TRENDS IN THE NEW EU MEMBER STATES MACROECONOMIC POLICIES TO ADOPT THE EURO. PERFORMANCE OF THE ROMANIAN MACROECONOMIC POLICIES TO ADOPT THE EURO

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Rezumat

Criza financiară globală a creat noi provocări pentru țările care s-au alăturat Uniunii Europene în 2004 şi în 2007, dar nu sunt încă membre ale zonei euro, menținerea indicatorilor de convergență sub valorile de referință fiind pentru noile state membre ale Uniunii Europene o reală provocare. În acest studiu ne propunem o evaluare a politicilor macroeconomice de adoptare a monedei euro în aceste țări, pornind de la analiza stadiului de îndeplinire a criteriilor nominale de convergență şi identificând apoi câteva caracteristici ale conduitei politicilor macroeconomice, precum şi importanța reformulării şi recalibrării acestora, pentru a răspunde problemelor actuale.

Abstract

The global financial crisis created new challenges for the states that have joined the European Union in 2004 and 2007, but that are not yet members of the Euro zone; the maintenance of the convergence indicators below the reference values is a real challenge for the new EU member states. This study aims to evaluate the macroeconomic policies which these countries implemented in their endeavour to adopt the Euro. It starts from the analysis of the stage of meeting the nominal criteria of convergence and it subsequently identifies some characteristics of the macroeconomic policies, stressing on the importance of reformulating and recalibrating these

macroeconomic policies so that they can cope with the current challenges.

Keywords: nominal criteria of convergence, adoption of the Euro, economic and financial crisis, new member states, macroeconomic policies

JEL classification: E24, E31, E52, E58, E62

As of mid September 2008, the financial crisis which by then had manifested only in the developed states, entered a new period by directly affecting the new member states[1]. The concerns increasingly related to the recession and to the deterioration of the financial situation by an increased risk-aversion were the main traits of this new period. The lack of liquidity on the global markets and the risk revaluation by the international investors have reduced the availability of credits for the real economy, for the companies and households, which hastened the decline of demand; this decline transferred on to the productive and commercial activity which declined dramatically in the analysed countries. The distrust towards some emerging countries caused the interbanking liquidity to decrease, which, in turn, produced record increases of the interbanking interest rates in most new member states. The analysis of the macroeconomic evolutions in the new member states shows common manifestations of the effects induced by the crisis: economic recession, lower inflationist pressure, periods of the national currency depreciation (in the countries with flexible currency regime) and dramatic corrections of the balance of the current account of foreign payments balance, meaning lower deficits.

[1] *Until that moment these countries didn't suffer serious turbulences on the financial markets because the banks from these states hold very little toxic assets, or even at all, and the financial innovations are very weak. Only Latvia experienced financial problems as of early 2007.*

Considerations on the stage of meting the nominal criteria of convergence by the new member states within the process of adopting the Euro

Overall, before the crisis burst out, an increase of the **inflationist phenomenon** has been noticed in 2008 in all the analysed new member states, Slovakia being the only country with levels below the reference value. The factors which contributed to the increase of the inflationist pressure in the new member states were largely the same (internally: higher private consumption, labour force deficit, adjustments of the administrated prices and of the indirect taxes; externally: increased prices for foods and energy). During the first half of 2009, although inflation decreased in all nine new member states on the background of the unfavourable economic evolution, it still was above the reference value. This was due mainly to the even more dramatic decrease of the reference value compared to the inflation level from the analysed countries. Inflation tempering in the new member states will probably persist during the subsequent period, but the criterion remains difficult to accomplish.

Although until 2008, the new member states didn't exceed the reference values concerning the **average long-term interest rates** (except for Hungary and Romania), in 2008, other states failed to meet this criterion: Latvia, Estonia and Poland. The average long-term interest rates from all the Baltic States and from Bulgaria can easily exceed the limit imposed by this criterion. An explanation for this unfavourable situation is that the long-term evolution of the interest rates is largely influenced by the increased fears of higher budgetary deficits and of economic and politic instability and by the persistent perception of risks related to a negative economic growth during the subsequent period.

In terms of **exchange rate**, during 2004-2008 all the new member states have met this convergence criterion. In 2008, the exchange rate of the countries with monetary council remained unchanged (Bulgaria, Estonia, Lithuania), while the national currency of Latvia, Romania and Hungary depreciated, the largest depreciation being recorded for the Romanian leu. During the first eight months of 2009, the national currencies of the countries without a monetary council depreciated compared to the December 2007 value (except for the Czech crown, which appreciated towards the end of this period), the

Romanian leu followed by the Polish zloty displaying the larges depreciations. In 2010, Eurostat forecasts show that all new member states will meet the exchange rate criterion of convergence. An explanation for the depreciation of the exchange rate under conditions of economic crisis may be the fact that in the case of a fixed exchange rate, the convergence of the monetary indicators can be done through a strong modification of the inflation, while in the case of a floating exchange rate, the convergence of the monetary indicators can be done either by adjusting the exchange rate, or by adjusting inflation, or by both phenomena simultaneously. Therefore, it is explainable why in the following period we may witness a stronger deflation in the countries with monetary council than in the countries with a floating exchange rate.

If before the emergence of the first signs of the global economic and financial crisis, the main problems of the new member states related to the failure to observe the inflation criterion, after this moment, the main deficiencies shifted top the fiscal-budgetary area. Almost all new member states have fiscal flaws during this period. Thus, the criterion of the **budgetary deficit** ha not been met in 2008 by Lithuania, Latvia, Hungary, Poland and Romanian, although the previous year only Hungary was above the reference value. For 2009 and 2010, the states that will probably fail to meet this criterion seem to be somehow different: in 2009 Slovenia, Poland and Estonia will join the sphere of non-accomplishment, while Lithuania and Hungary will exit this area. The new member states are better placed than many of the Euro zone countries although they exceeded the reference value for the deficit of the consolidated general budget. Latvia and Romania are still confronted with serious problems generated by the strong increase of this indicator, which will persist in 2009-2010 on the background of the strong repercussions of the economic and financial crisis in Latvia and of the political instability in Romania.

The **public debt** increased in all new member states because of the increasing deficits and of the operations such as banking recapitalization and credits to private companies. In Hungary, the level of the public debt increased much the 2008 reference value, situation which will persist in 2009, being the only country experiencing real difficulties in observing this criterion. The explanation of this situation resides in the fact that most of the

governmental debt is foreign, while the combination of the foreign currency debt revaluation because of the (forint/Euro) exchange rate depreciation and the pessimistic forecasts of the economic growth caused the value of this indicator to increase and remain at a very high level.

The analysis shows that the process of meeting the criteria for nominal convergence by the new member states turned much more difficult and complex due to the economic-financial crisis: inflation tempering is not very obvious; the fiscal-budgetary deficit is worsening; the exchange rate stability is endangered by a high volatility of the exchange rates.

The new EU member states, irrespective of their **strategy of monetary policy** which they adopted had quite positive economic evolutions before the world financial and economic crisis burst out. The economic growth was extremely strong, driven particularly by the inflows of foreign capital and interconnected with the excessive demand on the market for goods and services, demand which generated, nevertheless, profound negative implications such as: increased current account deficit, higher foreign debt, faster increase of the wage than of work productivity, higher inflation. In the countries which use inflation targeting, in relation to the Euro, it helped partially to reduce inflation.

The monetary policy changed relatively once the global economic and financial crisis broke out in all the countries targeting the exchange rate by a less restrictive attitude of the monetary policy, in which the “relaxation” occurred rather in the requirements for the compulsory minimal reserves than in interest rates adjustment. The attitude of the monetary policy changed in mid 2008 in the inflation targeting countries under the conditions of a changed balance between the inflation risks and the economic growth risks: if until then the monetary policy attitude was restrictive, for fear of increasing inflation, after this period the central banks relaxed this attitude by gradually reducing, more or less aggressively, the monetary policy interest rates.

Within the new international context, the monetary policy of Romania also “loosened” its attitude, recalibrating its setoff instruments of monetary policy, by the concomitant reduction of the key interest rate (in three stages during 2009: February 4, by 0.25 pp;

in May, by 0.5 pp and in June, by another 0.5 pp, the interest rate reaching 9%) and of the minimal compulsory reserves, the relaxation of the monetary policy aiming to stimulate the activity of the Romanian economy. This measure intended to bring a surplus of liquidity to the banks that might be directed, via credits, to the population and companies.

During the following period, the behaviour of the monetary policy in all new member states will take into account the forecasts on the evolution of the real economy, which claim a further reduction of the interest rates (because of the lower inflation and wider production gap) and a better alignment of them to the interest rates of the European Central Bank, while not disregarding the fact that the excessive, fats reductions of the interest rates might cause either depreciation of the exchange rates in the countries without monetary council, or inflation increase in the countries with monetary council, which is in disagreement with the economic basics. Therefore, the monetary policy in all new member states should take into consideration not just the accomplishment of the criterion of consumer price stability, but also the accomplishment of the long-term financial stability.

In terms of **exchange rate evolution** of the national currencies of the EU member states outside the Euro zone which didn't join the ERM II, the evolutions varied much from one country to another. Most national currencies were rather stable during the first half of 2008, while others, such as the *Czech crown,* the *Magyar forint* and the *Polish zloty* appreciated and reached record parities against the Euro. However, as of October, the deepening financial crisis generated the rapid and strong depreciation of several national currencies, particularly of the *Polish zloty, Magyar forint* and *Romanian leu*, and less of the *Czech crown*.

Within the context of the global financial and economic crisis most of the central banks from the Central and Eastern Europe were confronted with strong speculative attacks on their national currencies. The economic-financial crisis expanded indirectly over the economies of the new member states through several channels: financial, commercial, investor's trust in these economies, and also through the exchange rate, when the lower foreign financing reflected in the depreciation of the national currencies of the countries without

a monetary council. Therefore, under conditions of crisis, the defence of the national currency against its strong depreciation, without a solid economic basis, becomes one of the immediate objectives of the central banks operating a floating exchange rate.

Notable changes appeared lately in the shift to ERM II and, subsequently, to the Euro. Thus, Bulgaria, Romania, Czechia, Hungary and Poland were not and still are not within the ERM II, while the Baltic States and Slovakia had joined the ERM II. In November 2008, the Polish government adopted a plan to shift to the Euro by 2012, the accession to ERM II being planned for 2009, which actually didn't happen. In Poland there also is a politic aspect, the adoption of the Euro requiring amendments to the Constitution, therefore political consensus. According to the governor of the Czech central bank, the adoption of the Euro in this country is possible during 2013-2015. The Baltic States set a medium-term for their shift to the Euro: Estonia in 2011, Latvia in 2014, Lithuania in 2011-2012. The Romanian authorities proposed joining ERM II as test of the national currency parity by 2010-2012 in an attempt to minimize the risks and vulnerabilities. If initially, the main goal was to go past the inflation criterion, lately the most important challenge refers to meeting the fiscal criteria.

The monetary criteria are extremely important in reaching the **sustainability of the fiscal-budgetary policies** because they can impede or facilitate meeting the fiscal criteria. An argument is that slowing down inflation is less important than the danger of the dramatic reduction of the economic growth, while within the context of meting the fiscal criteria, exchange rate targeting may a better strategy than the aggressive targeting of the inflation, which may worsen the fiscal deficits. Such an example is the recent situation. Thus, if during the recent years Hungary was the only country with an excessive deficit from all the analysed countries, as of 2008, Romania became the great problem, its excessive budgetary deficit being 5.2% of the GDP.

Focusing almost exclusively on meeting the fiscal criteria will have the advantage of an economic policy which maximizes the principle of subsidiarity in all the decisions imposed by the accession. In this way, any macroeconomic decision that affects the accession of the countries candidate to the Euro zone remains at their hands and is

not affected by the political decisions taken elsewhere, allowing them to make even fiscal-budgetary adjustments as needed. At the same time, although the fiscal-budgetary indicators display strong deviations, in evaluating the sustainability of the public deficit and debt in the new member states it is important that the forecasts take into consideration the economic support of the analysed countries, their productive potential, their competitiveness and infrastructure.

The world crisis has a strong influence on the **labour market evolution** by decreasing the employment rate and by the spectacular increase of the unemployment rate in all analysed states. The dramatic decrease of the employment rate and the higher unemployment rate were not tempered by governmental measures to freeze, or even to decrease substantially the income, because the fiscality and the other levies still are a significant proportion of the labour force costs. Furthermore, during the subsequent period, the measures that aimed to decrease labour force fiscality and job creation were not will not be put into practice because of the effects of the economic crisis on the budgetary deficits, already large enough. Therefore, the governments of the new member states should take into consideration limiting the effects of the crisis by maintaining a satisfactory level of the social protection and by maintaining and creating jobs where possible.

The implementation of multiannual public budgets, the stability of the fiscal code, the stability of the labour market and social legislation are just few measures that might ease the current situation not only on the labour market, but also on other major macroeconomic areas in the new member states.

In 2008, the **situation of the current account and of the capital account** in the EU member states that are outside the Euro zone differed from country to country. Thus, the average current account deficit within the GDP was the lowest in the new member states that didn’t adopt the Euro and that are not ERM II members (-6.6% in the period 2004-2008, Romania having the highest value from this group), while the highest average was displayed by the ERM II countries plus Bulgaria (-14.1%). The new member states that have adopted the Euro had an average current account deficit of -7.4%. The states with a fixed foreign currency regime had higher current

account deficits. Some countries (Hungary, Poland, Czechia, Slovakia and Slovenia) improved or stabilised lately their current account deficit after a period of high values of the deficit. Other countries (Bulgaria, Romania, the Baltic States) displayed an increasing trend of the current account deficit which peaked at very high levels.

The world financial crisis of 2008 and its repercussions on the real economy tempered or reduced the domestic demand which reduced the foreign deficit in many EU member states that are outside the Euro zone. Among the countries with large current account deficits, Estonia and Latvia displayed the strongest shrinkage of the current account deficit, while it decreased less strongly in Lithuania and it remained quite unchanged in Romania. The current account deficit increased in Bulgaria on the background of continuing imports to meet the strong domestic demand and of lower exports because of the weaker foreign demand. In the countries mentioned previously, the deficit continued to be in excess of 10% of the GDP, while it exceeded 20% for Bulgaria. In the first part of 2009, the current account deficit of Romania reduced substantially because of fewer imports, while un Czechia, Hungary and Slovakia the exports were depressed.

The financing of the foreign deficits turned difficult for the emerging countries, the NMS included, on the background of the crisis, because of the increased risk aversion of the investors. In many cases, the central banks of the new member states had to make use of their reserves.

In most countries, the foreign misbalances were determined by the deficit from the trading exchanges of goods, except for Czechia, Slovakia and Hungary, where they were caused mainly by the deficit of the revenues (repatriation of the profits in the case of Hungary). Compared to 2007, in 2008, the net inflow on direct investments decreased in some countries.

The foreign debt was high reflecting the strong dependency, over the recent years, on the flows on foreign capital. In Lithuania, the gross foreign debt reached 72% of the GDP during the second quarter of 2008, while in Bulgaria, Estonia, Hungary, Slovenia and Latvia it exceeded 100% (137% for the last country). Furthermore, in many new member states an important share of the foreign debt is on the short-term: over 35% in Bulgaria, Latvia and Estonia.

The recent experience of the countries which adopted the Euro

Slovenia was the first of the new EU member states which met the Maastricht Treaty criteria. The process of meeting the criteria of nominal convergence progressed on the background of a robust economic growth and the current account deficit and the fiscal deficit, unlike the situation of other countries which had joined the EU in 2004, maintained permanently at moderate levels and didn't threaten the macroeconomic balance. After a few months from the adoption of the Euro, inflation started to increase in Slovenia (5.5% in December 2008) because of the higher prices for energy and food, much over the increase in other EU member states, because of the lack of competition on the market and because of the speculations with the new currency. However, some demand factors also put inflationist pressure (factors related to the phase of the economic cycle). Thus, according to empirical studies (IMF, 2009) based on the analysis of the traditional Philips curve, the lagged inflation and the production gap are the main determinants of the current inflation next to the increased prices for food and energy. The effects of the demand on inflation are even more obvious in Slovenia than in other countries from the Euro zone. The high level of work rigidity might also explain the persistent inflation and the deviation from the economic potential. The global crisis and the induced recession dampened anyhow this inflationist pressure and the inflation differential from the other countries in the Euro zone still persists. Structural problems pertaining to the high labour force market rigidity will continue to put pressure on the cost of the labour force affecting the prospective economic growth in Slovenia.

For **Slovakia**, the main challenges in adopting the Euro were the *impossible trinity* (the countries with open capital account can not control the exchange rate and the inflation simultaneously), *an as short as possible participation in ERM II* (the inflation criterion is not known beforehand and many times it depends on the evolution from the countries outside the Euro zone) and the *Balassa-Samuelson effect* (a higher increase of the inflation in the non-tradable sector increases, generally, inflation). The adoption of Euro in Slovakia seems to be a success and it was the result of a good collaboration

between the government and the central bank.[2] Another important factor which contributed to its success was the rather modest wage increases during the period of participation in the ERM II; they were always lower than the productivity increase, containing thus the inflationist pressure. However, there also are exogenous elements which can influence the success of adopting the Euro. Thus, the world economic conjecture and the trends of the global inflation were favourable to the process of Slovakia's accession to the Euro zone: the period of the "great moderation" characterized by cheap imports from Asia contributed to the reduction of the core inflation.

The experience of Slovakia gives two lessons on the admission within the ERM II. The first one concerns the necessity of a wide consensus on the time and ways of adopting the Euro: an intelligent strategy relying on the cooperation between the government, Ministry of Finances, and the Central Bank is basic. The second lesson shows that the success of participating in the ERM II should rely on stable inflows of capital. The current world economic conjecture claims prudence in this matter.

Slovakia is the first of the countries with a floating exchange rate conditions that adopts the Euro; hence, its evaluation will become a precedent for the other countries with this organization, to verify the compatibility with these conditions.

Evaluations concerning the faster shift to the Euro within the context of the crisis

The problem of *relaxing the criteria* required to adopt the Euro was raised on the background of the new economic crisis. Several EU leaders showed availability for an acceleration of the East European countries shift to the Euro without, however, taking into consideration a relaxation of the adhesion criteria or derogations from them.

The unilateral adoption of the Euro was suggested by the International Monetary Fund in March-April 2009, in a confidential report cited by the *Financial Times*. The International Monetary Fund raised the option of relaxing the admission criteria to the Euro zone so that the Central and Eastern Europe emerging countries may

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[2] *The National Bank and Ministry of Finances of Slovakia discussed a strategy to adopt the Euro in 2003 – 6 years before the targeted year – and collaborated tightly all along this process.*

adopt the single currency without the right for representation within the European Central Bank. According to this report, such an initiative would solve the problems related to the foreign debts of these countries and would remove the incertitude of the regional markets.

The European Commission rejected the information suggesting that the report is outdated and stated that the European Union has taken several measures to support Eastern Europe to go past the world economic crisis.

The European Central Bank[3] too considers that the EU emerging countries should not adopt unilaterally the single currency because such an action would undermine the worldwide trust in the Euro. This option would deepen too much the macroeconomic divergences of the Euro zone and would contradict the conditions set previously.

An acceptable solution would be, however, to accelerate the admission of the emerging countries within the ERM II mechanism after getting aware of the risks of such step. By joining the ERM II a particular country undertakes the responsibility to maintain stable exchange rates for a determined period.

Among the benefits of joining the ERM II is the stabilising role of the exchange rate (by anchoring the expectations on the exchange rate) and of the economy, as well as the positive effect on the consistency of the macroeconomic policies. These benefits are visible when we examine the monetary development in most West-European economies during the period of adopting the Euro. The question is if for the less developed European countries presently undergoing a process of economic transformation and which experience fluctuating inflows and outflows of foreign capital, the participation in ERM II is beneficial in comparison with the alternative conditions that might function until the introduction of the Euro.

Our analyses show that the participation *for a longer period into the ERM II is not beneficial to the macroeconomic stability* and the simple participation in ERM II doesn't remove the currency turbulences. We consider thus that the idea of reducing the compulsory two-year stage in ERM II would be to the benefit of the candidate countries, without affecting the economic stability in the Euro zone.

[3] *Ewald Nowotny, member of the Governing Council of the European Central Bank, cited by Reuters.*

Even if there would be some advantages if **Romania** would adopt the Euro (elimination of the currency risk), as long as all the convergence criteria are not completely fulfilled, risks appear which are generated by the macroeconomic situation which is inadequate to this approach. The adoption of the Euro would eliminate the exchange rate risk and the companies would run lower costs for the trading activity, while the Romanian economy would gain in its stability. The exchange rate which will be used to shift to the Euro is very important; if a depreciated level of the leu will be tken into consideration, the prices would increase. On the other hand, the wages will not increase easily, the National Bank of Romania will no longer be able to set the interest rates and the inflation will be difficult to control. The objective of adopting the Euro remains, however, a catalyst of the coherent policies for the future.

The economic and financial crisis made the EU member states which didn't adopt the Euro yet, to review their attitude towards adopting the Euro and many comments come from the exterior in support of this idea. Thus, the Danish Prime Minister stated in October 2008[4] that Denmark must adopt the Euro because of the financial crisis. In February 2009, Joaquin Almunia said that there are great chances that the Great Britain adopts the single European currency, and in the future the price of giving up the single currency would be so big that none of the EU member states would take this risk to solve its economic problems. The last report released in Sweden[5] shows that the arguments against its adhesion to the Euro zone are not valid and that the difficult situation confronting the country shows that it is now the right moment for it to adopt the single currency.

Reconsideration of the macroeconomic policies within the context of the current economic crisis

The intensification of the world financial crisis in the fall of 2008 generated additional challenges for the monetary policy in most EU member states outside the Euro zone, some countries being confronted with liquidity problems on the interbanking markets and

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[4] *Anders Fogh Rasmussen, October 30, 2008, after a survey which showed that 50.1% of the population was in favour of adopting the Euro.*
[5] *Study of the Swedish Centre for Business and Policy Studies in January 2009.*

with tensions on the currency markets. The reactions of the national central banks to these challenges differed with the existing economic conditions and framework of the monetary policy.

Under the conditions of improved world evolutions, the economies of the Baltic States and Bulgaria will feel a favourable change that will allow them, in the situation of a good implementation of the fiscal policy and of maintaining a sufficiently restrictive behaviour of the monetary policy, tom accomplish the convergence criteria imposed by the Maastricht Treaty and, therefore, to access to Euro zone.

The countries which target the inflation as monetary strategy, the monetary policy must be shaped so as to assist the economy emerge easier from the period of recession and to support the process of adopting the Euro. The fundamental objective of the monetary policy is to ensure price stability, but the national banks must seek, simultaneously, the financial stability as well.

The recession of the domestic economic activity, a potentially higher volatility during this period and the economic-financial situation of the main partner countries are major landmarks in configuring the monetary policies in these states, taking into account the goal of price stability and financial stability and the process of preparing the adoption of the Euro, more precisely, getting ready to join the ERM II.

The sudden slowing of the economic activity determined a rapid deflation in these countries cancelling the possible inflationist impact of the lower interest rates used during the previous months by the national banks. The new member states are in a more or less serious stage of economic crisis and the central banks should assess the effects of the economic activity slowing, those of supporting the deflation process, on the one hand, and the effects of a higher volatility of the national currencies (with a potential of depreciation) during this period, volatility that might affect inflation.

The dependency on the external environment, on the situation of the western European economies make relative the importance of the internal macroeconomic adjustments and shows that, next to these internal corrections, the measures adopted by the partner new member states to control or alleviate the effects of the global financial crisis are also important through the positive or negative influence they may have on the economies of the new member states. Through the communication channels existing between them and their partner countries, the monetary policy of the national banks loses somehow

from its importance if it is not supported by fiscal and wage policies that are adequate to this period.

The transition to the Euro of the inflation targeting countries is much more complex than that of the countries targeting the exchange rate. Unlike the latter, the inflation targeting countries are confronted with a radical change of the monetary strategy: the shift from free floating to a controlled floating. Although Slovakia managed a successful shift to the Euro, the current financial crisis has obviously complicated this process. The high volatility of the national currencies observed during this period of crisis brought back into discussion the issue of the flexible exchange conditions as absorbent or generator of misbalances within the internal economy. The modification of the exchange conditions in these countries also presumes much lower real interest rates under the conditions in which the process of real convergence is progressing, which might increase the intensity of the boom and bust-type cycles and of the induced damages. Under the conditions of an independent monetary policy, with a flexible exchange rate, the monetary authorities may change the nominal exchange rate but this doesn’t mean they can achieve a sustainable change of the real exchange rate. It was generally noticed that the type of exchange rate conditions (fixed or floating) influenced price convergence during the catching-up process. Thus, under fixed exchange rate conditions, price convergence can be done through a higher inflation level. If the exchange rate is floating, price convergence can be achieved by a nominal appreciation, a higher inflation or a combination of the both. The necessity of a sustainable deflation justified the option of the Romanian monetary strategy to adopt inflation targeting as strategy of monetary policy (as early as since the summer of 2005).

The financial crisis increased the volatility on the monetary and foreign currency markets in Romania, which tended to amplify the slowing-down of the economic activity. Thus, the lower external financing and the existence of the large external misbalances triggered the depreciation of the national currency, leu, which increases inflation and requires a rather high interest rate. The financial system, sensitive to a significant depreciation of the leu and the higher interest rates tend to impede the economic growth and create costs for the indebted ones, risking to destabilise the financial sector. Under these conditions we have to choose between price

stability and the financial stability as goals of the monetary policy. Because the low and stable inflations helps the sustainable economic growth, the long-term goal of the monetary policy must be a low and stable inflation, but the efficiency of the monetary policy in achieving this goal is limited by the financial instability affecting the economic cycle. Usually, the periods of high inflation also had a severe financial instability and crises within the banking system, or were followed by recession after the authorities adopted improper measures to temper inflation. However, a low inflation rate is not enough to ensure the long-term financial stability. On the long term, the incapacity to maintain the financial stability can only make inflation soar back. The present economic and financial crisis makes it necessary to reanalyse the role of the central bank to ensure simultaneously price stability and financial stability, many times conflicting measures being adopted while accomplishing these objectives.

Profound structural reforms are required in Romania in view of meeting the nominal criteria: a budgetary deficit lower or equal with 3% of the GDP presumes rebalancing and self-financing of the public pension system, while a stable exchange rate presumes observing the correlation between the increase of productivity and the increase of the real wage. In other words, the process of meting the criteria of nominal convergence must be accompanied by measures to adapt the real economy through a process of real convergence.

Romania must also adapt its macroeconomic policies to the new context created by the international financial crisis, the mix of economic policies having to be recalibrated in agreement with the challenges created by the crisis.

The process of economic adjustment can not be fully programmed, but the institutional intervention is required in terms of coherent and credible economic policies in order to avoid the hard landing. The “soft” adjustment of the economy and the improvement of the foreign investors’ perception require a combination of the macroeconomic policies which to yield concomitantly a correction of the external deficit (current account deficit) and of the internal deficit (budgetary deficit) too.

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