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Research

Research Update:

Romania Ratings Affirmed At 'BB+/B'; Outlook Stable

25-May-2012

Overview

- In our view, Romania is undergoing a process of economic rebalancing and has moderate general government debt levels.
- However, it also has relatively low prosperity, exposure to foreign parent bank financing risks, and high, if declining, external debt.
- We are therefore affirming our 'BB+/B' long- and short-term foreign and local currency sovereign credit ratings on Romania.
- The stable outlook reflects our opinion that Romania's government will continue to consolidate its public finances largely in line with the targets it has specified and that external imbalances will remain more moderate than in the recent past.

Rating Action

On May 25, 2012, 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 stable. The transfer and convertibility (T&C) assessment is 'BBB+'.

Rationale

The ratings on Romania are constrained by low prosperity and the economy's vulnerability to external shocks owing to still-high, albeit declining, external debt and dominant ownership of the banking sector by Austrian and Greek parent banks. The ratings are supported by the country's improving fundamentals; the fiscal deficit is declining, the current account deficit has narrowed, and the economy has started to rebalance, with the support of an IMF program.

Foreign institutions own 83% of total banking sector assets. Austrian banks dominate, holding 39% of total market share, while Greek banks' subsidiaries account for 13% of banking sector assets. We believe operational autonomy might limit spill-over effects if confidence in the Greek banking sector continues to weaken.

In our view, however, there is a risk that foreign parent bank difficulties could cause the parents to significantly reduce cross-border exposure to their subsidiaries, thereby reducing credit availability. Lines of credit from parent banks to their subsidiaries are 25% of total balance sheet liabilities (excluding capital) for Romania's aggregate banking sector, and 35% for the Greek subsidiary banks. However, we note that the regulatory and prudential frameworks have been strengthened so as to mitigate the risk of a funding or capital withdrawal by parent banks.

Following economic growth of 2.5% in 2011, we expect the pace of expansion to slow to 1.2% in 2012, owing to a moderation in external and domestic demand.

In our view, real GDP will strengthen to an annual average of 3.5% in the medium term owing to rising investment, facilitated by the increased use of EU funds and a recovery in foreign direct investment (FDI), which will support household spending and exports. However, private consumption is likely to remain constrained in the short term by the need for continued household deleveraging--foreign-currency household borrowing (mainly euros) accounts for about two-thirds of the loan book. While the currency has stabilized, it is currently about 30% weaker in nominal terms against the euro compared with its peak in mid-2007, increasing households' debt burden in local currency terms.

The authorities have so far adhered to the reforms agreed with the IMF under its current program. The stand-by arrangement (SBA) with the IMF was renewed in March 2011 for two years, on a precautionary basis. However, commitment to structural reform or fiscal restraint may be tested by public opposition, especially against the background of the upcoming general elections. Moreover, a concurrent slowdown in the European economy could weaken Romania's balance of payments performance and raise external funding vulnerabilities.

The authorities aim to lower the general government budget deficit to under 3% of GDP in 2012 on the accruals-based EU ESA 95 accounting standard, despite a decision to raise public sector wages in June and December (reversing previous wage cuts). Fiscal consolidation will include means testing for social welfare benefits, a reduction in the number of social assistance programs, steps to broaden the tax base, a pension freeze, and capital expenditure rationalization. We expect some fiscal slippage, partly owing to our lower projection for GDP growth, and risks associated with the November 2012 parliamentary election, though the rise in public sector wages may stimulate consumption-related taxes more than currently expected.

Standard & Poor's anticipates that net general government debt will peak at about 30% of GDP in 2012 before falling very gradually. While general government arrears have declined to 0.2% of GDP currently, mainly at the local government level, total state-owned enterprises' (SOEs') arrears are high at about 4% of GDP. SOEs in the energy and transport sectors are in the process of being reformed by liberalizing prices and restructuring, although we believe there may be a reluctance to close loss-making companies or sell state assets, given that this would be publicly unpopular.

The country's net external liability position has narrowed to 130% of current account receipts (CARs). However, because of capital account flows and FDI and other equity funding, external debt net of liquid assets is lower at 60% of GDP, also down from recent years, following a period of rapid growth. We expect Romania's current account deficit to remain around 4% of GDP in 2012, after having adjusted from 11.6% in 2008. External liabilities are expected to decline relative to CARs, as external leverage in the private sector decreases.

Outlook

The stable outlook reflects our opinion that Romania's government will continue to consolidate its public finances largely in line with specified targets, and that external imbalances remain more moderate than in the recent past. We expect that the SBA will help to minimize the risk of fiscal slippage and that the parents of Romanian banking subsidiaries will not significantly reverse their cross-border advances.

If, against our expectations, the pace and extent of fiscal consolidation were to slow beyond what we currently expect, the authorities were to deviate from the structural reform strategy, or Romania's external deficits were to widen significantly without improving the country's long-term growth potential, the ratings could come under pressure.

Conversely, if the government continues to push through with structural

measures to improve competitiveness and potential growth, while building a sustained track record of fiscal prudence, as external pressures diminish, we could raise the ratings.

Related Criteria And Research

- Sovereign Government Rating Methodology and Assumptions, June 30, 2011
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- Introduction Of Sovereign Recovery Ratings, June 14, 2007
- Local-Currency Ratings On Romania Cut To 'BB+/B' On Criteria Update; Foreign-Currency Ratings Affirmed; Outlook Stable, Nov. 29, 2011
- Romania, July 1, 2011
- Global Aging 2010-2011: After Years Of Fiscal Extravagance, Pension Reform Takes Center Stage In Romania, April 12, 2011

Ratings List

Ratings Affirmed

Romania	
Sovereign Credit Rating	BB+/Stable/B
Transfer & Convertibility Assessment	BBB+
Senior Unsecured	BB+
Recovery Rating	3
Short-Term Debt	B

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