2003-39
November 27, 2003

Romania

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

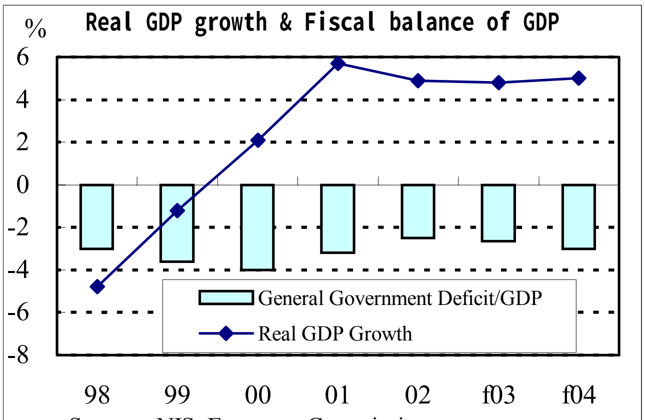
<Main Viewpoints on the Rating>

Positive Factors

Improved macroeconomic performance.
Rapid improvement on external liquidity position and reduction of debt-service burden due to drops in public external debt.
IMF's support for economic structural reforms.

Negative Factors

Persistent concern about inflation due to rapid rises in prices and wages.
Delay in transformation of industrial structure and deficient financial intermediary function.



Sources: NIS, European Commission

<Updated: from August 2003 to October 2003>

Positive Factors

Completion of IMF's fourth and fifth (final) reviews of standby credit and full disbursement of all tranches. It is the first time that Romania has gone through all its IMF reviews.

Government's projection of high real GDP growth rates -- 5.5% in 2004 and 5.2% in 2005 -- on condition of economic recovery in major trading partners, e.g. Italy and Germany.

NBR hiked the reference rate totally by 200bp to prevent possible adverse effect of high growth in private domestic credit and inflation.

Negative Factor

Expansion of fiscal deficit from 2.65% of GDP in 2003 to 3.0% in 2004 as projected under 2004 draft budget. Expenditure is expected to increase with the general and presidential elections scheduled for November 2004.

<Outlook and Noticeable Points>

(1) Economic growth with a concern for overheating

- Real GDP growth decelerated to 4.3% year-on-year in the 1st half of 2003 from 4.9% in 2002, due to slower growth of exports caused by the economic slowdown in main trading partners, e.g. Italy and Germany. The government projects GDP to grow at 4.8% in real terms in 2003, as the economy will grow by more than 5% in the second half of the year, buoyed by recovery of domestic demand and good performance of investments. It forecasts real GDP growth in 2004 at 5.5% on the assumption that equipment investment will perk up helped by economic recovery in major trading partners and that public works spending will be front-loaded to accelerate infrastructure development ahead of the country's accession to the European Union. JCR regards 5.5% growth slightly higher than Romania's potential growth and will watch the government's economic and fiscal policies with keen attention.
- CPI increase was high at 15.8% year-on-year in October 2003. However, it was due primarily to the hikes of gas, electricity and other utility rates. Price increases excluding these factors have been slowly decelerating since the beginning of this year. However, the increase rate of monthly average disposable income remained high at 26.6% year-on-year in September 2003. Given the tightening employment situation, it will remain relatively high and may bring about inflation pressure.
- IMF has expressed concern that the high growth of outstanding credit (resulting from lower interest rates) could lead to an overheating of the economy. NBR tightened its monetary policy by raising the reference rate by 1% to 20.25% on October 6 for fear of adverse impacts of the higher growth of outstanding credit growth

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(caused by increased lending to SMEs and individuals). Then, NBR raised it again by 1% to 21.25% on November 20 to constrain the inflation, caused by the depreciation of Lei against Euro.

(2) IMF completes all reviews on standby credit for the first time since the transition

- IMF completed the fourth and fifth (final) reviews of its standby credit on October 15 and approved the disbursement all remaining tranches. IMF lauded (1) overall improvement of the economy, (2) progress in structural reform, e.g. privatization, hike on utility rates and (3) a sound fiscal policy, e.g. a stricter collection of unpaid bills on utility and social security services.
- IMF has provided Romania with six sets of standby credit since the country's transition. This is the first time that IMF has completed all its reviews on the standby credit and approved the disbursement of all tranches. This may help enhance the external credibility in Romania.
- With regard to delay in privatization, the Romanian government agreed with IMF to transfer 25% of its shares in BCR to EBRD and IFC. There also has been progress in the privatization of Petrom and other state-run corporations.
- The European Commission gave up recognizing Romania as a 'Functioning Market Economy' in its accession report released on November 5. This came as a shock for the Romanian government, which had planned to join the European Union in 2007 along with Bulgaria, which already has won such recognition from the commission. JCR assumes that the relatively slow progress in economic reforms has prompted the commission's decision on Romania. However, the decision may give an impetus to economic reforms in Romania, which regards its accession to EU as a 'National Agenda'.

(3) Budget deficit for 2004 to widen to 3.0% of GDP

- A draft budget for 2004 was submitted to parliament on October 15. Budget deficit will widen to 3% of GDP in 2004 from 2.65% in 2003 due mainly to increased spending on infrastructure, e.g. highway construction (to bring Romania's road standards closer to the EU's).
- Romania will be in for an election year in 2004. As was the case with other East European countries in recent years, Romania may see expenditure increase beyond what is earmarked in the original budget. JCR will cautiously watch future developments in Romania's fiscal situation.
- When the interest rate will be risen additionally, that may lead increase of the budget deficit, because of the higher cost of debt service payment and the decrease of the revenue. However, the budget deficit will likely widen in 2004, as other eastern European countries did, when the election will be held.
- For the medium-long term perspective, it is unlikely that the budget deficit will expand recklessly, because of the goal to become a member of EU in 2007. Thus, fiscal discipline shall be maintained.

Romania: Main Economic Indicators

		1999	2000	2001	2002	2003f	2004f
Real GDP growth rate	(%)	-1.2	2.1	5.7	4.9	4.8	5.5
Unemployment rate (year-end)	(%)	11.8	10.5	8.8	8.1	7.0	7.3
CPI (annual average)	(%)	45.8	45.7	34.5	22.5	16.2	11.6
Nominal wage (annual average)	(%)	46.1	40.5	41.2	28.5	21.7	17.1
Commercial lending rate	(%)	65.9	53.5	45.1	35.2	25.2	17.5
Government deficit/GDP	(%)	-3.6	-4.0	-3.2	-2.5	-2.7	-3.0
Government debt/GDP	(%)	33.4	31.6	28.7	28.4	30.2	31.8
Trade balance (goods)/GDP	(%)	-3.5	-4.5	-7.4	-5.7	-6.7	-6.6
Current account balance/GDP	(%)	-3.6	-3.7	-5.5	-3.4	-4.4	-4.5
Foreign exchange reserves	(US$ mln)	2,687	3,922	5,442	7,211	8,041	8,764
Import coverage (G&S)	(Months)	2.8	3.4	4.0	4.6	4.5	4.5
Gross external debt/GDP	(%)	25.8	28.8	30.7	34.0	36.8	40.0
Net inflow of FDI	(US$ mln)	1,025	1,048	1,174	1,090	1,490	1,910
Exchange rate (average)	(Leu / US$)	15,333	21,709	29,061	33,055	34,890	38,014

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

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