"The budget deficit target for 2014 provides for further fiscal adjustment, while also supporting greater absorption of European Union funds. Improved capital spending, better revenue collection, and implementation of an expenditure control system are key priorities. Additional action is required to reform the health care sector and shield vulnerable households from deregulated energy prices.

"Efforts are needed to strengthen monetary policy transmission. The banking system remains well capitalized, but the authorities need to accelerate the resolution of non-performing loans and closely monitor risks from parent bank deleveraging. The non-bank financial regulator needs to be reformed in line with best international practices.

"Structural reforms in the energy and transportation sectors have progressed. Electricity prices for commercial users have been liberalized and initial public offerings were held in two major energy companies. Sustained progress in state-owned enterprise reform, including a restructuring of the freight railway company and a reduction of arrears will continue to be critical components of the program.

"The EPE concluded that the program objectives were largely met, although progress on structural reforms was uneven and vulnerabilities remain. The evaluation draws several lessons for Fund engagement with Romania. First, program conditionality, particularly as regards complex structural reforms, is no substitute for country ownership. Second, addressing financial sector risks requires strong coordination between home and host supervisors, appropriate macro-prudential policies, and data transparency."

Statement by Mr. Menno Snel, Executive Director for Romania, and Mr. Serban Matei, Senior Advisor to the Executive Director March 26, 2014

We thank the staff for their efforts and constructive dialogue. The current economic program, jointly supported by the Fund, the European Commission, and the World Bank, played an important role in stabilizing the Romanian economy, generating concrete results in maintaining growth and fiscal and financial stability. Romania's performance under the current program continues to be strong. Significant adjustments have taken place in essential areas: exports improved, the current account deficit has narrowed, inflation has decelerated, interest rates considerably adjusted, the fiscal consolidation has continued and the financial sector maintains significant buffers.

The Romanian authorities continue their efforts to reach the goals of a broad structural agenda, with a focus on structural reforms in the energy, transport and healthcare sectors, and continue the reform of the state-owned enterprises. Initial public offerings (IPOs) of shares have been launched in two significant state-owned energy companies and the energy regulator implemented the next steps of the energy price liberalization roadmaps as planned. Absorption of EU funds has significantly accelerated, which is particularly important since domestic demand has been weaker than expected. For 2014, the Romanian authorities remain committed to gradually reducing the fiscal deficit, while slightly moderating the adjustment path to facilitate greater absorption of EU funds with a view to enhancing the economy's growth potential. The prior action on SOE arrears has already been met, together with four out of five quantitative performance criteria.

The recent economic developments are encouraging. Despite a challenging environment, Romania's economic recovery continues. Real GDP grew by 3.5 percent in 2013 and is projected at 2.2 percent in 2014, less than in 2013 but with a significant pick-up in non- agricultural growth. The main engine of growth was exports, which offset a sharp fall in domestic demand. For 2013 exports to other EU countries increased by 8 percent while exports to non-EU countries were even stronger, growing at 10 percent. A bountiful harvest and good industry performance further boosted output, with agriculture accounting for almost a third of the annual output increase.

The inflation rate has rapidly fallen below the central bank's target range, from 1.6 percent in the second half of 2013 to 1.1 percent (yoy) in February on account of declining food prices due to the abundant autumn harvest, a reduction in VAT on flour and bakery products, the dissipating effects of administered price increases in 2012, and weak domestic demand.

The external position has been consolidated. The current account deficit narrowed, with 1.1 percent expected for 2013. There are signs that some of the improvement could be permanent, such as the greater value added in exports, larger share of service exports, and lower energy imports. Romania continued and improved its presence on international capital markets, thus generating buffers equal with 9 months of gross financing needs.

The authorities successfully tapped international capital markets several times since September, most recently garnering USD 2 billion from an issuance of 10- and 30-year Eurobonds in January 2014, which followed the 2013 Euro denominated issuances for 1.5 billion in September 2013 and 0.5 billion in October 2013. Sovereign and CDS spreads widened during the recent market turbulence but less than in most other many emerging markets, underpinning that sound macroeconomic policies have shielded Romania from most of the recent volatility. Private sector capital flows were more mixed with FDI picking up from recent lows, while banking sector deleveraging continued. The central bank sustained international reserves at €35 billion as of end-February, while making substantial repayments to the Fund in 2013 (almost 60 percent of the amount).

Despite the progress achieved, the recovery remains vulnerable to adverse developments in international markets, regional unrest, and possibly continued bank deleveraging. The monetary policy tightening in advanced economies could trigger capital outflows as investors reassess portfolio risks and return with further downward pressure on the exchange rate. Capital flows could also come under pressure if confidence wanes as the situation in the region unfolds. Given the large volume of foreign-currency lending, a sharp depreciation in the exchange rate could lead to further deterioration in bank and private sector balance sheets. Possible spillovers to Romania from the Ukrainian situation are marginal, especially in the short run. The authorities will remain vigilant, act proactively, and take the necessary steps to contain these risks. Therefore, continued firm policy implementation and maintenance of fiscal, external, and financial sector buffers to safeguard against risks are essential for the Romanian authorities.

Good progress has been made in the fiscal sector. Since the start of the first program, Romania significantly improved its fiscal position and the authorities remain committed to continue this process. The new government, formed in early March intends to pursue new fiscal measures only provided that they are consistent with the fiscal framework. In 2013, the fiscal deficit remained below 3 percent of GDP, below the threshold of the EU's Excessive Deficit Procedure. Under the new fiscal strategy, implementing further structural adjustments, the 2014 budget targets a cash deficit of 2.2 percent of GDP. Compensating measures to achieve the deficit target have been taken, with excises increased in line with inflation instead of the exchange rate and the base on property taxes has been expanded to include special constructions. The implementation of the disputed 7 euro cent surcharge on diesel and gasoline products will start on April 1st, 2014. Given the recent acceleration in the absorption of EU funds, the deficit ceiling was increased by

0.2 percent of GDP compared to program approval to create room for more co-financing of EU funds (in the form of an adjuster). Specifically, additional EU funds absorption has been incorporated into the baseline deficit target, which will be tightened if actual EU cofinancing is less than projected.

The government considers its measures towards eliminating central and local government arrears crucial. Program arrears targets were met, with central government arrears remaining at a de minimis level, while local government arrears minimally increased, although remaining below the indicative ceiling.

The monetary authorities responded appropriately to economic developments. The National Bank of Romania (NBR) continued the easing cycle during September 2013 to February 2014, lowering the policy rate by a cumulative 100 basis points to 3.5 percent. Reflecting this decline, average interest rates on new loans reached historical lows at the end of 2013 (7.6 percent). In addition, in January 2014 the NBR reduced the high minimum reserve requirements (MRRs) by three percent for Romanian Leu denominated liabilities and two percentage points for the foreign exchange denominated ones, with a view to gradually bringing the MRRs closer to levels maintained by the European Central Bank and prevailing in most other EU countries.

Base money creation has increasingly reflected treasury operations related to growing disbursements of EU funds. The resulting buildup of excess liquidity, which in the meantime has been mopped up, explained the divergence between interbank rates and the policy rate, which has complicated monetary operations. The central bank will ensure adequate liquidity conditions in the banking system, while underpinning the good functioning of money markets and reducing the divergence between interbank rates and the policy rate in order to strengthen the transmission of monetary policy signals. The Romanian monetary authorities are committed to closely monitor inflation developments following the recent easing steps to ascertain that inflation expectations remain firmly anchored, and market conditions remain favorable.

The Romanian financial sector is performing well. It maintains reassuring capital buffers, enhanced liquidity and provisioning, but is still confronted with pressures from foreign bank deleveraging. Total prudential provisions at the end of 2013 were sufficient to cover 89.8 percent of NPLs while the IFRS provisioning ratio increased to 67.6 percent. In line with EU regulatory requirements, the prudential filter started its scheduled phase-out period at end- January 2014. It was reduced by one fifth, and will be gradually eliminated until 2018. This measure will have a positive impact on the level of own funds that are taken into account for determining the level of the capital adequacy ratio, due to the gradual decrease of the number of prudential filters previously used as deductions from own funds. The provisioning requirements, along with low lending activity and a relatively high cost base, led banks to obtain a positive financial result in 2013. The

capitalization of the banking sector remained strong at 15 percent. A new collateral audit mandated by the central bank in the last quarter of 2013 led to the identification of a system-wide provisioning gap of RON 800 million, which was closed by year-end. Foreign-owned bank deleveraging has accelerated in line with the rest of the region but remains orderly, with a parent funding decline of 30 percent since end-2011 (19 percent in 2013 alone up to December). As a result, reliance on local funding has increased, especially deposits, prompting a significant fall of the system-wide loan-to-deposit ratio to 105 percent at end-2013, from 117 percent the previous year. The central bank will continue to closely monitor and supervise the banking system and take any necessary measures to ensure that banks maintain sufficient capital and liquidity and, in close coordination with the IMF and EC, the NBR will continue to regularly conduct top-down and bottom-up solvency stress tests as well as liquidity stress tests of the banking industry.

Significant progress has been achieved in the implementation of the structural reform agenda. Since the debut of the current program authorities have launched a landmark IPO of the state-owned natural gas producer (Romgaz), sold 10 percent of the shares in the nuclear energy company (Nuclearelectrica) and the energy regulator raised prices in accordance with the liberalization calendars. Both IPOs were oversubscribed and generated significant million in gross proceeds. Moreover, the Romgaz transaction was completed at the upper end of the price range. The authorities also committed to undertake a major restructuring of the state- owned freight railway operator (CFR Marfa) in the wake of the failed privatization effort. The process has already started with measures in avoiding arrears and will continue with the authorities' intention to re-launch the privatization of this company. On the transport sector, authorities will continue to work closely with the World Bank and EBRD to continue reform of the rail sector with the goal of improving the financial and operational performance of railway SOEs and the quality of rail service.

Healthcare represents another important pillar of the reform. Progress has been made in reforming the healthcare system to ensure financial sustainability, raise efficiency, and improve health services delivery. The authorities have defined and evaluated a basic health package. The reform measures are designed to remain within the existing budget in 2014. Remaining services to be covered by private co-payments and private health insurance will be defined by September 2014. The authorities have already launched discussions with the private sector on various private insurance schemes to cover those remaining services.

In conclusion, my authorities concur that the current precautionary Stand-By Arrangement is crucial in maintaining the reform momentum, providing additional security against unforeseen risks, and building on the considerable progress achieved over the past years. The program set the stage for strong and sustainable economic development while maintaining external and internal stability. The authorities remain committed to the economic program.