2009-023
August 28, 2009

Romania

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

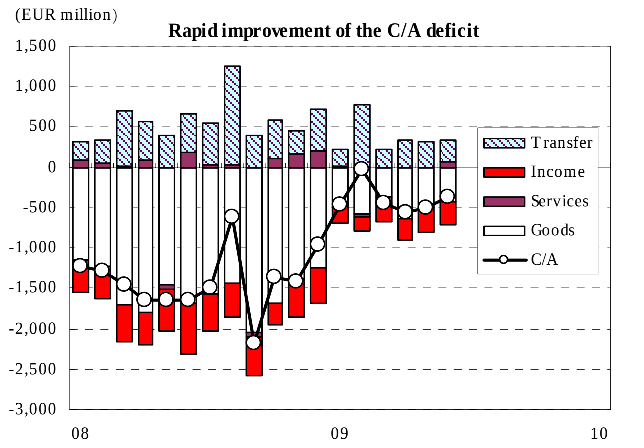
<Rating Perspective>

Positive Factors

- Substantial reduction of government debt
- Expanding production capacity rendered by massive investments following inflows of foreign direct investment and EU subsidies

Negative Factors

- Threatened sustainability of external financing
- Surging external debt led by the persistent current account deficit
- Widening fiscal deficit caused by the expansionary fiscal policies pursued by the former government
- Transformation of industrial structure still at primary stage



<Update: from May 2009 to August 2009>

Positive Factors

- Following the IMF approval of the loan commitments to Romania, the government received the first tranche equivalent to EUR5 billion on May 4. The government also received the first installment of EUR1.5 billion from the loan commitment made by the EU at the end of July.
- The general government fiscal deficit in the first half of 2009 settled at 2.7% of GDP, within the 2.73% limit agreed with the IMF, although widened from 1.0% a year earlier.
- The parent banks of the nine largest foreign-owned Romanian banks signed letters with the National Bank of Romania (NBR) on August 10, committing to keep their subsidiaries' overall exposure to Romania and to increase their capital adequacy ratio to 10%.
- The country's economic downturn moderated somewhat in the April-June quarter of 2009 as the real GDP growth rate improved to -1.2% quarter-on-quarter from -4.6% in the previous quarter.
- The current account deficit in the first half of 2009 was 1.9% of GDP, narrowing markedly from 6.5% a year earlier.
- The Romanian government introduced a new tax on business turnover in May to boost its annual revenues by EUR83 million.
- Another cut in the minimum reserves requirements by the NBR both for RON and foreign currency deposits on June 24 boosted the liquidity position of the banking system.
- The NBR cut its policy rate three times between May and August by a total 150bps to 9.5%.

Negative Factors

- The European Commission began applying excessive deficit procedures to four countries including Romania on May 13
- The unemployment rate in June rose sharply to 6.3% from 4.3% at the end of 2008

<Outlook and Points to Watch>

Improved external financing

(1) Economic downturn moderating

The Romania fell into economic recession from the July-September quarter of 2009 amid deepening recession in its major European trading partners and the global financial crisis. Its real GDP growth rate turned negative in the July-September quarter of 2008, shrinking 0.1% from the previous quarter. The contraction has been continuing for four consecutive quarters since then. However, the downturn somewhat moderated in the April-June quarter of 2009, with the real GDP growth rate improving to -1.2% from -4.6% in the previous quarter. By contrast, the unemployment rate in June rose sharply to 6.3% from 4.3% at the end of 2008. JCR projects that the Romanian economy will contract round 3% in 2009 but may resume growing by around 1% in 2010, helped by an economic recovery in its major trading partners and the currency depreciation. The consumer price inflation accelerated in early 2009 due to higher service prices and a weaker RON but eased to 5.9% year-on-year in June 2009 on stabilization of food prices. While inflation rate was higher than the target set by the NBR (3.5% plus/minus 1pp), the central bank lowered its policy rate by a total 150bps between May and August on the assumption that inflation will continue decelerating amid the persistent recession. The NBR made another cuts in the ratios of minimum reserve requirements both for RON and foreign currency deposits in June

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following the ones in March. The steps have helped to improve the liquidity position of the banking system, with the short-term market interest rates falling to the levels before September 2008.

(2) Romania making progress on loan conditions as planned

Following the IMF approval of its loan commitments to Romania, the government drew the first tranche equivalent to EUR5 billion on May 4. It also drew the first installment of EUR1.5billion at the end of July from the loan commitments made by the EU. The remainder of the IMF commitments is to be disbursed over the next two years, subject to progress Romania will make to meet the loan conditions agreed with the IMF. These require the government to carry out fiscal consolidation mainly through major spending cuts, recapitalize the banks and strengthen their supervision. As for fiscal consolidation, the government is obliged to cut the fiscal deficit (ESA95) to 5.1% of GDP in 2009, 4.1% in 2010 and below 3% in 2011 from 5.4% in 2008. Meanwhile, the European Commission initiated its excessive deficit procedures for Romania and three other countries on May 13, requiring it to cut the fiscal deficit to less than 3%.

Romania has so far been making progress on the conditions as planned. The general government fiscal deficit in the first half of 2009 widened to 2.7% of GDP from 1.0% the year before but settled within the 2.73% limit agreed with the IMF. The parent banks of the nine largest foreign-owned Romanian banks signed letters with the NBR on August 10, committing to maintain their subsidiaries' overall exposure to Romania and to raise their capital adequacy ratio to 10%.

(3) The current account deficit improving rapidly on slower imports

The current account deficit, which widened to 12.3% of GDP in 2008, has been rapidly improving since late in 2008 when imports began falling faster than exports. The deficit in the first half of 2009 narrowed to 1.9% of GDP from 6.5% a year earlier. The deficit has been entirely covered by non-debt creating funds as the ratio of net FDI inflows to the current account deficit improved to 121% in the first half of 2009 from 59% in 2008.

The external liquidity position has also improved thanks to the IMF loans and a sharp reduction of short-term external debts. The external debt as of the end of June 2009 widened to 60% of GDP from 53% at the end of 2008, due mainly to the first tranche drawn from the IMF. Excluding the first tranche, the total external debt at the end of June decreased 4% as compared with the end of 2008. In particular, the short-term external debt which accounts for 30% of the total debt shrank by a substantial 18% in the same period. The foreign exchange reserves totaled EUR27.3 billion at the end of July 2009, gaining EUR1.1 billion from the end of 2008. JCR holds that the government will be able to secure the necessary external financing for 2009 if it can draw the IMF loans as scheduled.

(4) Fiscal consolidation measures deserves close attention

Since taking office last November, Romania's new coalition government has made realistic revisions of its 2009 fiscal deficit and economic growth estimates, projecting the deficit at 4.6% of GDP and the economic growth at -4%. While implementing a stimulus package including massive public investment projects funded with EU subsidies, the government has pledged to enforce a substantial reduction of expenditures through a pay cut for public employees and a slash of various expenses. With the economy expected in 2009 to face the worst contraction since 1997 and 1998, the government may suffer a revenue shortfall, being forced to consider a further spending cut. JCR will watch how the new government with a working parliamentary majority will carry out the spending cuts agreed with the IMF. The coalition government also won the European parliament elections held in June.

Main Economic Indicators: Romania

		2004	2005	2006	2007	2008	2009f	2010f
(Convergence criteria)	**Criteria**							
1.CPI (annual average)	3.8%(note)	11.9	9.1	6.7	3.9	7.9	6.0	4.5
2.10 year government bond yield	5.0%(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	-5.2	-3.8
4.General gov't debt/GDP(ESA95)	Below 60%	18.8	15.8	12.4	12.7	13.6	23.5	30.3
Real GDP growth rate	(%)	8.5	4.2	7.9	6.2	7.1	-3.5	1.5
Unemployment Rate	(%)	8.1	7.2	7.3	6.5	5.8	7.5	8.2
Current account balance/ GDP	(%)	-8.4	-8.7	-10.4	-13.5	-12.3	-7.0	-5.4
Trade balance/GDP	(%)	-8.8	-9.8	-12.0	-14.5	-13.4	-9.1	-7.5
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	59.3	98.8
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	221.7	242.7
Public external debt/ Export (G&S)	(%)	45.8	46.3	36.8	36.3	39.0	67.1	89.9
FOREX/monthly imports	(months)	4.8	5.8	5.9	5.6	5.2	7.9	11.1
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	37.3	37.7

Note: Figures for criteria 1 and 2 are moving average between August 2008 and July 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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