Country update

ROMANIA

Summary

The fragile political stability is currently the main weakness of Romania. Although the cabinet survived three votes of no-confidence last year, dissatisfaction also within the coalition over the harsh austerity measures is rising. Higher taxes, public sector wage cuts and several other measures are part of the aim to adhere to the conditions of the IMF/EU aid package. A new aid package is expected, when the current one ends in May 2011. In the medium term, more structural fiscal reforms are necessary to improve the sustainability of the fiscal situation. With the focus on the fiscal side, the external position is less closely scrutinized. The current account deficit might have improved much since the start of the crisis, but at around 5-6% of GDP the deficit is still substantial. As most external financing needs are covered by debt financing, investor confidence is important. More investment and a return of consumer confidence are necessary to speed up economic recovery. Currently, the economy is expected to slowly recover from -2% in 2010 to around 2% in 2011 and around 4% in 2012.

Things to watch:

- Political developments (e.g. more votes of no-confidence)
- Renewal of the IMF/EU agreement (spring 2011)
- Structural fiscal reforms (e.g. public employment, pension system, state-owned firms)

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Romania

National facts		
Type of government	Republic	
Capital	Bucharest	
Surface area (thousand sq km)	238	
Population (millions)	21.5	
Main languages	Romanian (91%)	
	Hungarian (6.7%)	
Main religions	Eastern Orthodox (86.8%)	
	Potestant (7.5%)	
	Roman Catholic (4.7%)	
Head of State (president)	Traian Basescu	
Head of Government (prime-minister)	Emil Boc	
Monetary unit	leu (RON)	

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	156	0.25
Nominal GDP at PPP	249	0.34
Export value of goods and services	57	0.31
IMF quotum (in mln SDR, 2009)	1030	0.47
Economic structure	*2010*	*5-year av.*
Real GDP growth	-2.0	3.6
Agriculture (% of GDP)	13	11
Industry (% of GDP)	38	36
Services (% of GDP)	52	55
Standards of living	*USD*	*% world av.*
Nominal GDP per head	7279	74
Nominal GDP per head at PPP	11623	100
Real GDP per head	5158	64

Social and governance indicators	rank / total
Human Development Index (rank)	50 / 169
Ease of doing business (rank)	56 / 183
Economic freedom index (rank)	63 / 179
Corruption perceptions index (rank)	69 / 178
Press freedom index (rank)	52 / 178
Gini index (income distribution)	32.1
Population below $1 per day (PPP)	1%

Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
Germany	19	Germany	17
Italy	15	Italy	12
France	8	Hungary	8
Turkey	5	France	6
Main export products (%)			
Machinery & equipment			26
Textiles & products			10
Basic metals & products			10
Minerals, fuels			6
Main import products (%)			
Machinery & equipment			27
Chemical products			11
Minerals, fuels			10
Textiles & products			7
Openness of the economy (2010)			
Export value of G&S (% of GDP)			36
Import value of G&S (% of GDP)			42
Inward FDI (% of GDP)			2.6

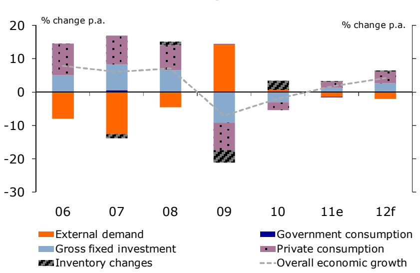
Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

Romania's economy failed to recover from the strong recession in 2009 (-7.1%). In 2010, growth was still negative (-2%), which was well below expectations as mentioned in our Country Risk Report of February 2010 (+1%). Exports and restocking supported growth, but private consumption and investment remained low. Private consumption was hindered by low consumer confidence, rising unemployment, wage cuts and limited credit supply (despite ample liquidity). The latter, combined with lower FDI and weaker growth prospects, also slowed down investment. Fiscal tightening, a 5% VAT hike in July and a 25% cut in public sector wages were other factors that prevented a strong recovery. The economy is expected to slowly recover to around 2% in 2011 and around 4% in 2012.

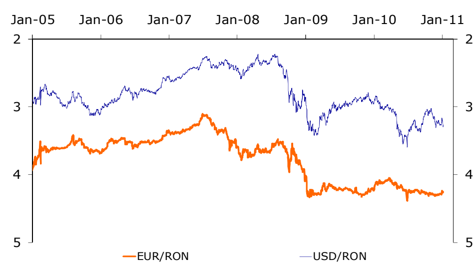
The Romanian leu depreciated rapidly in the second half of 2008. Due to the continued political unrest within Romania, euro zone ups and downs, and lower inflow of foreign capital, the leu has failed to recover so far. This keeps the leu value of repayments on the numerous foreign currency loans elevated, although no substantial increase in arrears have been seen yet.

Chart 1: Economic growth



Source: EIU

Chart 2: Romanian leu



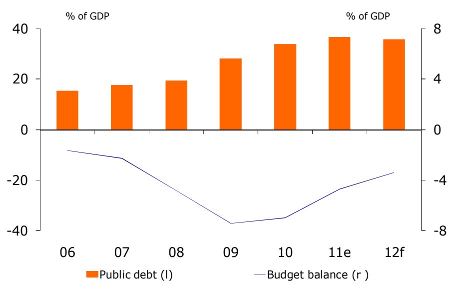
Source: Ecowin

Political stability fragile and structural reforms needed

The political situation remains fragile in Romania. Prime minister Boc and his cabinet have faced three votes of no confidence so far (since their start early 2010), which they have all survived. The third vote was won by a wider margin than the previous two, boding well for future votes. However, as more motions can be expected, the position of the cabinet remains delicate. The cabinet, consisting out of Boc's Democratic Liberal Party (PD-L), the Democratic Union of Hungarians in Romania (UDMR) and several independents, has a small majority. But even within the coalition parties there is criticism on the harsh fiscal tightening. If the cabinet would collapse, this could lead to a political and economic crisis, as it would affect domestic and foreign confidence, postpone IMF/EU disbursements and hinder fiscal reforms.

Fiscal consolidation is an essential part of the IMF/EU rescue package, which has been in place since early 2009. The IMF-set (and already adjusted) budget target for 2010 was a deficit of 6.8% of GDP, which is expected to be overshot slightly. This was largely due to the lower than expected economic growth (-2% vs. -0.5%). The budget target for 2011 is set at a deficit of 4.4% of GDP by the government (based on an economic growth of 1.5%), in line with the IMF target. The multilateral facility will run until May 2011 and will likely be extended to cover part of the public financing needs in 2011 and 2012. A new program will not only provide cash to the government, it will also give comfort to the market. The program could function as a fiscal anchor in the run up to the parliamentary elections of November 2012.

Chart 3: Fiscal balance and public debt



Source: EIU

Tax increases (mainly VAT) and public sector wage cuts have been the main ways to reduce the deficit last year. In the medium term, these measures will likely be unsustainable (among others because of the parliamentary elections next year) and more structural reforms are necessary. However, reaching consensus on social benefit and pension reforms, reducing public sector employment –the government employs as much as a third of all employees- and privatization (or liquidation) of loss-making state companies is difficult.

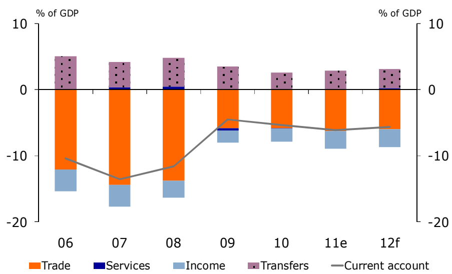
Besides the issues that require immediate attention, the government will also need to address long-standing problems, such as corruption, red tape, tax evasion and poor infrastructure. To attract more investment, the government has announced several tax and investment incentives.

External position still weak, but less closely scrutinized by the market

Romania's current account balance has improved much since the start of the global financial crisis. In the years preceding the crisis, the current account deficit increased to 13.5% of GDP in 2007. In 2009, it improved to a deficit of 4.5% of GDP. Last year, a slight worsening was seen again. This was mainly due to the lower surplus on the transfer balance. Remittances fell as unemployment in host countries rose. Moreover, EU transfers were lower in 2010, due to frontloading in 2009 and poor absorption capacity (i.e. as Romania was unable to spend all its 2009 transfers, the funds

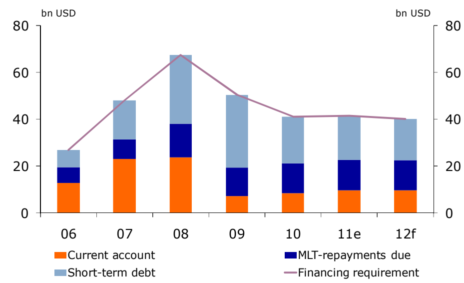
were lowered in 2010). The deficit on the trade balance, which was the major improvement in 2009, stayed at the same level. In the coming years, the current account deficit is expected to stay at around 5-6% of GDP. Although this is a major improvement from a few years ago, it remains rather high. However, considering the fiscal situation and political situation, it is likely that government actions will be more closely scrutinized by the market than the current account deficit. As a result of lower current account deficits, the external financing needs of Romania have decreased substantially from USD 67bn in 2008 to USD 41bn in 2010 (see chart 5). For 2011/12, the financing requirement will stay at the same level. Romania's financing needs are almost fully covered by debt financing. Foreign direct investment (FDI) and portfolio inflows are expected to double in 2011 compared to 2010, but will still be below pre-crisis level.
Debt financing has pushed the level of foreign debt up to 74% of GDP in 2010, which is rather high. Depending on whether a new IMF program is arranged and economic growth, the level of foreign debt is expected to decrease to around 72% and 65% of GDP in 2011 and 2012, respectively, or stay at the same level as in 2010.

Chart 4: Current account balance



Source: EIU

Chart 5: External financing needs



Source: EIU

Romania

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	7.9	6.0	7.1	-7.1	-2.0	1.7	4.2
Consumer prices (average % change pa)	6.6	4.8	7.8	5.6	6.1	5.3	3.4
Current account balance (% of GDP)	-10.4	-13.5	-11.6	-4.5	-5.4	-6.1	-5.6
Total foreign exchange reserves (mln USD)	28066	37194	36868	40757	46186	44090	44300
Economic growth							
GDP (% real change pa)	7.9	6.0	7.1	-7.1	-2.0	1.7	4.2
Gross fixed investment (% real change pa)	19.3	28.9	19.3	-25.3	-10.0	5.0	9.0
Private consumption (real % change pa)	11.4	10.2	8.4	-9.2	-2.7	2.0	3.9
Government consumption (% real change pa)	3.5	7.4	3.7	1.2	-2.0	-1.0	2.0
Exports of G&S (% real change pa)	10.6	8.7	19.4	-5.3	13.4	9.5	10.7
Imports of G&S (% real change pa)	22.4	26.1	17.5	-20.5	8.5	8.9	10.5
Economic policy							
Budget balance (% of GDP)	-1.6	-2.3	-4.8	-7.4	-7.0	-4.7	-3.4
Public debt (% of GDP)	15	18	19	28	34	37	36
Money market interest rate (%)	8.3	7.0	10.4	10.9	9.0	8.0	7.0
M2 growth (% change pa)	28	34	17	8	7	10	8
Consumer prices (average % change pa)	6.6	4.8	7.8	5.6	6.1	5.3	3.4
Exchange rate LCU to USD (average)	2.8	2.4	2.5	3.0	3.2	3.4	3.4
Recorded unemployment (%)	5.2	4.1	4.4	7.8	7.6	7.2	6.7
Balance of payments (mln USD)							
Current account balance	-12785	-23080	-23719	-7298	-8379	-9710	-9640
Trade balance	-14836	-24566	-28182	-9482	-9186	-9970	-10280
Export value of goods	32336	40555	49760	40713	47036	50270	55650
Import value of goods	47172	65121	77942	50195	56221	60250	65930
Services balance	5	530	951	-497	-35	90	270
Income balance	-4079	-5662	-5372	-2968	-3148	-4260	-4780
Transfer balance	6125	6618	8884	5649	3989	4440	5150
Net direct investment flows	10971	9647	13606	6710	3960	6850	8800
Net portfolio investment flows	-239	623	-943	3495	833	900	900
Net debt flows	13913	25185	19957	8983	6547	3260	50
Other capital flows (negative is flight)	-3244	-2630	-9390	-7251	2468	-3350	100
Change in international reserves	8616	9745	-488	4639	5429	-2050	220
External position (mln USD)							
Total foreign debt	53939	84033	104943	111580	115405	114440	112110
Short-term debt	16570	29197	31116	20017	18936	17680	17420
Total debt service due, incl. short-term debt	16334	28406	48047	48059	36049	34650	33280
Total foreign exchange reserves	28066	37194	36868	40757	46186	44090	44300
International investment position	-48588	-79692	-97032	-105252	n.a.	n.a.	n.a.
Total assets	42228	54184	54892	64151	n.a.	n.a.	n.a.
Total liabilities	90816	133876	151924	169403	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-12.1	-14.4	-13.8	-5.9	-5.9	-6.3	-6.0
Current account balance (% of GDP)	-10.4	-13.5	-11.6	-4.5	-5.4	-6.1	-5.6
Inward FDI (% of GDP)	9.3	5.8	6.8	4.2	2.6	4.4	5.2
Foreign debt (% of GDP)	44	49	51	69	74	72	65
Foreign debt (% of XGSIT)	111	133	133	182	174	166	147
International investment position (% of GDP)	-39.6	-46.7	-47.5	-65.3	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	34	45	61	78	54	50	44
Interest service ratio incl. arrears (% of XGSIT)	5	5	5	8	5	4	3
FX-reserves import cover (months)	6.2	6.0	4.9	8.1	8.4	7.5	6.9
FX-reserves debt service cover (%)	172	131	77	85	128	127	133
Liquidity ratio	104	93	81	95	109	106	107

Source: EIU