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Research Update:

Romania 'BB+/B' Ratings Affirmed On Budgetary And External Adjustments; Outlook Positive

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Overview

- Romania is making steady progress in adjusting external demand, fiscal consolidation, and financial sector stability.
- We are therefore affirming our 'BB+/B' long- and short-term foreign and local currency sovereign credit ratings on Romania.
- The positive outlook incorporates the possibility that we could raise the ratings on Romania if the government sticks to its fiscal and reform programs.

Rating Action

On Nov. 22, 2013, Standard & Poor's Ratings Services affirmed its 'BB+/B' long- and short-term foreign and local currency sovereign credit ratings on Romania. The outlook is positive.

Rationale

The affirmation reflects Romania's steady progress in adjusting the economy toward external demand, consolidating the fiscal accounts, and bolstering financial sector stability.

We believe Romania's GDP growth will gradually strengthen over 2013-2016, helped by the continued rebalancing of its economy toward external demand. Over 2013-2016, we project that Romania will post an average annual current account deficit of about 1.6% of GDP. The shift to external demand over the past five years has occurred primarily due to higher exports, leaving the expected 2013 trade deficit at between 3% and 4% of GDP, versus 14% of GDP in 2007. This adjustment has made Romania a more open economy, with exports that we project to exceed 45% of GDP in 2016, versus 30% of GDP in 2009. The export growth reflects Romania's improved cost competitiveness against that of most of its trading partners. In this context, we believe Romania's 2011 labor market reform has improved the economy's flexibility and facilitated the swing toward export-led growth.

At the same time, domestic demand remains subdued, constrained by public-sector spending cuts, modest wage dynamics, and weak investment activity, resulting from banking sector deleveraging and negative credit growth to the private sector, among other things. As of September 2013, credit growth was still negative by slightly more than 3% annually in nominal terms. In the coming years, we expect the currently low capacity of the government to deploy EU Structural and Cohesion Funds to continue improving, which could lead to an increase in investment activity. We consider that the key deterrents to foreign direct investment (FDI) stem from judicial and bureaucratic uncertainties. With net FDI having declined from an average of 7% of GDP before the 2008-2009 financial crisis to below 2% of GDP per year since 2010, we view the government's progress on making the business environment more transparent and predictable, alongside the reform of state-owned enterprises and judicial reform, as key to how fast the economy can grow. That said, we also acknowledge that much of the decline in net FDI flows is linked to the current weak EU economic recovery.

The International Monetary Fund (IMF) agreed to extend a new two-year precautionary Stand-By Arrangement to Romania in September 2013, which combined with the precautionary financial assistance approved by the EU in October 2013 amounts to equivalent of almost €4 billion, while €300 million remain available under a €1 billion World Bank policy loan. We view the agreements with the IMF and the EU as a positive development, both to bolster the government's resolve as it presses forward with its pro-growth structural reforms and to serve as a backstop if Romanian banks' external rollover rate remains below 100% (as it has since 2010) or if the country's broader external financing conditions deteriorate.

On the budgetary side, we expect authorities to meet their own revised 2013 general government deficit target of 2.6% of GDP this year, despite some revenue underperformance so far and an increase in the discretionary government wage bill. This would represent a consolidation of almost 6.5% of GDP since 2009. We expect the deficit to decline further in 2014. In light of the fiscal constraints and commitment to meet the budgetary target, the government has in the revised 2013 budget trimmed domestic capital expenditure, which in our view could detract from Romania's long-term economic growth prospects. On the other hand, the government has increased its budgetary flexibility in case of a faster-than-planned increase in the absorption of EU funds.

We also understand that general government arrears have declined substantially and are now mainly at the local government level. Still, we estimate public enterprise arrears at about 2.5% of GDP. A renewed accumulation of government arrears could pose a risk to fiscal consolidation, as would further significant discretionary increases in current spending, such as on the public sector wage bill or other line items. We anticipate that net general government debt will begin to stabilize just below 35% of GDP during 2013-2016 before declining. During the same period, we expect general government interest payments to represent about 5.6% of general government revenues annually.

We believe there is a risk that the Romanian government could deviate from its budgetary and structural reform plans in the run-up to European and presidential elections in 2014. We recognize, however, that Romania benefits from buffers that should help to maintain investor confidence and keep borrowing costs down. These cushions include a flexible exchange rate regime, which helps the central bank pursue an independent monetary policy, foreign exchange reserves that currently exceed short-term external debt by remaining maturity, and potential financial support from official creditors.

Outlook

The positive outlook indicates our estimate that there is at least a one-in-three possibility that we could raise our ratings on Romania in the second half of 2014. We could raise the ratings if the planned program of budgetary consolidation, public finance reform, and public enterprise restructuring is implemented in line with our expectations, while keeping external imbalances and financial sector stability in check.

We could revise the outlook to stable if--against our expectations and perhaps in the run-up to the 2014 elections--the budget deficits widen significantly or the government pulls back from the restructuring of the public enterprises. The ratings could also come under downward pressure if Romania's external imbalances re-emerge or if stability in its financial sector weakens.

Key Statistics

Table 1

Romania - Selected Indicators

	2006	2007	2008	2009	2010	2011	2012	2013e	2014f	2015f	2016f
Nominal GDP (US$ bil)	123	171	204	164	165	183	169	183	192	204	216
GDP per capita (US$)	5,678	7,912	9,491	7,644	7,678	8,528	7,932	8,599	9,036	9,630	10,202
Real GDP growth (%)	7.9	6.3	7.3	(6.6)	(1.1)	2.3	0.7	2.2	2.2	2.5	2.8
Real GDP per capita growth (%)	8.1	6.5	7.5	(6.5)	(0.9)	2.4	1.0	2.5	2.5	2.8	3.1
Change in general government debt/GDP (%)	(0.9)	2.6	3.1	9.9	7.9	6.0	5.0	2.7	2.2	2.3	2.2
General government balance/GDP (%)	(2.2)	(2.9)	(5.7)	(9.0)	(6.8)	(5.6)	(3.0)	(2.5)	(2.2)	(1.9)	(1.8)
General government debt/GDP (%)	12.4	12.8	13.4	23.6	30.5	34.7	37.9	38.4	38.5	38.9	39.0
Net general government debt/GDP (%)	8.4	9.4	11.4	19.6	27.0	31.4	32.9	33.7	34.3	34.7	34.8
General government interest expenditure/revenues (%)	2.5	2.0	2.1	4.8	4.6	4.8	5.3	5.6	5.6	5.6	5.5
Oth dc claims on resident non-government sector/GDP (%)	27.0	36.7	39.4	40.9	41.0	41.0	39.6	36.6	35.0	34.5	34.6
CPI growth (%)	6.6	4.8	7.8	5.6	6.1	5.8	3.3	2.4	2.9	2.7	2.7
Gross external financing needs/CARs + usable reserves (%)	101.4	112.3	114.8	103.9	95.9	95.3	95.7	90.0	90.2	90.0	90.9
Current account balance/GDP (%)	(10.4)	(13.4)	(11.6)	(4.2)	(4.4)	(4.5)	(4.4)	(1.4)	(1.4)	(1.5)	(2.1)
Current account balance/CARs (%)	(26.2)	(36.3)	(30.2)	(11.2)	(10.8)	(9.9)	(9.6)	(2.9)	(2.8)	(3.0)	(3.6)
Narrow net external debt/CARs (%)	24.5	42.3	49.4	76.3	72.5	63.8	70.9	60.4	50.9	41.3	30.2

Table 1

Romania - Selected Indicators (cont.)											
Net external liabilities/CARs (%)	97.5	124.9	120.0	169.6	151.1	128.7	147.9	138.3	131.6	122.6	105.5

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts. e--S&P estimate. f--S&P forecast. The data and ratios above result from S&P's own calculations, drawing on national as well as international sources, reflecting S&P's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Related Criteria And Research

- Sovereign Government Rating Methodology And Assumptions, June 24, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Sovereign Defaults And Rating Transition Data, 2012 Update, March 29, 2013
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Ratings Affirmed

	To	From
Romania		
Sovereign Credit Rating	BB+/Positive/B	BB+/Stable/B
Transfer & Convertibility Assessment	BBB+	
Senior Unsecured	BB+	
Short-Term Debt	B	

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