

# A LOOK AT THE EVOLUTION AND CHARACTERISTICS OF THE ROMANIAN FOREIGN DEBT OVER THE PAST YEARS

---

---

Camelia MILEA, PhD\*

## Abstract

The foreign debt represents foreign capital used by a country when the domestic capital is not enough for the investments needed at the national level. On the basis of the analysis of some indicators characterizing the evolution and state of Romania's foreign debt (on the short, medium and long-term), as well as the structure by creditors of the medium and long term Romanian public foreign debt, and finally the structure of the reserve assets of the National Bank of Romania, in the article<sup>1</sup> the author intends to depict not only some of the effects, but also the possible causes of this situation and to show if Romania's foreign debt is sustainable, using qualitative and quantitative evaluations, interpretations and comparative analyses. The analysis is conducted for the period 2013-2016 and it shows that 2009, as well as 2013, have represented turning points in the evolution of the Romanian foreign debt on the medium and long term and its components.

**Keywords:** structure of debt, external public debt, debt sustainability, risks

**JEL Classification:** F21, F32, F34, H63

## 1. Introduction

The economic, social and political transformations at the macro and microeconomic levels internationally, as well as the need for easy, complete and coherent accessing generates the continuous

---

\* Scientific Researcher III, "Victor Slăvescu" Centre for Financial and Monetary Research, Romanian Academy, Bucharest.

<sup>1</sup> The article is based on the chapter "The assessment of the external equilibrium", from the research project "The financial stance of Romania, edition 2016" elaborated in CFMR "Victor Slăvescu" in 2016, under the coordination of Marin C., PhD.

updating of the methodological framework of economic statistics. This phenomenon also takes place in the external sector which, from 2014, reports the information according to IMF's Manual on the Balance of Payments and International Investment Position, the 6th edition (BPM6).

The foreign debt<sup>2</sup> represents foreign capital used by a country when the domestic capital is not enough for the investments needed at the national level. Foreign debt is a supplement for internal savings and for domestic credit. Thus, it supports the demand, it improves the standard of living and it supports the transition process. The foreign loans can also be used to refinance the temporary deficits of the balance of payments, providing an alternative to the reduction of the internal consumption (Milea, 2009).

The foreign financing provides access to more debt instruments, which allows a more efficient management of the cost of debt and of the risks, which can thus be sometimes cheaper than the internal financing.

Based on the analysis of indicators regarding the Romanian foreign debt (short, medium and long term), the structure by creditors of the foreign medium and long term public debt and regarding the structure of the reserve assets of the National Bank of Romania, the author intends to present not only some effects, but also the possible causes which generated these results, in addition to other existing studies (Monthly Bulletins and Annual Reports of the National Bank of Romania). The methodology used consists in qualitative and quantitative evaluations, interpretations, comparative analyses, correlations and proposals of measures. The analysis is done for the period 2013-2016.

In Romania, the structural reforms took place slowly, generating a structural imbalance of the economy, with effects on the consolidated state budget and on the current account which had large deficits until 2009, produced by an economy, which consumes more than it produces. Due to a low rate of the internal accumulation, these deficits and the internal absorption for consumption and investments

---

<sup>2</sup> *The definition of the foreign debt given internationally presents gross foreign debt, at a particular moment, as the "total amount of the contracted loans, used and not paid back, up to that particular moment, from the foreign financial markets, and the obligation of the residents to reimburse the capital instalments and the related interest".*

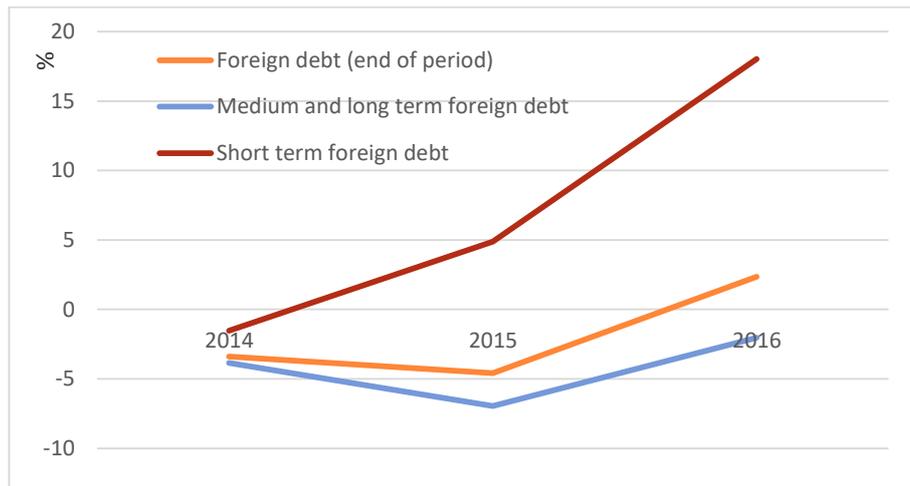
have been covered by foreign capital, either as investments, or as loans, which have increased gradually the foreign debt. Thus, the medium and long-term foreign debt has increased almost continuously starting with 1990, 2013 being the first year when the foreign debt has decreased, trend continued until 2016 inclusive. The external public debt has also increased almost continuously after 1990, peaking in 2009-2012, when Romania has taken a foreign loan from the international financial organizations. 2009, as well as 2013, have represented turning points in the evolution of the Romanian foreign debt on the medium and long term and its components.

## **2. The Trend and the Characteristics of the Short, Medium and Long-Term External Debt and of its Components**

In 2013-2016, the total external debt displayed a slightly decreasing trend until 2015, with a 2.4 percent points increase in 2016 compared to 2015 (Chart 1).

The structure by maturities of the external debt shows that the proportion of the short-term external debt increased in 2013-2016, reaching 25%. This trend must be monitored closely because a high share of the short-term external debt within the total external debt raises sustainability risks. In terms of value, the short-term external debt decreased in 2014 and increased in 2015 and 2016.

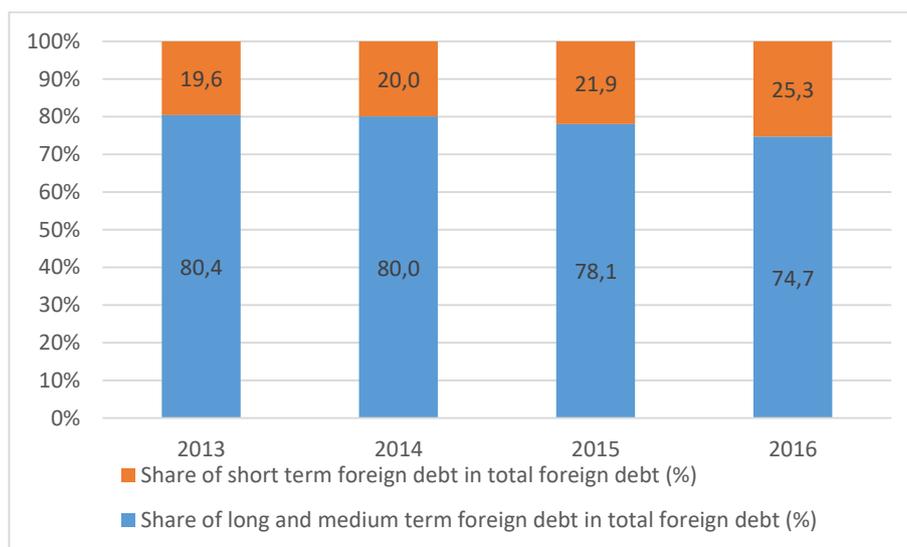
**Chart 1**  
**The evolution of the Romanian external debt and of its components (annual rate, %)**



Source: National Bank of Romania (NBR) data (National Bank of Romania, 2017) and author's calculation

In Romania, the medium and long-term foreign debt represents most of the total external debt during the surveyed period (Chart 2). A longer maturity supports the national economy in a sustainable manner, since the burden of the debt is spread on a longer period of time, so that it doesn't hamper the budget decisions and the investment projects of the government. Compared to 2013, the medium and long-term foreign debt has decreased in each year of the period 2014-2016 (Chart 1), decreasing trend also noticed regarding its proportion within the total external debt. This has decreased in 2014-2015 and has increased in 2016. The year 2013 represented a turning point for the medium and long-term foreign debt of Romania, since it was the first year after 1990, when it decreased.

**Chart 2**  
**The evolution of the structure of the Romanian external debt**  
**(share, %)**

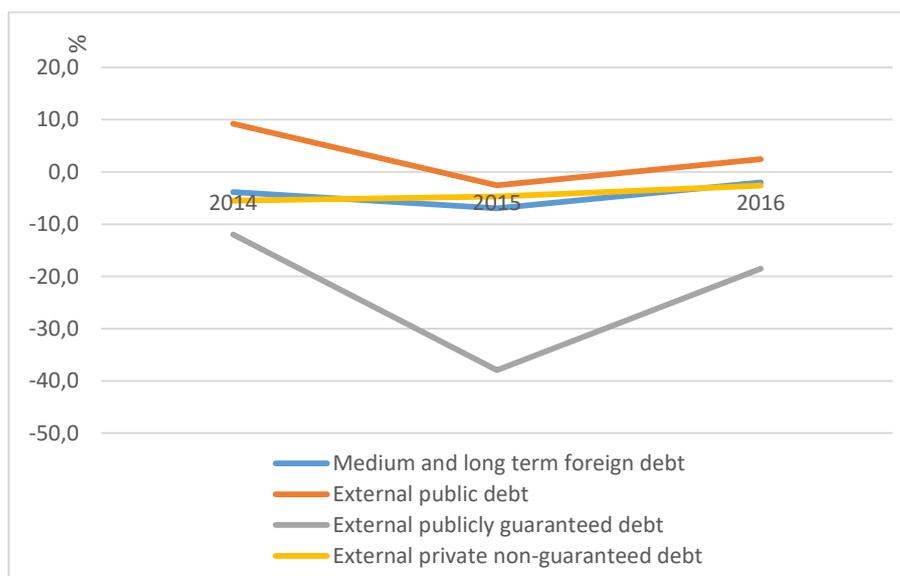


Source: NBR data (National Bank of Romania, 2017) and author's calculation

The external public debt increased in 2014 and 2016, and decreased in 2015 (Chart 3). The share of the external public debt within the medium and long-term external debt of Romania increased in 2013 – 2016.

The evolution of the external public debt has been mainly determined by the trend of the external direct public debt and less by the external publicly guaranteed debt, which decreased in each year of the surveyed period. The share of the external publicly guaranteed debt on the medium and long-term within the medium and long-term external debt has decreased in 2013 - 2016.

**Chart 3**  
**The evolution of the medium and long-term external debt and of its components in Romania (annual rate, %)**



Source: NBR data (National Bank of Romania, 2017) and author's calculation

According to the Financial Stability Report (FSR) from 2015, although the public debt of Romania (39.9% of the GDP, i.e. 59.3 billion Euro, at the end of 2014), is lower than in most of the EU member states (fourth lowest level in the EU) and below the maximal threshold regulated by the EU Treaty (60%), yet its fast dynamics and, often, the procyclic character of the Romanian fiscal policy require a deeper analysis and a close monitoring of the evolution of our country's public debt. The significant increase of the public debt after 2008 is due both to the financial crisis, as well as to the process of fiscal consolidation.

According to FSR 2015, the external debt accounts for about half of the public debt of Romania.

Before the crisis, the increase of the public debt was offset by a high rate of economic growth, but after the onset of the global economic and financial crisis, the Romania's access to funding from the international capital market was strongly impelled, which required the assistance of international financial bodies (such as WB, EU and IMF), on the condition of adopting painful domestic measures of

reorganisation. The public debt increased spectacularly in 2009-2011 in order to finance the budget deficit, requiring subsequently, for fiscal consolidation, adjustments even tougher than those generated by the effects of the financial crisis (e.g. decreasing some public expenditures, reducing the public wages expenditures, diminishing public investments, which were, however, maintained above the level of the budget deficit).

It should be mentioned that it is acceptable that a country increases the volume of loans in general, and of foreign, loans in particular, as long as the cost of the loans is lower or equal with the marginal product of the borrowed capital, because, only in this case, the increase of the foreign debt improves the growth rate of the national income. The foreign loans do not generate economic growth if they are used inefficiently (i.e. to balance the excessive exports of capital, or with lower yields than the interest rate paid for them, or to finance unproductive activities such as the consumption); on the contrary, they lead to the need to take more loans, which eventually diminishes the access of that country to foreign financing, and even to a foreign debt crisis. (Milea, 2009).

According to FSR 2015, after 2012, the increase of the public debt was also generated by the establishment of a financial reserve in hard currency, at the disposal of the Ministry of Public Finances, meant to cover the needs for liquidity of the state, covering completely the service of the external public debt, and about 50% of the service of the total public debt.

The financial reserve at the disposal of the Ministry of Public Finances, which is also an asset, is included in the total public debt, which means that the net external public debt is significantly lower than that from the statistics (for instance, in 2014 it was 35.3% of the GDP, according to FSR 2015).

According to FSR 2016, in September 2016, the public debt was 36.8% of the GDP, and the external debt was adjusted to 18.1% of the GDP. Regarding the sustainability of the external debt, the ratio between the short-term external debt and the foreign exchange reserves settled down (for instance, in September 2016, it was about 61.6%, according to FSR 2016), while the coverage of the short-term external debt (calculated at the residual value) by NBR's foreign exchange reserves reached 94.2% in September 2016, which shows a good capacity of the Romanian economy to cope with any negative evolutions of the external sector.

According to FSR 2015, the “public debt sustainability must be evaluated from at least four perspectives: its size, the residual maturity, the cost of financing and the structure of the investors basis”.

In terms of the public debt size, Romania is below the critical threshold which might trigger the economic recession (according to FSR 2015, it is calculated econometrically to 40-50%), but rather close to it, which requires a prudent stabilizing (below 3% of the GDP) of the budget deficit.

The average residual maturity of the public debt expanded over the period 2008-2015, according to FSR 2015, which is an important aspect for diminishing the annual requirement of funding and for decreasing the risk of refunding. In terms of the public debt sustainability, a maturity inappropriate to the requirements can be a risk factor even more important than the level of the public debt.

The measures of fiscal consolidation and of restoration of the macroeconomic equilibria, the inclusion of the Romanian state bonds within some international reference indices for the investments in assets of the emergent states, as well as the improvement of the country rating for Romania by the major rating agencies, have brought about the improvement of the liquidity on the secondary market and the increase of the average maturity of the newly-issued bonds. In 2015-2016, about 29% of the state bonds stock (amounting to 11.8 billion euro) had due date, while the rest of the debt is due gradually up to 2044. Under these circumstances, the fiscal-budgetary policy had to be maintained within a prudent framework, so as the refunding of the due debt to be done in conditions as favourable as possible in terms of cost and maturity (FSR 2015).

A positive aspect is that the cost of financing the public debt decreased significantly in 2008-2015, while the debt tripled. Within the context of a possible international or regional trend reversal, the cost of financing the public debt can become a risk factor for its sustainability. “The reduction of the cost of financing the public debt has been influenced by the favourable external conditions (very low interest rates and high liquidity), by the domestic macroeconomic structural adjustments (decrease of the budget deficit and of the inflation rate) and by the liquidity conditions on the local monetary market (FSR 2015)”.

The concentration level of the basis of investors for the public debt decreased over the period 2009-2014, according to FSR 2015,

but the financing of the public sector has been done mainly by the banking sector. This trend might reverse in the future due to the changes in the banking sector (generated by the restart of the credit demand, by the implementation of the European proposals to increase the capital requirements regarding the exposure of the sovereign debt and by the need to boost the economic growth). In terms of financial stability, the strengthening of the link between the public debt and the local banking sector had also positive aspects such as: the reduction of the risk of regional contagion within the banking system, on the background of the uncertainty in the Euro zone, the improvement of the liquidity of the banks and the avoidance of a disordered financial disintermediation within this sector.

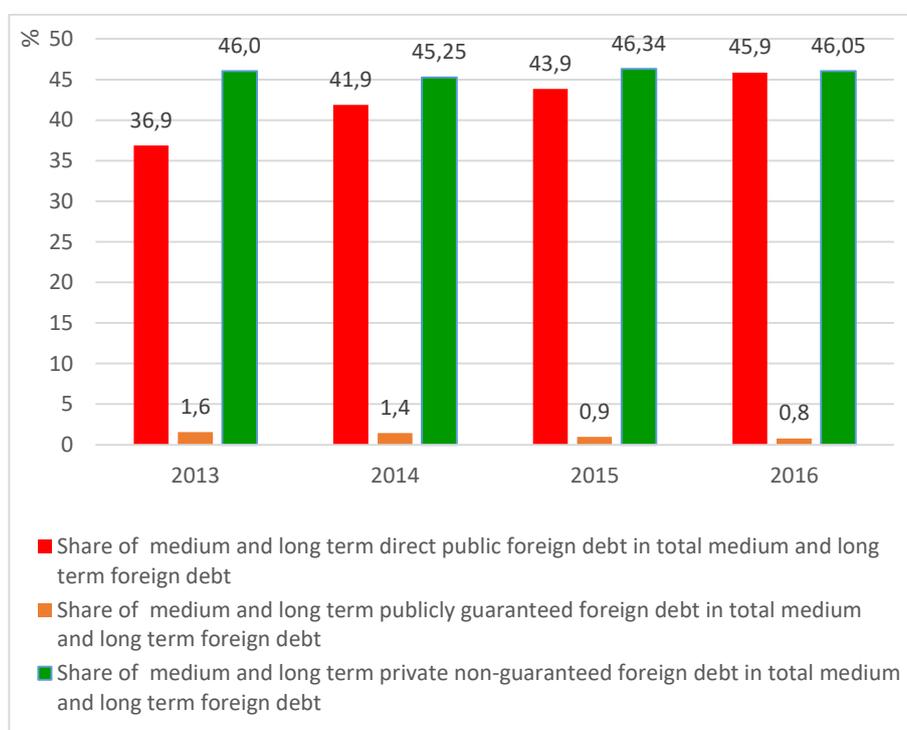
In conclusion, regarding the sustainability of the public debt, according to FSR 2015, "The average residual maturity increased, the interest costs decreased, and the basis of investors in state bonds diversified. Therefore, the profile of public debt sustainability improved over the recent years, offsetting the increase of the public debt. The evolution of the stock of public debt must be, nevertheless, closely monitored, as it increased significantly compared to 2008".

The medium and long-term external private non-guaranteed debt decreased in 2013-2016 (Chart 3), on the background of continuous displays such as: an economic activity below the potential, a still low liquidity and the persistence of the risk aversion due to the global and regional economic and financial crises (such as the euro zone debt crisis). Before the onset of the crisis, in general, the private sector preferred to borrow from the external markets, against a more favourable external cost compared to the price of the domestic financing resources, due to an overvalued real exchange rate of the national currency, to the high interest rates for loans in Romania and to the sometimes improper behaviour of the banks in Romania throughout the crediting process. Within this context, in the years precursory of the crisis (up to 2009 included), on the background of the optimism generated by the economic boom, the external debt of the private sector increased significantly. The external credit conditions continue to be more favourable than those offered by the banking sector in Romania.

Over the period 2005-2010, the external private non-guaranteed debt accounted for most of the total medium and long-term external debt of Romania, which shows, on the background of a macroeconomic context still dominated by uncertainty, an important

increase of the dependence on the external financial markets. The decrease of the proportion of the external private non-guaranteed debt, starting with 2011 (below 50%), is encouraging for the sustainability of Romania's external debt. The analysis shows that, in 2014-2016, the share of the external public debt approached the proportion of the external private non-guaranteed debt within the total medium and long-term external debt, but it still is below it (Chart 4).

**Chart 4**  
**The evolution of the structure of the Romanian medium and long term external debt (share, %)**



Source: NBR data (National Bank of Romania, 2017) and author's calculation

Over the period 2013-2016, the balance of the financial account shows, unlike the previous years, capital outflows, therefore a positive influence on the international investment position due to an increase of the net assets more important than the increase of the net liabilities, which signifies increasing rights over the non-residents. This occurs due to paying back long-term loans, despite the inflows of

foreign direct investments and of portfolio investments (except in 2015 for the portfolio investments). The loans taken by Romania from the bonds market, at the same time with the reduction of the long-term external loans, shows the replacement of the institutional lenders with private lenders. As the debt from the multilateral institutions has lower costs, taking into account the interest rate used for the countries perceived as having a high risk on the of private capital international market; longer total maturity, longer grace period; I consider that the replacement of the creditors is a thoroughly negative evolution for the situation of the Romanian economy. Instead of paying back the older foreign debt we borrow more capital under harsher lending conditions.

As of 2012, the Romanian state diversified the external markets by issuing bonds on the US market. The Romanian treasury bonds, issued in US Dollars, represent one third of the value of the issues on the external financial markets, according to July 2015 data. The increase of the fiscal deficit will probably have to be largely funded by non-residents (given the important exposure of the residents to such portfolios). The increasing share of non-residents financing the public debt would increase the contagion risk in case the international financial markets experience changes in the investors' risk appetite (FSR, 2015).

Therefore, it is necessary to develop and observe a national indebtedness strategy which should establish an optimal ratio between the medium and long-term debt and the short-term debt, between their due dates, so as to avoid payment peaks by an even distribution of the external debt burden. It is also necessary to have a complex and coherent reimbursement strategy of the external debt, in accordance with the progress of the economic reform and with the stage of the national economy reorganisation.

### **3. The structure by creditors of the medium and long-term external public debt**

The multilateral credits hold the majority within the structure by creditors of the Romanian medium and long-term external public debt in almost every year of the surveyed period (Chart 5). This can be explained by the interest of the international financial organisations towards the evolution of the Romanian economy, but particularly by the needs of our economy for external capitals, both during the

economic boom, and especially within the context of the world economic and financial crisis, with a strong increase in 2009-2010.

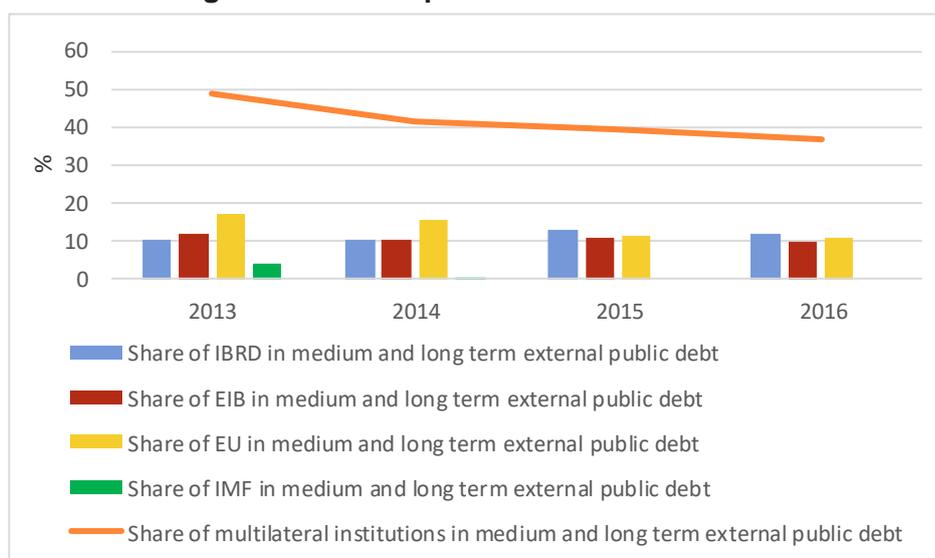
However, a decrease of the debt towards the multilateral institutions was noticed during the surveyed period, and also of the share of these credits within the medium and long-term external public debt (Chart 5).

Analysing the structure by lenders of the medium and long-term external public debt, we notice that between 2013 and 2015, on the background of returning the loans towards the International Monetary Fund (IMF) and the European Union (EU), Romania took loans from the International Bank for Reconstruction and Development (IBRD) and from the European Investment Bank (EIB) (except in 2014). In 2016, Romania has returned a part of the credits from IBRD and EIB.

Therefore, the share of the loans from EU and IMF within the medium and long-term external public debt decreased in 2013-2016, while the proportion of the loans taken from IBRD increased (particularly in 2015), and decreased in 2016. The share of the loans taken from EIB fluctuated around 10% (Chart 5). The proportion of the loans granted by the European Union is important, although it decreased from 17.20% to 11.04% between 2013 and 2016 (Chart 5).

The credits from the European Commission and IBRD are to be returned in the near future (2015-2019, and 2022-2023, respectively), which might lead to a decrease of the stock of external public debt.

**Chart 5**  
**The evolution of the structure by creditors of the medium and long-term external public debt of Romania**



Source: NBR data (National Bank of Romania, 2017) and author's calculation

Despite the media hype about the credits from the International Monetary Fund, they hold only a small proportion compared to the loans from IBRD, EIB and EU.

The loans taken from official creditors have several advantages: generally, they have a longer total period, a longer period of grace; therefore lower costs, which make them easier to honour. However, these credits have also disadvantages: limited available funds and the excessive use of this type of financing deters foreign investors, because exceptional financing is meant to support the efforts of structural adjustment of the economy and to cover the current account deficit, which raises questions about endless efforts of economic reform.

#### **4. The structure of the reserve assets of the National Bank of Romania**

The reserve assets of the National Bank of Romania increased slightly in 2014 compared to 2013, but decreased a little in 2015 compared to 2014. A new increase of the reserve assets has

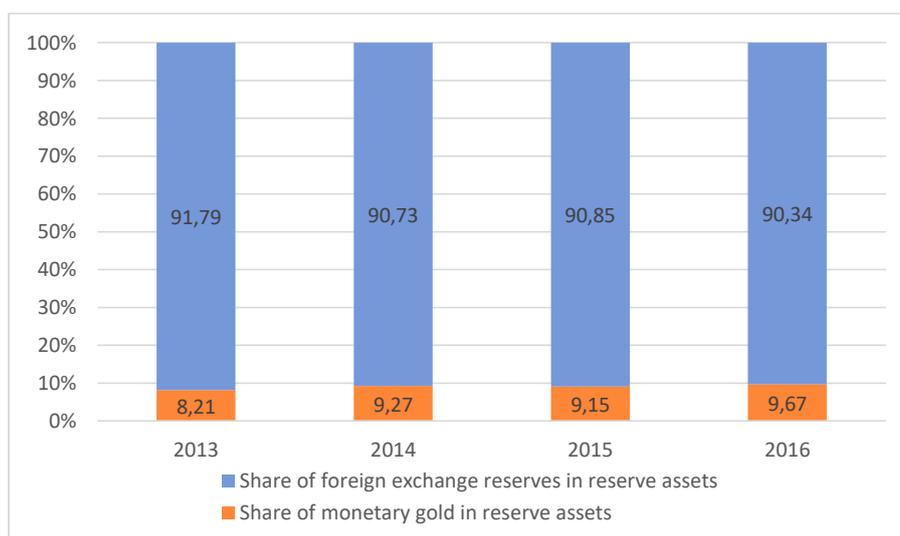
taken place in 2016, compared both to 2015 and to 2013. This evolution shows the financial and banking credibility and stability of Romania. The reserve assets, which represent those real foreign assets (expressed in hard currency) that are urgently available to the monetary authorities in order to support external credits, to finance the balance of payments, to manage the exchange rate and to maintain and increase the confidence in the national currency, must be supported by adequate and responsible public policies, which should make the most of them, as they are an important fundament for the credibility of a national economy.

Analyzing the structure of NBR's reserve assets over the surveyed period (2013-2016), we notice that the value of the monetary gold remained at a level of about 3,000 million Euro, representing a rather small, but constant proportion within the total NBR's reserve assets. The monetary gold decreased strongly in 2013 compared to the previous period but increased moderately in 2014 and 2016 on a year-to-year basis (Chart 6).

Between 2013 and 2015, the foreign exchange reserves remained almost unchanged, although in 2014 it decreased slightly, only to increase in 2016 compared to the previous year (Chart 6).

**Chart 6**

**The evolution of the components of NBR' reserve assets**



Source: NBR data (National Bank of Romania, 2017) and author's calculation

The foreign exchange reserves, expressed in months of imports, are large enough to be regarded as satisfying for covering imports, but its decrease in 2013-2016 from 7.3 months of imports in 2013 to 6.4 months of imports in December 2016, might signal imbalances in the sustainability of imports, particularly if the current unfavourable evolution continues.

## **5. Conclusions**

After 2009, year which represented a turning point in the evolution of the medium and long-term external debt and of its components, in 2013-2016, the medium and long-term external debt decreased gradually, trend which should continue in the future, particularly as the total external debt decreased also over the surveyed period, except for 2016. Thus, we may also consider 2013 as a turning point for the Romanian medium and long-term external debt, as it is the first year after 1990, when the medium and long-term external debt decreased.

Although it increased in 2014 and 2016 on a year-to-year basis, the Romanian public debt remained below the maximal threshold regulated by the European Union Treaty (60%).

The analysis of the public debt sustainability (in terms of size, residual maturity, cost of financing and structure of the basis of investors) shows that the profile of the public debt sustainability has improved lately, offsetting the increase of the public debt. Nevertheless, its fast dynamics and often the procyclic character of the fiscal policy in Romania require a close monitoring of the public debt evolution of our country.

On the other hand, the increase of the share of the short-term external debt within the total external debt of Romania, during the entire surveyed period, must also be closely monitored due to the risks to sustainability.

On the background of continuing mistrust and risk aversion of the creditors, of a still modest flow of liquidity, and of an economic activity that is still recovering after the strong effects of the global economic and financial crisis, the Romanian private non-guaranteed external debt decreased slightly in 2013-2016.

The multilateral credits represented the majority within the structure by creditors of the medium and long-term external debt in almost every year of the surveyed period showing the interest of the

international financial organisations towards the evolution of the Romanian economy, but also the need for external capitals of our economy, both during the economic boom, and especially within the context of the world economic and financial crisis. The multilateral credits decreased slightly in each year of the surveyed period (2013-2016).

I consider that the replacement of the institutional lenders by private lenders (as of 2013) is a negative evolution for the Romanian economy. Instead of paying back the old debts, we keep taking loans under harsher credit terms.

The credit conditions from abroad are still more favourable than the credit conditions offered by the banks acting in Romania, which has negative consequences on the evolution of the Romanian economy.

The almost continuous, although modest, increase of NBR's reserve assets in 2013, 2014 and 2016, with a slight decrease in 2015, reveals the financial-banking credibility and solidity of Romania.

In conclusion, the indices analysis shows a good capacity of the Romanian economy to cope with the possible negative evolutions of the external sector.

Although the indicators analysed show that the medium and long-term Romanian foreign debt is within the limits that are considered sustainable internationally, an analysis of the causes which have led to this ever increasing trend of the foreign debt in Romania and of how much the foreign debt has supported the economic growth of Romania might be appropriate.

### References

1. Georgescu G. (2016), *Prospects of Romania's international investment position and financial stability risks*, Munich Personal RePEc Archive, <https://mpra.ub.uni-muenchen.de/69501/>
2. International Monetary Fund (2016), *Report on the International Investment Position of Romania* <http://dsbb.imf.org/pages/sdds/DQAFBase.aspx?ctycode=ROU&catcode=IIP00>
3. International Monetary Fund (2014), *External Debt Statistics Guide For Compilers And Users*, <http://www.tffs.org/pdf/edsq/ft2014.pdf>

4. International Monetary Fund (2009), *Sixth Edition of the Balance of Payments and International Investment Position Manual* (BPM6), <http://www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf>
5. Milea C., Ailincă A., Bălășescu F. (2017), *Starea financiară a României – anul 2016, Evaluarea echilibrului extern*, Center for Financial and Monetary Research – Victor Slăvescu, Bucharest.
6. Milea, C. (2009), *The balance of payments of Romania. Factors of influence. Restrictions and opportunities*, PhD thesis, Romanian Academy, Bucharest.
7. National Bank of Romania (2017), *Monthly Bulletin January-August 2017*, year XXV, no. 279, ISSN 1584-0840, Bucharest.
8. National Bank of Romania (2008-2014), *Monthly Bulletin – December 2007- January 2014*, Bucharest.
9. National Bank of Romania (2017), *Report on Financial Stability 2016*, p.p. 163-180, ISSN 1843-3243 Bucharest, (online version), [www.bnr.ro/files/d/Pubs\\_ro/RSF/RSF2016dec.pdf](http://www.bnr.ro/files/d/Pubs_ro/RSF/RSF2016dec.pdf)
10. National Bank of Romania (2015), *Report on Financial Stability 2015*, p.p. 163-180, ISSN 1843-3243 (online version), Bucharest.
11. National Bank of Romania (2016), *Annual Report 2015 – Balance of Payments and International Investment Position of Romania*, ISSN 1584-0956 (online version), Bucharest.
12. National Bank of Romania (2015), *Annual Report 2014 – Balance of Payments and International Investment Position of Romania*, ISSN 1584-0956 (online version), Bucharest.
13. National Bank of Romania (2013), *Annual Report 2012 – The balance of payments and the international investment position of Romania*, Bucharest.
14. \*\*\*, <http://www.bnro.ro/page.aspx?prid=12877>
15. \*\*\*, (2015), *BSP Implementation of BPM6*, <http://www.bsp.gov.ph/downloads/Publications/FAQs/bpm6.pdf>
16. \*\*\* [www.bnro.ro](http://www.bnro.ro) December 2012 - August 2017.