

Romania

Foreign LT: BBB-/Stable, Local LT: BBB/Stable (Affirmed on December 13, 2005)

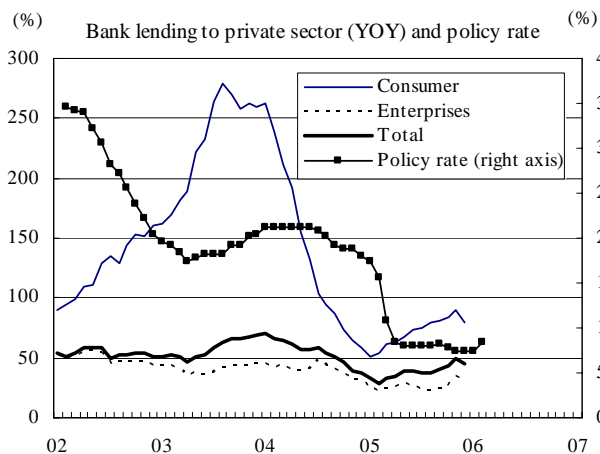
<Rating Perspective>

Positive Factors

- Progress on political, economic and budgetary reforms in pursuit of EU entry in 2007.
- Reduced government debt burden brought by restrained fiscal deficit
- High economic growth prospects

Negative Factors

- Deteriorating external balance due to strong domestic demand led by consumer spending
- Transformation of industrial structure still at primary stage



<Update: from November 2005 to January 2006>

Positive Factors

- On February 8, the National Bank of Romania (NBR) decided to adopt comprehensive measures to tighten monetary policy.
- As a result of discussions on the annual Article IV report on macroeconomic and financial developments held from January 24th to February 7th 2006, IMF and the Romania government reached an agreement on main macroeconomic policy for 2006 and 2007.
- In a competition bid for the sale of a 68.88% stake in state-owned Banca Comerciala Romana (BCR), Romania's biggest bank, Austria's Erste Bank won the bid for EUR3.75 billion.
- Inflows of net FDI in the first eleven months of 2005 remained high at EUR4.4 billion or 5.7% of GDP.
- The general government fiscal balance in the first ten months of 2005 was in surplus by RON3.85 billion or 1.4% of GDP.

Negative Factors

- Current account deficit in 2005 widened 35% year-on-year to EUR6.9 billion or 9% of GDP.
- Bank lending to consumer grew a robust 80% year-on-year in December 2005, showing no sign of deceleration.
- Real GDP growth rate in the July-September quarter of 2005 slowed down to 1.8% year-on-year from 4.1% the previous quarter.

<Outlook and Points to Watch>

Comprehensive measures to tighten monetary policy to be implemented

(1) External imbalance continues widening on strong domestic demand

Romania's real GDP growth rate slowed down to 1.8% year-on-year in the July-September quarter of 2005 from 4.1% the previous quarter. After four consecutive quarters of double-digit growth, domestic demand decelerated to a 5.8% year-on-year gain amid slower private consumption and a significant decline in inventories caused by the severe flood damage. On the other hand, exports grew 8.4% while imports expanded 17.4%. As a result, net exports continued to contribute negatively to the economic growth by 4.4 percentage points. Bank lending to consumers, one of factors behind the robust personal consumption, remained on the rise, spurred by a relaxed monetary policy, an income tax reduction in January 2005 and an increase in real gross wages. Lending balance surged 80% year-on-year in December 2005, showing no sign of deceleration.

Reflecting the strong domestic demand, the country's current account deficit in 2005 widened to 9.0% of GDP from 8.7% in 2004. Consumer price inflation in December 2005 was 8.6% year-on-year, slightly higher than the upper end of the target (7.5%±1%) set by the NBR. Inflation pressure remained strong amid rapid growth of real wages and bank lending as well as high energy prices.

Despite the reduction of the personal and corporate income tax rates at the beginning of 2005, tax revenues expanded on strong

private consumption, helping to turn the government general budget balance from a deficit in 2004 (1.1% of GDP) to a surplus equivalent to 1.4% of GDP in the first ten months of 2005. JCR projects that the fiscal deficit/GDP ratio in 2005 as a whole improved from 2004, even after allowing for the impact of post-flood reconstruction costs and a chronic year-end increase in budget spending. Romania's public debt remained extremely low. Its ratio to GDP is believed to have fallen below 20% at the end of 2005 from 22.8% in 2004.

(2) Comprehensive measures to tighten monetary policy adopted by NBR

There is little concern about financing the large current account deficit for the present, given the massive inflow of foreign direct investment following the privatization of large state enterprises and a steep increase in the foreign exchange reserves. Although the NBR has relaxed its monetary policy since June 2004 to contain speculative foreign capital inflows that may arise from the liberalization of capital transactions, it has adopted a series of credit restraint measures and raised the reserve requirement ratio for foreign-currency deposits in a move to hold back domestic demand. However, bank lending to consumers has been on the rise since the beginning of 2005. The demand restraint measures to date have proved rather ineffective.

On February 8, the NBR belatedly adopted comprehensive measures to tighten monetary policy. The package will raise the bank's policy rate to 8.5% from 7.5%, continue measures to sterilize excess liquidity via open market operations, increase the minimum reserve ratio for foreign-currency deposits from 35% to 40% (effective from March 24), maintain prudential measures aimed at containing lending to the private sector and implement legislation to regulate the lending activity of non-bank financial institutions. These measures, though not quite sufficient, may have some effect in moderating excessive domestic demand and suppressing inflationary pressure. JCR considers that the NBR needs to implement an additional increase of its policy rate while tolerating a further appreciation of the currency to some extent.

(3) JCR retains credit ratings

Romania failed to agree with the IMF on its precautionary stand-by agreement* on October 31, 2005. A meeting on the annual Article IV report on macroeconomic and financial developments was held from January 24th to February 7th 2006. The IMF and Romania reached an agreement on the country's macroeconomic policy for 2006 and 2007. This has raised hopes that Romania may resume negotiations on the stand-by agreement with the IMF. A decision on Romania's EU accession in January 2007 is expected to be made, based on an EC monitoring report due to be published in May 2006. The report will evaluate the progress on reforms in areas where the European Commission (EC) had called for greater efforts by the Romanian government, in particular "fight against corruption" and "competition policy".

The adoption of the comprehensive measures to tighten monetary policy and efforts being made for resumption of the negotiation on the stand-by agreement will have some favorable impact on the assessment of Romania's EU membership bid. JCR holds that the coalition government will continue to promote reforms and that the country will be able to join the EU in January 2007 as planned. Its accession might be put off by one year if the EC comes out with a severe evaluation of the reform initiatives made by the Romanian government. However, JCR considers that one year's delay would not affect its ratings.

*In July 2004, the IMF approved the precautionary stand-by agreement, allowing Romania to withdraw SDR250 million or about US\$370 million over two years

Main Economic Indicators: Romania

		2001	2002	2003	2004	2005f	2006f	2007f
Real GDP growth rate	(%)	5.7	5.1	5.2	8.3	4.0	4.8	5.5
CPI (annual average)	(%)	34.5	22.5	15.3	11.9	9.0	7.5	5.5
Unemployment Rate	(%)	8.8	8.4	7.4	6.2	5.8	6.0	5.8
Reference rate	(%)	5.7	5.1	5.2	8.3	4.0	4.8	5.5
General Gov. Fiscal balance/GDP	(%)	-3.2	-2.6	-2.3	-1.2	-0.6	-1.0	-0.5
Gross General Gov. Debts/GDP	(%)	28.7	28.8	26.9	23.1	19.5	17.4	15.8
Current account balance	(EUR mln)	-2,488	-1,623	-3,060	-5,099	-6,891	-8,151	-8,684
Current account balance/ GDP	(%)	-5.5	-3.3	-6.0	-8.7	-9.0	-8.6	-7.4
Trade balance/GDP	(%)	-7.4	-5.7	-7.8	-9.0	-10.2	-9.4	-8.1
Net FDI inflows	(EUR mln)	1,312	1,194	1,910	5,127	4,757	5,400	4,650
Net FDI inflows/GDP	(%)	2.9	2.5	3.8	8.7	6.2	5.7	4.0
Foreign exchange reserve (FOREX)	(EUR mln)	4,445	5,877	6,374	10,848	16,500	17,500	19,500
FOREX/monthly imports	(months)	2.9	3.5	3.4	4.8	5.8	5.2	4.9
FOREX/short-term external debt	(times)	8.1	8.2	6.0	5.3	5.2	4.6	4.2
Gross external debt/ GDP	(%)	30.3	30.9	31.3	31.0	34.7	32.3	29.8
Gross external debt/ Export (G&S)	(%)	90.5	87.3	86.8	83.7	101.8	100.2	99.3
Public external debt/ Export (G&S)	(%)	58.5	53.6	53.0	46.0	43.2	37.8	36.7
Short term external debt/ Total	(%)	4.1	4.8	6.7	11.2	12.0	12.4	13.2
Debt service ratio	(%)	24.1	24.2	20.8	21.9	18.2	14.7	12.8

Source: NBR, Ministry of Public Finance, National Institute of Statistics, Figure between 2005 and 2007 are based on JCR forecast

Note: NBR introduced redenomination to new 1Leu (RON) for old 10,000Lei (ROL)

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