

Meeting of the Romanian Banking Association

Recent Macroeconomic & Banking System Developments

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NATIONAL BANK OF ROMANIA



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Developments in 2005-2006

Developments in 2005-2006

- **CPI inflation:** 8.6% (Dec. 2005/Dec. 2004);
4.87% (Dec. 2006.-Dec. 2005)
- **GDP growth:** 4.1% in 2005;
2006 estimate: 7.9%
- **Current account deficit:** EUR 6.9 bn. (8.7% of GDP) in 2005;
75.6% covered by FDI;
2006: around 10% of GDP
- **Foreign Direct Investment:** EUR 5.2 bn. at end-2005;
2006 estimate: EUR 9-9.2 bn.
- **Fiscal balance:** -0.8% of GDP in 2005
2006 estimate: -1% of GDP

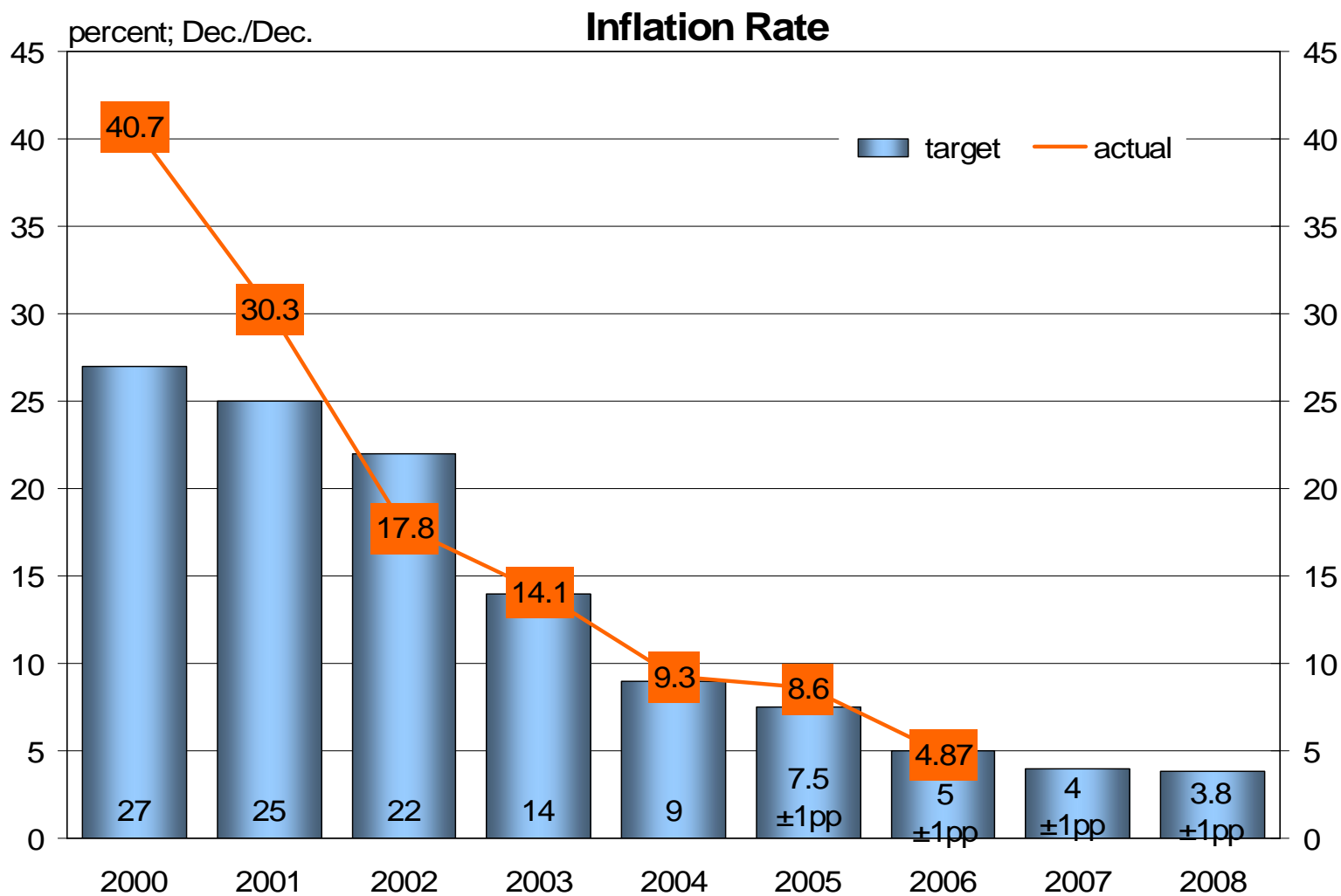
Developments in 2005-2006

- **International reserves at record level (foreign currency including gold):**
 - 2005: EUR 18.3 bn.; forex reserves EUR 16.8 bn.
 - 2006: EUR 22.9 bn.; forex reserves EUR 21.3 bn.

- **Rating agencies upgraded Romania's rating**
 - **Fitch upgraded Romania's foreign currency rating from BBB- to BBB with stable outlook on August 31, 2006**
 - **Japan Credit Rating Agency improved its rating from BBB- to BBB with stable outlook on November 29, 2006**

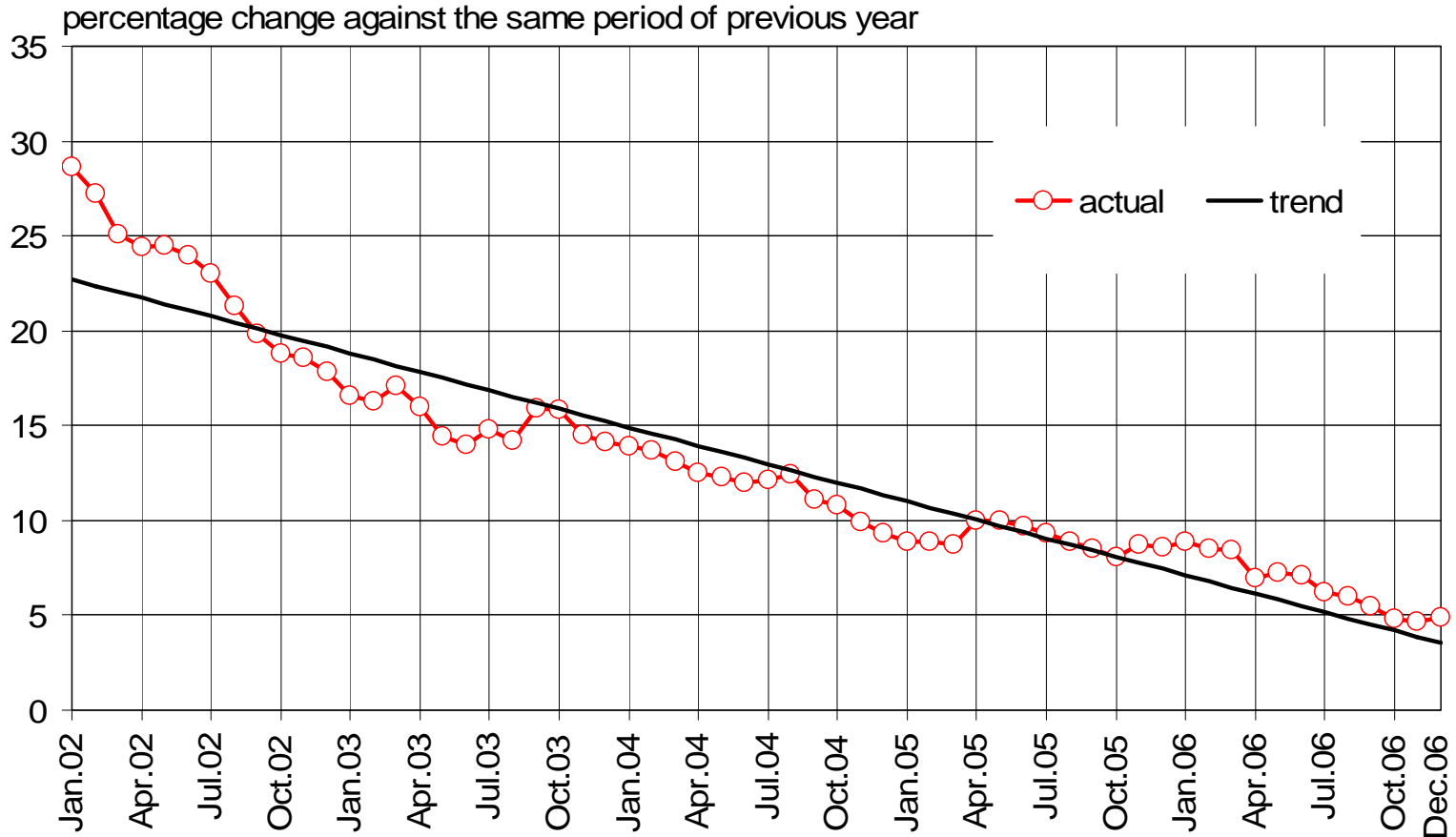
Macroeconomic Indicators

- Inflation
- Real sector
- External sector
- Fiscal position
- Monetary data



Source: National Institute of Statistics, National Bank of Romania

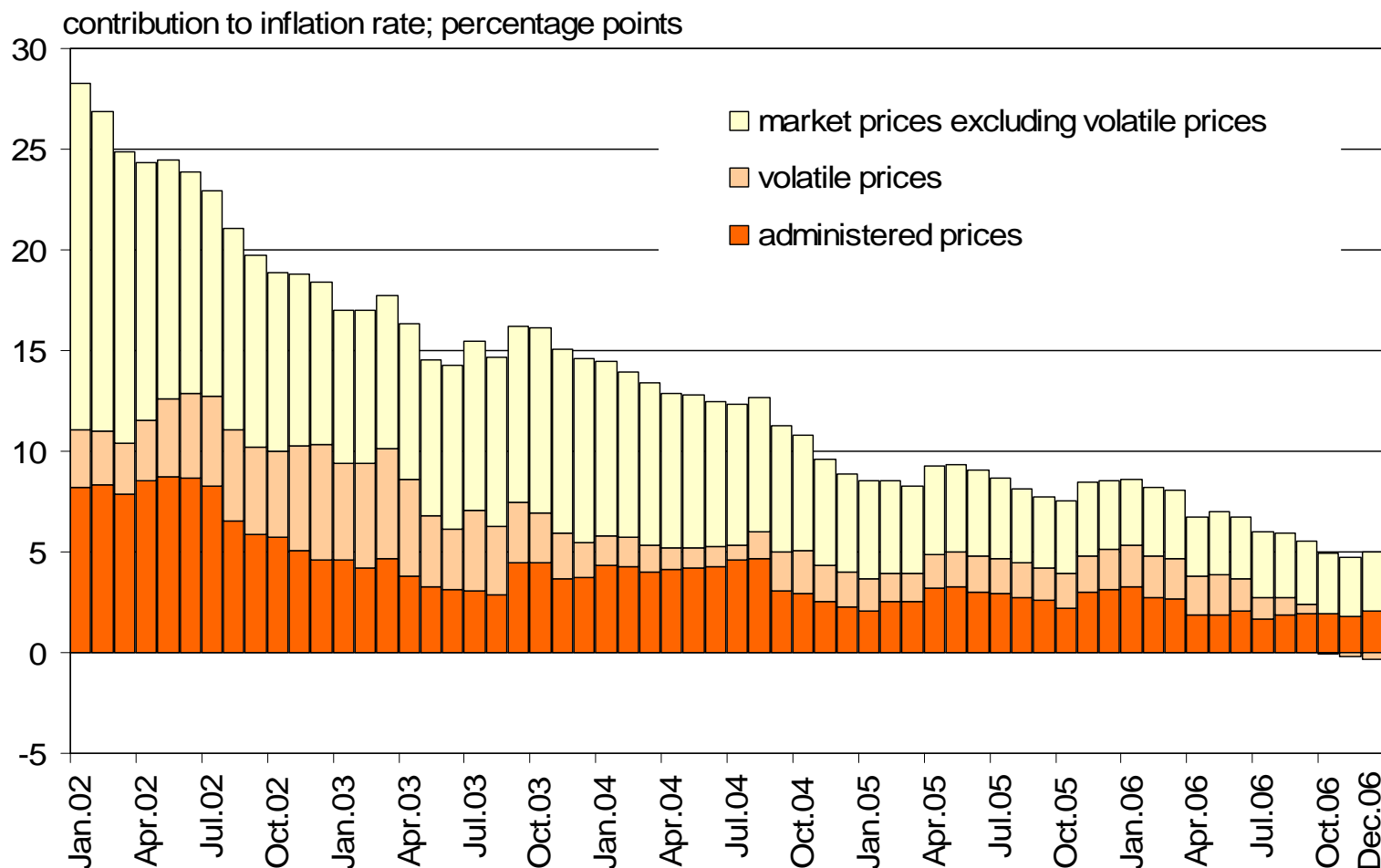
Inflation Rate



CPI inflation Dec. 2006/Dec. 2005: 4.87%

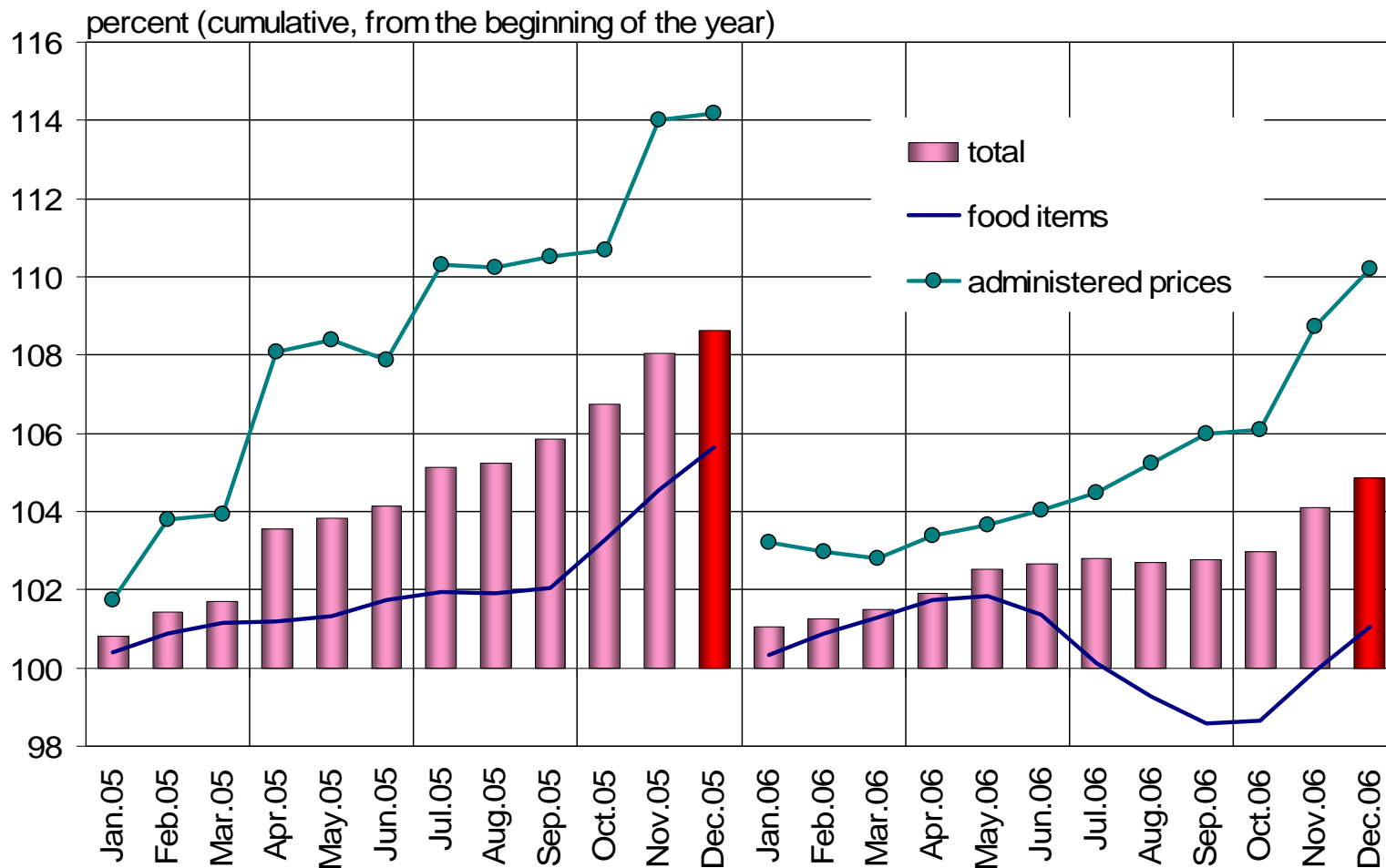
Source: National Institute of Statistics

Inflation Rate



Source: National Institute of Statistics; National Bank of Romania calculations

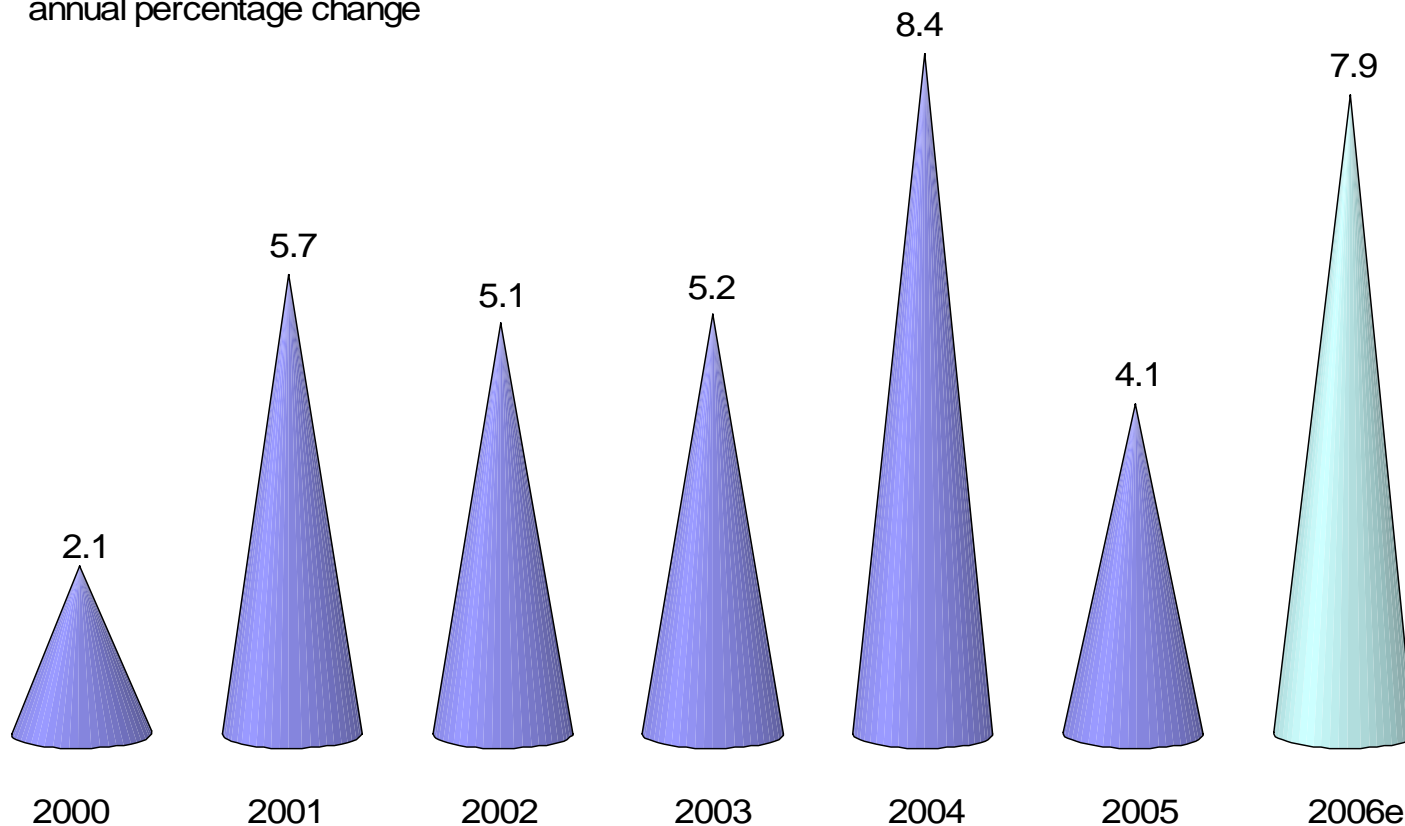
Consumer Price Index



Source: National Institute of Statistics

Real GDP

annual percentage change

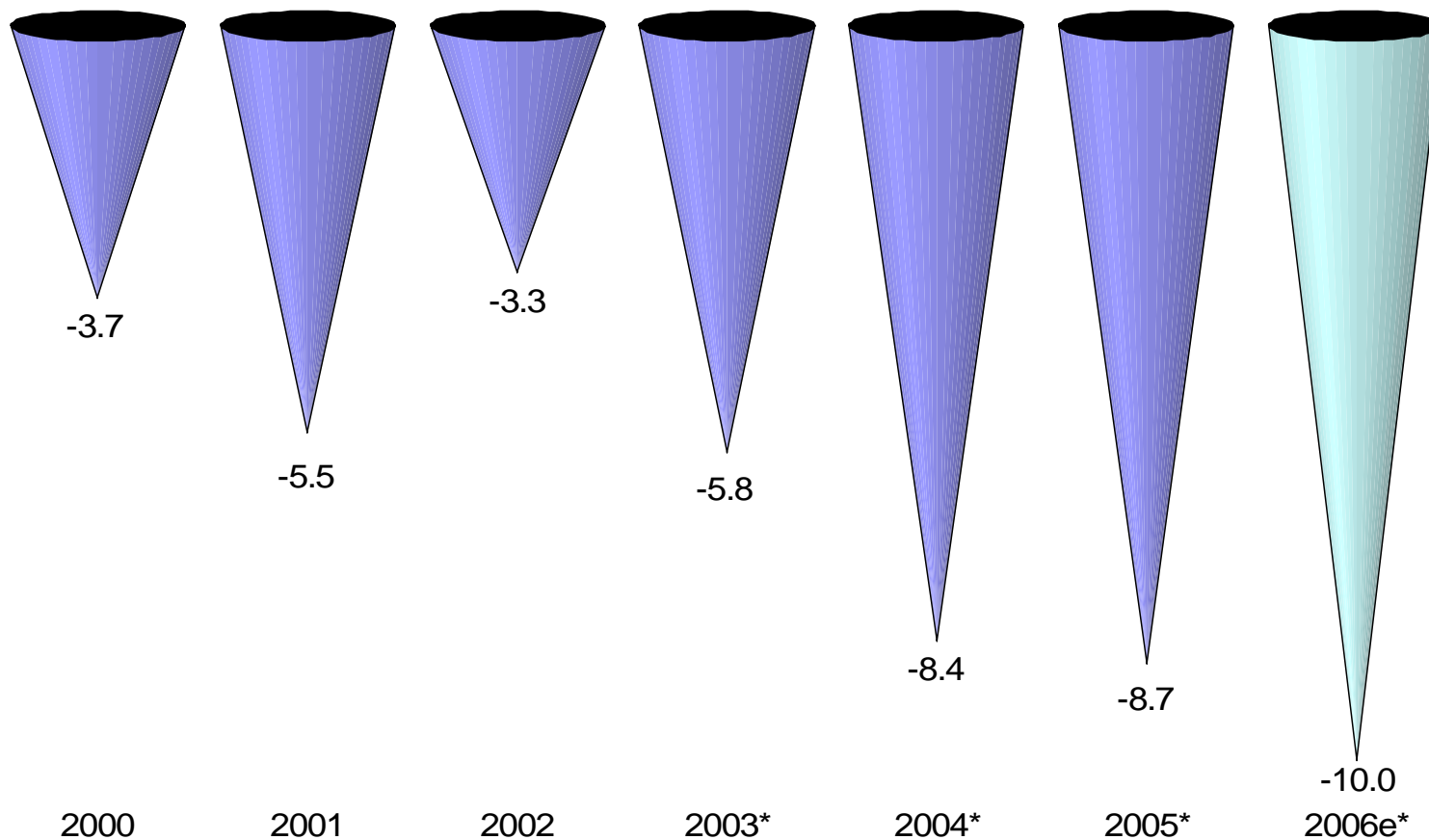


2005: investment up 13%; private consumption up 9%

Source: National Institute of Statistics; National Commission of Prognosis

Current Account Balance/GDP

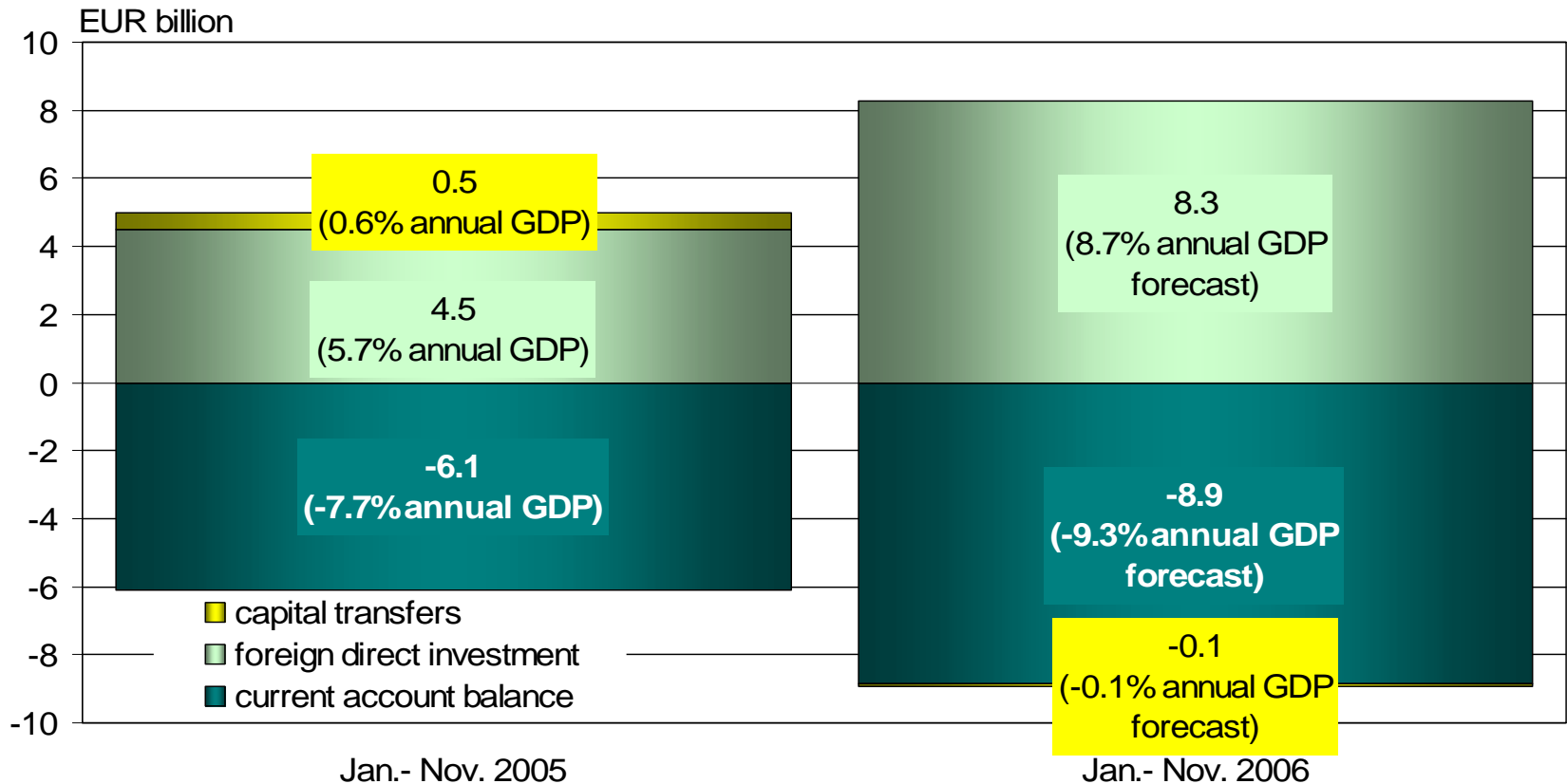
percent



*) including reinvested profit

Source: National Bank of Romania; National Institute of Statistics; National Commission of Prognosis

Current Account Deficit Financing via FDI

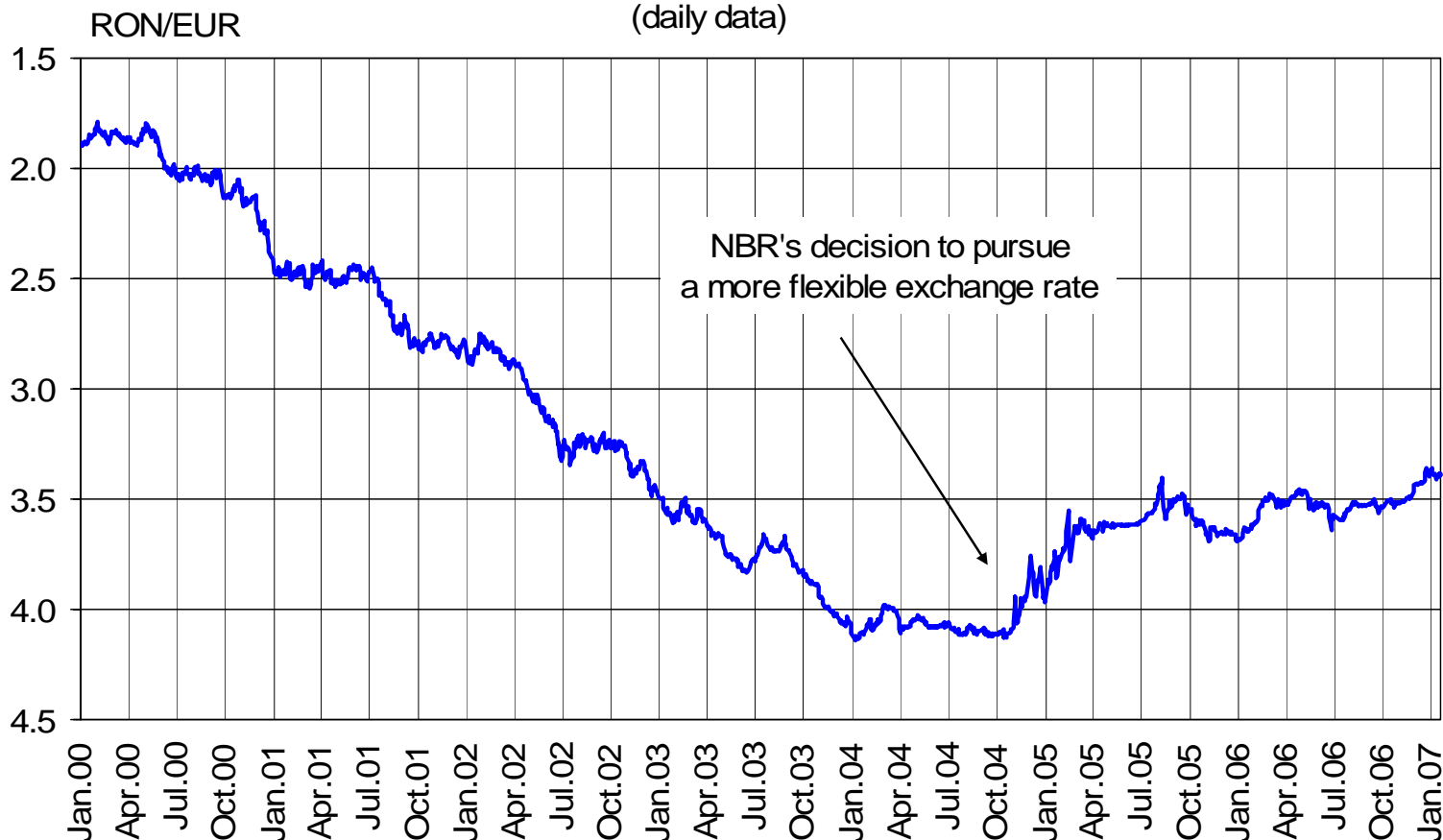


Current account financing via FDI (including capital transfers) amounted to 92.5% in Jan.-Nov. 2006 vs 81.3% in Jan.-Nov. 2005. In Jan.-Nov. 2006, net FDI was 1.8 times higher yoy.

Source: National Bank of Romania; National Institute of Statistics; National Commission of Prognosis

Nominal Exchange Rate

(daily data)

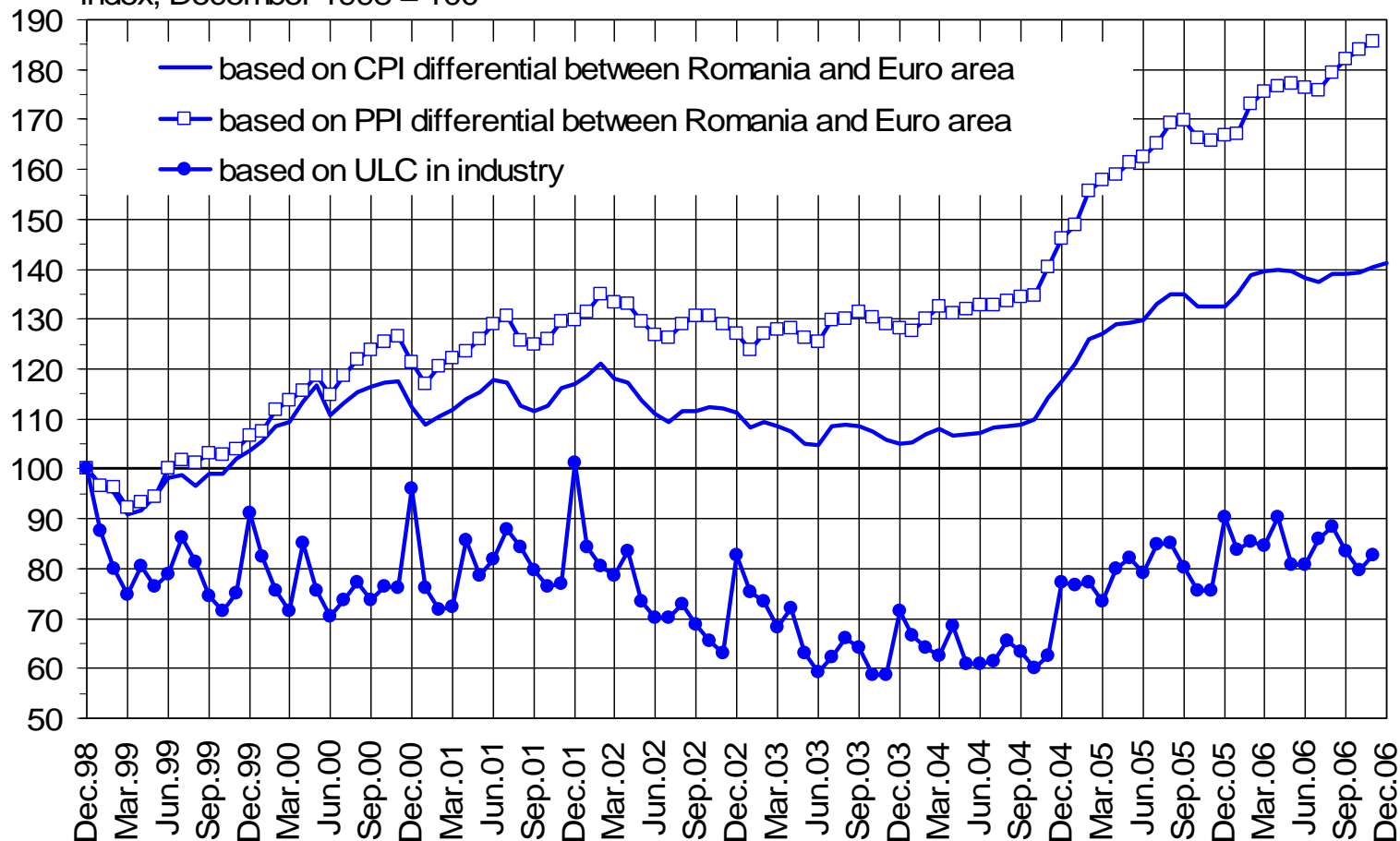


At end-December 2006, real appreciation of the RON against the EUR was 39.4% compared with end-October 2004 and 14% compared with end-December 2005.

Source: National Bank of Romania

Real Average Exchange Rate of the RON against the EUR

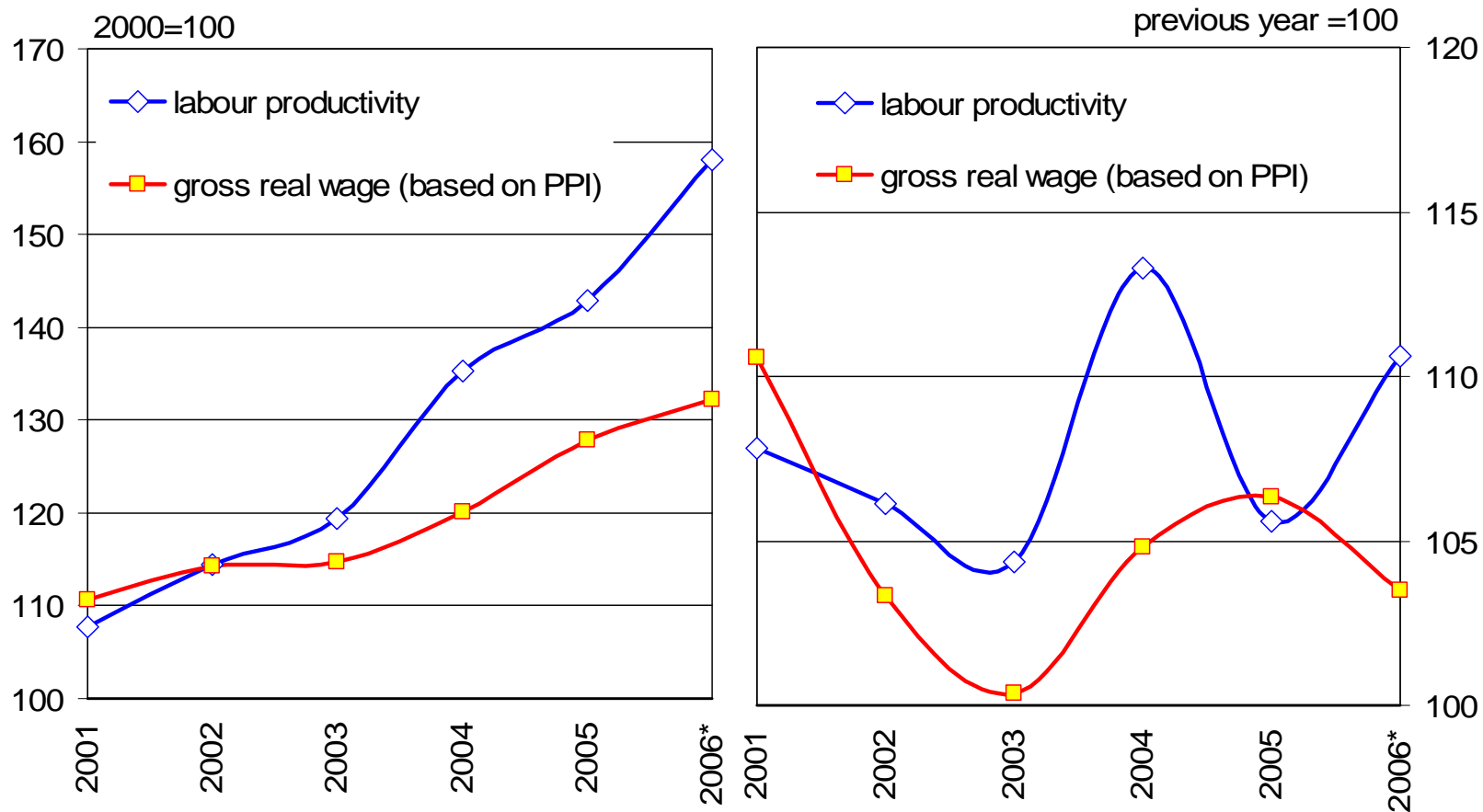
index, December 1998 = 100



Source: National Bank of Romania calculations, National Institute of Statistics, International Financial Statistics



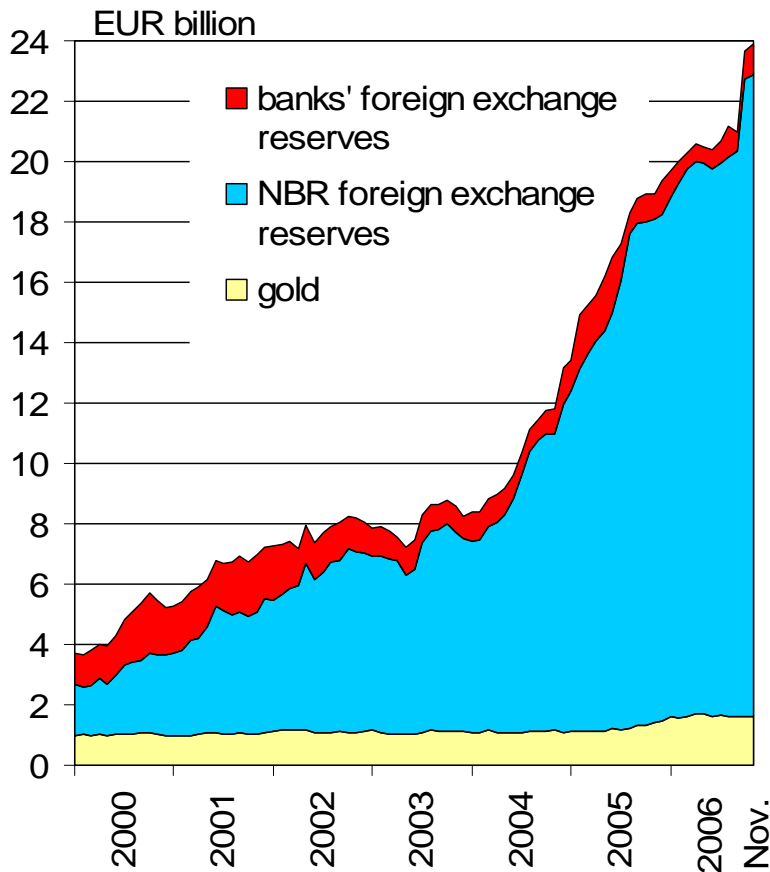
Real Wage, Labour Productivity in Manufacturing



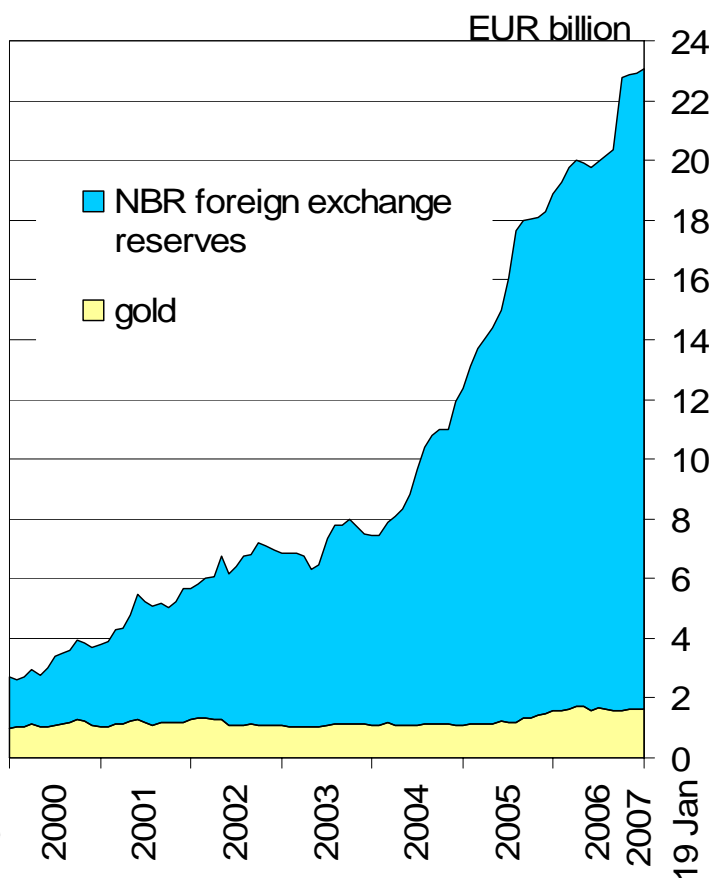
Source: National Institute of Statistics, National Bank of Romania calculations

*) Jan.-Nov.

Gross International Reserves



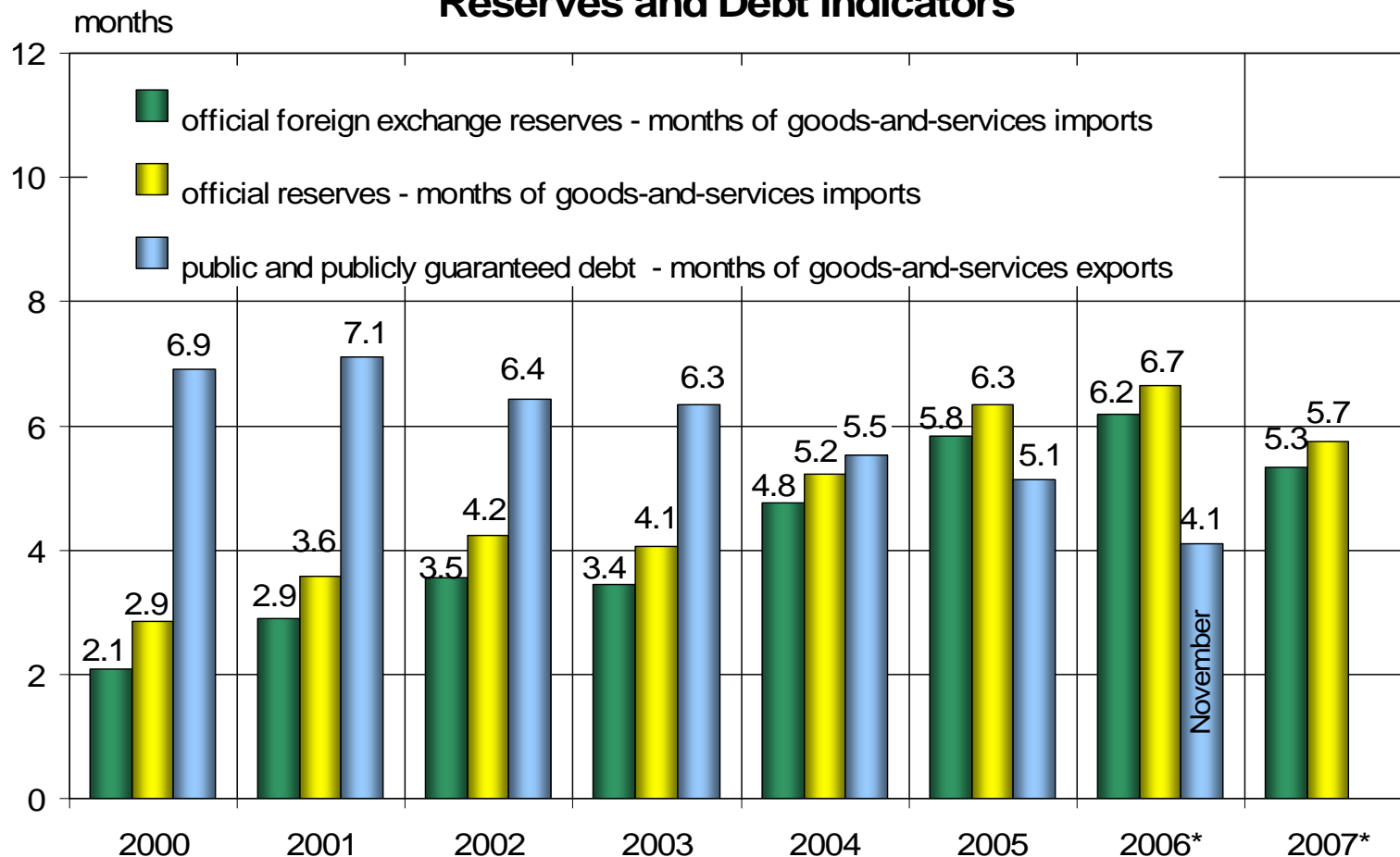
Gross Official Reserves



19 January 2007: NBR forex reserves equalled EUR 21.4 bn. and gross official reserves EUR 23.1 bn.

Source: National Bank of Romania

Reserves and Debt Indicators

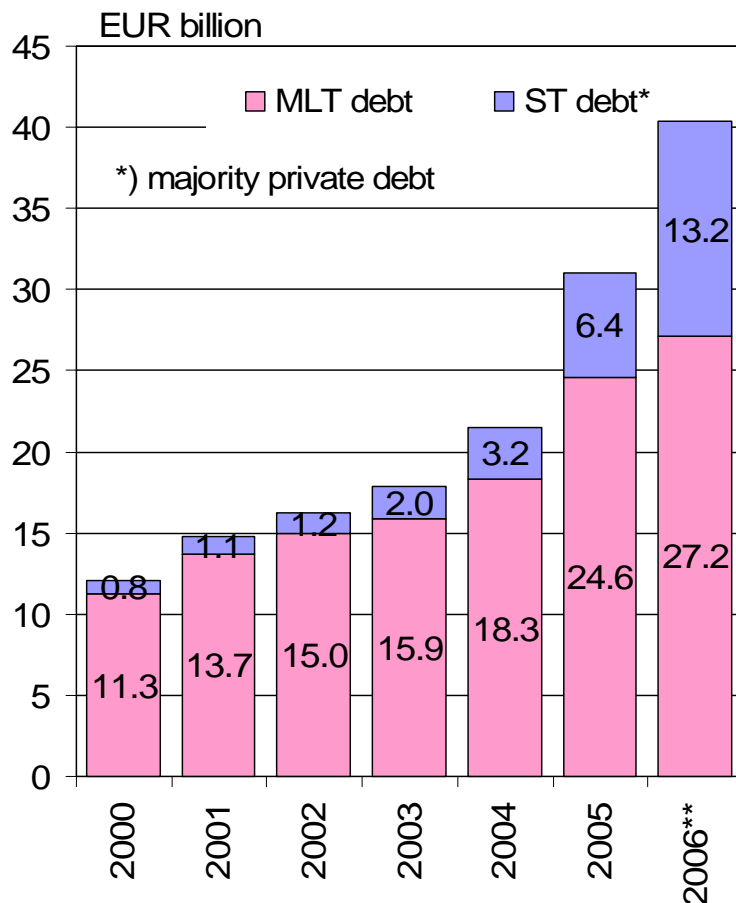


*) For 2006 and 2007, calculations based on prospective exports/imports of goods and services

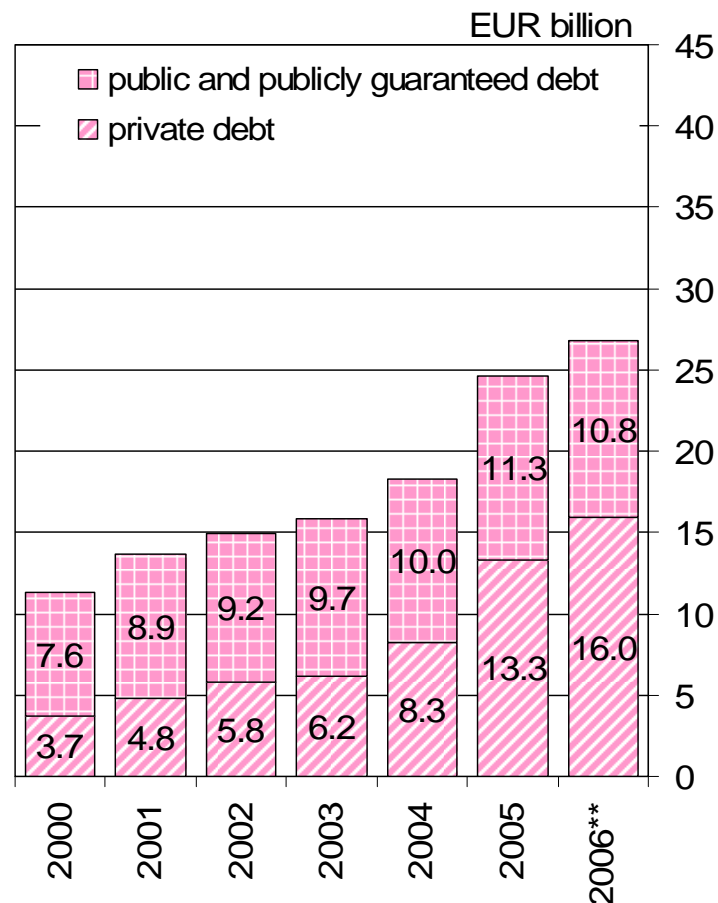
19 Jan.

Source: National Bank of Romania, Ministry of Public Finance

Total External Debt



MLT External Debt



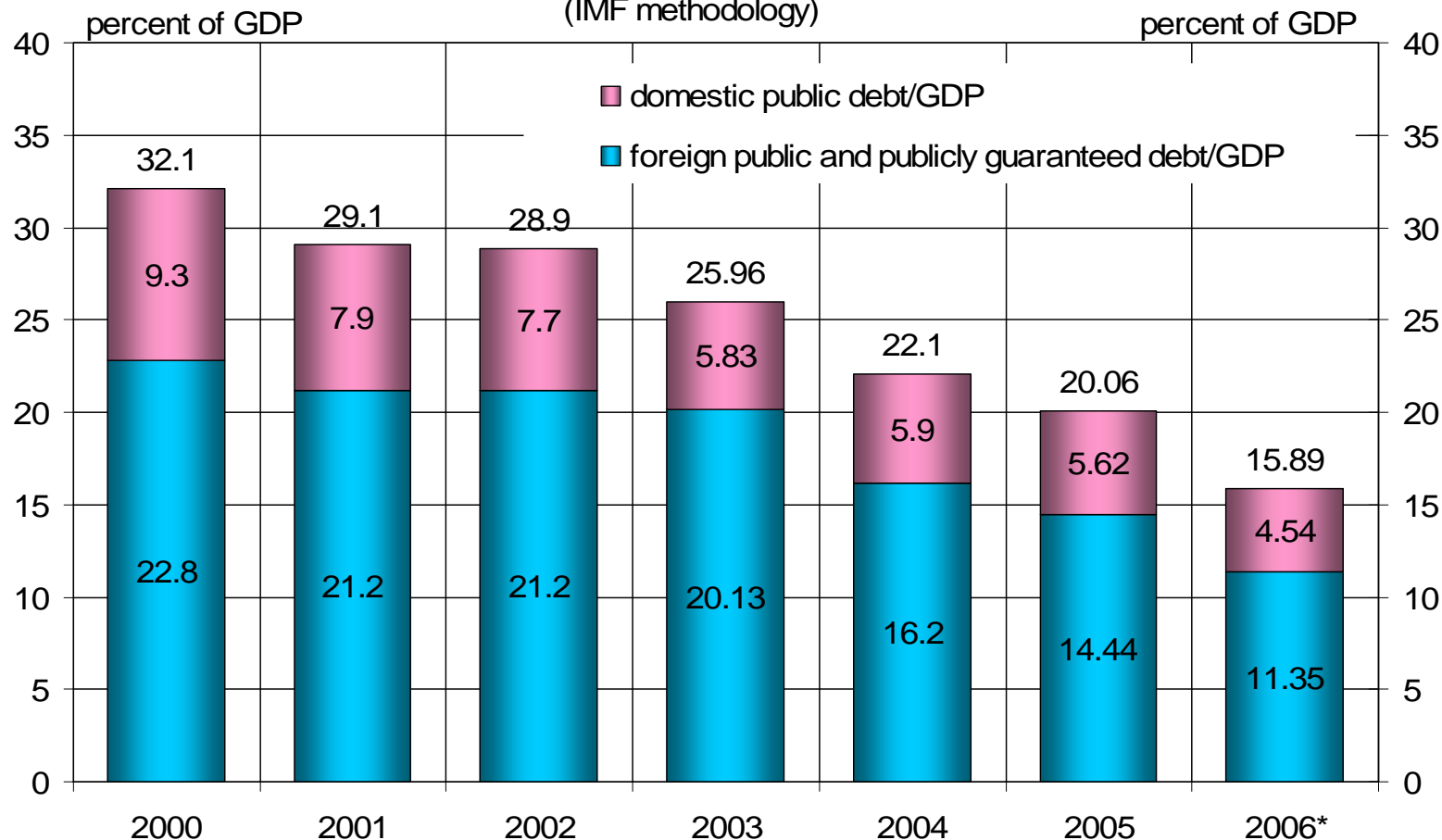
Public debt was 20.1% of GDP in 2005 (domestic debt: 5.6% of GDP; external debt: 14.4% of GDP)

Source: National Bank of Romania, Ministry of Public Finance, National Institute of Statistics

**) November

Public Debt Stock

(IMF methodology)



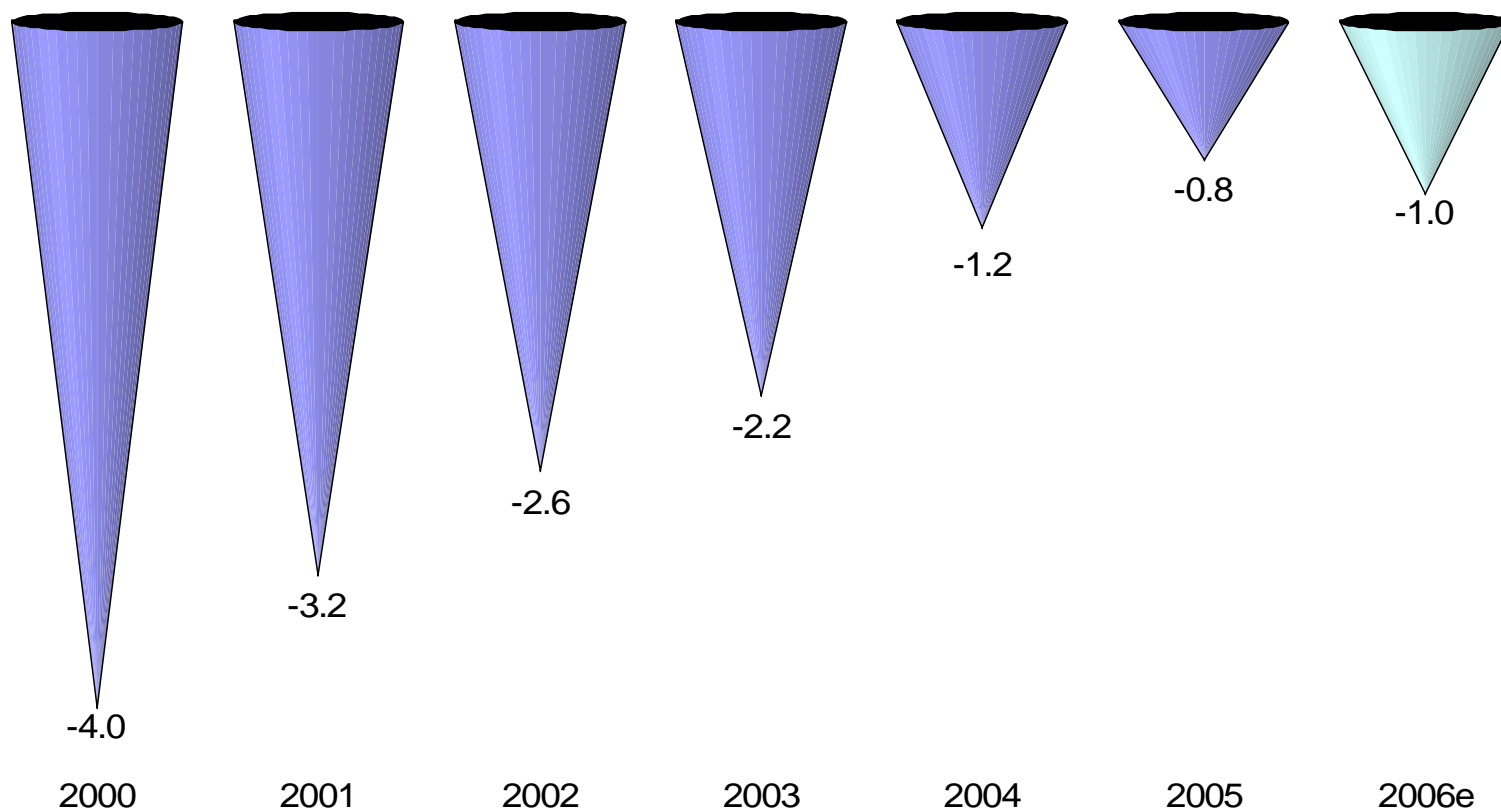
*) 30 Sep. 2006/ 2006 GDP forecast

Source: Ministry of Public Finance, National Bank of Romania, National Institute of Statistics

General Government Deficit /GDP

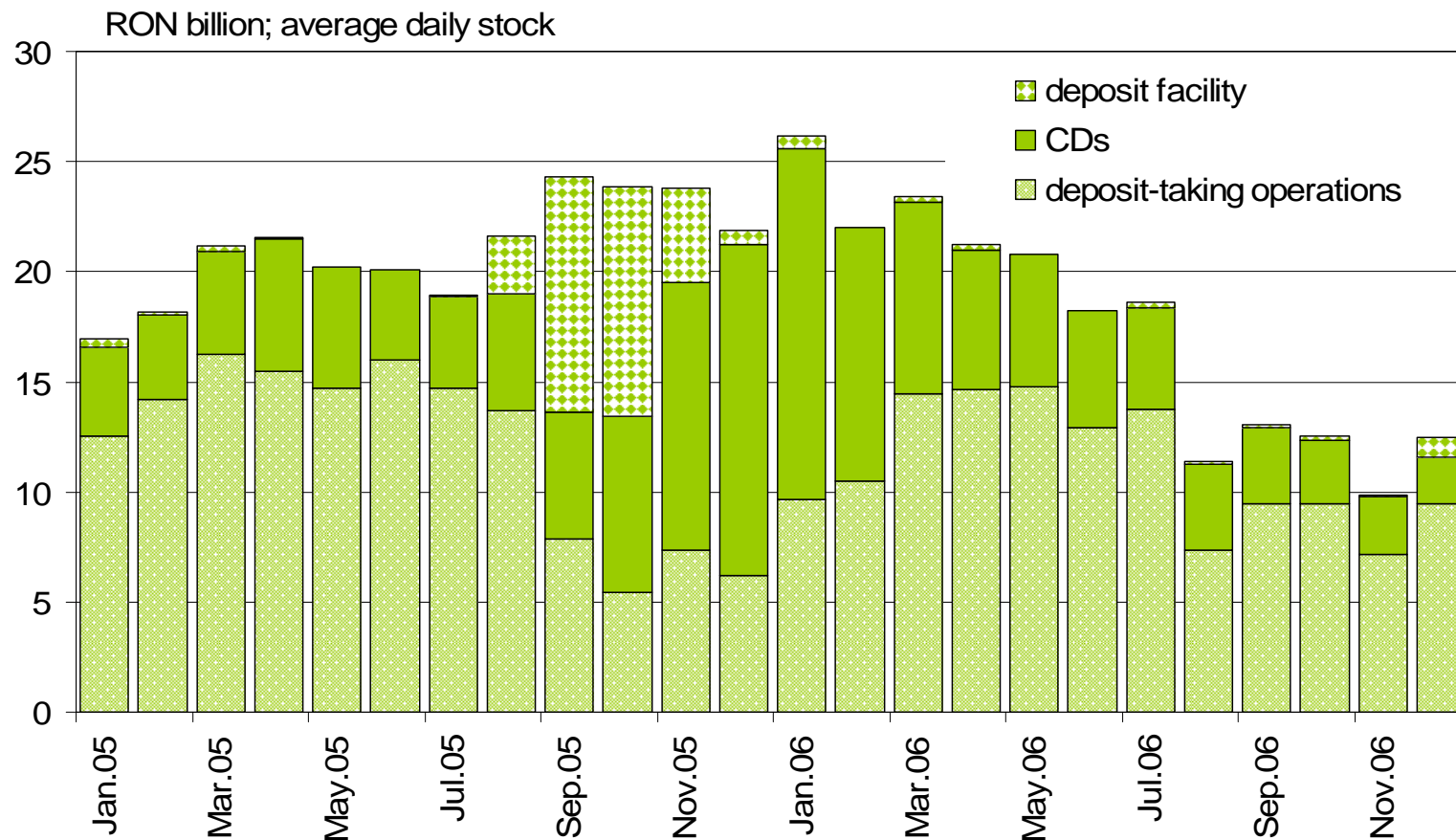
(IMF methodology)

percent



Source: Ministry of Public Finance, National Institute of Statistics

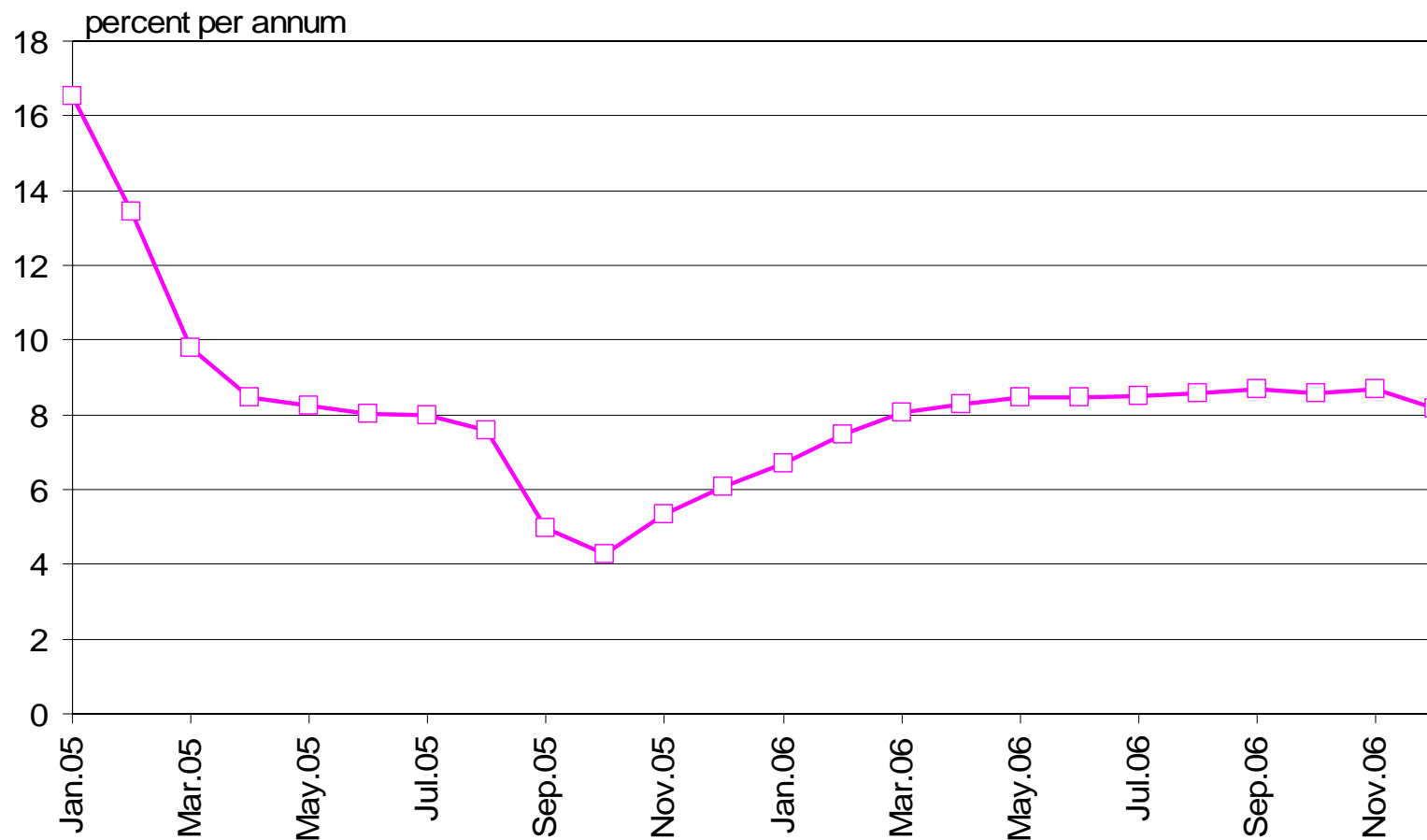
Sterilization Volume



In 2006, sterilization volume (average stock) accounted for 5.1% of GDP compared to 6.5% of GDP in 2005.

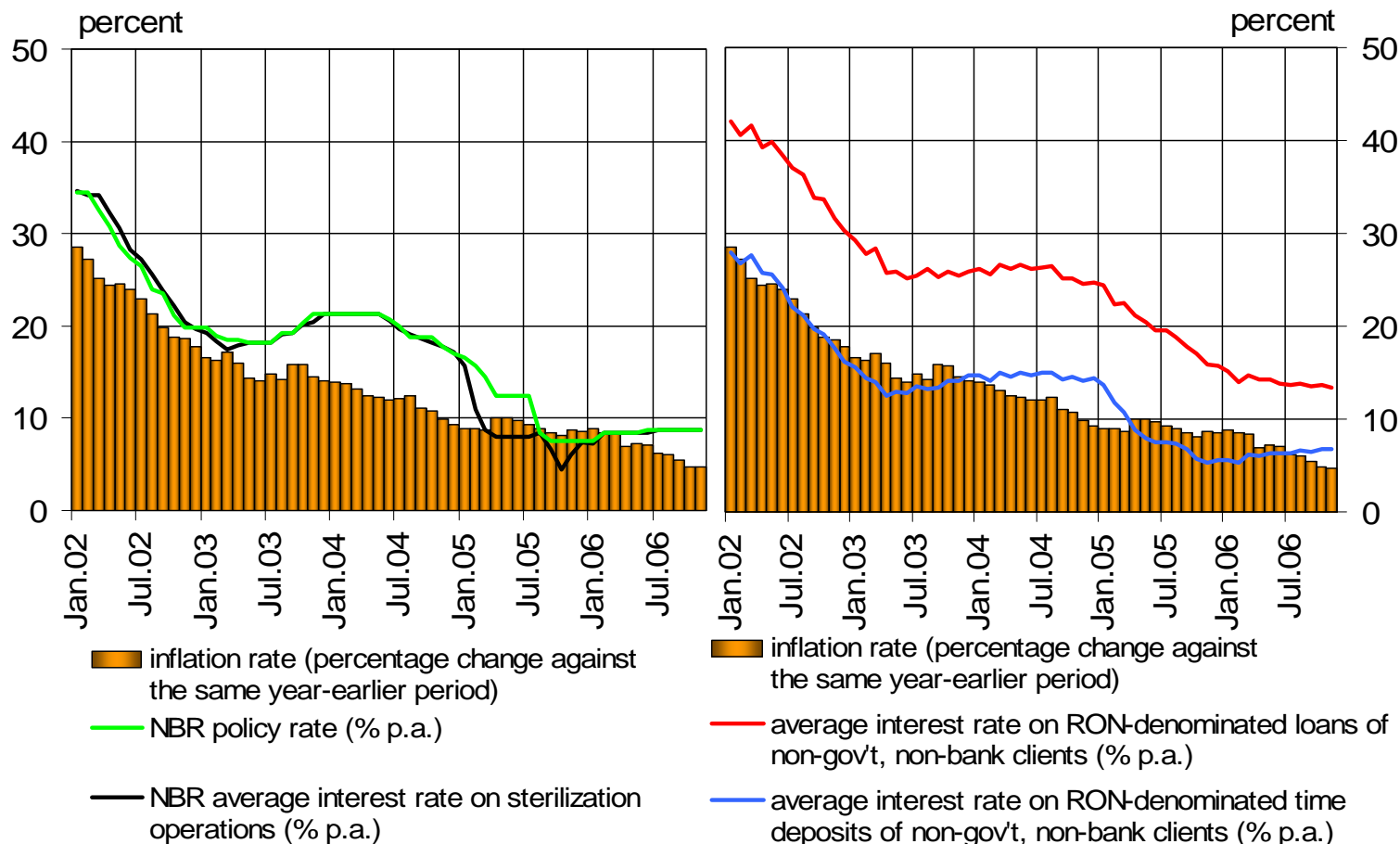
Source: National Bank of Romania

Average Interest Rate on NBR's Sterilization Operations (deposit-taking operations+CDs+deposit facility)



Source: National Bank of Romania

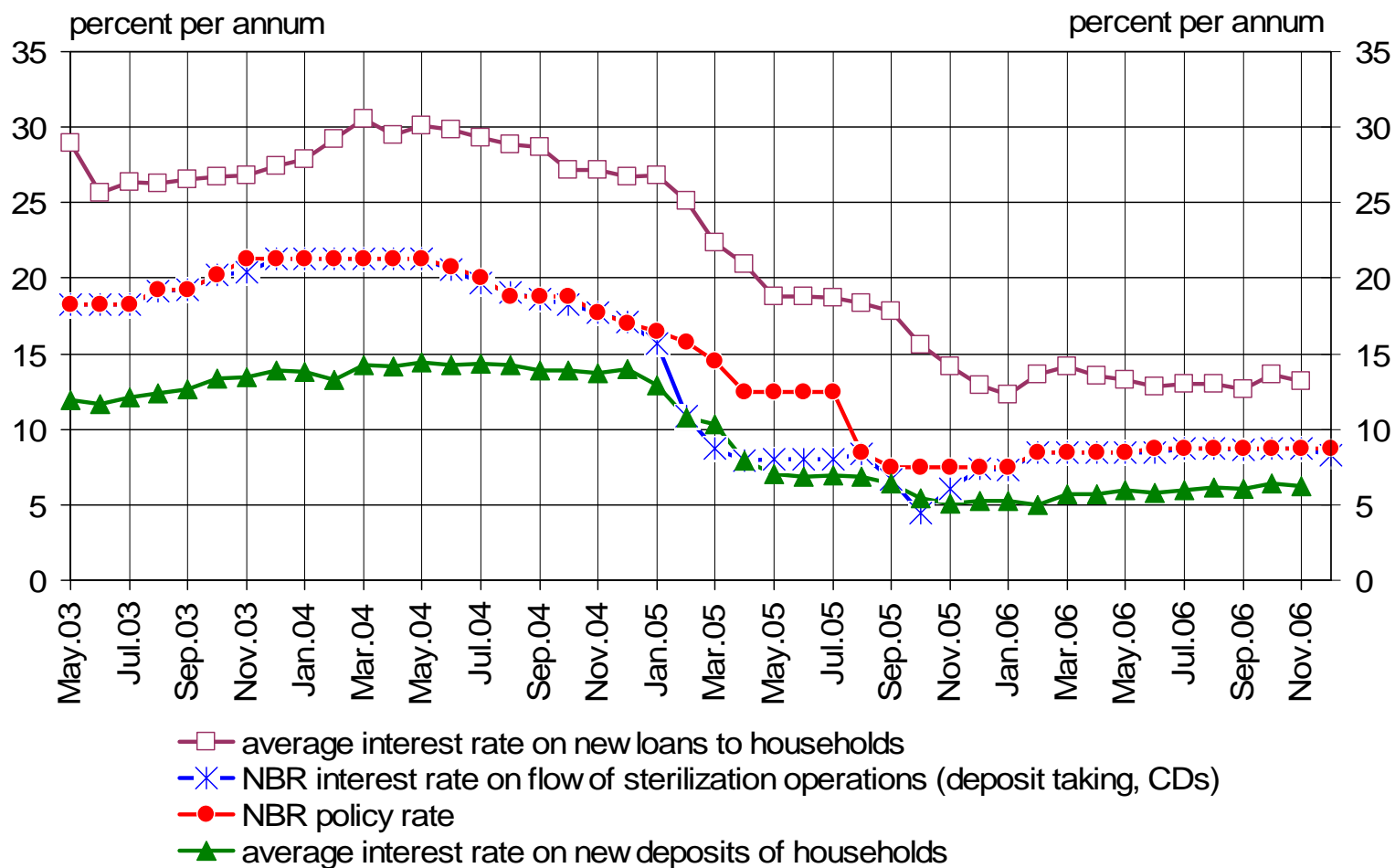
Inflation Rate and Interest Rates



NBR policy rate: 8.75% starting with 28 June 2006

Source: National Bank of Romania, National Institute of Statistics

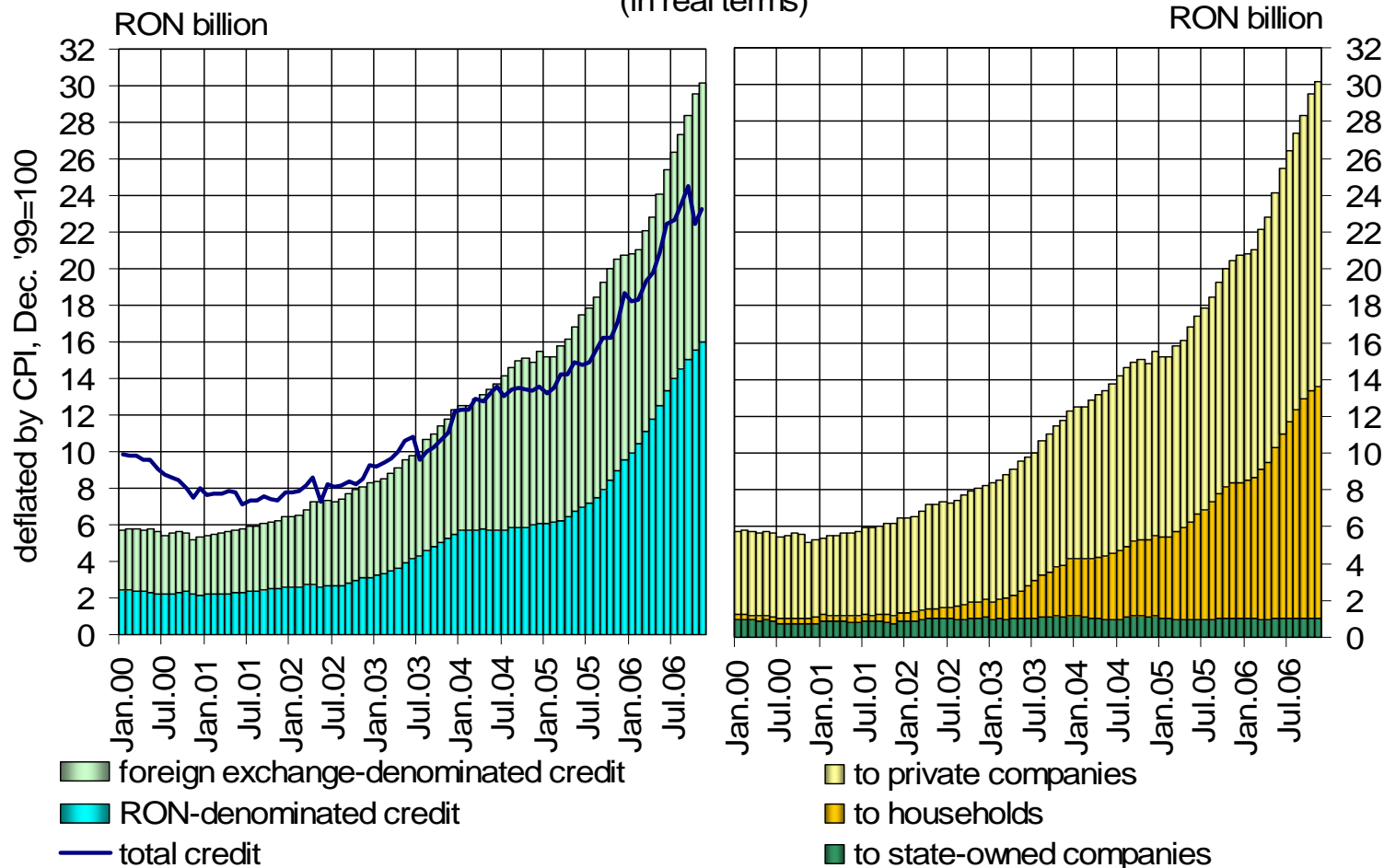
Interest Rates in the Banking System



Source: National Bank of Romania

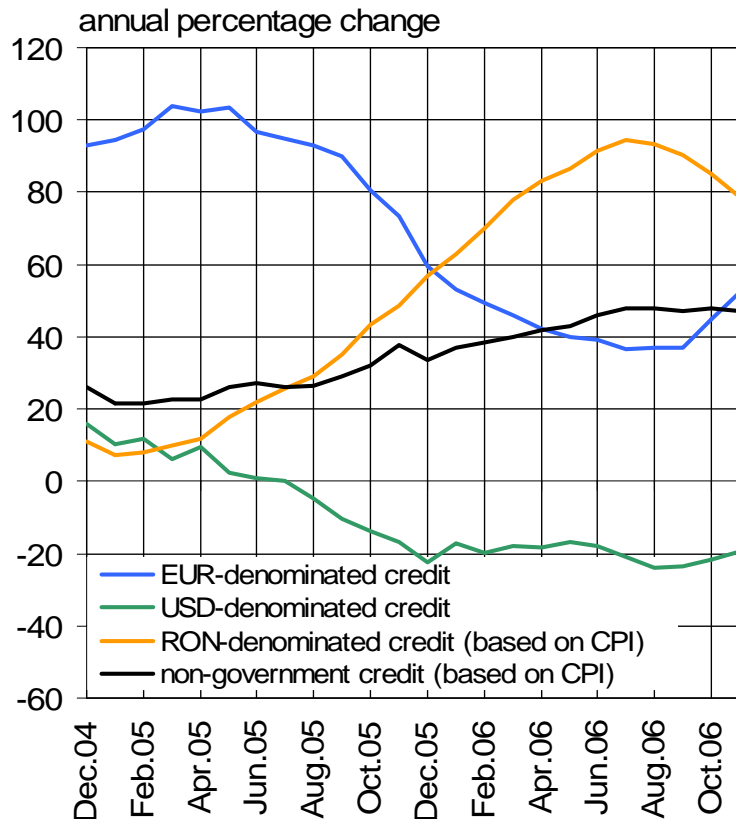
Total Credit and Non-Government Credit

(in real terms)



Source: National Bank of Romania, National Institute of Statistics

Non-Government Credit



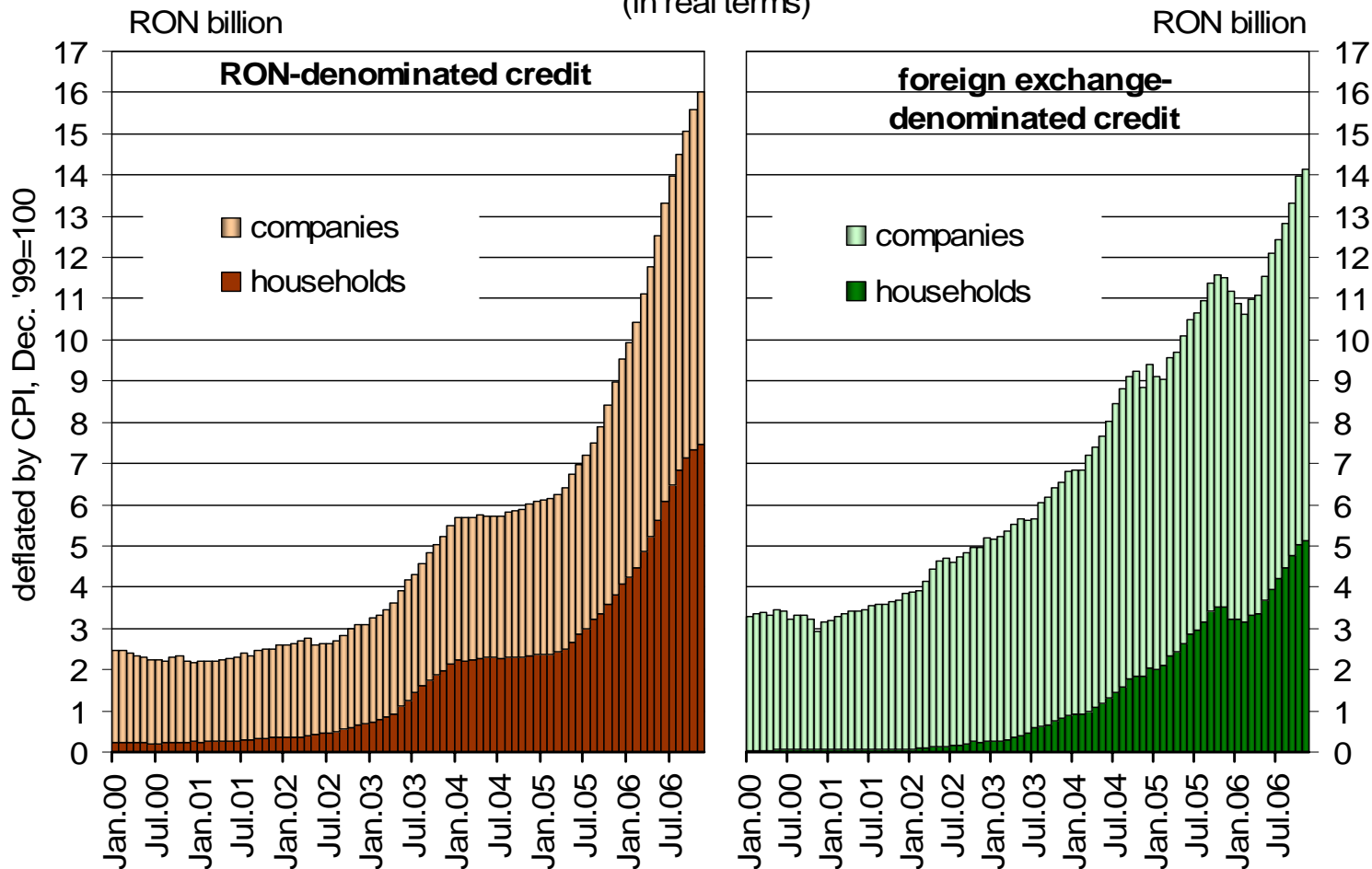
	TOTAL real annual change	RON		FOREIGN CURRENCY	
		real annual change	% in total	real annual change	% in total
Dec.04	26.2	11.1	39.2	38.4	60.8
Mar.05	22.6	9.7	39.5	32.7	60.5
Jun.05	27.0	21.9	39.9	30.6	60.1
Sep.05	28.9	35.0	41.0	25.0	59.0
Dec.05	33.7	56.8	46.0	18.8	54.0
Mar.06	39.9	77.8	50.3	15.1	49.7
Jun.06	45.8	91.3	52.4	15.6	47.6
Sep.06	47.0	90.5	53.1	16.8	46.9
Nov.06	47.2	78.7	53.1	22.7	46.9

Note: real annual change calculated based on CPI

Source: National Bank of Romania, National Institute of Statistics

Non-Government Credit

(in real terms)



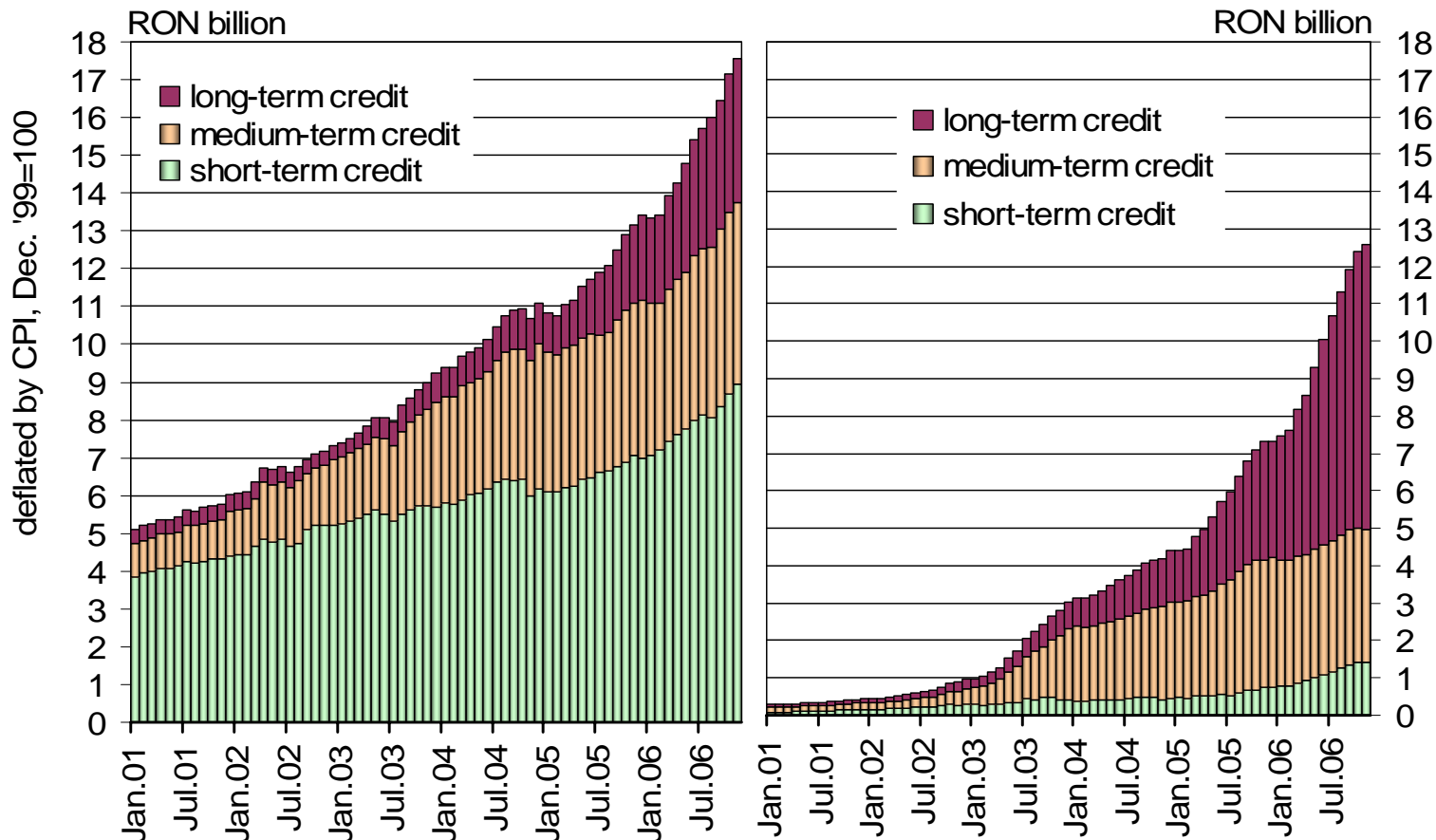
Source: National Bank of Romania, National Institute of Statistics

Non-Government Credit

(in real terms)

Corporate Loans

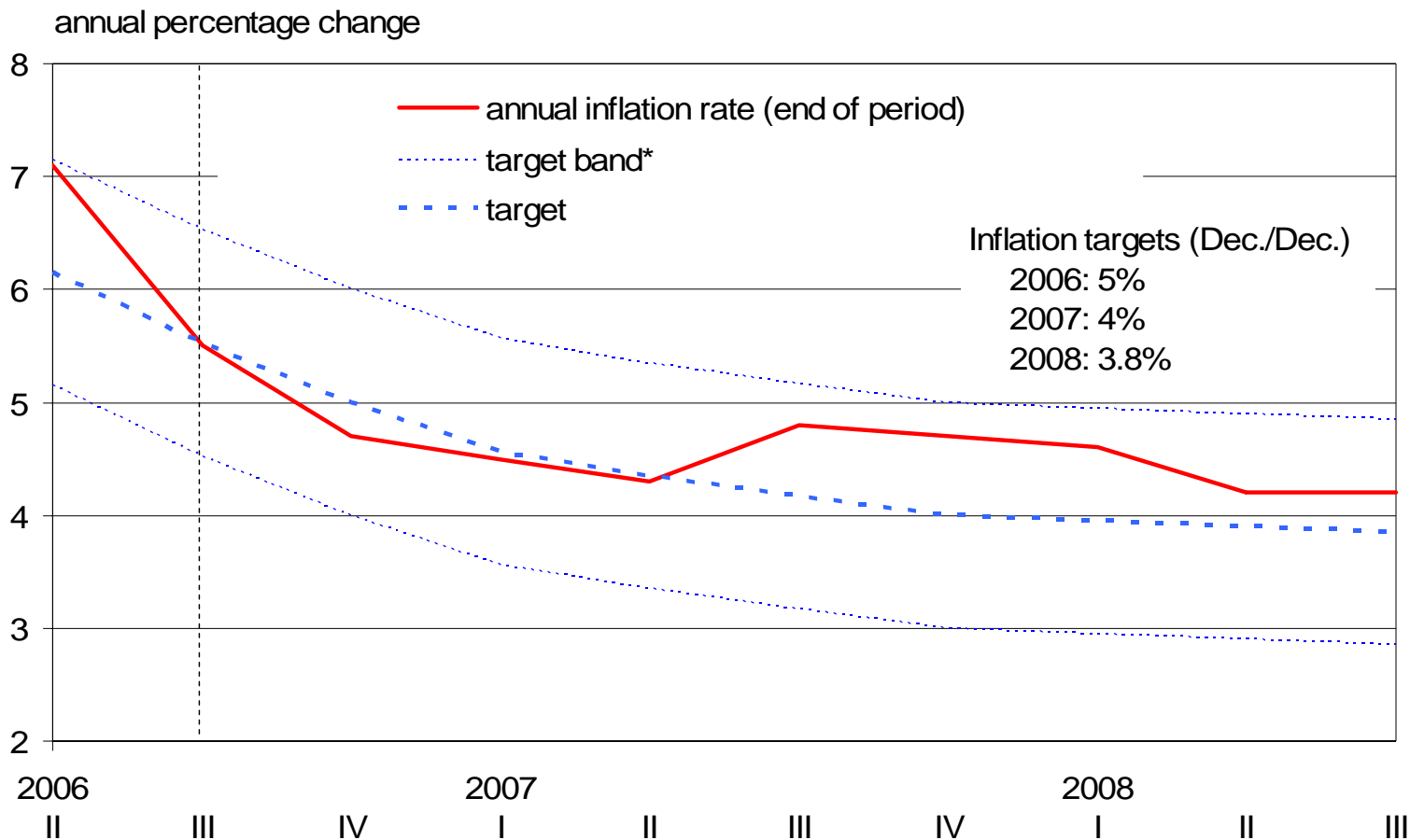
Household Loans



Source: National Bank of Romania, National Institute of Statistics

Inflation Forecast and Monetary Policy Guidelines

Inflation Forecast



*) ± 1 percentage points around the (dis)inflation path

Source: National Institute of Statistics; National Bank of Romania calculations

Risks Associated with the Inflation Projection

- Likelihood of larger fiscal policy easing, especially in the event of early elections within the forecast horizon
- Higher-than-projected wage increases in both public and private sectors
- Unsustainable widening of the current account deficit, whose potential correction would reignite inflation
- Uncertainties surrounding:
 - The magnitude and calendar of administered price adjustments
 - The schedule of aligning indirect taxes to the levels under the agreements concluded with the EU
 - The dynamics of volatile food prices

Monetary Policy Guidelines for 2007 and 2008

- The decline in inflation rate should be continuous and long-lasting
- The targets for 2007 and 2008 can be achieved even in a difficult inflationary environment; nonetheless, the known inflationary pressures and the risk of shocks on aggregate prices stood behind the decision of setting a less ambitious target for 2008
 - Even though 2007 will be a good agricultural year as well, this year's bumper crops will induce a base effect likely to overburden the attainment of the target
 - Administered price adjustments will further generate inflationary pressures
- Interest rate will gain greater importance in the array of monetary policy instruments

Challenges to Continuation of Disinflation

- Pressures exerted by movements in relative prices (Balassa-Samuelson)
- Further adjustments of administered prices (especially energy price)
- Still strong domestic demand
- External shocks (oil price)

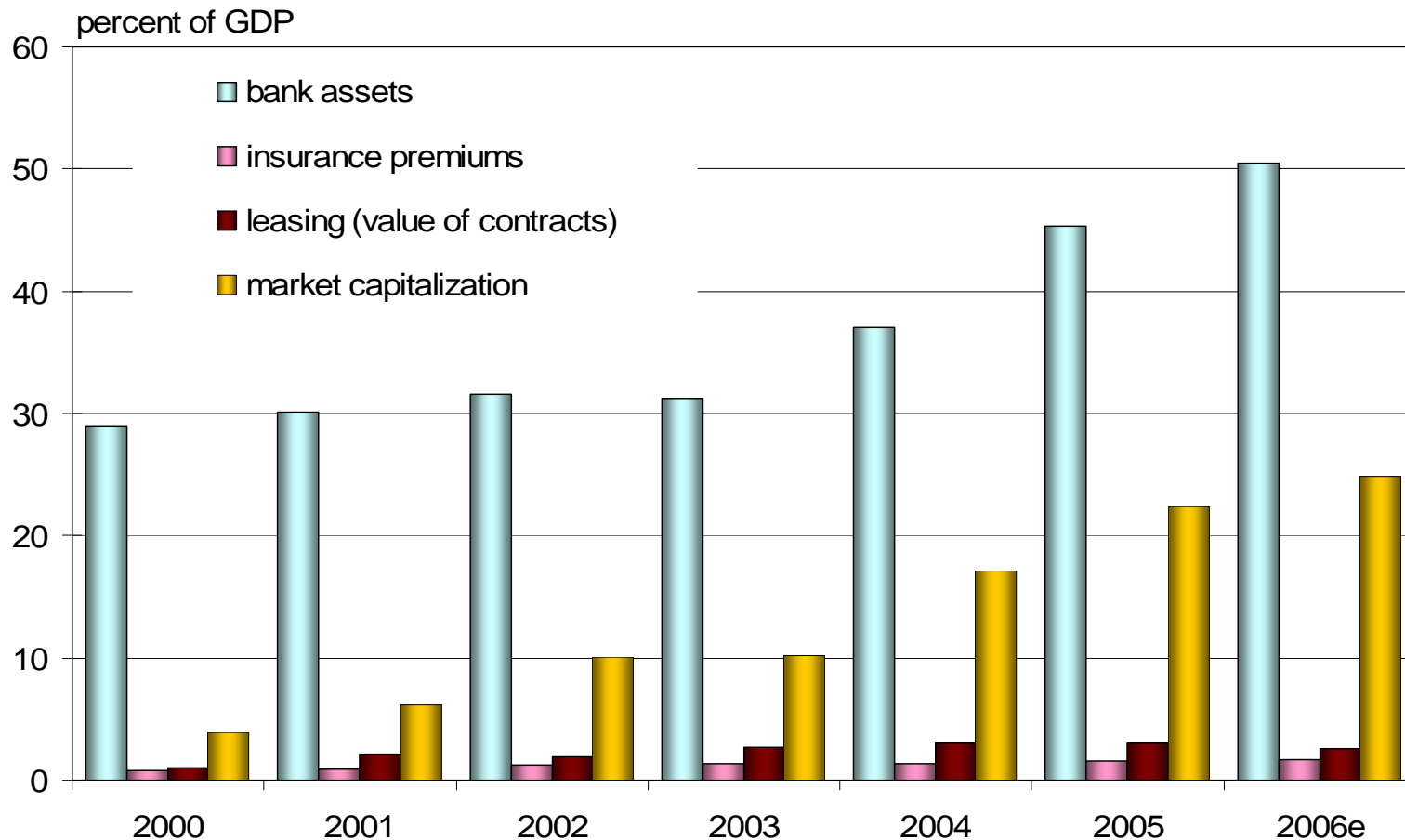
Policies for Continuing Disinflation

- Monetary policy will maintain its restrictive stance
- Fiscal and wage policies should remain prudent in order to support disinflation
- Fundamentals must be strengthened further, considering that RON appreciation should be less resorted to

Banking System



Main Components of Financial System



Source: Bucharest Stock Exchange, Rasdaq, Insurance Supervisory Commission, Bank Leasing Association, NBR, NIS

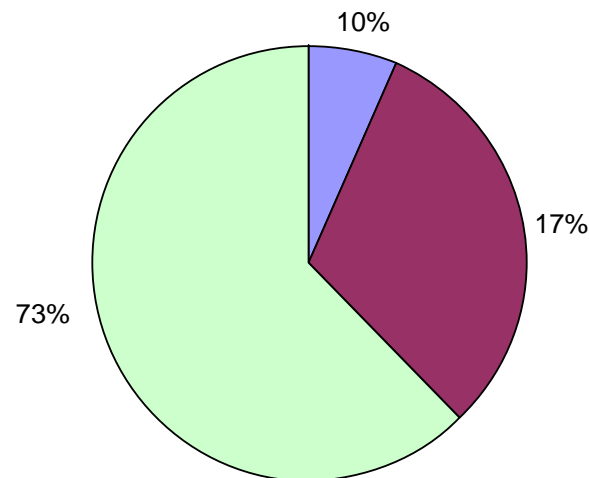
Features of the Romanian Banking System*

Features

- 37 banks, of which 6 branches of foreign banks
- Total assets: 43 billion (about 54% of GDP)
- 61% of bank assets are held by the top-five banks
- Solvency ratio: 17.9%
- Shareholding comprising mostly foreign entities

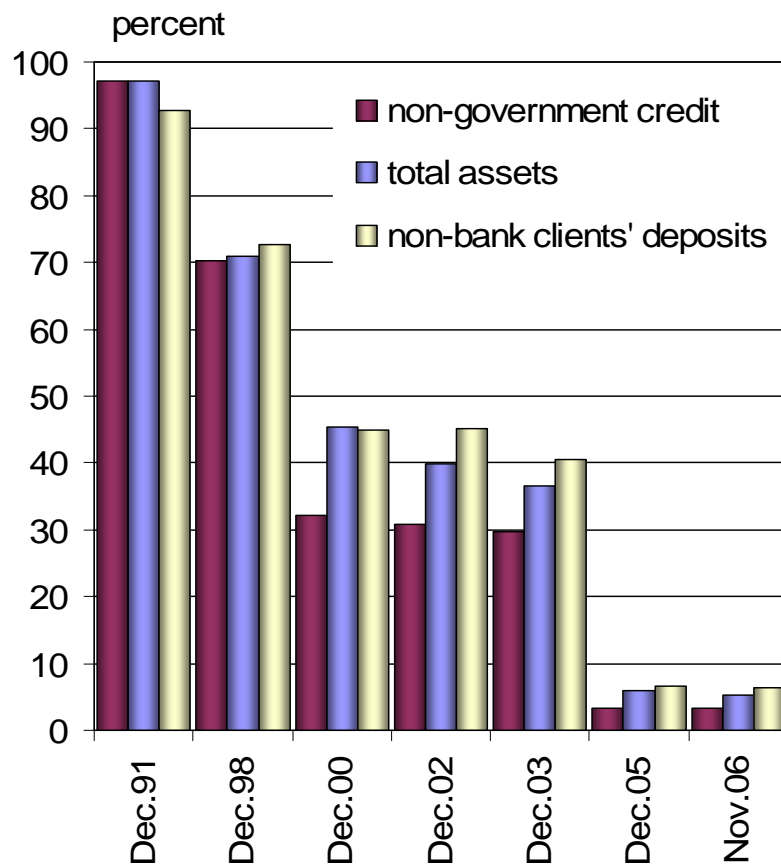
* September 2006

Shareholding



- majority state-owned banks
- majority domestic privately-owned banks
- majority foreign-owned banks (including the branches of foreign banks)

Share of Majority State-owned Banks in Total Banks



Source: National Bank of Romania

share in total banks (%); November 2006

	Total assets	Non-govt. credit	Non-bank clients' deposits
Banks with majority foreign capital	87.9	89.0	85.3
Banks with majority domestic private capital	6.8	7.5	8.4
Banks with majority domestic state-owned capital	5.3	3.4	6.3

Banking Sector Concentration (Top 5 Commercial Banks)

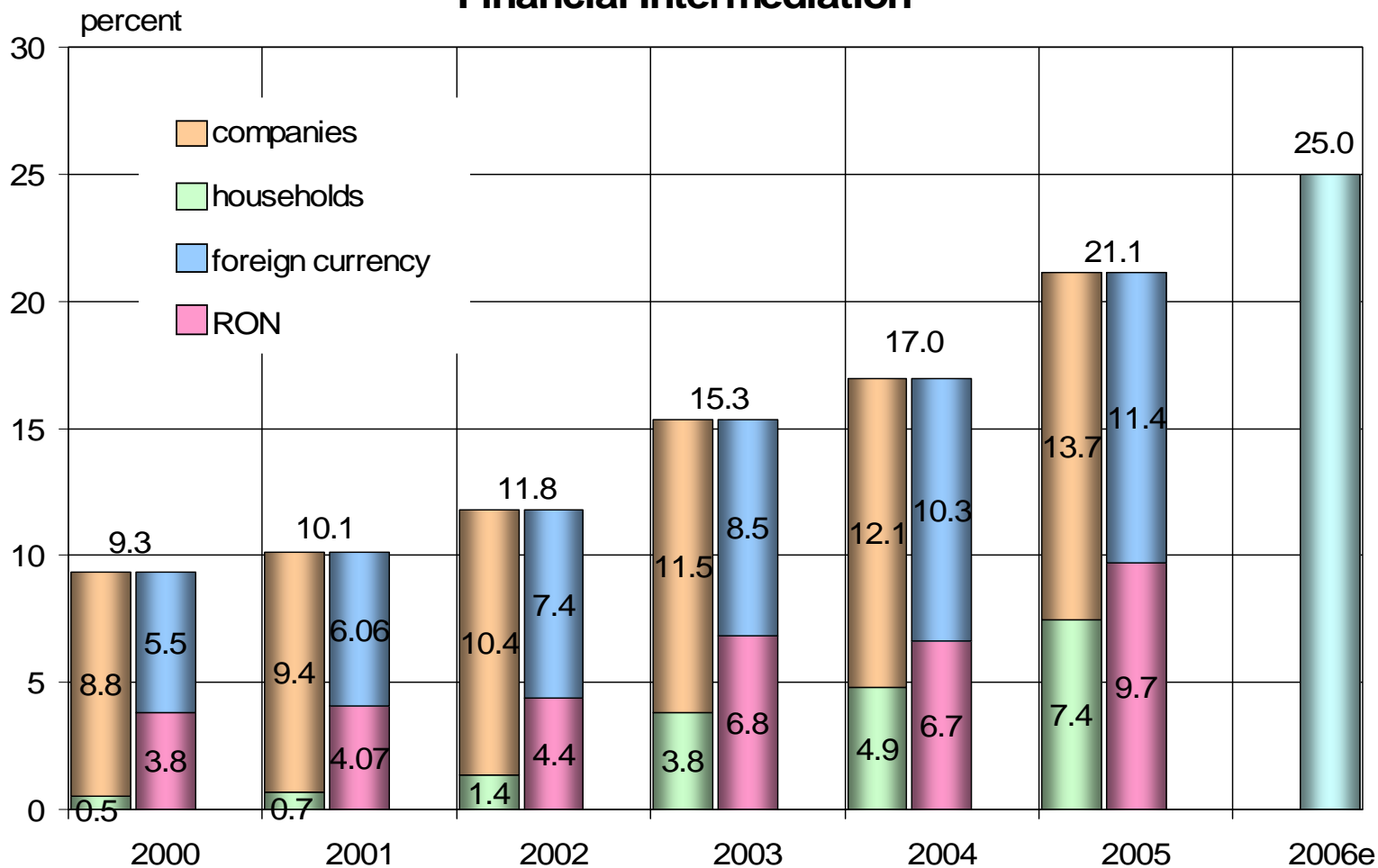
December 2005	RON billion	EUR billion	% of total banking system
Assets	75.4	20.5	58.8
Loans	37.0	10.1	61.2
Deposits	52.4	14.3	57.0
Own capital	8.9	2.4	55.1

September 2006			
Assets	92.5	26.2	61.1
Loans	54.6	15.5	64.5
Deposits	61.5	17.4	58.8
Own capital	10.6	3.0	54.4

Source: National Bank of Romania



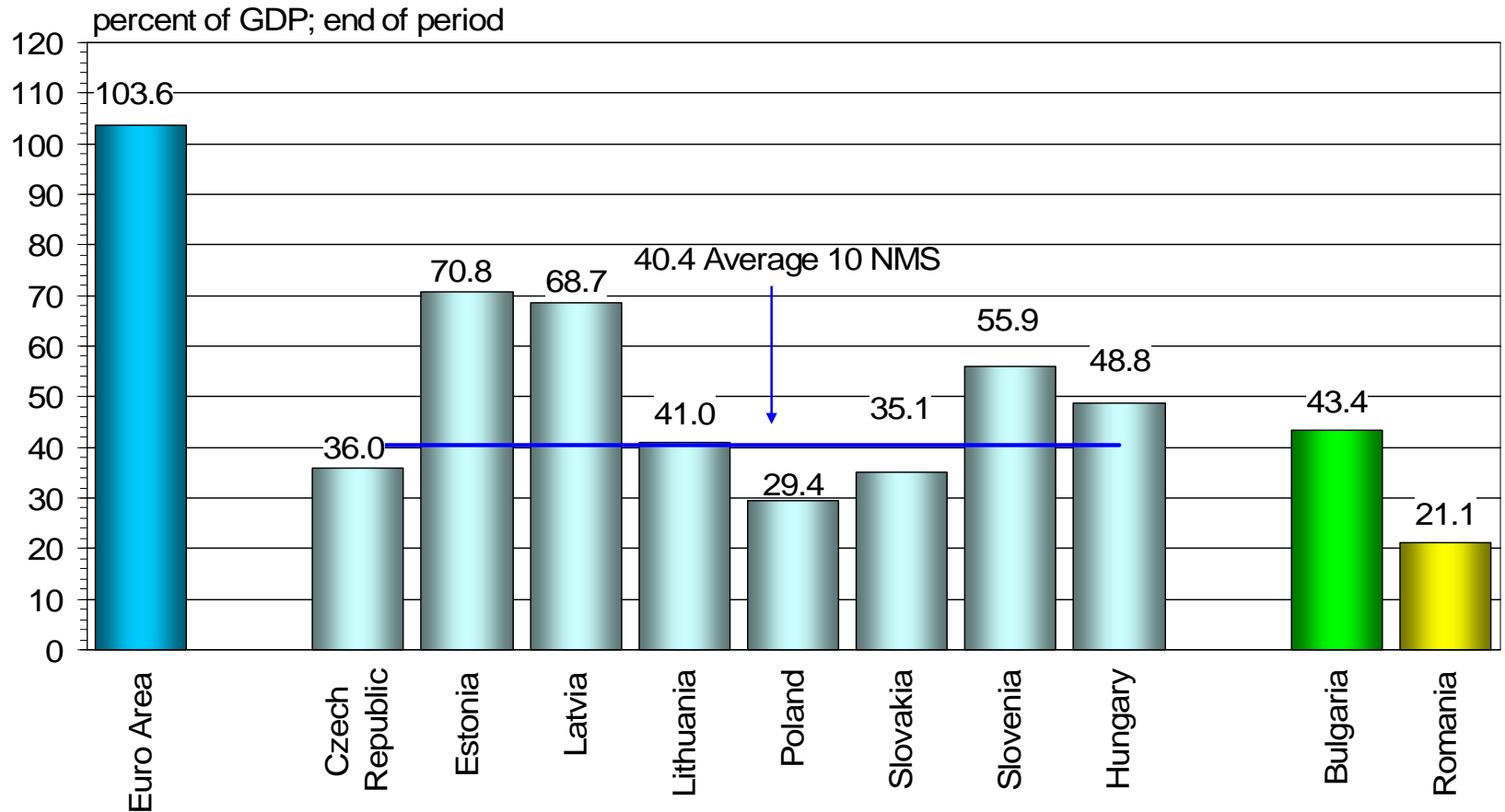
Financial Intermediation*



Source: National Bank of Romania, National Institute of Statistics

*) non-government credit/GDP

Financial Intermediation* 2005

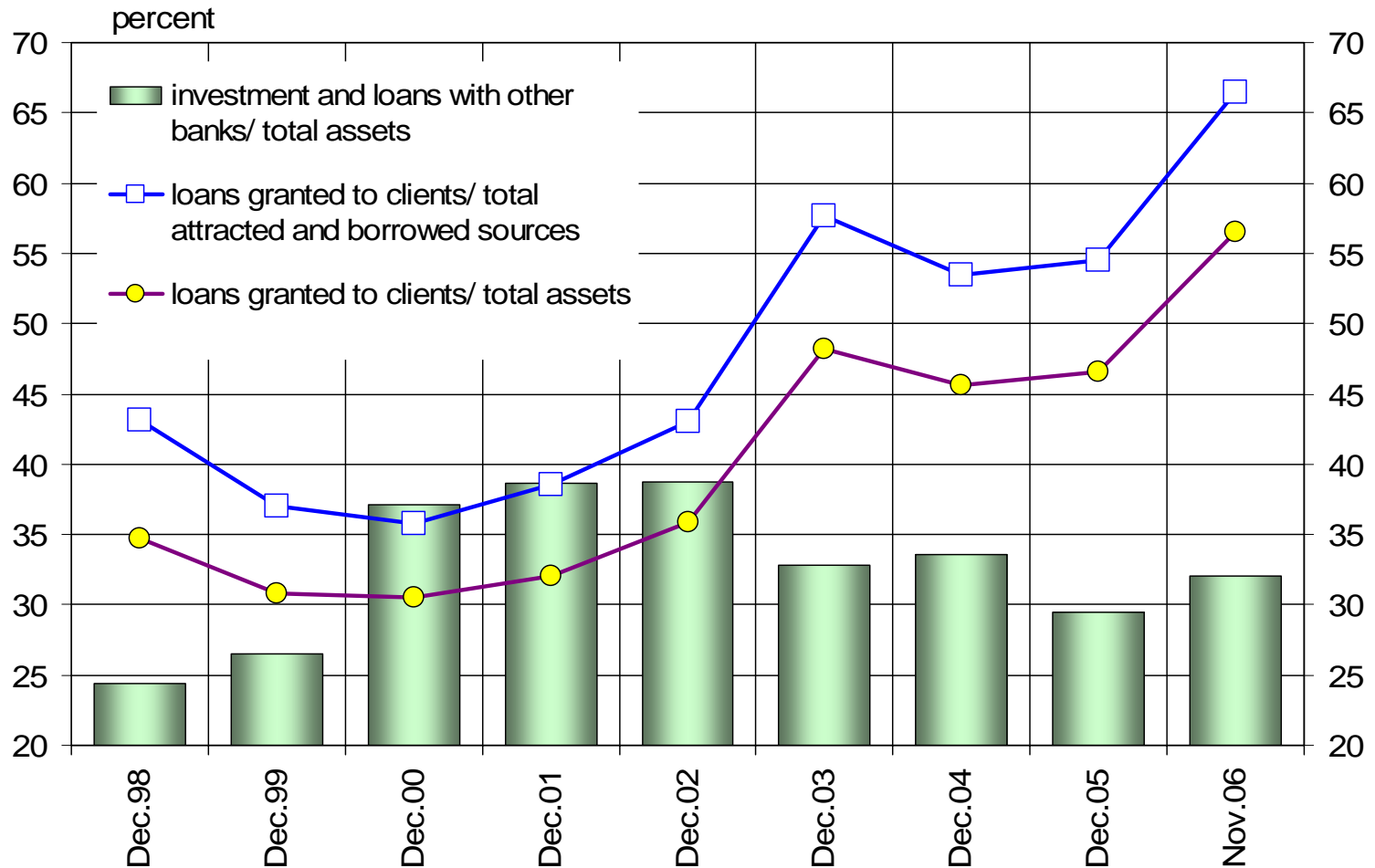


Source: EUROSTAT;

for Romania: National Bank of Romania, National Institute of Statistics

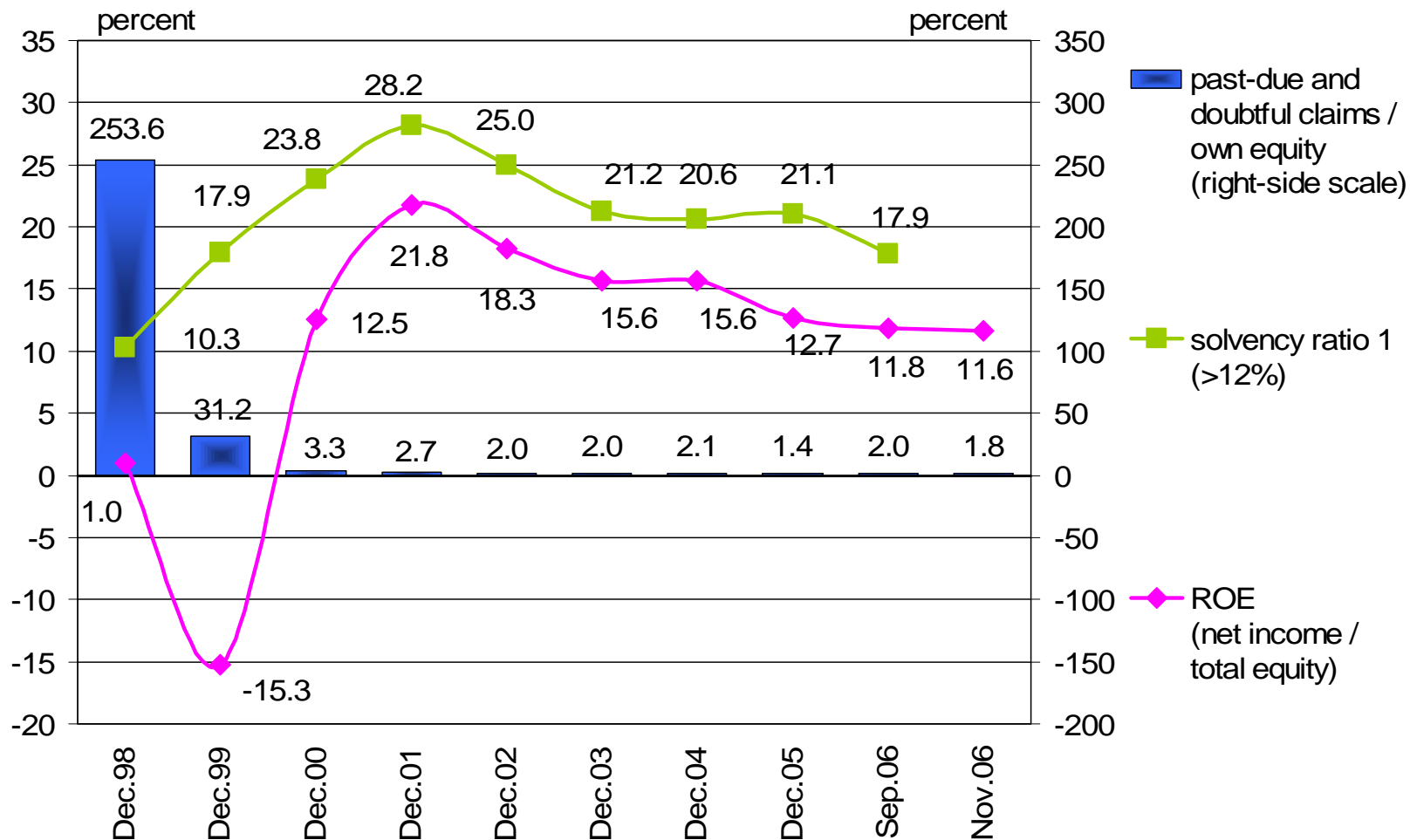
*) non-government credit/GDP

Banking Indicators



Source: National Bank of Romania

Analysis Ratios for the Banking System



Source: National Bank of Romania

Emergency Ordinance No. 99/2006 on Credit Institutions and Capital Adequacy

- Gathers in a single piece of legislation the specific provisions for all types of credit institutions (banks, credit cooperative organisations, savings banks for housing, mortgage loan banks, electronic money institutions)
- Lays down, from a Member State perspective, the single passport principle for the pursuit of business through a branch or by way of direct provision of services, and the principle of prudential supervision of the activity of EU credit institutions' branches by the competent authority in the home Member State
- Includes provisions which are the basis for the issue of prudential regulations for setting capital requirements for credit risk, market risk and operational risk, in accordance with the methods set out in the Capital Requirements Directive

Romania's Participation in ECB/Eurosystem

ECB/Eurosystem Tasks

- **Define and implement the monetary policy**
- **Conduct foreign exchange operations**
- **Promote the smooth operation of payment systems**
- **Ensure stability of the financial system**
- **Undertake legislation-related activities**
- **Carry out statistical activities**
- **Reporting/communication**
- **Issue banknotes and approve coin volume**
- **Perform financial accounting**
- **Organise auditing**

ECB Decision-Making Bodies

The Governing Council

- The primary decision-making body of the ECB and the Eurosystem/ESCB
- Formulates the euro area monetary policy and the other policies for which the ECB and the Eurosystem are responsible (strategic decision-making)

The Executive Board

- Implements the above-mentioned policies (operational decision-making)

The General Council

The General Council Tasks

The General Council contributes to fulfilling:

- **Advisory tasks** of the ECB according to Art. 4 and 25.1 of the Statute (i.e. ECB Opinions on proposed Community and national draft legislation)
- **Statistical tasks** of the ECB
- **Reporting activities** of the ECB (Annual Report, ECB financial accounts, etc.)

Implications of NBR's ESCB Membership

- The Governor became a member of the ECB General Council
- The NBR paid up its subscribed capital to the ECB: EUR 10.2 mill., representing 7% of its total subscription to the ECB capital

The Path to Euro Adoption

Maastricht Criteria

(Nominal Convergence Indicators)

Nominal Convergence Indicators	Maastricht Criteria	Romania 2006
Inflation rate (percent, annual average)	<1.5 pp above the three best performing Member States 2.8 percent**	6.56
Long-term interest rates (percent per annum)	<2 pp above the three best performing Member States 6.2 percent**	7.49¹⁾
Exchange rate (vs. euro) (maximum percentage change vs. 2-year average*)	+ / -15 percent	+10.0 / -6.1
General government deficit (percent of GDP)	below 3 percent	-2.4²⁾
Government debt (percent of GDP)	below 60 percent	13.0²⁾

1) August 2005 issue of Treasury certificates

2) estimate for 2006; according to ESA95 methodology

*) The period 2004-2005 was considered, as the fulfilment of this criterion is assessed depending upon exchange rate stability over the past 2 years. **) ECB Convergence Report - December 2006

Source: EUROSTAT, European Central Bank, National Institute of Statistics, National Bank of Romania

Real Convergence Indicators (GDP/capita)

	EUR					PPS*				
	2000	2002	2004	2005	2006e	2000	2002	2004	2005	2006e
EU-15	23,100	24,500	25,800	26,500	27,600	22,100	23,500	24,700	25,400	26,500
Romania	1,795	2,224	2,805	3,668	4,200	5,000	6,100	7,300	8,100	8,900
% in EU-15	7.8	9.1	10.9	13.8	15.2	22.6	26.0	29.6	31.9	33.6

*) Purchasing Power Standards

Source: EUROSTAT, National Institute of Statistics, National Bank of Romania

Exchange Rate Mechanism (ERM II)

Participation for at least two years in ERM II, when the national currency should be highly stable against the euro, is compulsory for adoption of the euro

➤ **Two landmark decisions:**

- The moment of ERM II entry
- The stay in ERM II

➤ **Recommendations from the European Commission and the European Central Bank:**

- ERM II entry should take place after the country's EU accession
- Stay in ERM II should not exceed, as a rule, the compulsory two-year period, which assumes that the country is relatively well prepared at the time of ERM II entry
- Nominal convergence criteria should be fulfilled in a sustainable manner

ERM II Entry and Inflation Targeting

- Inflation targeting strategy will be kept in place until ERM II entry at least
 - Cohabitation between inflation targeting and an explicit exchange rate target is challenging
- Inflation targeting ensures gradual achievement of the Maastricht criteria and is supportive of real convergence

Euro Adoption

1. Pre-ERM II period:

- Consolidation of low inflation (sustainable disinflation)
- Establishment of domestic market for long-term capital and interest rate convergence
- Relative stability of the RON exchange rate (amid full convertibility) around the long-term equilibrium level (sustainable exchange rate)

Euro Adoption

2. ERM II entry (2010-2012)

- **Timing conditional upon:**
 - Fulfillment of nominal convergence criteria to shorten the stay in ERM II
 - Progress in real convergence
- Early entry might extend the stay in ERM II
- Late entry might weaken the rationale for fast-paced reform

3. Euro zone entry (2012-2014)