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Country Focus – Romania

S&P raises Romania´s sovereign credit outlook to stable from negative

On March 10, Standard & Poors revised Romania's sovereign credit outlook to stable from negative and reiterated its current long-and short-term ratings (BB+ and B, respectively). The rating agency said that the government will more likely continue to comply with the IMF/EU conditionalities, thus, helping to further ease external financing concerns. The stable outlook also reflects the government' success with fiscal consolidation and it's determination to proceed with the required fiscal reforms. In addition, the rating agency expects domestic authorities to implement, if necessary, ‘‘adequate policy measures to seek to contain the ongoing deterioration in the banking sector's asset quality."

In my view, the move did not come as a complete surprise, especially as Fitch took similar action in last February. Indeed, the new government has managed to successfully complete the second and third reviews of the IMF program. Romania just received €2.3 bn of funding from 2nd-3rd tranches which brings the total amount of disbursements to €9.3 bn (out of the €20 bn IMF led support package). The funds aim to address the external financing needs, boost currency reserves and help finance part of the budget deficit.

Yet one should not forget that IMF had to revise the fiscal target of the agreement from 4.6% of GDP to 7.3% last year, thus offering the government additional room for policy maneuvering. IMF set the fiscal target at 5.9% of GDP in 2010, which implies a sizeable fiscal adjustment on the spending side. As a result, the implementation of the 2010 budget may well prove a Herculean task because unpopular spending cuts may encounter significant resistance. The government has committed itself to cutting public wage bill by 2 pps of GDP. The press has repeatedly mentioned that this is equivalent of 100,000 lay offs in the public sector. On top of that, the fiscal reforms agenda is particularly heavy: the government (which enjoys a very thin majority in Parliament) needs to go ahead with an unpopular pension reform after the adoption of the fiscal responsibility law.

We expect rating agencies to continue to monitor closely the government´s policies on structural reforms in the period ahead and undertake further positive action if the government shows tangible evidence of success in its fiscal consolidation plans. Currently, only Moody's rates Romania as investment grade. Yet, the most recent outlook revision (by S&P) is undoubtedly good news for the Ministry of Finance, especially in view of the forthcoming Euro bond issue.

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