Romania
Rating Report

BBB- STABLE OUTLOOK

Credit strengths	Credit challenges
• Strong medium-run growth potential • EU membership, access to substantial EU investment fund inflows • Still-moderate public debt	• Rigid budget structure and comparatively weak tax base • Persistent current-account deficits • Moderate reserve coverage

Rating rationale:

Romania's BBB- ratings consider several credit strengths, including strong medium-run growth potential, EU membership with resulting access to significant EU structural and recovery fund inflows, as well as Romania's still-moderate levels of public debt.

Despite these credit strengths, significant challenges remain affecting Romania's BBB- ratings. Firstly, a rigid budget structure and comparatively weak tax base significantly constrain the budgetary outlook and result in structural budget deficits. Secondly, Romania observes elevated current-account deficits, which are the result in part of fiscal imbalance and of weaker competitiveness when compared with other regional trading partners. Lastly, Romania's available reserves are moderate in covering foreign-currency liabilities under more stressed economic scenarios, representing an ongoing balance of payment risk.

Romania's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aa-		+1/3	
Public Finance Risk		25%	bbb		-2/3	
External Economic Risk		10%	b-		-2/3	
Financial Stability Risk		10%	aaa		-1/3	BBB-
ESG Risk	Environmental Risk	5%	aaa		-1/3	
	Social Risk	5%	bb-		-1/3	
	Governance Risk	10%	b		0	
Overall outcome		**bbb+**		**0**	**-2**	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings GmbH

Outlook and rating triggers

The Stable Outlook balances the risks from still-elevated budget and current account deficits against strong growth prospects and ongoing access to EU structural and recovery fund inflows.

Positive rating-change drivers	Negative rating-change drivers
• Sustained and strengthened adjustment of fiscal policies results in a stabilisation in debt through the cycle • Sustained reductions in net external debt, build-up of reserves and/or tangible steps in the longer-run adoption of the euro curtail external sector risks • Romania's institutional weaknesses are redressed, political stability is enhanced more durably and/or the government's capacity for reform were improved	• Elevated budget deficits or a reversal in fiscal consolidation result in substantive deterioration in medium-run debt sustainability • Curtailed capacity to absorb EU investment funds undermines growth and public finance outlooks • Deterioration in market conditions and/or shrinking official reserves raise the likelihood of a balance-of-payments crisis

Ratings and Outlook

Foreign and local currency

Long-term issuer rating	BBB-/Stable
Senior unsecured debt	BBB-/Stable
Short-term issuer rating	S-2/Stable

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Bloomberg: RESP SCOP

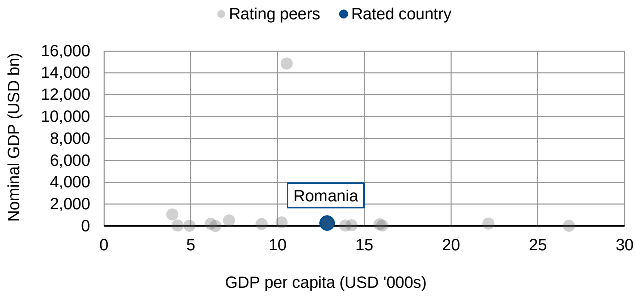
Domestic Economic Risks

- **Growth outlook:** Romania's ratings are supported by strong growth potential in the medium-term, estimated by Scope at 4% annually, raised by the considerable allocation of EU investment fund inflow. Under the EU long-term 2021-27 Budget, Romania has been allocated structural funds of around EUR 50bn (21% of 2021 GDP) under the Cohesion Policy and Common Agricultural Policy, plus another EUR 29.2bn (12% of GDP) via the Recovery and Resilience Facility, of which EUR 14.2bn are in grants with the remaining EUR 14.9bn in concessional loans. This considerable allocation of EU monies helps anchor strategic medium-run investment projects and reduce near-term pressure on public finances, even though historically weak absorption rates of EU funds (of only 55% over the previous 2014-20 EU budget as of end-2021) remain a continued growth bottleneck. For this year, Scope expects a substantial moderation in growth due to significantly higher energy prices, weakened external environment, consumer and investor sentiment. Scope projects growth of 2.5% in 2022, down from a previous forecast of 5% as of December 2021.
- **Inflation and monetary policy**: Inflation (CPI) accelerated to 8.5% Y-o-Y in February 2022, up from an average of 5% in 2021, mostly driven by rising energy and commodity prices. Further strong price pressures are expected in the short-term from the Russia-Ukraine crisis, via higher prices for oil and agricultural commodities. The Romanian government extended the cap on electricity and natural gas prices for households until March 2023 to mitigate the pressure on their budgets. Higher commodity prices and extended supply-chain bottlenecks are likely to result in elevated inflation during 2022-23. To anchor medium-term inflation expectations and to prevent second round effects from supply-side shocks, the Romanian central bank (NBR) initiated a rate-hiking cycle since October 2021, raising the policy rate in three steps of 0.25pps in October, November 2021, and January 2022 to 2%. The NBR increased the step of hiking the policy rate to 0.5pps in February, April 2022, to 2.5% and to 3% respectively. In March, the NBR conducted purchases of government bonds on the secondary market in relatively small amounts (RON 367mn), in the context of worsening liquidity in the capital market and significant increase in government bond yields. Scope does not expect a return to a sizeable purchasing programme anytime soon.
- **Labour markets**: Romania's labour market weathered the Covid-19 crisis relatively well, supported by targeted government discretionary measures for businesses and workers. The unemployment rate stood at 5.7% as of January 2022, unchanged from the 2021 average levels, but still higher than the pre-crisis levels of 5% in 2019. Slowing economic growth is expected to dent labour market outcomes during 2022.

Overview of Scope's qualitative assessments for Romania's *Domestic Economic Risks*

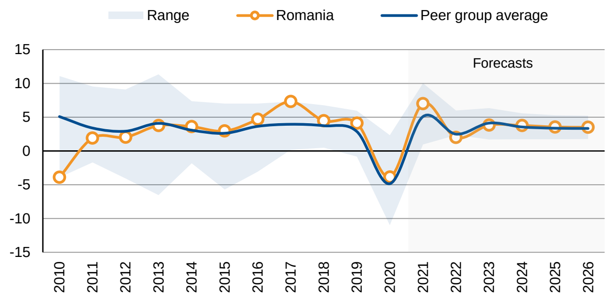
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Growth potential of the economy	Strong	+1/3	Strong growth potential, but challenges from adverse demographics and slow progress on structural reform
	Monetary policy framework	Neutral	0	Adequate monetary policy response during the current crisis
	Macroeconomic stability, sustainability	Neutral	0	Diversified industrial sector; skilled labour shortages

Nominal GDP and GDP per capita



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

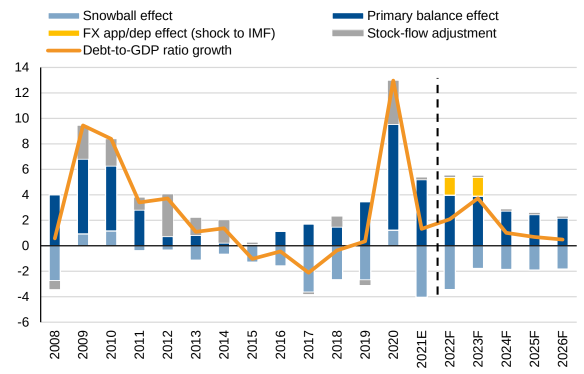
Public Finance Risks

- **Fiscal outlook:** The fiscal policy risks have been reduced due to moderate but vital consolidation measures introduced in the budget since 2021, mostly on the expenditure side in respect to public sector pensions and wages. This implicitly pulls back on multiple years of strongly expansionary fiscal policy. The budget deficit is planned to be reduced to 6.2% of GDP (in ESA terms) in 2022 (based on an economic growth of 4.6%), 4.4% of GDP in 2023 and further to 2.9% of GDP in 2024. Scope expects a more gradual narrowing of budget deficit and projects a deficit of 7.5% of GDP for 2022 due to lower economic growth. In the medium-term, a rigid budget structure and comparatively weak tax base constrain the budgetary outlook. Spending on state pensions and wages alone uses up around 90% of overall tax collections. In the absence of more significant fiscal reform, including an expansion of the tax base (Romania's tax revenues, at 26% of GDP in 2020, are the EU's second lowest after that of Ireland), the medium-run fiscal outlook remains overly contingent upon sustained high economic growth and unsustainable prudence of expenditure policy. In addition, uncertainty over the pace of future pension hikes remains, representing a risk for the budgetary outlook.
- **Debt trajectory:** Under Scope's baseline, the gradual deficit reduction results in a measured increase in Romania's public debt-to-GDP ratio in the medium-term, to 53% by end-2022, from 48.9% in 2021 before stabilising at below a euro convergence ceiling of 60% by 2024. Public debt net of liquid financial assets is estimated to stabilise at around 50% of GDP by 2024. Scope thus assumes a scenario largely consistent with medium-run fiscal consolidation plan of authorities, although with official forecasts conversely envisaging public debt medium run remaining at 50% of GDP.
- **Debt profile and market access:** Romania's ratings are helped by the sovereign's access to domestic and external financing on relatively favourable terms. This is underpinned by its EU membership and the resulting access to sizeable EU fund inflows, which helps finance external deficits, as well as by a mostly foreign-owned and sound banking system, which holds almost half of all Romanian government securities. While the Romanian central bank has shown readiness in the past to absorb extra government debt via secondary market purchases in exceptional cases, any such purchase has been modest in size, mindful of added pressure it could exert on the currency, given a high share of FX borrowing by private and public sectors.

Overview of Scope's qualitative assessments for Romania's *Public Finance Risks*

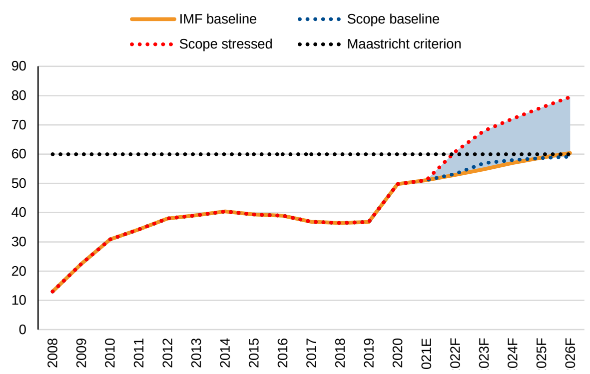
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Fiscal policy framework	Weak	-1/3	Track record of expansionary fiscal policies and excess deficits, rigid budgetary structure; recent introduction of fiscal consolidation
	Debt sustainability	Weak	-1/3	Rising debt burden and elevated structural deficits pose debt sustainability risk; reduced near-term risk due to introduction of fiscal consolidation
	Debt profile and market access	Neutral	0	Access to funding on favourable terms; nonetheless higher financing rates than some peers, risk from FX share of government debt and comparatively lesser access to lenders of last resort as a non-EMU EU state

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

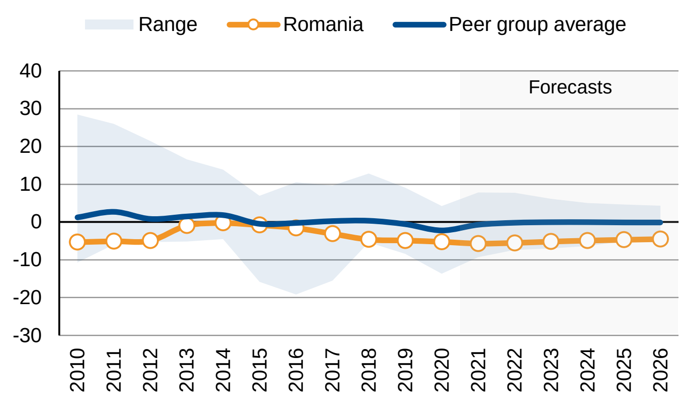
External Economic Risks

- **Current account:** Romania observes elevated current-account deficit, expected by Scope at 8% of GDP in 2022 and 6% of GDP in 2023. Such external deficits are the result in part of fiscal imbalance as well as of weaker competitiveness as compared with that of regional trading partners because of the economy's comparatively higher inflation in the past.
- **External position:** As a result of persistently large structural current-account deficit, Romania's net external debtor position (net international investment position) at 46.5% of GDP as of Q3 2021 remains higher than that of other central and eastern European EU member states. Moreover, in the past three years, the current-account deficit has been increasingly covered by debt-financing inflows, which Scope expects to continue this year. However, Scope projects non-debt-financing inflows to cover most of current-account deficit in the medium-term, due to a front-loaded absorption of EU grants and resumed FDI flows. Additionally, more than half of Romania's gross external liabilities relate to inward foreign direct investment. This curbs the risk of external balance sheets deteriorating markedly during periods of global stress and enhances long-term sustainability of the external position.
- **Resilience to shocks:** Romania's foreign-currency reserves stood at near-all-time high of EUR 41.9bn in February, compared to EUR 35.1bn a year before. While the foreign-exchange reserves cover 86.7% of short-term (by remaining maturity) external debt as of end-January, the Covid-19 and the geopolitical crises have exposed Romania to higher exchange rate risk as well as risk of capital outflows. Romania's available reserves, thus, could come under pressure under more stressed economic scenarios, representing an ongoing balance of payment risk. Scope notes, that a euro liquidity line agreed between the European and Romanian central banks, of up to EUR 4.5bn (equivalent to 12% of Romania's current foreign-currency reserves) until March 2022, has constructively served as a buffer for addressing possible liquidity needs in the presence of market instability due to the COVID-19 pandemic.

Overview of Scope's qualitative assessments for Romania's *External Economic Risks*

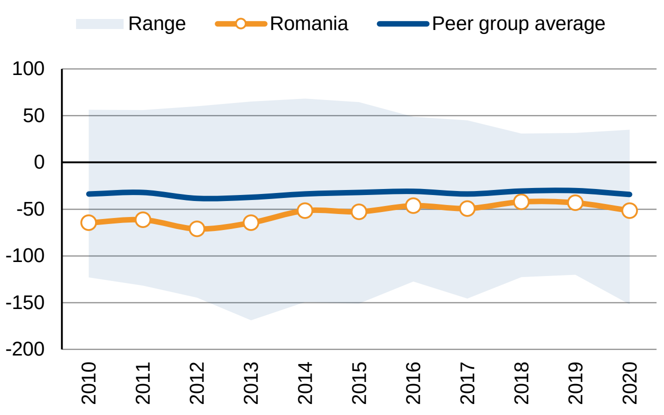
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b-	Current account resilience	Weak	-1/3	External competitiveness weaknesses vis-à-vis trading partners, persistently large structural current-account deficit
	External debt structure	Neutral	0	Sizeable but declining share of direct investments in external liabilities
	Resilience to short-term shocks	Weak	-1/3	Limited available reserves to cover foreign currency liabilities under stressed scenarios

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

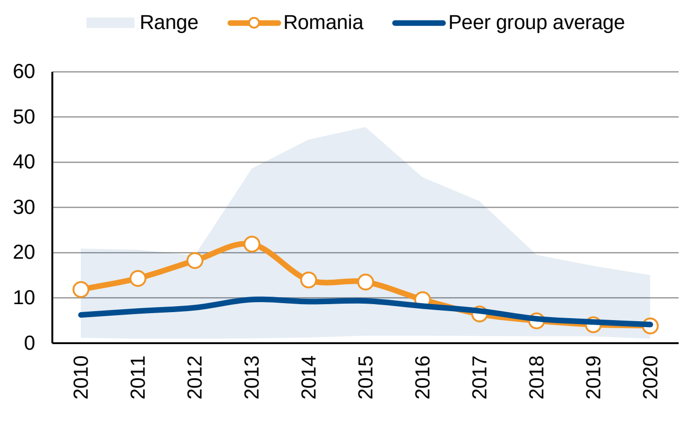
Financial Stability Risks

- **Banking sector:** In Scope's view, Romania's mostly foreign-owned banking sector presents a moderate contingent liability risk for the sovereign balance sheet. The banks are well-capitalized, with system-wide Tier 1 capital ratio of around 21% of risk-weighted assets as of Q3 2021, higher than the EU average of 17%. However, the fact that the banking sector holds almost half of all Romanian government securities increases sovereign-bank nexus. Furthermore, despite significant recent reduction in foreign-currency exposure of the banking system, the share of foreign-currency denominated loans in total loans remains substantial at around 25% as of Q3 2021, nonetheless, down from around 50% in Q3 2015.
- **Private debt:** Non-financial private-sector debt stood at 48.4% of GDP as of end-2020, the lowest in the EU, and only slightly above end-2019 lows (46.7%) but below peaks of 75% of GDP in 2010. Debt of the private sector increased slightly during the Covid-19 crisis in part due to the government's discretionary support measures to households and businesses. However, credit risk in the corporate sector could rise due to build-up of structural vulnerabilities and uncertainty over future economic developments. Such vulnerabilities stem from large number of undercapitalised non-financial corporates in Romania, high reliance of the corporate sector on energy-intensive activities as well as small share of high-tech companies in the economy.
- **Financial imbalances:** The financial intermediation of the Romanian banking sector is among the lowest in the EU, with loans to the private non-financial sector at only 26.5% of GDP in 2021. As a result, there is a sizeable share of underbanked Romanian market, which weighs on economic activity. Nonetheless, the banking system benefits from low non-performing-loan ratio, at 3.4% as of January 2022, after a downward trend posted during 2021. Some deterioration in asset quality is likely due to a negative impact of the current crisis on the financial standing of firms and households.

Overview of Scope's qualitative assessments for Romania's *Financial Stability Risks*

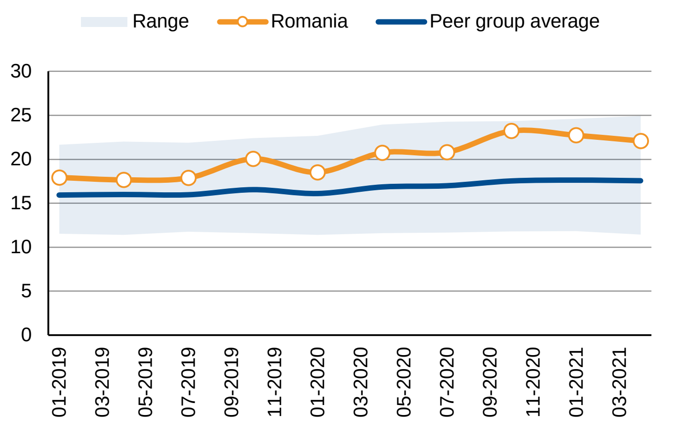
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Well-capitalised and liquid banking sector; profitability and asset quality likely to be impacted by the ongoing crisis
	Banking sector oversight	Neutral	0	Effective supervision; timely and comprehensive regulatory measures taken
	Financial imbalances	Weak	-1/3	Still-elevated foreign-currency exposure in the banking system

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

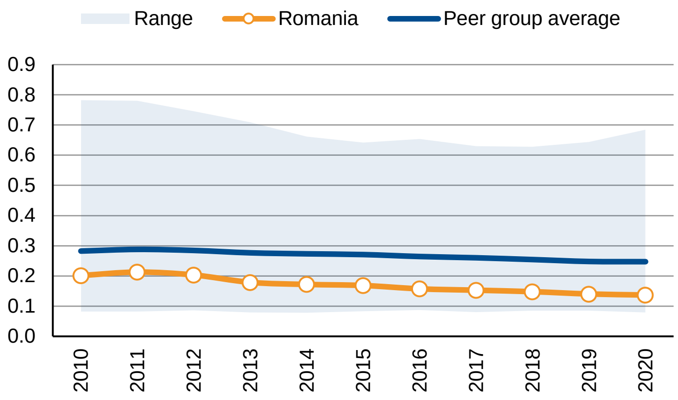
ESG Risks

- **Environment:** Environment-related credit risks of Romania remain significant. The economy displays one of the highest carbon intensities in the EU. The comparative dependence of the Romanian economy upon higher energy-intensity production presents a challenge for policy makers under a context of tightening fiscal policies and needed economic transitions towards the green economy. Romania faces investment needs of around EUR 150bn (7% of GDP annually) to achieve climate objectives through 2030. Here, the current long-term EU budget presents a critical opportunity for Romania to increase production of renewable energies and make possible such transition to lower-carbon economic designs long term. Scope notes that Romania is less dependent on Russian energy sources compared to regional peers due to local production and is expected to increase investment in offshore gas production in the Black Sea.
- **Social:** Social-related credit factors are captured via unfavourable demographic trends reflecting an ageing population and significant net emigration, high income inequality and poverty, that will constrain longer-term growth prospects of Romania and pose budgetary pressures. The old-age dependency ratio (those aged 65 years or over as a percentage of those aged 15-64) is projected to increase to 34% by 2030, from 29% in 2020.
- **Governance:** The near-term political stability under the majority coalition government strengthens credibility of the government's fiscal policy with a higher likelihood that the budgetary programme could see a lengthier period of implementation. However, Romania's poor historical track record with respect to sustained fiscal consolidation, record of unstable government, which increases incentives for periods of expansionary fiscal policy around frequent electoral periods, plus governance bottlenecks in spending control and a substantial overshoot of the fiscal deficit target this year present challenges to its debt sustainability as well as upside risks to baseline debt projections. These challenges are further underscored by an unfavourable demographic profile and ageing population. Acknowledging risks, any reversal in fiscal discipline being observed of current and future governments and/or renewed challenge to the outlook for debt sustainability could see risk for the ratings.

Overview of Scope's qualitative assessments for Romania's *ESG Risks*

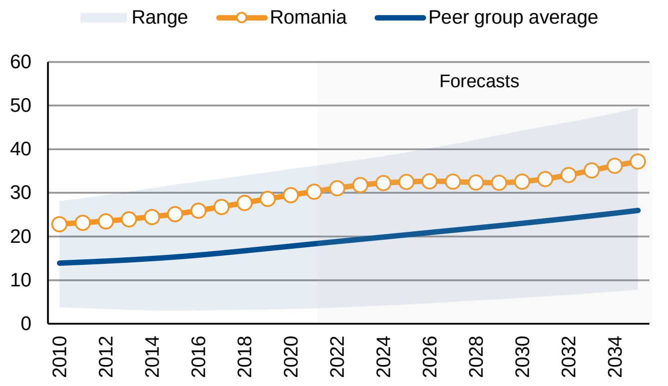
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Environmental risks	Weak	-1/3	High carbon and energy intensity of the economy
	Social risks	Weak	-1/3	Elevated poverty, elevated income inequality, adverse demographics
	Institutional and political risks	Neutral	0	Improved political stability

CO2 emissions per GDP, mtCO2e



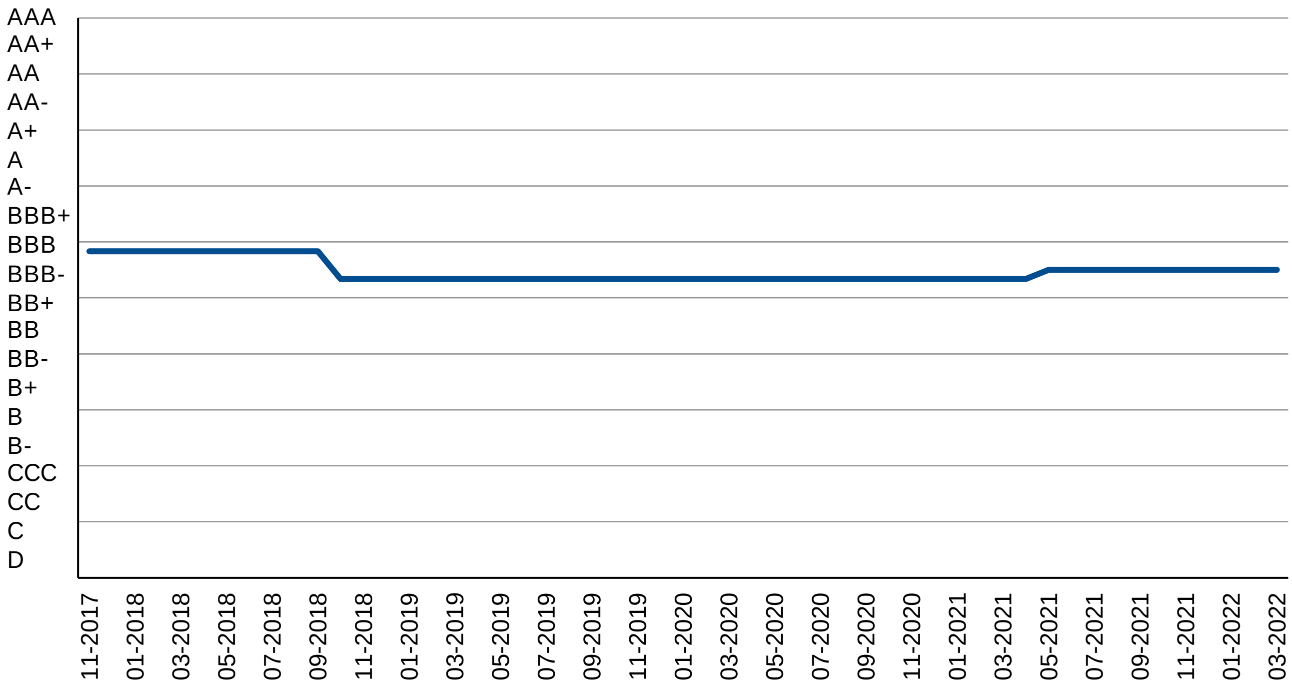
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard.

Peer group*
China
Croatia
Cyprus
Hungary
Portugal

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD 000s'	9.5	10.8	12.4	12.9	12.9	14.9	16	18
Nominal GDP, USD bn	188	212	241	250	249	287	314	344
Real growth, %[1]	4.7	7.3	4.5	4.2	-3.8	5.9	2.5	4
CPI inflation, %	-1.5	1.3	4.6	3.8	2.6	5.0	9	4
Unemployment rate, %[1]	6.7	5.7	4.9	5.0	6.3	5.7	7	6
Public Finance Risk								
Public debt, % of GDP[1]	37.3	35.1	34.7	35.3	47.4	48.9	53	55
Net interest payment, % of government revenue	4.4	4.1	4.6	3.8	4.6	5	6	6
Primary balance, % of GDP[1]	-1.1	-1.7	-1.5	-3.5	-8.3	-7	-7	-5
External Economic Risk								
Current account balance, % of GDP	-1.6	-3.1	-4.6	-4.9	-5.0	-7.0	-8	-6
Total reserves, months of imports	6.2	5.3	4.8	4.5	5.6	4.9	-	-
NIIP, % of GDP	-48.7	-46.6	-43.7	-43.3	-47.7	-45.6	-	-
Financial Stability Risk								
NPL ratio, % of total loans (IMF)*	9.6	6.4	5.0	4.1	3.8	3.6	-	-
Tier 1 ratio, % of risk weighted assets (IMF)*	17.5	18.0	18.6	20.0	23.2	21.4	-	-
Credit to private sector, % of GDP	28.1	26.5	25.7	24.7	26.1	-	-	-
ESG Risk								
CO^2 per 1,000 units of GDP, $mtCO^2e$	156.7	152.2	147.3	139.6	136.3	-	-	-
Income quintile share ratio (S80/S20), x	7.1	7.7	7.6	-	-	-	-	-
Labour force participation rate, %	65.5	67.4	67.9	68.8	-	-	-	-
Old age dependency ratio, %	25.9	26.8	27.7	28.6	29	30	31	32
Composite governance indicator[2]	0.3	0.2	0.2	0.3	0.3	-	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF, World Bank, national statistical office and central bank, Scope Ratings GmbH; * 2021 data relates to Q3 2021

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging market and Developing economy
5y USD CDS spread (bps) as of 8 April 2022	192

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