2006-21
August 31, 2006

Romania

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

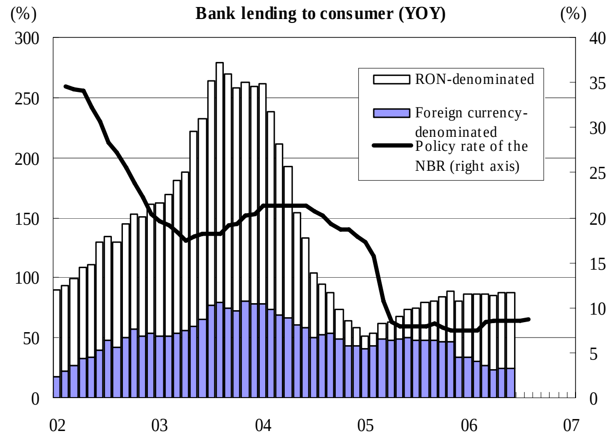
<Rating Perspective>

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 May 2006 to July 2006>

Positive Factors

- Romania has made greater progress than Bulgaria in EU accession preparations while the European Commission (EC) has put off from May to October its final recommendation on whether the two countries should join the EU in 2007 or 2008 (May 16).
- The National Bank of Romania (NBR) raised its policy rate by 0.25 percentage points to 8.75% and the minimum reserve requirements on domestic currency (RON)-denominated liabilities by 4 points to 20% at the end of June.
- Consumer price inflation in July 2006 eased to 6.9% year-on-year from 8.9% in January 2006 on drops in administered prices.
- The general government fiscal surplus in the first five months of 2006 more than quadrupled to RON4,187 million or equivalent to 1.2% of GDP from a year before.

Negative Factors

- Trade deficit in the first six months of 2006 widened 20% to EUR 909 million (equivalent to 1% of GDP).
- Bank credit to consumers continued expanding 87.8% year-on-year in June 2006.

<Outlook and Points to Watch>

Romania seen to join EU in January 2007

(1) Decision of EU accession date postponed

The European Commission (EC) has decided to postpone from May 2006 to October 2006 its final recommendation to the European Council on whether Bulgaria and Romania should join the EU in January 2007. The EC apparently took the decision mainly because the progress the two countries had made on reforms of outstanding issues fell short of its expectation. The EC had specifically urged Romania to act swiftly to create an institution to manage EU subsidy and an animal registration system needed to receive EU subsidy, devise measures to prevent BSE and set up a computer system for tax collection and administration. Romania and Bulgaria are aiming to attain EU accession in January 2007. However, a delay in reform programs for those remaining issues could lead to a postponement until 2008. A final decision on their entry date is set to be made by the European Council, based on an EC report due to be submitted on September 26.

JCR holds that both countries are highly likely to join the EU in January 2007 because there can be arranged a conditional accession with a safeguard clause that obliges both countries to attain reforms in arrears within three years of their membership.

Jiji Press Building, Ginza 5-15-8, Chuo-ku, Tokyo, 104-0061, JAPAN Tel: 813-3544-7024 Fax: 813-3544-7028 http://www.jcr.co.jp

(2) External balance continues deteriorating amid robust domestic demand

Romania's real GDP growth rate accelerated to 6.9% year-on-year in the January-March quarter of 2006 from 4.3% the previous quarter. Consumer spending and investment continued to lead the strong expansion. Amid robust domestic demand, the country's external balance deteriorated considerably, with the current account deficit in the first five months of 2006 swelling 53.1% to EUR3,336 million. Fueling the strong consumer spending were the rises of real wages, surging bank lending and growing employment. Bank lending to consumers continued expanding 87.8% year-on year in June 2006, showing no signs of deceleration. Consumer price inflation, which surged to 8.9% year-on-year in January 2006 due primarily to the hike of some indirect taxes, slowed down to 6.9% in July 2006 on drops in administered prices. However, inflation pressure persisted amid the rapid growth of real wages and bank lending as well as the high energy prices.

(3) The NBR takes additional measures to curb domestic demand

There is little concern about financing the large current account deficit for the present, given the massive FDI inflows following the privatization of large state enterprises and a steep increase in the foreign exchange reserves. However, the ongoing excessive domestic demand is not sustainable. After relaxing its monetary policy in June 2004 to contain speculative foreign capital inflows that might be triggered by the liberalization of capital transactions, the NBR has taken a series of credit restraint measures since the beginning of 2006. These included a hike in the bank's policy rate to 8.5% from 7.5%, sterilization of excess liquidity via open market operations and an increase in the minimum reserve requirements on foreign-currency denominated liabilities from 35% to 40%. As a result, foreign currency-denominated bank lending to consumers began to slow down, but domestic currency (RON)-denominated lending remained buoyant. Against this backdrop, the central bank took additional measures to curb domestic demand at the end of June. It raised its policy rate from 8.5% to 8.75% and the minimum reserve requirements on domestic currency (RON)-denominated liabilities from 16% to 20%.

(4) Fiscal policy is likely to be eased

The government has so far been maintaining a tight fiscal policy. The general government fiscal balance remained favorable in the first five months of 2006, with the surplus more than quadrupling from a year before to RON4,187 million or equivalent to 1.2% of GDP. While the annual growth of budget expenditures was kept abreast with the nominal GDP growth, revenues grew faster than expected on increased tax income brought by the economic expansion. Given the current trend, fiscal deficit in 2006 is likely to narrow from the previous year, even taking into account a usual concentration of spending in the final quarter of the year. However, the government revised its deficit target for 2006 from 0.45% of GDP to 0.9% in April and then to 2.5% in late June, signaling that the bias of fiscal policies will shift from restrictive to easy on demand.

JCR considers that the policy mix will be inefficient to contain the excessive domestic demand. The current account deficit is likely to deteriorate further. It is crucial for Romania to adopt a tighter monetary policy and carry out a shift to restrictive fiscal polices. EU accession is a positive factor for the ratings. However, for further upgrading of the ratings, JCR sees the introduction of appropriate fiscal policies is very important.

Main Economic Indicators: Romania

		2001	2002	2003	2004	2005f	2006f	2007f
Real GDP growth rate	(%)	5.7	5.1	5.2	8.4	4.1	5.5	5.0
CPI (annual average)	(%)	34.5	22.5	15.3	11.9	9.0	7.5	5.8
Unemployment Rate	(%)	8.8	8.4	7.4	6.2	5.8	6.0	5.8
General Gov. Fiscal balance/GDP	(%)	-3.2	-2.6	-2.3	-1.2	-0.6	-2.5	-2.0
Gross General Gov. Debts/GDP	(%)	28.7	28.8	26.9	23.1	19.5	18.4	17.8
Current account balance	(EUR mln)	-2,488	-1,623	-3,060	-5,099	-6,891	-8,903	-10,590
Current account balance/ GDP	(%)	-5.5	-3.3	-6.0	-8.7	-9.0	-9.3	-9.0
Trade balance/GDP	(%)	-7.4	-5.7	-7.8	-9.0	-10.2	-10.1	-9.7
Net FDI inflows	(EUR mln)	1,312	1,194	1,910	5,127	5,208	5,400	4,650
Net FDI inflows/GDP	(%)	2.9	2.5	3.8	8.7	6.8	5.6	4.0
Foreign exchange reserve (FOREX)	(EUR mln)	4,445	5,877	6,374	10,848	16,795	20,500	24,500
FOREX/monthly imports	(months)	2.9	3.5	3.4	4.8	5.9	6.0	6.3
FOREX/short-term external debt	(times)	8.1	8.2	6.0	5.3	5.2	5.1	5.1
Gross external debt/ GDP	(%)	30.3	30.9	31.3	31.0	36.0	35.2	33.9
Gross external debt/ Export (G&S)	(%)	90.5	87.3	86.8	83.7	105.7	109.9	113.3
Public external debt/ Export (G&S)	(%)	58.5	53.6	53.0	46.0	43.2	43.1	42.7
Short term external debt/ Total	(%)	4.1	4.8	6.7	11.2	11.6.	11.9	12.1
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 2006 and 2007 are based on JCR forecast

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

（Toshihiko Naito, Senior Analyst）