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Romania

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SOVEREIGN RATING	Initial rating	Review
Date of Rating Committee	13.01.2016	21.06.2018
Date of rating publication	15.01.2016	22.06.2018
Long-term rating	BBB- (ns)	BBB- (ns)
Outlook	Stable	Stable
Short-term rating	A-3 (ns)	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.

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Overview

In the beginning of 2018, political situation in Romania remains unstable. The government had its fourth Prime Minister since the constitution of the present Parliament, when Viorica Dăncilă headed the PSD cabinet in January 2018. The changes in the tops of the government are to a great extent due to disagreements inside the ruling party. Such political tensions do not significantly affect country's stability, but inevitably lead to delay of structural reforms in social sphere, public administration and improvement in business environment.

Some regulative initiatives of the government concerning key issues such as the ongoing judiciary, tax and pension reforms bring to civil and political discontent. As a result, the cabinet confronts the President, European institutions, and parts of the civil society. Along this line of thinking legal and judicial unpredictability remain a major issue at overall positive economic development of the country.

Romania's economic growth accelerates notably to 6.9% in 2017 - the fastest pace of the post-crisis period and the second fastest across the EU. Being strongly fuelled by government's pro-cyclical fiscal measures, the consumer demand has a prevailing contribution to the GDP growth.

Economic activity in the first quarter of 2018 remains robust, albeit GDP growth decelerates to 4.0% (7.5% in Q1 2017). Private consumption growth also marks a deceleration amid surging inflation and rising interest rates. Investment activity is in a recovery pace and the uptrend is likely to continue in the period ahead as well, due to an improved EU funds absorption. Boosted by the higher domestic demand, imports' growth outweighs the rise in exports. Hence net exports generate negative contribution to the GDP growth, despite the continued export market share gains.

About 75.0% of country's international trade in goods takes place within the European Union. Germany and Italy remain the major trade partners with a cumulating weight of 34.1% in total exports and 30.1% in total imports in 2017. Hungary, France, Poland and Turkey also retain their notable presence in the country's international trade.

The pro-cyclical fiscal expansion has an adverse effect on economy's price competitiveness, thus posing risks to Romania's external position. The balance-of-payments current account deficit is widening from EUR 3 548 mln (2.1% of GDP) in 2016 to EUR 6 295 mln (3.4% of GDP) at the end of 2017, mainly driven by the deterioration of country's trade balance.

Romania's current account deficit, although at a much lower level than before crisis, rises concerns, as most of the Central and Eastern European peer countries record surpluses. In the period ahead, developments in domestic consumption are likely to further put pressure on the external balance. Unlike the previous years (2013-2016) foreign direct investment inflows in 2017 are insufficient to cover the increasing current account deficit.

The EUR/RON exchange rate follows a generally upward path since the beginning of 2017. In 2018, the euro climbed for the first time to over RON 4.66 on January 19, then reached its historic maximum of RON 4.6679 on January 23, after which it moved within the bands of 4.63-4.66. The exchange rate is considered as a common "barometer" for the economy as well as for political developments. So the record rise in January was mainly related to the resignation of Mihai Tudose cabinet. The increasing trade and current account deficits also support the leu depreciation.

At the end of March 2018, country's gross external debt stands at EUR 95 527 mln (47.9% of the projected GDP), increasing by EUR 2 049 mln against the end of 2017. The upward dynamics is driven by changes in government external debt and intercompany lending, while the debt of the other institutional sectors continues to shrink.

On the 31 of March 2018, Romania's international reserves stand at EUR 38 309 mln. The level of reserves ensures more than 5 months coverage over imports of goods and services and 147.7% coverage of short-term external debt, enough adequate to reduces the risk of inability to respond to unexpected events occurring on international markets.

The labour market performs notably well. It tightens following the positive real sector dynamics, as well as the procyclical government policies. Employment is on the rise for the first time in three years in absolute terms, and so does the activity rate of the population. The rate of unemployment

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(15+) decreases to the record low 4.9% for 2017 (5.9% in 2016).

Active income policy of the Romanian government continues to reinforce the labour income increase in 2017 and the beginning of 2018. On average, the net monthly wage for the economy has grown by 14.2% in nominal terms in 2017 and by 11.6% in the first quarter of 2018. The rapid wage growth continues therefore to put upward pressure over the labour costs which have been registering the highest growth rates in the EU since the beginning of 2016.

The annual CPI inflation rate follows upward trend, reaching 4.95% in March 2018 (2.5% annual average), well above the upper bound of the NBR target (2.5% ±1 percentage point). The changes in indirect taxation and regulated utility prices in Romania have played a significant role in the recent inflationary spell, adding to the underlying inflationary pressures stemming from the expansionary fiscal policy. External factor of the process is the surge of oil prices internationally.

The fiscal policy is likely to remain a risk for Romanian sovereign debt. In the framework of the fiscal relaxation measures the consolidated general government budget deficit widens to EUR 5 311 mln or 2.83% of GDP in 2017. The cash deficit is below the government's target of 2.96% of GDP, but marks a nominal increase by about a third compared to 2016, when it stood at EUR 4 074 mln or 2.4% of the GDP.

The beginning of 2018 brought additional fiscal relaxation measures. The flat personal income tax rate was cut from 16% to 10% from January 2018. On the expenditure side, public wages have been significantly increased in 2017 and 2018, following the adoption of the Unified Wage Law. Starting January 2018, the government changed the structure of social contributions by shifting their burden almost entirely to the employees. To compensate for the shift of social contributions, the government raised the minimum gross wage by 31% to RON 1 900 (~EUR 413). As of July 1, 2018, the social pension would reach RON 640 and the pension point would be increased to RON 1 100. The government also aims to back the SMEs with new or by continuing state aid schemes in the field that encourage investments and with offering support for local SMEs to expand abroad.

The cited measures have conflicting effects on the economy – most of them are intended to stimulate the economic activity of households and firms, but on the other hand, the budgetary balance, and mostly its revenue side, is burdened by the decreases in tax rates and other reliefs extended to the private sector. The expected positive effect on government revenues from the undertaken measures are mostly aimed at its secondary effects – increased economic activity and growth, achieving higher voluntary compliance and better collectability in due obligations.

The cash budget deficit in 2018 is estimated at 2.97% of GDP. However, the 2018 budget suggests a reduced fiscal room to respond to unexpected shocks and enhanced risks for keeping the budget gap within the -3.0% of GDP target in the absence of compensatory measures. Total budget revenues increase by 11.5% year-on-year in January-March 2018 period, but are largely outpaced by expenses, which increase by 22.1%. At the end of March, general government consolidated budget registers a deficit of EUR 958 mln, compared with a surplus of EUR 337 mln in the same period of 2017.

To prevent growing deficits from threatening fiscal sustainability, medium-term consolidation should be considered, backed by broad structural reforms to enhance the effectiveness of the public sector. The EC has warned Romania on several occasions that the ongoing policies of decreasing tax rates alongside increasing expenditures generates macroeconomic imbalances and may lead to a failure of meeting the medium-term objectives in the following years.

Public debt of Romania remains relatively low. During 2017, public debt increases by 8.6% in nominal terms to EUR 79 026 mln. As a share of GDP, public debt decreases from 44.5% in 2016 to 42.9% at the end of 2017 due to the rapid growth of the economy, which outpaced the increase in the debt. Gross government debt, according to EU methodology, stands at 35.0% of GDP at the end of 2017, well below the 60% ceiling of the Maastricht Treaty. However, future rise in country's indebtedness may stem from the ongoing fiscal stimuli and the expected growth deceleration, unless a prudent policy mix is implemented.

Public debt continues to be vulnerable to exchange rate risk, with foreign currency denominated debt

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accounting for about half of total public debt. Given the small share of debt contracted at floating rates, the exposure to interest rate risk remains moderate.

Romania's sovereign 10-year bonds yield, a barometer for the cost of financing in the economy, reached a new four years high of 4.69% in May 2018. Due to the still-volatile political environment and uncertainty regarding macroeconomic policies, the bonds yield has been generally increasing since October 2016. The development rises concerns, as higher borrowing cost can quickly translates into higher public debt.

Romanian banking sector exhibit further consolidation over 2017. Despite the structural changes, the system records stable growth in assets and deposit funding. Credit growth in the segment of non-financial corporations is restored and those of households, accelerates. Along with this, the non-performing exposures reach admissible portion of the total portfolio (6.4% as of end-2017). The other main quality indicators remain appropriate and witness for improved profitability and good capitalisation of the system.

In response to the inflationary pressures on the economy, NBR takes measures on the interest rates through setting higher key policy rates during the four months of 2018 compared to the previous three years.

Among the risks that Romanian banks face are the persisting legislative uncertainty in the country as well as possible changes in the macroeconomic environment (regarding interest rate levels and overall economic activity).

Outlook:

The stable outlook of the Sovereign Rating of Romania reflects the BCRA's opinion that the upside and downside risks to the rating are currently balanced. Continued conflict within the ruling party delays important structural reforms. On the other hand, Romanian economy marks high growth rates. Expansionary fiscal policy has weakened public finances, but country's rating is supported by the still moderate public debt level.

BCRA would consider upgrading the Sovereign Rating and/or the Outlook for Romania if:

- The country marks an improvements in the institutional framework;
- The government takes measures for fiscal consolidation;
- Sustained improvement in external finances is visible.

Negative pressures on the Sovereign Rating and/or the Outlook would be considered:

- Further deterioration of the budget balance, resulting in a significant rise in the public debt level;
- Intensifying external imbalances;
- Reversal of institutional reforms;
- Capital outflow related to changes in investors' sentiment towards future economic developments.

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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.

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Clarifying Notes:

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 for the corresponding period (i.e. yearly, quarterly, and monthly). There may also be some differences stemming from using average values for the period rather than end-period values. The cited growth rates in the current report are based on changes in national currency, with the exception of data recorded in EUR (i.e. Balance of payments, External debt, Net international investment position). The data on which the current report is based includes the public data available until June 2018, with some exceptions, for which data is released more frequently.

Summary of the minutes of the Rating Committee:

On the 21st of June 2018 Rating Committee of BCRA – CREDIT RATING AGENCY (BCRA) had a session, on which was discussed the **Report regarding the affirmation of an unsolicited sovereign rating of Romania.**

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 discussed in detail the development of country's macroeconomic indicators, assessing the effects of the procyclical fiscal policy on them. The respective income rise and the overall positive development of the labour market boost the growth through consumption. The assessment took into account the improved performance of the banking system.

The main risks are associated with the growing imbalances in the external sector, the volatility of the exchange rate and the rising price level. Committee members raised concern about the dynamics of the country's fiscal indicators.

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

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Tables:

Country	Development classification
Romania	Emerging and Developing Europe (IMF classification)

MAIN MACROECONOMIC INDICATORS							
	Q1 2018	Q1 2017	2017	2016	2015	2014	2013
Gross domestic product (EUR mln):	37 958	36 341	187 897	169 756	160 328	150 327	144 253
Final consumption	31 271	29 394	146 029	130 595	120 973	113 871	108 498
Gross fixed capital formation	6 575	5 952	42 390	38 980	39 672	36 542	35 638
Change in inventories	892	1 222	3 473	1 708	680	576	1 237
External balance of goods and services	-779	-226	-3 995	-1 527	-996	-662	-1 119
Exports of goods and services	20 599	18 794	77 873	70 168	65 757	61 922	57 338
Imports of goods and services	21 378	19 020	81 868	71 696	66 753	62 584	58 457
GDP (real growth rate, %)	4.0	5.7	6.9	4.8	4.0	3.1	3.5
GDP per capita (EUR, current prices)			9 600	8 600	8 100	7 500	7 200
Unemployment rate (%)[1]	4.5	5.2	4.9	5.9	6.8	6.8	7.1
Average net monthly wage (EUR)	566	507	531	465	416	384	367
CPI, annual rate of change, end of period (%)	5.0	0.2	3.3	-0.5	-0.9	0.8	1.6
CPI, annual average rate of change (%)	2.5	-0.8	1.3	-1.5	-0.6	1.1	4.0
Average exchange rate RON/EUR	4.655	4.521	4.568	4.491	4.445	4.445	4.419
Average exchange rate RON/USD	3.786	4.246	4.053	4.059	4.006	3.349	3.328
EXTERNAL SECTOR							
EUR millions	Q1 2018	Q1 2017	2017	2016	2015	2014	2013
Current account balance	-967	-770	-6 295	-3 548	-1 973	-1 012	-1 540
Goods	-2 583	-2 122	-11 912	-9 305	-7 788	-6 536	-5 816
Services	1 803	1 897	7 932	7 723	6 794	5 868	4 702
Primary income	-464	-793	-4 956	-4 467	-3 772	-2 029	-3 112
Secondary income	277	248	2 639	2 501	2 795	1 685	2 688
Official reserves assets	38 309	38 572	37 107	37 905	35 485	35 506	35 434
Gross external debt	95 527	93 475	93 477	92 910	92 068	94 744	98 069
NIIP	-86 233	-84 649	-85 423	-83 556	-84 247	-86 233	-88 700
% of GDP[2]							
Current account balance	-0.5	-0.4	-3.4	-2.1	-1.2	-0.7	-1.1
Goods	-1.3	-1.1	-6.3	-5.5	-4.9	-4.3	-4.0
Services	0.9	1.0	4.2	4.5	4.2	3.9	3.3
Primary income	-0.2	-0.4	-2.6	-2.6	-2.4	-1.3	-2.2
Secondary income	0.1	0.1	1.4	1.5	1.7	1.1	1.9
Official reserves assets	19.2	20.5	19.7	22.3	22.1	23.6	24.6
Gross external debt	47.9	49.7	49.7	54.7	57.4	63.0	68.0
NIIP	-43.2	-45.1	-45.5	-49.2	-52.5	-57.4	-61.5

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PUBLIC FINANCE							
EUR millions	**Q1 2018**	**Q1 2017**	**2017**	**2016**	**2015**	**2014**	**2013**
Consolidated budget revenues	14 258	13 170	55 126	49 818	52 543	48 219	45 344
Consolidated budget expenditures	15 216	12 833	60 437	53 892	54 874	50 805	48 918
Budget balance	-958	337	-5 311	-4 074	-2 331	-2 586	-3 574
Public debt[3]	78 589	75 272	79 026	74 669	69 827	65 964	59 569
Government consolidated gross debt			64565	59371	58312	53429	49446
% of GDP[2]							
Consolidated budget revenues	7.1	6.9	29.3	29.3	32.8	32.1	31.4
Consolidated budget expenditures	7.6	6.8	32.2	31.7	34.2	33.8	33.9
Budget balance	-0.5	0.2	-2.8	-2.4	-1.5	-1.7	-2.5
Public debt[3]	39.4	42.0	42.9	44.5	44.3	44.3	41.9
Government consolidated gross debt			35.0	37.7	39.1	37.5	36.9

BANKING SYSTEM							
	Q1 2018	**Q1 2017**	**2017**	**2016**	**2015**	**2014**	**2013**
Assets (EUR mln)	92 693	86 517	91 725	86 686	83 365	81 244	80 777
Deposits of non-financial sector (EUR mln)	61 406	56 941	61 210	56 955	52 650	48 737	44 709
Loans and advances to non-financial sector (EUR mln)	49.4	46.8	48.5	47.3	47.0	46.3	48.1
Non-performing loans ratio (%)	*6.2*	*9.4*	*6.4*	*9.6*	*13.5*	*20.7*	-
Capital adequacy (%)	*19.8*	*19.8*	*20.0*	*19.7*	*19.2*	*17.6*	*15.5*

[1] Unemployment rate of population aged 15 years and over, Labour Force Survey.
[2] The GDP ratios for 2018 are calculated on the basis of GDP amounting to RON 929 952 million (MPF estimate).
[3] Public debt according to Romanian national legislation (the GEO no 64/2007) includes:
-public government debt representing indebtness incurred directly or guaranteed by the Romanian Government trought MoPF , including the amounts advanced temporary from the State Treasury accounts and debt contracted by the line ministries.
- local public debt representing indebtedness incurred directly or guaranteed by the local administration unit.

Source: National Institute of Statistics, National Bank of Romania, Ministry of Public Finance, Eurostat, the International Monetary Fund, BCRA's database