# Romania

2004-36
*November 24, 2004*

Foreign LT: **BB+/Positive**, Local LT: BBB-/**Positive** (Upgraded on November 15, 2003.)

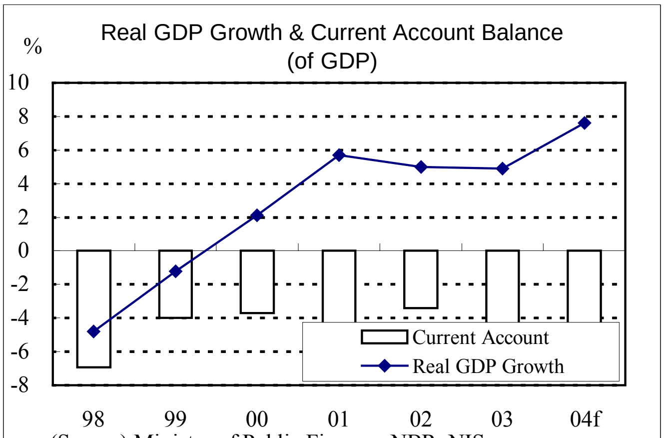
## <Rating Perspective>

### Positive Factors

- Stronger possibility of the country becoming a member of the EU
- Generally improving macroeconomic trend
- Maintenance of fiscal discipline
- Reduced public debt-service payments brought by extended loan terms and falling interest rates

### Negative Factors

- Existence of corruption and human rights issues
- External vulnerability due mainly to large current account deficit



(Source) Ministry of Public Finance, NBR, NIS

## <Update: from August to October 2004>

### Positive Factors

- There is a stronger possibility of Romania being accepted as a member of the EU in 2007, along with Bulgaria, now that it has been designated by the European Commission as a "functioning market economy."
- Real GDP growth accelerated to 6.6% (y/y) in 1H/2004 from 4.9% in 2003.With higher agricultural production reported this autumn, the government has revised its GDP growth estimate for 2004 upward to 7.6%.
- Encouraged by bigger-than-expected tax revenues on economic recovery and enhanced tax collection, the government estimates the budget deficit to narrow to 1.6% of GDP in 2004 from 2.3% in 2003. The government plans to cut the ratio further to 1.5% under its draft budget for 2005.

### Negative Factors

- Current account deficit expanded by 46.4% (y/y) in the January-August period of 2004 on a steep increase in merchandise trade deficit.
  (JCR expects the deficit expansion to decelerate in the September-December quarter on slower import growth brought by recovery of agricultural production in autumn.
- JCR estimates that the current account deficit will remain high at 5.3% of GDP in 2004 after 5.7% in 2003.

## <Outlook and Points to Watch>

### (1) JCR upgraded the ratings for Romania by 1 notch on remarkable economic and fiscal improvement; kept the outlook positive

The upgrading reflects the country's generally improving macroeconomic indicators, an expectation of further accelerated economic growth on progress in the privatization of large energy utilities, which has been a long-standing concern for the country, the maintenance of fiscal discipline, an appropriate control of public debts through prolonged maturities, and the greater possibility of the country becoming a member of the EU in 2007 following its designation by the European Commission as a "functioning market economy."
On the other hand, the rating is constrained by the country's external vulnerability as exemplified, in particular, by the high-level current account deficit and the need of

improvement on qualitative factors, such as corruption and human rights records.
JCR has kept the rating outlook positive primarily in view of a favorite economic outlook and improving prospects of the fiscal and debts situation.
Real GDP grew 6.6% year-on-year in real terms in the first half of 2004, underpinned by the growth of gross fixed capital investment (10.4% year-on-year) amid economic recovery in Europe and the U.S. and the expansion of private consumption (9.0%) on improved employment. On top of these factors, it is expected that the recovery of agricultural production will spur private consumption and that the shrinkage of trade deficit on export pickup will contribute to accelerating economic growth in the latter half of the year. Consequently, real GDP growth is expected to accelerate to 7.6% in 2004 as a whole, much higher than the 4.9% registered in 2003. Inflationary pressure has weakened, reflecting a stabilization of the currency. A year-on-year rise in CPI is estimated to decelerate from 14.1% at the end of 2003 to around 9.3% at the end of 2004. On the fiscal side, the ratio of general budget deficit to GDP is expected to shrink to 1.6% in 2004 from 2.3% in 2003, due mainly to increased tax revenues amid a good economic performance. The government's draft budget for 2005 envisages the deficit/GDP ratio to slightly improve to 1.5%.

**(2) European Commission's report suggests further progress toward EU accession in 2007**

The European Commission designated Romania as a "functioning market economy" in its regular report published on October 6. The report highly evaluated Romania, saying: "Macroeconomic stability has been achieved and profound economic reforms carried out. If remarkable improvement will continue, it can cope with competitive pressure within the Union in the near term." This is presumably attributable to the progress Romania has made in structural reforms, e.g. the privatization of large energy utilities, the maintenance of fiscal discipline and an appropriate control of public debts. The report mentioned the need to preserve the momentum of disinflation and stabilize the external position as priority areas to be addressed for further improvement.
Although the government concluded the *acquis communautaire* negotiations on 27 of the 31 chapters at the end of October 2004 and aims to wind up talks on the remaining four chapters by the end of this year, many observers consider that talks on one of them pertaining to "justice and home affairs" may drag on into the first half of 2005.
At the same time, the commission defined the "safeguard clause" that would require Romania's EU accession to be postponed by one year should there arise any serious concern about the fulfillment of its commitments. This may be taken as a warning against delay in reform initiatives and external pressure for relaxation of fiscal restraint. JCR expects that Romania will maintain its current reform policy and seek to become a member of the EU, even if the opposition wins in the next general and presidential elections to be held on November 28.
The commission said in the report that corruption poses "a serious and widespread problem" in Romania. Given the significant economic improvement made so far, JCR considers that Romania will see further economic development through sophistication of its industry with the help of FDI inflow, once this issue can be resolved.

**(3) Reform unlikely to set back even in political power shift**

Whichever may win the next general and presidential elections, the current center-left ruling Social Democrat Party (PSD) or the National Liberal Party (PNL)-Democratic Party (PD) opposition alliance (DA), JCR sees little likelihood of a policy shift that will entail a major setback in the country's structural reform initiatives, for the following reasons.
First, the next government would be hesitant to adopt a popular anti-reform policy in light of the national agenda to achieve EU accession in 2007. Second, the reforms have been promoted by PSD, which has transformed itself into a center-left party and has avoided taking a policy that smacks of the image of the Communist Party. Third, if the opposition alliance DA comes into power, it may adopt a more stringent fiscal policy in deference to the policy lines advocated by its power base.
Additionally, as Romania's EU accession is scheduled to come during the term of the new

administration (to run until November 2008), regardless of the election results, it will stick to reform policy lines in order to avert a delay in the accession schedule being caused by application of the safeguard clause.

SDP has named Premier Adrian Nastase as its presidential candidate to replace incumbent President Ion Iliescu, who is a founder member of the Democratic National Salvation Front (former Communist Party). This may mean that generation change will proceed in PSD and that the party will gradually blur its image as a left-wing party. PSD nominated Foreign Minister Mircea Dan Geoana as its candidate for next prime minister.

**Romania: Main Economic Indicators**

| | | 2000 | 2001 | 2002 | 2003 | 2004f | 2005f |
|---|---|---|---|---|---|---|---|
| Real GDP growth rate | (%) | 2.1 | 5.7 | 5.0 | 4.9 | 7.6 | 5.2 |
| Unemployment rate (year-end) | (%) | 10.5 | 8.6 | 8.1 | 7.2 | 6.5 | 6.3 |
| CPI (annual average) | (%) | 45.7 | 34.5 | 22.5 | 15.3 | 11.8 | 8.1 |
| Nominal wage growth (average) | (%) | 40.5 | 41.2 | 28.5 | 25.4 | 19.0 | 15.3 |
| Commercial lending rate | (%) | 53.5 | 45.1 | 35.2 | 25.4 | 20.5 | 15.0 |
| General Gov.Fiscal balance/GDP | (%) | -4.0 | -3.2 | -2.6 | -2.3 | -1.6 | -1.5 |
| General Government debt/GDP | (%) | 29.9 | 27.4 | 25.8 | 26.2 | 26.6 | 26.2 |
| Merchandise Trade balance/GDP | (%) | -4.6 | -7.3 | -5.6 | -7.8 | -8.0 | -7.9 |
| Current account balance/GDP | (%) | -3.7 | -5.5 | -3.3 | -5.7 | -5.3 | -5.0 |
| Forex reserves (excl. Gold) | (US$ mln) | 3,922 | 5,442 | 7,211 | 9,002 | 12,015 | 14,727 |
| Import coverage (G&S) | (Months) | 3.4 | 4.0 | 4.6 | 4.3 | 4.6 | 5.0 |
| Debt to service ratio | (%) | 13.3 | 17.4 | 18.4 | 14.9 | 14.4 | 2.7 |
| Gross external debt/GDP | (%) | 28.5 | 31.2 | 30.8 | 30.9 | 33.6 | 33.0 |
| External debt/Export (G&S) | (%) | 87.5 | 93.7 | 89.9 | 91.6 | 93.0 | 94.7 |
| Public external debt/Export (GS) | (%) | 56.5 | 57.2 | 59.2 | 58.9 | 57.5 | 55.0 |
| Short term external debt/ Total | (%) | 3.7 | 3.9 | 4.7 | 6.4 | 9.5 | 12.3 |
| Net inflow of FDI | (US$ Euro) | 1,161 | 1,312 | 1,194 | 1,591 | 2,050 | 2,550 |
| Exchange rate (average) | (Lei/ US$) | 21,708.7 | 29,060.8 | 33,055.4 | 33,200.1 | 34,050.0 | 35,150.0 |

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

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