litigation	25,009	25,009
Provisions for credit risk – principal	(25,009)	(25,009)
Total	-	-

As at 31 December 2016, the loans in litigation include the loan amounting to RON 11,800 thousand granted to Credit Bank S.A. according to Government Emergency Ordinance no. 26/2000 regarding the authorization of the National Bank of Romania to grant a loan to cover public demands for the withdrawal of deposits with "Renașterea Creditului Românesc" Bank– Credit Bank S.A. (31 December 2015:

¹⁷⁸ Law No. 72/16.04.2010 approving Government Emergency Ordinance no. 10/2010 ratifying the Letter of intent signed by the Romanian authorities in Bucharest on 5 February 2010 and approved by the Decision of the IMF Board of 19 February 2010 and amending Government Emergency Ordinance No. 99/22.09.2009 regarding the ratification of the Stand-By Arrangement between Romania and the IMF, agreed by the Letter of intent sent by the Romanian authorities, signed in Bucharest on 24 April 2009, and by the Decision of the IMF Board of 4 May 2009, and by the additional Letter of intent signed by the Romanian authorities on 8 September 2009 and approved by the Decision of the IMF Board of 21 September 2009.

RON 11,800 thousand) and the loan amounting to RON 13,209 thousand (31 December 2015: RON 13,209 thousand) granted by the Bank to Credit Bank S.A. prior to its bankruptcy, both loans being granted prior to the year 2000.

As at 31 December 2016 and 31 December 2015, the provision for credit risk included the provision made by the Bank for the loan in amount of RON 11,800 thousand granted to Credit Bank S.A. and for the loan in amount of RON 13,209 thousand granted to the same bank.

13. Tangible and intangible fixed assets

	lei thousand				
	Land and buildings	Equipment	Work in progress	Intangible assets	Total
<i>Cost or revalued amount</i>					
As at 31 December 2015	1,341,931	143,855	37,057	62,402	1,585,245
Additions	23,373	11,462	31,797	22,663	89,295
Disposals	(158)	(8,040)	(27,406)	(1,337)	(36,941)
Accumulated depreciation adjustment (revaluation purpose)	(95,197)	-	-	-	(95,197)
Net revaluation differences	(54,280)	-	-	-	(54,280)
As at 31 December 2016	1,215,669	147,277	41,448	83,728	1,488,122
<i>Accumulated depreciation</i>					
As at 31 December 2015	62,879	88,053	-	50,565	201,497
Depreciation for the year	33,611	14,661	-	10,310	58,582
Disposals	(30)	(3,215)	-	(1,337)	(4,582)
Accumulated depreciation adjustment (revaluation purpose)	(95,197)	-	-	-	(95,197)
As at 31 December 2016	1,263	99,499	-	59,538	160,300
Net book value:					
As at 31 December 2015	1,279,052	55,802	37,057	11,837	1,383,748
As at 31 December 2016	1,214,406	47,778	41,448	24,190	1,327,822

At 31 December 2016, the land and buildings were revalued by an ANEVAR accredited valuer, in accordance with the recommendations of the International Valuation Standards (IVS 300 – Valuations for financial reporting). As at 31 December 2016, the accumulated depreciation was removed from the gross carrying amount and the net carrying value was set at the revaluation value.

The unrealized gains/losses are booked in the balance sheet under the item „Reserves”. The unrealized losses are compensated with unrealized gains from previous revaluations, for each revalued asset; if the unrealized losses exceed the unrealized gains previously booked for the same asset, they are booked as expenses (RON 1,474 thousand). The unrealized gains, which compensate the previous revaluation expenses, are booked as income (RON 147 thousand). Furthermore, the valuer reviewed the useful life of some of the Bank’s buildings.

As at 31 December 2016, the category *Equipment* includes fixed assets acquired through financial leases in gross amount of RON 1,380 thousand (31 December 2015: gross value of contracts – RON 4,128 thousand). No new financial lease contracts were signed by the Bank in 2016 or 2015.

14. Participating interests

The participating interests are accounted for at cost, in accordance with the provisions of Norm no. 1/2007, as subsequently amended and supplemented; thus, these financial statements are not consolidated.

The participating interests amounting to RON 2,323 thousand (31 December 2015: RON 2,321 thousand) include the shares held by the Bank in TRANSFOND S.A. (a 33% participation, representing RON 2,240 thousand both as at 31 December 2016 and as at 31 December 2015) – a joint-stock company providing settlement services for the local banks' interbank transactions – and 8 shares held by the Bank in the share capital of SWIFT, as a result of the reallocation performed on 20 February 2006; the number of shares in the capital of SWIFT was not modified by the reallocation procedure performed in 2008. As at 31 December 2016, the SWIFT shares have a carrying value of EUR 18 thousand – RON 83 thousand (31 December 2015: EUR 18 thousand – RON 81 thousand). No impairment adjustments were necessary.

A summary of the ongoing audit of the financial statements of TRANSFOND S.A. is disclosed in the following table:

	lei thousand	
	31 December 2016	31 December 2015
Equity	55,796	55,902
Total assets	60,759	151,870
Net profit for the year	21,333	19,572

15. Settlement account with the State Budget

The balance as at 31 December 2016 comprises mainly the state's share of 80% of the net revenues of the Bank, which will be settled according to the legal provisions. As at 31 December 2015, the balance represented the state's share of 80% of the net revenues of the Bank, which were subsequently settled according to the law.

16. Revaluation differences for off-balance-sheet items

The Bank has spot transactions accounted for in off-balance-sheet accounts. These balances are revalued on a monthly basis and the revaluation result is booked on the balance sheet. As at 31 December 2016, there were no favorable revaluation differences (31 December 2015: RON 19,016 thousand).

17. Provisions for other assets

	lei thousand	
	31 December 2016	31 December 2015
Provisions for:		
Guarantees paid by the NBR for Credit Bank S.A. (a)	67,942	65,485
Other provisions related to assets (b)	4,356	3,785
Total	72,298	69,270

a) As at 31 December 2016, the RON equivalent of the guarantees paid by the Bank, as a guarantor for Credit Bank S.A., amounted to RON 67,942 thousand (31 December 2015: RON 65,485 thousand). These foreign currency guarantees were revalued as at 31 December 2016 and 31 December 2015.

b) This item includes mainly the provisions against sundry debtors in litigation.

The provisions in paragraphs a) and b) represent adjustment figures for the balance sheet items included in "Other assets".

18. Accrued interest receivable

	lei thousand	
	31 December 2016	31 December 2015
Accrued interest receivable from:		
Foreign currency securities	501,645	629,452
Foreign currency deposits and placements	7,389	4,829
Loans granted to banks	7,413	6,508
Other assets	264	341
Total	516,711	641,130

19. Provisions for credit risk – interest

As at 31 December 2016 and 31 December 2015, the provision for credit risk, amounting to RON 6,068 thousand, was maintained; it refers to the interest receivable on the loan granted to Credit Bank S.A., in accordance with Government Emergency Ordinance no. 26/2000 regarding the authorization of the National Bank of Romania to grant a loan to cover public demands for the withdrawal of deposits with “Renașterea Creditului Românesc” Bank – Credit Bank S.A.

20. Currency in circulation

	lei thousand	
	31 December 2016	31 December 2015
Banknotes	62,543,662	53,165,883
Coins	476,121	427,424
Total	63,019,783	53,593,307

21. Due to international financial institutions

	lei thousand	
	31 December 2016	31 December 2015
IMF deposits	10,479,082	5,921,187
Financing agreements	-	552,487
Other	646	622
Total	10,479,728	6,474,296

As at 31 December 2016, the IMF deposits amounted to RON 10,479,082 thousand – the equivalent of SDR 1,811,404 thousand (the Bank acting as a depository for the deposits of the IMF related to the Romania's quota), due to the February 2016 increase of SDR 781,204 thousand (31 December 2015: SDR 1,030,200 thousand).

As at 31 December 2016, the borrowing from the IMF was zero due to the completion of its reimbursement in January 2016. As at 31 December 2015, the remaining amount was RON 552,487 thousand – the equivalent of SDR 96,126 thousand.

22. Demand deposits taken

As at 31 December 2016, the Bank has deposits taken from European institutions amounting to RON 21,199 thousand – EUR 4,668 thousand (31 December 2015: RON 845,324 thousand – EUR 186,833 thousand).

23. Borrowings from banks and other financial institutions

As at 31 December 2016, the Bank has borrowings amounting to RON 1,380 thousand – the equivalent of EUR 304 thousand (31 December 2015: RON 4,125 thousand – the equivalent of EUR 994 thousand), representing financial leasing agreements for the acquisition of banknote processing systems/machines.

24. Counterpart of special drawing rights allocated by the IMF

This item includes a non-refundable loan bearing the same interest rate as the SDR current account with the IMF. As at 31 December 2016 and 31 December 2015, the SDR allocations from the IMF amounted to SDR 984,767,719 with an annual interest rate of 0.24% at end-2016 and 0.05% respectively at end-2015.

25. Current account of the State Treasury

	lei thousand	
	31 December 2016	31 December 2015
Current account of the State Treasury		
– in RON	8,827,163	5,103,838
– in foreign currencies	38,622,044	32,571,482
Total	47,449,207	37,675,320

The current accounts of the State Treasury have an interest rate. In 2016 and 2015, the current account of the State Treasury denominated in RON had the same interest rate as the RON-denominated minimum required reserves of the credit institutions. The current accounts of the State Treasury denominated in EUR bore the EONIA interest rate (ECB's euro overnight index average) and the current accounts of the State Treasury denominated in USD bore an interest rate equal to the Federal Funds Rate (FED volume-weighted average of overnight interest rate).

26. Accrued interest payable

	lei thousand	
	31 December 2016	31 December 2015
Accrued interest payable for:		
Foreign borrowings	17,506	7,803
Minimum required reserves of credit institutions	839	991
Current account of the State Treasury	300	328
Total	18,645	9,122

27. Transactions with related parties

The Romanian Government, through the State Treasury, maintains current accounts with the Bank, the operations being subject to commission fees starting 31 December 2005. Furthermore, the Bank acts as a registry agent on behalf of the State Treasury for the issues of government bonds and Treasury certificates, manages the foreign currency reserves and ensures timely servicing of Romania's external public debt.

The Bank exercises influence, through the members appointed to the Boards of Directors, over two other state institutions: the NBR Printing Works and the State Mint.

In 2016, the total purchases of banknotes and coins from the aforementioned two entities amounted to RON 179,809 thousand (in 2015: RON 160,653 thousand). As at 31 December 2016, the Bank had no debts to or receivables from any of the two entities. As at 31 December 2015, the Bank had a debt amounting to RON 2,187 thousand to the NBR Printing Works, which was reimbursed in January 2016; there were no receivables from the NBR Printing Works or the State Mint. All transactions with these two entities were carried out under normal commercial terms and conditions.

The Bank has a significant influence over TRANSFOND S.A., an entity established in 2000 in order to outsource the Bank's settlement activities of domestic interbank operations. On 8 April 2005, the real-time gross settlement system (ReGIS) went live; afterwards, SENT (the module for small value payments – fully managed by TRANSFOND S.A.) and SaFIR (the module for Treasury bills and deposit certificates issued by the Bank – managed by the Bank) entered into operation. In the following period, the Bank will take over ReGIS and SaFIR operation.

28. Reserves

	lei thousand	
	31 December 2016	31 December 2015
Statutory reserves	151,590	136,908
Other reserves	905,187	859,301
Revaluation gains – tangible fixed assets	1,203,128	1,256,176
Total	2,259,905	2,252,385

As at 31 December 2016 and 31 December 2015, the statutory reserves result from the distribution of 60% of the remaining profit.

Other reserves are non-distributable and comprise:

- reserves set up from the fund designated for tangible fixed assets (both 31 December 2016 and 31 December 2015: RON 14,450 thousand);
- reserves set up from the fund designated for the Bank's own financing sources of investments (both 31 December 2016 and 31 December 2015: RON 57,629 thousand);
- reserves set up from the fund designated for the quota at the IMF (both 31 December 2016 and 31 December 2015: RON 318,532 thousand);
- reserves set up from the previous BIS participating interest fund (both 31 December 2016 and 31 December 2015: RON 44,550 thousand);
- reserves set up, according to the law, for the Bank's own financing sources of investments amounting to RON 319,877 thousand as at 31 December 2016 (31 December 2015: RON 272,942 thousand);
- other reserves amounting to RON 150,148 thousand as at 31 December 2016 (31 December 2015: RON 151,198 thousand).

The tangible assets revaluation gains represent the difference between the fair value and the net book value of tangible fixed assets.

29. Special revaluation account

	lei thousand	
	31 December 2016	31 December 2015
Unrealized gains from the revaluation of holdings of gold, precious metals and stones	12,529,742	10,560,056
Unrealized gains from the revaluation of assets and liabilities denominated in foreign currency	2,833,581	3,234,983
Securities denominated in foreign currency (market value revaluation)	139,579	45,569
Total	15,502,902	13,840,608

As at 31 December 2016 and 31 December 2015, the amounts recorded in the special revaluation account represent favorable revaluation differences.

In 2016 and 2015, the Bank recorded long positions for all the currencies in the portfolio, as well as for gold (total claims exceeding total debts in a given currency), except for the SDR position, which was short until June 2016.

30. Interest income

	lei thousand	
	2016	2015
Foreign currency operations		
Interest and similar income from:		
Foreign currency placements	118,021	45,242
out of which:		
– negative interest on the current account of the State Treasury	88,921	19,658
Amounts in SDR	3,399	27
Total interest income from foreign currency operations	121,420	45,269
RON operations		
Interest and similar income from:		
Loans to credit institutions	-	6,010
Other income	5	135
Total interest income from RON operations	5	6,145
Total interest income	121,425	51,414

In 2016, the interest income from foreign currency operations comprises mainly the negative interest on the EUR-denominated current accounts of the State Treasury (bearing the ECB's overnight index average) in amount of RON 88,921 thousand (2015: RON 19,658 thousand) and the interest on foreign currency placements in amount of RON 29,100 thousand (2015: RON 25,584 thousand).

As at 31 December 2015 the interest income from transactions denominated in RON comprises mainly the interest resulting from loans granted to credit institutions and from the transfers and related repurchase agreements of securities, in amount of RON 6,010 thousand.

31. Interest expense

	lei thousand	
	2016	2015
Foreign currency operations		
Interest and similar expenses from:		
Foreign currency securities, minimum reserves and deposits taken	283,756	97,233
Operations with the International Monetary Fund	4,837	31,117
Total interest expense from foreign currency operations	288,593	128,350
RON operations		
Interest and similar expenses from:		
Term deposits of credit institutions	23,604	11,226
Minimum reserves of credit institutions	17,344	30,667
Current account of the State Treasury	12,472	27,608
Total interest expense from RON operations	53,420	69,501
Total interest expense	342,013	197,851

In 2016, the interest expense from foreign currency operations comprises mainly the net expenses related to the foreign currency securities amounting to RON 176,792 thousand (2015: RON 32,748 thousand) determined as premium amortization (2016: RON 1,448,990 thousand; 2015: RON 873,051 thousand) minus related coupons (2016: RON 1,235,825 thousand; 2015: RON 811,732 thousand) and minus the discount amortization (2016: RON 36,373 thousand; 2015: RON 28,571 thousand), the interest paid on foreign currency minimum reserves and on deposits taken in amount of RON 49,257 thousand (2015: RON 52,327 thousand), the negative interest applied to deposits placed amounting to RON 57,300 thousand (2015: RON 12,158 thousand) and the interest expense for the borrowing from the IMF – RON 4,837 thousand (2015: RON 31,117 thousand).

32. Fees and commissions income

	lei thousand	
	2016	2015
Fees and commissions income		
– in RON	109,183	100,423
– in foreign currencies	15,225	10,715
Total fees and commissions income	124,408	111,138

Fees and commissions income in RON comprises the commission income from the settlement of operations of credit institutions and of the State Treasury in amount of RON 109,183 thousand (2015: RON 100,423 thousand).

The income from fees and commissions in foreign currencies represents the commissions for the Trans-European Automated Real-Time Gross Settlement Express Transfer System (TARGET2) and the commissions from securities lending (through an agent), amounting to RON 15,225 thousand (2015: RON 10,715 thousand).

33. Fees and commissions expense

	lei thousand	
	2016	2015
Fees and commissions expense		
– in RON	14,228	18,670
– in foreign currencies	12,829	24,773
Total fees and commissions expense	27,057	43,443

The RON fees and commissions expenses amounting to RON 14,228 thousand (2015: RON 18,670 thousand) mainly represent the commissions for services used by the Bank, including the services provided by TRANSFOND S.A.

The expenses with fees and commissions denominated in foreign currencies, in amount of RON 12,829 thousand, mainly represent the amount of fees paid for the operations performed through TARGET2. As at 31 December 2015, the amount

of RON 24,773 thousand derived mainly from the IMF commitment fee for the precautionary Stand-By Arrangement signed for the period September 2013 – September 2015 (the amount corresponding to January-September 2015) and from the commissions paid for TARGET2 operations.

34. Net realized gains arising from foreign currency operations

	lei thousand	
	2016	2015
Income from foreign currency operations		
Income from exchange rate differences	1,375,588	1,800,775
Dividends on shares in the Bank for International Settlements	10,568	10,897
Total income from foreign currency operations	1,386,156	1,811,672
Expenses from foreign currency operations		
Expenses from exchange rate differences	(40,604)	(327,511)
Other expenses from foreign currency operations	(2,398)	(2,381)
Total expenses from foreign currency operations	(43,002)	(329,892)
Net realized gains arising from foreign currency operations	1,343,154	1,481,780

In 2016 and 2015, the income and expenses from exchange rate differences were mainly generated by the outflows of foreign currencies for which the Bank had long positions, calculated using the average cost method (Note 2i).

35. Net realized gains arising from securities operations

	lei thousand	
	2016	2015
Income from securities operations	128,544	77,217
Expenses from securities operations	(3,180)	(4,897)
Net realized gains arising from securities operations	125,364	72,320

The income/expenses represent the market price effect resulting from the sales of securities denominated in foreign currencies, calculated based on the average cost method (Note 2j).

36. Net realized losses arising from precious metals operations

	lei thousand	
	2016	2015
Expenses from precious metals operations	(323)	(362)
Net realized losses arising from precious metals operations	(323)	(362)

Expenses from precious metals operations mainly represent the fees paid for depositing the gold with the foreign depository.

37. Unrealized losses from revaluation differences

	lei thousand	
	2016	2015
Expenses with unfavorable revaluation differences		
Market value revaluation of foreign currency securities	110,231	29,447
Exchange rate revaluation of foreign currency holdings	535,803	82,258
Unrealized losses from revaluation differences	646,034	111,705

Unrealized losses represent the unfavorable differences between the market value of foreign currency securities as at 31 December and their net average cost, as well as the unfavorable differences from foreign currency holdings revaluation using the revaluation exchange rate (Note 2p).

The SDR hedging operation performed as at 31 December 2015 enabled the Bank to record as expenses the result (net unfavorable differences) of the net SDR holding revaluation following its compensation with the results of the revaluation of the other foreign currency holdings included in the net SDR holding designated in accordance with the structure of the SDR currency basket.

38. Currency issue expenses

Currency issue expenses include the expenses arising from printing banknotes and minting coins.

39. Net unrealized losses from the revaluation of buildings, land and other assets

As at 31 December 2016, this item amounted to RON 1,327 thousand representing net unrealized losses from the revaluation of buildings, land and other assets (31 December 2015: RON 10 thousand).

40. Foreign currency risk

The breakdown of the Bank's assets (RON thousand) by currency as at 31 December 2016 is the following:

	lei thousand						
	RON	EUR	USD	SDR	Gold	Other	Total
Cash and other cash equivalents	46,361	153	148	-	-	-	46,662
Non-monetary gold	-	-	-	-	166,288	-	166,288
Other precious metals and stones	38,128	-	-	-	-	-	38,128
Current account in SDR with the IMF	-	-	-	5,717,560	-	-	5,717,560
Monetary gold	-	-	-	-	16,613,515	-	16,613,515
Demand deposits placed	-	19,388,284	2,374	-	-	6,119,300	25,509,958
Term deposits placed	-	6,970,589	-	-	-	1,845,918	8,816,507
Placements in foreign currencies	-	-	2,391,977	-	-	-	2,391,977
Securities in foreign currencies	-	89,941,789	13,124,155	-	-	6,709,178	109,775,122
Loans in foreign currencies	-	-	2,666,325	-	-	-	2,666,325
Quotas in international financial institutions	-	47,972	-	10,581,447	-	-	10,629,419
Other foreign assets TARGET2	-	5,314,093	-	-	-	-	5,314,093
Loans in litigation	25,009	-	-	-	-	-	25,009
Provisions for credit risk – principal	(25,009)	-	-	-	-	-	(25,009)
Loans to employees	38	-	-	-	-	-	38
Tangible and intangible fixed assets	1,327,822	-	-	-	-	-	1,327,822
Inventories	4,431	-	-	-	-	-	4,431
Participating interests	2,240	83	-	-	-	-	2,323
Settlement accounts with the State Budget	206,006	-	-	-	-	-	206,006
Accruals and prepaid expenses	29,364	-	115,544	-	-	-	144,908
Other assets	74,490	-	-	-	-	-	74,490
Provisions for other assets	(72,298)	-	-	-	-	-	(72,298)
Accrued interest receivable	6,333	419,878	31,878	2,045	-	56,577	516,711
Provisions for credit risk – interest	(6,068)	-	-	-	-	-	(6,068)
Total assets	1,656,847	122,082,841	18,332,401	16,301,052	16,779,803	14,730,973	189,883,917

40. Foreign currency risk (continued)

The breakdown of the Bank's liabilities (RON thousand) by currency as at 31 December 2016 is the following:

	lei thousand						
	RON	EUR	USD	SDR	Gold	Other	Total
Currency in circulation	63,019,783	-	-	-	-	-	63,019,783
Due to international financial institutions	-	-	646	10,479,082	-	-	10,479,728
Demand deposits taken	-	21,199	-	-	-	-	21,199
Borrowings from banks and other financial institutions	-	1,380	-	-	-	-	1,380
Counterpart of special drawing rights allocated by the IMF	-	-	-	5,696,942	-	-	5,696,942
Current accounts of the domestic banks	22,453,679	-	-	-	-	-	22,453,679
Amounts withheld at court disposition	5,317	150	-	-	-	-	5,467
Deposits of the domestic banks	4,489,480	-	-	-	-	-	4,489,480
Foreign currency minimum reserves	-	13,033,285	54,159	-	-	-	13,087,444
Accounts of bankrupt credit institutions	649	-	-	-	-	-	649
Other liabilities TARGET2	-	5,314,093	-	-	-	-	5,314,093
Current account of the State Treasury	8,827,163	30,835,873	7,754,196	-	-	31,975	47,449,207
Sundry creditors	29,313	-	-	-	-	-	29,313
Salaries and other personnel-related liabilities	75	-	-	-	-	-	75
Settlement account with the State Budget	7,912	-	-	-	-	-	7,912
Accruals and income collected in advance	1,023	-	-	-	-	-	1,023
Revaluation differences for off-BS items	270	-	-	-	-	-	270
Other liabilities	5,033	-	-	-	-	-	5,033
Accrued interest payable	673	14,844	1,090	2,038	-	-	18,645
Total liabilities and equity	98,840,370	49,220,824	7,810,091	16,178,062	-	31,975	172,081,322
Net assets / (net liabilities)*	(97,183,523)	72,862,017	10,522,310	122,990	16,779,803	14,698,998	17,802,595

*) represent the Bank's equity and reserves

40. Foreign currency risk (continued)

The breakdown of the Bank's assets (RON thousand) by currency as at 31 December 2015 is the following:

	lei thousand						
	RON	EUR	USD	SDR	Gold	Other	Total
Cash and other cash equivalents	44,847	84	189	-	-	-	45,120
Non-monetary gold	-	-	-	-	147,489	-	147,489
Other precious metals and stones	31,912	-	-	-	-	-	31,912
Current account in SDR with the IMF	-	-	-	49,312	-	-	49,312
Monetary gold	-	-	-	-	14,669,552	-	14,669,552
Demand deposits placed	-	1,852,933	2,503	-	-	577,458	2,432,894
Term deposits placed	-	6,741,505	-	-	-	2,906,904	9,648,409
Placements in foreign currencies	-	-	2,287,246	-	-	-	2,287,246
Securities in foreign currencies	-	106,192,842	14,177,318	-	-	2,722,274	123,092,434
Loans in foreign currencies	-	-	7,720,944	-	-	-	7,720,944
Quotas in international financial institutions	-	47,797	-	6,022,908	-	-	6,070,705
Other foreign assets TARGET2	-	586,561	-	-	-	-	586,561
Loans in litigation	25,009	-	-	-	-	-	25,009
Provisions for credit risk – principal	(25,009)	-	-	-	-	-	(25,009)
Loans to employees	51	-	-	-	-	-	51
Tangible and intangible fixed assets	1,383,748	-	-	-	-	-	1,383,748
Inventories	4,041	-	-	-	-	-	4,041
Participating interests	2,239	82	-	-	-	-	2,321
Settlement accounts with the State Budget	66,947	-	-	-	-	-	66,947
Accruals and prepaid expenses	36,453	-	-	-	-	-	36,453
Revaluation differences for off-BS items	19,016	-	-	-	-	-	19,016
Other assets	72,029	-	-	-	-	-	72,029
Provisions for other assets	(69,270)	-	-	-	-	-	(69,270)
Accrued interest receivable	6,410	596,969	30,433	4	-	7,314	641,130
Provisions for credit risk – interest	(6,068)	-	-	-	-	-	(6,068)
Total assets	1,592,355	116,018,773	24,218,633	6,072,224	14,817,041	6,213,950	168,932,976

40. Foreign currency risk (continued)

The breakdown of the Bank's liabilities and capital (RON thousand) by currency as at 31 December 2015 is the following:

	lei thousand						
	RON	EUR	USD	SDR	Gold	Other	Total
Currency in circulation	53,593,307	-	-	-	-	-	53,593,307
Due to international financial institutions	-	-	622	6,473,674	-	-	6,474,296
Demand deposits taken	-	845,324	-	-	-	-	845,324
Borrowings from banks and other financial institutions	-	4,125	-	-	-	-	4,125
Counterpart of special drawing rights allocated by the IMF	-	-	-	5,660,040	-	-	5,660,040
Current accounts of the domestic banks	20,402,647	-	-	-	-	-	20,402,647
Amounts withheld at court disposition	4,684	150	-	-	-	-	4,834
Deposits of the domestic banks	10,098,915	-	-	-	-	-	10,098,915
Foreign currency minimum reserves	-	17,283,446	76,817	-	-	-	17,360,263
Accounts of bankrupt credit institutions	1,369	-	-	-	-	-	1,369
Other liabilities TARGET2	-	586,561	-	-	-	-	586,561
Current account of the State Treasury	5,103,838	20,102,636	12,438,735	-	-	30,111	37,675,320
Sundry creditors	21,728	-	-	-	-	-	21,728
Salaries and other personnel-related liabilities	82	-	-	-	-	-	82
Settlement account with the State Budget	8,114	-	-	-	-	-	8,114
Accruals and income collected in advance	207	-	-	-	-	-	207
Other liabilities	1,148	-	-	-	-	-	1,148
Accrued interest payable	751	5,958	970	1,443	-	-	9,122
Total liabilities and equity	89,236,790	38,828,200	12,517,144	12,135,157	-	30,111	152,747,402
Net assets / (net liabilities)*	(87,644,435)	77,190,573	11,701,489	(6,062,933)	14,817,041	6,183,839	16,185,574
*) represent the Bank's equity and reserves							

41. Commitments and contingencies

As at 31 December 2016, the Bank has in custody the following:

- a promissory note issued by the Ministry of Public Finance in favor of the Multilateral Investment Guarantee Agency, amounting to USD 600,510 (31 December 2015: USD 600,510);
- a promissory note amounting to SDR 7,250,000 issued by the Ministry of Public Finance in favor of the Black Sea Bank for the 20% share of Romania in the bank's capital. In 2016 this promissory note was reduced by the amount of SDR 3,625,000 (31 December 2015: SDR 10,875,000);
- a promissory note issued by the Ministry of Public Finance in favor of the International Development Association (IDA) amounting to RON 16,174 thousand (31 December 2015: RON 16,014 thousand).

42. Profit distribution

In 2016, the Bank recorded a profit amounting to RON 124,636 thousand. According to the law, an amount of RON 100,166 thousand – representing the 80% share of the Bank's net revenues – was distributed to the state budget. 60% (RON 14,682 thousand) of the remaining profit (RON: 24,470 thousand) was allocated for increasing the statutory reserves. The remaining amount of RON 9,788 thousand will be distributed in 2017, according to the law, in the following order for:

- a) the bank's own financing sources of investments;
- b) the employees' profit-sharing scheme;
- c) the reserves at the Board's disposal.

In 2015, the Bank recorded a profit amounting to RON 783,449 thousand. According to the law, an amount of RON 626,997 thousand – representing the 80% share of the Bank's net revenues – was distributed to the state budget. 60% (RON 93,871 thousand) of the remaining profit (RON: 156,452 thousand) was allocated for increasing the statutory reserves. The remaining amount of RON 62,581 thousand was distributed during 2016 in accordance with the law.

Governor

Mr. Mugur Isărescu

The background of the page features a photograph of a classical building facade, showing several columns and ornate architectural details. A semi-transparent vertical band is positioned on the right side of the image. Overlaid on the left side of the page is a pattern of thin, wavy, horizontal lines in a light beige or gold color.

Statistical section

		2012	2013	2014	2015	2016
Economic activity						
Gross domestic product ¹	lei million ²	595,367	637,456	668,144	711,103	761,474
	annual change (%) ³	0.6	3.5	3.1	3.9	4.8
Final consumption, total ¹	annual change (%) ³	1.1	-0.3	4.0	4.9	6.9
Actual final consumption of households ¹	annual change (%) ³	1.7	-2.4	4.4	5.5	7.3
Actual final consumption of general government ¹	annual change (%) ³	-5.6	23.7	0.5	-0.7	3.3
Gross capital formation ¹	annual change (%) ³	-4.8	0.5	1.7	7.5	1.1
Exports of goods and services ¹	annual change (%) ³	1.0	19.7	8.0	5.4	8.3
Imports of goods and services ¹	annual change (%) ³	-1.8	8.8	8.7	9.2	9.8
Agriculture ¹	annual change (%) ³	-26.1	33.7	4.3	-11.8	0.0
Industry ¹	annual change (%) ³	-7.0	3.8	3.6	5.4	1.8
Construction ¹	annual change (%) ³	-1.1	4.4	1.9	6.8	1.8
Services ¹	annual change (%) ³	9.2	0.4	0.9	1.0	2.1
GDP/capita (PPS)		14,341	14,582	15,253	16,460	17,095
GDP/capita (PPS, EU-28=100)	percent	50.3	50.9	51.9	53.6	55.6
Industrial output	annual change (%) ³	2.4	7.8	6.1	2.8	1.7
Industrial output in manufacturing	annual change (%) ³	2.2	9.2	7.5	3.5	2.6
Employed persons	thousand	8,221.6	8,178.9	8,254.4	8,234.8	8,166.1
Number of unemployed	thousand	494	512	478	436	418
Unemployment rate	percent	5.4	5.7	5.4	5.0	4.8
Industrial producer prices and consumer prices						
Industrial producer prices (domestic and foreign markets)	annual change (%)	5.4	2.1	-0.1	-2.2	-1.8
Industrial producer prices (domestic market)	annual change (%)	4.8	3.7	0.2	-1.8	-2.2
Industrial producer prices (foreign market)	annual change (%)	6.7	-1.0	-0.7	-3.2	-1.0
GDP deflator ¹	annual change (%)	4.7	3.4	1.7	2.4	2.2
CPI	annual change (%)	3.33	3.98	1.07	-0.59	-1.55
Adjusted CORE2	annual change (%)	2.54	1.87	0.21	-1.42	-1.35
HICP	annual change (%)	3.4	3.2	1.4	-0.4	-1.1
General government						
General government revenues ⁴	percent of GDP	33.6	33.3	33.5	35.0	31.7
General government expenditures ⁴	percent of GDP	37.2	35.4	34.9	35.8	34.7
General government balance ⁴	percent of GDP	-3.7	-2.1	-1.4	-0.8	-3.0
General government primary balance ⁴	percent of GDP	-1.9	-0.3	0.3	0.9	-1.5
General government balance ⁵	percent of GDP	-2.5	-2.5	-1.7	-1.4	-2.4
Public debt ⁴	percent of GDP	37.3	37.8	39.4	38.0	37.6
Exchange rate calculated and released by the NBR						
EUR/RON	end of period	4.4287	4.4847	4.4821	4.5245	4.5411
	average ⁶	4.4560	4.4190	4.4446	4.4450	4.4908
USD/RON	end of period	3.3575	3.2551	3.6868	4.1477	4.3033
	average ⁶	3.4682	3.3279	3.3492	4.0057	4.0592
International reserves						
International reserves, total	EUR million	35,413.0	35,434.5	35,505.6	35,485.1	37,905.4
gold	EUR million	4,206.8	2,909.6	3,289.7	3,247.1	3,663.8
foreign currency	EUR million	31,206.2	32,524.9	32,215.8	32,237.9	34,241.6

2016											
Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
x	x	146,447	x	x	178,727	x	x	207,409	x	x	228,890
x	x	4.3	x	x	6.0	x	x	4.3	x	x	4.8
x	x	7.2	x	x	8.9	x	x	5.8	x	x	6.0
x	x	7.7	x	x	9.1	x	x	6.4	x	x	6.3
x	x	3.2	x	x	7.4	x	x	0.1	x	x	3.3
x	x	3.1	x	x	4.7	x	x	0.0	x	x	-0.6
x	x	5.6	x	x	8.6	x	x	8.0	x	x	10.9
x	x	10.0	x	x	13.2	x	x	7.8	x	x	8.6
x	x	-0.8	x	x	17.7	x	x	2.0	x	x	-16.7
x	x	0.4	x	x	2.8	x	x	1.8	x	x	1.8
x	x	1.9	x	x	7.1	x	x	2.8	x	x	-0.1
x	x	6.4	x	x	7.6	x	x	6.0	x	x	7.9
x	x	x	x	x	x	x	x	x	x	x	x
x	x	x	x	x	x	x	x	x	x	x	x
-1.8	0.5	2.6	3.8	1.2	1.1	-3.4	5.4	3.4	-0.3	5.4	3.6
-1.3	1.9	3.9	4.9	2.1	1.4	-2.9	7.1	4.5	0.3	6.3	3.7
x	x	7,960.4	x	x	8,225.4	x	x	8,334.5	x	x	8,144.0
430	427	419	411	411	411	420	421	418	418	417	418
4.9	4.9	4.8	4.7	4.7	4.7	4.8	4.8	4.8	4.8	4.8	4.8
-2.1	-3.3	-3.4	-2.9	-2.7	-2.3	-2.3	-1.9	-1.5	-0.3	-0.2	0.9
-2.4	-3.6	-3.8	-3.3	-3.2	-2.7	-2.5	-2.3	-1.8	-0.7	-0.8	0.1
-1.5	-2.8	-2.6	-2.1	-1.7	-1.4	-1.9	-1.3	-1.0	0.6	1.1	2.6
x	x	0.4	x	x	3.8	x	x	0.8	x	x	3.3
-2.13	-2.68	-2.98	-3.25	-3.46	-0.70	-0.78	-0.20	-0.57	-0.43	-0.67	-0.54
-3.58	-3.82	-3.86	-3.86	-3.85	0.43	0.50	0.55	0.57	0.59	0.49	0.35
-1.5	-2.1	-2.4	-2.7	-3.0	-0.7	-0.3	0.3	-0.1	0.1	-0.2	-0.1
x	x	x	x	x	x	x	x	x	x	x	x
x	x	x	x	x	x	x	x	x	x	x	x
x	x	x	x	x	x	x	x	x	x	x	x
x	x	x	x	x	x	x	x	x	x	x	x
x	x	x	x	x	x	x	x	x	x	x	x
x	x	x	x	x	x	x	x	x	x	x	x
4.5337	4.4692	4.4738	4.4774	4.5115	4.5210	4.4654	4.4535	4.4523	4.5057	4.5162	4.5411
4.5303	4.4818	4.4657	4.4727	4.4994	4.5218	4.4858	4.4594	4.4506	4.4942	4.5102	4.5173
4.1525	4.0970	3.9349	3.9348	4.0491	4.0624	4.0203	3.9945	3.9822	4.1131	4.2616	4.3033
4.1702	4.0395	4.0201	3.9455	3.9802	4.0257	4.0529	3.9775	3.9700	4.0756	4.1710	4.2820
35,079.0	34,596.7	34,900.4	35,208.5	36,296.8	35,673.3	36,663.0	36,897.8	37,255.8	38,224.8	38,123.9	37,905.4
3,400.0	3,771.7	3,618.4	3,737.2	3,624.4	3,944.5	4,004.5	3,929.8	3,956.5	3,878.1	3,737.2	3,663.8
31,678.9	30,825.0	31,282.0	31,471.4	32,672.4	31,728.8	32,658.5	32,968.0	33,299.2	34,346.7	34,386.7	34,241.6

		2012	2013	2014	2015	2016
NBR rates						
Monetary policy rate	percent per annum	5.25	4.00	2.75	1.75	1.75
Lending facility rate	percent per annum	9.25	7.00	5.25	3.25	3.25
Deposit facility rate	percent per annum	1.25	1.00	0.25	0.25	0.25
Interest rates applicable by credit institutions⁷						
Lei						
Interest rates on new loans	percent per annum	10.23	9.29	7.29	5.87	5.47
households	percent per annum	11.83	10.83	8.27	6.94	6.88
non-financial corporations	percent per annum	9.55	8.50	6.46	4.75	3.90
Interest rates on new time deposits	percent per annum	5.33	4.20	2.43	1.31	0.66
households	percent per annum	5.90	4.83	3.22	1.92	1.06
non-financial corporations	percent per annum	4.95	3.72	1.94	0.94	0.42
EUR						
Interest rates on new loans	percent per annum	5.08	4.84	4.37	3.85	3.15
households	percent per annum	5.06	4.65	5.28	4.65	4.20
non-financial corporations	percent per annum	5.09	4.92	4.29	3.65	3.08
Interest rates on new time deposits	percent per annum	3.00	2.34	1.49	0.79	0.38
households	percent per annum	3.47	2.72	1.82	1.00	0.42
non-financial corporations	percent per annum	2.50	1.82	1.08	0.48	0.29
Broad money (M3)						
M3 (broad money)	lei million	222,018	241,547	261,831	286,256	314,135
	annual change (%)	2.7	8.8	8.4	9.3	9.7
	annual change (%) ³	-2.2	7.1	7.5	10.4	10.3
	percent of GDP	37.3	37.9	39.2	40.3	41.3
M2 (intermediate money)	lei million	221,830	241,251	261,573	286,126	314,026
	annual change (%)	4.6	8.8	8.4	9.4	9.8
	annual change (%) ³	-0.3	7.1	7.5	10.4	10.3
M1 (narrow money)	lei million	89,020	100,311	118,582	149,550	179,980
	annual change (%)	3.7	12.7	18.2	26.1	20.3
	annual change (%) ³	-1.2	11.0	17.2	27.3	21.0
Cash in circulation	lei million	31,477	34,784	39,890	46,482	54,672
	annual change (%)	2.8	10.5	14.7	16.5	17.6
	annual change (%) ³	-2.0	8.8	13.7	17.6	18.3
ON deposits	lei million	57,543	65,526	78,691	103,069	125,308
	annual change (%)	4.2	13.9	20.1	31.0	21.6
	annual change (%) ³	-0.7	12.1	19.1	32.2	22.2

2016											
Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
5.56	5.90	5.78	5.60	5.66	5.79	5.68	5.63	5.21	5.05	5.21	4.93
7.10	6.86	6.65	6.61	6.58	6.87	7.04	7.21	7.15	7.30	6.89	6.57
4.22	4.35	4.43	4.07	4.01	4.16	3.94	3.73	3.51	3.71	3.66	3.72
0.81	0.76	0.72	0.68	0.71	0.73	0.61	0.62	0.57	0.53	0.58	0.61
1.27	1.22	1.18	1.12	1.09	1.07	1.01	0.95	0.94	0.92	0.91	0.90
0.55	0.46	0.39	0.40	0.46	0.48	0.38	0.42	0.33	0.33	0.37	0.44
3.66	3.30	3.54	3.21	3.11	3.01	3.15	3.15	2.64	2.92	3.25	3.08
4.00	4.09	4.15	4.25	4.25	4.45	4.40	4.68	4.30	4.60	4.13	4.11
3.57	3.06	3.47	3.12	3.02	2.97	3.11	3.06	2.60	2.85	3.22	3.05
0.47	0.40	0.41	0.36	0.38	0.37	0.36	0.38	0.39	0.33	0.36	0.32
0.55	0.46	0.45	0.42	0.42	0.41	0.39	0.37	0.39	0.38	0.38	0.34
0.35	0.23	0.31	0.25	0.24	0.25	0.29	0.41	0.37	0.22	0.30	0.24
284,054	283,735	280,766	285,451	290,646	295,068	294,172	295,708	296,024	296,605	301,913	314,135
9.5	9.7	9.9	10.8	12.7	13.1	13.1	12.7	12.2	11.8	11.9	9.7
11.9	12.7	13.3	14.5	16.8	13.9	14.0	13.0	12.9	12.3	12.7	10.3
x	x	x	x	x	x	x	x	x	x	x	x
283,934	283,623	280,655	285,342	290,543	294,965	294,072	295,605	295,923	296,506	301,808	314,026
9.5	9.7	9.9	10.8	12.8	13.1	13.1	12.8	12.2	11.9	11.9	9.8
11.9	12.7	13.3	14.6	16.8	13.9	14.0	13.0	12.9	12.3	12.7	10.3
148,638	148,610	145,970	152,167	155,064	159,686	161,772	162,189	164,149	166,628	171,017	179,980
25.4	25.5	25.0	28.0	29.4	27.7	27.2	24.8	25.3	26.0	25.7	20.3
28.1	28.9	28.8	32.3	34.0	28.6	28.2	25.0	26.0	26.6	26.5	21.0
47,300	46,973	46,540	48,124	48,898	50,373	51,675	51,758	51,788	52,215	53,257	54,672
16.3	13.5	14.4	16.8	16.4	19.2	19.5	18.1	18.2	18.1	17.2	17.6
18.8	16.7	17.9	20.8	20.5	20.0	20.5	18.3	18.8	18.6	18.0	18.3
101,339	101,637	99,429	104,043	106,166	109,314	110,097	110,431	112,361	114,413	117,761	125,308
30.1	31.8	30.7	33.9	36.4	32.0	31.1	28.2	28.9	30.0	30.0	21.6
33.0	35.5	34.7	38.4	41.3	32.9	32.1	28.5	29.6	30.6	30.8	22.2

		2012	2013	2014	2015	2016
Breakdown of monetary financial institutions' deposits and loans						
Deposits, total	lei million	197,295	215,646	233,334	253,418	274,267
	annual change (%)	5.3	9.3	8.2	8.6	8.2
	annual change (%) ³	0.4	7.6	7.3	9.6	8.8
Lei-denominated deposits	lei million	125,454	142,043	156,082	171,327	188,451
	annual change (%)	0.7	13.2	9.9	9.8	10.0
	annual change (%) ³	-4.0	11.5	9.0	10.8	10.6
Foreign currency-denominated deposits	lei million	71,841	73,603	77,252	82,090	85,816
	annual change (%)	14.5	2.5	5.0	6.3	4.5
	annual change (%) ³	9.1	0.9	4.1	7.3	5.1
Household deposits, total	lei million	122,221	129,727	138,018	146,780	163,462
	annual change (%)	8.4	6.1	6.4	6.3	11.4
	annual change (%) ³	3.3	4.5	5.5	7.3	12.0
Household deposits, lei	lei million	74,799	80,071	86,200	91,681	103,643
	annual change (%)	3.7	7.0	7.7	6.4	13.0
	annual change (%) ³	-1.1	5.4	6.8	7.4	13.7
	% of household deposits	61.2	61.7	62.5	62.5	63.4
Household deposits, fx	lei million	47,422	49,656	51,818	55,100	59,819
	annual change (%)	16.7	4.7	4.4	6.3	8.6
	annual change (%) ³	11.2	3.1	3.5	7.3	9.2
	% of household deposits	38.8	38.3	37.5	37.5	36.6
Deposits from non-financial corporations, total	lei million	61,190	70,781	80,427	91,433	95,175
	annual change (%)	-1.9	15.7	13.6	13.7	4.1
	annual change (%) ³	-6.6	13.9	12.7	14.8	4.7
Deposits from non-financial corporations, lei	lei million	41,200	51,167	59,404	68,590	73,381
	annual change (%)	-4.9	24.2	16.1	15.5	7.0
	annual change (%) ³	-9.4	22.3	15.1	16.5	7.6
	% of total	67.3	72.3	73.9	75.0	77.1
Deposits from non-financial corporations, fx	lei million	19,990	19,614	21,024	22,843	21,794
	annual change (%)	4.9	-1.9	7.2	8.7	-4.6
	annual change (%) ³	0.0	-3.4	6.3	9.7	-4.1
Domestic credit, of which:	lei million	304,689	298,923	296,711	307,034	313,359
	annual change (%)	3.7	-1.9	-0.7	3.5	2.1
	annual change (%) ³	-1.2	-3.4	-1.6	4.5	2.6
	percent of GDP	51.2	46.9	44.4	43.2	41.2
Loans to the private sector – total, of which:	lei million	225,836	218,462	211,164	217,399	220,101
	annual change (%)	1.3	-3.3	-3.3	3.0	1.2
	annual change (%) ³	-3.5	-4.7	-4.1	3.9	1.8
	percent of GDP	37.9	34.3	31.6	30.6	28.9
Loans to the private sector, lei	lei million	84,723	85,354	92,100	110,157	125,946
	annual change (%)	3.8	0.7	7.9	19.6	14.3
	annual change (%) ³	-1.1	-0.8	7.0	20.7	15.0
	% of total ⁸	37.5	39.1	43.6	50.7	57.2
Loans to the private sector, fx	lei million	141,113	133,108	119,064	107,242	94,155
	annual change (%)	-0.2	-5.7	-10.6	-9.9	-12.2
	annual change (%) ³	-4.9	-7.1	-11.3	-9.1	-11.7
	% of total ⁸	62.5	60.9	56.4	49.3	42.8
Loans to households, total	lei million	104,461	103,244	102,117	107,953	113,037
	annual change (%)	0.2	-1.2	-1.1	5.7	4.7
	annual change (%) ³	-4.5	-2.7	-1.9	6.7	5.3
	% of total ⁸	46.3	47.3	48.4	49.7	51.4
Loans to non-financial corporations, total	lei million	118,789	112,340	105,468	104,832	101,642
	annual change (%)	3.0	-5.4	-6.1	-0.6	-3.0
	annual change (%) ³	-1.9	-6.9	-6.9	0.3	-2.5
	% of total ⁸	52.6	51.4	49.9	48.2	46.2

2016											
Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
250,494	250,677	248,248	251,532	256,208	259,430	257,172	258,496	258,530	258,879	263,149	274,267
8.8	9.5	9.5	10.1	12.4	12.3	12.2	11.8	11.1	10.8	10.9	8.2
11.1	12.5	12.9	13.8	16.4	13.1	13.1	12.0	11.8	11.3	11.6	8.8
168,038	166,757	165,045	167,639	172,521	175,102	172,509	174,733	174,313	174,146	178,525	188,451
10.3	10.6	11.1	11.4	15.1	15.3	15.0	15.1	14.5	13.6	13.9	10.0
12.7	13.6	14.5	15.2	19.3	16.1	15.9	15.4	15.1	14.1	14.6	10.6
82,456	83,920	83,203	83,893	83,687	84,328	84,663	83,763	84,217	84,733	84,624	85,816
5.8	7.5	6.5	7.5	7.1	6.7	6.9	5.4	4.8	5.4	5.0	4.5
8.1	10.4	9.8	11.1	10.9	7.4	7.8	5.6	5.4	5.8	5.7	5.1
148,404	147,952	148,262	150,445	152,348	154,480	154,303	153,888	154,274	155,834	158,536	163,462
6.6	6.2	6.4	7.4	8.4	9.3	9.3	9.2	9.3	9.8	10.5	11.4
8.9	9.1	9.7	11.0	12.3	10.0	10.1	9.4	9.9	10.2	11.2	12.0
93,004	92,777	93,000	94,727	95,869	97,459	97,425	96,939	97,086	97,655	100,083	103,643
6.8	6.4	6.7	7.8	9.3	10.7	10.5	10.5	10.5	10.8	12.1	13.0
9.1	9.3	10.0	11.5	13.2	11.5	11.3	10.8	11.1	11.3	12.9	13.7
62.7	62.7	62.7	63.0	62.9	63.1	63.1	63.0	62.9	62.7	63.1	63.4
55,400	55,175	55,263	55,718	56,480	57,021	56,878	56,949	57,188	58,179	58,453	59,819
6.2	5.9	5.9	6.6	7.0	6.9	7.3	6.9	7.3	8.0	7.7	8.6
8.5	8.9	9.1	10.2	10.8	7.6	8.1	7.2	7.9	8.5	8.5	9.2
37.3	37.3	37.3	37.0	37.1	36.9	36.9	37.0	37.1	37.3	36.9	36.6
87,292	86,648	84,846	85,239	86,859	87,344	84,723	87,132	87,649	87,959	89,348	95,175
15.1	16.0	15.8	16.1	18.3	16.3	14.8	13.9	13.5	13.8	12.5	4.1
17.6	19.2	19.3	20.0	22.5	17.1	15.7	14.2	14.2	14.3	13.3	4.7
64,013	62,457	60,891	61,095	63,712	64,006	60,934	64,220	64,590	65,440	67,281	73,381
16.9	17.6	18.3	17.8	21.3	19.4	17.8	18.1	18.5	18.8	17.5	7.0
19.5	20.8	21.9	21.8	25.6	20.2	18.8	18.3	19.2	19.3	18.3	7.6
73.3	72.1	71.8	71.7	73.4	73.3	71.9	73.7	73.7	74.4	75.3	77.1
23,279	24,191	23,956	24,144	23,147	23,338	23,788	22,912	23,059	22,519	22,067	21,794
10.4	12.2	9.7	11.9	10.8	8.4	7.8	3.7	1.6	1.4	-0.4	-4.6
12.8	15.3	13.1	15.6	14.8	9.2	8.7	3.9	2.1	1.8	0.3	-4.1
304,710	304,808	306,642	308,591	308,790	308,587	307,977	302,110	305,733	310,685	314,210	313,359
2.6	1.1	1.9	4.3	2.2	1.9	3.4	0.5	1.2	4.0	3.0	2.1
4.8	3.9	5.1	7.8	5.9	2.6	4.2	0.7	1.8	4.4	3.7	2.6
x	x	x	x	x	x	x	x	x	x	x	x
216,112	215,251	216,308	216,439	217,889	217,594	216,138	215,385	216,847	218,754	220,625	220,101
2.8	2.4	2.8	3.0	2.4	1.2	1.8	0.7	1.2	2.0	1.0	1.2
5.0	5.2	5.9	6.5	6.0	1.9	2.6	0.9	1.8	2.5	1.7	1.8
x	x	x	x	x	x	x	x	x	x	x	x
110,006	111,329	113,834	115,747	117,596	118,986	119,545	120,376	121,899	123,392	125,470	125,946
20.1	20.7	20.2	21.1	19.3	16.2	15.7	14.3	13.2	13.5	12.9	14.3
22.7	24.0	23.9	25.1	23.6	17.0	16.6	14.5	13.8	14.0	13.7	15.0
50.9	51.7	52.6	53.5	54.0	54.7	55.3	55.9	56.2	56.4	56.9	57.2
106,105	103,922	102,474	100,692	100,293	98,609	96,593	95,009	94,947	95,362	95,154	94,155
-10.6	-11.9	-11.5	-12.0	-12.2	-12.5	-11.4	-12.5	-11.0	-9.8	-11.4	-12.2
-8.7	-9.5	-8.8	-9.1	-9.1	-11.9	-10.7	-12.3	-10.5	-9.4	-10.8	-11.7
49.1	48.3	47.4	46.5	46.0	45.3	44.7	44.1	43.8	43.6	43.1	42.8
107,623	107,245	107,949	108,683	109,393	110,526	110,468	110,802	111,369	112,282	112,848	113,037
4.9	5.0	5.4	6.0	4.7	5.2	6.0	5.8	6.3	6.6	4.9	4.7
7.1	7.9	8.7	9.6	8.4	6.0	6.8	6.0	6.9	7.1	5.6	5.3
49.8	49.8	49.9	50.2	50.2	50.8	51.1	51.4	51.4	51.3	51.1	51.4
104,058	103,400	103,853	102,729	103,156	101,631	100,409	99,077	99,850	101,402	102,221	101,642
-0.2	-0.8	-0.7	-1.5	-1.9	-4.1	-3.9	-5.9	-5.3	-3.6	-4.2	-3.0
2.0	1.9	2.4	1.8	1.6	-3.4	-3.2	-5.8	-4.8	-3.2	-3.5	-2.5
48.2	48.0	48.0	47.5	47.3	46.7	46.5	46.0	46.0	46.4	46.3	46.2

		2012	2013	2014	2015	2016
Banking system – key prudential indicators						
Total capital ratio (previously solvency ratio)	percent	14.9	15.5	17.6	19.2	19.7
Tier 1 capital ratio	percent	13.8	14.1	14.6	16.7	17.5
Common Equity Tier 1 capital ratio	percent	x	x	14.6	16.7	17.5
Leverage ratio	percent	8.0	8.0	7.4	8.2	8.9
Non-performing loan ratio (EBA definition)	percent	x	x	20.7	13.5	9.6
Immediate liquidity	percent	35.9	41.5	41.1	40.8	40.3
ROA	percent	-0.6	0.0	-1.3	1.2	1.1
ROE	percent	-5.9	0.1	-12.5	11.8	10.4
Balance of payments^{1,9}						
Current account, balance	EUR million	-6,386	-1,539	-1,012	-1,978	-3,966
	percent of GDP	-4.8	-1.1	-0.7	-1.2	-2.3
Balance on trade in goods	EUR million	-9,267	-5,816	-6,536	-7,794	-9,254
	percent of GDP	-6.9	-4.0	-4.3	-4.9	-5.5
Balance on trade in services	EUR million	2,476	4,702	5,868	6,794	7,658
	percent of GDP	1.9	3.3	3.9	4.2	4.5
Capital account, balance	EUR million	1,880	3,038	3,954	3,901	4,237
Financial account, net	EUR million	-3,306	1,673	3,068	2,280	1,577
External debt⁹						
External debt, total	EUR million	100,857	98,069	94,744	90,434	92,377
	percent of GDP	75.5	68.0	63.0	56.5	54.5
Long-term external debt, of which:	EUR million	79,936	78,860	75,829	70,557	68,979
	percent of GDP	59.8	54.7	50.4	44.1	40.7
Direct public debt	EUR million	23,782	29,069	31,754	30,941	31,694
	percent of GDP	17.8	20.2	21.1	19.3	18.7
Publicly guaranteed debt	EUR million	1,424	1,225	1,078	669	545
	percent of GDP	1.1	0.8	0.7	0.4	0.3
Non-publicly guaranteed debt	EUR million	37,183	36,303	34,312	32,694	31,697
	percent of GDP	27.8	25.2	22.8	20.4	18.7
Long-term deposits of non-residents	EUR million	7,745	6,453	6,091	4,880	3,787
	percent of GDP	5.8	4.5	4.1	3.1	2.2
Loans from the IMF	EUR million	8,655	4,708	1,421	122	0.0
	percent of GDP	6.5	3.3	0.9	0.1	0.0
SDR allocations from the IMF	EUR million	1,148	1,102	1,173	1,252	1,255
	percent of GDP	0.9	0.8	0.8	0.8	0.7
Short-term external debt	EUR million	20,921	19,209	18,915	19,876	23,398
	percent of GDP	15.7	13.3	12.6	12.4	13.8

1) 2012-2014: final data; 2015: semi-final data; 2016: provisional data; 2) current prices; 3) real terms; 4) ESA 2010 methodology; 5) national methodology; 6) annual figures based on monthly averages; monthly values are calculated as the average of the daily exchange rates calculated and released by the NBR; 7) annual figures are annual averages; 8) total loans to the private sector; 9) BPM6 methodology.

Source: National Bank of Romania, National Institute of Statistics, Ministry of Public Finance, Eurostat, European Commission, NBR calculations.

2016											
Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
x	x	19.5	x	x	19.1	x	x	18.8	x	x	19.7
x	x	17.2	x	x	16.8	x	x	16.6	x	x	17.5
x	x	17.2	x	x	16.8	x	x	16.6	x	x	17.5
x	x	8.7	x	x	8.6	x	x	8.6	x	x	8.9
13.5	13.6	13.5	13.1	12.4	11.3	11.0	10.6	10.0	10.0	9.9	9.6
40.5	39.6	38.7	38.5	38.4	39.2	38.7	39.4	39.2	37.9	38.2	40.3
0.9	1.4	1.3	1.3	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.1
8.9	13.0	11.7	12.4	10.8	12.3	12.6	12.7	12.3	12.2	12.0	10.4
199	-139	-315	-905	-1,714	-1,958	-2,226	-2,650	-2,691	-3,072	-3,445	-3,966
x	x	-1.0	x	x	-2.7	x	x	-2.3	x	x	-2.3
-372	-987	-1,872	-2,637	-3,506	-4,165	-4,798	-5,758	-6,487	-7,358	-8,138	-9,254
x	x	-5.7	x	x	-5.8	x	x	-5.5	x	x	-5.5
578	1,208	1,822	2,486	3,151	3,793	4,443	5,031	5,689	6,415	6,974	7,658
x	x	5.6	x	x	5.2	x	x	4.8	x	x	4.5
256	585	1,310	1,747	2,021	2,567	2,823	3,289	3,715	4,087	4,118	4,237
198	-106	1,071	1,457	1,033	1,510	1,820	2,184	2,932	3,529	2,530	1,577
89,710	89,630	90,851	88,415	88,017	91,630	90,049	90,092	93,675	92,213	92,498	92,377
x	x	x	x	x	x	x	x	x	x	x	x
69,944	70,716	71,139	69,993	69,935	70,198	69,381	70,167	70,515	70,385	69,758	68,979
x	x	x	x	x	x	x	x	x	x	x	x
30,590	31,221	31,281	30,644	31,576	30,710	31,007	31,988	31,935	32,254	31,537	31,694
x	x	x	x	x	x	x	x	x	x	x	x
646	656	639	638	635	605	594	593	580	580	580	545
x	x	x	x	x	x	x	x	x	x	x	x
32,468	32,652	33,398	32,637	31,700	33,530	32,153	32,315	32,651	32,324	32,447	31,697
x	x	x	x	x	x	x	x	x	x	x	x
4,995	4,940	4,602	4,848	4,785	4,116	4,392	4,039	4,120	3,991	3,938	3,787
x	x	x	x	x	x	x	x	x	x	x	x
0	0	0	0	0	0	0	0	0	0	0	0
x	x	x	x	x	x	x	x	x	x	x	x
1,245	1,248	1,220	1,226	1,239	1,237	1,235	1,232	1,230	1,236	1,257	1,255
x	x	x	x	x	x	x	x	x	x	x	x
19,766	18,914	19,713	18,422	18,082	21,432	20,669	19,925	23,160	21,829	22,740	23,398
x	x	x	x	x	x	x	x	x	x	x	x

Abbreviations

BIS	Bank for International Settlements
CCR	Central Credit Register
CPI	Consumer Price Index
CRD IV	Capital Requirements Directive IV
CCR	Capital Requirements Regulation
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EIB	European Investment Bank
ESA	European System of Accounts
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
EU	European Union
Eurostat	Statistical Office of the European Union
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices
IBRD	International Bank for Reconstruction and Development
IFRS	International Financial Reporting Standards
ILO	International Labour Organisation
IMF	International Monetary Fund
MPF	Ministry of Public Finance
NBFI	non-bank financial institution
NCFS	National Committee for Financial Stability
NCMO	National Committee for Macroprudential Oversight
NIS	National Institute of Statistics
NPL	non-performing loans
PIR	Payment Incidents Register
ROBOR	Romanian Interbank Offered Rate
SDR	Special Drawing Rights
VAT	value added tax
WB	World Bank

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