2008-050
February 27, 2009

Romania

Foreign LT: BBB-/Negative, Local LT: BBB/Negative

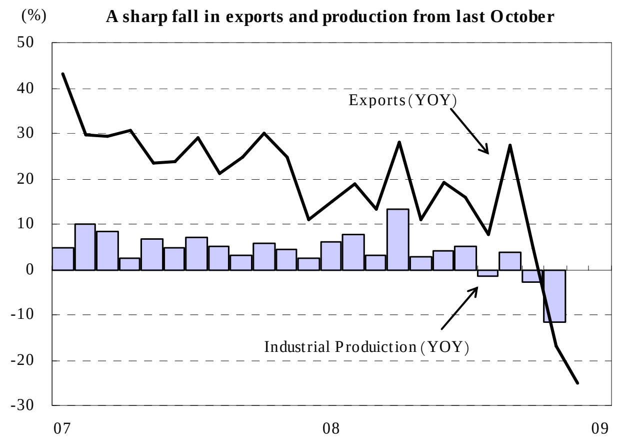
<Rating Perspective>

Positive Factors

- Substantial reduction of government debt
- Expanding production capacity rendered by massive inflows of foreign direct investment

Negative Factors

- Weakening resilience to external financing amid the deepening global de-leveraging process
- Surging external debt led by the continuing current account deficit
- Widening fiscal deficit caused by the expansionary fiscal policy pursued by the former government
- Transformation of industrial structure still at primary stage



<Update: from November 2008 to January 2009>

Positive Factors

- Following the Lower and Upper House elections in November 2008, the former opposition parties, the center-left Democratic Liberal Party (DLP) and the center-right alliance of the Social Democratic Party and the Conservative Party (SDP-CP), formed a coalition government. The ruling coalition parties won a working majority in the elections with 100 seats in the 137-seat Upper House and 229 seats in the 334-seat Lower House. DLP leader Mr. Emil Boc became new prime minister.
- The current account deficit in 2008 narrowed to 12.8% of GDP from 13.8% in 2007. Monthly current account deficit improved for three consecutive months from October 2008.
- The growth of bank lending to the private sector in December 2008 moderated further to 33.4% year-on-year.

Negative Factors

- Industrial output contracted by 11.5% year-on-year in November 2008, a sharpest fall since January 1999.
- Romanian currency (RON) depreciated by 18% against US dollar and 13% against euro in the last four months from October 2008.
- The general government fiscal deficit in 2008 widened to 5.2% of GDP from 2.6% in 2007.
- Foreign exchange reserves at the end of January 2009 shrank to EUR27.3 billion, down 4.8% from the peak level in October 2008.

<Outlook and Points to Watch>

Economy, external position rapidly deteriorating

(1) JCR lowered ratings on Romania with negative rating outlook

On December 18, JCR lowered its rating on Romania's foreign currency long-term senior debts to BBB- from BBB and the rating on the local currency long-term senior debts to BBB from BBB+. The downgrade primarily reflects the country's huge current account deficit, its widening fiscal deficit brought by the expansionary fiscal policy the former government had taken ahead of the general election in November 2008, concern over possible adverse impacts of the increased foreign-currency-denominated liabilities owed by households and companies may have on its financial system and its weakening resilience to external financing amid the deepening global financial crisis, given the surge in its short-term external debts.

The outlook of the ratings is negative. A sharp fall in Romanian economy and its currency is adding negative pressure on the country's financial system. If the global de-leveraging process deepens further, the county may fall into difficulties in external financing. JCR will carefully watch how the new coalition government will address the ongoing financial and economic crisis.

(2) The economic growth rate in 2009 may slow down to the lowest since Romania's economic transition

The Romanian economy grew robustly in the first three quarters of 2008 with the real GDP growth rate exceeding an annualized 8%. However, it has been slowing down markedly since last October as industrial output and exports deteriorated significantly amid the deepening economic recession in major European trading partners and the global financial crisis. Industrial output in October and November 2008 contracted 2.8% and 11.5% year-on-year respectively. Industrial output is highly likely to

Jiji Press Building, Ginza 5-15-8, Chuo-ku, Tokyo, 104-0061, JAPAN Tel: 813-3544-7448 Fax: 813-3544-7028 http://www.jcr.co.jp/english/

have fallen further in December as automaker Dacia suspended its assembly line during the month. These indicate that the real GDP rate sharply slowed down in the October-December quarter of 2008. The consumer price inflation, which surged to 9.1% year-on-year in July 2008, improved to 6.4% in December on stabilization of food and energy prices. The central bank lowered its policy rate to 10.00% from 10.25% on February 4 on the assumption that inflation will continue decelerating as the impact of the currency's recent depreciation will be more than offset by the negative supply-demand gap amid shrinking aggregate demand. With the global financial woes and the recession in the major European trading partners expected to deepen, Romania's real GDP growth rate is highly likely to slow down to around 0% in 2009. The economy may somewhat recover after the turn of the year, but the growth rate will be only modest at around 3%.

(3) **The financial system remains instable**

Romania's money market came under pressure in October 2008 as interbank interest rates surged due to liquidity problems in the banking sector. But the market has been restoring its stability as the central bank took countermeasures including a reduction of its minimum reserve requirement ratio on national currency-denominated liabilities and an increase in the deposit guarantee limit, in addition to the cut of its policy rate. The interbank interest rates returned to the levels in September 2008. However, the spread between the policy rate and interbank rates (1 week) remained at around 300bps in mid-February. Furthermore, RON has depreciated 18% against the US dollar and 13% against the euro since October 2008. Major Romanian banks are the subsidiaries of big European banks, in particular those in Austria. So far, the parent banks have taken no outright actions to reduce the credit lines made available to their subsidiaries. But they may do so if their risk capacity weakens. In particular, financial burdens are weighing heavily on households (whose foreign currency-denominated liabilities account for 57% of the total liabilities) and companies (the corresponding ratio stands at 55%) as the currency depreciation persists. The nonperforming loan ratio in the banking sector remained low at 1.1% as of the end of September 2008. However, if those foreign currency-denominated loans turn delinquent, the country's financial system could be seriously affected.

(4) Weak external position

The current account deficit, a major cause for concern, shrank slightly to 12.8% of GDP in 2008 from 13.8% in 2007. But the foreign debt swelled to around 54% of GDP at the end of 2008 as Romania covered nearly half its current account deficit with debt-creating funds in 2007 and 2008 (the net FDI/current account deficit ratio was 52% in 2008). In particular, the short-term foreign debt expanded substantially to EUR22 billion at the end of 2008, accounting for 30% of the total external debt. The country's resilience to external financing has been weakening, with the ratio of its foreign exchange reserves to the short-term foreign debt falling below 1 at the end of 2008. Romania's debt repayments in 2009 are estimated at around EUR13 billion. For the present, it will be able to rely on its foreign exchange reserves now totaling more than EUR26 billion. However, should a sudden capital flight occur, Romania might have to seek financial support from the IMF and EU.

(5) Prudent fiscal policy is essential for new coalition government

The general government fiscal deficit in 2008 widened to 5.2% of GDP from 2.6% in 2007 due mainly to reduced tax revenues amid the economic slowdown and increased spending by the former government. The new coalition government has revised the 2009 budget plan, cutting its economic growth estimate in 2009 to 2.5% from 3.5% and widening the fiscal deficit estimate to 1.7% of GDP from 2.0%. The government plans to adopt a stimulus package including a massive public investment project mainly funded with EU subsidy. Given the worsening economy, however, the government may be forced to consider a further spending cut. JCR will watch how the new government with working majority will respond to the economic and financial crisis and slow progress on reforms in the judicial system and anti-corruption initiatives, which have been required by the European Commission.

Main Economic Indicators: Romania

		2004	2005	2006	2007	2008f	2009f	2010f
(Convergence criteria)	**Criteria**							
1.CPI (annual average)	4.0%(note)	11.9	9.1	6.7	4.9	7.9	5.3	4.0
2.10 year government bond yield	5.4%(note)	n.a.	7.0	7.2	7.1	n.a.	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-1.2	-1.2	-2.2	-2.6	-5.2	-3.8	-2.7
4.General gov't debt/GDP(ESA95)	Below 60%	18.8	15.8	12.4	12.9	14.8	15.6	16.8
Real GDP growth rate	(%)	8.5	4.2	7.9	6.0	7.4	0.0	4.0
Unemployment Rate	(%)	8.1	7.2	7.3	6.4	6.0	6.3	6.5
Current account balance/ GDP	(%)	-8.4	-8.7	-10.4	-13.8	-12.8	-9.7	-6.8
Trade balance/GDP	(%)	-8.8	-9.8	-12.0	-14.8	-13.8	-12.7	-9.7
Net FDI inflows/GDP	(%)	8.4	6.6	8.9	5.8	6.7	2.9	4.4
Foreign exchange reserve (FOREX)	(EUR mn)	10,848	16,796	21,310	25,307	26,220	20,000	21,500
Net FDI/CA	(%)	100.5	76.0	85.9	42.2	52.4	29.7	64.8
Gross external debt/ GDP	(%)	34.7	38.9	42.0	48.6	54.4	56.5	50.8
Gross external debt/ Export (G&S)	(%)	96.5	117.4	130.6	161.0	169.8	155.2	152.4
Public external debt/ Export (G&S)	(%)	45.8	46.3	36.8	36.8	38.5	35.2	33.8
FOREX/monthly imports	(months)	4.8	5.8	5.9	5.6	5.3	4.0	4.2
FOREX/short-term external debt	(times)	3.4	2.7	1.7	1.3	1.2	1.0	0.9
Debt service ratio	(%)	16.4	20.1	20.7	23.2	28.6	31.9	31.2

Note: Figures for criteria 1 and 2 are moving average between February 2008 and January 2009. Figures for 2008, 2009 and 2010 are based on the projection made by JCR
Source：The European Commission, the NBR, Ministry of Public Finance and National Institute of Statistics

(Toshihiko Naito, Senior Analyst)