

Romania

 Foreign LT: **BB/Positive**, Local LT: **BB+/ Positive** (Latest rating review released on December 17, 2003)

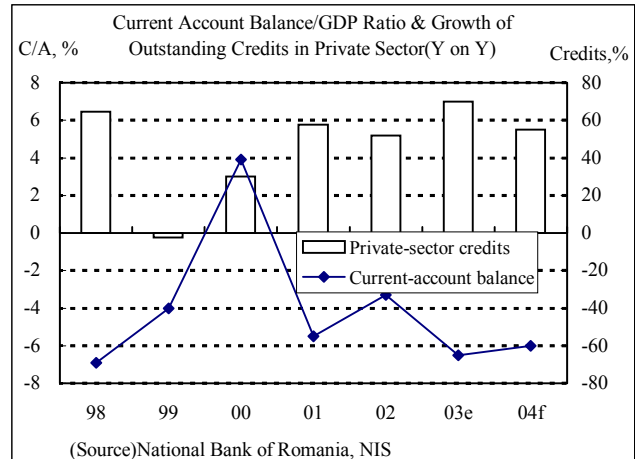
<Main Viewpoints on the Rating>

Positive Factors

Improved macroeconomic performance.
 Maintenance of fiscal discipline.
 Reduction in public debt-service payments driven by extension of loan terms and lower interest rates.

Negative Factors

Delay in structural reforms in terms of its efficiency and administration
 Expansion of current account deficit amid rapid growth of outstanding credits to private sectors.



<Updated: from November 2003 to January 2004>

Positive Factors

Romania's real GDP grew strongly by 4.7% in the first nine months of 2003 (y-on-y), driven by private consumption and capital investments. The government estimate of 4.8% growth for the full year is seen certain to have been achieved with the help of improving external environments. A growth rate of 5% in 2004 and 2005 is also in sight.

Negative Factors

Current account deficit is estimated to have widened to 6.5% of GDP in 2003 from 3.4% in 2002, due to expansion of trade deficit resulting from strong domestic demand spurred by rapid growth of outstanding private credits.

Helped by stronger external demand and the depreciation of the lei against the euro, CPI rose 14.1% in 2003 (y-on-y), indicating that a downward spiral of prices came to a halt.

Ms. Nicholson, the European Parliament's Rapporteur (lawmaker) for Romania, stated that the accession negotiations with Romania should be suspended until it tackled corruption and set up an independent judicial system. Her statement may have an adverse impact on the future of the negotiations.

(1) High economic growth to continue; disinflationary trend comes to an end

- Romania's real GDP grew 4.7% year-on-year in the 1Q-3Q of 2003, mainly spurred by private consumption and gross fixed capital formation. On a full-year basis, the government projection of 4.8% is estimated to have been almost achieved. In 2004, recovery of equipment investment and exports may fall short of the government projections, due to slower economic recovery in the country's main trading partners, e.g. Italy and Germany. However, JCR forecasts a steady growth rate of 5.2% for 2004 in view of solid consumption and accelerated infrastructure investment in preparation for the EU accession.
- CPI increase was at 14.1% year-on-year at the end of 2003, slightly higher than the government estimate of 14.0%. It is clear that the disinflationary trend came to a halt at the middle of 2003, due mainly to higher import prices caused by the depreciation of the lei against the euro. In 2004, utility prices were raised. The governmental projection of 9.0% at the end of 2004 seems to be difficult to achieve.
- Despite the prospect of accelerating economic growth, the employment situation is expected to worsen in 2004. Due to the tightened monetary policy adopted last spring, the business environment has deteriorated in the construction industry, where further layoffs are seen unavoidable. The government plans to reduce the workforces in unprofitable state-owned enterprises, including those in the mining sector. The unemployment rate rose to 7.2% at the end of 2003 after hitting a low of 6.5% in September 2003.

(2) Lending rules tightened to curb the surge in outstanding credits

- National Bank of Romania (NBR) put a stricter standard for bank lending in place in February 2004. The decision apparently aimed to curb the surge in the outstanding balance of private credits caused by lower interest rates in recent years, stem the expansion of the current account deficit and forestall the deterioration of credits held by the banks. In the past, borrowers were allowed to set aside up to 50% of their monthly income for the repayment of principal and interest. The tightened rules lowered the limit to 30% for consumer loans and 35% for mortgage loans.
- NBR raised its reference rate by 100bp to 21.25% in January, bringing the cumulative rate hikes to 385bp since the spring of 2002. However, the stricter rules triggered a rush of borrowing before their implementation. As a result, the outstanding balance of private credits swelled 68.5% year-on-year in November. A steep rise in imports brought about a bigger trade deficit, sending the current account deficit deteriorating to an estimated 6.5% of GDP in 2003 from 3.3% the year before, far above the original government estimate of 4.8%. NBR stated that the current account deficit cannot be reduced by more than 0.2% of GDP with the hike of its reference rate and the application of the stricter lending norms. In a situation where rate hikes cannot stem the import surge, any significant reduction of the current account deficit would seem a remote chance.
- The growing demand for foreign currency (euro) needed to pay for the surging imports has accelerated the depreciation of the lei against the euro. NBR had to intervene in the market to buy lei and sell euro in an effort to curb inflation. As a result, Romania's foreign exchange reserves (excluding gold) fell by ca. 10% to US\$8,082 million at the end of December 2003 from US\$8,968 million a month before.

(3) Concern over procedures for amendment of domestic laws may affect accession talks

- On February 3, Baroness Nicholson, the European Parliament's Rapporteur (lawmaker) in charge of Romania, admitted that the country has made progress in a number of areas. At the same time, however, she remarked that "Romania's accession negotiation should be suspended until progress is confirmed in measures to meet corruption, secure an independent judicial system and address the family affairs." Her remarks may have some impact on the negotiations on Romania's EU accession.
- What Nicholson saw as an issue was not "the delay in the negotiations". She pointed out that the procedures followed by the government in amending laws in conformity with EU laws are not democratic. She said that the government often resorts to "ordinances" rather than "parliamentary resolutions" in an apparent bid to quicken the pace of the negotiations. What she saw as controversial was different from what had been mentioned in the past.
- Romania had completed only 22 of 31 chapters of 'acquis communautaire' by the end of 2003. It is far behind Bulgaria that has gone through 26 chapters. The European Commission failed to recognize Romania as a "functioning market economy" in its progress report published last November. What is important for Romania is not only to finalize the negotiation on the remaining chapters including agriculture but also to amend its laws in conformity with the EU standards through a "democratic process".

Romania: Main Economic Indicators

		1999	2000	2001	2002	2003f	2004f
Real GDP growth rate	(%)	-1.2	2.1	5.7	4.9	4.8	5.5
Unemployment rate (year-end)	(%)	11.8	10.5	8.8	8.1	7.2	7.8
CPI (annual average)	(%)	45.8	45.7	34.5	22.5	15.4	12.5
Nominal wage (annual average)	(%)	46.1	40.5	41.2	28.5	21.7	17.1
Commercial lending rate	(%)	65.9	53.5	45.1	35.2	25.4	17.5
General Gov. Fiscal balance/GDP	(%)	-3.6	-4.0	-3.2	-2.5	-2.7	-3.0
General Government debt/GDP	(%)	34.2	31.5	30.6	29.1	30.7	29.8
Merchandise Trade balance/GDP	(%)	-3.1	-4.5	-7.4	-5.7	-6.7	-6.6
Current account balance/GDP	(%)	-4.0	-3.9	-5.5	-3.3	-6.5	-6.0
Foreign exchange reserves	(US\$ mln)	2,687	3,922	5,442	7,211	8,082	8,764
Import coverage (G&S)	(Months)	2.8	3.4	4.0	4.6	4.0	4.0
Debt to service ratio	(%)	36.7	18.8	18.8	21.0	18.7	19.2
Gross external debt/GDP	(%)	25.8	28.8	30.7	34.0	36.8	40.0
Net inflow of FDI	(US\$ mln)	1,025	1,048	1,174	1,090	1,490	1,910
Exchange rate (average)	(Lei/ US\$)	15,333	21,709	29,061	33,055	33,200	32,512

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

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