Romania

Outlook

Romania's economy is estimated to have contracted by -7% yoy in 2009, slightly better than previously expected but deteriorating wages and labor market uncertainties will drag down consumption while investment recovery will be slow. Fiscal slippage remains one of the main country risks given the rigidity of social spending and depressed budget revenues on the back of weak economic performance. On the positive side, with a new government in place there is more likelihood of implementing the extensive public sector restructuring that was announced before the elections.

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	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa3 stable**	**BB+ negative**	**BB+ negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	123.7	136.9	118.4	124.1	144.2
Population (mn)	21.5	21.4	21.3	21.2	21.1
GDP per capita (EUR)	5745	6391	5552	5852	6832
GDP (constant prices yoy %)	6.2	7.1	-7.0	0.4	3.5
Private Consumption, real, yoy (%)	9.8	8.4	-11.5	0.6	4.6
Fixed Investment, real, yoy (%)	29.0	19.3	-20.5	1.0	5.0
Public Consumption, real, yoy (%)	7.6	3.7	0.7	2.0	2.7
Exports, real, yoy (%)	7.9	19.4	-5.4	4.0	7.0
Imports, real, yoy (%)	27.2	17.5	-25.1	8.5	11.0
CPI (average, yoy %)	4.8	5.7	5.6	4.0	3.9
Central bank reference rate	7.50	10.25	8.00	6.50	5.75
Gross Monthly wage, nominal (EUR)	312	348	323	343	394
Unemployment rate (%)	4.3	4.0	6.3	8.5	7.0
Budget balance/GDP (%)	-2.3	-4.8	-8.0	-7.0	-5.0
Current account balance (EUR bn)	-16.7	-16.9	-5.9	-6.7	-8.1
Current account balance/GDP (%)	-13.5	-12.3	-5.0	-5.4	-5.7
Net FDI (EUR bn)	7.2	9.0	4.9	5.0	5.8
FDI % GDP	5.8	6.6	4.1	4.0	4.0
Gross foreign debt (EUR bn)	38.7	51.4	63.2	72.1	79.1
Gross foreign debt (% of GDP)	31.3	37.6	53.4	58.1	54.9
International reserves (EUR bn)	27.2	28.3	30.9	30.2	28.7
(Cur.Acc-FDI)/GDP (%)	-7.7	-5.7	-0.9	-1.4	-1.7
Int. reserves/Gross foreign debt (%)	70.2	55.0	48.8	42.0	36.3
Exchange rate to USD eop	2.45	2.88	2.95	2.84	2.84
Exchange rate to EUR eop	3.58	4.03	4.23	4.20	4.00
Exchange rate to USD AVG	2.43	2.50	3.04	2.81	2.85
Exchange rate to EUR AVG	3.34	3.68	4.24	4.30	4.10

Source: UniCredit Research

STRENGTHS

- Significant IMF and EU balance of payments support
- Low public sector debt levels
- High roll-over rates of banks' external financing

WEAKNESSES

- High public deficit with risk of overshooting
- High FX leverage in domestic private sector
- Some political risk

New government convey ample public sector restructuring

Romania's economy is set for a very slow recovery of 0.4% during 2010

The Romanian economy contracted by 7.1% yoy in 3Q, slightly up on the 8.7% yoy drop in 2Q. As expected, exports and inventories entered positive territory. Meanwhile, investment contracted by 28.6% yoy, while consumption dropped by 12.7% yoy. On the supply side, agriculture surprised positively, as it rose by 2.4% yoy (10% yoy drop in 1H) while the worst performer remains the construction sector, which contacted by 17.4% yoy. For 2010, two opposing forces will be at work: On the one hand, exports will drive a further improvement in industrial production, as reflected by the leading sentiment indicators, while the turning of the inventory cycle will also give a boost. On the other hand, domestic demand will remain weak, with further contraction in consumer spending and depressed investment levels. On balance therefore we expect a very modest recovery during 2010, with full-year growth of just 0.4%.

Disinflation trend to continue in 2010

Weak local demand will help the disinflation trend to continue with end-2009 inflation at 4.7% yoy, slightly above our previous expectation driven by fuel price growth and the excise duties hike in September, but this is still very close to the CB's target band of 3.5% +/-1%. We expect inflation to stay relatively low during 2010, ending the year at 4.2%.

Huge C/A correction amid good FDI coverage. Balanced external trade in 2010

Another positive side effect of the recession is that the C/A deficit has contracted sharply, by 72% yoy in the first 10M of 2009 to EUR 4bn, driven by the narrowing trade deficit (-67% yoy) but also helped by current transfers, less affected by the crisis (-31% yoy), and by a sharp reduction in outflows on the incomes balance (-49% yoy). Moreover, FDI (EUR 3.7bn) coverage of the deficit remained high at 94%. We expect this improvement to continue, and forecast the C/A deficit at 5% of GDP in 2009.

Monetary policy softening to continue in 2010

Uncertainties on the local inter-bank market and Central Bank (CB) support of the local currency kept interest rates high (200-250bp above the policy rate). Moreover, the CB adopted a more cautious monetary stance at its November meeting by holding the key rate at 8%. We see total 150bp interest rate cuts during 2010, accompanied by further MRR reduction.

Budget deficit slippage remains the major risk for 2010 although with improved outlook for ample public sector restructuring

On the fiscal side, the 11M public sector deficit reached 6% of GDP. We see a significant risk of the budget deficit overshooting, ending 2009 at around 8% of GDP. The Parliament will begin talks on the 2010 budget bill on Jan, 11. Deficit target is set at 5.9% of GDP (with 1.3% GDP growth).The proposed budget envisages up to 100,000 public sector job cuts and freezing on pension and wages. Despite of this, the mandatory spending on pensions and social welfare is estimated to increase to 14.9% of GDP, compared to some 13% of GDP in 2009. After the delay of the third IMF tranche worth EUR 1.5bn, Romania faced some public financing pressure, but the Central Bank provided some help by lowering the MRR ratio on FX liabilities with residual maturities of up to two years to 25% from 30%. For 2010, public financing pressures will remain intact with the outlook for a deficit of around 7%.

Newly elected president means also new government that got parliamentary approval at the end of 2009

The 2009 presidential elections have received special importance in shaping the new government, given that the new Prime Minister has been nominated by the newly elected president. The incumbent President Traian Basescu won the elections with a tight margin and Romania's new centrist coalition won parliamentary approval on 23 December. The new government is built around his Democrat-Liberal party with Emil Boc as PM and comprises an ethnic Hungarian party, other minorities and independent allies. The cabinet faces three years with no elections if it can complete its term (given that its majority is slim).

Sovereign credit rating outlook still dependent on fiscal performance

Fiscal performance and external financing, conditional on the IMF/EU stand-by-agreement, continues to be crucial for the credit outlook. It should be noted that financing through IMF tranches is expected to resume in February 2010, while the strong balance of payment correction should bring some stability. Given these risks we keep our previous call of 4.2 EUR/RON for end -2010. Still, some stronger RON strengthening cannot be ruled out on the back of relatively high rates, improved C/A and the catch up potential vs. the CEE peers.

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