Romania and its debt vulnerabilities

1. External Debt Sustainability

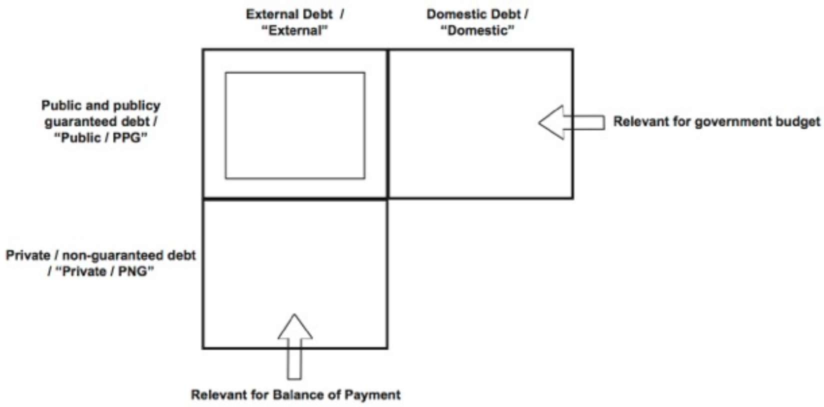
Romania's external debt indicators for end-2012[1] are all beyond indicative debt sustainability thresholds (in parentheses):

- Total external debt / Annual Export earnings: 203.7% (150%)
- Total external debt service / Annual Export Earnings: 34.2% (15%)
- External Debt /GNI: 78.7% (60%).

The two export-based indicators would qualify the country for debt relief under WB/IMF-led Heavily Indebted Poor Countries (HIPC) initiative - were it an African low-income country.

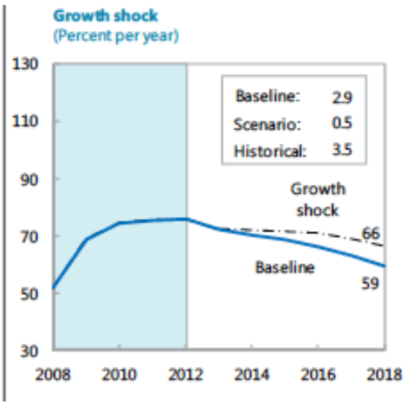
However, the total picture is a bit more complex, and not quite as alarming as the comparison with HIPC indicators would signal.

Out of a total external debt of US-$ 131 bn., 27bn are short-term debt, which is a relatively high proportion and as such critical, but not relevant for the consideration of long-term debt sustainability. Out of a total long-term debt of US-$ 89bn, only 30bn are public or publicly guaranteed debt, while almost US-$ 60bn are private without any government guarantee or involvement. As the overview graph shows, these amounts are not relevant for the government's budget, but are liabilities of private Romanian enterprises, banks and individuals.



However, while there is no formal responsibility of the Romanian state for these liabilities, the experiences of Ireland and Spain in the Eurozone as well as several East Asian countries during the East Asian crisis of the late 1990s have shown that a state can be forced to cover private liabilities in order to avoid a meltdown in the domestic financial system, or due to pressure from influential external creditors.

In its projections regarding Romania's future debt vulnerabilities the IMF produces the normal curve, which - like in most countries - predicts falling debt indicators from the moment onwards, when reality turns into projections (see the graph taken from the 2014 debt sustainability analysis). However, as we can see the growth assumptions for both the baseline scenario (2.9% annual growth on average) as well as the growth shock scenario (0.5%) are far more conservative than in other cases (like f.i. Bulgaria) and low compared to Romania's recent historical track record. So, the Fund's optimism may be more justified in Romania than elsewhere.



2. Public Debt Sustainability

[1] World Bank: International Debt Statistics 2014

The IMF considers Romania's public debt to be sustainable. As we have seen above, public domestic and external debt is low. Even under various stress tests, public debt / GNI remains firmly below the Maastricht threshold of 60%. The remaining risks stem from relatively short maturities, i.e. the need for the state to repay a relatively big part of its external debt in a relatively short timeframe; additionally there is some risk in the fact that some of the "domestic" public debt is owed to non-residents directly or indirectly holding national-currency claims on the Romanian state. Like in some other Balkans countries this may be a result of foreign ownership of the domestic banking system.

Like most of its peers, Romania has tapped domestic and external debt markets. In the first half of 2014 alone the government has sold almost 6bn € worth of debt on the domestic market, making use of the historically low interest rates.[2]

All other possible sources of risk, which the IMF has tested with regard to Romania's public debt are unproblematic, as demonstrated by the largely green IMF risk matrix.[3]

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

3. Debt Relief

Romania has twice re-negotiated its external debt with its creditors in the Paris Club, namely in 1982 and 1983. Neither agreement did imply any debt relief, and both have long since been paid back.

After the arrangements of the early 1980s, Romania undertook one of the most famous and most gruesome periods of structural adjustment, when the Communist government enforced maximum temperatures below 13 degrees Celsius during winter upon the population along with other dramatic hardships, which ultimately led to the overthrow of the regime.

4. Conclusion

The high debt indicators in relation to the country's export earnings are neglected in the analyses of the IMF. This is justified as long as there are no distortions in the inflow of hard currency through domestic investment and roll-over loans for both the public and the private sector and as long as the national currency does not come under devaluation pressure. Should either of the two happen, Romania might face severe debt servicing problems very quickly.

Jürgen Kaiser, erlassjahr.de, July 22nd 2014

[2] Romania sells 300m lei in Oct. 2015 bonds; Reuters July 17th 2014

[3] IMF: Romania. Country Report 14/87; March 2014, p.50. Yellow shows alert for a potential debt risk and red actually rings the alarm bells, while green stands for "no risk".