2003-24
August 19, 2003

Romania

Rating on Foreign Currency Long-term Senior Debts: BB/Stable (Latest rating review released on December 18, 2002.)

<Main Viewpoints on the Rating>

Positive Factors

Improved macroeconomic performance.

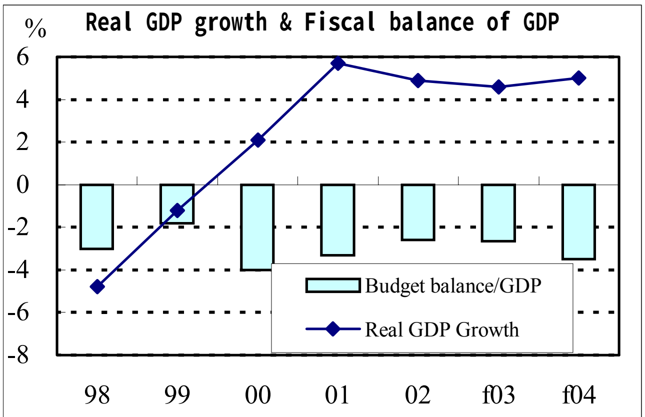
Rapid improvement in the external liquidity position and the reduction in the debt-service burden due to the drop in public external debt.

IMF's support toward the economic structural reform.

Negative Factors

Concern about persistent inflation due to lingering high rises in prices and wages.

Delay in the transformation of the industrial structure and the deficient financial intermediary function.



Sources: NIS, European Commission

<Updated: from May 2003 to July 2003>

Positive Factors

Higher probability of the disbursement of the final tranche of IMF's stand-by credit.

The decline of the unemployment rate from 8.1% in December 2002 to 7.4% in May 2003.

The decline of CPI to 14.0% (year on year) in June 2003 from 17.8% in December 2002 and the declining trends of the rate of wage raise, which stood at 24.6% (year on year) in June 2003.

Negative Factor

Deceleration of the economic growth to 4.4% in the 1st quarter of 2003 (year on year) from 4.9% in 2002, due to slower growth in capital investment and exports.

<Prospects and Noticeable Points>

Continuously improving economy and fiscal position

Though the economic growth slightly decelerated, inflation and employment situations improved

- Real GDP growth decelerated to 4.4% (year on year) in the 1st quarter of 2003 from 4.9% in 2002, due to slower growth in capital investment and exports. Slower growth in exports was attributable to the deceleration of economic growth in main trading partners, including Italy and Germany. The slowdown in the growth of capital investment was due to the prospect of subdued external and domestic demand temporarily.
- CPI trended downward lowering to 14.0% (year on year) in June 2003 from 22.5% (annual average) in 2002, partly due to the appreciation of the Romanian currency (along with the appreciation of the euro) against the US dollar. The rate of monthly average wage raise also trended downward, though gradually, declining to 24.6% (year on year) in May 2003.
- The unemployment rate declined to 7.4% in May 2003 from 8.1% in December 2002, because the phase of employment adjustment through the downsizing of privatized former state-owned enterprises was over and employment in services sector rose.
- While the Romanian economic growth will slightly decelerate temporarily affected by the sluggish EU economy, the economy is likely to recover toward the end of this year following a recovery of the EU economy.

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(2) IMF will probably approve the disbursement of the final tranche of the stand-by credit

- The IMF nearly reached an agreement with the Romanian government on the fourth (final) review of the stand-by credit.
- This was because Romania's macroeconomic performance had been on improving trends, the privatization of Banca Comarciala Romania, a state-owned commercial bank, that had been pending became in sight, and because a privatization plan for other state-owned enterprises, including Petrom, was released.
- They failed to reach a final agreement, however. Discussions will be continued for issues such as wage and salary raises for workers in public enterprises, an additional raise of energy prices to appropriate levels and the size of the budget deficit in 2004.

(3) The disbursement of the final tranche will be probably approved, though an improvement in the fiscal balance and trends of wages should be observed

- Finance Minister Mihai Tanasescu said that the government wanted to persuade the IMF to allow it to expand the budget deficit for 2004 to 3.7 (3.5 ??)% of GDP from 2.65% (projected by the government) for 2003, as the government wanted to increase spending on the highway project to level up its infrastructure closer to the EU standards, in anticipation of it joining the EU in 2007.
- The budget balance bottomed out at minus 4.0% of GDP in 2000 and then has been improving, based on the program drawn up by the IMF. However, as the government may turn to an expansionary fiscal policy taking into account the general election and the presidential election to be held in 2004, it will be necessary to watch the stance of the fiscal policy of the government.
- The IMF is concerned about the trend of wages, particularly wage raise of public sector employees. In fact, while the labor productivity of the country grew by 5% in the 1st half of 2003 (year on year), the real wages rose by 9% in the same period.
- Recently, more and more enterprises headquartered in the EU have reportedly set up their production base for low-value-added products in Ukraine, Beralus and China, where production costs are lower than in Romania., The raise of real wages would not only have adverse impacts on the budget balance and prices, but weaken the competitive position of Romania in the long term perspective. Consequently, it is required to constrain real wage hikes and to reduce production cost.
- Romania is required to reach the agreement with the IMF on the issues still under discussion to avail itself of the final tranche of the stand-by credit. JCR considers that the IMF will finally agree with the government on the disbursement of the final tranche, in view of the government's necessity of meeting the conditions for joining the EU and of getting credit supplement by the IMF through the disbursement.

Romania: Main Economic Indicators

		1999	2000	2001	2002p	2003f	2004f
Real GDP growth rate	(%)	-1.2	1.8	5.7	4.9	4.6	5.0
Unemployment rate (year-end)	(%)	11.8	10.5	8.8	8.1	7.5	7.8
CPI (annual average)	(%)	45.8	45.7	34.5	22.5	13.0	11.0
Nominal wage (annual average)	(%)	46.1	42.7	40.5	27.1	18.5	16.5
Commercial lending rate	(%)	65.9	53.5	45.1	35.2	25.2	17.5
Government deficit/GDP	(%)	-1.8	-4.0	-3.3	-2.6	-2.7	-3.5
Government debt/GDP	(%)	34.2	31.5	29.1	30.7	29.8	28.5
Trade balance (goods)/GDP	(%)	-3.1	-4.6	-7.5	-5.7	-6.2	-5.5
Current account balance/GDP	(%)	-3.7	-3.7	-5.9	-3.4	-4.1	-3.5
Foreign exchange reserves	(US$ mln)	2,687	3,922	5,442	7,211	8,100	9,000
Import coverage (G&S)	(Months)	2.8	3.3	4.0	4.6	4.7	5.3
Gross external debt/GDP	(%)	25.8	28.9	31.1	34.0	32.2	31.9
Net inflow of FDI	(US$ mln)	1,025	1,037	1,157	1,385	1,595	1,680
Exchange rate (average)	(Leu / US$)	15,333	21,709	29,061	33,055	34,000	35,000

Sources： NIS, NBR, Ministry of Development and Forecast, IMF, European Commission and EIU

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