AN OVERVIEW OF ROMANIA'S FOREIGN DEBT OVER THE RECENT YEARS

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Abstract:

The paper analyses indicators reflecting the state of Romania's foreign debt by maturity and creditors, as well as the structure of the reserve assets held by the National Bank of Romania (NBR), over the period 2013-2015. One may notice that during the surveyed period, the medium and long-term foreign debt has decreased gradually. The private foreign debt has had the same trend, on the background of the mistrust and risk aversion of creditors, but also of a modest flow of liquidity and of the economic activity still recovering after the strong effects of the global economic and financial crisis. As revealed by the analysis, in the structure by creditors of the medium and long-term foreign debt, the multilateral loans have been prevalent. The almost continuous, yet modest, increase of NBR' reserve assets shows the financial and banking credibility and stability of Romania. The paper is based on the chapter "Assessing the external equilibrium", from the research project "The financial state of Romania" elaborated in "Victor Slăvescu" Centre for Financial and Monetary Research in 2015, under the coordination of PhD Constantin Marin

Key words: foreign debt, reserve assets, public debt, sustainability

JEL classification codes: F34, H63

Introduction

The foreign debt is important particularly in terms of sustainability, since it affects the future economic development of any particular country.

On the background of the global microeconomic and macroeconomic evolutions, and of the demands of information users, the methodological framework governing the foreign sector statistics has been renewed. Thus, as of 2014, the international methodology standard for drafting the balance of payments and the international investment position has been updated. The new methodology, presented in the IMF Handbook *Balance of Payments and International Investment Position, sixth edition* (BMP6), replaces the BMP5 version from 1993. The new methodology aims to support a higher level of completeness, coherence and harmonization between the balance of payments and other sets of macroeconomic data such as: national accounts, statistics of the governmental finances, monetary and financial statistics, etc.

Description of the problem

The foreign debt of Romania, although at a sustainable level according to the international standards, has increased almost continuously after 1990, on the background of the needs of the national economy and of the insufficient domestic capital.

After 2009, which represented a turning point in the evolution of the medium and long-term foreign debt and its components, during 2013-2015, the medium and long-term foreign debt has decreased gradually, against a shrinking total foreign debt. The public foreign debt has increased in 2014, compared to the previous year, and has decreased slightly in 2015, being, nevertheless, still higher than in 2013.

The private foreign debt has diminished slightly from 2013 to 2015, on the background of continuing mistrust and risk aversion of creditors, but also of a still modest flow of liquidity and of the economic activity still recovering after the strong effects of the global economic and financial crisis.

As shown by the structure of the foreign debt by creditors, the multilateral loans have been prevalent, almost every year of the surveyed period, which shows the interest of the international financial institutions for the evolution of the Romanian economy, as well as the need of the

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Romanian economy for foreign financing both during the period of economic boom and, particularly, within the context of the world economic and financial crisis. In each year of the surveyed period (2013-2015), the multilateral credits have decreased slightly.

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

Methodology and data sources

Hereinafter, based on the BMP6 methodology, we shall calculate and analyse in dynamics several primary and relative indicators, which highlight the evolution of the short, medium and long-term foreign debt, as well as of the structure of the medium and long-term foreign public debt, and also the structure of reserve assets held by the National Bank of Romania.

We shall also try to document the importance of understanding this field for the proper management of the macroeconomic policies.

The data have been taken from NBR statistics.

Results obtained

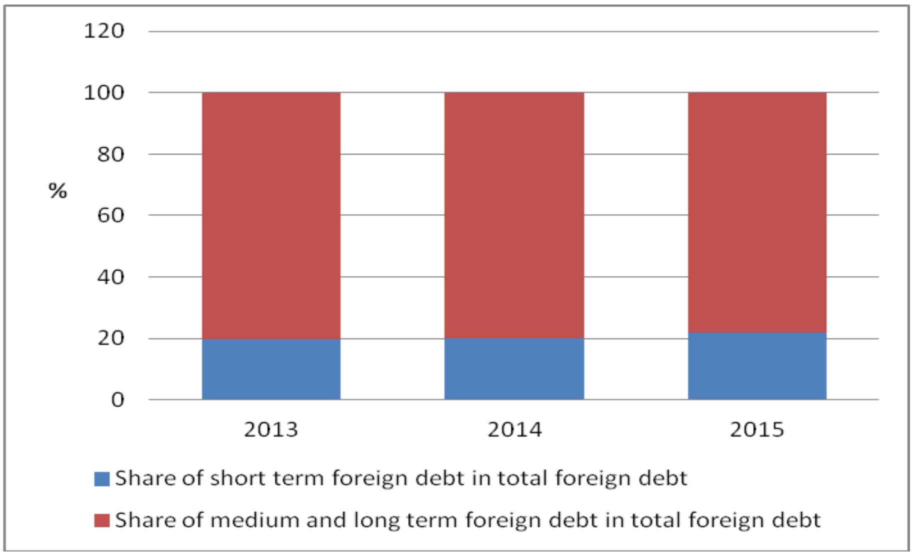
1. Indicators for the short, medium and long-term foreign debt

The total foreign debt displayed a decreasing trend in 2013-2015, which has been stronger in 2015, when the decrease was of 8.2 percentage points, compared to the level of 2013 (Milea, 2014).

Regarding the structure by maturity of the foreign debt, one may notice that the proportion of the short-term foreign debt within the total foreign debt has increased in 2013-2015, being around 20%, which shows a rather adequate structure of the foreign debt. Nevertheless, in terms of value, the short-term foreign debt has decreased in 2014 and has increased in 2015.

The medium and long-term foreign debt holds the majority share in Romania's total foreign debt in the surveyed period (see Figure 1). As we know, a longer maturity can support the sustainability of the national economy since the burden of the debt is spread on a longer period of time, so that it represents no burden for the budgetary decisions of the government and it doesn't endanger its development projects. Compared to 2013, the medium and long-term foreign debt has diminished in 2014 and in 2015, both as a absolute value and as a share of total foreign debt, on the background of the total foreign debt's decrease. Romania's medium and long-term foreign debt has had a turning point in 2013, which was the first year after 1990, when the medium and long-term foreign debt diminished (Milea, 2014).

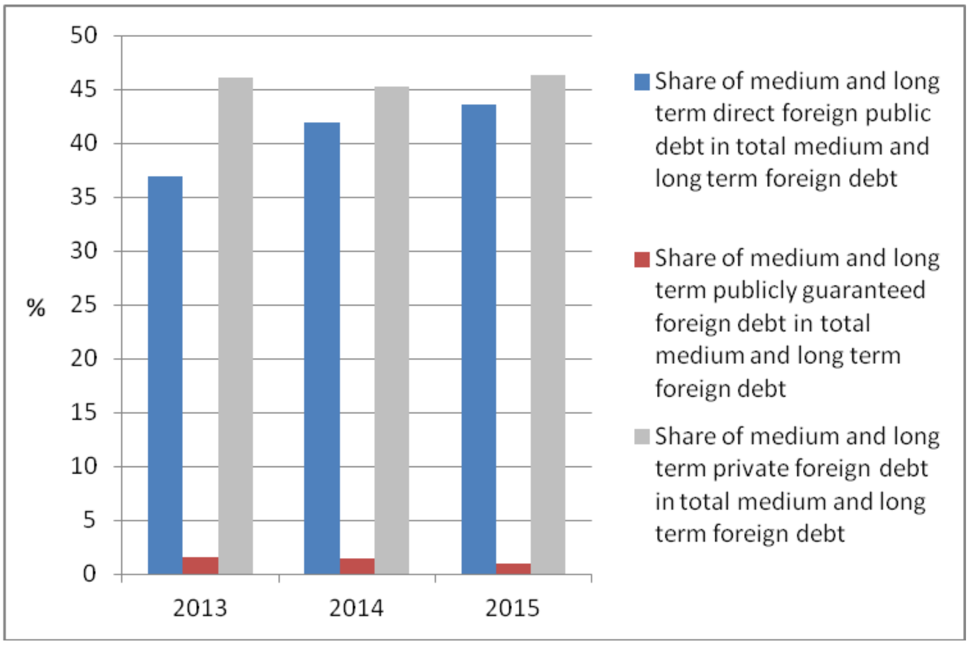
Figure 1 – The trend of the short term and of the medium and long-term foreign debt of Romania (%)



Source: NBR data

In terms of creditors, the public foreign debt has increased in 2014 and has decreased in 2015. However, the proportion of the foreign public debt within our country's medium and long-term foreign debt has augmented in 2013-2015. This evolution of the foreign public debt has been determined mainly by the evolution of the direct foreign public debt, and less by the publicly guaranteed foreign debt, which has decreased in each year of the surveyed period (2013-2015). The proportion of the medium and long-term publicly guaranteed foreign debt within the total medium and long-term foreign debt also displayed a decreasing trend (see Figure 2).

Figure 2 – The trend of the components of the medium and long-term foreign debt in Romania (%)



Source: NBR data

In the period before the crisis, the increase of the public debt has been offset by a higher rate of economic growth, but after the onset of the global economic and financial crisis, the access of Romania to financing on the international capital market has been strongly limited. In this situation, Romania required assistance from the international financial bodies (such as the World Bank, EU, IMF), on the condition of adopting painful domestic restructuring measures. The public debt increased strongly in 2009-2011, as means of financing the budget deficit; requiring later for the fiscal consolidation several other adjustments, even tougher than those generated by the effects of the financial crisis (e.g. cutting of the public wages, the reduction of some public expenditure, the decline of public investments, the latter being maintained, however, over the budget deficit).

According to the Financial Stability Report (FSR) from 2015, although Romania's public debt (38.6% of the GDP at the end of 2015 – FSR 2016, lower than in 2014, 39.8% of GDP), is still below the maximal level regulated by the Treaty of the European Union (60%), and below the value reported by most EU member states, its high dynamics, due to the financial crisis, to the process of fiscal consolidation or to the procyclic character of the Romanian fiscal policy, requires a deeper analysis.

The foreign debt had the largest contribution to the decrease of the public debt stock between December 2014 and December 2015, with a share of GDP decreasing slightly from 20.7% to 19.1%, while the domestic debt has increased during the same interval (by 0.3 percentage points, to 19.4% of GDP (FSR 2016).

According the RSF 2015, after 2012, the public debt also increased due to the creation of a hard currency financial reserve, available to the Ministry of Public Finances, meant to cover the requirement of liquidity of the state, covering entirely the foreign public debt service and about 50% of the total public debt service. It must be mentioned that the hard currency financial reserve, available to the Ministry of Public Finances, which represents also an asset element, is included in the total public debt, which makes the net foreign public debt to be significantly lower than the figures from the statistics (for instance, in 2014 it represented 35.3% of the GDP, according to FSR 2015).

According to RSF 2015, the "sustainability of the public debt must be evaluated from at least four points of view: its size, the residual maturity, the cost of financing and the structure of investors' base".

In terms of the size of the public debt, Romania is still below the critical threshold which might trigger economic recession (according to FSR 2015, it is calculated econometrically to 40-45%), but very close to it, which calls for a prudent maintenance (below 3% of the GDP) of the budget deficit.

The medium residual maturity of the public debt has expanded between 2008 and 2015, according to FSR 2015, which is important for the decrease of the refinancing risk and for the diminishment of the annual financing requirement. In terms of the public debt sustainability, a maturity inadequate to the needs may be a risk factor even more important than the level of the public debt.

The measures of fiscal consolidation and attaining the macroeconomic balances, the improvement of the country rating given to Romania by the main rating agencies, and the inclusion of the Romanian state securities within some international reference indicators for the investments in assets of the emerging states, are aspects which generated the increase of the average maturity of the newly issued securities, and the improvement of the liquidity on the secondary market. During the following period, particular attention must be granted to the need to refinance titles issued previously, the public debt being estimated to peak in 2016. Furthermore, about 29% of the state securities stock (worth of 11.8 billion Euros), is due in 2015-2016, while the rest is spread up to 2044. Under these circumstances, the fiscal-budgetary policy for 2015-2016 must remain within prudent limits, aiming to refinance the due debts in, as good as possible, terms of cost and maturity (FSR, 2015).

A positive fact is that the financing costs for the public debt have decreased significantly in the period 2008-2015, while the debt has increased three times. Within the context of a possible trend reversal at the international or regional level, the cost of public debt financing might become a risk factor for its sustainability. The "reduction of the public debt financing costs has been influenced both by the favourable external conditions (very low interest rates and high liquidity), by the domestic macroeconomic structural adjustments (decrease of the budget deficit, lower inflation rate) and by the liquidity conditions from the local monetary market" (FSR, 2015).

The level of concentration of the investors' base regarding the public debt has decreased between 2009 and 2014, according to FSR 2015, but the financing of the public sector has been largely done by the banking sector; however, this trend might reverse in the future on the background of the changes from the banking sector (due to the implementation of the European proposals meant to increase the capital requirements for the exposure to the sovereign debt, to the rebirth of the demand for credits and to the need to boost the economic growth). In terms of the financial stability, the strengthening of the relation between the public debt and the local banking sector, had also positive consequences such as: improved liquidity of the banks, lower risk of regional contagion within the banking system, in the context of uncertainties in the euro zone, and the avoidance of an erratic financial desintermediation within this sector.

According to FSR 2015, the capacity for additional financing of the public sector by the local banking sector is still limited, under the conditions in which the exposure of the credit institutions towards the public administration is important (21.5% of the total banking assets, in December 2015).

As of 2012, the Romanian state has diversified the foreign markets by issuing state bonds on the US market. The Romanian state bonds in US Dollars account at present for a third of the value of the foreign markets' issuance, according to data from July 2015. A higher fiscal deficit, most probably, will have to be largely financed by non-residents (given the important exposure of the residents on such portfolios). The higher proportion of non-residents financing the public debt might increase the risk of contagion if the international markets will experience changes in the risk appetite of the investors (FSR, 2015).

In conclusion, regarding the sustainability of the public debt, according to FSR 2015, "the average residual maturity has increased, the costs with the interests have decreased, and the portfolio of investors in state securities has diversified. Therefore, the profile of the public debt sustainability has improved over the recent years, offsetting the increase of the public debt. The stock of the public debt has, nevertheless, to be monitored carefully, given its significant increase compared to 2008".

The Romanian medium and long-term private foreign debt has decreased from 2013 to 2015, on the background of a continuous risk aversion of the creditors, of a still low liquidity, of an economic activity still below its potential, as a consequence of the effects of the global and regional economic and financial crises, particularly the euro zone debt crisis. Before the outburst of the crisis, the private sector usually borrowed from the foreign markets, against rather advantageous costs compared to the cost of the domestic sources of financing, due to the still high interest rates for credits in Romania, and to the persistence of the overvalued real exchange rate of the national currency, and sometimes, to the inadequate behaviour in the crediting process of the banks operating in Romania. Within this context, in the years before the crisis (2009, included), on the background of the optimism generated by the economic boom, the foreign debt of the private sector increased significantly.

The private foreign debt represented most of the Romanian medium and long-term foreign debt in the period 2005-2010, which shows, on the background of a macroeconomic context still dominated by uncertainty, a significant increase of the dependency on the foreign financial markets. A good thing for the sustainability of the Romanian foreign debt is the decrease of the weight of the private foreign debt below 50%, as of 2011. The analysis also shows that the proportion of the public foreign debt has been almost equal, in 2014 and 2015, to the proportion of the Romanian private foreign debt within the medium and long-term foreign debt, but remained, however, lower than the latter (see Figure 2).

In 2013-2015, the balance of the financial account showed, unlike the previous years, capital outflows on the background of an increase in the net assets larger than the boost of the net liabilities, which means higher rights over non-residents, therefore a positive influence on the international investment position. This has occurred in 2013-2015, due to paying back the long-term credits, despite the inflow of foreign direct investments and portfolio investments (except in 2015 for the portfolio investments). The loans taken by Romania from the securities market at the same time with the decrease of the foreign long-term loans signifies the replacement of the institutional creditors by private creditors. Under the conditions in which the debt from the multilateral institutions is cheaper, taking into account the interest rate demanded for the countries perceived as riskier on the international private capital markets; the longer period of grace; and the longer total duration, the replacement of the creditors shows a deeply negative evolution of the Romanian economy. Instead of paying back the already committed foreign debt, we keep on making more debts, under harsher terms (Milea, 2014).

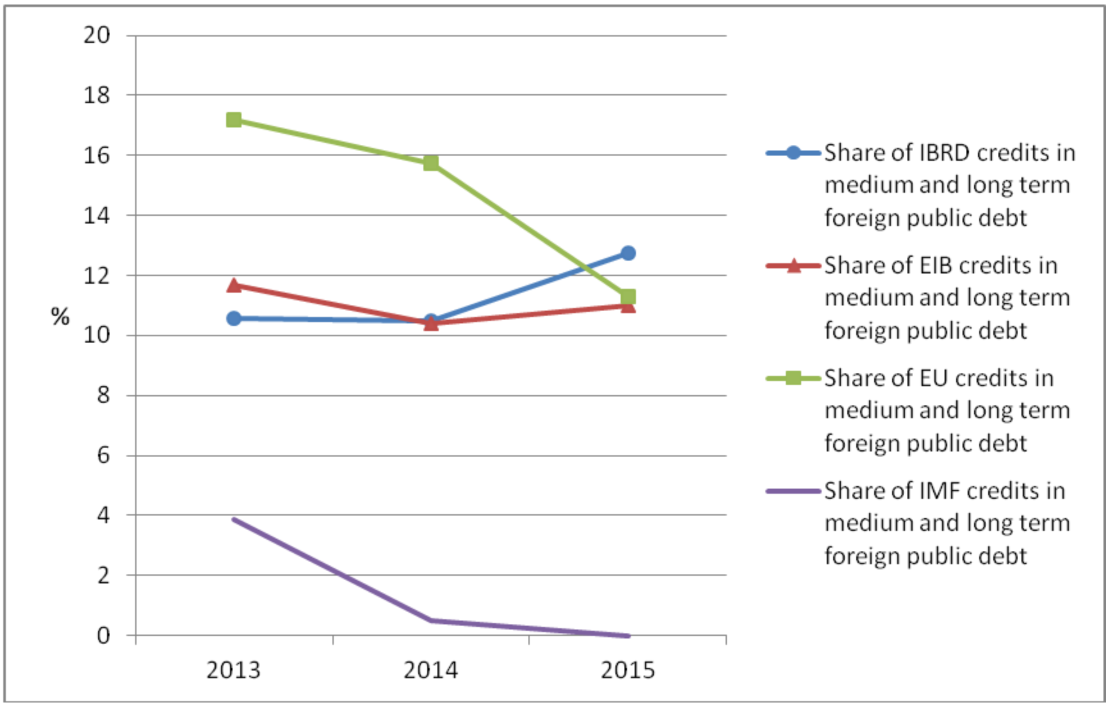
This shows the importance of a complex and coherent strategy for paying back the foreign debt, in close relation with the still low level of restructuring of the national economy, and with the progress of the economic reform. A national borrowing strategy must be drawn up and observed; which should establish an optimal ratio between the medium and long-term debt and the short-term debt, respectively between their due dates, so that the burden of the foreign debt should be spread uniformly along the years, thus avoiding payment peaks.

2. Indicators for the structure by creditors of the medium and long-term public foreign debt

In the structure by creditors of the medium and long-term public foreign debt, the majority proportion has been held by the multilateral credits almost every year of the analysed period, which shows the interest of the international financial organisations for the evolution of the Romanian economy, as well as the needs of the Romanian economy for external financing both during the economic boom and, particularly, within the context of the world economic and financial crisis. However, it can be noticed a decrease of the proportion of the multilateral institutions within the medium and long-term public foreign debt during the analysed period (NBR, 2016).

Analysing the structure by creditors of the medium and long-term public foreign debt, we notice that between 2013 and 2015, on the background of reimbursing the loans to the International Monetary Fund (IMF) and EU, Romania has borrowed from the International Bank for Reconstruction and Development (IBRD) and from the European Investment Bank (EIB) (except for 2014) (NBR, 2016). Thus, the weight of the EU and IMF loans has decreased significantly in 2013-2015, while the weight of IBRD loans has increased (particularly in 2015), and the weight of EIB loans has remained around 11%. The proportion of the loans from the European Union is important, although it has decreased from 17.20% to 11.32% in the period 2013-2015 (see Figure. 3).

Figure 3 – The trend of the structure by creditors of the medium and long-term foreign public debt in Romania



Source: NBR data

The loans from the European Commission and IBRD are to be paid back in 2015-2019 and in 2022-2023, which might decrease the stock of foreign public debt.

Despite the excessive mediatisation of the loans from IMF, they have a lower weight than those from IBRD, EIB and EU.

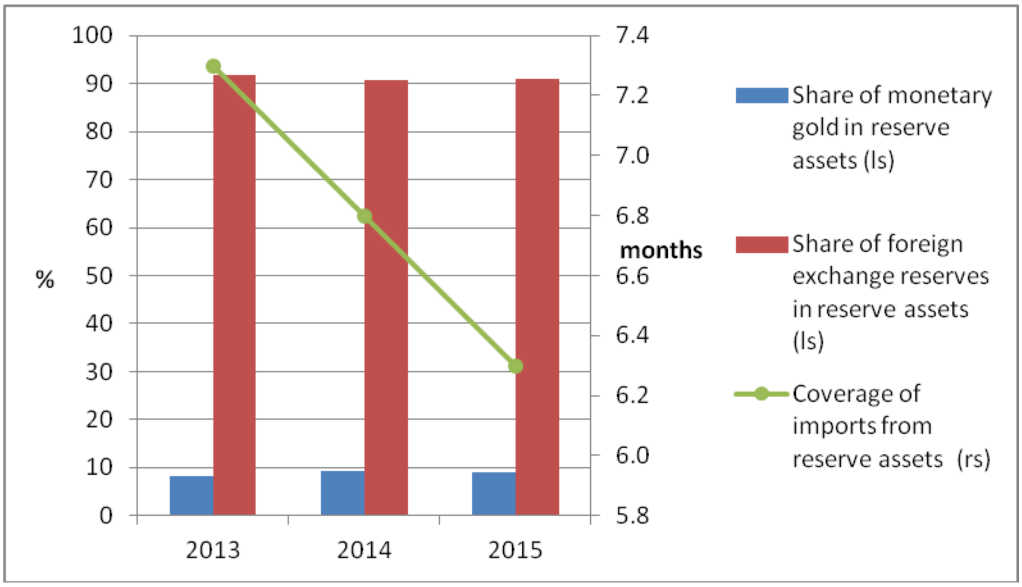
The loans from official creditors have several advantages: generally, their costs are lower, they have a longer period of grace, a longer total duration, which alleviates the paying back effort. These loans have also disadvantages: limited available volume; the extended use of such type of financing conveys a not encouraging message towards the foreign investors, because the exceptional financing is meant to cover the current account deficit and to support the structural adjustment of the economy. Within the context, this signal means efforts to reform the economy, never properly accomplished (Milea, 2014).

3. Indicators for the structure of the reserve assets of the National Bank of Romania

The reserve assets of the National Bank of Romania have increased slightly in 2014, compared to 2013, but they have decreased slightly in 2015, compared to 2014. This evolution reveals the financial-banking stability and credibility of Romania. The reserve assets are those actual external assets (expressed in hard currency) that can be urgently available to the monetary authorities to manage the exchange rate, to finance the balance of payments, to support foreign credits and to maintain and improve the confidence in the national currency. They are fundamental for the credibility of a national economy, and they must be supported by adequate, responsible public policies, which should make best use of them.

The structure of the reserve assets of NBR shows that although the monetary gold holds a low proportion within the total (about 9%) and it has decreased severely in 2013, compared to the previous period, its value still amounts to about 3,000 million Euros in 2013-2015, with a moderate increase in 2014 compared to 2013 (see Figure 4).

Figure 4 – The trend of the components of NBR's reserve assets



Source: NBR data

In the surveyed period, the foreign exchange reserves of our country have remained almost unchanged, although they have decreased slightly in 2014.

The coverage of imports from reserve assets (in months of imports) is high enough to be considered at an acceptable level to cover the imports. However, its decrease from 7.3 months of imports in 2013 (NBR, 2014) to 6.3 months of imports in 2015, may be a warning concerning the sustainability of imports, particularly if the unfavourable evolution continues.

Conclusions

The structure of the foreign debt in terms of due date is rather adequate, the short-term foreign debt not exceeding 20% in the surveyed period.

Although the public debt of Romania is below the maximal standards set in the EU, its fast dynamics and the often procyclic character of the Romanian fiscal policy require a close monitoring of the evolution of the public debt stock.

The public debt sustainability has improved during the recent years on the background of a longer residual maturity, of lower interest rates costs and due to the diversification of the investors in state securities.

A good fact for the sustainability of the Romanian foreign debt is the decreasing proportion of the private foreign debt, which went below 50% since 2011. Toward the end of the analysed period, the share of private foreign debt got near the proportion of the public foreign debt within the medium and long-term foreign debt, being slightly higher than it.

The loans taken by Romania from the bonds market, along with the decrease of long-term foreign loans, signifies the replacement of the institutional creditors with private creditors. Under the conditions in which the loans from the multilateral institutions enjoy better terms (lower interest rates, longer period of grace, longer total duration), the replacement of creditors shows a deeply negative evolution of the Romanian economy. Instead of paying back the existing foreign debt, we keep borrowing, under harsher conditions.

The almost continuous, yet modest increase of the NBR’s reserve assets reveals the financial-banking credibility and stability of Romania.

We conclude by highlighting the importance of a complex and coherent strategy of reimbursement of the foreign debt, in close correlation with the level of national economy reorganisation and with the progress of the economic reform. It is also necessary to draw up and observe a national borrowing strategy, which should consider setting an optimal ratio between the medium and long-term debt, and the short-term debt, between their due dates, so that the burden of the foreign debt is spread uniformly along the years, thus avoiding the payment peaks.

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