

2009-08

May 28, 2009

## Romania

**Foreign LT: BBB-/Negative, Local LT: BBB/Negative**

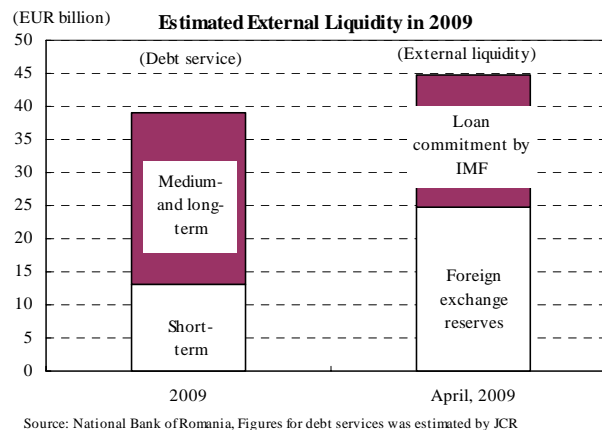
### <Rating Perspective>

#### Positive Factors

- Substantial reduction of government debt
- Expanding production capacity rendered by massive inflows of foreign direct investment

#### Negative Factors

- Weakening resilience to external financing amid the deepening global de-leveraging process
- Surging external debt led by the continuing current account deficit
- Widening fiscal deficit caused by the expansionary fiscal



### <Update: from February 2009 to May 2009>

#### Positive Factors

- The Romanian government agreed on a fresh loan program totaling EUR20 billion with the IMF, EU and other multilateral financial institutions on March 25.
- The IMF approval of its loan commitment on May 4 has made it possible for Romania to draw EUR5 billion immediately.
- The Romanian currency (RON) recovered and appreciated by around 10% against the US dollar and 3% against the euro from the record lows at the beginning of March.
- Parliament approved the budget plan for 2009, which sets the fiscal deficit target for the year at 2.0% of GDP.
- The current account deficit in the first three months of 2009 narrowed substantially to 0.5% of GDP from 2.9% the year before.
- The ratio of the net FDI inflow to the current account deficit improved markedly to 205% from 54.8% in 2008.
- The growth of bank lending to the private sector in March 2009 moderated further to 23.5% year-on-year.
- The National Bank of Romania (NBR) cut the policy rate by 25bps on February 4 and by 50bps on May 14 to 9.5%.

#### Negative Factors

- Industrial output contracted by 13.1% year-on-year in the January-March quarter of 2009, a steepest fall since 1999.
- Due mainly to increased expenditures, the general government fiscal deficit in 2008 widened to 5.4% of GDP from 2.5% in 2007.
- Foreign exchange reserves at the end of April 2009 shrank to EUR24.9 billion, down 9% from the peak level in October 2008.
- The European Commission initiated excessive deficit procedures for four countries including Romania on May 4.

## <Outlook and Points to Watch>

### IMF loan commitment bolsters external position

#### (1) IMF approves loan commitment

The Romanian government agreed on a fresh loan program totaling EUR20 billion with the IMF, EU and other multilateral financial institutions on March 25. Following the official approval of the loan agreement by the IMF on May 4, the government can now draw EUR5 billion immediately. The IMF loan will be disbursed over the next two years.

The package loan is conditional on Romania's fiscal consolidation centering on significant spending cuts, restoring its external imbalance and additional measures to strengthen its banking system including preemptive recapitalization and strengthened supervision. Furthermore, Romanian subsidiaries of major European banks agreed with the IMF on maintaining their overall exposure to the country and on increasing the capital of their subsidiaries. With the worst economic recession since the late 1990s expected in 2009, the new government elected in November 2008 has already committed to implement comprehensive reform measures based on the agreement with the IMF. If the remaining portion of the loan program is disbursed as planned, the government will be able to secure the external financing for 2009 barring a drastic capital flight from the country.

On December 18, 2008, JCR downgraded its rating on Romania's foreign currency long-term senior debts to BBB- from BBB and the rating on the local currency long-term senior debts to BBB from BBB+. The outlook of the ratings was kept negative. The new loan program

equivalent to more than 15% of GDP should shore up the country's external position and keep its general government debt as low as around 30% of GDP even when the loan is entirely disbursed. However, the government faces enormous difficulties in implementing its fiscal reform measures. There remains concern over problems the banking system faces, such as an increasing volume of nonperforming loans. JCR will retain its ratings and their outlook, and will closely monitor how the situation will develop.

### (2) Romania may see worst economic recession since late 1990s

The Romanian economy grew robustly in the first three quarters of 2008 with the real GDP growth rate exceeding an annualized 8%. However, it has been slowing down markedly since last October as real GDP growth rate in the October-December quarter falling to 2.9% year-on-year amid the deepening economic recession in major European trading partners and the global financial crisis. The economy continued to fall further and contracted by 6.4% year-on-year in the January-March quarter of 2009 on a steep plunge of exports and weakening domestic demand. While the global financial woes and the recession in the major European trading partners eased somewhat, the Romanian economy will contract round 3% in 2009 and its recovery in 2010 will be only modest due to continued spending cuts. The consumer price inflation, which increased slightly at the beginning of 2009 on higher service prices, decelerated to 6.5% year-on-year in April 2009 on stable food and energy prices. While the inflation rate remains above the target (3.5% plus/minus 1%pp) set by the NBR, the bank lowered its policy rate by 25bps on February 4 and by 50bps on May 14 to 9.5% on the assumption that the inflation rate will continue decelerating amid the deepening economic recession. However, the NBR reduced the minimum reserve requirement on the foreign currency denominated liabilities with maturities of more than two years from 40% to zero on March 31.

### (3) Current account deficit improves rapidly on sharp fall in imports

The current account deficit, which widened to 12.3% of GDP in 2008, has been improving rapidly since the end of 2008 due primarily to a steep fall in imports. The deficit in the January-March quarter of 2009 narrowed to 0.5% of GDP from 2.9% the year before. The deficit was entirely covered by non-debt creating funds, with the ratio of net FDI to current account deficit improving to 205% in the January-March quarter from 52.8% in 2008.

The foreign debt increased to 53.4% of GDP at the end of 2008 from 47.4% a year before. The IMF loan, when entirely disbursed, would push up the country's external debt, mainly in the government sector, to around 60% of GDP at the end of 2009. By contrast, the country's external liquidity position was bolstered by the IMF loan. The foreign exchange reserves at the end of April 2009 shrank to EUR24.9 billion, down 9% from the peak level in October 2008. However, the reserves, combined with the IMF loan commitment, would exceed the country's debt services for 2009 (estimated by JCR at EUR40 billion including short-, medium- and long-term debts).

### (4) Fiscal consolidation measures of new coalition government need to be watched

The new coalition government has revised the 2009 budget plan, cutting its economic growth estimate in 2009 to -4% and narrowing the fiscal deficit to 2.0% of GDP. While the government plans to adopt a stimulus package including a massive public investment project mainly funded with EU subsidy, it has substantially reduced expenditures such as wages of public employees and other expenses. Given the worsening economy, however, the government may be forced to consider a further spending cut. JCR will watch how the new government with a working majority will carry out the spending measures agreed with the IMF.

## Main Economic Indicators: Romania

		2004	2005	2006	2007	2008	2009f	2010f
<b>(Convergence criteria)</b>	<b>Criteria</b>							
1.CPI (annual average)	4.0%(note)	11.9	9.1	6.7	3.9	7.9	6.0	4.5
2.10 year government bond yield	5.4%(note)	n.a.	7.0	7.2	7.1	7.6	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-1.2	-1.2	-2.2	-2.5	-5.4	-4.0	-3.5
4.General gov't debt/GDP(ESA95)	Below 60%	18.8	15.8	12.4	12.7	13.6	22.3	29.8
Real GDP growth rate	(%)	8.5	4.2	7.9	6.2	7.1	-3.0	1.5
Unemployment Rate	(%)	8.1	7.2	7.3	6.5	5.8	7.2	7.6
Current account balance/ GDP	(%)	-8.4	-8.7	-10.4	-13.5	-12.3	-8.3	-6.5
Trade balance/GDP	(%)	-8.8	-9.8	-12.0	-14.5	-13.4	-10.5	-8.6
Net FDI inflows/GDP	(%)	8.4	6.6	8.9	5.7	6.8	4.2	5.3
Foreign exchange reserve (FOREX)	(EUR mn)	10,848	16,796	21,310	25,307	25,919	33,500	45,500
Net FDI/CA	(%)	100.5	76.0	85.9	42.2	54.8	50.4	81.9
Gross external debt/ GDP	(%)	34.7	38.8	42.0	47.4	53.4	63.6	67.9
Gross external debt/ Export (G&S)	(%)	96.5	117.3	130.8	160.0	172.3	206.1	224.5
Public external debt/ Export (G&S)	(%)	45.8	46.3	36.8	36.3	39.0	62.4	83.2
FOREX/monthly imports	(months)	4.8	5.8	5.9	5.6	5.2	7.9	10.3
FOREX/short-term external debt	(times)	3.4	2.7	1.7	1.3	1.2	1.5	1.9
Debt service ratio	(%)	16.4	20.1	20.7	23.2	29.3	37.2	36.5

Note: Figures for criteria 1 and 2 are moving average between March 2008 and February 2009. Figures for 2009 and 2010 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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