

## Romania

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

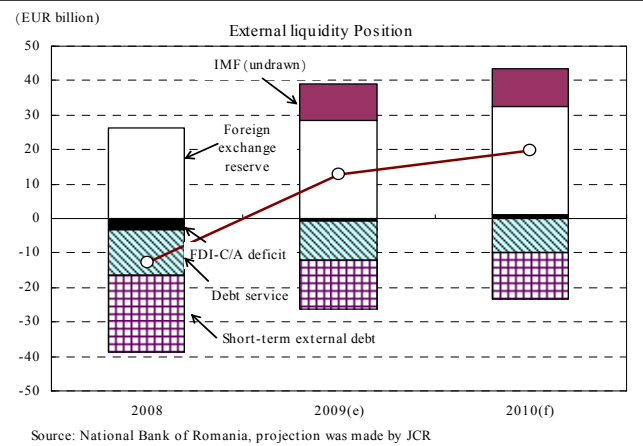
### <Rating Perspective>

#### Positive Factors

- The country's improved external financing position backed by an IMF financial aid package
- Low level of government debt
- Expanding production capacity rendered by massive investments on the back of inflows of foreign direct investment and EU subsidies

#### Negative Factors

- High level of external debt led by persistent current account deficit
- Widening fiscal deficit amid falling revenues
- Transformation of industrial structure still at a primary stage



### <Update: from December 2009 to February 2010>

#### Positive Factors

- Following the collapse of the government in October 2009, the new coalition government formed by the Democratic Liberal Party (DLP), the Hungarian Union of Democrats in Romania (HDUR), national minorities' group and small bloc of independent deputies was approved in parliament with a thin majority on January 14, 2010
- On January 27, Romania reached provisional agreement with the IMF on the second and third reviews of the Stand-By Arrangement. The third (EUR 1.5 billion) and the fourth (EUR 0.8 billion) disbursements would become available upon official approval
- Five year CDS of Romania increased only moderately (279 bps as of Feb. 18) as compared with that of Greece
- The economy continues to recover in the October-December quarter of 2009 as industrial production turned out to be positive year-on-year growth in November and December. By contrast, the pace of contraction of real GDP slightly widened to 1.5% quarter-on-quarter from 0.6% in the previous quarter
- The general government fiscal deficit (cash base) in 2009 is estimated to around 7% of GDP, in line with the 7.3% agreed with the IMF
- The current account deficit in 2009 narrowed to 4.2% of GDP from 9.2% in 2008
- Over 90% of the current account deficit in 2009 was covered by FDI inflows
- The National Bank of Romania (NBR) cut its policy rate twice in January and February by a total 100 bps to 7.5%

#### Negative Factors

- The unemployment rate in December of 2009 continues to surge to 7.8%, up 3.4 percentage points from a year earlier.

### <Outlook and Points to Watch>

#### Focal point is fiscal policy of new coalition government

##### (1) On January 15, JCR has affirmed its ratings and maintain their negative rating outlook

The rating affirmation mainly reflects the country's improved external liquidity position bolstered by IMF financial program, a low level of government debt, which may inevitably increase in the coming years though, and an expanded production capacity resulting from investments prompted by massive foreign direct investment (FDI) and EU subsidy. On the other hand, the ratings remain constrained by a large fiscal deficit and increased external debts and the industrial transformation still remaining at a primary stage.

The outlook of the ratings kept negative. The 2010 budget plan, whose introduction had been delayed due to the political turmoil, was finally submitted to parliament after the formation of Prime Minister Emil Boc's second administration. The budget plan was finally approved by the parliament on January 14. This paves the way for resumption of the delayed IMF loan disbursement. However, uncertainty remains over whether new coalition government led by the DLP can carry out its reform commitments to the IMF with maintaining the political support from coalition partners; HDUR, national minorities' group and small bloc of independent deputies. Those commitments include implementation of the *Fiscal Responsibility Law* and reforms on pensions and public employee wages. The reform initiatives are crucial for reduction of the fiscal deficit. Another failure will eventually lead a delay of the IMF loan disbursement and greater pressure on the country's external financing. Furthermore, risks also remains in banking sector due to further deterioration of the asset quality reflecting poorer corporate profit performances and rising unemployment in the midst of economic downturn.

## (2) IMF financial program helps stabilize Romania's external liquidity position

The IMF and EU financial program totaling EUR20 billion has contributed to stabilizing Romania's external liquidity position. The program, officially approved in May 2009, will be effective over the next two years. Its loan disbursement is conditional to progress of the government's comprehensive reforms which call for, among others, fiscal reforms and a further strengthening of the financial sector. Progress had been made as planned at least until the collapse of the former coalition government in October 2009, with more than 40% of the pledged financial program disbursed. Part of the assistance was put into the foreign exchange reserves, which as of the end of November 2009 swelled to reach a record EUR 28.7 billion. In contrast, short-term external debts, which had risen to EUR 20.6 billion at the end of 2008, shrank more than 30% to EUR 14.4 billion at the end of 2009. This meant that the foreign exchange reserves cover two times as much as the short-term debts. Meanwhile, the current account deficit in 2009 narrowed substantially to 4.2% of GDP from 9.2% a year earlier. The deficit was covered with non-debt funds as the ratio of net FDI inflows to the current account deficit improved to 94% during the ten-month period.

## (3) Progress on fiscal reform remains uncertain due to weak political base

The general government fiscal deficit (ESA95) in 2008 widened to 5.5% of GDP due mainly to the impact of the expansionary fiscal policy pursued prior to the November 2008 general election. The government agreed with the IMF that the deficit (GFS) will widen to 7.3% in 2009 and narrow to 5.9% in 2010. The deficit for 2009 was estimated to be around 7 % of GDP, in line with the accord. The 2010 budget plan, whose compilation had been marred by the fall of the government in October 2009, was finally approved by the parliament on January 14 after new government was installed. On January 27, Romania reached provisional agreement with the IMF on the second and the third reviews of the Stand-By Arrangement. This should allow an early resumption of the delayed IMF loan disbursement. The reduction of budget deficit requires the government to push reforms on both revenues and expenditures as agreed with the IMF. It calls for implementing the *Fiscal Responsibility Law* and carrying out reforms on pensions and public employee wages. However, uncertainty remains over whether a coalition government led by the DLP can carry out its reform initiatives with maintaining the political support from the coalition partners. Meanwhile, the general government debt (ESA95) is seen certain to expand to reach higher than 30% of GDP in 2011 from 13.6% in 2008, which however remains one of the lowest in the EU.

## (4) Romanian economy to recover modestly in 2010, but risks remain in banking sector

Romania faces the worst economic recession since late 1990s amid the credit crunch stemming from the global financial woes and the subsequent economic downturn in its major European trading partners. Real GDP contracted for six consecutive quarters (on a quarter-on-quarter basis) from the July-September quarter of 2008, though there have been signs of modest pickup lately. Meanwhile, the unemployment rate jumped to 7.8% in December 2009 from 4.4% a year earlier. Romanian economy contracted 7.2% in 2009 and is likely to recover only modestly in 2010 as an economic recovery of major trading partners and Romanian currency depreciation counterbalanced with the widening supply-demand gap. The consumer price inflation accelerated in early 2009 but eased to 4.7% year-on-year in December 2009 on stabilization of food prices regardless of the excise hikes for tobacco products. While the rate was still higher than the 3.5% plus/minus 1 pp target set by NBR, the central bank has cut its policy rate by a total 325 bps to 7.0% since February 2009 reflecting the continued improvement of inflation outlook.

Romania's banking system has regained its stability. At the initiative of the IMF, the parent banks of the nine largest banks in the country agreed with the NBR to retain the exposure of their subsidiaries and keep their capital adequacy ratios higher than 10%. The agreement has helped to stem any significant capital outflow from the country. However, possible deterioration of their asset quality due to poorer profit performances and rising unemployment could adversely affect their capital adequacy.

### Main Economic Indicators: Romania

		2005	2006	2007	2008	2009f	2010f	2011f
<b>(Convergence criteria)</b>	<b>Criteria</b>							
1.CPI (annual average)	0.2%(note)	9.1	6.7	3.9	8.1	5.6	4.0	3.2
2.10 year government bond yield	4.8%(note)	7.0	7.2	7.1	7.7	9.7	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	▲1.2	▲2.2	▲2.5	▲5.5	▲7.6	▲7.0	▲6.0
4.General gov't debt/GDP(ESA95)	Below 60%	15.8	12.4	12.6	13.6	23.5	30.3	33.6
Real GDP growth rate	(%)	4.2	7.9	6.2	7.1	▲7.2	1.0	2.5
Unemployment Rate	(%)	7.2	7.3	6.5	5.9	7.0	7.8	7.6
Current account balance/ GDP	(%)	▲8.7	▲10.4	▲13.5	▲12.4	▲4.2	▲5.1	▲5.7
Trade balance/GDP	(%)	▲9.8	▲12.0	▲14.5	▲13.4	▲5.7	▲5.3	▲5.8
Net FDI inflows/GDP	(%)	6.6	8.9	5.7	4.8	4.0	6.0	6.5
Foreign exchange reserve (FOREX)	(EUR mn)	16,796	21,310	25,307	26,220	28,481	31,500	34,800
Net FDI/CA	(%)	76.0	85.9	42.1	52.1	94.4	116.1	113.0
Gross external debt/ GDP	(%)	38.8	42.0	47.4	53.0	66.2	67.2	65.0
Gross external debt/ Export (G&S)	(%)	117.3	131.0	160.7	173.0	218.3	240.7	244.6
Public external debt/ Export (G&S)	(%)	46.3	36.8	36.8	38.2	73.3	101.8	109.3
FOREX/monthly imports	(months)	5.8	5.9	5.6	5.2	7.9	8.4	8.3
FOREX/short-term external debt	(times)	2.7	1.7	1.3	1.2	2.0	2.3	2.4
Debt service ratio	(%)	20.1	20.7	23.2	31.6	31.6	33.4	31.6

Note: Figures for criteria 1 and 2 are moving average between January 2009 and December 2009. Figures for 2009, 2010 and 2011 are based on the projection made by JCR  
Source: The European Commission, the NBR, Ministry of Public Finance and National Institute of Statistics

(Toshihiko Naito, Chief Analyst)