

Romania

Foreign LT: BBB/Stable, Local LT: BBB+/Stable (Upgraded on November 29, 2006)

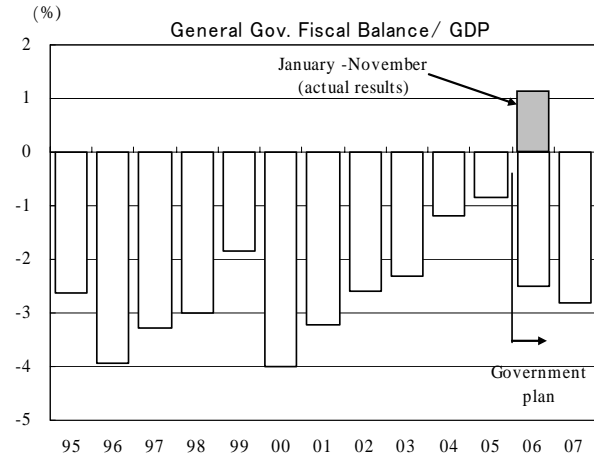
<Rating Perspective>

Positive Factors

- High economic growth prospects following the EU accession.
- Reduced government debt burden brought by restrained fiscal deficit
- Increasing exports on expanding production capacity rendered by inflows of foreign direct investment.

Negative Factors

- a deteriorating current account deficit resulting from strong imports spurred by robust private-sector demand
- Transformation of industrial structure still at primary stage



<Update: from November 2006 to January 2007>

Positive Factors

- On January 1, 2007, Romania and Bulgaria joined the EU
- Real GDP growth rate accelerated to 7.5% year-on-year in the first nine months of 2006
- Consumer price inflation in December 2006 eased further to 4.9% year-on-year
- The general government fiscal balance in the first eleven months of 2006 recorded a surplus equivalent to 1.2% of GDP.
- The net inflows of foreign direct investment in the first ten months of 2006 rose by 88.7% year-on-year to EUR 7.9 billion or 8.2% of GDP.

Negative Factors

- Following the withdrawal of the Conservative Party from the four-party coalition in December 2006, 29 MPs who had departed from the National Liberal Party, the largest coalition party, created the Liberal Democratic Party
- The current account deficit in the first ten months of 2006 widened 48.3% year-on-year to EUR 7.7 billion or 8.0% of GDP
- Bank credit to consumers continued expanding 80.3% year-on-year in November 2006

<Outlook and Points to Watch>

Acceded the EU on January 1, 2007

(1) JCR has upgraded the ratings on the foreign and local currency long-term senior debts

On November 29, 2006, JCR has upgraded the ratings on foreign and local currency ratings of Romania. The rating action is prompted by Romania's high economic growth prospects secured by its sophisticated political, economic and budgetary systems and a substantial amount of subsidy it will receive from the EU following its EU accession in January 2007. Also supporting the ratings are the country's substantial reduction of the government debt stemming from an improved fiscal deficit and debt repayment with the proceeds from the privatization of state-owned corporations and growing exports, in particular, of machinery and transportation products thanks to an expanding production capacity rendered by massive foreign direct investment (FDI) inflows in recent years.

On the other hand, the ratings are constrained by a deteriorating current account deficit resulting from strong imports spurred by robust private-sector demand and the fact that the country is still at a primary stage of industrial transformation as exemplified by more than 30% of the total employment still being engaged in the primary industry with extremely low productivity.

The current fiscal and monetary tightening is not sufficient to curb the widening current account deficit. However, refinance risk of the deficit is largely mitigated by the continuing strong FDI inflows spurred by the EU accession and

large-sized privatization schemes and strong external liquidity position. The rating outlooks are stable.

(2) Robust domestic demand in private sector continues deteriorating current account deficit

The economy is growing faster than the country's potential growth rate on robust private-sector demand. The current account deficit continues widening through surging imports. Real GDP growth rate accelerated to 7.5% year-on-year in the first nine months of 2006 from 4.1% in 2005 on expanding consumer spending and investment. While consumer spending is fueled by increased real wages, improved employment and swelling bank lending to the private sector, investment is spurred by massive FDI inflows in recent years. The robust private-sector demand pushed up the current account deficit in the first ten months of 2006 to a level in excess of 8% of GDP. Despite the monetary tightening measures such as increases in the reserve requirement ratio and interest rate hikes since the beginning of the year (the bank lowered the policy rate by 75bp on February 9), bank lending to households remained strong at 80.3% year-on-year in November 2006. On the other hand, consumer price inflation slowed down further to 4.9% year-on-year in December 2006 on appreciation of the currency and falls in food prices. As a result, the inflation target at the end of the year (5.0% ± 1p.p.) set by the National Bank of Romania (NBR) has achieved.

(3) Improved fiscal deficit and substantial reduction of the government debt

The fiscal balance in the first eleven months of 2006 improved significantly compared with the year before to register a surplus equivalent to 1.2% of GDP. The government revised its deficit target for 2006 from 0.5% of GDP to 0.9% in April 2006 and then to 2.5% in late June. The government has explained that much of the increased expenditures will be for investment in education, environment and transportation projects aimed to make full use of EU subsidy. The increased expenditures, if fully disbursed, would signal a shift in the fiscal policy from restrictive to loosening. Fiscal discipline, however, has been kept even in the latter half of 2006. The deficit in 2006 will end in narrower than the one estimated under the revised fiscal plan. The 2007 budget plan approved by the Cabinet envisages a fiscal deficit equivalent to 2.8% of GDP, primarily citing an increase in expenditures.

(4) Regardless of widening current account deficit, refinance risk of the deficit remains mitigated

For the present, there is little concern about refinancing of the current account deficit, which is expected to reach more than 10% of GDP in 2006, given the continuing FDI inflows prompted by the country's EU accession and large-sized privatization schemes and strong external liquidity position. The current account deficit was amply covered by net FDI inflows in the first ten months of 2006. Foreign exchange reserves are enough to cover 5.5 months of monthly imports. Furthermore, the financial system remains sound as the bad loan ratio is kept low despite the surging bank lending to the private sector. However, JCR considers that the current policy mix will not be sufficient to curb the excessive domestic demand. It is crucial for Romania to tighten monetary policy and maintain fiscal tightening.

(5) Maintaining political stability became uncertain

In the process of the EU accession, four-coalition party has promoted reforms in a body. However, after the final confirmation of the EU accession by the European Commission in September 2006, 29 MPs who had departed from the National Liberal Party, the largest coalition party, created the Liberal Democratic Party in December 2006, the Conservative Party withdrew from the coalition. A deteriorated relations over the policy issues between the two largest coalition parties—the center-right National Liberal Party and the center-left Democratic Party—has finally came to the surface after the EU accession. There is a possibility of early parliamentary election being called in 2007.

Main Economic Indicators: Romania

		2002	2003	2004	2005	2006f	2007f	2008f
Real GDP growth rate	(%)	5.1	5.2	8.4	4.1	7.5	6.5	6.0
CPI (annual average)	(%)	22.5	15.3	11.9	9.0	6.6	5.0	4.5
Unemployment Rate	(%)	8.4	7.4	6.3	5.9	5.5	5.2	5.0
General gov. fiscal balance/GDP	(%)	-2.6	-2.3	-1.2	-0.8	-0.7	-1.5	-2.2
Gross general gov. debts/GDP	(%)	28.8	26.9	22.4	19.1	15.5	13.3	11.4
Current account balance/ GDP	(%)	-3.3	-6.0	-8.4	-8.7	-10.0	-10.8	-9.7
Trade balance/GDP	(%)	-5.7	-7.8	-8.8	-9.8	-11.6	-12.4	-10.8
Net FDI inflows/GDP	(%)	2.5	3.8	8.4	6.6	9.3	6.8	5.2
Foreign exchange reserve (FOREX)	(EUR mn)	5,877	6,374	10,848	16,795	21,300	24,500	27,500
Net FDI/CA	(%)	73.6	62.4	100.5	76.0	93.4	62.8	53.8
FOREX/monthly imports	(months)	3.5	3.4	4.8	5.8	6.0	5.8	5.9
FOREX/short-term external debt	(times)	4.8	3.2	3.4	2.6	1.6	1.6	1.5
Gross external debt/ GDP	(%)	33.4	35.2	35.4	39.1	41.3	41.0	40.4
Gross external debt/ Export (G&S)	(%)	94.5	97.5	98.5	118.0	125.1	120.9	116.8
Public external debt/ Export (G&S)	(%)	53.6	52.9	46.0	42.8	33.8	27.9	22.9
Short term external debt/ Total	(%)	7.6	11.1	14.9	20.9	33.3	34.1	36.3
Debt service ratio	(%)	24.2	20.8	21.9	18.0	19.0	18.0	16.0

Source: NBR, Ministry of Public Finance, National Institute of Statistics, Figures between 2006 and 2008 are based on JCR forecast

Note: NBR introduced redenomination to new 1Leu (RON) for old 10,000Lei (ROL) in July 2005

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