

2004-25  
August 16, 2004

## Romania

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

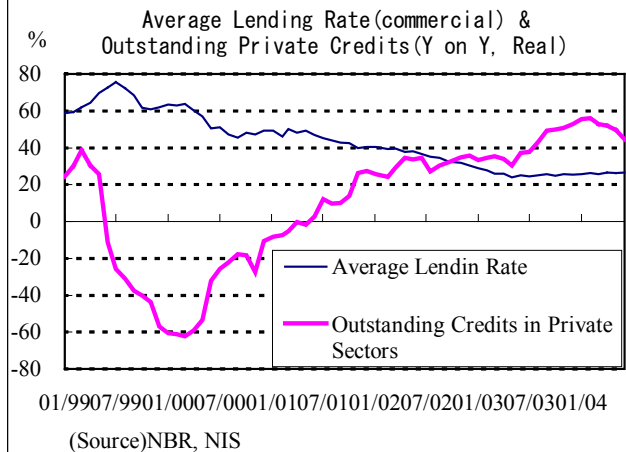
### <Main Viewpoints on the Rating>

#### Positive Factors

Improved overall macroeconomic performance.  
Maintenance of fiscal discipline.  
Reduced public debt-service payments brought by extended loan terms and falling interest rates.

#### Negative Factors

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



### <Updated: from February 2004 to April 2004>

#### Positive Factors

Real GDP growth rate accelerated to 6.1% in the 1st quarter of 2004 from 4.9% in 2003, driven by private consumption and capital investment. JCR forecasts that the GDP will grow by 5.8% in 2004, bolstered for the time being by a steady expansion of capital investment amid a better economic outlook in major trading partners, e.g. Italy and Germany, and continuing growth of private consumption spurred by an improved prospect of employment and increased credits backed by lower interest rates and easier bank loans.

The IMF Executive Board has approved a 24-month, SDR250 million precautionary standby credit for Romania. Through its monitoring under the arrangement, the IMF may endorse progress in Romania's structural reforms, such as the privatization of state-owned resources companies. This may prompt recognition of the country as a 'functioning market economy,' one of prerequisites for its EU membership.

#### Negative Factors

Current account deficit widened by 16.4% in the January-May period of 2004 from the same period a year before. The government target of reducing the current account deficit in 2004 to 5.5% of GDP is not likely to be achieved. JCR expects that the ratio will remain virtually unchanged from 2003 at 5.7%. NBR's policy to curb imports through stricter norms on lending by commercial banks is unlikely to have much effect in reducing the current account deficit.

### <Outlook and Noticeable Points>

#### (1) Government to upgrade GDP growth estimate for 2004 on good performance of private consumptions and capital investment.

- The Romanian government is expected to revise its real GDP growth estimate for 2004 upward from 5.5% to nearly 7% when it announces a revised budget outlook in September. In the 1st quarter of 2004, GDP grew a strong 6.1%, underpinned by private consumption and capital investment. Since late July, both Prime Minister Adrian Nastase and Finance Minister Nicolae Tanasescu have mentioned a possible upward revision of the government estimate. They have noted that exports will increase on recovery of the EU economy, that there will be increased investments by foreign enterprises (e.g. an expansion of the assembly lines by Dacia, the Romanian subsidiary of French auto giant Renault, for its new strategic low-priced model "Logan") and privatized Romanian enterprises for modernization of equipment and that personal consumption will grow on improvement in the income and employment situation.
- As for the budget balance, JCR expects that the ratio of general government deficit to GDP will improve to 2.1% in 2004 from 2.3% the year before on increased tax revenues amid business recovery and intensified tax collection. On the other hand, the trade deficit was widening as imports grew faster than exports. The current account deficit is likely to improve only modestly to 5.7% of GDP in 2004 from 5.8% the year before, much higher than the 5.25%

<1/3>

government target. However, as we will see later in this report, both portfolio and capital investments are expected to accelerate in tandem with progress in privatization. Coupled with a steady increase in the remittance by nonresident workers, this will make the funding of the deficit easier than before.

## **(2) "Pre-cautionary standby arrangement" endorsed by IMF**

- On July 7, the IMF Executive Board endorsed a "precautionary standby arrangement" for Romania totaling SDR250 million for a period of 24 months. The government has ruled out the possibility of tapping on the facility, which is meant for use only in an emergency involving current account deficit. However, IMF monitoring under the arrangement will unravel progress in Romania's structural reforms, which may have a good impact on negotiations for its EU accession. While stressing the need of further reform efforts, the IMF has commended progress made so far in privatization and stabilization of prices.
- Finance Minister Tanasescu announced on August 2 that the ratio of "arrears" (with taxes, levies and social contributions) to GDP had been cut by 0.8% year-on-year at the end of June, surpassing the 0.5% earlier required by the EU. As the IMF had put the ratio at 39.7% at the end of June 2003, it has now been reduced to an estimated 38.9%. As the government and energy utilities have begun stepping up collection of the arrears, the problem that has mired commercial and economic activities will now be gradually resolved.

## **(3) With privatization of Petrom, Romania's EU entry negotiations will come to final stage**

- On July 23, the Austrian oil company OMV announced an agreement with the Romanian government on acquisition of 33.3% of the outstanding shares of Petrom, the country's largest state-run oil corporation, for Euro669 million. Under this deal, OMV is set to increase its stake to 51% through subscription to share allocation in Petrom's capitalization increase from Euro723 million to Euro855 million. This is the largest privatization of oil companies in the CEE countries. Petrom produces more than two-thirds of domestic petroleum demand and accounts for more than a third of retail fuel sales. Oil deposits in its concessions are estimated at 1 billion barrels.
- On July 19, Italian energy company Enel bought 51% of stocks of each of Romania's two electricity companies for a total Euro 118 million. The two utilities have a combined 20% share in the country's electricity retail market.
- On July 15, the bid for two gas transportation companies, Distrigaznord and Distrigazsud, was closed. The bidding had been postponed three times in late last year and in March and June this year. Five companies including Enel and Russia's Gazprom made their bids. After selecting successful bidders, the government will finalize procedures for the sale by the end of October. With the two companies accounting for a combined 90% of Romania's total gas supplies, the bidders will be allowed to buy either of them rather than both in a package deal.
- With the privatization of major energy utilities all but complete, matters of concern for the IMF and other international institutions have been largely removed. JCR considers that Romania will probably be recognized as a 'functioning market economy' this autumn, a factor that should have a favorable impact on the negotiations for its EU accession.

## **(4) Ruling SDP suffers setback in local election prior to presidential and general elections scheduled for November**

- In the provincial assembly elections held in June, the ruling Social Democratic Party (PSD) lost an unexpectedly large number of seats. In contrast, the center-right alliance consisting of the National Liberal Party (PNL) and the Democratic Party (PD) increased the number of its seats. The alliance garnered slightly more votes than PSD. Recent public opinion polls show that the PNL-PD alliance will hardly be able to win a majority though it may increase the number of seats in the general election scheduled for November 28. PSD would probably stay in power as a minority government with the support of the Democratic Union of Magyars (UDMR) from outside the cabinet. Even if the ruling party should be replaced, there would be no major policy change such as suspension of structural reforms, which are inevitable for the country's accession to EU in 2007.
- Meanwhile, in the presidential election to be held simultaneously with the general election, the possibility has emerged that Prime Minister Nastase will be fielded as a PSD candidate. His name value is extremely high and he is said to be eager to be nominated as a presidential candidate. At the moment, Mr. Nastase is regarded as the most powerful PSD candidate. If he decides to run in the election, PSD will have to choose a candidate to succeed him as party leader and prime minister. PSD members may consider either Finance Minister Tanasescu or Foreign Minister Mircea Dan Geoana as a candidate. Incumbent President Ion Iliescu, who is serving his second term, is expected to return to PSD as a parliamentary member. The country's law prohibits a president from serving a third term.

**Romania: Main Economic Indicators**

		2000	2001	2002	2003f	2004f	2005f
Real GDP growth rate	(%)	2.1	5.7	5.0	4.9	5.8	5.3
Unemployment rate (year-end)	(%)	10.5	8.6	8.1	7.2	7.0	7.3
CPI (annual average)	(%)	45.7	34.5	22.5	15.3	11.5	7.5
Nominal wage growth (average)	(%)	40.5	41.2	28.5	25.4	20.0	17.0
Commercial lending rate	(%)	53.5	45.1	35.2	25.4	20.5	18.0
General Gov.Fiscal balance/GDP	(%)	-4.0	-3.2	-2.6	-2.3	-2.1	-2.1
General Government debt/GDP	(%)	31.3	28.6	28.3	26.6	26.5	26.3
Merchandise Trade balance/GDP	(%)	-4.6	-7.4	-5.7	-7.9	-7.0	-6.7
Current account balance/GDP	(%)	-3.7	-5.5	-3.4	-5.8	-5.7	-5.0
Forex reserves (excl. Gold)	(US\$ mln)	3,922	5,442	7,211	9,002	10,373	11,250
Import coverage (G&S)	(Months)	3.4	4.0	4.6	4.3	4.7	4.8
Debt to service ratio	(%)	18.7	18.8	21.0	18.4	18.2	16.3
Gross external debt/GDP	(%)	28.7	30.7	34.3	34.6	33.2	32.8
Net inflow of FDI	(US\$ mln)	1,048	1,174	1,129	1,521	2,050	2,550
Exchange rate (average)	(Lei/ US\$)	21,708.7	29,060.8	33,055.4	33,200.1	34,050.0	35,150.0

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

(Hisatoshi Funada, Analyst)