

2006-07
May 31, 2006

Romania

Foreign LT: BBB-/Stable, Local LT: BBB/Stable (Affirmed on December 13, 2005)

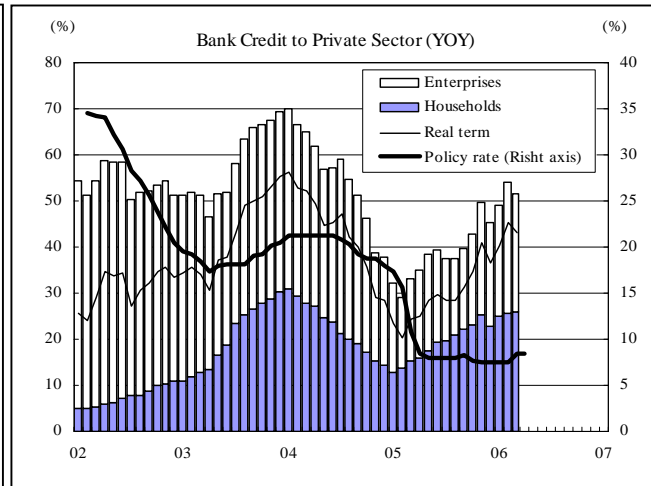
<Rating Perspective>

Positive Factors

- Progress on political, economic and budgetary reforms in pursuit of EU entry in 2007.
- Reduced government debt burden brought by restrained fiscal deficit
- High economic growth prospects

Negative Factors

- Deteriorating external balance due to strong domestic demand led by consumer spending
- Transformation of industrial structure still at primary stage



<Update: from February 2006 to April 2006>

Positive Factors

- National Bank of Romania (NBR) raised its policy rate by 1.0 percentage point to 8.5% and foreign-currency reserve ratio by 10 points to 45.0% in March.
- Consumer price inflation in April 2006 decelerated to 6.9% year-on-year from 8.6% in December 2005 on falls of administered prices.
- General government fiscal surplus in the first three months of 2006 more than trebles to RON6.7 billion or 2.0% of GDP.

Negative Factors

- European Commission (EC) has put off making final recommendations on whether Romania and Bulgaria should join the EU in 2007 or 2008 (May 16).
- IMF sounded a warning on widening current account deficits in European transition countries including Romania.
- Trade deficit in the first three months of 2006 widened 59% year-on-year to EUR 1,694 million (1.8% of GDP).
- Bank credit to private sector in February and March 2006 grew more than 50% year-on-year.

<Outlook and Points to Watch>

Decision on date of EU entry in 2007 put off

(1) Date to be recommended on Oct. 26

The European Commission (EC) has delayed making final recommendations on whether Romania and Bulgaria should join the EU in 2007 or 2008 in its monitoring reports published on May 16. The EC had been expected to recommend to the European Council a date for their accession to the EU. That date is now to be recommended on October 26. While the EC said in the reports that the two countries were lagging in their preparations for EU membership, it acknowledged that Romania was making more progress than Bulgaria. The EC mentioned four points about Romania and six points about Bulgaria as areas for 'serious concern.' The four areas with Romania were: a lack of fully operational EU farm subsidy payment agencies; failure to set up an integrated administration and control system for agriculture; the poor veterinary standards to prevent mad cow disease; and the VAT collection computer system not compatible with those in the EU countries. In addition, the EC cautioned that Romania needs to make further efforts to produce results in its fight against corruption and in judicial reforms.

(2) Domestic demand remains strong amid unabated growth of bank credit to private sector

Real GDP growth rate in the October-December quarter of 2005 improved to 4.0% year-on-year from 1.8% in the

previous quarter on recovery of production which had been hit by the flood damage. However, the growth rate in 2005 slowed to 4.1% from 8.3% in 2004 due primarily to a negative contribution of net exports brought by robust domestic demand. Bank lending to the private sector remained strong, growing more than 50% year-on-year in February and March 2006. Overall credit to the private sector showed no signs of deceleration, though the outstanding balance of foreign currency-denominated consumer loans somewhat abated under monetary restraint policies. Inflation pressure continued strong amid rapid growth of real wages, robust bank lending, and high energy prices as well as tax hikes for tobacco and alcohol products, although the CPI growth rate decelerated to 6.9% year-on-year in April 2006 from 8.6% in December 2005 on falls of administered price. The strong domestic demand and lingering inflationary pressures prompted the National Bank of Romania to raise its policy rate by 1.0 percentage point to 8.5% and foreign-currency reserve ratio by 10 points to 45.0% in March.

JCR projects that the economy will continue growing modestly by below 5% in 2006 and 2007 as domestic demand slows down following implementation of tighter monetary policies. Consumer price inflation is likely to decelerate to around 6% year-on-year, helped by monetary tightening and a strong currency, but will narrowly miss the year-end target of 5.0%±1%.

(3) External imbalance deteriorates despite fiscal surplus

Amid the robust domestic demand, the country's external imbalance deteriorated as the trade deficit in the first three months of 2006 widened 59% year-on-year to EUR1,694 million. There is little concern about financing a large current account deficit for the present, given the massive inflow of foreign direct investment spurred by the privatization of large state enterprises and a steep increase in the foreign exchange reserves. However, the current excessive domestic demand will be hard to sustain. The general government fiscal balance in the first three months of 2006 registered a surplus of RON6.7 billion or 2.0% of GDP, more than three times as much as the year before. However, the government initially plans to hold the fiscal deficit in 2006 to 0.5% of GDP, but revised the target to 0.9% in view of the need to increase investment in infrastructure.

(4) Further tightening measures on monetary and fiscal policies are essential

JCR considers that further monetary and fiscal tightening is inevitable to bring the economy back to sustainable growth. The IMF and the EC gave warnings to Romania over the current monetary and fiscal policies and called for further tightening measures. The IMF and Romania remain apart from each other after talks based on their precautionary stand-by agreement* collapsed on October 31, 2005. The EC in its monitoring report urged the Romanian government to improve its external imbalances. Under such external pressure, the government and the NBR may decide to adopt additional tightening measures. JCR will closely watch what fiscal and monetary measures they will implement. Romania's EU accession might be put off by one year, but a delay of that score would not affect the JCR ratings.

*In July 2004, the IMF approved the precautionary stand-by agreement, allowing Romania to withdraw SDR250 million or about US\$370 million over two years

Main Economic Indicators: Romania

		2001	2002	2003	2004	2005	2006f	2007f
Real GDP growth rate	(%)	5.7	5.1	5.2	8.3	4.1	4.4	4.8
CPI (annual average)	(%)	34.5	22.5	15.3	11.9	9.0	7.0	5.5
Unemployment Rate	(%)	8.8	8.4	7.4	6.2	5.8	6.0	5.8
General Gov. Fiscal balance/GDP	(%)	-3.2	-2.6	-2.3	-1.1	-0.8	-1.0	-0.5
Gross General Gov. Debts/GDP	(%)	28.7	28.8	26.9	23.1	19.5	17.4	15.8
Current account balance	(EUR mln)	-2,488	-1,623	-3,060	-5,099	-6,891	-8,151	-8,684
Current account balance/ GDP	(%)	-5.5	-3.3	-6.0	-8.7	-9.0	-8.6	-7.4
Trade balance/GDP	(%)	-7.4	-5.7	-7.8	-9.0	-10.2	-9.4	-8.1
Net FDI inflows	(EUR mln)	1,312	1,194	1,910	5,127	4,757	5,400	4,650
Net FDI inflows/GDP	(%)	2.9	2.5	3.8	8.7	6.2	5.7	4.0
Foreign exchange reserve (FOREX)	(EUR mln)	4,445	5,877	6,374	10,848	16,500	17,500	19,500
FOREX/monthly imports	(months)	2.9	3.5	3.4	4.8	5.8	5.2	4.9
FOREX/short-term external debt	(times)	8.1	8.2	6.0	5.3	5.2	4.6	4.2
Gross external debt/ GDP	(%)	30.3	30.9	31.3	31.0	34.7	32.3	29.8
Gross external debt/ Export (G&S)	(%)	90.5	87.3	86.8	83.7	101.8	100.2	99.3
Public external debt/ Export (G&S)	(%)	58.5	53.6	53.0	46.0	43.2	37.8	36.7
Short term external debt/ Total	(%)	4.1	4.8	6.7	11.2	12.0	12.4	13.2
Debt service ratio	(%)	24.1	24.2	20.8	21.9	18.2	14.7	12.8

Source: NBR, Ministry of Public Finance, National Institute of Statistics, Figure for 2006 and 2007 are based on projection of JCR

Note: NBR introduced redenomination to new 1Leu (RON) for old 10,000Lei (ROL)

Toshihiko Naito, Senior Analyst