2003-10
May 16, 2003

Romania

Rating on Foreign Currency Long-term Senior Debts: BB/Stable (Latest rating review released on December 18, 2002.)

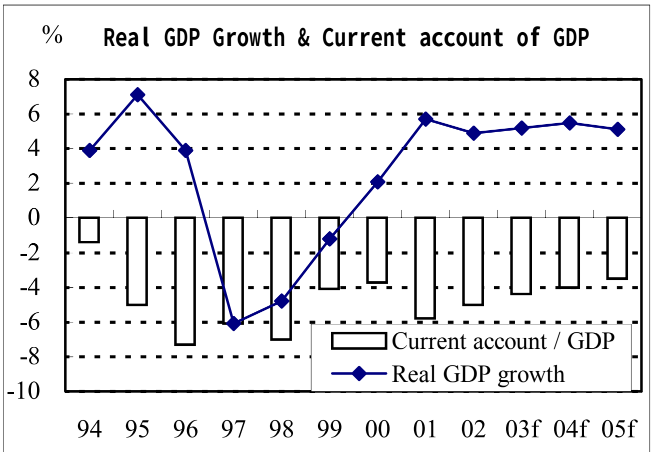
<Main Viewpoints on the Rating>

Positive Factors

- Improved macroeconomic indicators.
- The rapid improvement in the external liquidity position and the reduction in the debt-service burden due to the drop in public external debt.
- The IMF lifted the freeze on the 4th tranche of stand-by credit and extended its validity due to the improvement in economic indicators including inflation and debt.

Negative Factors

- Concern continues about persistent inflation due to lingering high rises in prices and wages.



(Source) NIS, European commission

<Updated: from February 2003 to April 2003>

Positive Factors

- Economic growth decelerated to 4.9% in 2002 from 5.7% in 2001, but surpassed the original government forecast of 4.5%. Exports and capital investment continued to grow high with little impact currently of the European economic deceleration on the Romanian economy.
- Foreign exchange reserves increased by 32.2% to US$7,212 million (covering 4.6months of imports) at the end of 2002 due to the issuance of foreign currency bonds and the increasing inflow of foreign direct investment. The current account deficit to GDP ratio improved to 3.4% in 2002 from 5.9% in 2001 due to the drop in the visible trade deficit and the rise in receipts from current transfers.
- CPI was 17.8% year-on-year in December 2002, below the original official target of 22% agreed with the IMF. However, it was the highest of the candidate countries of the EU accession. Attention should be paid to its development, though it declined further to 17.1% in March 2002.
- The IMF lifted the freeze on the disbursement of the fourth tranche (SDR 55.1million) of stand-by credit and extended its termination date of the credit.

Negative Factors

- There is concern about a growing impact of rapid economic slowdown in the two largest trading partners, Italy and Germany

<Prospects and Noticeable Points>

Continuously improving economy and budgetary position

(1) Good economic performance: 4.9% economic growth in 2002, higher than original target of 4.5%

Real GDP grew at 4.9%; higher than the original government forecast of 4.5%, in 2002, though decelerated from 5.7% recorded in the previous year. According to the economic forecast published by European Commission on April 8 2003, the Romanian economy was expected to continue to grow at 4.9% in 2003 and 5.0% in 2004 maintaining as high growth rates as in the latest past. Continuously strong growths in capital investment and external demand contributed to confining the effect of the weakened growth of private

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consumption to the minimum in 2002, similarly in 2001.

The unemployment rate is expected to rise to 8.9% at the end of 2003 from 8.1% a year ago, due to cuts in employees made in the process of the privatization of state-owned enterprises. However, the rate would decline to 8.6% at the end of 2004, in view of a probable rise in employment in the private sectors in line with a recovery of domestic demand. Accordingly, stronger private consumption would help to pull the economy.

CPI declined to 22.5%; below the original government target of 24%, in 2002 (annual average) due to the milder depreciation of leu, the Romanian currency, against U.S. dollar (in line with the appreciation of the euro against U.S. dollar). On the other hand, pay rises remained high at 27.1% (annual average) in 2002, though declined from 40.5% in 2001, causing serious concern about their effects on the budgetary position as well as the inflationary trend.

(2) Continuous decline in budget deficit

The general government budget deficit to GDP ratio shrank to 2.6% in 2002 from 3.3% in the previous year, recording the improvements for two consecutive years. Primarily, this was attributable to the constraint on expenditures made to aim at the EU accession, and in addition, to the reduction in the borrowing cost of the government due to the upgrading of its ratings by rating agencies reflecting the strengthened capability of the government debt repayments, and due to the affiliation to the EU scheduled in 2007. Secondly, this was partly because tax revenue steadily increased due to the good economic performance of the country. In 2003, the government is scheduled to raise the excise tax rates on such items as cigarettes, alcoholic beverages and automobiles by degrees to adjust them to the EU standards. JCR forecasts that the budget deficit will stand at some 2.7% of GDP in 2003. Due to political consideration for the next general and presidential elections to be held before November 2004, it would be difficult to reduce the government expenditure, though the debt-servicing cost will continue to decline. As a result, the budget deficit to GDP ratio for 2004 would be about the same as in 2003. However, it will be improvable that the budget balance will get worse significantly, because the government will have to abide by fiscal discipline to achieve the national goal of the EU accession (scheduled in 2007).

(3) Freeze on the 4th tranche of stand-by credit was lifted with extension of validity for 6 months

The IMF lifted the freeze on the disbursement of the 4th tranche of the stand-by credit decided in October last year and extended its validity for 6 months up to October 2003 on April 25 this year. This was because the IMF appreciated the good economic performance of the country, including the lowered inflation rate and the declined budget deficit, though it pointed out that matters for concern for 2003 were the minimum pay rise by 43% for public sector employees decided in January this year and the deteriorating external economic circumstances.

As for the delay of the privatization of the largest commercial bank in Romania; Banca Comerciala Romania (BCR), (in which the government holds 70% of shares,) the government's plan to sell 25% of its shares first to EBRD and IFC is currently under way. Therefore, what the IMF stated on this matter was: 'In the banking sector, the government is committed to sell a minority share in the largest bank, BCR, and to complete the bank's privatization as soon as market conditions improve.' This was because the IMF had to take into account the difficult conditions at present for privatizing BCR, caused by the worsening external environment such as sharp across-the-board decreases in profits for 2002 of European financial institutions, as shown by the results of the last two bids for the privatization, in which any qualified bidders did not participate,.

(4) Despite good export performance, impacts on the Romanian economy of economic slowdown in the two largest trading partners need to be watched

The economic performance of the two largest trading partners of Romania; Italy and Germany, turned worse than previously expected. There is growing concern about adverse impacts of this on the Romanian economy in the medium-term perspective. The combined amount of the Romanian exports to and imports from those two trading partners accounts for more than 50% of the total foreign trade. It has been generally believed so far that demand for Romanian export products, mainly consisting of cheap consigned manufactured goods, will be stable independently of phases of business activity in the EU area, because its export products do not compete directly with EU products. Furthermore, southern European economies such as Italy grew at higher pace than countries like Germany till 2001. In fact, the Romanian export performance has so far been in good shape as is generally believed.

However, the real GDP growth of Italy significantly decelerated to 0.4% in 2002 from 1.0% in 2001 and that of Germany to 0.2% in 2002 from 0.6% in 2001. As the decline in their economic growths is much larger than the rest of EU member countries (average real GDP growths of the EU economies decelerated to 1.1% in 2002 from 1.6% in 2001.), JCR will keep watching impacts of the sluggish economy of both of the countries on Romania’s exports and capital investment in the medium-term perspective.

Romania: Main Economic Indicators

		1999	2000	2001	2002p	2003f	2004f
Real GDP growth rate	(%)	-1.2	1.8	5.7	4.9	4.9	5.0
Unemployment rate(year-end)	(%)	11.8	10.5	8.8	8.1	8.9	8.6
CPI (annual average)	(%)	45.8	45.7	34.5	22.5	16.0	11.8
Nominal wage(annual Average)	(%)	46.1	42.7	40.5	27.1	21.0	16.5
Commercial lending rate	(%)	65.9	53.5	45.1	35.2	25.5	17.5
Government deficit/GDP	(%)	-1.8	-4.0	-3.3	-2.6	-2.7	-2.7
Government debt/GDP	(%)	34.2	31.5	29.1	30.7	29.8	28.0
Trade balance (goods)/GDP	(%)	-3.1	-4.6	-7.5	-5.7	-5.8	-5.5
Current account/GDP	(%)	-3.7	-3.7	-5.9	-3.4	-3.7	-3.5
Foreign exchange reserves	(US$ mln)	2,687	3,922	5,442	7,211	8,200	9,000
Import coverage (g&s)	(Months)	2.8	3.3	4.0	4.6	4.9	5.4
Gross external debt/GDP	(%)	25.8	28.9	31.1	34.0	32.2	31.6
Net inflow of FDI	(US$ mln)	1,025	1,037	1,157	1,385	1,595	1,680
Exchange rate(Average)	(Leu / US$)	15,333	21,709	29,061	33,055	34,250	35,250

Sources： NIS, NBR, Ministry of Development and Forecast, IMF, European Commission and EIU