

Romania

Foreign LT: BBB/Stable, Local LT: BBB+/Stable

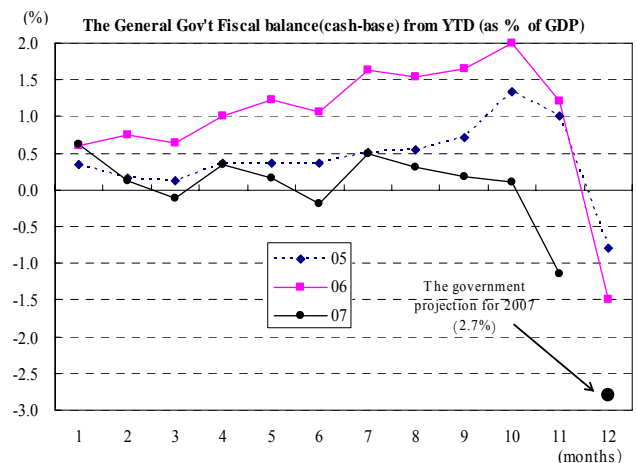
<Rating Perspective>

Positive Factors

- High economic growth prospects following EU accession
- Substantial reduction of government debt
- Expanding production capacity rendered by massive inflows of foreign direct investment

Negative Factors

- Concern over further deterioration of the fiscal deficit prior to general elections
- Surging current account deficit stemming from strong imports amid robust private-sector demand
- Transformation of industrial structure still at primary stage



<Update: from November 2007 to January 2008>

Positive Factors

- The National Bank of Romania (NBR) raised its policy rate by a total 150 bps on January 7 and February 2 amid prospects that price increases will remain higher than its inflation target. In February, NBR decided to increase the provision for foreign currency denominated loans made by banks

Negative Factors

- In its interim report published on February 5, the European Commission (EC) expressed its concern over the delay in Romania's reform initiatives, particularly in the fight against corruption and improvement on the judiciary system
- Consumer price inflation surged to 7.3% year-on-year in January 2008 on higher food prices caused by the prolonged drought effects
- Domestic demand continued expanding robustly, although the real GDP growth rate in the July-September quarter of 2007 remained almost flat at 5.6% year-on-year, as compared with 5.8% in the first half of the year
- The current account deficit widened substantially to 14.5% of GDP in 2007 from 10.5% in 2006
- The ratio of net FDI inflows to the current account deficit fell to 60% in 2007 from 86% in 2006
- The general government fiscal balance in the first eleven months of 2007 ended up in a deficit equivalent to 1.1% of GDP
- Growth of bank lending to the private sector accelerated further to 64.5% year-on-year in December 2007

<Outlook and Points to Watch>

Concern over relaxed fiscal policy ahead of elections

(1) Current account deficit further widens amid robust domestic demand

Domestic demand kept accelerating led by consumer spending and investment, although the real GDP growth rate in the July-September quarter of 2007 remained almost flat at 5.6% year-on-year, as compared with 5.8% in the first half of the year. While the growth of consumer spending slowed to 8.2% year-on-year in the July-September quarter, investment expanded a robust 32.2%. As a result, the growth of the whole domestic demand surpassed 20% year-on-year. In contrast, economic expansion was held down considerably by a major contraction of net exports as imports grew faster than exports on strong domestic demand. The bank lending to the private sector, which fueled domestic demand, showed no sign of deceleration as it swelled 64.5% year-on-year in December 2007. The impact on the Romanian economy of the ongoing global financial turmoil has been rather limited so far, although the value of its currency and bond and stock prices dropped to some degree since the beginning of last fall.

Consumer price inflation, which fell to a record low 3.7% year-on-year in March 2007, rose to 7.3% in January 2008 on higher food prices caused by the prolonged effects derived from drought and the surge of energy prices. The National Bank of Romania (NBR) carried out additional policy rate hikes totaling 150 bps on January 7 and February 2 amid heightened prospects that price increases may continue to outpace its inflation target (3.8%±1 percentage point at the end of 2008). In February, NBR decided to increase the provision for foreign currency denominated loans made by

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banks. The growing inflation pressure stemming from wage increases and tightening supply-demand gap may force NBR to carry out another rate hike in the coming months.

The current account deficit has kept widening since 2003 on strong import growth spurred by robust domestic demand. It reached 14.5% of GDP in 2007. In 2006, as much as 86% of the current account deficit was covered by net FDI inflows. However, as the ratio fell to 60% in 2007, the country had to depend more on debt-creating foreign funds borrowed through banks. There is little short-term concern about the liquidity as the foreign exchange reserves stood at a level enough to cover more than five months of imports and the foreign debt was kept low at around 45% of GDP in September 2007 despite a recent rise in the private-sector debt. While a rapid increase in foreign currency-denominated loans and household loans may be a source of concern, the country's banking system remains well positioned to absorb adverse shocks, with more than 80% of the bank capital controlled by foreign banks.

(2) Expansionary fiscal policy adding fuel to domestic demand

The general government fiscal deficit (ESA95), which had been narrowing since 2000, began widening moderately in 2006, with its ratio to GDP rising to 1.9%, up from 1.4% in 2005. In the first ten months of 2007, the fiscal balance produced a marginal surplus (in cash basis accounting) but fell into deficit in the first eleven months of the year. The fiscal deficit in 2007 as a whole is seen to have exceeded 2.7% of GDP as envisaged in the budget, given the substantial increase in pension benefits that started in November and the usual year-end spending pattern in recent years. This means that the annual fiscal deficit has widened for the second consecutive year. JCR considers that the government has shifted its fiscal policy to an expansionary one geared up for the upcoming elections. The government has estimated the fiscal deficit in 2008 at 2.7% of GDP under its budget plan for the year. Indications are that the budget will have little effect in curbing the excessive domestic demand as in 2007.

(3) Spending pressure may grow ahead of 2008 elections

The three-party coalition government (National Liberal Party: NLP, Democratic Party: DP and Hungarian Democrat Union in Romania: HDUR), which had led Romania to EU membership, collapsed in March 2007 after the smoldering feud between Prime Minister Calin Popescu Tariceanu (NLP) and President Trian Basescu (DP) finally came to the fore. The current two-party minority government, comprising the NLP and HDUR, controls only 75 out of 332 parliamentary seats. Since taking office in April 2007, it has depended on non-cabinet support from the Social Democratic Party (SDP), the largest opposition force with 103 parliamentary seats. Romania is set to have local elections in the middle of 2008, general elections in late 2008 and presidential election in early 2009. With both the coalition parties and the SDP struggling with their slumped approval ratings, the government finds it hard to promote a restrictive fiscal policy aimed at reining excessive domestic demand. Furthermore, in its interim report published on February 5, the EC expressed concern over the delay in the country's reform programs, particularly in the fight against corruption and improvement on the judiciary system.

JCR holds that any remarkable progress on various reforms is unlikely to come before the general elections. It will initiate a review of the ratings if the fiscal deficit deteriorates drastically.

Main Economic Indicators: Romania

		2003	2004	2005	2006	2007f	2008f	2009f
(Convergence criteria)	Criteria							
1.CPI (annual average)	2.8%(note)	15.3	11.9	9.0	6.6	4.8	5.8	4.0
2.10 year government bond yield	5.7%(note)	n.a.	n.a.	7.0	7.2	7.1	7.5	7.2
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	▲1.5	▲1.5	▲1.4	▲1.9	▲3.2	▲3.7	▲3.0
4.General gov't debt/GDP(ESA95)	Below 60%	21.5	18.8	15.8	12.4	13.5	15.0	14.6
Real GDP growth rate	(%)	5.2	8.4	4.1	7.9	5.8	5.5	5.0
Unemployment Rate	(%)	7.4	6.3	5.8	5.4	4.3	4.0	3.8
Current account balance/ GDP	(%)	▲6.0	▲8.4	▲8.7	▲10.5	▲14.5	▲17.3	▲14.7
Trade balance/GDP	(%)	▲7.8	▲8.8	▲9.8	▲12.1	▲15.1	▲18.3	▲15.6
Net FDI inflows/GDP	(%)	3.8	8.4	6.6	9.0	8.7	6.4	4.6
Foreign exchange reserve (FOREX)	(EUR mn)	6,374	10,848	16,796	21,310	25,307	28,500	31,500
Net FDI/CA	(%)	62.4	100.5	76.0	85.9	60.3	39.5	40.7
Gross external debt/ GDP	(%)	35.2	34.7	38.0	43.1	44.7	45.9	47.5
Gross external debt/ Export (G&S)	(%)	97.7	96.5	114.7	133.1	140.7	137.0	133.4
Public external debt/ Export (G&S)	(%)	53.0	45.8	42.9	38.4	36.8	33.3	29.8
FOREX/monthly imports	(months)	3.4	4.8	5.8	5.9	5.6	5.3	5.1
FOREX/short-term external debt	(times)	3.2	3.4	2.6	1.6	1.7	1.7	1.7
Debt service ratio	(%)	16.9	16.4	13.5	13.4	11.6	10.5	8.9

Note: Figures for criteria 1 and 2 are as of end 2007. Figures for 2007, 2008 and 2009 are based on the projection made by JCR

Source: The European Commission, the NBR, Ministry of Public Finance and National Institute of Statistics

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