S&P Global Ratings (/en_US/web/guest/home)

Outlook On Romania Revised To Negative On Rising Fiscal And External Deficits; 'BBB-/A-3' Ratings Affirme

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Overview

Large spending deviations by the previous government have forced Romania's current leadership to revise up its fiscal targets for 2019 and 2020, against the backdrop of a slowing economy.
Planned wage and pension increases will contribute to a widening of Romania's already substantial current account deficit through 2020.
While we assume significant fiscal consolidation commences next year, the rigid budget structure and volatile policy environment pose risks to that assumption.
We are therefore revising our outlook on Romania to negative from stable, and affirming our 'BBB-/A-3' ratings.

Rating Action

On Dec. 10, 2019, S&P Global Ratings revised its outlook on Romania to negative from stable. At the same time, we affirmed our long- and short-term foreign and local currency sovereign cre ratings at 'BBB-/A-3'.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Romania are subject to certain publication restrictions set out in Art. 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2019 EMEA Sovereign, Regional, And Local Government Rating Publication Dates: Midyear Up (/en_US/web/guest/article/-/view/sourceId/10798236)," published July 2, 2019, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in l circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the reason for the deviation is the rising risk that delayed policy response coul the erosion of Romania's key credit strengths: its modest public and external leverage. The next scheduled rating publication on Romania will be in 2020, with the exact timing publicly availab next "Calendar Of Sovereign, Regional, And Local Government Rating Publication Dates," which will be published later this month.

Outlook

The outlook revision reflects increasing risks to Romania´s economic and fiscal stability should policymakers be unsuccessful stabilizing and consolidating Romania's budgetary stance, includi plans to implement further pension hikes from next year.

Downside scenario

We could lower our ratings on Romania within the next 24 months if:

Fiscal and external imbalances continue to deteriorate and persist for longer than we currently anticipate, with the absence of fiscal consolidation resulting in higher public and external debt tl currently forecast.
A lack of economic policy synchronization leads to an overextension of real wages and increased exchange rate volatility, with potential negative repercussions on public- and private-sector b sheets.

Upside scenario

We could revise the outlook to stable if we observed that the government has made headway in anchoring fiscal consolidation, leading to a stabilization of Romania's public finances and exter position.

Rationale

Policymakers have increased their projections for the budgetary deficit for 2019 and 2020 to 4.3% and 3.5%, respectively, of GDP from 2.8% and 3.0%, signifying a major deviation from origina These revisions largely reflect Romania's new government's transparent decision to settle overdue invoices and arrears with suppliers within the 2019 budget while revising downward its expe for revenue growth.

However, we believe there are grounds to question the realism of the revised budgetary targets over the 2020-2022 period. First, we understand the government intends to stand by the pensi mandated in the July 2019 pension law, leading to over 3% of GDP in cumulative pension spending increases in 2020-2022.

Second, in our view, any plans for offsetting budgetary measures are complicated by the upcoming election cycle. Given that the general government deficit will likely exceed the EU's 3% of GD Excessive Deficit Procedure (EDP) ceiling this year and next, Romania may not be able to avoid the EDP determined by the European Commission under the Stability and Growth Pact. Romania w subject to the EDP from 2009 to 2013.

Third, an economic slowdown would weigh on government revenues, leading to further budgetary pressures. Under our base-case macroeconomic scenario, we assume growth remaining clos through 2022.

Despite these concerns, we have decided to affirm the rating given comparatively low stocks of general government and external debt. The affirmation also reflects Romania's EU membership, benefits its institutional framework, in our opinion. Constraints to the ratings include low economic wealth, relatively weak administrative capacity, an unpredictable policy environment, and or average monetary flexibility relative to peers.

Institutional and economic profile: Short-term political considerations continue to guide policy

Economic growth in Romania should remain just below 4% this year before weakening in 2020-2021, since external demand and wage growth are slowing.
Erratic policy execution, low administrative capacity, corruption, and polarization weigh on our institutional assessment, which is nevertheless helped by Romania's EU membership.
We do not expect meaningful fiscal consolidation before the 2020 elections.
We believe that the volatile political and policy environment will constrain the interim government, headed by Mr. Ludovic Orban, in delivering reliable fiscal consolidation ahead of next year's elections. Should the 2020 budget proposal not achieve parliamentary support in the December budget vote, the prospect for snap elections would rise. The likelihood of this scenario and its are difficult to predict given the fluidity of Romanian politics. Ultimately, we believe that an election and a reset of parliamentary positions would likely be required to form a government with a sufficiently strong mandate to move ahead with a firmer consolidation agenda.

Romania's political environment remains subject to confrontational rhetoric and parliamentary infighting. Political dynamics are in flux because support for the historically dominant Social Dem PSD party has been declining, culminating in the October 2019 no-confidence vote and the landslide re-election of centrist President Iohannis in November. Given the busy election calendar, w anticipate that short-term political objectives will continue shaping Romania's historically procyclical fiscal policy.

The Romanian government has repeatedly deviated from the medium-term objectives stipulated in the EU's Stability and Growth Pact. The planned headline deficits for 2019 and 2020 suggest longer delay in responding to the imposition of an EDP than we had anticipated. That said, we continue to regard Romania's EU membership as an important policy anchor, and we believe the v likely imposition of the EDP in 2020 will ultimately serve to instill fiscal discipline--but not before a new legislative term has commenced. For these reasons, our base-case scenario forecasts s fiscal deficits will start declining from 2021, after the general elections take place.

Romania will likely close 2019 with headline growth of just under 4%, after consumption-led expansion. This follows average wage inflation so far this year of close to 15% alongside increased government that boosts demand. We understand that authorities plan to move ahead with a 7.2% increase in the minimum wage early in 2020, a measure that would likely contribute further to term overheating and an even wider current account deficit.

Over the medium term, however, we believe growth will decelerate as fiscal impetus subsides. For our base-case macroeconomic scenario, we assume growth remaining close to 3% through 20 though we acknowledge that there are near-term uncertainties in either direction.

Over the longer term, Romania's growth prospects will remain constrained by the high net emigration of skilled labor and negative population growth. Structural reforms to address these issue appear to be lacking. High wage growth in recent years has not been accompanied by comparable increases in productivity, which has in part eroded the competitiveness of Romania's exports.

Flexibility and performance profile: External imbalances have widened, but low stocks provide scope for adjustment

We expect general government deficits will reach 4.3% of GDP in 2019 and 4.0% of GDP in 2020.
The funding mix of Romania's current account deficits is shifting, as foreign direct investment (FDI) and capital account flows decrease.
Despite the uncertain fiscal outlook, we expect Romania's central bank to keep inflation expectations under control and maintain adequate foreign currency reserves.
Romania's fiscal deficit is widening more rapidly than we originally projected. In its November budget revision, the new government has announced a deficit of 4.3% of GDP for 2019 compared planned 2.8% deficit of its predecessor. The deterioration stems in part from weaker-than-expected tax revenues but is primarily due to payment of arrears to suppliers. We believe pressures Romania's budget will persist through 2022. The composition of the budget and structure of the deficit suggest imbalances are significant, with spending on wages and pensions now standing over 80% of tax revenue. We consider the fiscal choices made thus far particularly problematic, given the country's challenging demographics.

Weaker fiscal performance stems from the pre-electoral context, which constrains the interim government's room to maneuver. We have revised our forecasts to include in 2020 fiscal expendi 1% of GDP, related to the pension law and only partly mitigated by government's potential offsetting measure. For 2021, we assume the elections will provide the government with a mandate t material elements of the pension increases anticipated in the July pension law. Absent such measures, we project that Romania's fiscal deficit will climb to about 6% of GDP by 2022, with gover debt sharply higher as a share of GDP, implying an increase in interest expenses and further strain on its external position.

Yields on government securities showed fluctuations over 2018-2019, with an increase in the cost of government borrowings. This, in our view, reflects the country's higher financing needs ar greater uncertainty regarding fiscal policy. The widening of government deficits in 2019-2020 has amplified short-term financing requirements. With mounting uncertainty on the prospects of stabilization, this situation could lead to a further rise in funding costs and a higher interest bill. Romania's government debt stood at 35% of GDP in 2018, with government liquid assets repre approximately 5% of GDP. The maintenance of this fiscal reserve buffer will continue to help limit refinancing risk, alleviating the effects on access to financing in the event that foreign investm starts dwindling.

Romania's current account deficits will likely remain elevated through 2022, mirroring the ongoing consumption-led growth and evolution of the government's fiscal position. Strong domestic and softening exports will result in deficits exceeding 5.0% of GDP on average over 2020-2021, in our base case. Perhaps more importantly, we observe that the current account deficit is incre covered by debt-financed inflows, since FDI and capital account flows are moderating. Compared with 2017, deficit coverage by these flows declined to around 70% in 2018 from over 90% and reduced further in 2019 as the current account deficit widened. Moreover, we note a lack of foreign greenfield investments, suggesting that investors might be increasingly hesitant due to the wage growth, lack of infrastructure development, and continuing political and policy uncertainties in Romania. This will likely keep Romania's external debt on an upward trajectory.

The leu's value is determined under a managed float in an inflation-targeting regime, with a target of 2.5%, plus or minus 1 percentage point. We forecast an inflation rate of 4.0% in 2019, and that the inflationary environment will keep the spotlight on monetary policy, due to the need to firmly anchor inflation expectations. Consumer price index-based data shows that the real effec exchange rate has been stable since the end of 2016. However, wage-adjusted real effective exchange indicators suggest overvaluation.

We have observed that the National Bank of Romania (NBR) has countered depreciation pressures on the leu through intervention in the foreign currency market, in particular through Novembe saw a meaningful net outflow of reserves. Failure to anchor fiscal policies will pressure the leu, further complicating the central bank's mission. Over 2019, the NBR has been adamant that an e rate correction as a way to handle the external deficit is not on the table. We expect the NBR to uphold monetary policy credibility, anchor inflation expectations, and keep foreign currency res a solid level. We forecast a controlled exchange rate correction through 2021 in our base scenario as the outlook for fiscal consolidation remains uncertain. Elevated exchange rate volatility co severe repercussions on public- and private-sector balance sheets, in particular because about half of Romania's government debt is denominated in foreign currency. Moreover, an estimated financial sector deposits are denominated in foreign currency, as well as roughly one-third of sectorwide loans.s

Romania's predominantly foreign-owned banking sector remains sound, in our view. The system's loan-to-deposit ratio declined to about 80% at year-end 2018 from its peak of 137% in 2008 Lending growth has remained positive for the past two years, with loans to households and loans denominated in Romanian leu increasing strongly, though this trend has recently decelerated. Nonperforming loans had dropped to less than 5% of total loans by Dec. 31, 2018, from over 21% at midyear 2014. Liquidity and solvency ratios remain strong, and banks have maintained the profitability despite low interest rates.

Key Statistics

Table 1

Romania Selected Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021	
Economic indicators (%)										
Nominal GDP (bil. LC)	635	669	713	765	858	944	1,025	1,101	1,172	1,
Nominal GDP (bil. $)	191	200	178	188	212	240	243	252	268	28
GDP per capita (000s $)	9.5	10.0	9.0	9.5	10.8	12.3	12.5	13.0	13.8	14
Real GDP growth	3.5	3.4	3.9	4.8	7.1	4.0	3.9	3.5	2.9	2.
Real GDP per capita growth	3.9	3.8	4.3	5.4	7.7	4.6	4.2	3.8	3.2	3.
Real investment growth	(5.6)	3.3	7.5	(0.2)	3.6	(3.3)	4.1	4.0	3.1	3.
Investment/GDP	25.6	24.7	25.1	23.3	23.4	24.2	25.2	25.6	25.3	25
Savings/GDP	24.5	24.0	23.9	21.2	20.2	19.6	19.6	20.0	20.3	20
Exports/GDP	39.9	41.2	41.0	41.2	41.5	41.6	41.2	40.9	41.0	41
Real exports growth	20.2	8.0	4.6	16.0	7.6	5.4	5.0	4.2	4.3	6.
Unemployment rate	7.1	6.8	6.8	5.9	4.9	4.2	4.0	4.1	4.1	4.
External indicators (%)										
Current account balance/GDP	(1.1)	(0.7)	(1.2)	(2.1)	(3.2)	(4.6)	(5.6)	(5.6)	(5.0)	(4
Current account balance/CARs	(2.4)	(1.5)	(2.7)	(4.5)	(7.0)	(10.0)	(12.2)	(12.2)	(10.9)	(1
CARs/GDP	45.3	45.8	46.0	45.8	45.7	45.8	45.5	45.6	45.9	46
Trade balance/GDP	(4.0)	(4.3)	(4.9)	(5.5)	(6.5)	(7.3)	(8.1)	(8.7)	(8.4)	(8
Net FDI/GDP	2.0	1.8	1.8	2.7	2.6	2.4	1.8	1.6	1.8	1.
Net portfolio equity inflow/GDP	0.6	0.3	0.1	(0.3)	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)	(0
Gross external financing needs/CARs plus usable reserves	103.6	99.7	95.6	97.8	96.4	98.5	101.0	102.8	104.8	10
Narrow net external debt/CARs	64.1	48.5	40.1	29.0	30.9	32.1	36.5	40.8	43.3	44
Narrow net external debt/CAPs	62.6	47.8	39.0	27.7	28.9	29.2	32.5	36.4	39.0	40
Net external liabilities/CARs	141.8	113.5	114.3	100.8	109.0	104.5	110.6	113.5	114.6	11
Net external liabilities/CAPs	138.5	111.9	111.3	96.4	101.9	94.9	98.6	101.2	103.3	10
Short-term external debt by remaining maturity/CARs	57.1	51.5	43.4	37.1	29.3	28.3	27.2	26.9	26.0	25
Usable reserves/CAPs (months)	6.3	6.3	6.2	5.1	4.6	4.4	4.1	3.8	3.3	3.
Usable reserves (mil. $)	48,818	43,164	38,705	39,959	44,450	42,132	40,517	37,701	36,991	36
Fiscal indicators (general government; %)										
Balance/GDP	(2.1)	(1.2)	(0.6)	(2.6)	(2.6)	(3.0)	(4.3)	(4.0)	(3.2)	(3

Change in net debt/GDP	2.0	1.9	1.5	0.3	2.4	3.4	4.3	4.0	3.2	3.
Primary balance/GDP	(0.3)	0.5	1.0	(1.1)	(1.4)	(1.8)	(2.9)	(2.5)	(1.7)	(1
Revenue/GDP	33.3	34.1	35.5	31.9	30.9	32.3	32.0	32.5	33.0	33
Expenditures/GDP	35.4	35.3	36.1	34.5	33.6	35.2	36.3	36.5	36.2	36
Interest/revenues	5.3	4.8	4.6	4.7	4.1	3.7	4.3	4.6	4.7	4.
Debt/GDP	37.6	39.2	37.8	37.3	35.1	35.0	36.5	38.0	38.9	39
Debt/revenues	112.9	114.9	106.4	116.9	113.4	108.5	114.2	117.0	117.9	11
Net debt/GDP	32.0	32.3	31.7	29.9	29.0	29.8	31.8	33.6	34.7	35
Liquid assets/GDP	5.6	6.9	6.0	7.4	6.1	5.2	4.8	4.4	4.2	3.
Monetary indicators (%)										
CPI growth	3.2	1.4	(0.4)	(1.1)	1.1	4.1	4.0	3.5	3.2	3.
GDP deflator growth	3.4	1.7	2.6	2.5	4.7	5.9	4.5	3.7	3.5	3.
Exchange rate, year-end (LC/$)	3.26	3.69	4.15	4.30	3.89	4.07	4.35	4.40	4.35	4.
Banks' claims on resident non-gov't sector growth	(3.2)	(3.0)	3.1	1.1	5.6	7.9	5.0	4.7	4.3	4.
Banks' claims on resident non-gov't sector/GDP	34.7	32.0	31.0	29.2	27.5	26.9	26.0	25.4	24.9	24
Foreign currency share of claims by banks on residents	37.0	33.7	29.3	25.4	22.0	20.8	31.3	31.3	31.3	31
Foreign currency share of residents' bank deposits	34.1	33.1	32.4	31.3	31.8	33.2	31.0	31.0	31.0	31
Real effective exchange rate growth	4.7	0.7	(3.4)	(1.8)	(1.5)	2.8	N/A	N/A	N/A	N/

Sources: Eurostat (economic indicators), Bank of Romania and IMF (monetary indicators), Eurostat (fiscal and debt indicators), and Bank of Romania (external indicators)

Adjustments: No data adjustments applied

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus th in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid asse by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local curre CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Romania Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	4	Policy choices over the past few years have led to very procyclical fiscal policies and hence weakened support for sustainable public finances. The countr from weak transparency owing to political interference undermining institutional independence.
Economic assessment	4	Based on GDP per capita ($) as per the Selected Indicators in Table 1.
External assessment	3	The Romanian leu is neither a reserve nor an actively traded currency. Based on narrow net external debt and gross external financing needs as per the S Indicators in Table 1.
Fiscal assessment: flexibility and performance	4	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indi in Table 1. Bank exposure to government sector stands at 21% as of March 2019 and over 40% of government debt denominated in foreign currency
Monetary assessment	3	Managed float. Since 2005, the National Bank of Romania has targeted inflation but hasn't moved to a full-inflation targeting framework. It therefore inte in foreign exchange markets. The central bank enjoys operational independence with market based instruments.
Indicative rating	bbb-	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BBB-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt
Local currency	BBB-	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external asse (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordanc S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

Criteria | Governments | Sovereigns: Sovereign Rating Methodology (/en_US/web/guest/article/-/view/sourceId/10221157), Dec. 18, 2017
General Criteria: Methodology For Linking Long-Term And Short-Term Ratings (/en_US/web/guest/article/-/view/sourceId/10011703), April 7, 2017
General Criteria: Use Of CreditWatch And Outlooks (/en_US/web/guest/article/-/view/sourceId/5612636), Sept. 14, 2009
General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments (/en_US/web/guest/article/-/view/sourceId/5402435), May 18, 2009

Related Research

Sovereign Ratings List (/en_US/web/guest/article/-/view/sourceId/11269135), Dec. 12, 2019
Sovereign Ratings History (/en_US/web/guest/article/-/view/sourceId/11269141), Dec. 12, 2019
Sovereign Risk Indicators (/en_US/web/guest/article/-/view/sourceId/10729619), Oct. 10, 2019. An interactive version is also available at http://www.spratings.com/sri (http://www.spratings.com/sri)
Global Sovereign Rating Trends: Midyear 2019 (/en_US/web/guest/article/-/view/sourceId/11080646), July 25, 2019
Default, Transition, and Recovery: 2018 Annual Sovereign Default Study And Rating Transition, March 15, 2019
Sovereign Debt 2019: Eurozone Commercial Borrowing To Increase 1.6% In 2019 (/en_US/web/guest/article/-/view/sourceId/10884350), Feb. 22, 2019

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qua and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decis views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating actior 'Related Criteria And Research').

Ratings List

Ratings Affirmed; Outlook Action

Romania

Sovereign Credit Rating	BBB-/Negative/A-3BBB-/Stable/A-3

Transfer & Convertibility Assessment	A-	A-
Senior Unsecured	BBB-	BBB-
Short-Term Debt	A-3	A-3

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefor read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contai "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsD www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left c Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49 33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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