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12034

Romania

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Long-term Rating	BBB
Outlook*	Stable
Short-term Rating	-

*Long-term Rating refers to Long-term Issuer Rating in principle.

1. Overview

Romania had a population of 19.05 million (as of January 2022) and a nominal GDP of 323.16 billion euros in 2023, making it the second-largest economy in Central and Eastern Europe (CEE) after Poland. After the regime change in 1989, the country promoted reforms toward democratization and a market economy, becoming a member of NATO in 2004 and the EU in 2007. Its GDP per capita in PPP terms is the sixth-lowest in the EU as of 2022. As a member country in the process of catching up, Romania has a relatively high growth potential. On the other hand, the country faces twin deficits in the current account and fiscal balance, and correcting them remains one of challenges it needs to address. The coalition government consisting of the National Liberal Party (NPL) and the Social Democratic Party (PSD) has been promoting reforms that are conditions for receiving the EU's Recovery and Resilience Facility, while working to reduce the budget deficit.

2. Political and social situation and economic policy

The current government, which was inaugurated in October 2021, is a grand coalition between the two main parties, the PNL and the PSD. Although the center-right PNL and the leftist PSD are traditionally rivals, the foundation of their government is relatively stable. This seems to be partly attributable to the fact that the two parties share the general objective of implementing policies to support the economy. The next general election is scheduled toward the end of 2024, and the dominant view is that the current government will serve its entire term until then. Since the last election, the pro-Russian far-right party Union of Romania (AUR) has been gaining support. In an opinion poll conducted in October 2023, the PSD was in first place with a support rating of 30%, followed by the PNL and the AUR with a support rating of 19% each. JCR holds that a major policy shift as a result of the upcoming election is unlikely given that all major parties except the AUR take a pro-EU and pro-NATO stance. Nevertheless, JCR will closely watch the movements involving the AUR.

Based on an agreement reached at the start of the government, the prime minister post was handed over from PNL's Mr. Ciucă to PSD's Mr. Ciolacu in June 2023. Major cabinet members are also held by the PSD. The PSD has been in power as the ruling party since the first Ponta administration in 2012. During the years between 2012 and 2015, the party made good progress in fiscal consolidation under the IMF's stand-by arrangement. From around mid-2015, however, it shifted to expansionary fiscal policies, including large-scale tax cuts, increases of public servant salaries and measures to expand social security. Due to its widening budget deficit, Romania has been subject to the European Commission's excessive deficit procedure (EDP) since 2020.

The EU created the Recovery and Resilience Facility (RRF) to promote economic recovery after the COVID-19 pandemic. Unlike its Cohesion Fund, which is kept in place on an ongoing basis within the Multiannual Financial Framework (MFF), the RRF is a temporary instrument in operation until the end of 2026. In line with the EU's policy agenda, each country has formulated a Recovery and Resilience Plan (RRP), setting out investments and reforms to be implemented by the end of 2026. The RRF functions as an incentive to move reforms forward as funding is provided based on the progress achieved on those investments and reforms. The approved fund allocation for Romania (as revised in November 2023) is 28.5 billion euros (14.9 billion euros in grants and 13.6 billion euros in loans), equivalent to 13% of its GDP in 2020. While most of the funds have been earmarked for green transition and digital transformation, milestones also include judicial reforms, anti-corruption measures and pension system and tax reforms. As such, the RRF is intended to promote a wide range of reforms covering political, economic and fiscal issues. With the progress of the reforms, Romania has received the second payment so far, and the government submitted a request for the third payment to the European Commission in December 2023. Romania is ahead of other CEE countries in terms of the absorption of the funds, with the absorption rate of over 30%. The RRP is expected to continue to be an important policy anchor towards 2026.

3. Economic base and economic trends

As a latecomer member of the EU, Romania is in the process of catching up, making progress on economic convergence by benefiting from trade and financial integration with other EU economies and subsidies from the EU budget. Direct investment from Western European countries has contributed to building up a cluster of manufacturing industries, and more than 70% of the country's exports are destined for EU member countries led by Germany. Its GDP per capita in PPP terms approximately tripled over the 15 years since joining the EU, reaching about 40,000 USD in 2022, the highest among the countries rated in the BBB range by JCR. As for governance indicators (as published by the World Bank), the country ranks higher in terms of rule of law and control of corruption than other countries in the BBB range. JCR sees this as an indication that the development of a legal system in line with EU standards is progressing as Romania has been working on judicial reform and anti-corruption measures for many years. The country faces structural issues of a decline in the workforce due to aging population and an outflow of skilled workers, which could hinder its medium- to long-term growth if no countermeasures are taken.

In terms of energy balance, natural gas accounts for around 30% of the country's energy mix. However, the country meets most of its domestic natural gas consumption through domestic production, and its dependence on Russian gas has traditionally been relatively low among the EU member states. According to Eurostat, the ratio of domestic production to domestic consumption climbed to 97.2% in 2023 from 73.9% in 2021. Meanwhile, the country's gas imports from Russia decreased significantly in 2022, with procurement from alternative sources seen to be progressing. Moreover, a gas field development project (Neptun Deep) in the Black Sea is currently underway, with production scheduled to begin in 2026. After the start of this operation, Romania is expected to achieve complete self-sufficiency in natural gas.

Romania's economic growth has been slowing since the second half of 2022 due to the impact of the energy crisis triggered by Russia's invasion of Ukraine. However, the growth rate reached 4.1% in 2022 and 2.1% in 2023 (preliminary figure), maintaining a relatively high growth rate among CEE countries. The growth of private consumption and exports has slowed due to soaring inflation and sluggish external demand, but expansion of investment has been compensating for this to support growth. Public investment funded by EU funds has been growing significantly. In addition, private consumption has remained resilient although slowing, as Employment has been continuing to increase, while real wages turned positive compared to the previous year in March 2023, showing a faster recovery than in other CEE countries.

Regarding EU funds, around 31 billion euros were allocated under the 2021-2027 MFF, with 28.5 billion euros still available as of September 2023. Approximately 20 billion euros remain in the RRF. Assuming full absorption of the remaining funds, the annual average inflow of funds from the MFF and RRF over the next few years will be around 3% of GDP. In addition, 2024 is the final year for receiving funds under the 2014-2020 MFF, and as of September 2023, the remaining funds are approximately 1.6% of the estimated GDP for 2023. The inflow of these funds is expected to continue to support the country's economic growth over the medium term.

Consumer price (HICP) inflation (year-on-year) in Romania had trended downward after peaking at 14.6% in November 2022. Nevertheless, it remained high at

7.1% (EU average: 2.8%) in February 2024. Core inflation, excluding energy and unprocessed food, was even higher at 8.1% (EU average: 3.7%). In an effort to curb the inflation, the National Bank of Romania raised its policy rate by a total of 575 basis points between October 2022 and January 2023, and has since kept it at 7%. Going forward, a further easing of inflation is projected, leading to a pickup in purchasing power. In line with this and a rebound of the EU economy, JCR predicts that the country's growth rate will rise to the 3% range in 2024 and 2025.

4. Financial system

Romania's financial system remains stable. Following the global financial crisis and the European debt crisis, important structural reforms have progressed in the banking sector. The improvement in the funding structure has been particularly remarkable. In the past, the banking sector had relied on external funding, mainly borrowing from parent banks, but now it is mainly funded by domestic deposits. On the other hand, foreign currency-denominated loans, which were the main cause of the increase in nonperforming loans, have been curtailed. The proportion of foreign currency-denominated loans in total loans has declined from over 60% in 2013 to around 30%. JCR judges that the financial system's resilience to external shocks has increased as its liquidity, exchange rate and credit risks have been significantly reduced. The nonperforming loan ratio (as defined by the EBA) has been on a consistent downward trend since 2014, and even after the COVID-19 pandemic and the energy crisis, it remained low at 2.61% as of the end of September 2023. The sector's profitability stayed high, with the capital adequacy kept at a sufficient level of 22.3% as of the same date.

5. External position

The country's current account balance has been chronically in deficit due to a deficit in trade balance, with the deficit in 2022 widening to 9.1% of GDP, the highest since 2009. The current account deficit/GDP ratio had been on the rise since 2015 as imports increased amid expanding domestic demand. Adding to this was the impact of soaring energy prices. Another factor that led to the increase in the current account deficit over the medium-term should be the deterioration of competitiveness, which stemmed from the rise of the unit labor cost as a result of the hikes of wages at a pace exceeding the increase in labor productivity. In 2023, the current account deficit shrunk to 7% of GDPsupported mainly by the improved energy trade balance amid a cooling of energy prices. Nevertheless, this is still a higher level among the CEE countries. JCR projects the current account deficit/GDP to remain high in the medium term, as the structural factors should not be easy to resolve in the short time and also because the increase in the current account deficit is partly deemed to be a natural consequences of the economic growth.

External financing needs are large, but most (about 60% in 2023) of the current account deficit has been financed with inflows of direct investment and EU funds in recent years. These are non-debt increasing types of capital, the inflow of which do not lead to an increase in external debts. This trend is expected to continue in the medium term supported by a high-level inflow of EU funds.

The gross external debt/GDP ratio stood at 53.3% at the end of 2023. This is close to the end-2017 level, meaning that the continuation of large current account deficit in recent years has not led to a deterioration of the external debt position. Meanwhile, the net external debt/GDP ratio (on an IIP basis) was 39.9%, the lowest levels in the past decade or so. As the net external debt was mostly direct investment, the net external debt/GDP ratio excluding direct investment stood low at 5% at the end of 2023. As portfolio investment and other investments tend to be easily affected by conditions in global financial markets, an external debt structure with less of such investments can lead to greater external stability. The country's foreign exchange reserves have been on an increasing trend in recent years due to capital inflows. As of the end of December 2023, the reserves stood at 59.8 billion euros, 1.3 times the short-term external debt and 5.1 times the monthly imports in the year.

6. Fiscal position

After expanding to 9.3% in 2020 due to the impact of the pandemic, the general government deficit/GDP ratio (based on EU standards) fell to 6.3% in 2022, supported by higher tax revenues brought by the economic recovery, reduced pandemic-related spending and restrained expenditures. Under the EDP, the government had initially planned to improve the fiscal deficit/GDP ratio to 4.4% in 2023 and to 3% in 2024. However, the ratio is estimated to have remained close to the 2022 level as tax revenues did not grow as expected due to the economic slowdown while expenditures increased due to significantly higher investment spending, energy-related support measures, wage increases for government sectors such as teachers, health sector workers and military servants. The fiscal deficit remained high even after the pandemic subsided due to the impact of the measures implemented in the past, including large-scale tax cuts and spending increases focused on public-sector wages and social benefits implemented since 2016. Against this background, the fiscal deficit/GDP ratio rose to 4.3% in 2019, exceeding the 3% upper limit set by the EU.

The government has been demonstrating its commitment to fiscal consolidation, deciding on a consolidation package in September 2023. The size of the package is approximately 1.1% of GDP, of which 0.9% is to come from revenue-related measures. The government expects the biggest effect to come from the revision of income taxes and social security contributions, where exemptions granted to persons engaged in the agriculture, construction and IT sectors are limited. The package also includes the reduction of the number of goods subject to the reduced VAT rate, and the increase of the corporate tax rate applied to small businesses in some specified sectors. Under the RRP, the government is also working on reforms to strengthen tax collection and improve tax compliance. These initiatives, aimed to address the long-standing issue of low tax collection efficiency, are expected to increase revenues over the medium term. An expansion of public investment, a bigger defense budget and the short-term cost of the pension reform may lead to increased expenditures. All in all, however, JCR believes that fiscal consolidation will proceed gradually as the measures related to the energy crisis will also be withdrawn in the medium term. The government will need to take significant additional measures in order to achieve the target of reducing the fiscal deficit to 3% of GDP in the medium term. While pressure to increase spending may mount in the run-up to the general election at the end of 2024, JCR believes that the EDP and RRP will be key anchors for policy management and that fiscal discipline is highly likely to be maintained in general.

The general government debt/GDP ratio reached 48.9% at the end of 2023, up slightly from the end of 2022. This is still low in the EU context and is also below the average for the countries rated in the BBB range by JCR. JCR expects the ratio to stabilize at around 50% over the medium term, helped by a narrowing of the fiscal deficit and growth of nominal GDP. The debt burden is at a manageable level, with the interest expense/revenue ratio staying stable at around 5%.

7. Conclusion and Rating Outlook

The ratings on Romania are primarily supported by the country's relatively developed economic base, low government debt and the benefits it enjoys as an EU member state in the forms of subsidy and improvement on institutional frameworks. On the other hand, they are constrained by its chronic current account deficit and large fiscal deficit stemming from structural factors. The outlook of the ratings is Stable. Under the EU's EDP, the government has been addressing the reduction of the fiscal deficit, which swelled due to the impact of the easy fiscal policies promoted in the past and the COVID-19 pandemic. JCR expects that effects of the fiscal consolidation efforts will materialize in the medium term as the government is firmly committed to promote structural reforms anchored by the RRP. While the country's current account deficit will remain large in the medium term, risks associated with its external finance is mitigated partly by the stable capital inflow from the EU funds.

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Selected Economic and Fiscal Indicators

		2019	2020	2021	2022	2023
Nominal GDP	EUR billion	224	220	241	284	323
Population (as of January)	million	19.4	19.2	19.0	19.1	-
GDP per capita (purchasing power parity)	USD	32,680	33,072	35,620	39,828	41,580
Real GDP growth rate	%	3.8	▲ 3.7	5.9	4.7	2.1
Consumer price inflation　(HICP)	%	3.9	2.3	4.1	12.0	9.7
Unemployment rate　(annual average)	%	4.9	6.1	5.6	5.6	5.6
General government revenue/GDP	%	32.0	32.5	32.9	33.7	33.5
General government expenditure/GDP	%	36.3	41.8	40.0	40.0	47.3
General government balance/GDP	%	-4.3	-9.3	-7.2	-6.3	-6.3
General government debt/GDP	%	35.1	46.8	48.5	47.2	48.9
Current account balance/GDP	%	-4.9	-4.9	-7.2	-9.2	-7.0
Gross external debt/GDP	%	49.0	57.5	56.6	50.6	52.3
Gross external debt/exports of good and services	%	121.8	155.9	139.3	117.0	133.9
Foreign currency reserves/monthly imports	times	4.0	4.9	4.3	3.9	5.1
Foreign currency reserves/short-term external debt	times	0.9	1.1	1.0	1.0	1.3

* Figures for the most recent period could be indicators based on preliminary figures
* Fiscal data for 2023 are the European Commission's forecasts as of October 2023.

Source: National Institute of Statistics, ,Ministry of Public Finance, National Bank of Romania, Eurostat

Ratings

(millions)

	Rating	Outlook*	Amount	Currency	Rate (%)	Issue Date	Maturity Date	Release
Foreign Currency Long-term Issuer Rating	BBB	Stable	-	-	-	-	-	2023.11.27
Local Currency Long-term Issuer Rating	BBB+	Stable	-	-	-	-	-	2023.11.27

History of Long-term Issuer Rating (Long-term Issuer Rating or its equivalent)

Date	Rating	Outlook*	Issuer
1996.03.05	BB+	-	Romania
1998.09.28	#BB+	-	Romania
1998.12.15	#BB-	-	Romania
1999.04.14	BB-	-	Romania
2000.05.29	BB-	-	Romania
2001.12.12	BB-	Positive	Romania
2002.12.18	BB	Stable	Romania
2003.12.17	BB	Positive	Romania
2004.11.15	BB+	Positive	Romania
2005.09.09	BBB-	Stable	Romania

2006.11.29	BBB	Stable	Romania
2008.12.18	BBB-	Negative	Romania
2010.12.17	BBB-	Stable	Romania
2015.04.23	BBB-	Positive	Romania
2016.03.18	BBB	Stable	Romania
2020.06.22	BBB	Negative	Romania
2023.02.01	BBB	Stable	Romania

*Outlook for long-term issuer rating, or direction in case of Credit Monitor

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