Chapter 33

Romania: Social Acceptance, Unmet Criteria

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Abstract

The present chapter explores the most important monetary policy issues in Romania; specifically presents Romania's state of preparedness for joining the euro area, its place and role in the banking union (as an outsider but EU Member State), and the measures it took during the crisis. This chapter also examines the different components of the Maastricht criteria, such as the price stability criterion, government budgetary position criterion, exchange rate stability criterion, and interest rate convergence criterion. A short detour is made to discuss the real convergence criteria in addition to the nominal criteria. Moreover, the most important findings referring to Romania in the Flash Eurobarometer Report are presented, providing insights into public opinion concerning the adoption of the common currency. Subsequently, aspects related to the banking union, the Single Rulebook, and banking supervision are explored. In this context, it is important to mention that Romania follows a dual supervisory mechanism, in which banking supervision requires a national authority (the National Bank of Romania) in addition to the European one. However, as Eurozone banks own a large part of the Romanian banking system, the Single Supervisory Mechanism, the domestic supervisory authority of Eurozone banks, is a key partner of the National Bank of Romania. Further, this chapter discusses the monetary aspects of crisis management processes, the most important decisions of the Governing Council of the National Bank of Romania on monetary policy issues from 2020 to 2023, why the monetary policy interest rate changed from 1.25%/year at the beginning of 2021 to 7% at the beginning of 2023 (where it remained until October 2023), and changes in the inflation rate.

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1. Lessons related to the introduction of the Euro

1.1. The Maastricht convergence criteria, their economic rationale, and Romania's compliance

The nominal convergence criteria, based on which Member States are entitled to join the Eurozone, are laid down in the Maastricht Treaty. The aim of the criteria is to ensure sustainable nominal convergence in terms of price development, exchange rates, and long-term interest rates, as well as budget deficits and government debt.

According to the price stability criterion,

> a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1.5% that of, at most, the three best performing Member States in terms of price stability.[1]

The reference period considered in the latest ECB report was May 2021–April 2022, and the reference value was calculated as the unweighted arithmetic average of the three lowest inflation rates of the EU Member States; namely, France (3.2%), Finland (3.3%) and Greece (3.6%), the reference value this way having been 4.9%.[2]

The criterion for the government budgetary position stipulates that candidate Member States fulfil the following two fiscal requirements: the ratio of the planned or actual government deficit to GDP must not exceed 3% of the GDP reference value, and the ratio of government debt to GDP must not exceed 60% of the GDP reference value.[3]

The criterion regarding exchange rate stability requires that a Member State has respected the normal fluctuation margins provided by the exchange rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State should not have devalued its currency's bilateral central rate against the euro on its own initiative for

1 European Central Bank, 2022, p. 7.
2 Malanca and Cîndea, 2022, p. 193.
3 Ibid.

the same period.[4] In the latest ECB report, the reference period for this criterion was 26 May 2020 to 25 May 2022.[5]

The interest rate convergence criterion assumes that the average nominal long-term interest rate

> does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions.[6]

The reference period taken into account was May 2021–April 2022 and the reference value was calculated only on the basis of the interest rates of France (0.3%), Finland (0.2%), and Greece (1.4%). Thus, the average rate was 0.6%; adding two percentage points yields a rate of 2.6%.[7]

According to the convergence report of the European Central Bank (ECB) issued in 2022, Romania's degree of fulfilment of the Maastricht criteria is as follows: (i) In April 2022, Romania's average annual HICP inflation rate was 6.4%, well above the reference value of 4.9% for the price stability criterion. Over the last 10 years, this indicator has fluctuated over a relatively wide range, between 1.7% and 6.4%, while the average over the period has been moderate at 2.2%.[8] This rate gradually increased in the following months, particularly as a result of rising commodity prices, widespread price pressure, and the further worsening of bottlenecks in production and distribution chains in light of the war between Russia and Ukraine. (ii) Although Romania's budget deficit significantly exceeded 3% of the GDP reference value in 2021, the excessive deficit procedure, initiated in April 2020, has been temporarily suspended. As of April 2020, Romania has been subject to an excessive deficit procedure as its fiscal position exceeded 3% of the GDP reference value in 2019 (4.3%). In 2021, the budget deficit was 7.1% of GDP, below the recommended target, and the required fiscal effort was achieved; therefore, the excessive deficit procedure was temporarily suspended. Thus, the budget deficit decreased to 6.3% by 2022.[9] Looking over a longer period reveals that Romania had better values in the past decades; specifically: 5.5%, 3%, and 2.3% from 2011 to 2013.[10] Although the public debt ratio is below 60% of GDP, it has increased since 2019. The European Commission's latest assessment in the area of fiscal sustainability points to low risks to sustainability in

4 European Central Bank, 2022, p. 12.
5 Malanca and Cîndea, 2022, p. 193.
6 European Central Bank, 2022, p. 13.
7 Malanca and Cîndea, 2022, p. 194.
8 European Central Bank, 2022, p. 73.
9 *Governance Finance Statistics* [Online]. Available at: https://ec.europa.eu/eurostat/statistics explained/index.php?title=Government_finance_statistics#General_government_surplus.2Fdeficit (Accessed: 15 January 2024).
10 Eurostat, 2014.

the short term, high risks in the medium term, and moderate risks in the long term. Moving forward, Romania needs to address the problems associated with population aging.[11] The public debt ratio also had better values in the 2011–2013 period, varying from 33.9% in 2011 to 32.7% in 2013;[12] from 2020 to 2022, these values were between 46.8% and 47.2%. (iii) During the reference period from 26 May 2020 to 25 May 2022, the RON did not participate in the European Exchange Rate Mechanism, but was traded under a flexible exchange rate regime with a controlled float. The exchange rate of the Romanian leu against the euro was characterised, on average, by a very low degree of volatility during the reference period. On 25 May 2022, the exchange rate was 4.9416 RON/EUR, 2.2% lower than the average level in May 2020. In June 2020, the National Bank of Romania (NBR) agreed to a repo facility arrangement with the ECB whereby it could lend up to EUR 4.5 billion against high-quality euro-denominated collateral to provide euro liquidity to financial institutions in Romania to meet potential liquidity needs during the pandemic. Because this arrangement reduced the potential risk posed by financial vulnerabilities, it also likely impacted the development of the exchange rate during the reference period.[13] From a longer-term perspective, the available RON/EUR exchange rate communicated on 31 May 2012 was 4.4652[14] (for more recent exchange data, see Figure 1. (iv) In the reference period, from May 2021 to April 2022, the long-term interest rates in Romania were, on average, 4.7% – well above the benchmark of 2.6% and thus in alignment with the interest rate convergence criterion. In Romania, long-term interest rates have been on a downward trend since 2012, with 12-month average rates falling from just above 7% to approximately 4.5%.[15]

The aforementioned Convergence Report of the ECB also emphasises that creating an environment conducive to sustainable convergence in Romania requires stability-oriented economic policies and comprehensive structural reforms. Furthermore, regarding macroeconomic imbalances, the European Commission selected Romania for an in-depth analysis in the 2022 Alert Mechanism Report, highlighting its external position and cost competitiveness issues. Although Romania has made significant progress in meeting the conditions for economic convergence since the early 2010s, concerns remain regarding its low levels of productivity. The relatively poor quality of the country's institutions and governance, as well as its vulnerable business environment, continue to mitigate its growth potential. In addition, the effective absorption of EU funds remains essential for stimulating medium-term growth and guiding the economy through upcoming green and digital transitions. Efforts are also required to implement reforms aimed at fighting corruption, improving competition, and increasing the predictability of the country's fiscal, judicial,

11 European Central Bank, 2022, p. 73.

12 Eurostat, 2014.

13 European Central Bank, 2022, p. 73.

14 *Arhiva Curs Bnr – Curs valutar (exprimat in RON) comunicat in data de 31 mai 2012* [Online]. Available at: https://www.cursbnr.ro/arhiva-curs-bnr-2012-05-31 (Accessed: 15 January 2024).

15 European Central Bank, 2022, p. 74.

regulatory, and administrative systems. To further boost confidence in the financial system, competent national authorities should continue to improve their supervisory practices, *inter alia*, by complying with applicable recommendations issued by relevant European and international bodies and working closely with other national supervisory authorities in EU Member States in supervisory colleges.[16]

The Convergence Report also points out that Romanian legislation does not meet all requirements regarding central bank independence, the prohibition of monetary financing, and the legal integration of the central bank into the Eurosystem. It is important to note that Romania is an EU Member State with a derogation that must comply with all adaptation requirements.[17]

According to an ECB report of May 2012, Romania fulfilled only one nominal convergence criterion: the level of public debt as a percentage of its GDP.[18] In 2011, this level was 38.4%, which is well below the 60% reference value. It is clear that Romania has not made any progress in meeting the nominal convergence criteria in the sense that, according to the ECB report of June 2022, it still only meets the criterion for the level of public debt. In addition, although Romania still meets this criterion its level of public debt increased significantly in 2022 to 50.9%.[19]

Regarding the above description, Romania is seriously lagging behind most of the nominal convergence criteria, putting the adoption of a single currency on a rather distant horizon. In particular, the degree of fulfilment of the nominal convergence criteria must be considered in conjunction with the fulfilment of the real convergence criteria and optimal currency area criteria as well as a cost-benefit analysis. In this context, justified postponements must be understood and accepted because speeding up accession without any corresponding changes to the economic reality can only have harmful consequences for a country that has been unduly ambitious to benefit from advantages that are not actually available to it. At the same time, however, the unjustified procrastination of accession to the European Monetary Union (EMU) widened the gap between Romania and the countries in the EMU.[20]

In addition to nominal convergence, it is important to consider real convergence. In the Romanian context, several indicators have been proposed to measure the degree of the economy's real convergence, such as the openness of the economy,[21] the sectoral structure of the economy,[22] the ratio of EU exports and imports to foreign trade,[23] and the evolution of GDP per capita.[24]

16 Ibid.
17 Ibid.
18 European Central Bank, 2012.
19 Malanca and Cîndea, 2022, p. 198.
20 Ibid.
21 Szeles and Marinescu, 2010, p. 183.
22 Duhnea, Ghita-Mitrescu and Vancea, 2012, p. 154.
23 Bădîrcea, Pîrvu and Manta, 2017, p. 57.
24 Dumitru, 2009, p. 26.

In its broadest sense, 'real convergence' refers to the process of adjusting economic and social structures to those of the euro area. Notably, per capita gross domestic product (GDP/capita) is one of the main indicators used to assess the extent of differences in economic development.[25] According to Eurostat data, the real GDP per capita in Romania was EUR 10,110 in 2022, which is 35.03% of the EU27 average and 31.90% of the average of the 20 countries forming the Eurozone.[26] The dynamics of real GDP growth rates in Romania were higher than those in other countries in the 2000–2020 period, with real GDP moving closer to the EU average at an accelerating rate after 2012.[27]

1.2. Romania's perspective on accession to the Eurozone

The introduction of the euro would undoubtedly be beneficial for Romania; however, it also has a number of negative effects. Notably, the current scope of the community process is determined by these effects. To be sure, introducing the euro incurs several administrative, legal, operational, and psychological costs (as a result of changing banknotes).[28] Romania's approach to the Eurozone is essential in terms of all opportunities at the moment, and preparing for the adoption of the euro increases its credibility as a responsible partner within the EU.

The euro has become the second-most widely used currency in the world in terms of economic size. It has stimulated world trade as well as the size and liquidity of capital markets. One of the major advantages of joining the EMU is the positive effect of trade expansion on the entering country, which is often called the 'Rose effect'. Indeed, increased trade is crucial for stimulating economic growth. The Rose effect has appeared in both theoretical and empirical studies, particularly in the works of Andrew K. Rose.[29] Specifically, based on a gravity model, Rose presents the Rose effect to argue in support of monetary unions and situate national currencies as an 'obstacle' to international trade. In this scenario, monetary integration brings about a better correlation to the affairs of the Member States. A 1% increase in a country's trade results in a 0.33% increase in its GDP. By eliminating the exchange rate, the common currency reduces risk and thus leads to a lower real interest rate, which, in turn, stimulates economic growth.[30]

Some aspects of Romania's perception of the adoption of the euro should be analysed. First, the evolution of the RON/EUR exchange rate is an interesting research question, particularly regarding changes during the COVID-19 pandemic period. In 2020, despite the extreme circumstances triggered by the health crisis, the overall

25 Schipor, 2020, p. 193.

26 *Eurostat Data Browser – Real GDP per capita* [Online]. Available at: https://ec.europa.eu/eurostat/databrowser/view/sdg_08_10/default/table?lang=en (Accessed: 29 September 2023).

27 Schipor, 2020, p. 193.

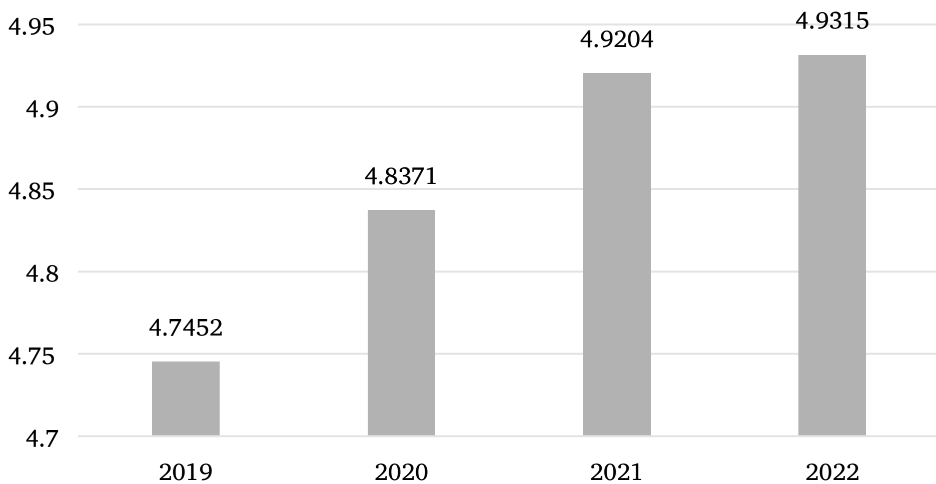
28 Istrate and Gontariu, 2019, p. 285.

29 Istrate and Gontariu, 2019, p. 286; See also: Frankel and Rose, 2000.

30 Schadler et al., 2005, p. 2.

dynamics of RON/EUR volatility indicated a slight depreciation of the national currency against the euro. Consequently, the RON/EUR exchange rate rose by 1.89% in 2020, from 4.7789 RON/EUR (3 January 2020) to 4.8694 RON/EUR (31 December 2020).[31] Despite the provisions from 2020 that suggested a gradual depreciation of the Romanian leu that could have led to the value of 5.00 RON/EUR, the exchange rate remained below 5.00 even in 2023.

Figure 1: Yearly average RON/EUR exchange rate from 2019 to 2022[32]



In 2018, the Romanian Government adopted Emergency Ordinance No. 24/2018 (approved by Law No. 249/2018), which established the National Commission to substantiate the National Plan for the adoption of the euro. The main objective was to identify the actions and promote the necessary reforms to prepare the Romanian economy for the changeover to the euro.[33] The National Commission is headed by the Prime Minister and President of the Romanian Academy (as co-chairs) and by the Governor of the NBR and a Deputy Prime Minister appointed by the Prime Minister, by decision (as vicechairs). The members include, among others, representatives of the Economic Planning Council and other independent experts; representatives of the Romanian Academy; the Minister of Public Finance; the Minister Delegate for European Affairs; a representative of the NBR; the President of the Financial Supervisory Authority; personalities of science, culture, and university academic life appointed

31 Schipor, 2020, p. 196.

32 Source: Author, based on: *Banca Naţională a României – Statistics* [Online]. Available at: https://www.bnr.ro/Statistics-3229-Mobile.aspx (Accessed: 25 October 2023).

33 Ordonanţa de urgenţă nr. 24 din 21 martie 2018 privind înfiinţarea, organizarea şi funcţionarea Comisiei Naţionale de fundamentare a Planului naţional de adoptare a monedei euro, Monitorul Oficial, nr. 273 din 28 martie 2018.

by the Prime Minister; representatives of non-governmental organisations; civil societies with experience in the field of economics; and the President of the National Institute of Statistics. It is, therefore, clear that experts and politicians alike are involved in the National Commission to draw up the right plan for the introduction of the euro, taking into account the country's economic constraints. The National Plan for the adoption of the euro, prepared in 2018, scheduled the date for euro adoption in Romania for 2024,[34] which was later postponed to 2029 and changed again. With the rise of the COVID-19 pandemic, priorities have shifted towards protection and prevention, with less emphasis placed on measures to introduce a single currency.

Șimandan and others classify the determinant factors for Euro adoption into three categories: economic factors, political economic factors, and internal political factors. Economic factors refer to economic structure, trade relations, labour market flexibility, and business cycle synchronisation, while political economic factors deal with the nominal and real convergence criteria analysed above. The internal political factors focus on the president, political parties, and their relationships with the national bank.[35]

According to Dăianu and others, accession will be a political decision and must receive the widest possible democratic support from citizens.[36] In this context, another important issue to discuss is public opinion in different Member States that have not yet adopted a common currency. The latest report in this context, the Flash Eurobarometer 527, was published in June 2023.[37] The Romanian situation is similar to other member states (Bulgaria, Czechia, Hungary, Poland, and Sweden). The key findings regarding the awareness of the euro show that, in Romania, 41% of respondents feel informed about the common currency and 28% are aware that the Eurozone contains 20 Member States (the overall average of the six countries for this point is 34%). The proportion of Romanian respondents who reported that they had used euro banknotes or coins is 80%, making Romania the country in which interviewees are most likely to have used euro banknotes or coins in their own country

34 Guvernul României, 2018.

35 Șimandan, Leuștean and Dobrescu, 2019, p. 273.

36 Dăianu et al., 2016, p. 8.

37 Between 17 April 2023 and 25 April 2023, Ipsos European Public Affairs carried out Flash Eurobarometer 527 at the request of the European Commission, Directorate-General for Economic and Financial Affairs. This was a general public survey coordinated by the Directorate–General for Communication, 'Media monitoring and Eurobarometer' Unit. The Flash Eurobarometer 527 covers the population of EU citizens, aged 15 years and over, and residents in the six Member States that have not yet joined the euro area and have no specific opt-out. All interviews were carried out via Computer-Assisted Telephone Interviewing (CATI). In each country, respondents were called both on landlines and mobile phones. The telephone numbers sampled and contacted were generated via Random Digit Dialling (RDD) methods. The basic sample design applied in all countries is a random (probability) design. In households contacted via a landline phone, the respondent was drawn at random from all household members (aged 15 years and over) following the 'most recent birthday rule'. In Romania 1,011 interviews were conducted. The maximum margin of sampling error when comparing individual country results between surveys is ±8.8% for countries with a sample size of 500 and ±6.2% for countries with a sample size of 1,000.

(Swedish people are the most likely to have used them only abroad). In Romania, 67% of respondents were aware that euro banknotes look exactly the same in all countries in which the euro is used, which is much higher than the average of the six countries (47%). However, 27% of Romanian respondents knew that euro coins have partly different designs from country to country (the average of the six countries for this point was 41%).[38] Regarding information campaigns, National Central Banks are the most trusted sources of information. In Romania, the ratio of trust in the Romanian National Bank is 82%; meanwhile, European institutions occupied second place, trusted by 70% of Romanian respondents. Referring to information actions considered essential in both 2022 and 2023, Romanian respondents are more likely to say that a dual display (in shops, bills, and payslips) is essential.[39]

Section 3 of the Flash Eurobarometer Report describes attitudes toward introducing the euro. Across the six countries surveyed, an average of 60% of respondents believed that the introduction of the euro has positive rather than negative consequences for countries that are already using it; this rate is slightly above the 2022 value (63 %). Meanwhile, the proportion of respondents who believed that the euro had negative consequences increased by five percentage points, from 27% to 32%.[40]

In response to the question, 'What consequences do you think the introduction of the euro has had in countries that are already using the euro?' Romanian respondents' answers were distributed as follows: 17% felt it has had very positive consequences, 49% felt it has had rather positive consequences, 18% felt it has had rather negative consequences, 10% felt it has had very negative consequences, and 6% answered that they did not know.[41]

In particular, regarding public opinion about introducing the euro, Question 11 of the Flash Eurobarometer is essential: 'Generally speaking, are you personally more in favour or against the idea of introducing the euro in Romania?' Romanian respondents' answers were distributed as follows: 71% were in favour of its introduction, 28% were against its introduction, and 1% answered that they did not know. Regarding Romanian respondents' perception of Romania's readiness to introduce the euro, their answers were distributed as follows: 36% felt that Romania was ready to introduce it, 60% felt that its introduction would have very positive (19%) or rather positive (41%) consequences for Romania, and a large proportion of respondents (65%) felt that its introduction would have very positive (22%) and rather positive (43%) consequences for them personally.[42]

Respondents from Romania were most likely to want the euro to be introduced as soon as possible (45%), even though 12% felt that the common currency should never be introduced. In this context, it is interesting to examine the respondents' answers to

38 European Commission, 2023, p. 3.
39 European Commission, 2023, p. 17.
40 European Commission, 2023, p. 19.
41 Ibid.
42 Ibid.

Question 4c: 'When do you think the euro will be introduced in (THIS COUNTRY)?' Romanian respondents' answers were distributed as follows: 42% thought it would be introduced within five years, 37% within 10 years, and 20% thought that it would never be introduced (1% of the respondents did not know).[43]

A slim majority (52%) of Romanian respondents thought that introducing the euro would increase prices; meanwhile, more than one-third (37%) believed it would keep prices stable and 9% thought it would reduce prices.[44]

Views on the likely impact of the euro on national control of economic policy and national identity diverge from country to country. In Romania, 29% of the respondents totally agree and 19% tend to agree that with the introduction of the euro, control over national economic policy will be lost. Almost half of the respondents (49%–31% totally agreed, 18% tended to agree) agreed that adopting the euro would mean that their country would lose part of its identity. Respondents with a higher level of education, living in large towns, and who felt informed about the euro were more likely to disagree that adopting it would lead to a loss of national identity.[45]

2. The banking union: The Single Rulebook, supervision, resolution, deposit insurance

2.1. The Single Rulebook (2013–)

On 27 June 2013, the EU adopted banking regulations in response to the financial crisis, comprising Regulation (EU) 575/2013 on prudential requirements for credit institutions (Capital Requirements Regulation [CRR]) and Directive 2013/36/EU (Capital Requirements Directive [CRD IV]) on the prudential supervision of credit institutions. These acts constitute the 'single regulatory framework for the banking union' and implemented the Basel III Accord – the internationally agreed capital adequacy standards adopted by the Basel Committee on Banking Supervision (BCBS) in December 2020 – in EU law.

The BCBS is responsible for developing minimum standards for banking supervision. The committee has 45 members, including countries like Argentina, Australia, Belgium, Brazil, Canada, China, Switzerland, France, Germany, India, Indonesia, Italy, Japan, Mexico, UK, Netherlands, Russia, Turkey, and United States. The European Commission, European Banking Authority, and ECB have observer status.

43 European Commission, 2023, p. 30.

44 Ibid.

45 European Commission, 2023, p. 38.

As a member of the EU, Romania is subject to and aligned with its common regulatory framework for banking supervision. The EU regulatory framework for banking supervision has undergone significant changes since the 2008 global financial crisis and subsequent sovereign debt crisis. The adoption of the CRR and CRD IV, which constitute the Single Rulebook, was an important step towards stronger prudential regulation.[46] Specifically, the CRR, which is directly applicable to all EU Member States, sets prudential requirements for capital, liquidity, and credit risks. Regarding the capital requirements, the CRR requires banks to have sufficient capital buffers to cover unexpected losses and maintain solvency in times of stress. The amount of capital required – the 'own funds requirement' – depends on the risk associated with the assets held by a particular bank. Regarding the liquidity requirements, the CRR requires credit institutions to hold sufficient liquid assets to cover net cash outflows during a severe crisis for a 30-day period; this indicator has been phased in gradually, starting at 60% in 2015 and reaching 100% in 2018. Regarding credit risk, the CRR situates a bank's assets as 'leveraged' when they exceed the bank's funds ('leverage' is the ratio of a bank's funds to its total assets).[47]

On 27 June 2019, the acts amending the Single European Banking Framework, Regulation (EU) 2019/876 (CRR II), and Directive (EU) 2019/878 (CRD V) entered into force, introducing certain additional requirements, particularly regarding the own funds requirements, leverage ratio, and counterparty credit risk. The new regulations became applicable in February 2022[48] as the CRD V was only partially implemented by Romania. Within the CRD V framework, the new regulations also include new provisions on capital adequacy evaluations performed by the NBR, as well as on remuneration policies and implementing gender-neutral remuneration policies at the level of supervised entities.

The implementation of new capital and liquidity requirements has effectively meant that banks have to set aside more capital and liquid assets to be able to lend, which cannot be used for any other purpose until the loan is repaid in full or the deadline for granting the loan has been reached. Committing credit facilities thus limit the capital available to banks to cover capital and liquidity requirements, inciting higher funding costs for banks. As a result of these higher costs, banks are increasingly considering offering non-committing credit lines. The CRR allows banks to apply for a credit facility that has not drawn down an exposure amount equal to 0% if the facility meets its requirements. These non-committing loans have a dual benefit for the customer and the bank: they reduce funding costs associated with

46 International Monetary Fund, World Bank, 2018, p. 6.

47 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, 1–337.

48 Regulament nr. 2 din 1 februarie 2022, Monitorul Oficial, Partea I 121 7 februarie 2022, Intrare în vigoare la 7 februarie 2022, Regulamentul nr. 2/2022 pentru modificarea şi completarea Regulamentului Băncii Naţionale a României nr. 5/2013 privind cerinţe prudenţiale pentru instituţiile de credit.

loans for the benefit of the customer, while simultaneously reducing the impact of this type of lending on capital and liquidity requirements. Notably, the CRR does not necessarily consider a loan to be non-committing in the sense that the bank does not assume any obligation to grant the loan. Non-committing loans for which the bank assumes an obligation to make the loan available and which has not been drawn down may be classified as an asset (on-balance sheet or off-balance sheet as appropriate) with an exposure value of 0% when the bank has the right to unconditionally cancel or revoke this commitment, at any time, and without prior notice.[49]

2.2. Banking supervision (2014–)

The architecture of the EBU consists of three pillars: a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM), and a System Deposit Guarantee Scheme (SDGS).[50]

As Eurozone banks own a large part of the Romanian banking system, the SSM, as the domestic supervisory authority for Eurozone banks, is a key partner of the NBR. Prudential regulation of the NBR is broadly aligned with the requirements of the Basel Core Principles. As of 2017, the NBR identified 11 banks as systemically important, of which eight are supervised at the group level by the SSM.[51]

In Romania, deposits at domestic banks have increased in value and, as a result, dependence on foreign banks has fallen dramatically, despite 29 of Romania's 35 banks being foreign banks. In general, the financial sector in Romania is dominated by banks. The lending practices of the non-bank financial sector are likely to increase non-performing loans.[52]

As noted above, Romania follows a dual supervisory mechanism, with both national (the NBR) and European banking supervision. However, in January 2023, the ECB signed a Memorandum of Understanding with the national competent authorities of six EU Member States that are not part of the European banking supervision system, one of which is Romania (along with the Czech Republic, Denmark, Hungary, Poland, and Sweden).[53]

With its 14 articles, the agreement aimed to further strengthen supervisory cooperation at the European level. The agreement builds on the already-strong culture of cooperation between the ECB and non-participating EU national authorities that emerged from the work of the European Banking Authority. The Memorandum of Understanding provides a framework for Member States to exchange information on supervisory issues and matters relating to cross-border supervised institutions, as well as supervisory methods, approaches, and priorities.[54]

49 Regulament nr. 2 din 1 februarie 2022.
50 Lungu and Kállai, 2015, p. 37.
51 International Monetary Fund, World Bank, 2018, p. 6.
52 Batrancea et al., 2020, p. 2.
53 European Central Bank, 2023a.
54 Ibid.

According to the Memorandum of Understanding, the NBR is entrusted with specific tasks concerning the prudential supervision of credit institutions in accordance with Law No. 312/2004 of the Statute of the NBR, Government Emergency Ordinance No. 99/2006 regarding credit institutions and capital adequacy approved by Law No. 227/2007, and Government Emergency Ordinance No. 98/2006 on the supplementary supervision of credit institutions, insurance and/or reinsurance entities, investment firms, and asset management companies in a financial conglomerate.[55]

In accordance with the Confidentiality article of the Memorandum of Understanding (Art. 4), any confidential information requested or received by the ECB or the NBR (and the other authorities under the Memorandum) will be exchanged in accordance with applicable EU and national law, used exclusively for lawful purposes, and used only in relation to the performance of the duties and tasks of the ECB or the NBR (and the other authorities under the Memorandum).[56]

Art. 6 of the Memorandum regarding cooperation in relation to authorisation procedures, qualifying holdings assessments, fit, and proper assessment of key function holders provides that the ECB and the NBR (and the other authorities under the Memorandum) intend to notify each other, without undue delay, of applications for approval to establish cross-border establishments or make cross-border acquisitions. In accordance with the provisions of the CRD, the ECB and the NBR (and the other authorities under the Memorandum) intend to consult each other before authorising a cross-border establishment of a supervised institution in the jurisdiction of Romania (or other participating countries under the Memorandum) or assessing any acquisition of holdings in a supervised institution by or through a supervised institution located or operating in the jurisdiction of Romania (or other participating countries under the Memorandum).[57]

Art. 10 of the Memorandum refers to cooperation in emergencies. In this regard, the ECB and the NBR (and the other authorities under the Memorandum) will endeavour to inform each other immediately if an emergency situation arises (as provided in the regulation of CRD) or if they become aware of an emerging crisis such as, but not limited to, serious financial difficulties which might have an adverse impact on operations relating to any supervised institution in the jurisdictions of the ECB and the NBR (and the other authorities under the Memorandum).[58]

Romania's domestic legal regulations regarding banking supervision are based on ensuring the health and soundness of banks and the banking system.[59] According to the provisions of Law No. 312/2004 on the Statute of the National

55 European Central Bank, 2023b, p. 3.
56 European Central Bank, 2023b, p. 7.
57 European Central Bank, 2023b, p. 9.
58 European Central Bank, 2023b, p. 11.
59 Cosmescu, 2015, p. 9.

Bank of Romania, the NBR has exclusive power to authorise credit institutions and is responsible for the prudential supervision of the credit institutions it has authorised to operate in Romania.[60] Government Emergency Ordinance No. 99/2006 regarding credit institutions and capital adequacy provides that the NBR ensures the prudential supervision of credit institutions registered in Romania (including their subsidiaries established in other member states or third countries).[61] The objective of supervision is to monitor compliance with prudential rules and indicators according to regulations to assess the risks to which banks are exposed. The results of banking supervision consist of preventing and limiting risks specific to banking activities, protecting depositors' interests, and ensuring the stability of the banking system.[62]

If we take into account the content of banking supervision in Romania, a structure can be conceived based on three pillars; namely: banking risk assessment, proportionality, and capital requirements and liquidity. Banking risk assessment consists of a review of how banks manage and evaluate the risks to which they may be exposed (e.g. credit, operational, market, liquidity, and other significant risks), risks to which the bank exposes the financial system, and risks identified through stress test simulations. Proportionality refers to the verification and evaluation of the nature, extent, and complexity of bank activities. The pillar of capital requirements and liquidity means that the NBR determines whether the bank is managed prudently and if the risks are covered according to the risk profile. Moreover, the NBR demands additional capital and liquidity to improve its governance framework.[63]

The NBR exercises macro- and micro-prudential supervision of its financial systems. On the one hand, the objective of macro surveillance is to minimise systemic risk by limiting the malfunctioning of the financial system. This requires focusing on banks of systemic importance. Macro-surveillance instruments include the countercyclical capital buffer, systemic risk buffer, and systemic institution buffer. Meanwhile, the objective of micro-surveillance is to monitor the risks that may affect the liquidity of banks. This implies increased attention to banks' solvency and liquidity. Micro-surveillance instruments include capital, liquidity, and governance requirements.[64]

The SRM and European Deposit Insurance Scheme are further steps toward a banking union. Because Romania is outside the Eurozone, it is not obligated to participate in the SRM or other pillars of the banking union. However, as an EU Member State, Romania also needs to cooperate.

60 Art. 25 of Lege nr. 312 din 28 iunie 2004 privind statutul Băncii Naţionale a României, Monitorul Oficial, nr. 582 din 30 iunie 2004.

61 Art. 1 of Ordonanţa de urgenţă nr. 99 din 6 decembrie 2006 privind instituţiile de credit şi adecvarea capitalului, Monitorul Oficial, nr. 1.027 din 27 decembrie 2006.

62 Cosmescu, 2015, p. 9.

63 Cosmescu, 2015, p. 10.

64 Cosmescu, 2015, p. 14.

3. The monetary aspects of crisis management

The COVID-19 crisis has given rise to not only health, but also economic challenges in all countries, including Romania. Countries and their institutions must proactively intervene to mitigate the negative effects of macroeconomic challenges, which include fiscal and monetary problems. Accordingly, the NBR was involved and aligned with specific measures through monetary policy and recommendations from the ESCB and the Bank for International Settlements. In March 2020, the Governing Council of the NBR held an emergency meeting and adopted measures to mitigate the impact of the COVID-19 outbreak on the Romanian population and companies. According to this, the monetary policy interest rate was reduced by 0.5 percentage points, from 2.5% to 2%; this narrowed the symmetric corridor formed by standing facility interest rates around the policy rate to ±0.5% from ±1%. Thus, from 23 March 2020, the interest rate on the deposit facility was maintained at 1.50% and the interest rate on the lending facility (the Lombard rate) was reduced from 2.50% to 3.50%.[65] Moreover, together with the government, banks and creditors contributed to the measure to defer loan payments to firms and households for up to nine months under a government guarantee scheme. The beneficial effects stemming from the good position of the Romanian banking system in terms of capitalisation and a low level of non-performing loans consisted of providing liquidity to the national financial system to support the economic environment, lowering the ROBOR interest rate (to 2% instead 3%), and stopping massive cash withdrawals.[66]

Regarding liquidity assurance, the NBR reduced the level of minimum reserve requirements for liabilities in RON and foreign currency – a still-limited convergence measure within the levels practiced in the Euro Area – and initiated the purchase of government securities in RON on the secondary market. This decision was unprecedented and much commented upon by analysts, as it was equivalent to conducting quantitative easing to provide easy financing to the state. Moreover, the NBR said it was prepared to further reduce the minimum reserve requirement on RON and foreign currencies and reconsider some prudential requirements related to the capitalisation and liquidity of commercial banks (in line with the recommendations of the ECB) and the treatment of loan portfolios. Notably, aggressive measures, as they have been labelled in the market, have been taken to the limit at which the RON exchange rate could be contained in the face of depreciation. We can expect that the stress created by the exchange rate of the RON against the euro during the pandemic would be part of the stabilisation effort required in the coming period of the national currency's entry into the European Exchange Rate Mechanism.[67]

65 Banca Naţională a României, 2020a.
66 Pop, Ioan-Franc and Diamescu 2021, p. 199.
67 Pop, Ioan-Franc and Diamescu 2021, p. 200.

In March 2020, given the high degree of uncertainty in economic and financial development, the Governing Council of the NBR decided to suspend the previously announced calendar of monetary policy meetings and hold them whenever necessary. The next meeting of the Governing Council of the NBR on monetary policy issues was held two months later, on 29 May 2020, when the following actions had been decided: reducing the monetary policy interest rate to 1.75%/year from 2.0%/year from 2 June; reducing the interest rate on the deposit facility to 1.25%/year from 1.50%/year and of the interest rate on the lending facility (the Lombard rate) to 2.25%/year from 2.50%/year; maintaining the current levels of reserve requirements for credit institutions' liabilities in RON and foreign currency; continuing repo operations and the purchase of government securities in RON on the secondary market.[68]

The annual Consumer Price Index (CPI) inflation rate remained steady in March at 3.05% before falling to 2.68% in April (from 4.0% in December 2019). Its decline from December 2019 was driven by disinflationary base effects and a sharp decline in oil prices, along with the removal of the fuel excise tax. Lending activities remained relatively strong in March 2020; however, the effects of the pandemic were evident in April. The stock of loans to the private sector shrank slightly, with the annual growth rate falling from 5.7% to 6.9% during the previous month. The share of the RON component in total credit declined slightly from 67.1% to 67.6% in December 2019. Simultaneously, the RON/EUR exchange rate eased its fluctuations, oscillating within a narrow range, even in the context of improvement in the international financial market.[69]

A subsequent meeting of the Governing Council of the NBR on monetary policy issues took place at the beginning of August 2020. The most important actions decided upon at this meeting were as follows: reducing the monetary policy interest rate to 1.50%/year from 1.75%/year from 6 August; reducing the interest rate on the deposit facility to 1.00%/year from 1.25%/year, and the interest rate on the lending facility (Lombard) to 2.00%/year from 2.25%/year; maintaining the current levels of reserve ratios for credit institutions' liabilities in RON and foreign currency; and continuing repo operations and the purchase of government securities in RON on the secondary market. During this period, the average annual CPI and harmonised index of consumer prices (HICP) inflation rates decreased in June to 3.3% and 3.2%, respectively, from 3.6% in April. At the same time, the RON/EUR exchange rate remained almost stable, even showing a slight downward trend in July, in line with movements in the region in the context of optimism generated by the major economic recovery plan agreed upon at the EU level.[70]

The National Bank's Governing Council discussed monetary policy issues for the next time in November 2020. On this occasion, the following actions were decided:

68 Banca Naţională a României, 2020b.
69 Ibid.
70 Banca Naţională a României, 2020c.

maintaining the monetary policy interest rate at 1.50%/year; maintaining the interest rate on the deposit facility at 1.00%/year and the interest rate on the lending facility at 2.00%/year; reducing the reserve requirement rate for foreign currency liabilities of credit institutions from 5% to 6%; and maintaining the reserve requirement rate for liabilities in RON at 8%. Regarding the CPI inflation rate, the Governing Council's decision provides that the annual CPI inflation rate fell to 2.45 percent in September (2.68% in August) and 2.24% in October, dropping significantly below expectations, mainly on the back of a much larger-than-expected decline in vegetable and fruit prices. Thus, it fell from the last month of the second quarter, when it stood at 2.58%, while also sharpening its decline from the 4.04% level it reached at the end of the previous year.[71]

This gradual reduction and maintenance of the monetary policy interest rate allowed the rate to reach a minimum value of 1.25%/year at the beginning of 2021. The NBR retained this value until October 2021, when it increased it by 1.50%/year. This upward trend has not stopped until today; an increase of 0.5–1% was characteristic with the occasion of each meeting of the Governing Council of the NBR. From a value of 2% in January 2022, it reached an outstanding value of 7% in January 2023, which was maintained as of October 2023.

This increasing tendency can also be observed in the case of interest rates on deposits and lending facilities. Accordingly, the interest rate on deposit facilities rose from 1% in January 2022 to 6% at the beginning of 2023, while the interest rate on lending facilities reached 8% in January 2023, in comparison with the 3% applicable from the beginning of 2022. Similar to the monetary interest rate, the values of the deposit and lending facility rates remained the same during 2023. The maintenance of the reserve requirement rate for liabilities in RON and foreign currencies was also notable.

However, a significant increase in the CPI inflation rate is understandable. The average annual CPI inflation rate is expected to increase from 4.5% in November 2021 to 14.6% in November 2022. This excessively high value remained as of 2023. According to the latest decision of the Governing Council of the NBR, the annual inflation rate calculated based on the HICP (the inflation indicator for EU Member States) stood at 9.3% in August, similar to the level recorded in June 2023. Simultaneously, the average annual CPI and HICP inflation rates declined in August to 13.2% and 11.8%, respectively, from 14.2% and 12.5% in June, remaining below those prevailing in the region and Baltic countries.[72]

71 Banca Naţională a României, 2020d.
72 Banca Naţională a României, 2023.

4. Summarizing thoughts

The aim of the present chapter on Romania's monetary policy was to provide an overview of Romania's state of preparedness for joining the euro area, place and role in the banking union as an outsider but EU member state, and measures during the crisis.

An important conclusion is that Romania seriously lags behind most nominal convergence criteria, placing the adoption of a single currency on a rather distant horizon. In particular, Romania's degree of fulfilment of the nominal convergence criteria must be taken up in conjunction with its fulfilment of the real convergence criteria and optimal currency area criteria as well as a cost-benefit analysis. In the context of real convergence criteria, per-capita GDP is one of the most suitable indicators. According to Eurostat data, Romania's real GDP per capita was EUR 10,110 euro per capita in 2022, 35.03% of the EU27 average and 31.90% of the average of the 20 countries forming the Eurozone. Therefore, Romania still has a long way to go, even if its dynamics of real GDP growth rates were higher than those of other countries during the 2000–2020 period.

Despite these backlogs, it is important to highlight the RON/EUR exchange rate as a positive example. In 2020, against the extreme circumstances triggered by the health crisis, the overall dynamics of RON/EURO volatility indicated a slight depreciation of the national currency against the euro. Although a gradual depreciation of the Romanian RON was suggested in 2020, which could have led to a value of 5.00 RON/EUR, the exchange rate remained below 5.00, even in 2023.

In addition to the specific economic parameters that can be described in numerical terms (nominal and real convergence criteria), another important issue is public opinion regarding the introduction of a common currency. In this context, the Flash Eurobarometer 527 was published in June 2023. The respondents generally (71%) favoured the introduction of the euro in Romania and believed this would have positive rather than negative consequences for countries already using the euro.

Regarding the banking union, the Single Rulebook, and banking supervision, the most important aspects referring to Romania were discussed. In particular, it is notable that Romania follows a dual supervisory mechanism as it is subject to both national (NBR) and European supervising authorities for banking. However, in January 2023, the ECB signed a Memorandum of Understanding with the national competent authorities of six EU Member States that are not part of European banking supervision, one of which is Romania (along with the Czech Republic, Denmark, Hungary, Poland, and Sweden).

Romania's domestic legal regulations regarding banking supervision are based on ensuring the health and soundness of banks and the banking system. In accordance with EU common regulations, the content of banking supervision in Romania consists of a structure based on three pillars: banking risk assessment, proportionality, and capital requirements and liquidity.

This chapter also discussed the monetary aspects of crisis management processes, the most important decisions of the Governing Council of the NBR on monetary policy issues from 2020 to 2023, and how the monetary policy interest rate changed from 1.25%/year at the beginning of 2021 to 7% at the beginning of 2023 (where it remained until October 2023). Further, the changes in the inflation rate are also presented.

In conclusion, Romania has made a lot of progress in becoming a member of the euro area on the basis of the real and nominal convergence criteria. The positive effects of this move include a relatively stable exchange rate (even in times of crisis) and public affirmation of the introduction of the euro.

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