ROMANIA JOINING NEW EUROZONE UDER REFORMS

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Macroeconomic and Strategic Analysis

Eurozone: inflation is currently not an issue but fiscal sustainability and sovereign debt could become a problem

Maastricht criteria and expected fulfillment

Forecast 2010	Inflation* (at most 1.5 pps higher than 3 best performers' avg)	Budget deficit* (<3% of GDP)	Public debt* (<60% of GDP)	Long term rates *,(1) (at most 2 pps higher than 3 MS with lowest inflation)	ERM2
Bulgaria	2.3	-2.8	17.4	7.2	
Czech Republic	1	-5.7	39.8	4.8	
Estonia	1.3	-2.4	9.6	7.8	yes
Hungary	4.6	-4.1	78.9	9.1	
Latvia	-3.2	-8.6	48.5	12.4	yes
Lithuania	-0.1	-8.4	38.6	14	yes
Poland	2.4	-7.3	53.9	6.1	
Romania	4.3	-8	30.5	9.7	

*EC 2010 Spring forecast for 2010 and 2011, Source: Eurostat, green highlight = criteria is currently fulfilled

- **Budget deficits** seriously deteriorated during the crisis:
  - ⇨ According to the EC Autumn forecast only Bulgaria will be inside the 3%/GDP deficit limit in 2010
  - ⇨ Latvia, Lithuania seems to be most at risk
- The **debt level** is above the 60% limit only in Hungary
- Due to the significant recession **inflation** will not be a problem in any of the countries
- Based on the above factors the real obstacles are budget deficit and ERM2 membership. Accordingly the EMU membership becomes **a political issue** even more than before (i.e. are governments willing to cut fiscal spending)

Source: UniCredit Research
Note: (1) Data for Long term interest rates refers to 2009 historical data.

Advantages: Romania joining EMU from *"its own self-interest and welfare perspective" (Ishiyama (1975))*

Free movements of capital and lowering cost of transaction - the cost of changing money when travelling or doing business within the euro area (the cost of making cross-border payments has in most cases either disappeared or come down significantly.The ECB and the European Commission are working jointly on a Single Euro Payments Area to extend the benefits of more efficient and cheaper payments more widely. SEPA)

- **Exchange rates risk elimination-**Only part of the exchange rate risks can be eliminated, without further problems, by the use of certain hedging instruments of the markets for money and foreign exchange. That is an economic danger for those sectors of the economy which export and import. Fixed exchange rate is therefore preferred by the producers and the consumers of an economy
- **Nominal Anchor for price stability**– Romania faces relatively higher micro shocks compared to the more developed EMU countries with relatively more stable prices and factor costs. Through higher integration price of tradable will take the more stable property and channeled also to non-tradables. Safegard for breaking low inflation promises (driven by populist movements) The cost of reducing inflation can be quit substantial (see Isssing, Gaspar, Angeloni, and Tristani (2001))
- **Transfer of money and fiscal competencies** from national to community level, would mean economically strong and stable countries would have to co-operate in the field of economic policy with other, weaker, countries, which. are more tolerant to higher inflation and fiscal indiscipline
- **Enhancing the real convergence -**Meeting the convergence criteria with financial and monetary stability creates the best long-term investment conditions that boost production and real convergance!
- **Country Credibility & Attractiveness:** Flexible exchange rate might be also driven by market sentiment , which in case of economic shocks strongly affected and amplifies the vulnerability impacting real economy through credibility and attractiveness for further investments.
- **Smooth corrections:** Depreciation might affect directly or indirectly (through inflation) the purchasing power of the economic agents and in case of strong and fast movements might result in defaults: bankruptcy, non-performing loans. Fix exchange rate does not block but smooth the implementation of necessary corrections.

Optimum currency area characteristics – Europe privileging economic and monetary integration

Focus on correcting imbalances among member countries trough increasing productivity gains and competitiveness:

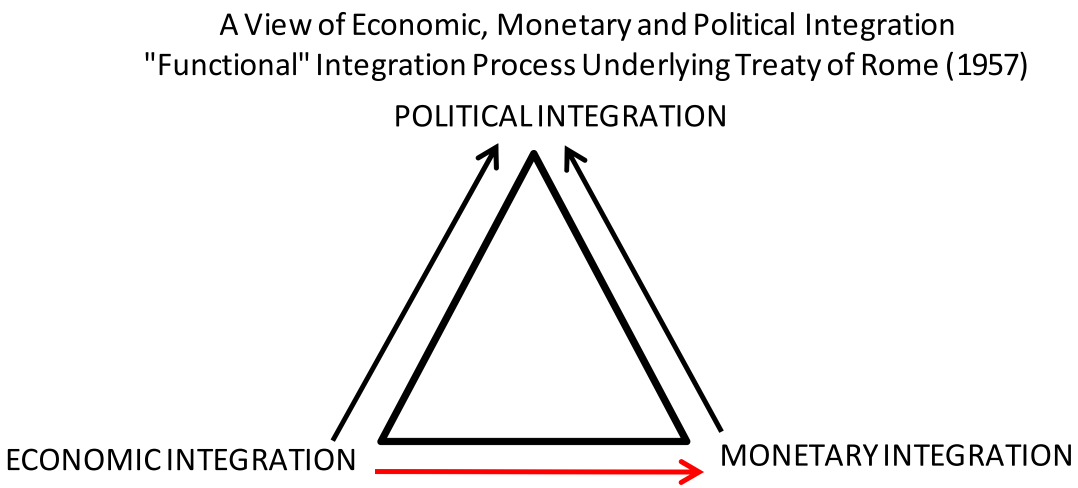
- **Correlation of economic cycles of individual countries:** role of similarity in shocks (although it is mitigated if they are financially integrate (see Mundell ,1973))
- **Similarities in inflation rate** (Fleming 1971): **problems appear from disparities in structural development, diversities in labor market institutions, differences in economic policies and diverse social preferences (like inflation aversion).** Exception: through catching-up process by less developed countries higher inflation is “normal” because of the productivity gains (Balassa-Samuelson types of effects until the process is completed, Eichengreen (1990)). Although it is not a precondition but is important that transition to low inflation to happen after the joining to monetary union (Gandolfo (1992))
- **Price and wage flexibility**: problem might appear if they are downward rigid (Friedman (1953))
- Capital and labor mobility (Mundell (1961)): positive shock: capacity to absorb capital without creating bubbles
- **Mobility of factor of production**
- **Financial market integration**: possibility to finance through debt the external imbalances (Ingram (1962))
- **Economic openness:** international price movements are transmitted fast to domestic cost of living even without exchange rate mechanism (McKinnon (1969))
- **The diversification in production and consumption**: dilutes the possible impact of a schock to a particular sector (Kenen (1969))

New focus: Optimum currency area characteristics –sustainable monetary integration through fiscal and political integration

- **Fiscal integration:** necessity of supra-national fiscal transfer system that would allow them to redistribute funds to a member country affected by adverse asymmetric shock (Kenen 1969)
- **Political integration: regarded by some authors as being the most important condition for common currency** (Mintz (1970)), Haberler (1970), compatibility of policy makers of different countries in trading-off between objectives (Tower and Willet (1976)). Coordinated action of policy-makers based on the type and similarity of schoks that a country and its monetary partners face
- Current situation:
  1. One eurozone country has been forced to seek IMF support; EU **approved on May 02, 2010 the activation of a three-year rescue package for Greece, which total EUR 110bn**. The EU will contribute EUR 80bn while the IMF will provide the remaining EUR30bn. The required fiscal adjustment in Greece will total 11% of GDP, and will reverse the increase in the debt/GDP ratio by 2013 and bring the fiscal deficit below 3% of GDP by 2014.
  2. The entire eurozone has appeared to be on the brink of systemic debt crisis, which was only averted thanks to the "shock and awe" package launched on May 10th. there is a EUR 750mn package ready to bail out EU sovereigns (and indirectly banks).
- On July 23th release of the stress **test results was a first step towards improved transparency**, but not yet sufficient to bring about a major improvement in confidence in the European banking system (84 of 91 lenders passed the examination).
- On Sept. 6. 2010Rules under consideration by the Basel committee may force banks to raise reserves. Germany's 10 biggest lenders, including Deutsche Bank and Comerzbank AG, may need about 105 billion euros in fresh capital because of new regulations, the Association of German Banks estimated
- Yet, just four months after the launch of Europe's "shock and awe" ¨750 billion stabilization package, sovereign bond spreads have risen to new record highs, not only in Greece but also in Ireland and Portugal.

Monetary integration

Through economic integration



UniCredit Țiriac Bank

Correlation of economic cycles

	2007	2008	2009	2010E	2011E
Poland	6.8	5.1	1.8	2.6	2.8
Hungary	1.0	0.6	-6.3	0.5	2.2
Czech Rep.	6.1	2.5	-4.1	1.8	2.2
Romania	6.2	7.1	-7.1	-2.5	1.7
Bulgaria	6.2	6.0	-5.0	-1.0	1.8
Croatia	5.5	2.4	-5.8	-1.5	1.6
Bosnia-H.	6.8	5.4	-3.5	0.5	1.2
Serbia	6.9	5.5	-3.0	0.0	2.2
Turkey	4.7	0.7	-4.7	5.6	5.2
Ukraine	7.6	2.1	-15.1	3.0	4.0
Russia	8.1	5.6	-7.9	3.4	5.0
EMU	2.9	0.3	-4.0	1.6	1.3

	Correlation of Romanian GDP	t-statisitic	Prob
Sample: 2001Q1 2010Q2, Hodrick-Prescott filter			
EA GDP	0.36	5.75	0.00
EA GDP (-1)	0.39	7.67	0.00
EA GDP (-2)	0.31	4.83	0.00
EA GDP (-3)	0.16	2.03	0.05

Source: INSSE, Eurostat, UniCredit Research

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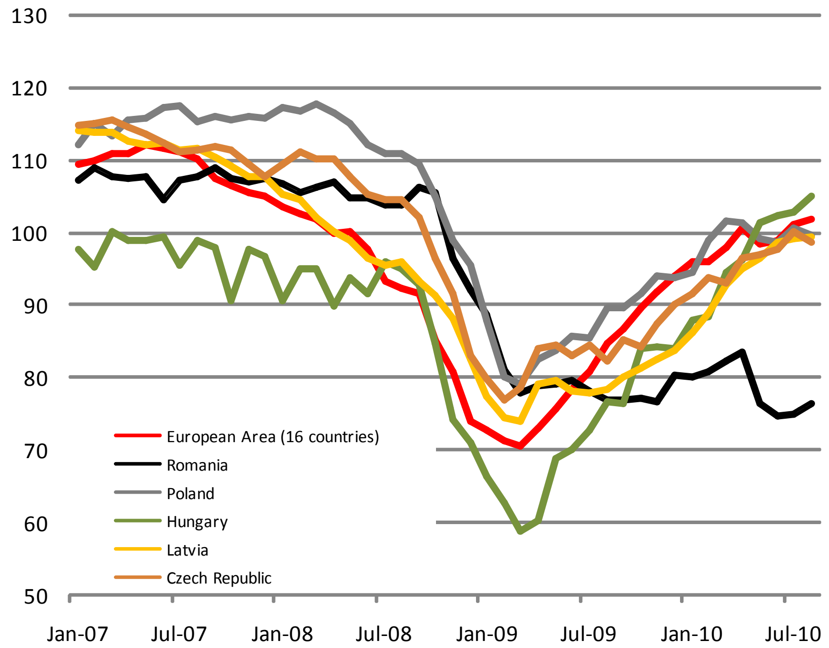
Correlation of economic cycles : domestic demand is more mixed and more deteriorated in Romania

Economic Sentiment Indicators in Romania and EU countries



- **There is a clear decoupling of the Romanian sentiment indicators from the rest of the CEE countries. Since most of the CEE countries continues the improving path, there is a clear deterioration of the Romanian sentiment indicator for the last couple of months. Given the harsh austerity measures and worsening economic outlook of prolonged recession (-2.5% drop of GDP in 2010) for 2H of 2010, further deterioration cannot be ruled out.**
- **Romanian economic sentiment is correlated with the European Union business confidence.**
- **Economic sentiment indicators pointed to a sharp deterioration in the growth across the whole EU region, but there are obvious signs of improvement, giving hopes for a recovery of the European economies and consequently improvements in the Romanian economy as well.**

	Correlation of Romanian sentiment indicator	t-statisitic	Prob
Sample: 2001M01 2010M07			
EA sentiment indicator	0.60	5.49	0.00
EA sentiment indicator (-1)	0.71	6.91	0.00
EA sentiment indicator (-2)	0.78	8.10	0.00
EA sentiment indicator (-3)	0.82	8.81	0.00
EA sentiment indicator (-4)	0.84	9.37	0.00
EA sentiment indicator (-5)	0.81	9.02	0.00

Source: European Commission, UniCredit Research

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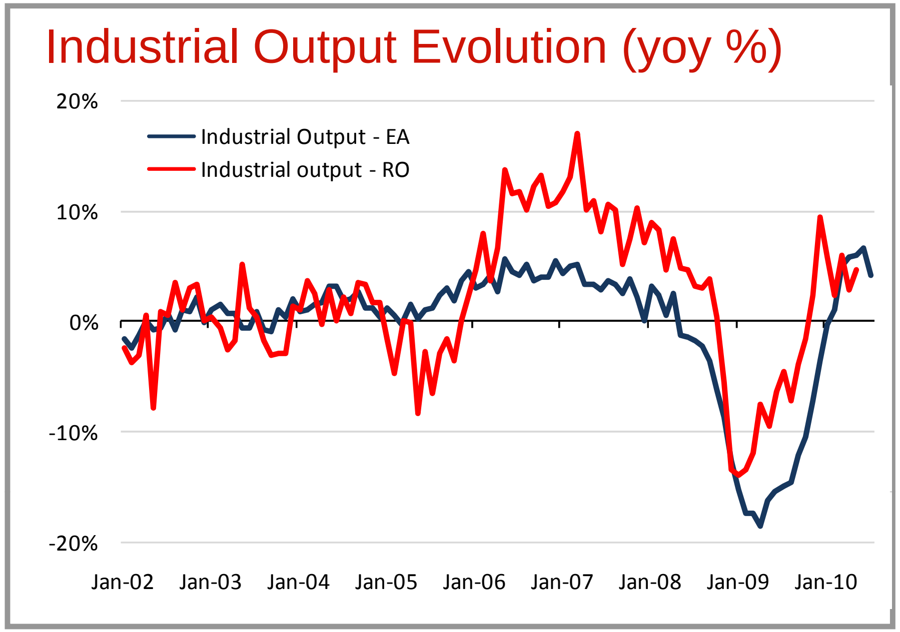
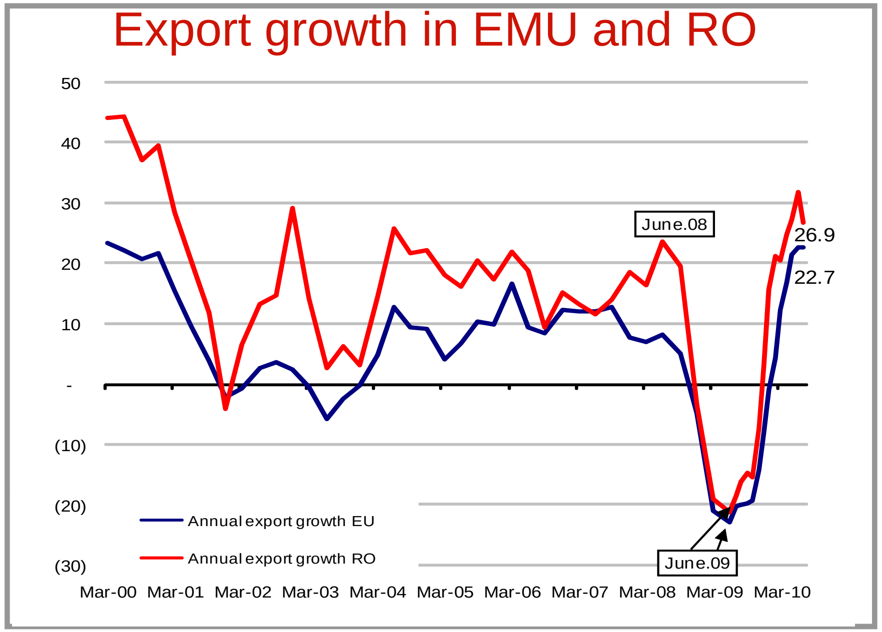
ECONOMIC OPENESS: INDUSTRIAL PRODUCTION DRIVEN BY EXTERNAL DEMAND





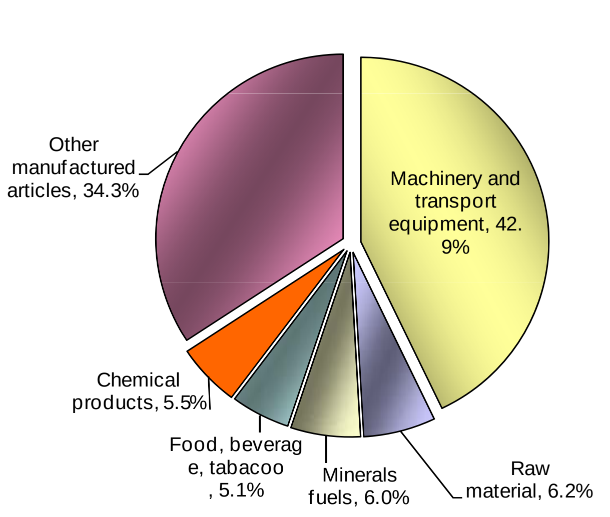
- Propelled by favorable new orders-to-inventories ratios, exports driven industrial production proved to be the key driver of recovery pulled by the upswing of Western European economies.
- Romanian exports are to significant extent correlated with EMU export cycle, due to their importance as intermediate goods in the supply chain.

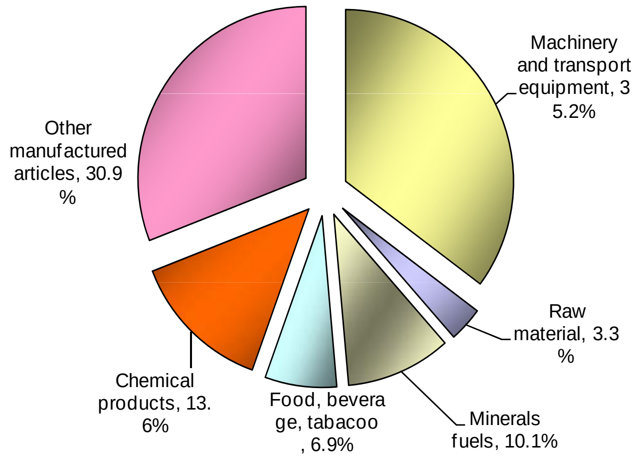
Correlation of Romanian industrial production with		t-statisitic	Prob
Sample: 2002M01 2010M07			
EA industrial production	0.63	11.34	0.00
EA industrial production(-1)	0.55	8.69	0.00
EA industrial production(-2)	0.47	7.07	0.00
EA industrial production(-3)	0.37	5.23	0.00

Correlation of Romanian export with		t-statisitic	Prob
Sample: 2001M01 2010M07			
EA export	0.58	14.53	0.00
EA industrial production(-1)	0.45	8.26	0.00
EA industrial production(-2)	0.38	6.71	0.00
EA industrial production(-3)	0.34	6.05	0.00

Source: INSSE, Eurostat

ECONOMIC OPENESS AND DIVERSIFICATION OF PRODUCTION





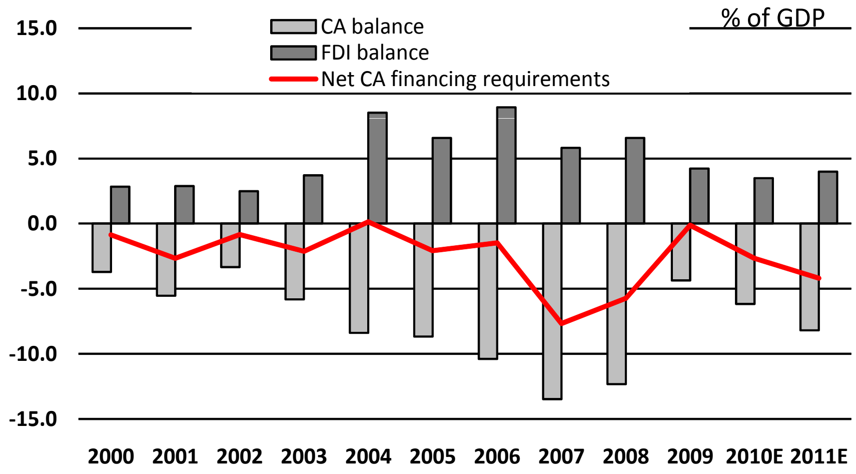
	2007	2008	2009	2010E	2011E
Export (% GDP)	23.9%	24.6%	25.0%	28.9%	31.2%
Import (% GDP)	38.3%	37.8%	30.9%	35.9%	39.9%
Exports towards EU 27		70.5%	74.3%		
Imports from EU 27		69.6%	73.3%		

- The main driver of the Romanian export rebound were the transport equipment and the food, beverage category were the main drivers. Despite the fact that the UE wide government support for the car scarp program has approached its end in Sept. last year, Romanian export registered further acceleration. (28% yoy growth of machinery and equipment for 7M 2010)

Source: INSSE

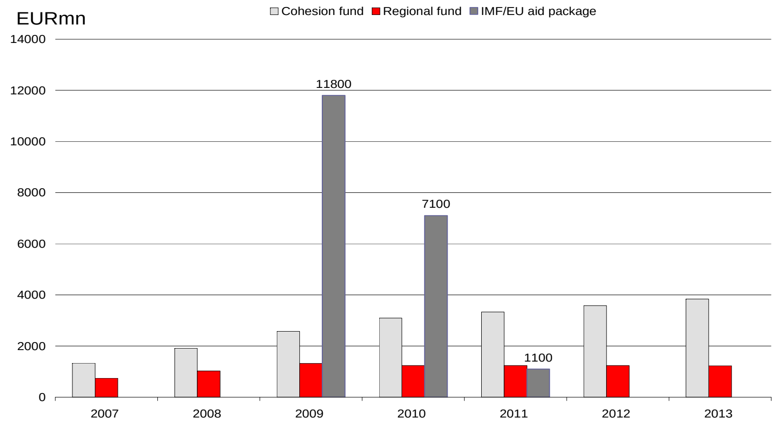
Financial market integration and mobility of capital: IMF/EU aid package to cover external financing gap

Relatively stable C/A, even as FDI looses some pace



Source: NBR, UniCredit Research estimates

EUR 20 bn IMF/EU aid package plus EUR 28bn EU funds available until 2013

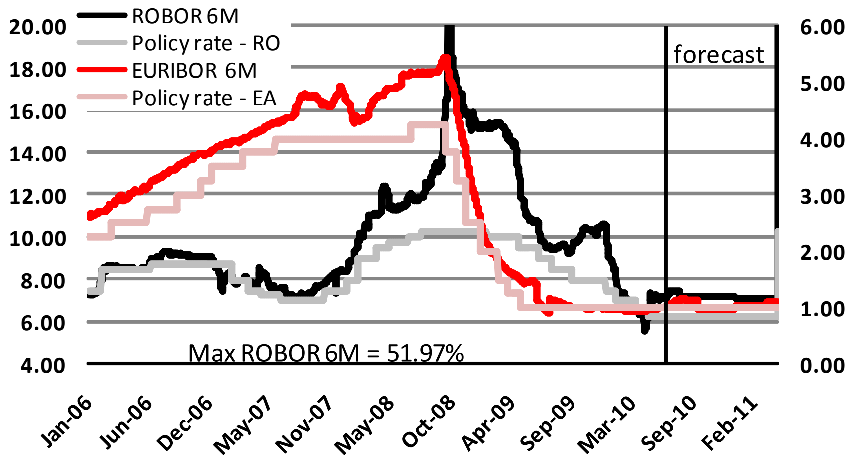


Source: NBR, UniCredit Research

- So far, Romania received around EUR10.1bn from the IMF and EUR 2.5bn from EU, out of the total aid package of EUR 20bn (EUR 12.9bn IMF money, EUR 5bn from EU and EUR 2bn from the World Bank and EBRD). This has been supportive for the RON, structural adjustments and country stability as a whole. The reimbursement of the financial support will be made until 2015
- EU funds provide a complementary financing source and continue to represent a long-term positive factor in financing Romania's structural convergence, while remittances suffered a 22% yoy decline in 1H10 (and a 48% drop vs. 1H08)
- The Romanian banking system displays a solid capital base (with a CAR of 14.3% and a Tier 1 ratio of 13.4% as at end June). This will continue to act as a buffer against macroeconomic shocks, as proven by the stress tests run by NBR
- The biggest nine foreign-owned banks (accounting for 70% of Romania's banking assets) have committed to maintain until April 2011 a solvency ratio of at least 10% and to provide additional capital to their Romanian subsidiaries if needed
- At the same time, the exposure of the foreign banks to the Romanian market has decreased, in line with the deceleration of the credit activity, as proven by the evolution of the short term external debt, down by around 30% vs. the 3Q08 peak. The subdued demand for loans leaves lots of liquidity in the market, amplified also by the failed state securities auctions since May 2010, due to the mismatch between offered and requested yields

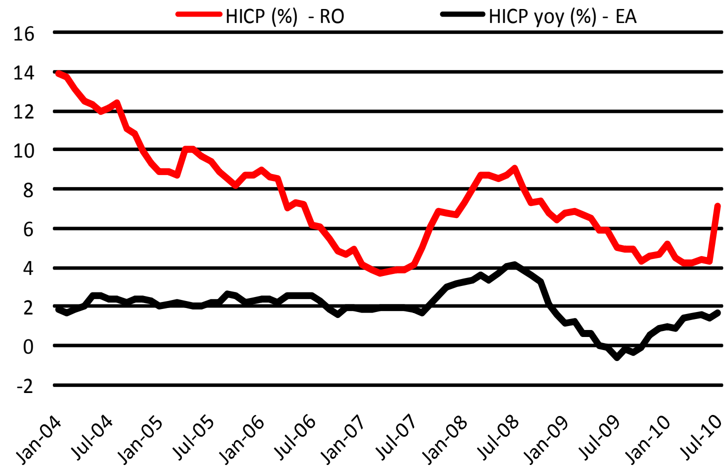
Monetary policy cycle and inflation- Romania versus EU. Romanian Easing cycle in the monetary policy put on hold until 2H11

Policy rate currently below market rates



Source: NBR, ECB, UniCredit Research estimates

YTD CPI peaked at 7.6% in Aug

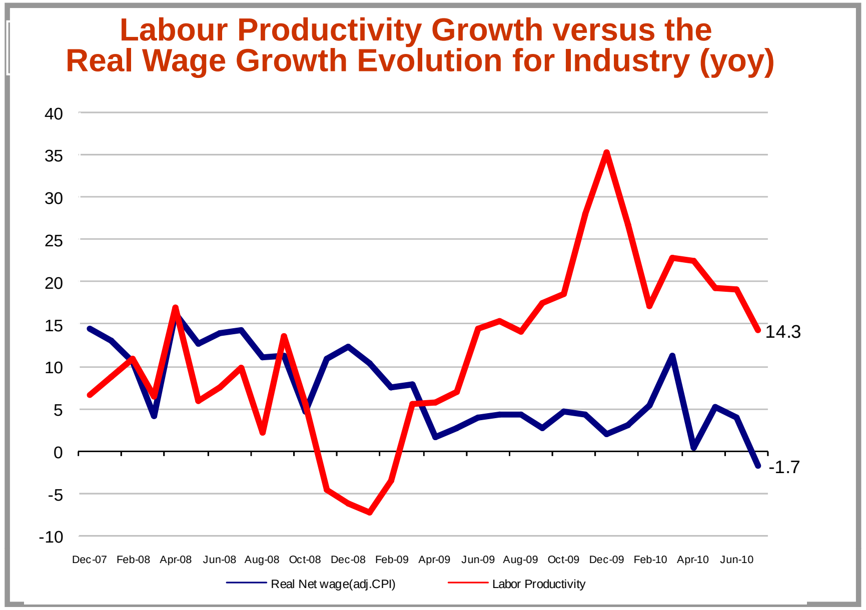


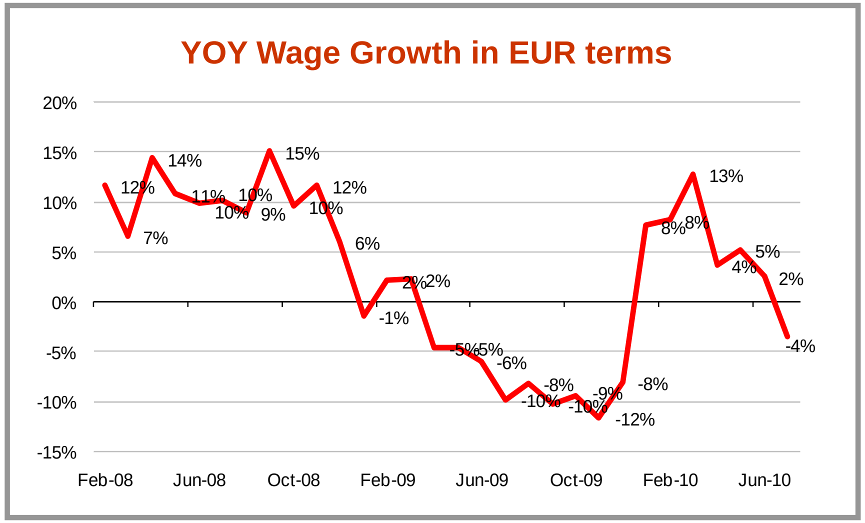
Source: INSSE, NBR, Eurostat, UniCredit Research

- Uncertainties on the local interbank market have kept the market rates above the policy rate. Despite the GDP decline, the monetary easing has been put on hold as a consequence of worsening inflationary outlook that will persist, in our view, during the whole year. Consequently, balancing between these two contradictory forces, the policy rate will probably be kept at the current level of 6.25% until the year end .
- Interest rates are likely to remain on hold for the foreseeable future, even if the ECB now sees risks to inflation as slightly to the upside (due to commodity prices and indirect taxes). The ECB announced on September 2nd that it will maintain its exceptional liquidity support "for as long as necessary", and at least into January 2011.

	Correlation	t-statisitic	Prob
Sample: 2005M01 2010M08			
Bubor with Euribor (detrended)	0.08	2.15	0.04
Sample: 2000M01 2010M08			
Bubor with Euribor (detrended)	0.00	0.23	0.82

Price and wage flexibility: Earnings versus Productivity





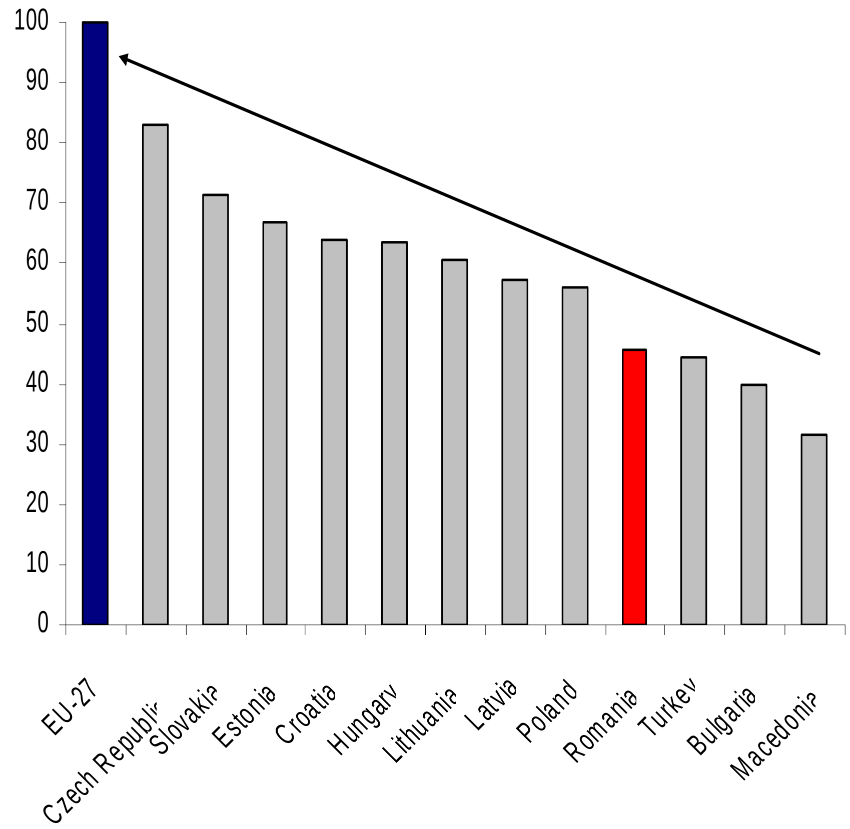
- **Labor productivity stabilized around 20% in May 2010 after the peak of 35% in Dec 2009 (driven also by strong base effect)**
- **Following the abrupt drop in productivity at the end of 2008, during 2009 the labor productivity has been continuously improving and it has strongly over passed the real wage growth, giving significant competitive advantage for the country and helping the economic recovery.**

- **Nominal earning expressed in EUR entered positive territory during 2010, given the relatively stable RON and slight growth of private sector's wages after stagnation during 2009 and it has stabilized around 5% yoy in April-May 2010.**
- **The net average earnings expressed in EUR have been falling considerably for quite some time, especially due to the weak RON that depreciated by as much as 27% in two years (average 2009 compared to the average 2007). The sharp drop of the wage growth may also be an advantage for Romania from international investors' point of view, as labor costs is adjusting fast to the current environment.**

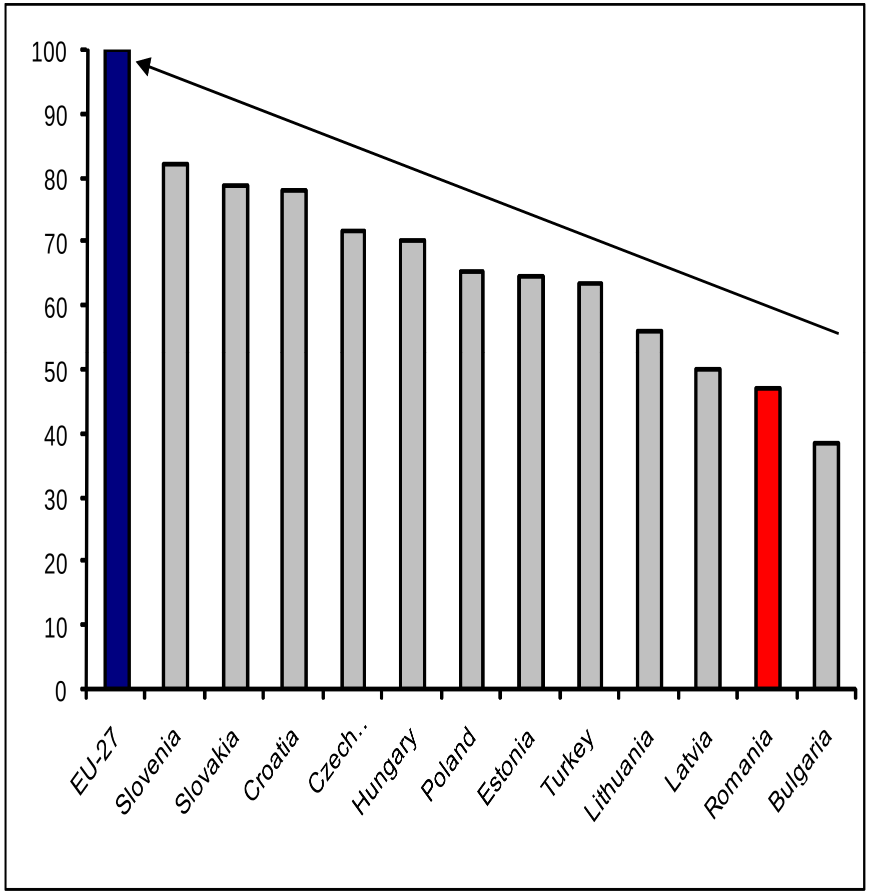
Source: INSSE, UniCredit Research estimates

Wage convergace strictly driven by productivity convergence

Real Wage convergence, 2008 -CEE
GDP per capita, PPS (EU-27=100)

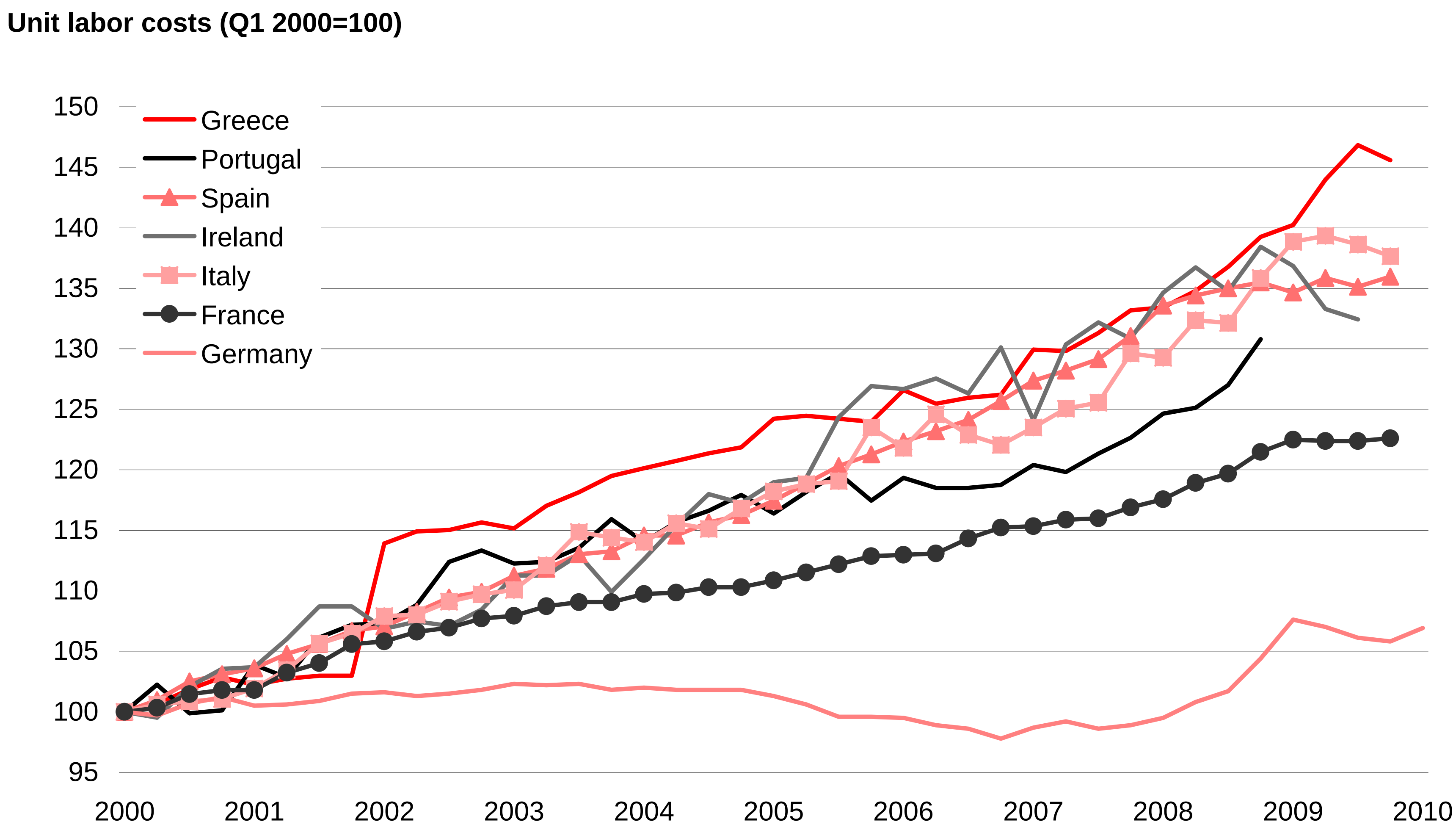


Labor productivity per capita, 2009
EU-27=100



Sursa: Eurostat, UniCredit Research

Divergence in competitiveness: problems also within the eurozone that need correction and clear action plan of this adjustment process.

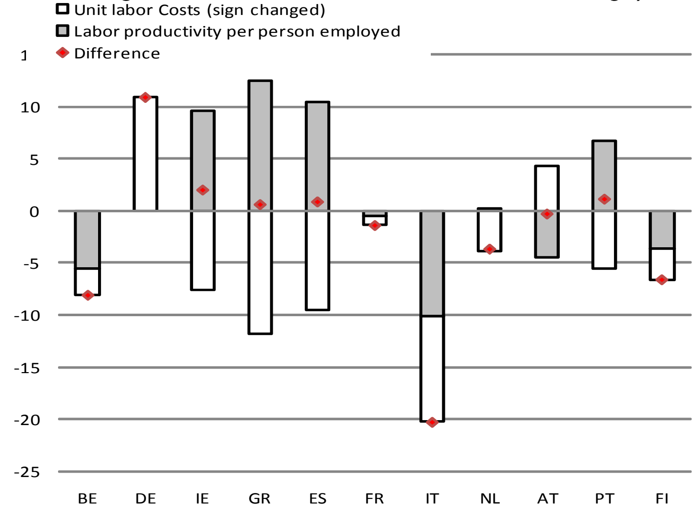


Sursa: Eurostat, UniCredit Research

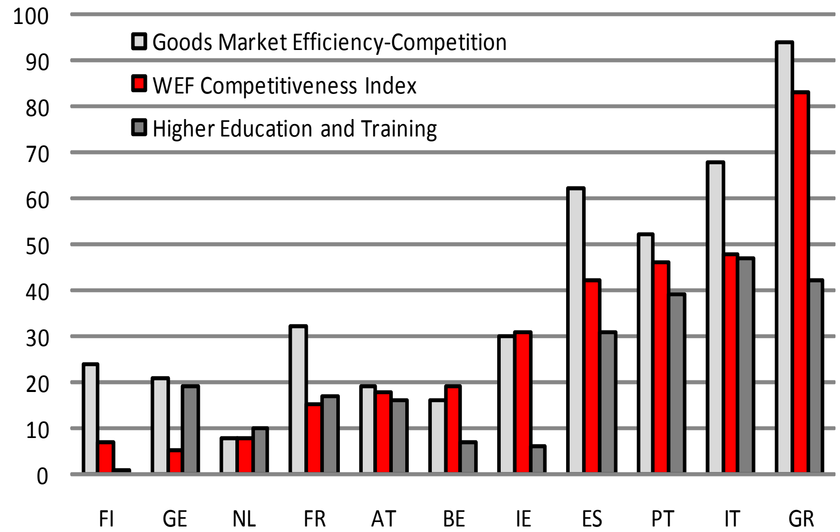
Diverging competitiveness

LABOR COST AND PRODUCTIVITY STORIES – EU

(Cumulated growth in 2000-2008, relative to EA average)



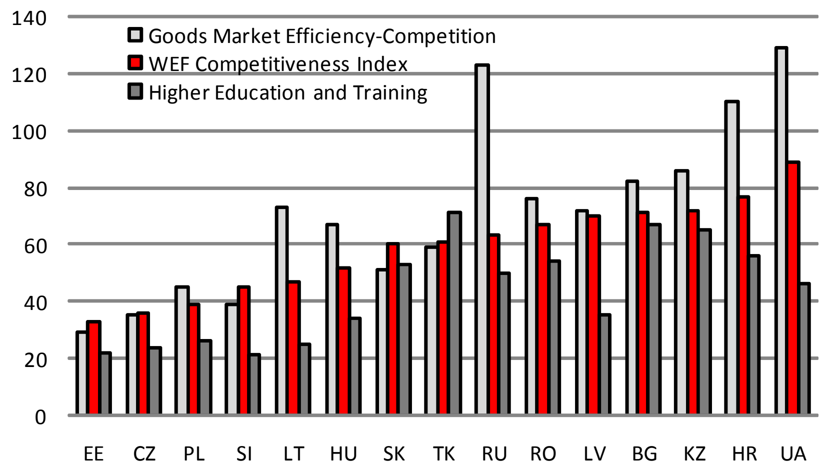
World Economic Forum Index and sub-index averages (ranking) - EU



LABOR COST AND PRODUCTIVITY STORIES – CEE

(Cumulated growth in 2000-2008, relative to EA average)

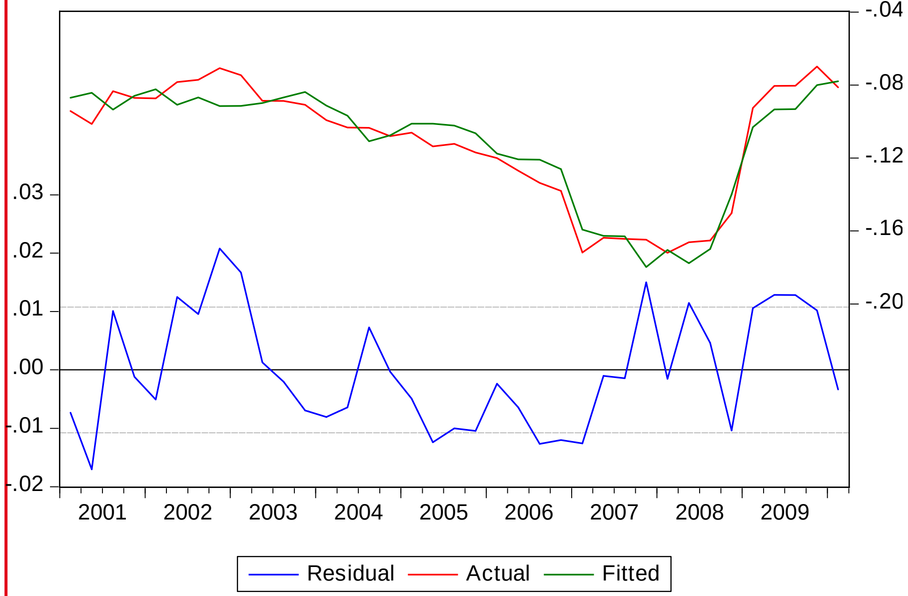
World Economic Forum Index and sub-index averages (ranking) - CEE



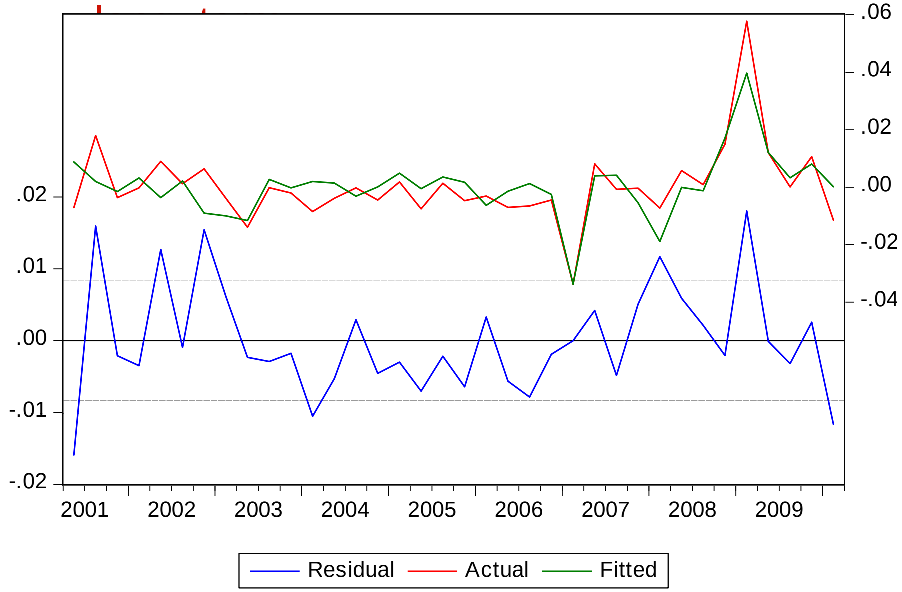
Sursa: Eurostat, AMECO, World Economic Forum, UniCredit Research

Price competitiveness through RER versus other market drivers

External deficit(as % of GDP) –long term



Change in external deficit(as % of GDP) –



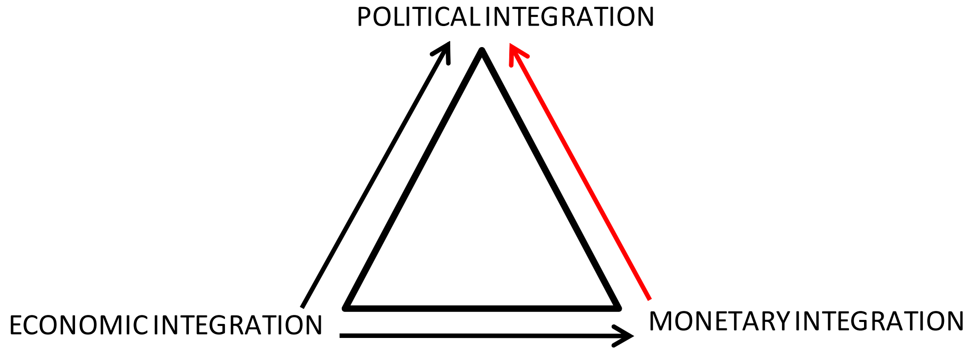
	Coefficient	t-statisitic	Prob
intercept	-0.09	-2.61	0.01
log(domestic demand)	-1.53	-8.59	0.00
short-term spread	0.001	2.34	0.03
log(oil price)	-0.03	-1.75	0.09
log (real exch. Rate index)	-0.01	-1.53	0.14
Dummy2007	-0.03	-4.18	0.00
Sample: 2001 Q1- 2010 Q1			
Adjusted R-square	89.9%		

	Coefficient	t-statisitic	Prob
intercept	0.01	4.21	0.00
%change in GDP	-0.50	-5.18	0.00
%change of oil price	0.01	0.56	0.58
Error correction term (-1)	-0.56	-3.64	0.00
%change RER	-0.07	-2.01	0.05
dummy2007	-0.04	-4.30	0.00
Sample: 2001 Q1- 2010 Q1			
Adjusted R-square	61.2%		

Monetary integration to be sustainable

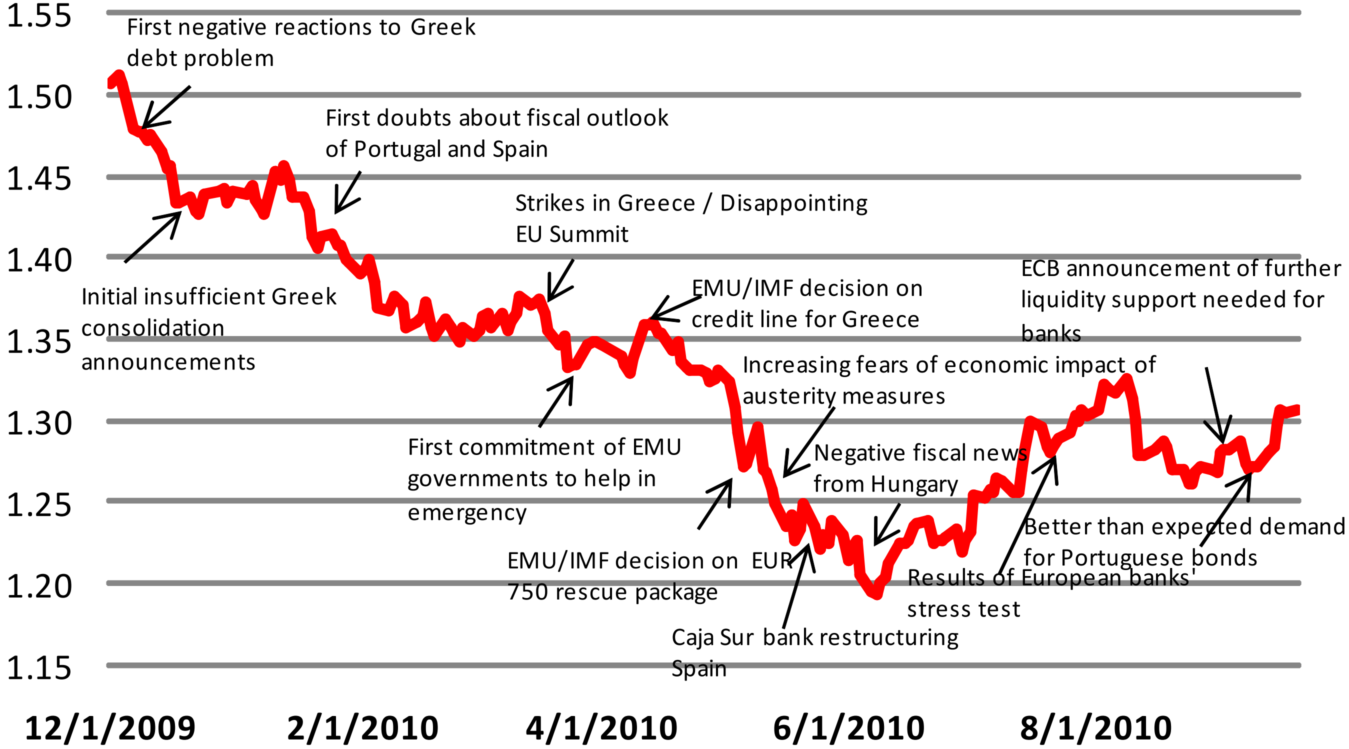
Need also political integration:

A View of Economic, Monetary and Political Integration
"Functional" Integration Process Underlying Treaty of Rome (1957)



EMU debt crisis weighs on single currency

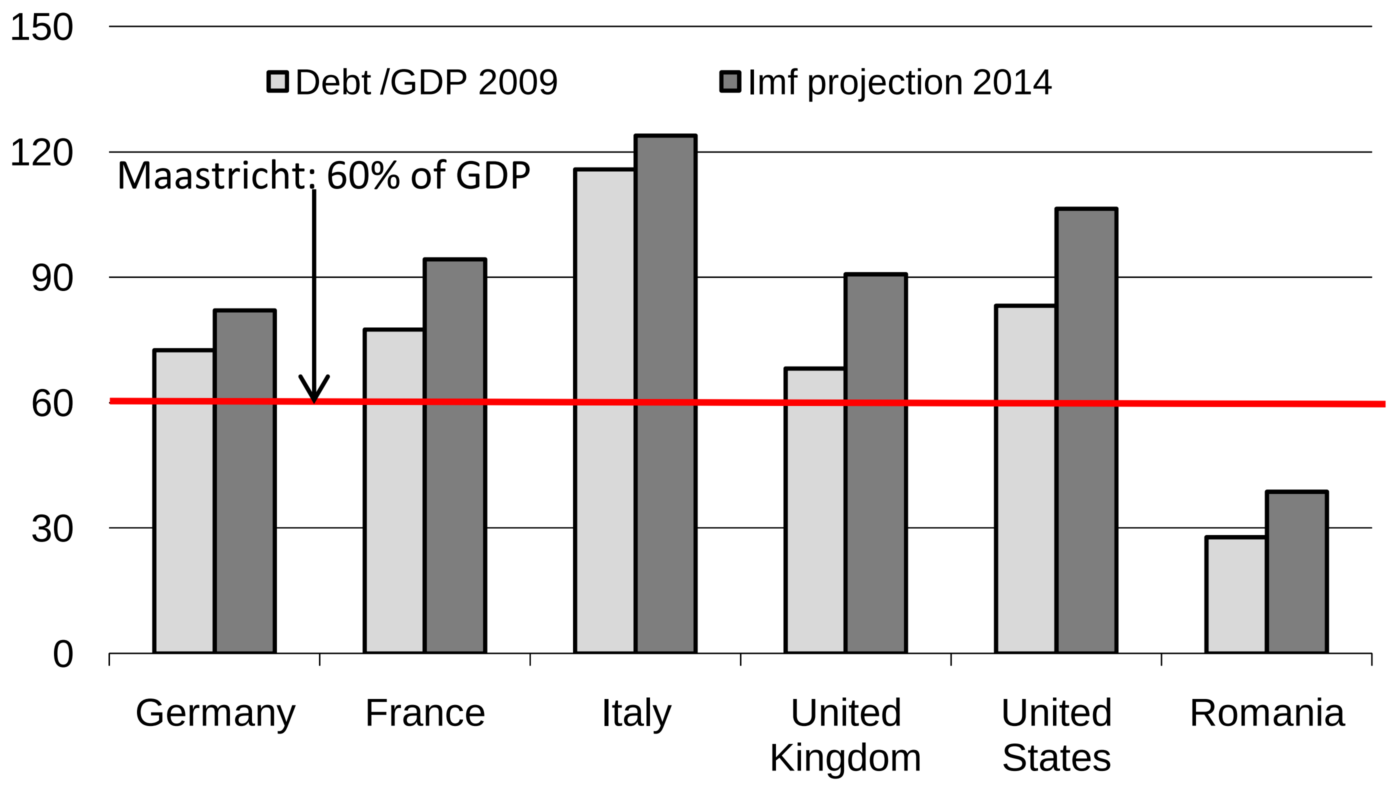
EUR-USD



The current tensions in the eurozone's sovereign debt market have marked the beginning of a true existential crisis for the single currency area: As a consequence, there is a growing consensus that the eurozone will need to undergo deep institutional changes, and a sizable minority of investors and observers now consider a breakup of the eurozone as a distinct possibility.

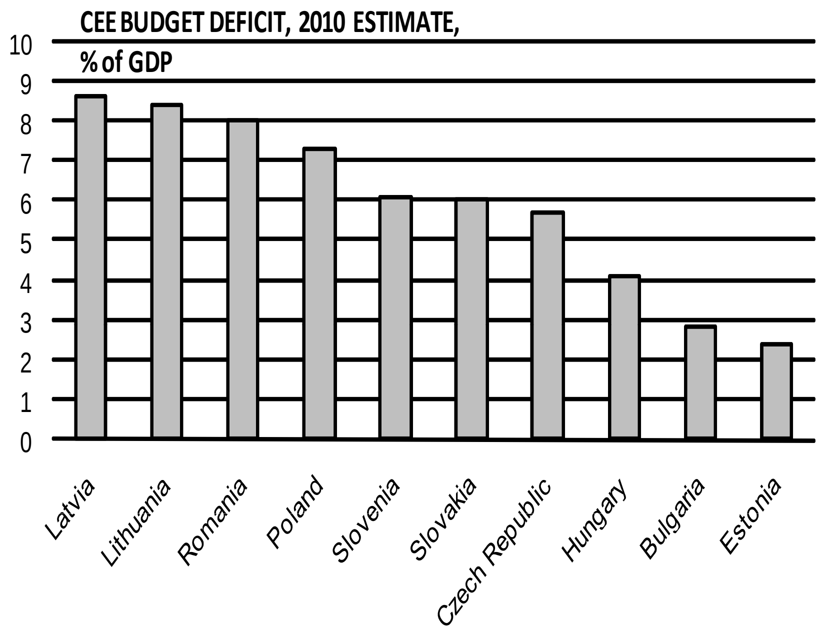
Source: ECB, Bloomberg

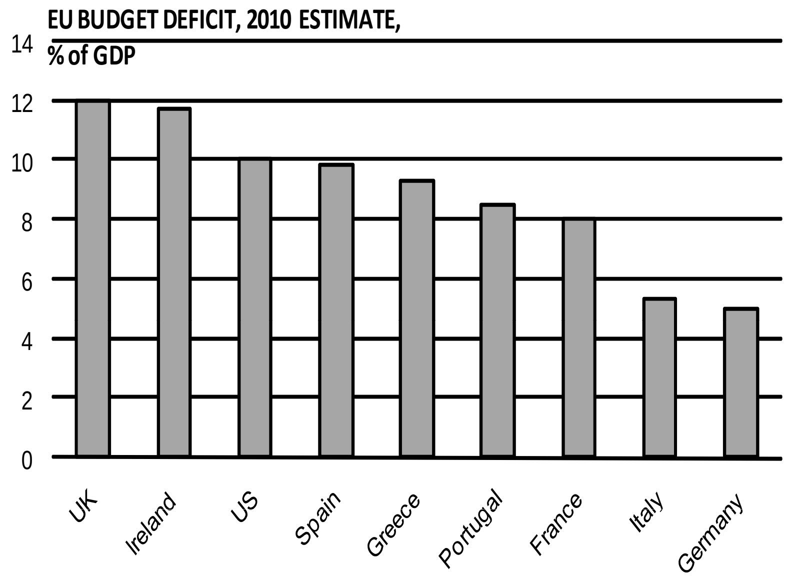
Fiscal integration: Sovereign debt crisis in the developed world?



Notes: Estimates for Romania according to UniCredit Tiriac Bank projections
Source: IMF

Fiscal integration: Budget deficit in developed world and CEE

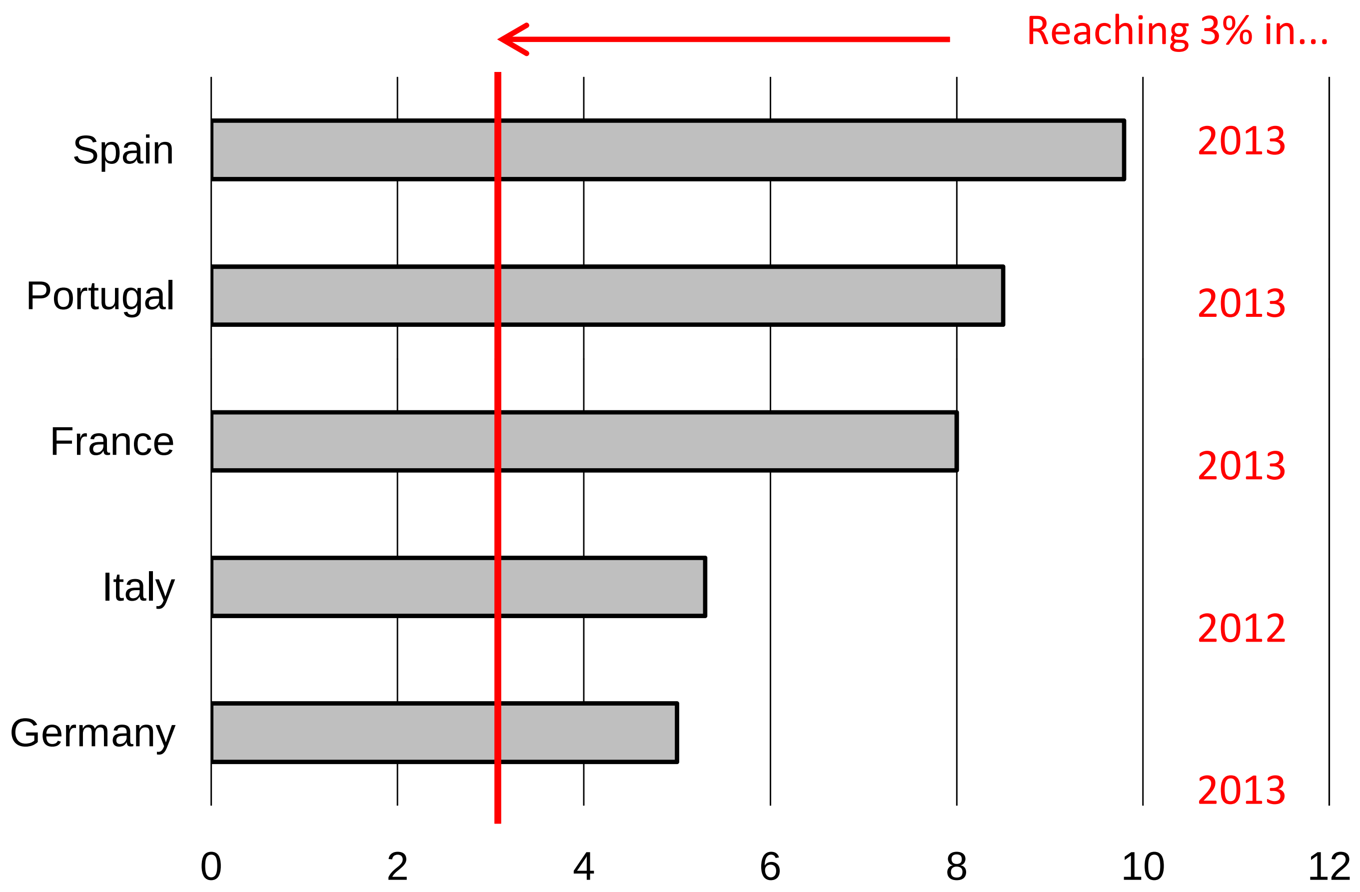




Source: European Commission, UniCredit Research

Fiscal integration: (Too) ambitious consolidation programs posing risks to the European economy

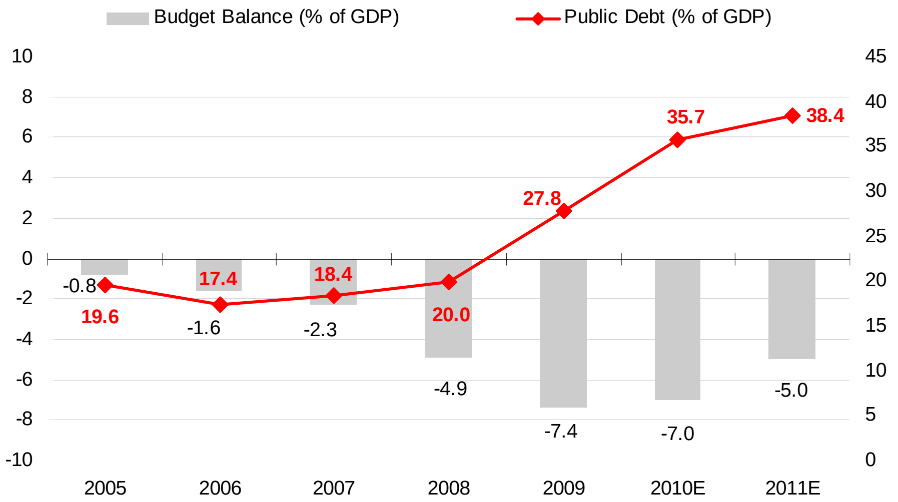
Public deficit, in % of GDP (2010)



Source: EU Commission, UniCredit Research

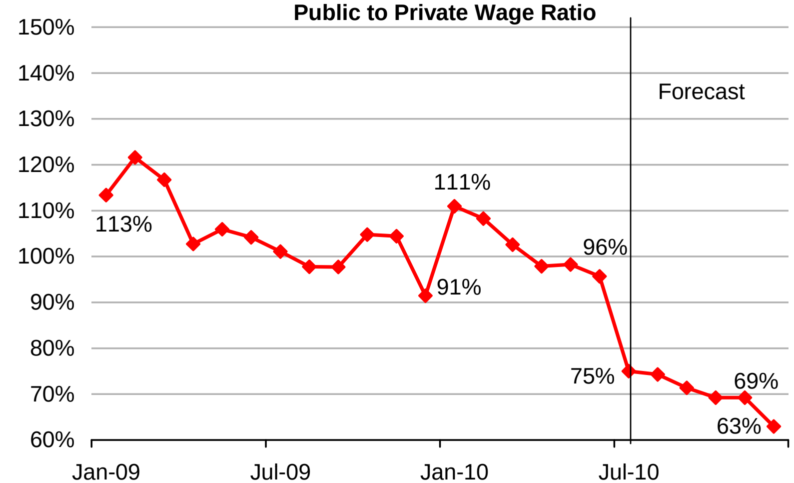
Fiscal slippage remains Romania's main risk

Public deficit and debt soared in 2009 and 2010YTD



Source: Ministry of Finance, NBR, UniCredit Research estimates

Fiscal austerity measures are yet to show their impact



Source: INSSE, UniCredit Research estimates

- The public debt is expected to remain at a sustainable level of 36% of GDP (2010 YE). YTD, the MinFin borrowed around RON 24bn from the local market and EUR 1bn via a Eurobond issue. It also announced a plan to issue EUR medium-term notes (3Y EMTNs) of around EUR 7bn on external markets
- On 1 July 2010 the government introduced an austerity package aiming at reducing the fiscal deficit by 2% of GDP (from a 2010YE target level of 6.8%). The measures refer to: 25% public sector wage cuts (around RON 5.5bn savings), 15% unemployment benefits cuts and the VAT tax increase from 19% to 24% (which should bring additional budget revenues of around RON 4bn according to our calculations); the amended Fiscal Code introduced additional taxes that should generate additional revenue of 0.3% of GDP, according to Ministry of Finance estimates
- The government also initiated the restructuring of the public sector: YTD over 30,000 jobs were cut, nearly half of the 70,000 layoffs agreed with the IMF for 2010. The total planned layoffs should reach around 0.35mn in the next 5 years

Romania: When to join or not to join

When is the proper time to join:

- When wages are strongly correlated with productivity (in case lower productivity wages might drop), free capital and labor mobility and (competitiveness (adjustment without exchange rate moovement)
- Finalizing already the fast catching-up period and major structural changes /corrections
- Proving the ability of the Romanian economy, leaders/politicians for increased economic, financial and political integration through strong commitments to correct economic imbalances through continuous structural changes, integration of institutions and to co-operate for the best approach for all members, in case of shocks
- Exchange rate is dominated by financial and monetary shocks and it cannot perform the macroeconomic stabilization factor and if price competitiveness on international market prove to be less effective (no cost of abandoning flexible exchange rate system but benefiting its advantage)
- **When is not appropriate time to join:**
- Strong imbalances like current account deficit and/or budget deficit, amid rigidity for structural changes and correction measures, and/or social preferences uncorrelated with economic development –in such cases market should adjust accordingly (price competitiveness through nominal exchange rate adjustments)
- Romania and the rest of the EU's economies are not in perfect step facing different levels of inflation and/or stance of economic cycle; one monetary policy may not be suited for all countries. Prices (inflation) affected and move independently (faster) than the eurozone, due to structural changes and catching-up process suggest that there is need for time till the process is finalized. (Alesina, Barro and Tenreyro (2002); Calvo and Reinhart (2002). During the transition period specific macro policy (boh monetary and fiscal) should be needed that might diverge from Maastricht criteria.

The Eurozone’s fate

- **What lies ahead? We can imagine three different scenarios:**

According to: **Thorsten Weinelt,** CFA Global Head of Research & Chief Strategist, UniCredit Group

Marco Annunziata, PhD, Chief Economist, Global Head of Economics, FI/FX Research, UniCredit Group

- (1) “**Quantum leap**” (20% probability)

- (2) “**Disintegration**” (15% probability)

- (3) “**Cosmetic surgery**” (65% probability)

Scenario 1: Quantum Leap (20% probability), Romania might benefit significantly in such environment, criteria being more restrictive, in this case delay in EURO adoption of Romania would be highly probable.

- Past crises have provided the trigger for major accelerations in the European integration process; it is therefore possible that the current crisis might also prove to be the trigger for another quantum leap in integration. In this case, this should be in the direction of guaranteeing much greater and credible coordination of fiscal policies and structural reforms.

- The best way to achieve this would be via closer political integration, turning the Eurozone into something much closer to a true federal state. At this stage, however, there seems to be limited political appetite for this in the national capitals.

- An alternative approach would be to formulate a new set of fiscal rules to replace the Stability and Growth Pact which has proved to be completely ineffective. The key requirement here though would be how to guarantee enforceability of the rules—in this context, enshrining common fiscal rules in national legislation would seem to be the safest option.

- The importance of the fiscal challenge should not be underestimated. The IMF projects that the debt to GDP ratio for advanced economies will rise to 110% by 2015, representing a nearly 40pp rise from pre-crisis levels. While the increase is particularly marked in UK and US, it is also very sharp in the Eurozone, even for core countries: according to the IMF projections, the ratio would exceed 90% in France and 80% in Germany.

Scenario 2: Disintegration (15% probability) –No place to join for Romania.

- The opposite, worst case scenario is one where the eurozone might break apart. This might happen in different ways:

- One possibility is that one of the countries with the weakest fiscal position and poorest competitiveness might decide to leave the Eurozone in order to gain some more flexibility by re-acquiring its own currency. The benefit would of course be only temporary, and would therefore need to be bolstered immediately with strong fiscal and structural reforms. Also, exit from the eurozone would almost automatically imply a debt default or restructuring. If one weak countries were to exit, the others would find themselves under enormous pressure and would need strong support from their peers.

- Another possibility is that one of the strongest countries might decide to leave the area. This could be justified, for example, if a “core” government reached the conclusion that keeping the eurozone together requires an open-ended commitment to support the weaker members, without any guarantees that fiscal discipline will be re-established.

Scenario 3: Cosmetic Surgery (65% probability), Romania might join and be an active partner of undergoing structural changes and continuous improvement. Nominal convergence might be reached in the targeted time-zone (around 2015).

- The most likely scenario is that we will see only "cosmetic surgery" which does not fully address the true underlying structural weaknesses of the eurozone.:

- For example, recent proposals by the European Commission envisage a form of enhanced surveillance which would monitor fiscal developments at an earlier stage and would also monitor the development of external imbalances and competitiveness within the eurozone. While a sound idea in principle, this would not provide any credible mechanism for enforcing the recommendations and corrective measures that would be identified by the Commission.

- Some encouragement might be drawn by the fact that a number of countries have launched fiscal adjustment measures in 2010, including Portugal, Spain, and Italy. However, there is no guarantee that these measures which have been launched in an emergency situation would be maintained once the emergency is over.

- Similarly, the priority of quickly boosting the eurozone's growth potential needs immediate concrete action on the structural reform front, and there is very little evidence of any move in this direction yet.

- Example: The case of Estonia

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Key Take-Aways

- **Eurozone:** Deep reforms and deleveraging are unavoidable! There might be also need for adjustment of the growth model of the most competitive countries (i.e. higher wage growth/consumption in Germany, for example) while attention should also be given to competitiveness and macroeconomic imbalances among members.
- **Romania** : There is plenty of room for the emerging countries to take an active role in the adjustment process. In particular, we have equally strong responsibility to accelerate structural reforms and boost productivity in order to achieve both real and nominal convergence. Increasing competitiveness is the major ingredient for convergence and correction of imbalances but price competitiveness proved to be less important. Consequently, flexible exchange rate adjustments are less effective for macroeconomic stabilization and adopting euro (fix exchange rate) would not hurt competitiveness!
- **For both old members and newcomers:** Fiscal discipline must be enforced in a preemptive way, in good times; debt sustainability should always be taken into account, with countries running high debt to GDP ratios required to make steady progress in reducing them. Moreover, for **fiscal consolidation and harmonized institutional reforms** there is a clear need for a greater degree of **political integration**!
- We give **65% probability for the scenario of "Cosmetic Surgery of EMU" and in this case** Romania has real chances to join and be an active partner of undergoing structural changes and productivity improvement. Nominal convergence might be reached in the targeted time-zone (around 2015). The case of Estonia supports this scenario.

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Thank you for your attention!

“EMU remains an experiment with the outcome likely to remain uncertain for a considerable time to come”

by **Otmar Issing**, who served as the European Central Bank's chief economist for its first eight years, Financial Times, April 16 2008