BCRA CREDIT RATING AGENCY	**BULGARIA** **95, Evlogi Georgiev blvd.** **1142 Sofia** **Tel. (+359 2) 9876363** **www.bcra-bg.com**

Romania **January 2016**	Nikoleta Koleva, Lead Economic Analyst **n.koleva@bcra-bg.com** Kalina Dimitrova, Economic Analyst **k.dimitrova@bcra-bg.com** Ventceslav Petrov, Financial Analyst **v.petrov@bcra-bg.com**

SOVEREIGN RATING	**Initial rating** **13.01.2016**
Long-term rating:	**BBB- (ns)**
Outlook:	**Stable**
Short-term rating:	**A-3 (ns)**

● (ns) – not solicited rating

BCRA – CREDIT RATING AGENCY AD (BCRA) *is the third fully recognized rating agency in the EU, registered pursuant to Regulation No. 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by the BCRA are valid throughout the EU and are fully equal to those, of the other agencies, recognized by the European Securities and Markets Authorities, without any territorial or other limitations.*

"BCRA - CREDIT RATING AGENCY" AD rates Romania with unsolicited sovereign long-term rating BBB- (ns) and short-term A-3 (ns) with stable outlook.

BCRA's officially adopted Sovereign Rating Methodology has been applied (http://www.bcra-bg.com/files/file_330.pdf).

The report has been prepared and the rating – assigned, based on public information, made available by the National Institute of Statistics, National Bank of Romania, Ministry of Public Finance, the World Bank, the International Monetary Fund, the European Commission, BCRA's database etc. BCRA uses sources of information, which it considers reliable, however it cannot guarantee the accuracy, adequacy and completeness of the information used.

Clarifying Note: There may be some differences in the stated values and changes in the analysed indicators due to the conversion of those values in another currency (namely in EUR). The used exchange rate is the publically announced by the National Bank of Romania as the average value for the corresponding period (i.e. yearly, semi-yearly, quarterly, monthly). There may also be some differences stemming from using average values for the period rather than end-period values.

The data on which the current report is based includes the public data available until November 2015, except for some indicators (investments of national economy), which are cited as given until mid-December 2015.

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The political life in Romania during last year has been marked by turbulent events: friction among political figures and parties; mass protests which led to Prime Minister Ponta's resignation; the formation of a new government, with a mandate till the parliamentary elections at the end of 2016.

The new cabinet, nominated at the end of 2015 by President Iohannis and led by the former European Commissioner Dacian Ciolos is a combination of technocrats, some with connections to the ruling political parties. Taking into consideration the short mandate of the new government, it is not expected to carry out the necessary reforms as the majority in parliament remains unchanged.

Presently, tensions between key political figures and forces in the country do not affect the existing consensus on the main directions in which the country needs to go. There are no substantial differences with respect to foreign policy either.

Although there is notable progress regarding the European integration of the country, Romania is still among the poorest in the EU. Corruption; problems in the rule of law and the functioning judicial system; the existence of large unintegrated minority groups; numerous but insufficiently effective bureaucracy are among the main short- and long-term challenges facing the country.

In the short term, friction between the main political parties will not be overcome. It is expected that, as the local and parliamentary elections approach, tension will rise and will further hinder the implementation of sustainable reforms by the interim government. Trust in key institutions and in the political elite as a whole is likely to decline.

Although the financial crisis in 2008 affects Romania's economy greatly, the country manages to get back on track quickly, recording growth of 3.4% for 2013 and 2.8% for 2014, and continuing with 3.6-3.8% for the first there quarters of 2015. The rates are higher than the EU-average, marking 0.2% and 1.4% for 2013 and 2014, respectively, and stand above many of its neighbouring Balkan economies (in terms of real growth).

The effects of the financial crisis in 2008 lead to a quick deterioration in the balance of payments resulting in a current account crisis. This development put Romania in an urgent need of help. The necessary support was provided through the Balance of Payments (BoP) Assistance Programme[1] and the two subsequent Precautionary Assistance Programmes, agreed on in May 2009, May 2011 and October 2013, respectively. They were carried out by the European Community, the IMF, the World Bank (WB), and a combined participation of the European Investment Bank and the European Bank for Reconstruction and Development. It amounts to approximately EUR 20 B. provided as EUR 5 B. by the European Community, EUR 12.95 B. by the IMF (in form of SDR), EUR 1 B. by the World Bank (WB), and EUR 1 B. combined by the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD).

The conditions under which the initial assistance were to be granted included fiscal consolidation and bringing the excessive budget deficit under more appropriate levels in the subsequent years. The approaches to do so included expenditure reductions and cuts, as well as introducing some new approaches to fiscal planning and implementing changes in the payment and pension systems in the public sector, as well as strengthening the banking sector. The aim of the first programme was to decrease the country's macroeconomic imbalances due to the financial crisis and the stemming effects. Although there were some delays, a great majority of the conditions were met.

The domestic factors that helped clean up the effects of the crisis include strong domestic consumption (both by the households and the government) and acceleration in the exports of the country in the after-crisis years. The great current account deficit has also shrunk considerably. The majority of the positive dynamics in the mentioned GDP components persist during the first half of 2015, as indicated from the data. The exports have caught up to the country's imports and tend for a positive value in 2014 through the net exports and remains positive during the first half of 2015. Among the GDP components, the gross fixed capital formation shows little change over the years in the period 2009 - 2014. For the first half of 2015 gross fixed capital formation marks a higher value compared to a year prior, but not by much.

For the analysed period Romania's international trade is in most part with EU-member countries, taking up to 70-71% of all its exports and 74-76% of all imports, with Germany, Italy, Hungary and France in the lead. Among the non-EU

[1] European Commission: Balance-of-Payments Assistance to Romania

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countries, Turkey and the Republic of Russian Federation also show considerable participation in the country's international trade relations. Its exports are mainly oriented towards trade with high-value added goods, indicating the presence of international competitiveness of the country's production. Imported goods also include high-value added articles, which partially counters the positive effects stemming from the exports' characteristics in the goods' trade balance.

The investors' interest has been growing slowly after the crisis. In the period 2010-2014 the importance of debt instruments has been low compared to the preceding years, the net investment inflows staying at levels below 1.8% of GDP. There is even net outflow of reinvested earnings, forming a peak in 2011. Investment flows in equity other than reinvested earnings also decrease some after 2008, then remains steady in 2012 and 2013 and record a growth in 2014. During the first nine months of 2015 the investors' activity keeps its levels close to the ones recorded for the same period in 2014, at around 1.6% of GDP, which is close to the situation of the prior year – about 1.4% of GDP (for I-IX 2014). The preferences of the investors have also changed since the pre-crisis years – they have turned from debt instruments towards equity (other than reinvested earnings).

With respect to the labour market, there are some positive changes, though not really palpable. There are administrative changes after the financial crisis represented by the introduction of the new Labour Code in 2011. It helps improve flexibility with respect to employment contracts. The authorities also address the high tax wedge on labour income in recent years, aiming at decreasing the shadow economy related to undeclared work.

Despite the administrative improvements, the labour force has shrunk and the unemployment rate (aged 15 and above) shows little change for the period 2010-2014, moving in bounds of 6.8-7.1%. The activity rate (around 53-55%) and long-term unemployment (between 2.8-3.2% of the labour force, and 40-45% of total unemployment) also have no certain trend and vary in small margins.

The GDP per capita for Romania increases gradually after 2007, after the country gains membership in the EU, but the levels achieved remain low compared to the EU-average: EUR 7,500 in 2014 in current prices and PPS 12,800 in real terms compared to the EU-average of 27,400 in both EUR in current prices and PPS. Despite the considerable real growth rates of the income throughout the analysed period, the values still remain low, generating a big gap between Romania's income and the EU-average. In terms of unit labour costs, Romania shows almost no change in the indicator until 2014. After decreasing in 2011 the index has been below 98 points. From the point of view of the employers, this could be considered as favourable, whereas in terms of income of the employed labour the indicator implies little development in improving the working conditions.

Romania's CPI weight coefficient structure indicates a considerable importance in the general price level of the changes in energy, gas and fuels as well as some major food groups such as meat, bakery and dairy products and non-food articles. The price level has been well above the EU-average throughout the analysed period (2008-2014) but in 2014 there is a considerable decrease in the annual inflation rate measured by the HICP, recording a disinflation of 1.8 p. p. The mentioned decrease is following the widespread slowdown in economic activity in the EU and the Balkan countries.

In June 2015 the authorities undertake a stimulating fiscal policy – extension of the application of the reduced 9% VAT for the delivery of food goods and beverages (in force as of 1 June 2015). The resulting direct reduction in prices for the final consumer of those goods results in a decrease in the price level, and the CPI marks a state of deflation after June.

Another fiscal change that occurs during 2015 is the reduction in the social contributions (paid by employers – by 5 p.p.) with the aim of decreasing the incentives of workers and employers to participate in the grey sector of the labour market.

The excessive deficit generated right after the crisis has been dealt with by the authorities, bringing it down to 2.2% of GDP for 2013 and 1.4% of GDP in 2014. In the revenue side the social contributions and the VAT receipts generate the close to half of the government revenues, whereas in the expenditure side the transfers take up a significant share in all government expenditures after 2009 (more than 40%). The social security budget deficit has been growing steadily after 2009 and the projections for the upcoming years indicate a continuation of its upward trend.

Among the current expenditures, the personnel expenses have been on the decline after 2008 until 2011 (in accordance with the BoP

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Assistance conditions), but in the subsequent years (2012 and henceforth) the dynamics in the group turns in the opposite direction and gradually grows. Capital expenditures, on the other hand, have been decreasing since 2011 due to the need to bring short-term targets (government expenditures and budget deficit) within desired bounds. This approach, however, harms the long-term development and hinders the possibility for sustainable improvement in the budget balance unless other alternatives are considered.

With regards to international relations, and namely – the BoP Assistance Programme, as of October 2015 the Post-Programme Surveillance enters into force, connected with the repayments of the received debts during the first programme.

Romania's public debt increases steadily since 2008, with more perceivable growth in in the years after the financial crisis due to growing needs of financing the excessive budget deficit and refinancing of public debt in that period. For 2013 and 2014 the debt's growth is moderate, leading the country's debt-to-GDP ratio to 39.9% for end-2014 and even decreasing (the ratio) to 37.8% in September 2015.

In July 2012 the Ministry of Public Finance (MoPF) adopts a Strategy on government public debt management in medium term. It includes bounds within which some public finance indicators should be kept, thus defining specific goals in order to maintain appropriate public debt management with long-term objectives.

The growth in public debt is generated by the changes in both domestic and external debt, which are almost balanced out in the debt's structure. There is a visible predominance of the long-term debt, enforced in recent years due to the decrease in the Government's reliance on short-term financing according to the strategy of the MoPF, targeted towards better management of the debt's refinancing risk. The currency structure of Romania's public debt changes little throughout the years. Since the beginning of 2015 there is a notable increase in the RON-denominated public debt compared to the EUR-denominated debt.

With respect to the banking system, the Romanian banking authorities are on a way to build a sounder and trustworthy sector. The improved balance sheets of banks and their high level of capital adequacy in recent years give grounds for this. The on-going reduction in the values of the non-performing loans ratio represents an important step forward, as well as the confidence in the local currency visible from reported increase in lending in local currency to both households and non-financial corporations.

Consolidation processes in the banking system take place on two levels. On the one hand, inside changes occur within the banks' ownership structure due to mergers. On the other hand, there are outside changes induced by the enhanced harmonization among European banking authorities and the local authorities, as well as adaptation of legal regulations.

There is some degree of uncertainty, which arises from the predominating foreign capital in the banking system – the observed deleveraging of the foreign banks' subsidiaries (with respect to their mother organizations) and high foreign capital presence could bring about higher vulnerability to external shocks to the sector.

Outlook:

The stable outlook of the Sovereign Rating of Romania reflects the BCRS's opinion that despite the unfavourable political state and the upcoming parliamentary elections, there would not be any drastic changes in the country's general economic indicators and its credit worthiness.

BCRA would consider upgrading the Sovereign Rating and the Outlook for Romania if it continues to realize sustainable high economic growth, as well as achieve more considerable growth in the income, the favourable developments in the labour market continue, as well as yielding results. Other positive developments that may be considered include restructuring the government budget in a way that ensures long-term sustainability, and achieving a successful erection of a sound and stable financial system

Negative pressures on the Sovereign Rating would be considered to be drop in the economic growth, the presence of prolonged deflation processes, deterioration in the labour market conditions, worsening in the government budget.

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Regulatory announcements

Rating initiative

This is an unsolicited sovereign rating. Neither the rated entity, nor a related third party has participated in the credit rating process. BCRA did not have access to the accounts, management and other relevant internal documents for the rated entity or a related third party.

Please, visit www.bcra-bg.com and http://www.bcra-bg.com/files/file_330.pdf to review BCRA's full policy on unsolicited credit/sovereign ratings.

Summary of the minutes of the Rating Committee:

On the 13th of January 2016 Rating Committee of BCRA – CREDIT RATING AGENCY (BCRA) had a session, on which was reviewed the Report regarding the assigning of an unsolicited initial sovereign rating of Romania.

This report has been written in accordance with the officially adopted by BCRA Sovereign Rating Methodology.

The members of the Rating Committee discussed the grades of numerous credit rating factors included in the Model for grading and analysed in the Credit Rating Report according to the Sovereign Rating Methodology. The members of the committee:

- Considered the relatively unstable situation in the political sector, due to existing friction among political figures and parties, mass protests by the population against corruption and the inability (due to its short mandate) of the interim government to carry out the necessary reforms in some key areas (judicial system, administrative bureaucracy and other problematic matters).
- The members also discussed the fast recovery of Romania's economy and the contribution of the Balance of Payments Assistance Programme (BoPAP) to it. The domestic factors that helped the economic growth were also taken into account.
- The Committee viewed the execution of most BoPAP conditions as generally successful and favourable. They included measures aimed at fiscal consolidation, introduction of fiscal planning and implementing changes in the payment and pension systems in the public sector, as well as improving key indicators in the banking sector.
- There were some administrative changes in the labour market, leading to greater flexibility with respect to employment contracts and lessening the tax ledge on gross income, but leads to little to almost no change in the unemployment rate. The GDP per capita remains considerably low, and the same holds for unit labour costs remain low (compared to other EU-countries).
- The change in the price level, generally attributable to the economic slowdown in the EU in recent years. The intentional reduction in the price of some major goods (through the reduced VAT-rate extension) which lead to deflation in the economy for the second half of 2015 was regarded as adequate measure for stimulating domestic consumption.
- The level of the budget deficit and the debt management were deemed to be adequate, with some considerations regarding the budget development (mainly the social security side), with some considerations related to the budget's structure and characteristics.
- The exchange rate of the RON against both the EUR and the USD is rather volatile in recent years, leading to its slight depreciation (generally against the USD).
- The banking system's state is viewed as moderately optimistic. The liquidity and the capital adequacy are quite high. The significant presence of foreign capital in banks' ownership unfavourably influences the system. The same applies to the lagged transposition of EU directives on banking activities and regulations.
- Additional in-depth discussion was held for the unfavourable historic development of two indicators: unit labour costs and the exchange rate.

The current initial sovereign rating and the related outlook have been determined based on the above discussion.

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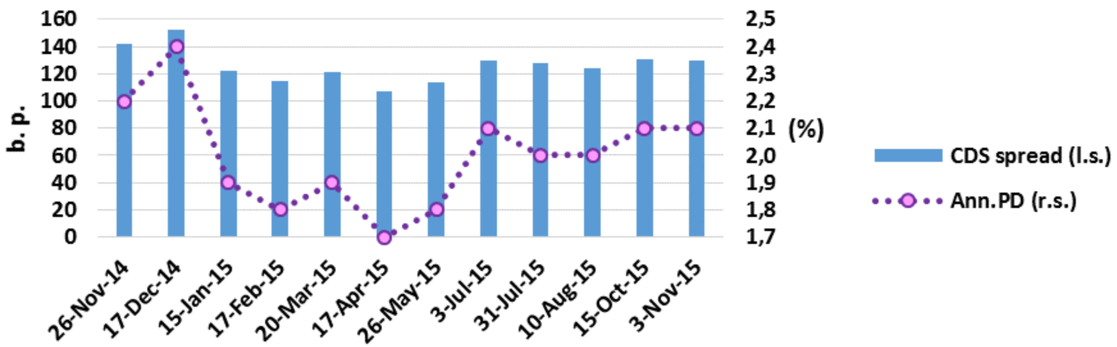
Tables

Country	Development classification
Unitary Semi-presidential Republic Romania	*Emerging and Developing Europe (IMF classification)*
Probability of default indicator	
CDS Market Indicator[2]:	



[2] Data from Deutsche Bank.

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General economy	2015 H1	2014 H1	2014	2013	2012	2011	2010	2009	2008	2007
GDP (in billion RON)	**302.7**	**285.8**	**666.6**	**637.6**	**596.7**	**565.1**	**533.9**	**510.5**	**524.4**	**418.3**
GDP (in billion EUR [1])	**68.1**	**64.0**	**150.0**	**144.3**	**133.9**	**133.3**	**126.8**	**120.5**	**142.4**	**125.3**
Final consumption	54.9	52.2	115.3	109.9	104.4	103.6	100.6	95.5	113.6	104.0
Gross fixed capital formation	12.7	11.6	33.0	34.3	36.8	36.1	32.9	31.3	54.7	45.1
Change in inventories	0.1	0.0	1.6	1.1	-0.7	1.0	1.1	1.4	-7.1	-5.9
External balance of goods and services	0.3	0.2	0.1	-1.0	-6.6	-7.4	-7.8	-7.7	-18.9	-17.9
Exports of goods and services	*32.3*	*29.8*	*61.7*	*57.3*	*50.1*	*49.1*	*41.0*	*33.0*	*38.4*	*36.5*
Imports of goods and services	*32.0*	*29.5*	*61.6*	*58.3*	*56.7*	*56.6*	*48.8*	*40.7*	*57.2*	*54.5*
GDP per capita (EUR) [2]	-	-	7,500	7,200	6,700	6,600	6,300	5,900	6,900	6,000
Total average net monthly wage (EUR) [3]	407.21	-	383.89	367.15	347.27	348.07	334.11	325.94	348.18	312.50
Inflation (CPI, %) [3]	1.0	-0.4	1.1	4.0	3.3	5.8	6.1	5.6	7.9	4.8
Unemployment rate (in %, population 15+)	6.9	6.9	6.8	7.1	6.8	7.2	7.0	6.5	5.6	6.4
Average exchange rate RON/EUR	4.45	4.46	4.44	4.42	4.46	4.24	4.21	4.24	3.68	3.34
Average exchange rate RON/USD	3.99	3.26	3.35	3.33	3.47	3.05	3.18	3.05	2.52	2.44

Balance of Payments

in million EUR	IX 2015	IX 2014	2014	2013	2012	2011	2010	2009	2008	2007
Net export of goods and services	**306 [4]**	**242 [4]**	**131**	**-964**	**-6,646**	**-7,423**	**-7,788**	**-7,723**	**-18,868**	**-17,924**
Current account	**-653**	**-1,168**	**-686**	**-1,540**	**-6,386**	**-6,596**	**-6,446**	**-5,817**	**-16,792**	**-17,296**
as % of GDP [5]	*-0.4%*	*-0.8%*	*-0.5%*	*-1.1%*	*-4.8%*	*-4.9%*	*-5.1%*	*-4.8%*	*-11.8%*	*-13.8%*
Goods and services	***-320***	***213***	***-468***	***-1,113***	***-6,792***	***-7,727***	***-8,125***	***-8,069***	***-19,085***	***-17,996***
Primary income	***-2,310***	***-2,646***	***-1,903***	***-3,112***	***-2,305***	***-1,680***	***-1,487***	***-1,589***	***-3,221***	***-4,126***
Secondary income	***1,978***	***1,265***	***1,685***	***2,688***	***2,711***	***2,810***	***3,166***	***3,840***	***5,515***	***4,825***
Capital account	***3,071***	***2,376***	***3,954***	***3,039***	***1,880***	***719***	***193***	***601***	***564***	***765***
Financial account	***3,028***	***2,887***	***3,068***	***1,673***	***-3,306***	***-4,750***	***-5,530***	***-5,258***	***-17,209***	***-16,650***

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Public finance

Indicators	*in billion EUR [6]*	**IX 2015**	**IX 2014**	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**
Consolidated general budget	Revenues	43.165 [7]	39.941 [7]	48.111	45.344	43.346	42.927	40.066	37.110	44.953
	Expenditures	41.129 [7]	39.504 [7]	50.922	48.918	46.661	48.566	48.049	45.708	51.685
	Budget balance	2.037 [7]	0.437 [7]	-2.811	-3.574	-3.316	-5.639	-7.983	-8.599	-6.732
	Surplus | Deficit (as % of GDP)	***1.3*** [7]	***0.3*** [7]	***-1.9***	***-2.5***	***-2.5***	***-4.3***	***-6.5***	***-7.4***	***-4.9***
State budget	Revenues	17.656	-	21.458	20.494	19.563	18.729	16.164	12.904	16.572
	Expenditures	18.834	-	26.013	24.921	23.467	25.033	24.378	21.205	21.965
	Surplus | Deficit	-1.178	-	-4.555	-4.428	-3.904	-6.304	-8.213	-8.301	-5.393
	Surplus | Deficit (as % of GDP)	***-0.8***	***-***	***-3.0***	***-3.1***	***-2.9***	***-4.7***	***-6.5***	***-6.9***	***-3.8***
General government debt [8]	**Public debt**	**58.585**	**57.299**	**59.782**	**54.807**	**49.999**	**45.589**	**37.915**	**27.964** [8]	**18.742** [8]
	as % of GDP	***37.8%***	***39.7%***	***39.9%***	***38.0%***	***37.3%***	***34.2%***	***29.9%***	***23.6%*** [8]	***13.4%*** [8]
	Domestic debt	30.209	27.433	28.685	24.928	24.557	23.160	19.445	14.408 [8]	**7.551** [8]
	External debt	28.377	29.866	31.098	29.880	25.442	22.429	18.470	13.556 [8]	**11.191** [8]
External debt [9]		**89.261**	**94.029**	**94.744**	**98.069**	**100.857**	**99.926**	**93.624**	**82.304**	**72.467**
as % of GDP		-	-	*63.2%*	*68.0%*	*75.3%*	*74.9%*	*73.8%*	*68.3%*	*50.9%*
Official reserve assets		**29.127**	**31.049**	**32.200**	**32.497**	**31.092**	**32.737**	**31.638**	**27.321**	**26.134**
Net international investment position		**-82.547**	**-86.455**	**-85.478**	**-88.951**	**-90.628**	**-85.558**	**-78.986**	**-74.814**	**-69.090**

[1] The values in EUR are calculated by using the average exchange rate of the RON/EUR for the corresponding period.
[2] Current prices
[3] The data in the column for H1 2015 (and H1 2014) is for I-IX 2015 (and I-IX 2014).
[4] For first half of corresponding year.
[5] The indicator is calculated as the sum for the period as % of GDP for the corresponding period; for IX 2015 and IX 2014 is used the GDP value for 2014.
[6] The values in EUR are calculated by using the average exchange rate of the RON/EUR for the corresponding period.
[7] The data is for the period I-X of the corresponding year
[8] For 2008 and 2009 the applied EU methodology is an older version (prior to ESA 2010).
[9] Includes *Direct public and publically guaranteed debt* and *Private debt (non-publically guaranteed)*.

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