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Romania

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SOVEREIGN RATING	Initial rating	Review
Date of Rating Committee	13.01.2016	21.12.2017
Date of rating publication	15.01.2016	05.01.2018
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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In 2017, political situation in Romania remained dominated by tensions between civil society and the political elite despite the successfully held early elections and the respective constitution of a new government. Frequent shifts in the country's leadership followed but the emphasis in internal policy has remained on the dubious laws on judicial reform. European Commission warnings about the unacceptability of the proposed legislation are reflected in the last Cooperation and Verification Mechanism report from November 2017. Along this line of thinking legal and judicial unpredictability remains a major issue at overall positive economic development of the country.

Romanian economy marks a real growth rate of 4.8% in 2016 - among the fastest pace in the EU. During 2017, the favourable dynamics are well maintained, as the economic growth accelerates notably to 8.8% in the third quarter of the year (7.0% year-on-year growth for the first nine months of the year). The economic performance of the country is driven by household consumption, fuelled by the rapid rise in wages and tax cuts. Boosted by the higher domestic demand, imports growth outweighs the rise in exports, thus net exports generate negative contribution to the GDP growth. In the period January – September 2017, industry sector marks its highest growth pace recorded in the last nine years, and forms 25.7% of the GVA. Agriculture sector also records a significant increase, thus largely contributing to the GVA growth in the period. Services remain robust, while the construction sector marks a negative growth rate, affected by a decline in infrastructure and non-residential construction.

The current account deficit widens from 1.2% of GDP in 2015 to 2.1% of GDP at the end of 2016, mainly driven by the deterioration of the trade balance. In the first nine months of 2017, the current account remains on the negative side, with a balance accumulated greatly exceeding the one recorded for the corresponding period in 2016.

The current account deficit, although at a much lower level than before crisis, rises concerns, as most of the emerging EU countries record current account surpluses. In the period ahead, developments in domestic consumption are likely to further put pressure on the external balance of the country under a higher growth rate of imports than exports and loose fiscal policy.

Net inflows of direct investment significantly strengthen in the course of 2016, despite the ongoing political events within the country. The generated FDI flows in the period January - September 2017 mark 1.9% increase against the same period in 2016. The instruments' structure consists mainly of equity and reinvested earnings, with the second gaining a larger share in the recent years. Domestic interest in foreign assets still indicates withdraws of investments abroad.

Affected by the internal political tensions domestic currency continues to lose ground against the euro. Following the protests against government plans to introduce controversial changes to the fiscal and judicial system, the Romanian leu weakened to an all-time low against the euro (RON 4.6495) on 13th November 2017. The increasing trade and current account deficits also support the leu depreciation.

The official reserves coverage over imports indicates a secure level of resource, coming up to 5.5 months for 2016, still quite above the indicator's values for the EU-average (1.9 months) and most of its neighbouring countries. This coverage ratio is enough adequate to reduces the risk of inability to respond to unexpected events occurring on international markets.

Gross external debt is moving upwards in nominal values since the second quarter of 2016, driven by the direct public debt, while private debt continues to shrink. As a share of GDP, external debt narrows from 54.8% at the end of 2016 to 50.7% in September 2017, because its growth lags behind the GDP growth.

The labour market development continues to follow the positive real sector dynamics, as well as the pro-cyclical 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.

Average income in the economy affirms its overall upward movement. 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 and this is expected to have an adverse effect on economy's price competitiveness.

After two years of deflation, the price level in Romania moves to positive territory at mid-2017.

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Rise in prices of basic commodities on international markets, local currency depreciation against the euro, as well as the increase in the disposable income are among the factors that will further exaggerate the inflation process.

A trend reversal of the fiscal consolidation that occurred over the past years is continued in 2017. Romanian fiscal relaxation measures, aiming to stimulate economic growth, are putting not only the country’s budget at risk but also the economy’s future development and hard-won stability. The changes in general taxes and expenditures have created a considerable gap between the expected balance and medium term objectives, thus the general government deficit increases from 1.5% in 2015 to 2.4% of GDP at the end of 2016. Furthermore, the budget deficit, according to ESA 2010 methodology, is widening from 0.8% of GDP in 2015 to the upper limit of the Maastricht treaty – 3.0% of GDP in 2016.

The beginning of 2017 brought additional fiscal relaxation measures. The authorities have enacted a series of tax cuts, including to VAT rates, excise duties and an elimination of the special construction tax. On the expenditure side, public wages have been significantly increased. The government also enacted an additional increase of the minimum salary and the old-age pensions. As a result Romania's consolidated budget deficit increases to 0.8% of the projected 2017 GDP in the nine months through September, from 0.5% a year earlier.

The cash budget deficit in 2018 is estimated at 2.97 % of GDP, while the ESA deficit is projected at 2.96% of GDP, kept below 3% of GDP, in line with the Maastricht Treaty provision. The government plans to further stimulate economic growth in 2018. Regarding consumption, the proposed measures include another hike of the minimum wage to RON 1900 from RON 1450 as of January next year, another increase of the pension point to RON 1100 from RON 1000 as of July 2018, and a personal income tax cut to 10% from 16%.

To prevent growing deficits from threatening fiscal sustainability, medium term consolidation should be considered. The EC has warned Romania on several occasions that the ongoing policy will lead to a failure of meeting the medium term objectives in the years following 2016. The European Council adopted a resolution on December 5 which states that Romania has failed to take effective action to correct significant budgetary deviation. The council has issued new recommendations under the EU’s ‘significant deviation procedure’. The IMF has also declared a stance that the proposed limits on the budget balance will be overstepped in the upcoming years, thus threatening the country of undergoing an excessive deficit procedure, having only exited it in 2013. In addition, the mentioned development could also result in a gradual increase in public debt, as means of financing the growing budget gap.

Despite the budget threats over the country’s indebtedness, public debt remains relatively steady in the recent months. As a ratio to GDP it moves within bounds of 2 – 4 p.p. (44.6% at the end of 2016 and 40.9% as of September 2017). Future rise of the country’s indebtedness may stem from the ongoing fiscal stimuli if no actions in either the revenue or expenditure side are made to correct the process. If the decreasing revenues and increasing expenditures are left to generate deficits in the following years, they will eventually lead to a gradual increase in the public debt.

The 10-year bond yield stays dynamic. For the past two years (2015, 2016) it has been below 4% on a monthly basis. However, due to the still-volatile political environment and uncertainty regarding fiscal and macroeconomic policies, it has been generally on the rise since October 2016 whereat the yield marks a three years record high at end-2017 (4.58% as of November 2017).

Improvement of Romanian banking system observed over 2016 is continued in the first three quarters of 2017. Domestic deposit funding further expands. Total assets keeps their increasing path despite the ongoing structural transformations towards sectoral consolidation. 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 (8.0% as of Q3 2017). The other main quality indicators remain appropriate and witness for good profitability and capitalisation that are characterising the system.

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).

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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. The economy is characterised by stable development in key economic indicators, while public finance developments are raising some concerns pertaining mostly for risks emerging in the long-run, which currently do not affect the country's creditworthiness.

BCRA would consider upgrading the Sovereign Rating and the Outlook for Romania if the country marks an enduring stabilization in its political situation and continues to record stable positive dynamics in key economic indicators, namely high GDP growth, improvement in the external balance and steady changes in the price level. The rating would be positively affected if the government takes measures for fiscal consolidation and effective public debt management.

Negative pressures on the Sovereign Rating and the Outlook would be considered to be further deterioration of the budget balance, resulting in a significant rise in the public debt. Additional factors will be considered prolonged and intensifying external imbalances, deterioration in the labour market situation and/or in the banking system.

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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 to review BCRA's full policy on unsolicited credit/sovereign ratings.

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 December 2017, with some exceptions, for which data is released more frequently.

Summary of the minutes of the Rating Committee:

On the 21st of December 2017 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 the continued instability in the internal environment related to controversial legislative initiatives by the ruling majority and respective protest reactions of the civil society and European institutions. Fiscal and non-fiscal incentives have been commented on as an element of sustained pro-cyclical economic policy, as well as their impact on the real sector of the economy. The measures taken stimulate consumption, which helps to maintain high economic growth, increase of incomes, and thus overcoming the price deflation. On the other hand, the performance of the public finances is deteriorating and the members of the committee have expressed concerns about their future development. The assessment also took into account the improved performance of the labour market and the banking system.

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)***

REAL SECTOR							
	I-IX 2017	**I-IX 2016**	**2016**	**2015**	**2014**	**2013**	**2012**
Gross domestic product (EUR million[1])	131 124	118 594	169 563	159 978	150 327	144 253	133 610
Final consumption	101 824	91 697	128 724	121 028	113 871	108 498	104 389
Gross fixed capital formation	29 487	27 433	38 437	39 617	36 542	35 638	36 529
Change in inventories	2 187	256	3 993	317	576	1 237	-662
External balance of goods and services	-2 374	-791	-1 591	-984	-662	-1 119	-6 645
Exports of goods and services	57 493	51 852	70 176	65 765	61 922	57 338	50 056
Imports of goods and services	59 867	52 643	71 767	66 749	62 584	58 457	56 701
GDP (real growth rate, %)	*7.0*	*4.9*	*4.8*	*3.9*	*3.1*	*3.3*	*0.6*
GDP per capita (EUR, current prices)	-	-	8 600	8 100	7 500	7 200	6 700
Average net monthly wage (EUR)	516	456	465	416	384	367	347
CPI, annual average rate of change (%)	*0.4*	*-1.7*	*-1.5*	*-0.6*	*1.1*	*4.0*	*3.3*
Average exchange rate RON/EUR	4.55	4.49	4.49	4.45	4.44	4.42	4.46
Average exchange rate RON/USD	4.10	4.02	4.06	4.01	3.35	3.33	3.47
	Q2 2017	**Q2 2016**					
Unemployment rate[2] (%)	*4.8*	*5.9*	*5.9*	*6.8*	*6.8*	*7.1*	*6.8*
EXTERNAL SECTOR							
EUR millions	**I-IX 2017**	**I-IX 2016**	**2016**	**2015**	**2014**	**2013**	**2012**
Current account, net	-4 191	-2 885	-3 498	-1 973	-1 012	-1 540	-6 386
Current account (% of GDP)[3]	*-2.3*	*-1.7*	*-2.1*	*-1.2*	*-0.7*	*-1.1*	*-4.8*
Goods and services, net	-2 370	-711	-1 531	-995	-667	-1 113	-6 792
Goods, net	-8 188	-6 487	-9 253	-7 788	-6 536	-5 816	-9 268
Services, net	5 818	5 777	7 723	6 794	5 868	4 702	2 475
Primary income, net	-3 611	-4 172	-4 467	-3 772	-2 029	-3 112	-2 305
Secondary income, net	1 789	1 998	2 501	2 795	1 685	2 688	2 711
Capital account, net	850	3 736	4 261	3 900	3 954	3 039	1 880
Financial account, net	-1 864	2 518	1 550	2 280	3 068	1 673	-3 306
	Q3 2017	**Q3 2016**					
NIIP	-86 165	-84177	-83753	-86014	-85477	-88951	-90 628
NIIP (% of GDP)[3]	*-46.9*	*-49.6*	*-49.4*	*-53.8*	*-56.9*	*-61.7*	*-67.8*
Gross external debt	93 811	93 811	92 910	92 068	94 744	98 069	100 857
Gross external debt (% of GDP)[3]	*55.3*	*55.3*	*54.8*	*57.6*	*63.0*	*68.0*	*75.5*

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PUBLIC FINANCE							
EUR millions	I-IX 2017	I-IX 2016	2016	2015	2014	2013	2012
Consolidated budget revenues	180 438	165 790	223 722	233 554	214 315	200 374	193 148
Consolidated budget expenditures	187 256	169 486	242 016	243 916	225 808	216 168	207 922
Budget balance	-6 818	-3 697	-18 294	-10 361	-11 493	-15 794	-14 774
Budget balance (% of GDP)[3]	*-0.8*	*-0.5*	*-2.4*	*-1.5*	*-1.7*	*-2.5*	*-2.5*
Public debt stock[4]	344 400	313 947	339 523	315 934	295 656	267 151	240 843
Public debt (% of GDP)[3]	*40.9*	*41.2*	*44.6*	*44.4*	*44.3*	*41.9*	*40.5*
Budget balance, EU methodology (% of GDP)	-	-	*-3.0*	*-0.8*	*-1.4*	*-2.1*	*-3.7*
Public debt, EU methodology (% of GDP)	*37.0*	*36.8*	*37.6*	*37.9*	*39.4*	*37.8*	*37.3*

BANKING SYSTEM							
EUR billions[4]	IX 2017	IX 2016	2016	2015	2014	2013	2012
Assets	88.4	84.9	86.7	83.4	81.2	80.8	82.6
Deposits (non-financial sector)	58.8	54.3	57.0	52.6	48.7	44.7	41.4
Loans and advances (non-financial sector)	49.2	47.4	47.3	47.0	46.3	48.1	50.4
in %	**Q3**	**Q3**					
Non-performing loans ratio	*8.0*	*10.0*	*9.6*	*13.5*	*20.7*	-	-
Capital adequacy	*19.0*	*18.8*	*19.7*	*19.2*	*17.6*	*15.5*	*14.9*

[1] The values in EUR are calculated by using the average exchange rate of the RON/EUR for the corresponding period.
[2] Unemployment rate of population aged 15 years and over, Labour Force Survey
[3] The GDP ratios for 2017 are calculated on the basis of GDP amounting to RON 837 100 million (MPF estimate).
[4] Public debt according to 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.
[5] The values in EUR are calculated by using the exchange rates at the corresponding period's end.

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