2009-033
November 30, 2009

Romania

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

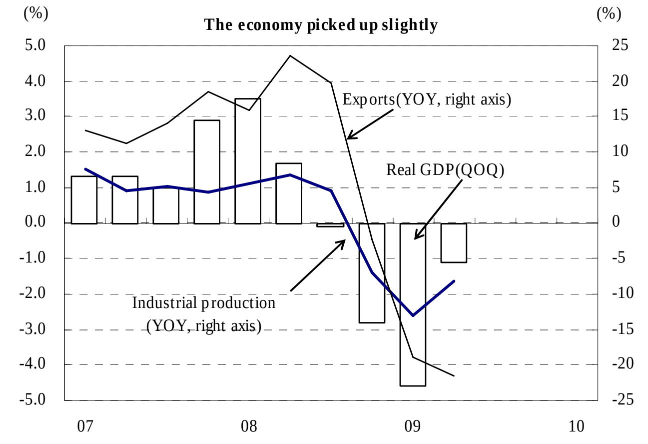
<Rating Perspective>

Positive Factors

- The country's improved external financing position backed by an IMF financial aid package
- Low level of government debt
- Expanding production capacity rendered by massive investments on the back of inflows of foreign direct investment and EU subsidies

Negative Factors

- High level of external debt led by persistent current account deficit
- Widening fiscal deficit amid falling revenues
- Transformation of industrial structure still at a primary stage



<Update: from August 2009 to November 2009>

Positive Factors

- The Romanian economy continued to recover in the July-September quarter of 2009 as the pace of contraction of real GDP and industrial production eased to some extent.
- The foreign exchange (excluding gold) reserves swelled to a record-high EUR 29 billion in October 2009.
- Following progress made on the reform programs committed to the IMF, the first and second tranches of the IMF aid program were disbursed as scheduled.
- The current account deficit in the first nine months of 2009 shrank to EUR 3.3 billion (2.6% of GDP), a third of the level a year earlier.
- The current account deficit was more than covered by FDI inflows in the first nine months of 2009.
- The National Bank of Romania (NBR) cut its policy rate twice between August and November by a total 100bps to 8.0%.

Negative Factors

- The parliamentary approval by the opposition parties of a no-confidence motion against the Emil Boc administration (on October 13) has resulted in political instability. The current situation may continue at least until the second round presidential election for December 6
- Since no candidates won the outright majority in the presidential election held in November 22, the incumbent Trajan Basescu (formally independent, but supported by DLP: Democratic Liberal Party) and Mr. Mircea Geoana (SDP: Social Democratic Party) proceeded to the second round election for December 6
- Due to the delayed implementation of reform measures triggered by the political instability, the third tranche of the IMF aid package is likely to be put off.
- The unemployment rate in August surged to 6.9%, up three percentage points from a year earlier.
- The general government fiscal deficit in the first eight months of 2009 widened to reach 4.2% of GDP, sharply up from 1.0% a year earlier. In August, the government revised its fiscal deficit estimate for 2009 to 7.3% of GDP from 4.6%, based on an agreement with the IMF

<Outlook and Points to Watch>

Political instability may delay reform programs

(1) Collapse of coalition government

Following the departure of the SDP from the coalition government, the center-right DLP fell into minority status on October 1. Thereafter, a no-confidence motion tabled against the minority government by the opposition parties was approved in parliament, which ended up with the collapse of the government led by Prime Minister Boc. Although President Basescu nominated Lucian Croitoru as his candidate for prime minister, a new Cabinet composed mainly of current ministers from the DLP and technocrats from government ministries was again rejected in parliament. Romania has since been in political instability, governed by an interim Cabinet led by Prime Minister Boc. Under the country's law, in order for a new government to be set up, a Cabinet formed by a prime minister nominated by the president must be approved in parliament. With the presidential election for November 22 and December 6, chances of a new government being formed before then look quite slim.

The presidential election has been contested mainly by three candidates, the incumbent Basescu, Mr. Geoana and Mr. Crin

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Antonescu of the National Liberal Party (NPL). In the presidential election held on November 22, Mr. Basescu and Mr. Geoana proceeded to the second round election for December 6, since no candidates won the outright majority. The next government is likely to be formed either by the SDP or the DLP. While SDP is rather cautious about the country's agreement with the IMF, other major parties remain committed to the agreement. JCR holds that whichever candidate may win, a new government will be less likely to break the accord with the IMF.

(2) Romania making progress as planned on loan conditions

Following the IMF approval of its loan commitments to Romania on May 4, the government drew the first tranche equivalent to EUR 5 billion and the second tranche equivalent to EUR 1.9 billion as scheduled. The remainder of the IMF loan is to be disbursed by May 2011, subject to progress Romania will make to meet the loan conditions. This requires the government to carry out fiscal consolidation mainly through major spending cuts, recapitalize the banks and strengthen their supervision. As for fiscal consolidation, the government is obliged to cut the deficit (ESA95) to 5.9% of GDP in 2010 from 7.3% in 2009. The government planned to implement spending cuts totaling 0.8% of GDP in 2009 and 2.0% in 2010. However, the implementation of the spending cuts may be delayed due to the political instability.

(3) Economic downturn looks moderating

The Romanian economy has been in recession since the July-September quarter of 2008 amid the global financial crisis and the subsequent economic downturn in its major European trading partners. However, there have been signs of modest improvement. The economic contraction has been somewhat moderating since the April-June quarter of 2009. Real GDP growth rate in the April-June and the July-September quarters improved to -1.0% and -0.7%, respectively, on a quarter-on-quarter basis from -4.6% in the January-March quarter due mainly to increased car production. Industrial production and exports in the July-September quarter also picked up modestly. By contrast, the unemployment rate rose to 6.9% in September, up by a steep three percentage points from a year earlier. JCR projects that the Romanian economy will contract more than 7% in 2009 but may resume growing by around 1% in 2010, helped by an economic recovery in its major trading partners and the depreciation of its currency. The consumer price inflation accelerated in early 2009 due to higher service prices and a weaker RON but eased to 4.9% year-on-year in September 2009 on stabilization of food prices. While the inflation rate was higher than the target (3.5% plus/minus 1pp) set by the NBR, the central bank enforced additional policy rate cuts by 100 bps to 8.0% between August and November on the assumption that inflation will continue decelerating amid the persistent recession.

(4) Improvement of current account deficit and external liquidity

The current account deficit, which widened to 12.3% of GDP in 2008, has been rapidly improving since late in 2008 when imports began falling faster than exports. The deficit in the first nine months of 2009 narrowed to 2.6% of GDP from 9.5% a year earlier. The deficit has been entirely covered by non-debt funds as the ratio of net FDI inflows to the current account deficit improved to more than 100% during the nine-month period. The external liquidity position has also improved thanks to the IMF loans and a substantial reduction of short-term external debts. The external debt as of the end of September 2009 widened to 62% of GDP from 53% at the end of 2008 due mainly to loans drawn from the IMF. However, excluding the IMF loans, the total external debt at the end of September remained almost unchanged from the end of 2008. The short-term external debt which accounts for 30% of the total debt shrank by a substantial 26% in the same period. The foreign exchange reserves (excluding gold) swelled to reach a record-high EUR29 billion at the end of October 2009. JCR holds that the government should be able to fill the gap in external financing if it can draw the remaining IMF loans as scheduled.

Main Economic Indicators: Romania

(Convergence criteria)	Criteria	2004	2005	2006	2007	2008	2009f	2010f
1.CPI (annual average)	0.8%(note)	11.9	9.1	6.7	3.9	7.9	6.0	4.8
2.10 year government bond yield	4.8%(note)	n.a.	7.0	7.2	7.1	7.6	n.a.	n.a.
3.General gov't fiscal balance/GDP(ESA95)	Below -3%	-1.2	-1.2	-2.2	-2.5	-5.4	-5.2	-3.8
4.General gov't debt/GDP(ESA95)	Below 60%	18.8	15.8	12.4	12.7	13.6	23.5	30.3
Real GDP growth rate	(%)	8.5	4.2	7.9	6.2	7.1	-7.2	1.0
Unemployment Rate	(%)	8.1	7.2	7.3	6.5	5.8	7.5	8.2
Current account balance/ GDP	(%)	-8.4	-8.7	-10.4	-13.5	-12.3	-7.3	-5.6
Trade balance/GDP	(%)	-8.8	-9.8	-12.0	-14.5	-13.4	-9.5	-7.8
Net FDI inflows/GDP	(%)	8.4	6.6	8.9	5.7	6.8	4.3	5.5
Foreign exchange reserve (FOREX)	(EUR mn)	10,848	16,796	21,310	25,307	25,919	31,500	45,500
Net FDI/CA	(%)	100.5	76.0	85.9	42.2	54.8	59.3	98.8
Gross external debt/ GDP	(%)	34.7	38.8	42.0	47.4	53.4	66.4	71.4
Gross external debt/ Export (G&S)	(%)	96.5	117.3	130.8	160.0	172.3	221.7	242.7
Public external debt/ Export (G&S)	(%)	45.8	46.3	36.8	36.3	39.0	67.1	89.9
FOREX/monthly imports	(months)	4.8	5.8	5.9	5.6	5.2	7.9	11.1
FOREX/short-term external debt	(times)	3.4	2.7	1.7	1.3	1.2	1.4	1.9
Debt service ratio	(%)	16.4	20.1	20.7	23.2	29.3	37.3	37.7

Note: Figures for criteria 1 and 2 are moving average between November 2008 and October 2009. Figures for 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

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