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Public debt, sovereign risk and sustainable development of Romania

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Abstract

The rapid increase in the government debt under the circumstances of the global crisis persistence and financial markets volatility raises the need for a new approach of public debt sustainability, including for Romania. Despite more intense contagion effects according to global markets connectivity, the importance of country specificity in the assessment of sovereign risk, which is decisive in dimensioning the borrowing costs, has grown. In the case of Romania, a sharp deterioration of its fiscal framework strength has been observed during post-crisis period, the public debt-to-GDP ratio currently reaching around 40%, thus doubling as compared to 2008. The structural analysis of government debt portfolio highlighted the main drivers of excessive public indebtedness and the increase in refinancing (rollover) risk on short term, which is supposed to overlap with the exchange rate and interest rate risks on medium and long term. Several indicators of Romania's debt sustainability are already on the warning levels edge which requires appropriate policies focusing on economic growth recovery, fiscal consolidation ongoing, increasing capacity of generating budgetary revenues, public debt management improvement. Maintaining the financial stability and the investment grade of sovereign risk are decisive for the development of Romania on a sustainable path.

Keywords: public debt; debt sustainability; sovereign risk; sustainable development; financial stability.

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1. Introduction

The absence of a consensus on international financial markets regulations and the excess of global capital flows and of risk exposures, including the derivative financial instruments, has led to a gradual split between the monetary and the real economy. The crisis triggered in the USA in 2007-2008 had contagious effects at the global level, favoured by the interconnected financial markets channels.

The increase in risk aversion and the deterioration of the post-crisis business climate, along with the banking system crisis and the credit contraction have finally degenerated into a recession of advanced economies which has been extended at the world scale.

After having seemingly recovered in 2010, the global growth decreased in 2011 and 2012 when the EU countries turned back into recession, which has been maintained in 2013, too (IMF, 2013,b). Looking ahead to the year 2014, the global growth is expected to remain modest, while macroeconomic risks are maintained, including from the view point of the financial stability, with increasing market and liquidity risks (IMF, 2013a).

The Euro Zone has been mostly affected by the impact of the global crisis. The bailout of the banking system in 2008-2009 required huge budgetary allocations which have brought about a serious deterioration of the public finances, especially in the Euro Zone periphery. On the UE 27, the government public debt has increased from 58.9% of GDP in 2007 to 93.4% at the end of June 2013 (Eurostat, 2013a, 2013b). Overcoming the sustenability debt level, in order to face due payments, Greece, Ireland and Portugal have received emergency financial packages from IMF-EU.

The austerity programmes adopted by the EU countries in view of fiscal adjustements, by severe budgetary constraints, have hindered their post-crisis economy relaunch and have brought about social tensions. Though steps have been taken, the european leaders' commitements looked for public finance consolidation, financial systems rebuilding, setting a banking union in the Euro Zone witch haven't been achieved until now, „the sovereign debt crisis" threat being still existent. In time, the high levels of public indebtedness in almost all the important advanced countries and the persistance of financial breaking up in the Euro Zone may lead to a new crisis occurence (IMF, 2013,b).

Romania has also suffered a significant increase in the public debt, which, though being situated below the level established by the Maastricht Treaty and under the one registered in the advanced states of the EU, the current high debt service may create payment issues that can endanger the sovereign risk and the development perspectives.

In this study we have tried to analyse the evolution of the public debt, mainly focused on the central gouverment debt, and to identify its main growth factors in the last years. We will try to show that some indicators which reflect Romania's indebtedness public degree are already at unsustenable levels and to reveal some guiding steps to be taken, which may contribute to the maintenance of the financial stability of the country and to allow its coursing toward a durable development trajectory.

2. The increase of Romania's gouvernment public debt: decoupling from the GDP increase

In an external context dominated by the global recession, which induces adverse effects on Romania, the public debt issue has become of extreme importance, also from the perspective of its sovereign risk on medium and long term.

Romania's internal and external financial framework has been under pressure, the imbalances have become chronic in the last years by accumulating current account and fiscal deficits**,** covered, in an increasing proportion, with sovereign and private loans, leading to a rapid growth of the indebtedness level and to a severe deterioration of its sustainability parameters.

On the other hand, after accessing into the European Union, Romania managed to absorb only to an insignificant extent the available European funds, which could have diminished the pressures on the internal and external financial requirements. As long as the macroeconomic policies, the budgetary austerity measures and the structural reforms cannot ensure competitiveness gains and the functioning mechanisms of financial balances adjustments, a deterioration of the public debt sustainability and endangering our country's reaching the goals of