GOVERNMENT OF ROMANIA

2012-2015

CONVERGENCE PROGRAMME

- April 2012 -

INTRODUCTION

The updated version of the 2012 - 2015 Convergence Programme has been based on the EC Council Regulation 1466/1997 on strengthening the supervision of budgetary positions and the supervision and coordination of economic policies, as amended in the EC Council Regulation 1055/2005 and EU Regulation 1175/2011 of the European Parliament and the Council.

The Convergence Programme is in accordance with the Code of Conduct regarding the specifications for the implementation of the Stability and Growth Pact and the Indicatives Lines for the format and contents of the Stability and Convergence Programmes of January 12, 2012.

The submission of the Convergence Programme by the Member States, and the assessment thereof by the European Commission, is one component of the "European Semester" that relates to the strengthening of the economic, structural and budgetary policies. The European Semester is the Europe 2020 Strategy's main instrument, the preventative instrument of the Stability and Growth Pact (amended by the 6-regulation pack coming into effect on December 13 2011), the macroeconomic imbalance procedure, as well as the Euro Plus Pact.

The Convergence Programme illustrates Romania's capacity to comply, starting 2014, the medium term budgetary objective (MTO) of a budgetary structural deficit of 0.7% of GDP, which is in line with the provisions of the Treaty on Stability, Coordination and Governance of the Economic and Monetary Union.

The commitment to adopt the euro in 2015 is maintained and it represents an important anchor for ensuring the consistency in time of the macroeconomic policy mix and of the structural reforms, as well as for fostering the adjustments needed to increase the resilience and flexibility of the Romanian economy.

The continuation of the reform process, particularly the fiscal consolidation process, based on the preventive financing agreement concluded with the EU, IMF and the WB can bring coherence to the macroeconomic and financial policies, thus adding to the consolidation of the investors' confidence and reducing the spill-over effect coming from other markets. While no other austerity measures and considered, similar to those implemented in 2010, a prudential approach will be maintained on the expenditures side, expressly to consolidate the sustainable trend of the public finances.

In the medium run, the specific objective of the budgetary policy is to further adjust the budget deficit, with the planned targets situated at 2.8% of GDP in 2012; 2.2% in 2013; 1.2% in 2014 and 0.9% in 2015 (according to ESA).

The Convergence Programme's macroeconomic framework takes into account the prospects of the international environment and the European economy as per the European Commission's forecasts. In addition, the macroeconomic scenario proposed for the interval 2012-2015 is convergent with the EC estimations in respect of the Romanian economy developments.

1. ECONOMIC POLICY FRAMEWORK

1.1 Economic Policy Background

In line with the Ruling Strategy and the consideration of the objectives included in the Europe 2020 Strategy, the Euro Plus Pact and the Preventive Agreement with EU and IMF, the medium term economic strategy of the Romanian Government is oriented towards the promotion of competitiveness and employment, consolidation of the public finances and of the financial stability. Specific measures have been included in both the 2011-2014 Convergence Programme and the Euro Plus Pact (EPP).

The Euro Plus Pact

For Europe, the Euro Plus Pact (EPP) is a political commitment aiming at the financial consolidation and the support of the Union's economic competitiveness, that has been made by 23 EU Member States, Romania included, at the European Council of March 2011.

EPP's objectives are to promote competitiveness and employment, consolidate the public finance sustainability and the financial stability. To reach these objectives, Romania has drawn up a list of actual measures that has been approved by the Government in the form of a Memorandum, on April 29, 2011. These measures have been included in the 2011 – 2013 National Reform Programme too, and in the 2011–2014 Convergence Programme.

By including the Euro Plus Pact's provisions in the Stability/Convergence Programmes and the National Reform Programmes, this pact has been integrated with the European Semester. Thus, a coherent assessment of the commitments assumed in the pact is ensured, as well as an efficient monitoring of the country specific recommendations.

The EPP implementation report, reflecting the progress made on March 15, 2012, underlines the important progress that has been made, especially with respect to public finance sustainability and consolidation of the financial sector stability.

The continuation of fiscal reforms contributed to improving Romania's credibility. In 2011, Romania entered the good path towards the general government budget deficit target.

The execution of the general consolidated budget as at December 31 2011 showed a deficit of 23.9 billion lei, i.e. 4.13% of GDP (cash), Romania complying with the initially planned deficit target of 4.4% of GDP.

For 2012, a cash deficit of 2.2% and an ESA deficit of 2.8% are envisaged, which will get us out of the excessive deficit procedure opened for Romania in 2009 as a result of the 2008 deficit.

Arrears and unpaid bills of the general government (SOEs not included) continued to go down since early 2011. Arrears are now at below 0.2% of GDP (almost 100% at the level of local authorities). The arrears of SOEs monitored under the EU/IMF financial aid programme went down in Q4 2011 by around 0.8% of GDP, reaching to 2.6% of GDP.

In the healthcare sector, the arrears showed by the recorded bills have been totally eliminated, with the bills not accounted that have been discovered during the inventory exercise by the end of 2011 being recorded in the system and planned for payment.

At local level, arrears decreased in 2011. The decreasing trend may accelerate, with the new amendments to the Local Public Finance Law preventing new arrears. In particular, the funds will be ensured for the implementation of the projects run by the local authorities and cofinanced by the state budget, in observance of the expenditure ceilings of the respective line ministries. In the medium run, the funds necessary to such projects shall be ensured under multiannual contracts signed by the line ministries with the local authorities, in line with the provisions of the local public finance law.

Over the next two years, the settlement interval for the invoices introduced in the central government system and the social security system will be gradually reduced. Directive 7/2011 on fighting delays in making payments under the commercial operations shall be introduced in the Romanian legislation in a timely manner.

The financial stability remained robust throughout 2011, despite the difficult domestic and foreign economic circumstances. The banking sector risks have been counteracted by efforts made by the credit institutions in the framework created by the activity of the National Bank of Romania (NBR) aimed at regulating in a prudential manner, monitoring and managing in an appropriate manner the system's risks, which resulted in the consolidation of the solvency, provision and liquidity levels. Most measures under NBR competence aimed at supporting a good and steady functioning of the financial sector were 100% implemented, and the proposed completion deadline for those still to implement is April 30, 2012, in line with the commitments made by the Romanian Authorities in the February 2012 Letter of Intent submitted to the IMF.

The adoption of the International Financial Reporting Standards (IFRS) is part of the overall trend aiming at bringing domestic standards in line with international standards on financial reporting, given the current economic and financial developments leading towards the internationalization at of banking operations and, by this, the increased need for an uniformization at international level of accounting rules which are the source of the published financial data.

The measures proposed for the IFRS implementation have been introduced by: the submission to Ministry of Public Finance of the comparative accounting monographies aimed at facilitating the understanding in respect of the accounting treatment differences; the updating of the accounting and statistics reporting framework [1] to account for the new accounting standards that have been introduced; updating and submission to the credit institutions of the clarifications regarding the MMR (Minimum Mandatory Reserves) reporting framework; updating the prudential rules [2] and issuance of proposed prudential filters aimed at further ensuring a prudential policy with respect to solvency, banking provisions and reserves. The changes brought to the regulatory framework will not entail significant changes when it comes to capitalization, provisioning or liquidity levels of domestic credit institutions, since risks are appropriately covered by the prudential requirements in force, implemented by NBR.

With respect to the consolidation of the banking system, the implementation of the measures included in the financing agreements concluded with EU and IMF for the interval 2009 – 2011 came to support the firm enforcement of macro-prudential policies. The new preventive agreement concluded with EU, IMF and WB in 2011, on top of the commitments made by the Romanian authorities under the national programmes, represents important benchmarks when it comes to preserving financial stability and continuing structural reforms in a move to encourage the economic growth potential.

[1] To this purpose, NBR issued three pieces of legislation: NBR Order 1/2011, published in the OG153 and 153bis of March 2, 2011; NBR Order 2/2011, published in OG 418 and 418 bis of June 15, 2011 and NBR Order 3/2011, published in OG 418 and 418 bis of June 15, 2011.

[2] 16 pieces of legislation were published in the Official Gazette which aims at updating the prudential rules after the introduction of the new accounting standards.

As a measure to strengthen the banking system, the Government Ordinance 13/2011 on the penalty and remunerative legal interest for monetary obligations and regarding certain financial and fiscal measures in the banking sector came into effect as of September 1, 2011; this piece of legislation amended the existing legislation, on one hand allowing the use of resources available in the Bank Deposit Guarantee Fund (FGDSB) to finance the restructuring measures approved by NBR for the transfer of deposits, and on the other hand ensuring the consistency of provisions included in the acts composing the FGDSB regulatory framework with those applying to credit institutions.

In addition, NBR prepared the standard contract framework for the acquisition of assets with takeover of liabilities, while the activities[3] for the preparation of internal procedures allowing the exercise of new competencies in respect of restructuring the credit institutions in distress are being finalized.

In order to facilitate the credit institutions' access to liquidity, as of October 3, 2011, the list of assets admitted in the NBR money market transactions was extended by introducing the Romania-issued euro-denominated bonds and the RON-denominated bonds issued by the international financial institutions (IFI), stored in the Euroclear system, as a result of the new connection SaFIR-Euroclear becoming operational. With the same purpose of expanding the list of eligible assets, it is worth mentioning that the RON-denominated bonds issued by the IFIs and stored into the RoClear system will be accepted as eligible assets after the contract allowing NBR to take part in the RoClear system will be signed and the direct SaFIR-RoClear[4] connection will become operational.

With the purpose of introducing a prudential treatment of temporary participation holdings acquired after the restructuring of existing loans, preventing at the same time the weakening of the banks' financial position, NBR prepared the Regulation 26/2011[5].

At the same time, NBR carefully monitored[6] the loans in foreign currency, individually in the non-financial and household sectors[7] and it will continue to do so including by adopting the required measures to ensure that the foreign currency loans are extended in a way that allows the appropriate management of risks of debtors which are not covered for the currency risk and that these risks are accurately reflected in the financial service prices. The actions implemented by NBR are in line with the global European context, aiming at resuming credit activity in a balanced manner, with a focus on the loans in domestic currency as compared to foreign currency, in addition to an appropriate management of the existing stock of foreign currency loans. To this end, consideration is being given to assessing the need and timing for

[3] On January 21, 2012, the *GO 1/2012 for amending various acts applying to credit institutions* came into effect, which amends *GEO 99/2006 on credit institutions and capital adequacy* and *GO 39/1996 on the establishment and operation of Bank Deposit Guarantee Fund*. In addition, a working group has been established, coordinated by the NBR first vice-governor, that is responsible for preparing all necessary procedures aimed at the implementation of the new tasks related to the credit institutions' restructuring, including for the implementation of stabilization measures which are the purpose of *GO 1/2012*.

[4] The connection is technically complete, with the General Shareholder Meeting (AGA) of the S.C. Depozitarul Central S.A. (Central Depository) having agreed to all proposals made by NBR and having approved the list of tariffs applying to the central banks. The S.C. Depozitarul Central S.A. is now to submit to NBR the participation contract, for signature. The contract is expected to be signed and the direct SaFIR – RoClear connection is expected to be up and running by March 15, 2012.

[5] The NBR Regulation 26/2011 on temporary holding of shares under an assistance or financial restructuring operation undergone by an entity outside the financial sector was published in the GO 855/5.12.2011.

[6] The most important conclusions of the monitoring action, as well as the new policy measures intended by NBR, were published in the latest *2011 Financial Stability Report* (the document was posted on the NBR site in September 2011).

[7] The NBR Regulation 24/2011 on loans to individuals was published in the Official Gazette 767/31.10.2011.

adjusting the regulatory framework and possibly expanding the list of risk monitoring tools in respect of the financial stability generated by the foreign currency crediting, in order to respond to the relevant recommendations made by the European Systemic Risk Board.

In order to prepare a contingency plan for the banking sector, a number of measures are being put in place[8] by NBR. To this end, an internal procedure has been developed for identifying the banks of systemic importance (the procedure will provide criteria and parameters for the assessment of the systemic nature of a credit institution). The procedure is to be approved by NBR as part of a more inclusive package of procedures related to the bridge bank tool. In addition, a suite of press releases[9] has been put together aiming at the three types of stabilization measures provided for in GO 1/2012.

In order to update the corrective policy array and the resolution tools, NBR is to assess the need for expanding its resolution tool collection in accordance with the provisions in the Directive regarding a new plan for recovery and solving the situation of problem banks, at the time it will become effective.

1.2 Monetary and Exchange Rate Policy

In compliance with its statute[10], the primary objective of the National Bank of Romania (NBR) is to ensure and maintain price stability. Starting August 2005, monetary policy has been implemented in the context of inflation targeting, against the background of a managed floating regime. This exchange rate regime is in line with using the inflation target as a nominal policy anchor and allows monetary policy to provide a flexible response to unexpected shocks that may hit the economy.

Monetary policy will remain firmly oriented towards meeting the inflation targets set by the NBR together with the government and implicitly ensuring a long-lasting reduction in the medium-term inflation rate to levels in line with the ECB's quantitative definition of price stability. In this respect, an underpinning is expected to be provided by the adoption of a flat multi-annual inflation target of 2.5 percent ±1 percentage point as from 2013. This decision was taken by the NBR Board at end-2010, along with that of maintaining the 2012 inflation target at the previous year's level, i.e. 3 percent ±1 percentage point. The shift to a flat inflation target is not only a beneficial, but also an ambitious change to the inflation targeting framework, providing the advantage of anchoring inflation expectations. This shift follows the stage of gradually declining annual inflation targets[11] set and announced over two-year horizons, which was a typical feature of this strategy since its implementation.

The recent drop[12] in the 12-month inflation rate to historical lows, as a result of fulfilling the economic and financial programme agreed under the external financing arrangements with

[8] The proposed deadline is April 30, 2012, in line with the provisions in par. 14 of the Economic and Financial Policy Memorandum attached to the Letter of Intent submitted to IMF in February 2012.

[9] These are to be integrated into the procedure draft regarding the external communication in situations where NBR decides to apply restructuring measures in the case of banks viewed as likely to impair the sound functioning of the banking system, which is part of NBR internal procedures regarding the implementation of bridge banks.

[10] Law 312/2004.

[11] Annual inflation targets were lowered from 7.5 percent ±1 percentage point in 2005 to 3 percent ±1 percentage point in
2011. The annual inflation targets for 2010 and 2012 were left unchanged from the previous years at 3.5 percent ±1 percentage point and 3 percent ±1 percentage point respectively.

[12] The 12-month inflation rate dropped to 3.14 percent in December 2011, in the immediate vicinity of the midpoint of the year-end target (3 percent ±1 percentage point), and stayed on a downward path to reach 2.6 percent in March 2012.

the European Union, the International Monetary Fund and other international financial institutions, provides positive underlying momentum for maintaining the annual inflation rate on a trajectory compatible with achieving the medium-term target.

Behind these developments stood the rapid slowdown in inflation in the latter part of 2011, following the fading out of the VAT hike impact and the relatively favorable developments in food prices, against the background of keeping adequate real broad monetary conditions. To these add the reconfirmed prospects, in the early months of 2012, of keeping the annual inflation rate inside the variation band around the midpoints of the 2012 and 2013 targets throughout the policy-relevant horizon.

In this context, the NBR resumed the rate-cut cycle in November 2011, lowering the monetary policy rate in four consecutive steps[13] of 0.25 basis points each to 5.25 percent, while also continuing to adequately manage liquidity conditions in the banking system. The central bank's cautious stance in calibrating the policy rate cut was warranted by the persistent uncertainties regarding the external environment, the volatility of capital flows, international investors' risk aversion, as well as developments in administered prices and some volatile prices, likely to keep the balance of risks to the inflation outlook tilted to the upside.

Monetary policy will preserve its prudent conduct over the period ahead, given that the major objective of the monetary authority is to ensure a firm anchoring of inflation expectations, while risks to consolidating inflation at low levels, compatible with achieving the medium-term target, remain significant[14].

Both in the short run and over a longer time horizon, the pace and magnitude of potential adjustments in the monetary policy rate and in the parameters of the monetary policy instruments, in the context of setting the adequate broad monetary conditions, will be calibrated primarily in correlation with the intensity of disinflationary pressures arising from the negative output gap – which, albeit gradually narrowing, is anticipated to remain significant over the period ahead – and with the behavior of medium-term inflation expectations. Furthermore, the likelihood of major risks to the medium-term inflation outlook materializing, on the one hand, and the specifics of the monetary policy transmission mechanism (and hence of lending, especially to the private sector), on the other, will continue to play an instrumental role in substantiating the central bank's decisions.

The effectiveness and viability of this monetary policy stance are further conditional upon the continued firm implementation of fiscal consolidation measures and structural reforms, along with enhanced efforts to absorb European funds, in line with the commitments under the external financing arrangements with the EU and the IMF. These are essential prerequisites for precluding an increase in Romania's sovereign risk premium and hence for consolidating disinflation and for the sustainable recovery of the domestic economy.

The commitment to adopting the euro in 2015 is maintained and is seen as a major anchor to ensure the time consistency of the macroeconomic policy mix and of structural reforms, as well as to promote the adjustments needed for enhancing the resilience and flexibility of the Romanian economy.

[13] The decisions were taken during the NBR Board meetings of November 2011, January, February and March 2012.

[14] Major risks stem from the potentially renewed worsening of the sovereign debt crisis (impacting exchange rate movements, external financing availability and costs, as well as the pace of recovery of the domestic economy), from the geopolitical tensions likely to linger in some parts of the world (with a detrimental impact on oil price), as well as from the more frequent and more sizeable administered price adjustments over the medium term.

1.3 Structural Reforms

NAFA Medium Term Objectives:

- ✓ Fight cross-border fraud, in particular the intra-Community fraud:
  - Fight carousel fraud;
  - Work together with the revenue administration offices and the European bodies to prevent and fight cross-border fraud, improve and streamline control techniques, methods and abilities; increase the number of audits performed jointly with the European revenue administration bodies and targeting the Romanian taxpayers involved in fraud chains.
- ✓ Implement e-commerce control;
- ✓ Verify high net worth individuals.
- ✓ Increase the number of traffic operations run by the Financial Guards' and Customs Authority's mobile teams.
- ✓ Monitor and intervene in the high risk areas (excisable goods, intra-Community acquisitions, import/export operations).
- ✓ Develop and implement the IT application for monitoring the movement of excisable goods under tax suspension arrangements, including the intra-Community movements with excise duties paid in the Member State of dispatch – EMCS Stage 3;
- ✓ Strengthen supervision of excisable goods and fiscal warehouses, including in the neighboring areas.
- ✓ Purchase monitoring equipment/systems used to secure the road transportation of goods too, and mobile scanning devices in order to reduce tax evasion and strengthen tax and customs control, wherever the risk assessment requires a non-destructive audit to be run;

2. ECONOMIC OUTLOOK

2.1 Economy at global level / technical assumptions

The economic situation in the European Union has been deteriorating towards the end of 2011, but there are certain signs that the situation will stabilize. EU-27 GDP increased by 1.5% and 1.4% in the Eurozone, technically in line with the 2011 Autumn Forecast. However, the slowdown in the EU economy at end-2011 proved stronger than expected. The sharp decrease in confidence, the sovereign debt crisis and a weaker economy at global level have undeniably influenced growth.

In early 2012, the financial markets showed signs of stabilization, while the EU Member States have adopted additional measures to improve the necessary fiscal consolidation, with the sovereign debt crisis continuing in some states of the Eurozone and likely to influence the growth outlook in the short run. The most recent confidence indicators stabilized and some even took an ascending trend. Under these circumstances, a certain contraction is anticipated in early 2012, in both EU and the Eurozone, followed by a modest recovery typical to post-crisis times, as of the latter half of the year. The 2012 forecast has been revised for EU-27 from 0.6% (as per the 2011 autumn forecast) to 0% in the 2012 spring interim forecast, with an economic downsize of 0.3 per cent expected in the Eurozone.

The global economy assumptions relate to maintaining the gross domestic product increase in the upcoming years to over 4%, increasing the volume of exports and imports, against the background of increasing oil product prices and decreasing non-oil product prices in 2012, followed by a decrease in respect of oil products and a slight increase for non-oil in 2013.

2.2 Cyclical developments and current perspectives

Current perspectives

GDP in Romania increased in 2011, in real terms, by 2.5% compared to 2010, which was a better evolution than expected in the autumn forecast.

The domestic demand increased by 3.1% in 2011 as compared to 2010, against the background of private consumption going up by 1.3% and the Gross Fixed Capital Formation going up by 6.3%. The government consumption, which includes Government’s individual and collective consumption, decreased by 3.5%. Exports of goods and services went up by 9.9%, whereas the imports increased by 10.5%, with a negative contribution of 0.8% of net export to the real GDP growth.

On the supply side, it is worth noticing the increase by 11.3% of the Gross Value Added in agriculture and by 5.0% in industry. The constructions went up by 2.7%, whereas the service sector saw a decrease by 0.1%, with a more significant GVA increase in „shows, cultural and recreational activities; repair of household goods and other services” (4.8%) and „trade, transport and storage; hotels and restaurants” (1.2%).

A positive fact is that it were simultaneously recorded both the budget deficit adjustment from 6.8% of GDP in 2010 to 5.2% of GDP in 2011 (ESA 95) and a sustainable current account deficit of 4.2% of GDP.

The quarterly figures show that, after a 1.7% increase of the GDP in the first quarter compared to the same quarter of 2010, in the second quarter the annual pace slowed down to 1.4%, to see after than Romania’s economy growing by 4.4% in Q3. This has been the biggest quarterly economic progress since early 2010, being supported by a good farming harvest, as well as by the growth in industry and the returning of constructions on a positive track. In Q4, despite a deteriorated international environment, the Romanian economy increased by 1.9%.

Given the fact that on the one hand, Romania's economy is dependent upon the EU27 economy, in particular the Euro zone, and the pessimistic outlook when it comes to the economic growth of this zone taking into account the sovereign debt crisis in some Member States of the Euro zone, on the other hand, the 2012 macroeconomic framework foresees a 1.7% economic growth, decreasing as compared to the previous version of the Convergence Programme when projected a 4% economic growth. The risk of economic growth slowing down in the EU Member States will be compensated by a better EU fund absorption and the gradual recovery of the domestic demand, due to continuing the strong policies' implementation aimed at ensuring the macroeconomic and financial stability.

The domestic demand will be the engine of the economic growth, with the Gross Fixed Capital Formation speeding up by 7.2%, the investment expenditures playing an important role in the budgetary policy.

With available revenues increasing, the private consumption will continue to grow at a moderate pace, of 1.8%. After the cuts in expenditures in the last couple of years, the government consumption expenditures will go up by 2.4%, while some budgetary restrictions will still be preserved.

Exports of goods and services will see a significant decrease, as they were projected to increase by 4.0% in real terms, while imports of goods and services will go up by 7.9%. In these conditions, the net export will have a negative contribution to the real growth of the gross domestic product, by 1.9 percent, respectively.

On the domestic supply side, the constructions sector is expected to pick up in 2012, its gross value added increasing by 3.7%. The industry and services will grow by 1.9% and 1.3%, respectively, while the agriculture is expected to keep the 2011 level.

The year 2011 showed a very good performance of the **Romanian foreign trade**. The achievements are even better than before the crisis, with the exports significantly contributing to the reducing of the economic downturn. Significant is that this good performance of the exports was accompanied by a more reduced increase of the imports of goods, i.e. 16.7% compared to 20.5% in the case of exports. The resulted trade deficit (FOB-FOB) was only 7.5 billion Euro, lower by 138 million Euro as compared to 2010. The monthly average in exports was 3.8 billion Euro compared to 3.1 billion Euro in 2008, with over 90% of the exported goods being industrial products.

The current account of the balance of payments saw a deficit increasing by only 2.9% up to 5.7 billion Euro, representing 4.2% of GDP.

The current account deficit has been financed 33.8% from foreign direct investments, which stood at 1.9 billion Euro, lower by 13.6% as compared to 2010.

During the first two months of 2012, domestic exports increased by 0.6%, compared to the same interval of 2011, with imports rising by 5.1%. Under these circumstances, the FOB-CIF trade deficit went up by 56%.

The current account of the balance of payments saw a deficit of 663 million Euros, higher by 164% compared to the same interval of 2011, 38% of it covered from foreign direct investments (FDI), having amounted to 253 million Euros.

Considering the evolution seen in 2011 and the first two months of 2012, being linked to the economic performance of Romania's main foreign partners which lead to a counteraction of the foreign demand, the exports of goods are expected to go up by 7.4% in 2012, with the imports of goods increasing by 11.1%. Under these circumstances, the share in GDP of the FOB-FOB trade deficit will go up by 1.6 percentage points compared to 2011 (7.1% as against 5.5%). The intra-communitarian and extra-communitarian exports of goods will increase by 7.2% and 7.7%, respectively, with the intra-communitarian and extra-communitarian imports of goods increasing by 11.3% and 10.7%, respectively.

The current account deficit of the foreign balance of payments is expected to remain in a sustainable interval, to represent 5.1% of GDP, 85% of it being covered from non-interest bearing autonomous sources.

After the first half of 2011, when the **annual inflation rate** was quite high, it went gradually down to 3.14% in December 2011, being 4.82 percentage points under the annual inflation at end-2010. The decrease of the inflation rate in the second half of 2011 was triggered by both the decrease of prices of the farming food goods and the removal of the base effect of the VAT hike in July 2010. As annual average, the 2011 inflation reached 5.79% which is 0.3 percentage points under the average inflation of 2010 (6.09%).

In 2011, the contribution of the excisable goods prices (tobacco, fuels and electricity) to the inflation calculated at the end of the previous year was 1.23%, decreased as compared to 2010, when the contribution of these products was 2.83 percentage points.

The core inflation[15] went up by 2.4% in December compared to the end of 2010, a level that is lower compared to the overall price increase. The price of administered goods increased over the overall consumer prices. Among the administered prices, the most significant increase was seen for thermal power (24.8%), water, sewage, sanitation (19.98%) and railway transport (19.68%).

Regarding the consumer prices in March 2012 compared to December 2011, according to the most recent data published by the NIS, they went up by 1.4% due to an increase of food and non-food goods prices by 2.18% and 1.12%, respectively. In terms of annual inflation in March 2012 it reached 2.4%.

In 2012, the inflation will remain at a low level, and will reach 3.5%, with an annual average of 3.0%. A positive impact on the inflation during 2012 is expected from the aggregate demand too, which is foreseen to keep a low level.

In addition, maintaining the leu/euro exchange rate above the last year's average may come as a pressure considering the increase of imported goods prices as well as the increase in the price of goods and services linked to the European currency.

The low volatility of the oil price that has been taken into account when estimating the inflation could be disturbed due to an escalation of tensions in the Middle East, which could lead to a substantial increase of the oil price on the foreign markets.

One other source of risk coming from the international environment is the continuation of the sovereign debt crisis, likely to generate higher costs and a more difficult access to foreign financing.

[15] Computed as the difference between the consumer price index and the administrated prices.

Employment, according to the national accounts[16], went up in 2011 by 0.4% compared to 2010, while the number of employees increased by 0.1% and self-employed increased by 1.1%. The number of employees increased in agriculture, industry and constructions and some services, while other services cut the number of employees.

In 2012, the economy still growing, employment is expected to go up by 0.3%, with the number of employees increasing by 0.2%.

In 2011, **the unemployment rate** according to ILO was 7.4%. The activity rate of the population aged 20 to 64 was 68.0% with the employment rate at 63%, accounting for a gap of 7 percentage points compared to the national target established by the Europe 2020 Strategy at 70%.

Cyclical developments

In terms of methodology, it is worth mentioning that according to the method used by the National Commission for Prognosis the potential employment is estimated starting from the working age population and applying the activity rate of the working age population (the trend of which is calculated using the Hodrick-Prescott filter), and the unemployment rate trend determined by using the same filter.

In 2010 – 2015 the levels of potential GDP are lower than before the crisis, with their composition revealing the positive contribution of all factors.

Contribution of factors to potential GDP growth

	Contributions - % -				
	GDP	**Capital**	**Labor**	**TFP**	**Output Gap**
2010	**2.1**	1.3	0.1	0.7	-3.3
2011	**2.1**	1.4	0.2	0.5	-2.9
2012	**2.2**	1.5	0.2	0.4	-3.4
2013	**2.4**	1.6	0.3	0.4	-2.8
2014	**2.6**	1.7	0.3	0.5	-1.8
2015	**2.8**	1.8	0.4	0.6	-0.7

Source: NCP

One can notice that capital continues to have an important contribution to the economic growth potential, simultaneously with an increased contribution of the other factors.

The output gap is still negative and its trend is to go down in the medium term, in line with the proposed macroeconomic policy mix.

2.3 Medium Term Scenario

Given the slowdown of the economic growth potential, in the medium term, namely the interval 2013-2015, the forecast scenario shows an acceleration of the economic growth by 3 to 4 %, which is slower than in the previous version of the Convergence Programme. The scenario is based on an improved activity in all economic sectors, particularly in the high

[16] The persons (employees and self-employed) involved in a production activity according to the European System of Accounts (ESA), namely resident and non-resident persons working in resident production units.

export range industrial sectors, as well as in the constructions sector that could capitalize on the infrastructure needs existing in all areas.

Macroeconomic projections					
	2011	**2012**	**2013**	**2014**	**2015**
	Percentage change				
Real GDP	2.5	1.7	3.1	3.6	3.9
Private consumption expenditures	1.3	1.8	3.2	3.6	3.6
Public consumption expenditures	-3.5	2.4	1.8	2.3	2.4
Gross Fixed Capital Formation	6.3	7.2	7.4	7.5	7.8
Exports of goods and services	9.9	4.0	5.8	7.3	8.7
Imports of goods and services	10.5	7.9	7.7	8.6	9.3

Source: NCP

The domestic demand will be the engine of this performance, with a growth pace of the gross fixed capital formation above 7%, up to 7.8% in 2015. While the private consumption expenditures will rise by a rough 3.5%, with the increase of available revenues and the rise of confidence in the economic climate, the government consumption expenditures will have a positive trend, still ensuring a reduced share in GDP and a more efficient budget spending. Exports and imports of goods and services will remain at high levels, with the net export seeing a negative contribution to the actual growth of the gross domestic product.

After a clearly higher increase pace of **exports** in 2011, in 2012 this pace is expected to slow down to 7.4% while the imports growth rate will decrease more slowly to 11.1%, thus leading to a significant increase of the trade deficit and, by this, of the current account deficit.

Under these circumstances, in the current Convergence Programme compared to the previous version we revised the forecast for both 2012 and the interval 2013-2015.

Considering the global economy's performance in the upcoming time period, during 2013-2015 we expect annual average increases in the exports of goods by 11.2% and the imports of goods by 11.8%. Therefore, the share in GDP of the FOB-FOB trade deficit will see an ascending trend, reaching 8.7% in 2015. The intra-Communitarian exports are expected to grow at an annual pace of 11.0% while the intra-Communitarian imports will rise by 10.8%. Extra-communitarian exports and imports are expected to grow in average by 11.5% and 14.2%, respectively.

The current account deficit will remain in the range 7.8 – 8.7 billion Euro with a share in GDP ofaround 5% to be almost 100% covered from non-interest bearing autonomous sources throught the interval.

The decreasing **inflation** trend will continue in 2013-2015, in terms of both end of year and annual average. The resumption of the inflation's decreasing trend will be supported by a continued firm conduct of the monetary policy and of other components of the economic policy mix (fiscal, revenues). The forecast has been based on normal years in agriculture and a low volatility in respect of the international oil price.

In addition, a gradual reduction in the excise duties increase, a prudential wage policy and continued structural reforms will keep the disinflation on a sustainable path. Hence, the inflation rate will go down to 2.3% in 2015, at an annual average of 2.5%. Furthermore, the continued disinflation process will help reducing the inflation expectations more. One other efficient way of anchoring the inflationary expectations will be the domestic currency resuming its appreciation trend against the Euro, in actual terms. This will be possible if consideration will be given to a more accelerated output growth in the Romanian economy, compared to Romania's foreign partners. The exchange rate impact will be modest and it will be seen in the support to disinflation. Hence, a slight nominal appreciation of the domestic currency against the European currency was taken into account.

Employment, according to national accounts, will go up in 2013-2015, particularly as a result of an increase in the number of employees. The labor productivity will improve following a more rapid growth of the gross domestic product compared to the increase of the employment. The compensation per employee will go up, but the share of compensation of employees (D1) in the gross value added will decline from a rough 42.5% in 2011 to 41% in 2015.

The unemployment rate, according to ILO, will go down to 6.5%, at the same time with the employment rate for the population aged 20 to 64 going up to 65%.

2.4 Sectoral Balances

In 2011, the current account of the balance of payments saw an increasing deficit by only 2.9% compared to 2010, with a share in GDP of 4.2%. The current account deficit was 33.8% financed by foreign direct investments, lower by 13.6% compared to 2010 when they amounted to 2219 million Euro.

In January 2012, the current account of the balance of payments saw a deficit of 37 million Euro, down by 73.4% compared to the same period of 2011. This was a result of the increase in the surplus of the current transfers balance by 2.4 times, mainly due to an increase of the EU funds received (483 million Euro). The current account deficit was financed 62.2% by foreign direct investments amounting to 23 million Euro.

In 2012, the current account deficit of the foreign balance of payments is expected to stay in a sustainable interval, so as to remain at 5.1% of GDP, 85% of it being covered from non-interest bearing autonomous sources.

In the medium term, the current account deficit shall remain in the range of 7.8 – 8.7 billion Euro, with a share in GDP of 5.0%.

The share of foreign deficit in GDP, taking into account the capital account, will decline from 4.1% in 2011 to 3.3% in 2015, against the background of an increased contribution of the capital account. Foreign investments are expected to go up in 2013 - 2015 from 3.5 billion Euro to 4.6 billion Euro.

3. GENERAL GOVERNMENT AND DEBT BALANCE

3.1 Strategic Policy

The medium-term budget policy is a continuation of the fiscal adjustment process started in 2009-2010 and its core purpose is the compliance with the parameters established at European level by the recent Fiscal Treaty.

The continuation of the reform process, particularly the fiscal consolidation process, based on the preventive financing agreement concluded with the EU, IMF and the WB can bring coherence to the macroeconomic and financial policies, thus adding to the consolidation of the investors' confidence and reducing the spill-over effect coming from other markets.

While no other austerity measures and considered, similar to those implemented in 2010, a prudential approach will be maintained on the expenditures side, expressly to consolidate the sustainable trend of the public finances.

3.2 Medium Term Objectives

On the medium term, the Government has established the elements of fiscal consolidation as follows:

- Restructure public expenditures to adjust the current expenditures and bring them to sustainable levels, with a view to cut the budget deficit and allocate discretionary expenditures to investment projects;
- Improve the policy in the investment sector;
- Continue the policy aimed at reducing and preventing arrears;
- Improve the corporate governance;
- Maintain the government debt at sustainable levels on a long term.
- Improve the tax revenues policy by: fighting tax evasion, boosting revenue collection efficiency, encouraging voluntary compliance.

Restructuring Public Expenditures is mainly focused on:

➢ Reducing the number of employees in the public sector, that will continue by further applying the policy according to which one employee in seven leaving the system can be replaced; this policy will be applied more flexibly, in a move to do away with deadlocks caused by the lack of personnel.

➢ **The reform of the healthcare system** will continue with the adoption, by end-2012, a new framework law in this field. This reform will be aimed at:

- Making sure that expenditures are committed in observance of the allocated budget;
- Reducing the scope of public services package that will be based more on cost sharing and the additional private insurance;
- Revising the co-payment law;
- Prepare and implement a negative list of healthcare services and drugs to include (i) revised lists of compensated drugs and (ii) a shorter in-patient care period and the implementation of the national plan regarding the hospital beds;

- Further implement the new IT system in the healthcare system;
- Distribute the new healthcare cards benefitting all stakeholders that will help keeping fraud under control and will lead to a better monitoring of committed expenditures.

- The Government decided its top priority will be to channel public funds to the investment sector, along with speeding up EU funds absorption, expected to top up the national budget and help economy boost its growth potential.
- Prioritize investments by:
  - Increasing the planning and monitoring capacity for capital investments, through a developed project database – progress has been made in putting together an investment portfolio that includes all projects run by the government, to ensure a good project monitoring and prioritization. This portfolio will be used to evaluate the projects, priority being given to projects that can receive 100% of funds over 3 to 5 years, or stop the low priority projects and non-performing projects that cannot be financed 100% in this time interval;
  - Monitoring projects financed under the National Program for Infrastructure Development;
  - Re-channel capital expenditures in the public sector to gradually move from investments 100% financed from national sources, to investments that are co-financed by the EU.
- **Reduce existing arrears and prevent new arrears** remains a priority:
  - In the healthcare sector, the arrears associated to registered invoices have been 100% eliminated, while the non-registered invoices revealed during the inventory exercise by end-2011 have been registered and planned for payment. The implementation of the clawback tax to prevent running new arrears in the healthcare sector;
  - The next stage in the process aimed at integrating the accounts reporting system with the treasury payment system is in progress, including for the control module and reporting of commitments at all administration levels;
  - In the next two years, the interval for paying the invoices registered in the state budget system and the social security system will be gradually reduced. *Directive 7/2011 of the European Parliament and the Council regarding the fight against delays in making payments under commercial transactions* will be integrated in the Romanian legislation in a timely manner;
  - Improving budget procedures and the expenditure management to avoid running new arrears, so that the budgets allocated to commitments taken at the central administration level under the multiannual capital projects may be fully included in the medium term budgetary framework. Multiannual investment projects will be contracted in line with the multiannual commitments.
- One political objective of Romania’s Government towards the IFIs (IMF, the European Commission and the World Bank) is to undertake a deep reform of the SOEs, in particular those in the key sectors such as energy and transport. In this context:
  - The implementation process of the general corporate governance law is underway;
  - The selection process has been intensified with respect to the private management teams of the main SOEs that will remain the government property.

- **Tax Administration Policy**

Increasing budget revenues as share to GDP is the main pillar supporting the reform strategy of the National Agency for Tax Administration (NATA).

The reforming objectives for 2012 – 2016 are as follows:

- *Improve voluntary compliance;*
- *Firmly fight tax evasion;*
- *Boost collection efficiency.*

The measures aimed at putting the above objectives into practice include:

- *Simplify procedures and improve the quality of services* mainly supported by an expansion of the use of electronic services and a diversification of these services, improved taxpayer assistance and new quality standards;

In terms of procedures, the main improvements to be implemented by NATA in 2012 – 2016 are:

  - Expand e-filing to 98% for legal persons, considering the returns that can be filed in an electronic environment;
  - Introduce a catalogue of taxpayer services and quality standards in the taxpayers assistance field;
  - Expand the taxpayer assistance scope to reach the single contact point between NATA and the taxpayer;
  - Encourage the increased share of payments made via the banking system;
  - Establish for taxpayers (individuals and legal persons) the possibility to visualize their fiscal situation, and request and receive documents via the NATA Portal.

- *Improve the classification of taxpayers and the allocate resources* to manage those categories of taxpayers that bring the highest share of budget revenues;

- *Fight the risk of non-compliance with* registration, filing and payment obligations, with a focus on strengthening the risk assessment, revise audit planning procedures and develop the desk audit function;

- *Render administrative penalties more efficient*, improve recovery of budget obligations assessed from fraud and tax evasion and cooperation with the investigators and criminal prosecution bodies, so as to have more convictions based on the criminal files submitted by NATA structures;

- *reorganize the local network to a regional structure and further reduce the number of fiscal units*, in a move to boost efficiency and reduce corruption risk. In mid-2013, 8 regional general directorates will be established, with their local competency matching the 8 development regions of Romania; these regional directorates will deal with medium taxpayers in the respective regions and will incorporate appropriate support functions. If the business processes is automated and the IT system is consolidated, so as to compensate for the lack of tax offices at local level, in 2015 the number of fiscal units will be reduced down to 47 (one for each county ("*județ*") and one for each sector of the Bucharest Municipality) with the public finance, customs and financial guard regional directorates to merge into one single organization;

- *requalify and reallocate staff* to areas facing staff shortages (fiscal audit, ex-post customs audit, taxpayers assistance, organizations dealing with large and medium-sized taxpayers or fiscal units having to deal with a large number of taxpayers) and recruit expert to fill out positions with a high value added (information technology and communications, legal, some management positions) in observance of the existing number of positions;

- *rationalize and integrate the agency's business processes*, in a move to redirect them towards the citizens, increase efficiency and cut agency risks;

- *modernize the IT&C System*, that will require important technology investments, centralizing the applications, establishing saving and recovery capacities after disaster and improving the interoperability with other institutions and authorities of the public sector.

The above measures are part of a medium term NATA modernization programme, supported by the World Bank and the IMF, which also includes some ambitious targets, as follows:

- *improve the filing voluntary compliance* from 87.27% in 2011, to 92% in 2016 and the payment voluntary compliance from 77.9% in 2011 to 85% in 2016;
- *increase the collected revenues share to GDP* from 28.75% in 2011 to over 30.5% in 2016, based on measures aimed at boosting collections against the background of a fiscal policy that will be neutral with respect to revenues;
- *cut collection costs* from 9.800 lei for 1 million lei collected in 2011 to below 9.000 lei for 1 million lei collected in 2016.

3.3 Budgetary Policy in 2011 and 2012[17]

Budgetary Policy in 2011

In 2011, the budgetary policy was prudential, restrictive and centered on the continuation of fiscal consolidation efforts to reach a cash budget deficit target of 4.4% of GDP.

Revenues:

Budget revenues estimation has been based on the following:

- unchanged corporate income tax, individual income tax and VAT rates;
- the 5.5% contribution to the health fund extended to pensions above 740 lei, with an impact on the national health insurance fund;
- increased budget revenues by fighting tax evasion;
- improve revenue collection and tax management.

Expenditures:

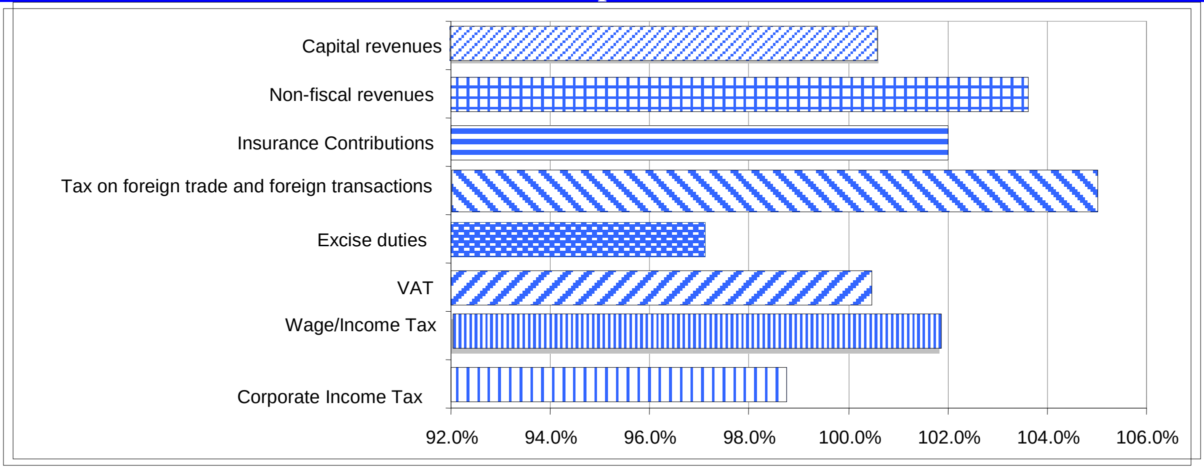
The main challenge of the expenditure policy fostered in 2011 was to continue adjustment measures, by maintaining the budgetary restrictions and continuing structural reforms.

[17] Unless otherwise advised, the numbers in this section are cash.

Budget Execution in 2011

The general government revenues amounted to 181.9 billion lei (31.4% of GDP), with a nominal increase of 7.9% compared to 2010, while compared to the annual plan the actual figure showed a 0.4% failure.

Actual General Government Revenues Compared to Plan



Source: MoPF

The budget revenues performed as follows:

- revenues from **corporate income tax** increased by 1.9% compared to the previous year.
- Revenues from **personal income tax** amounted to a total 19.1 billion lei, showing an raise by 6.2% compared to the previous year, due to an increase in the number of employees and in the gross average salary, and as a result of the taxation of interest income as of July 1, 2010 as well as the 16 percent flat tax applied to income from securities, other than shares and stocks of closed companies, irrespective of the period of holding the respective securities.
- Revenues from the **value added tax** showed an increase by 22.1% compared to the previous year, following the VAT rate increase from 19% to 24% in the second half of 2010, and the amounts collected after the settlement of some SOEs debts.
- Revenues from **excise duties** went up by 10.4% compared to the previous year due to a higher excise rate for some goods and to amounts collected after the settlement of some SOEs debts.
- **Non-fiscal revenues** went down by 6.3% compared to the previous year.
- **Social security contributions** collected by the general government went up by 10.8% compared to the previous year. This was the result of an increase in the number of employees and in the gross average salary by 6.5% in 2011, as well as of introducing, as of January 1, 2011 the obligation for some special categories of employees (defense, public order etc.) to pay social contributions and for the retired with a pension of above 740 lei to pay the health fund contribution, topped up by amounts collected after the settlement of some SOEs debts.

The general government expenditures amounted to 205.8 billion lei in total, showing an increase in nominal terms of 1.7% compared to the previous year, while the specific weight to GDP went down by 3.1 percentage points.

The general government expenditures performed as follows:

- **staff expenditures** went down by 10.3%, as a result of the wage cuts in the public sector (although these were partially reversed in 2011), the bonuses cuts in the public sector and the restructuring and layoffs at the central and local administration level.
- **expenditures with goods and services** went up by 7.4% in 2011 compared to 2010, mainly as a result of arrears paid in the health sector and following the takeover by the local administrations of the funding of Agricultural Chambers as of March 2010, and decentralized healthcare units, as of July 2010.
- **interest expenditures** went up by 22.1% compared to the previous year; this has been the effect of loans committed to cover an increase of the budget deficits from previous years, requiring an additional effort to cover principal and interest payments;
- **subsidies expenditures** declined by 4.9% mainly as a result of the rationalization measures aimed at restructuring the public companies, as well as reduced subsidies in agriculture and old technologies, household heating, etc;
- **social assistance expenditures** declined by 0.9% compared to 2010, following the legal amendments adopted in the social security field;
- **expenditures with EU-funded projects** went up by 47.5% compared to the previous year, accounting for 1.9% of GDP up by 0.5 pp as against the previous year;
- **investment expenditures** which include capital expenditures and expenditures for development programmes funded from both domestic and foreign sources amounted to 36.3 billion lei, as against 33.7 billion lei in the previous year.

Budgetary Policy in 2012

The annual budget law and the 2012 budget as well as the budget for 2013-2015 establishes the 2012 budgetary framework that will allow the continuation of economic activities and the allocation of funds to public services.

I. The 2012 budget preparation has been based on the below macroeconomic assumptions:

An ambitious fiscal consolidation programme has been implemented by the Romanian authorities as of 2010, with the national economy going through a restructuring process that created the environment for a sustainable development; this programme saw a changing trend in 2011, when the economic activity entered the positive path of growth.

The 2012 fiscal and budgetary policy took into account that a country’s prosperity is linked to its competitiveness, with the coherence and consistency of budget funding policies playing an important part, in parallel with encouraging domestic savings requiring a balanced policy mix oriented towards well defined priorities and objectives. The economic governance package implemented by the European Union through a better coordination of MD budgetary and economic policies and the fact Romania’s integration with the Euro Plus Pact are required to streamline these two aspects and send a sign of confidence to the foreign financial markets.

II. Assumptions of the budget construction:

- Early this year, the foreign multilateral financial agreement with EC, IMF and WB was successfully finalized, helping the foreign deficit adjustment, ensuring a proper foreign financing and improving confidence in the outlook of the domestic economy, in parallel with the *preventive financial support* arrangements with EU/IMF that will ensure the consolidation of medium term reforms started in 2009-2010.

- The reform measures started in 2010 with respect to the unified wage law in the public sector, the national education law, the pension law that totally changed the respective sectors and will consolidate these positive results in 2012.

- The targets and objectives undertaken by the Government in the 2012-2014 Fiscal and Budgetary Strategy, that will strengthen the commitment to reach the 2011 and 2012 budget deficit targets.

III. Core aspects of the 2012 budget:

- **Continue fiscal consolidation to ensure sustainable budget deficit targets in line with the medium term expenditure framework**

The deficit foreseen for 2012 will amount to **2.8% of GDP** in ESA terms and **2.2%** in cash terms.

This is an ambitious target below the 3% stipulated in the Maastricht Treaty and looking ahead to the year 2014, this is the first step taken towards a budget built on a structural deficit of maximum 0.7% of GDP, required by the dramatic change of financial models after the crisis.

- **Maintain a long term sustainable level of the public debt;**

In 2012, the government debt (according to ESA95 EU methodology) is estimated at 34.2% of GDP, and is expected to go below 34% of GDP in 2013-2015, which is under the 60% required by the Maastricht Treaty.

- **Stability, predictability and simplification of the fiscal system;**
    - Preserve the flat tax rate;
    - Cut the number of ad-hoc changes, to ensure the fiscal system's predictability and stability;
    - Improve the efficiency of the fiscal system;
    - Reduce the number of non-fiscal tariffs and fees.

- **Restructure public expenditures to have a better control over these expenditures**
    - The improvement and *prioritization, in 2012, of an increase of over 2 billion lei in investment expenditures, compared to 2011, shows that consideration is being given to boosting efficiency in allocating funds to public expenditures and creating the room for committing expenditures that are expected to have a multiplying economic effect and lead to growth and the creation of new jobs.*
    - *Allocation of funds required to implement EU-co financed projects, as a move to boost absorption;*

Absorption of foreign grant funds is among the Romanian Government's top priorities. The best use of the substantial EU allocation to Romania **for 2007-2013** (**around 34.6 billion Euros**) is a must, as this is one of the core elements in upholding the budget, taking account of the investing strategy and the fact that these funds are not reimbursable.

- *Continue cutting on subsidies to various economic operators, which accounts for a reduced government intervention in the economy and reflecting the market economy rules actually working*

- **Continue reducing existing arrears and preventing new arrears by:**
  - Improved corporate governance.
  - A general corporate governance reform that has been underway, requiring independent external audits to be run at regular intervals, the publication of financial data on a quarterly basis and the strengthening of OECD principles with respect to the corporate governance and the rights of minority-stake owners.
  - An improved framework of concepts and procedures, the passage and consolidation of the top-down budgeting and the program budgeting. The budgetary and fiscal responsibility law 69/2010, introducing a more prudential conduct of the fiscal and budgetary policy **featuring budget streamlining elements** such as *the multi-annual budget planning, the medium term budget framework, numerical fiscal rules, principles of expenditure efficiency and sustainability,* that is in line with the EU-fostered budget framework of the Member States, accounted for an important step in the implementation of the public budget reforms.

Revenues:

The estimation of budget revenues has been based on:

- the corporate income tax, personal income tax and VAT rates left unchanged, in parallel with expanding the taxable base;
- improved revenue collection and tax management;
- a lowered number of non-fiscal fees and tariffs;
- implement the increased excise duties according to the established calendar, for both diesel oil and cigarettes.

Expenditures:

The expenditure policy in 2012 will be focused on a continued fiscal consolidation, a process that is to be in some way relaxed, given the weak economic circumstances.

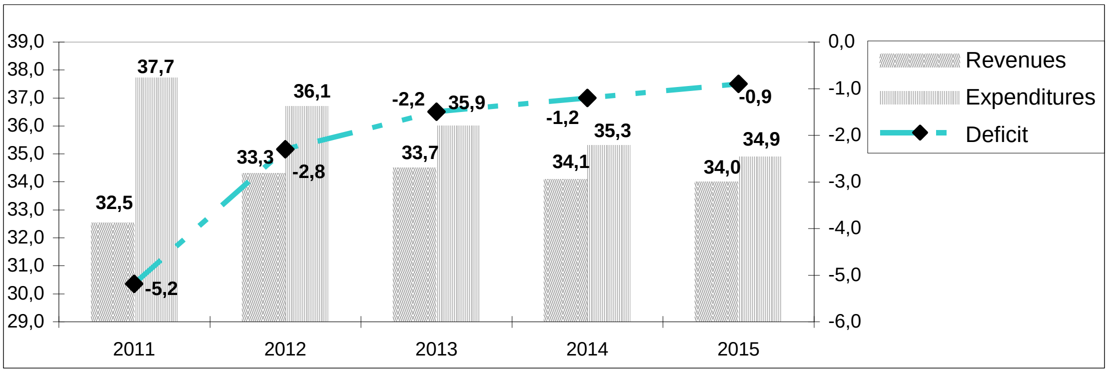
The public spending adjustments and the performance of the macroeconomic indicators have created the financial framework for:

- a phased-in reversal of the 2010 wage cuts required at the time by the application of Law 118/2010 on various measures needed to restore the budget balance, as amended;
- addressing the legal issues related to the 5.5% social security contribution withheld from pensions.

3.4. Medium Term Budget Outlook

On a medium term, the specific objective of the budget policy is to continue adjusting the budget deficit to reach the planned targets of 2.2% of GDP in 2013; 1.2% of GDP in 2014; and 0.9% of GDP in 2015 (according to ESA).

Consolidated Budget Position (%GDP)[18]



3.5 National Infrastructure Development Programme

The National Infrastructure Development Programme has been significantly revised by the Government Ordinance 14 ofApril 2012, with the total programme amount reduced to 5.1 billion and payments phased-in from 2013 to 2020. As a result, cash payments were included in the 2013-2015 budget projections.

In 2012 – 2015, the Ministry of Regional Development and Tourism and the Ministry of Environment and Forests may benefit of execution of works, with or without the final acceptance, in amount of 1 billion lei annually throughout the above-mentioned interval.

[18] The revenues-expenditures = balance correlation may show some variations due to decimal rounding-up.

Annex

NATIONAL PROGRAMME FOR INFRASTRUCTURE DEVELOPMENT

I. INFRASTRUCTURE IN THE FIELD OF REGIONAL DEVELOPMENT

1. Name of project: 10,000 km of county and local interest roads
Purpose of project: Build, modernise and rehabilitate county and local interest roads
Aim of project: Build 10,000 km county and local interest roads

MAIN CREDIT ORDINATOR: THE MINISTRY OF REGIONAL DEVELOPMENT AND TOURISM

thou. lei

Source of financing:			Project total present value	Estimates 2013	Estimates 2014	Estimates 2015	Estimates 2016	Estimates 2017	Estimates 2018	Estimates 2019	Estimates 2020
A			1=2+...+9	2	3	4	5	6	7	8	9
50.00	GRAND TOTAL:		4.209.869	74.408	74.408	676.851	676.851	676.851	676.851	676.851	676.798
	of which:										
	- Non-financial assets		4.209.869	74.408	74.408	676.851	676.851	676.851	676.851	676.851	676.798
50.01	State budget		4.209.869	74.408	74.408	676.851	676.851	676.851	676.851	676.851	676.798
	of which:										
	- Non-financial assets		4.209.869	74.408	74.408	676.851	676.851	676.851	676.851	676.851	676.798
70.01	Housing, services and public development		4.209.869	74.408	74.408	676.851	676.851	676.851	676.851	676.851	676.798
	of which										
	- Non-financial assets		4.209.869	74.408	74.408	676.851	676.851	676.851	676.851	676.851	676.798

II. INFRASTRUCTURE IN THE FIELD OF THE ENVIRONMENT

2. Name of project: Infrastructure in the field of water management, hydrotechnical works for protection against floods, increase of degree of and/or safety of dams and the rehabilitation and protection of the coastal area.
Purpose of project: Works of defense against floodings, ensure the safety of flash floods-mitigating dams, and protection of the water sources and rehabilitation of the coastal area.
Aim of project: Complete the investment works in the field of water management and reduce the negative effects of flash floods on water flows, sustainable use of water resources and rehabilitation and protection of the coastal zone.

MAIN CREDIT ORDINATOR: THE MINISTRY OF ENVIRONMENT AND FORESTS

thou. lei

Source of financing:			Project total present value	Estimates 2013	Estimates 2014	Estimates 2015	Estimates 2016	Estimates 2017	Estimates 2018	Estimates 2019	Estimates 2020
A			1=2+...+9	2	3	4	5	6	7	8	9
50.00	GRAND TOTAL:		858.510			143.085	143.085	143.085	143.085	143.085	143.085
	of which:										
	- Non-financial assets		858.510			143.085	143.085	143.085	143.085	143.085	143.085
50.01	State budget		858.510			143.085	143.085	143.085	143.085	143.085	143.085
	of which:										
	- Non-financial assets		858.510			143.085	143.085	143.085	143.085	143.085	143.085
70.01	Housing, services and public development		858.510			143.085	143.085	143.085	143.085	143.085	143.085
	of which										
	- Non-financial assets		858.510			143.085	143.085	143.085	143.085	143.085	143.085

Annex

I. Commitment appropriations
II. Spending appropriations

Infrastructure in the field of Regional Development

Name of project: Modernisation of localities

Purpose of project: Improve the quality of life for the population

Aim of the project: Rehabilitation and modernisation of localities

thou. lei

Source of financing:			Project total present value	Completed by end-2009	Programme 2010	Programme 2011	Estimates 2012	Estimates 2013	Estimates 2014	Estimates 2015	Estimates 2016	Estimates 2017	Estimates 2018	Estimates 2019	Estimates 2020
A			1=2+...+13	2	3	4	5	6	7	8	9	10	11	12	13
50.00	GRAND TOTAL:	I	641.000	-	-	641.000	-	-	-	-	-	-	-	-	-
	of which:	II	641.000	-	-	-	-	11.811	11.811	102.904	102.904	102.904	102.904	102.904	102.858
	- Non-financial assets	I	641.000	-	-	641.000	-	-	-	-	-	-	-	-	-
		II	641.000	-	-	-	-	11.811	11.811	102.904	102.904	102.904	102.904	102.904	102.858
50.01	State budget	I	641.000	-	-	641.000	-	-	-	-	-	-	-	-	-
	of which:	II	641.000	-	-	-	-	11.811	11.811	102.904	102.904	102.904	102.904	102.904	102.858
	- Non-financial assets	I	641.000	-	-	641.000	-	-	-	-	-	-	-	-	-
		II	641.000	-	-	-	-	11.811	11.811	102.904	102.904	102.904	102.904	102.904	102.858
70.01	Housing, services and public development	I	641.000	-	-	641.000	-	-	-	-	-	-	-	-	-
	of which	II	641.000	-	-	-	-	11.811	11.811	102.904	102.904	102.904	102.904	102.904	102.858
	- Non-financial assets	I	641.000			641.000									
		II	641.000					11.811	11.811	102.904	102.904	102.904	102.904	102.904	102.858

3.6 EU accession impact on public finances

A high absorption of EU funds in 2011-2013 is among Romania's strategic objectives and it is, at the same time, an opportunity to capitalize on a major benefit after the EU accession. This will require high efforts to put in place an efficient system for accessing and implementing European funds and do away with/reduce any barriers that could impair the absorption process.

The funds allocated to Romania in 2007-2013 under the main post-accession funds amount to 34,603 million Euros.

million Euros

2007-2013 EU Allocations

Instrument	Total
Structural and Cohesion Funds	19,668
European Agricultural Fund for Rural Development	8,124
European Fishery Fund	231
European Fund for Guarantee in Agriculture	6,580
Total	34,603

Source: MoPF

The amount to be reimbursed by the European Commission in 2012-2013 under the main post-accession funds amounts to 14,068.64 million Euros.

million Euros

Amounts to be reimbursed in 2012 – 2013, as a breakdown by the main EU post-accession funds

Instrument/Year	2012	2013	Total 2012-2013
Structural and Cohesion Funds	3,372.82	5,597.21	8,970.03
European Agricultural Fund for Rural Development	1,450.00	1,357.85	2,807.85
European Fishery Fund	50.00	66.63	116.63
European Fund for Guarantee in Agriculture	1,000.00	1,174.13	2,174.13
Total	5,872.82	8,195.82	14,068.64

Source: MoPF

3.7 Structural Balance and Fiscal Position

The budget deficit and the cyclical deficit, as well as the potential gross domestic products were calculated (using the Cobb Douglas type production function) based on OECD methodology of the European Commission, as described by van den Noord (2000) and Girouard (2005).

According to the above-mentioned methodology, the structural components of the budget are obtained by extracting the cyclical component from the current budget component, using the below formula:

$$CAB_t = B_t - B_t^C = B_t - \sum_j B_{t\ j}^C$$

The cyclical component of each category of revenues and expenditures ($B_{t\ j}^C$) is calculated by using the output gap and the estimated elasticity against GDP (α_j^{PIB}). The formula used to calculate the cyclical component is as follows:

$$B_{t\ j}^C = B_{t\ j} \times \alpha_j^{PIB} \times output\_gap_t$$

The results are illustrated in the below table:

Cyclical and Structural Deficit (% of GDP)

	2011	2012	2013	2014	2015
1. Actual GDP Increase (%)	2.5	1.7	3.1	3.6	3.9
2. Current Balance	-5.2	-2.8	-2.2	-1.2	-0.9
3. Net Interest Payments	1.6	1.7	1.7	1.7	1.7
4. Temporary and One-Off Measures	-1.1	0.1	0.0	0.0	0.0
5. Output Gap	-2.9	-3.4	-2.8	-1.8	-0.7
6. Cyclical Budget Component	-0.9	-1.0	-0.8	-0.5	-0.2
7. Adjusted Cyclical Balance	-4.3	-1.7	-1.3	-0.7	-0.7
8. Adjusted Primary Balance	-2.7	0.0	0.3	1.0	1.0
9. Structural Balance (7-4)	-3.2	-1.8	-1.3	-0.7	-0.7

Source: NPC, MFP

After the 2008 pro-cyclical and expansionist policy, with a structural deficit increased to 7.25% of GDP, the deficit has started to decline starting with 2009. On a medium term, the cyclical component follows a downtrend with the actual GDP estimated to grow more than the potential GDP.

Romania is foreseen to be able to meet its medium term objective (MTO) as early as 2014, i.e. a structural budget deficit of 0.7% of GDP.

3.8 Debt Performance and Debt Level

Government Debt[19] and the Debt Strategy

The Government Debt at end-2011, according to EU methodology, was below 34% of GDP, far beneath the 60% ceiling established in the Maastricht Treaty. Hence, while in the end of 2010 the government debt accounted for 30.5% of GDP, at the end of 2011, against the background of the financing needs secured through the year and the developments on both domestic and foreign financial markets impacted by the EU sovereign debt crisis considered, this indicator went up to 33.3% of GDP, of which domestic debt accounts for 16.9% of GDP, while the foreign debt amounted to 16.4% of GDP.

In 2012-2015, the budget deficit will be covered, in a relatively balanced manner, from both domestic and foreign sources, in line with the objectives laid down in the Government Debt Management Strategy on a medium term, during the interval 2011-2013, these objectives include:

i. the controlled increase of the government debt and keeping the debt at a sustainable level,

ii. reduce the costs of government debt on a long term, against the background of an acceptable risk level attached to the government debt portfolio,

iii. develop the market of government securities.

The strategy aimed at financing the budget deficit from domestic sources in the interval under discussion will focus primarily on government securities issued on the domestic market, namely average and long term T-Bills and Benchmark T-Bonds (the first benchmark bond issuance was issued in 2012 with 15 years maturity); these will be denominated in domestic and foreign currency, depending on the market opportunities and may be issued with a over 15 years maturity if the demand for long maturities will be sufficient on the market, under reasonable terms with respect to liquidity and costs. With the purpose of optimizing the government securities portfolio, the benchmark bonds issued in the previous years will be reopened up to an amount that will allow an increase of liquidity on the secondary market.

With respect to foreign financing sources, in 2012, Eurobonds will be issued on the foreign capital markets as part of the 2011-2013 Medium Term Notes Programme (MTN), topped up by loans contracted with the international financial institutions (IBRD) to finance the sectoral programmes, and the DDO preventive loan in amount of 1 billion de Euro. Taking advantage of the opportunity window opened on the foreign capital market at the end of January 2012, MoPF launched an Eurobond issuance under MTN, in amount of 1.5 billion USD, with 10 years maturity and a 6.75% coupon, that was oversubscribed by nearly 4.5 times. Given the positive performance of the USD Eurobond yield, the issuance was reopened at the end of February 2012 and attracted an additional amount of 750 million USD, considering a lower yield by 42 bp. This issuance too was oversubscribed by nearly 4 times.

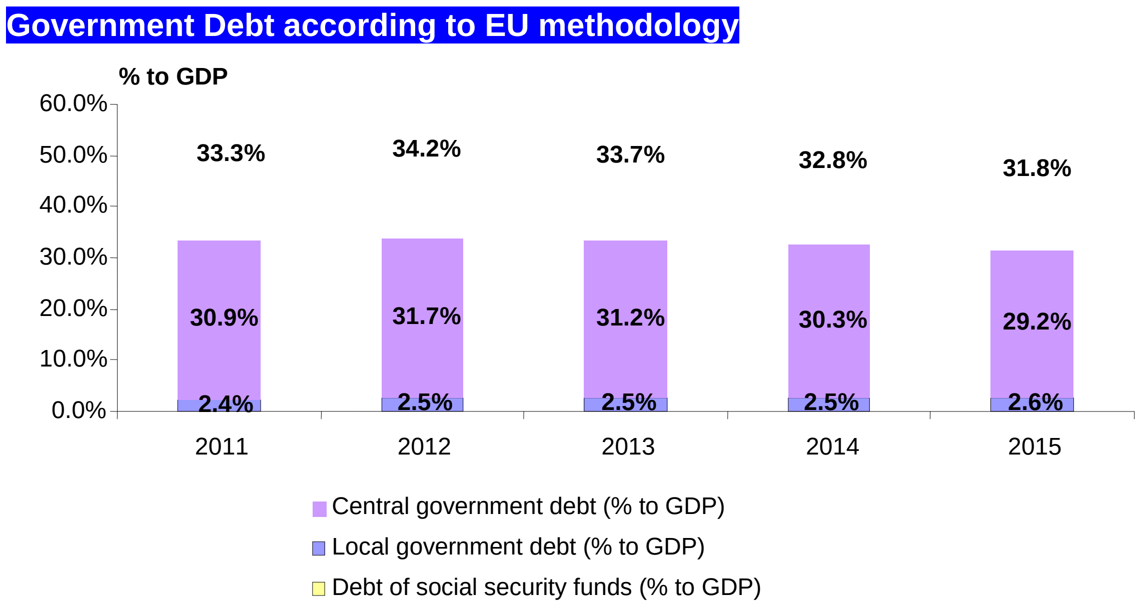
Starting in 2013, the foreign sources used to finance the budget deficit will come primarily from Eurobonds issued on the foreign capital markets.

The funds needed to refinance the government debt will be raised on the markets were these debts were issued and part of it will be provided by the MoPF financial buffer in foreign currency. Starting in 2010, as a measure to improve debt management and avoid seasonal pressure in raising the funds needed to finance the budget deficit and refinance the debt,

[19] All indicators used in this section are in line with EU methodology.

MoPF decided to establish a financial buffer in foreign currency equivalent to around 4 months of financing needs.

Thus, in 2012 – 2015, against the background on an average economic growth of 3.1% of GDP and the deficits below 3.0% of GDP calculated according to the EU methodology (ESA95), we expect the government debt share to stay beneath the level of 34.5 % of GDP, as illustrated by the chart below:



The factors contributing to the change of the government debt share to GDP in 2012-2015, including the stock-flow adjustments, are presented in Annex 4.

4. LONG TERM SUSTAINABILITY OF PUBLIC FINANCES

The Romanian pension system sustainability was assessed in the 2012 Sustainability Report based on population ageing-related expenditures in 2010-2060 as provided in the Ageing Report[20].

Taking into account the demographic chart trends in line with Eurostat estimates (EUROPOP 2010) the projections for Romania indicated a positive path of the public pension fund with respect to sustainability, with Romania expected, in 2060, to rank 14 in the top of EU states having a high pension expenditure share to GDP (behind Luxembourg, Slovenia, Belgium, Cyprus, Austria, Malta, Finland, France, Hungary, Greece, Italy, Norway and Spain). This ranking shows a significant progress compared to the result of the 2009 projection exercise having placed Romania on the fifth position.

Under the circumstances, the measures aimed at limiting the social assistance expenditures of the recent years and the public pension system reforms implemented through measures aimed at expanding the social contribution base in parallel with reducing additional costs generated by population ageing, account for an important step towards the improvement of long term sustainability of public finance.

The Pension Sector

The demoChart prospects for Romania, recently assessed by Eurostat (EUROPOP 2010), preserve the 2008 data on accelerated ageing process in 2010-2061 (a decrease by 37% of the population aged 20 to 65 compared to a decrease of only 20% of the total population) due to the low birth rate. The population over 65 will increase nearly 1.9 times, with the number of people between 20 and 55 basically down at 50 per cent at the end of the interval.

The ageing process celerity will negatively impact the labor market. The share of people aged over 65 to population at working age (aged 20 to 65) will grow substantially, which means that for the next 10 to 20 years the public pension system will have fewer resources than will be needed to cover its expenditures.

In addition, the age composition of the retired population shows a high share of relatively young retired (45 to 55) in particular on the disability pensions segment.

Therefore, the recent measures concerning the limited access to disability pensions, in parallel with increasing the retirement age for women, may have a substantial contribution to decreasing the number of retired over the years ahead, all the more since the number of people over 65 is expected to increase rapidly in 2025-2030.

The long term forecast of pension expenditures started from the EUROPOP 2010 demoChart assumptions performed by Eurostat and the prognosis of the National Prognosis Commission with regard to the employment market developments and macroeconomic indicators, considering the legislation in force at January 1, 2011 as the constant policy foundation.

The estimates are based on the legal measures introduced by the Pension Law, as follows:

- a new indexation formula as of 2013;
- until 2020, the pension point will be increased by 100% inflation rate annually, plus 50% of the real gross average salary increase of the previous year. if one of the indicators has a negative value, the one with a positive value will be used;

[20] The Ageing Report to be published in 2012.

- as of 2021, it will be increased annually by 100% inflation rate plus 45% of the actual increase of the gross average salary of the previous year, a percentage that is to be gradually reduced by 5% every year;
- retirement age gradually increased to 63 for women and 65 for men, until 2030;
- inclusion of the taxpayer categories that have not contributed to the system before (military, police etc);
- cut early retirements and limit the number of disability pensions;
- increase the contribution base by including new categories, such as liberal professions.

The measure of freezing the pension point at the 2010 level is still in force in 2012, as it has been in 2011, in a move to keep social assistance expenditures under control.

Pension Expenditures - Long Term Projection

% to GDP

	2011	2030	2040	2050	2060
Social security pensions [21], of which,	9.5%	10.3%	11.6%	12.8%	13.5%
Pension Pillar 1	9.0%	10%	11.6%	12.8%	13.5%
Pension Pillar 2		0.5%	1.2%	1.5%	1.1%

Source: NPC

The estimates resulting from the pension model show an increase of total pension expenditures to GDP to around 13.5% at the end of the interval under review.

Pillar 2 will have an increasing share in total pension expenditures, with a peak expected around 2050, when it is expected to reach 1.5% of GDP.

The data on the long term costs with population ageing have been already approved for inclusion in the 2012 Ageing Report; this data shows a drop of the pension system sustainability-related risk, as a result of the pension reform implemented in 2011, Romania being classified in the medium risk category (as against the maximum risk category in the 2009 Ageing Report). If we compare with the previous exercise (the 2009 Ageing Report), the pension expenditures will rise in 2060/2010 by only 3.7 pp (as against 7.4 pp in 2060/2007 before the reform, principally on the back of a decrease by 30% of the replacement rate due to gradual indexation of pensions in line with the inflation, but also to the increase of the retirement age and the restrictions on the early retirement segment.

In the light of the above, the long term cost component in the MTO formula drops from 3.8% of GDP (established under 2009 conditions) to nearly 2% of GDP with the MTO value decreasing accordingly, also depending on the selected upfront loading level.

[21] Including retired farmers.

ANNEXES

Table 1a. Macroeconomic Prospects

	ESA Code	2011	2011	2012	2013	2014	2015
		Level [1] Billion lei	Percentage change				
1. Real GDP	B1*g	535.4	2.5	1.7	3.1	3.6	3.9
2. Nominal GDP	B1*g	578.6	10.7	5.0	6.8	7.0	6.4
Components of real GDP							
3. Private consumption expenditure	P3	338.8	1.3	1.8	3.2	3.6	3.6
4. Public consumption expenditure	P3	82.4	-3.5	2.4	1.8	2.3	2.4
5. Gross Fixed Capital Formation	P51	133.1	6.3	7.2	7.4	7.5	7.8
6. Change in inventories and net acquisition of valuables (% of GDP)	P52+ P53		1.4	0.4	0.2	0.1	0.1
7. Exports of goods and services	P6	203.8	9.9	4.0	5.8	7.3	8.7
8. Imports of goods and services	P7	234.9	10.5	7.9	7.7	8.6	9.3
Contributions to real GDP Growth							
14. Final domestic demand			1.9	3.2	4.2	4.6	4.8
15. Change in inventories and net acquisition of valuables	P52+ P53		1.4	0.4	0.2	0.1	0.1
16. Net exports	B11		-0.8	-1.9	-1.3	-1.1	-1.0

[1] The real GDP level and its components is in the previous year's prices.

Table 1b. Price Developments

	2011	2012	2013	2014	2015
	Percentage change				
1. GDP deflator	8.1	3.3	3.7	3.3	2.5
2. Private consumption deflator	5.8	3.1	3.4	2.7	2.2
3. HICP	5.8	3.0	2.9	2.8	2.5
4. Public consumption deflator	1.0	2.3	2.3	2.5	2.3
5. Investment deflator	6.7	3.8	3.3	2.0	2.2
6. Export price deflator (goods and services)	8.8	6.0	2.9	2.5	2.5
7. Import price deflator (goods and services)	7.1	5.4	2.1	1.9	2.0

Table 1c. Labor Market Developments

	ESA Code	2011	2011	2012	2013	2014	2015
		Level thousand persons	Percentage change				
1. Employment, persons[1)]		9,087.2	0.4	0.3	0.4	0.5	0.5
2. Employment, thousands hours worked[2)]		16,817.5	0.4	0.4	0.5	0.6	0.6
3. Unemployment rate (%)[3)]			7.4	7.1	6.9	6.7	6.5
4. Labour productivity[4)]			2.0	1.3	2.7	3.0	3.3
5. Labour productivity, hours worked[5)]			2.0	1.2	2.5	2.9	3.3
6. Compensations to employees – mil.lei	D1	216,240	3.8	4.1	5.8	6.3	6.3
7. Compensation per employee		36,360	3.7	3.8	5.3	5.9	5.9

[1)] *Occupied population, domestic concept national accounts definition*
[2)] *National accounts definition*
[3)] *Harmonised definition, Eurostat levels (Labor Force Survey – AMIGO)*
[4)] *Real GDP per employed person*
[5)] *Real GDP per hour worked*

Table 1d. Sectoral Balances

% of GDP	ESA Code	2011	2012	2013	2014	2015
1. Net lending/borrowing, vis-à-vis the rest of the world	B9	-4.1	-3.7	-3.4	-3.5	-3.3
of which:						
- Balance of goods and services		-5.2	-6.9	-7.4	-8.0	-8.3
- Balance of incomes and transfers		1.0	1.7	2.3	2.9	3.3
- Capital account		0.1	1.5	1.7	1.6	1.6
2. Net lending/borrowing of the private sector	B.9	1.0	-1.4	-1.9	-2.3	-2.4
3. Net lending/borrowing of general government	PDE B.9	-5.2	-2.3	-1.5	-1.2	-0.9
4. Statistical discrepancy			optional	optional	optional	optional

Table 2. General Government Budgetary Prospects

	ESA Code	2011	2011	2012	2013	2014	2015
		Level in mil. lei	**% of GDP**				
The net balance (EDP B9), sub-sectors							
1. General Government	S.13	-30,335.5	-5.2	-2.8	-2.2	-1.2	-0.9
2.Central administrations	S.131	-26,466.5	-4.6	-2.4	-1.9	-1.0	-0.9
3.State administration	S.132	M	M	M	M	M	M
4.Local administration	S.133	-3,206.7	-0.6	-0.3	-0.2	-0.1	-0.1
5.Social insurance funds	S.134	-662.3	-0.1	-0.1	-0.1	-0.1	0.0
The consolidated budget (S13)							
6. Total revenue	TR	187,824.0	32.5	33.3	33.7	34.1	34.0
7. Total expenditures	TE[1)]	218,159.5	37.7	36.1	35.9	35.3	34.9
8. Net lending/borrowing	EDP B.9	-30,335.5	-5.2	-2.8	-2.2	-1.2	-0.9
9. Interest expenditure	EDP D.41	9,046.1	1.6	1.7	1.7	1.7	1.7
10. Primary balance[2)]		-21,289.4	-3.7	-1.1	-0.5	0.5	0.8
11. One-off and other temporary measures[3)]		-6,414.8	-1.1	0.1	0.0	0.0	0.0
Selected revenue components							
12. Total taxes (12=12a+12b+12c)		106,014.0	18.3	18.8	18.6	19.9	20.3
12a. Taxes on production and imports	D.2	72,645.3	12.6	12.8	12.5	optional	optional
12b. Current taxes on income, wealth, etc.	D.5	33,369.4	5.8	6.0	6.1	optional	optional
12c. Capital taxes	D.91	0	0	0	0	optional	optional
13. Social contributions	D.61	51,056.3	8.8	8.6	9.2	optional	optional
14. Property income	D.4	4,694.9	0.8	1.0	0.9	optional	optional
15. Other[)]		26,058.6	4.5	4.9	4.9	optional	optional
16=6. Total revenue	TR	187,824.0	32.5	33.3	33.7	34.1	34.0
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5)]							
Selected expenditure components							
17. Compensation of employees + intermediate consumption	D.1+P.2	78,112.8	13.5	13.3	13.2	13.0	12.0
17a. Compensation of employees	D.1	43,491.3	7.5	7.7	7.8	7.4	7.4
17b. Intermediate consumption	P.2	34,621.5	6.0	5.6	5.4	5.6	4.6
18. Social payments (18=18a+18b)		73,122.5	12.6	12.1	11.8	11.9	12.3

	ESA Code	2011	2011	2012	2013	2014	2015
		Level in mil. lei	**% of GDP**				
From which unemployment aid [6)]							
18a. Social contributions in nature	D.6311, D.63121, D.63131	6,607.7	1.1	1.0	0.9	0.9	1.0
18b. Social contributions	D.62	66,514.8	11.5	11.1	10.9	11.0	11.3
19=9. Interest expenditure	EDP D.41	9,046.1	1.6	1.7	1.7	1.7	1.7
20. Subsidies	D.3	2,572.6	0.4	0.3	0.2	0.2	0.2
21. Gross fixed capital formation	P.51	30,356.8	5.2	5.0	5.1	5.1	5.3
22. Capital transfers	D.9	13,486.5	2.3	2.0	1.9	2.2	2.3
23. Other [7)]		11,462.2	2.0	1.7	2.0	1.2	1.1
23=7. Total expenditures	TE1	218,159.5	37.7	36.1	35.9	35.3	34.9

[1)] *Adjusted for the net flow of swap-related, meaning TR-TE=EDP B9*
[2)] *The primary balance is calculated as (EDP B9, item 8) plus (EDP D.41, item 9)*
[3)] *A plus sign means deficit-reducing one-off measures*
[4)] *P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)*
[5)] *Including those collected by EU and including the adjustment for uncollected taxes and social contributions (D.995)*
[6 I]*includes benefits in cash(D.621 and D.624)and in nature (D.631), related to the unemployment aids*
[7)] *D.29+D4 (other than D.41)+D.5+D.7+D.9+P.52+P.53+K.2+D.8*

Table 3. Central Administration costs, after the function

% of GDP	*Cod COFOG*	*2010*	*2015*
1.General Public Services	1	4.5	n/a
2.National Defense	2	1.5	n/a
3.Public order and safety	3	2.4	n/a
4.Economic relations	4	6.8	n/a
5.Environmental protection	5	0.7	n/a
6.Domiciliary and community services	6	1.3	n/a
7.Health	7	4.2	n/a
8.Recreation, culture and religion	8	1.1	n/a
9. Education	9	3.4	n/a
10.Social protection	10	14.4	n/a
11. Total expenditures (=punct 7 = 23 in tabel 2)	TE	40.2	n/a

Table 4. General Government Debt Developments

% of GDP	SEC Code	2011	2012	2013	2014	2015
1. Gross Government Debt [1]		33.3	34.2	33.7	32.8	31.8
2. Change in Gross Government debt ratio		2.8	0.9	-0.5	-0.9	-1.0
Contributions to changes in gross debt						
3. Primary balance[2]		-3.7	-1.1	-0.5	0.5	0.8
4. Interest expenditure [3]	EDP D.41	1.6	1.7	1.7	1.7	1.7
5. Stock-flow adjustment		-2.5	-1.9	-2.7	-2.1	-1.9
of which:						
- Differences between paid and accrued interest[4]		-0.04	-0.04	-0.04	-0.04	-0.02
- Net accumulation of financial assets[5]		1.1	0.6	0.0	0.0	0.0
of which: - privatisation proceeds		0.0	0.6	0.0	0.0	0.0
- valuation effects and other [6]		-3.5	-2.5	-2.7	-2.1	-1.9
p.m. Implicit interest rate on debt[7]		5.7	5.4	5.4	5.5	5.7
Other relevant variables						
6. Liquid financial assets[8]		3.4	3.0	2.8	2.6	2.4
7. Net financial debt (7=1-6)		29.9	31.2	30.9	30.2	29.4
8.Debt amortization (existing obligations) since the end of the previous year[9])		8.7	9.2	3.6	2.8	3.1
9. Percentage of debt denominated in foreign currency		57.8	57.6	53.8	51.7	50.0
10. Average maturity (years) [10])		4.0	4.2	-	-	-

1) As defined in Regulation 3605/93 (is not ESA concept);
2) Cf. item 10 in Table 2
3) Cf. item. 9 in Table 2
4) The differences concerning interest expenditure, other expenditures and revenue could be distinguished when relevant or in case the debt-to- GDP ratio is above the reference value;
5)Liquid assets (currency), governmental securities, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant or in case the debt-to- GDP ratio is above the reference value.
6) Changes due to exchange rate movements and operation in secondary market could be distinguished when relevant or in case the debt- to-GDP ratio is above the reference value.
7) Proxied by interest expenditure divided by of the debt level of the previous year.
8) AF1, AF2, AF3 (consolidated at market value), AF5 (If quoted in stock exchange; including mutual fund shares).
9) The indicator is calculated on the basis of outstanding debt at 31.12.2011.
10) Average remaining maturity (years).

Table 5. Cyclical Developments

% of GDP	ESA Code	2011	2012	2013	2014	2015
1. Real GDP growth (%)		2.5	1.7	3.1	3.6	3.9
2. Net lending of general government	PDE B.9	-5.2	-2.8	-2.2	-1.2	-0.9
3. Interest expenditure	PDE D.41	1.6	1.7	1.7	1.7	1.7
4. One-off and temporary measures		-1.1	0.1	0.0	0.0	0.0
5. Potential GDP growth (%)		2.1	2.2	2.4	2.6	2.8
Contributions:						
- Labour		0.2	0.2	0.3	0.3	0.4
- Capital		1.4	1.5	1.6	1.7	1.8
- Total Factor Productivity		0.5	0.4	0.4	0.5	0.6
6. Output Gap		-2.9	-3.4	-2.8	-1.8	-0.7
7. Cyclical budgetary component		-0.9	-1.0	-0.8	-0.5	-0.2
8. Cyclicaly adjusted balance (2-7)		-4.3	-1.7	-1.3	-0.7	-0.7
9. Cyclically adjusted primary balance (8+3)		-2.7	0.0	0.3	1.0	1.0
10. Structural Balance (8-4)		-3.2	-1.8	-1.3	-0.7	-0.7

1)a plus sign means measures on off to reduce deficit

Table 6. Divergence from previous update

	ESA Code	2011	2012	2013	2014	2015
Real GDP growth (%)						
Previous update		1.5	4.0	4.5	4.7	
Current update		2.5	1.7	3.1	3.6	3.9
Difference		1.0	-2.3	-1.4	-1.1	
Bugetary ballance (% of GDP)						
Previous update	PDE B.9	-4.9	-3.0	-2.6	-2.1	
Current update	PDE B.9	-5.2	-2.8	-2.2	-1.2	- 0.9
Difference 2-1		-0.3	0.2	0.4	0.9	
General government gross debt (% of GDP)						
Previous update		33.3	33.2	32.8	31.9	
Current update		33.3	34.2	33.7	32.8	31.8
Difference		0.0	1.0	0.9	0.9	

Table7. Long Term Sustainability of Public Finance

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditures							
of which: age-related expenditures		17.6	16.9	18.2	19.9	21.7	22.9
Pension expenditure	6.44	9.82	9.21	10.25	11.63	12.76	13.52
expenditure on social insurances							
pensions for age limit and anticipated	5.27	8.10	7.76	8.81	10.14	11.24	12.01
other pensions (disability, heirs)	0.82	1.72	1.44	1.44	1.49	1.52	1.51
occupational pension (If the Central Administration related)							
Health Care		3.7	3.7	3.9	4.2	4.5	4.6
long-term care (previously included in healthcare)		0.6	0.7	0.8	1.0	1.1	1.4
Education expenditure	3.6	3.5	3.3	3.2	3.1	3.3	3.4
other expenses related to age							
Interest expenditure							
of which total incame							
of which income from property							
of which contributions to pension(or social contribution,		7.15	8.07	9.66	11.13	12.47	13.72
assets of funds for pensions reserves		1.07	6.01	11.36	8.81	5.66	3.94
of which consolidated assets of public funds for pensions(other assets than *liabilities of the Central Administration)*							
systemic reform of pensions 1)							
social contributions for mandatory private pensions system 2)		0.30	0.95	1.14	1.33	1.49	1.66
expenditure on pensions paid by the mandatory private pensions system 3)		0.00	0.12	0.48	1.19	1.48	1.14
Assumptions							
		- Average rates -					
Labour productivity growth		0.4	3.3	2.1	2.3	2.1	1.7
Real GDP growth		-1.3	2.1	1.3	1.2	0.7	0.5
	- % -						
Participation rate – males (aged 20-64)		77.0	78.1	75.6	73.4	72.9	73.8
Participation rate - females (aged 20-64)		59.9	59.4	57.3	55.6	55.2	56.4
Total participation rates (aged 20-64)		68.4	68.8	66.5	64.5	64.1	65.2
Unemployment rate – ILO		7.3	7.0	6.6	6.7	6.8	6.9
Population aged 65 and over from total population		15	18	20	26	31	35

Source NCP, MPF, 2012 Ageing Report
Participation rate refers to working age population (20-64).
Average rates refer to the mentioned interval.

1) *systemic reforms of pensions refers to pension reforms introducing a pillar, that includes a compulsory pillar with total own fund;*
2) *social contributions or other income obtained by a pillar required with own fund, to cover liabilities related to pension, attracted to the systemic reform in accordance to the systemic reform;*
3) *pensions expenditure or other social benefits paid by obligatory pillar with total own fund, about liabilities related to pension, attracted in accordance with the systemic reform.*