

Getting better, but still vulnerable

General Information



GDP	USD169.4 billion (World ranking 55, World Bank 2012)
Population	21.33 million (World ranking 55, World Bank 2012)
Form of state	Republic
Head of government	Victor-Viorel Ponta (USL)
Next elections	2014, presidential



Strengths

- Healthy public finances
- Improving economic prospects
- Reducing financing imbalances
- Resilient FX reserves

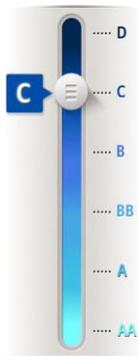
Weaknesses

- Banking sector exposure to the eurozone
- High private sector debt (notably in foreign currency)
- High external debt
- Still weak political stability

Country Rating

C3

Country Grade



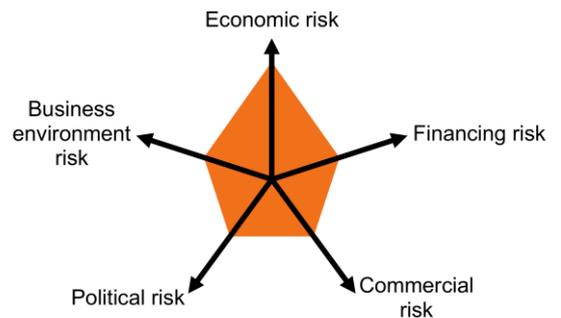
High risk

Low risk

Country Risk Level



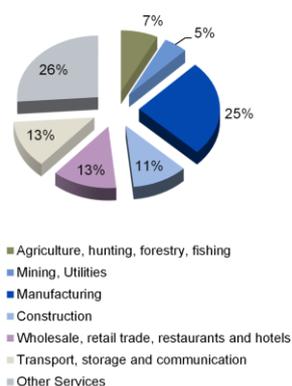
Risk Dimensions



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Economic Structure

GDP breakdown (% of total, 2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	-7.1	-1.1	2.2	0.7	1.9	2.4
Inflation (% , end-year)	4.7	8.0	3.1	5.0	3.5	3.1
Fiscal balance (% of GDP)	-7.3	-6.4	-4.3	-2.5	-2.3	-2.0
Public debt (% of GDP)	23.8	31.1	34.2	37.0	36.8	36.5
Current account (% of GDP)	-4.2	-4.4	-4.7	-3.9	-1.8	-2.7
External debt (% of GDP)	71.1	73.7	69.7	76.5	70.9	69.9

Source: IHS Global Insight, national sources, Euler Hermes

Economic Growth

Gradually improving economic prospects

GDP growth remained steady in Q2 2013 at +0.3% q/q, the same pace as in Q1. Private demand is expected to have remained weak as retail sales fell by 2.1% in Q2 (as real private wages are on a declining trend since H2 2012) and investment is likely to have remained in contractionary area. Positive contribution to growth is likely to have come from strong performance in industrial production (+2.7% on the quarter, the strongest increase since start 2011), agriculture and foreign trade (exports were up by +11% y/y in June while imports were down by -3% y/y).

Going forward, GDP growth is expected to be robust in Q3 on the back of a good harvest, agriculture accounting for 7% of Romanian GDP, and of a rebound in private demand. Further, absorption of EU funds could trigger a pick-up in investment, moderating inflation could give some leeway to the private consumption and stabilizing growth of Romania's top trade partners (Germany, France and Italy) could support exports. Thus, a gradual economic recovery is expected, with growth of +1.9% in 2013 and +2.4% in 2014. In this context, business insolvencies are expected to fall by -3% in 2013 and by -14% in 2014.

Trade structure (% of total, 2011)

Exports	Rank	Imports
Germany	19%	17%
Italy	13%	12%
France	7%	9%
Turkey	6%	6%
Hungary	6%	5%

Exports (% of total)	Rank	Imports (% of total)
Road vehicles	12%	9%
Electrical machinery, apparatus and appliances, n.e.s.	11%	9%
Telecommunication and sound recording apparatus	7%	7%
Articles of apparel & clothing accessories	6%	5%

GDP growth (%)



Sources: IHS Global Insight, Euler Hermes

Economic Policies

Fiscal consolidation is on track but official targets seem optimistic

After four years of austerity measures, the fiscal deficit narrowed to 2.5% of GDP in 2012 from 7.3% of GDP in 2009, allowing the country to exit the EU Excessive Deficit Procedure in June 2013. The signature of a new precautionary IMF agreement at end-July for 24-months (EUR4bn) seeks the continuation of fiscal consolidation in order to reach a 2.1% fiscal deficit in 2013 and 1.7% in 2014 and a structural deficit of not more than 1% of GDP by 2015. The latter stood at 2.7% of GDP at end-2012. While slowing fiscal consolidation would be supportive for growth, loss-making state-owned enterprises (SoEs) continue to be a pressure on the budget and the 3rd IMF agreement focuses on reforming (privatizing/ closing) inefficient SoEs – the sale of a majority stake in the state-owned railway freight company is on track while IPOs for the hydroelectric producer (Hidroelectrica) and gas producer (Romgaz) are scheduled to be held by end-2013.

Thus, selling stakes in strategic companies (targeted sectors by the IMF remain energy and transportation) could result in higher tax and dividend revenues for the government and therefore reduce the pressure on public finances. Further, access to market financing is likely to be sustained thanks to the IMF agreement. However, risks to the official fiscal deficit target remain skewed to the downside as EUR5.1bn (i.e. 4% of GDP) have to be reimbursed to the IMF in 2013 and because the structural reform implementation and privatizations could take longer than expected. This coupled with moderate GDP growth could trigger a slight fiscal slippage (especially as presidential elections will be held in 2014). EH expects the fiscal deficit to reach 2.3% of GDP in 2013 and 2.0% in 2014.

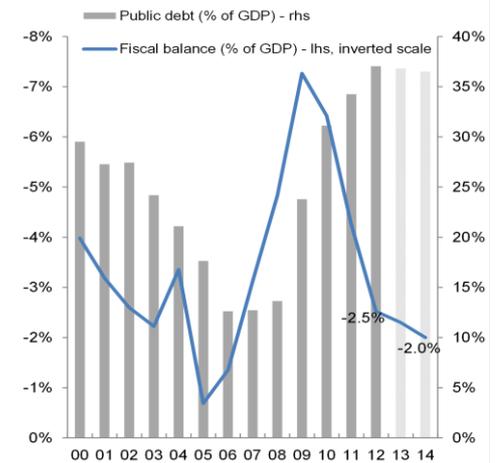
Easing inflationary pressures would allow further monetary easing

The cut of the VAT rate on bread and bakery products (from 24% to 9%) starting 1 September 2013 and a good harvest are likely to reinforce the slowdown in consumer price inflation from 4.4% y/y in July to 3.5% y/y in December, bringing it back to within the 1.5-3.5% target range of the National Bank of Romania (NBR). The NBR has already cut rates, by 25bps in July and by 50bps in August, to 4.5%. Further moderation in inflation (to 3.1% at end-2014) would allow additional monetary easing. This could strengthen real purchasing power and support private consumption.

The banking system is still vulnerable

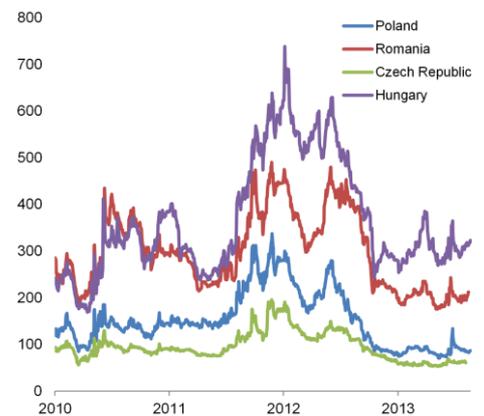
Domestic credit growth has continued to be in negative territory for five consecutive months as the high private sector debt burden and still elevated bank lending rates hurt credit demand and the parent bank deleveraging (80% of Romanian banks are foreign-owned) limits credit supply. Non-performing loans reached a new-record high in June, at 20.3% of total loans, while the loan-to-deposit ratio is still above 100%. Further, the elevated stock of loans in foreign currency, namely 62% of total loans or 24% of GDP, increases banks' vulnerability to exchange rate fluctuations. After a period of appreciation, the RON weakened recently. Further depreciation cannot be excluded on the back of the ongoing easing monetary cycle.

Fiscal balance and general government debt



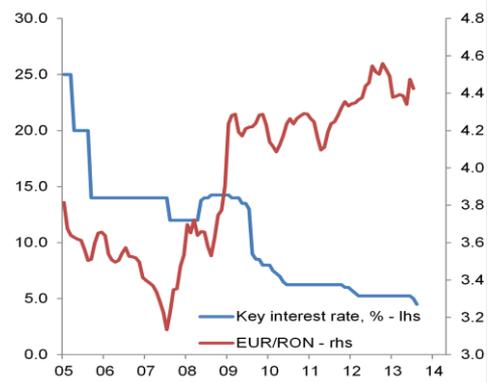
Sources: IHS Global Insight, national sources, Euler Hermes

5-yr CDS spreads



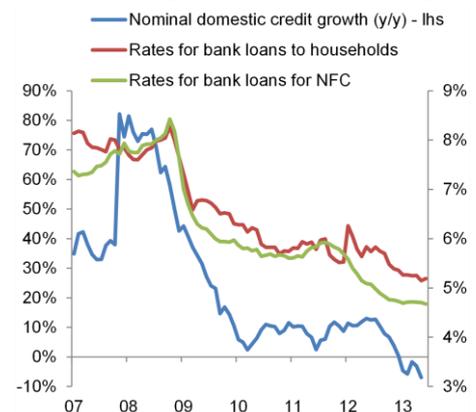
Sources: IHS Global Insight, Euler Hermes

Policy rate and exchange rates



Sources: IHS Global Insight, NBR, Euler Hermes

Domestic credit growth and bank lending rates



Sources: IHS Global Insight, Euler Hermes

Current account deficit narrows...

During H1 2013, the current account balance shifted to a surplus of EUR0.69bn, compared to a EUR2.78bn deficit in the same period of 2012. This improvement was mainly due to a sharp fall in the trade deficit to a historically low level (at EUR1.5bn in H1 2013 vs. EUR3.5bn in H1 2012). Current transfers remained strong, at EUR1.9bn, remaining an important source of financing for the country.

On the back of the improving trade balance (stronger exports due to gradually recovering trade partners in the EU, accounting for 71% of total exports) and of a rebound in net current transfers (thanks to the disbursement of EU funds), EH expects the annual current account deficit to narrow to 1.8% of GDP in 2013, before widening slightly to 2.7% in 2014.

...but pick-up in portfolio investment needs monitoring

Non-residents' investment in Romania totaled EUR0.66bn in H1 2013, below the EUR0.8bn registered in the same period of 2012, mainly due to a lack of new investment projects and postponed EU-financed projects. Portfolio investment, however, may continue to strengthen given the privatization plans and the still attractive Romanian governmental debt market attractiveness compared to its peers.

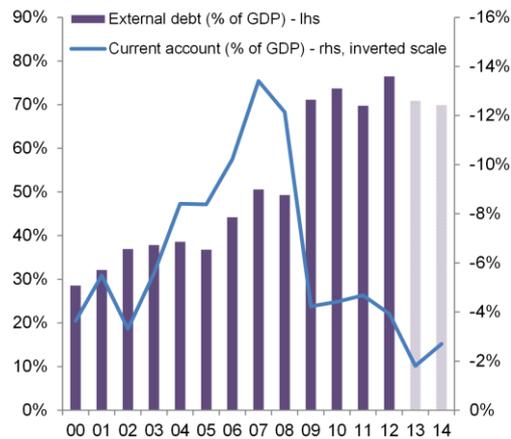
Foreign exchange reserves stagnating

FX reserves held well (EUR32bn in June 2013), despite repayments to the IMF (EUR2bn in 2012) on the back of improving market conditions. The current level of reserves is comfortable with regard to import cover (more than six months). However, reserves cover just about 83% of the estimated external debt payments due in 2014, which is well below an adequate level of at least 100%. Going forward, FX reserves could decrease somewhat on the back of a pick-up in the repayments to the IMF in 2013 and 2014 (about 30% of gross reserves).

External debt to decline going forward

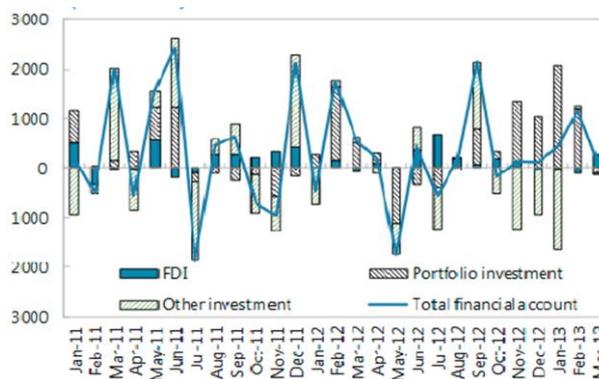
External debt continued to increase, reaching a new high of 76.5% of GDP at end-2012, of which around 20% was short-term external debt. However, external debt is likely to enter a declining trend given the gradual reimbursement (until 2019) of the EUR20bn bailout to the IMF/EU.

Current account and external debt



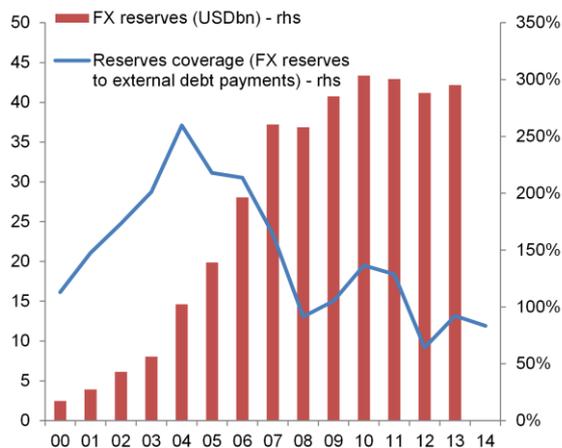
Sources: IHS Global Insight, national sources, Euler Hermes

Financial account breakdown



Sources: IMF, Euler Hermes

Foreign reserves excl. gold



Sources: IHS Global Insight, Euler Hermes

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