Romania
Rating Report

BBB- STABLE OUTLOOK

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

Rating rationale:

EU membership, access to substantial EU investment fund inflows: Romania has been allocated EUR 27.1bn (9.5% of 2022 GDP, out of which EUR 12.1bn in grants and EUR 14.9bn in loans) via the EU RRF, alongside structural funds of around EUR 50bn (17.5% of GDP). This substantial allocation of EU monies enhances the authorities' reform agenda and anchors strategic medium-run investment projects in the economy, while reducing near-term pressure on the budget.

Strong medium-run growth potential: Romania's ratings are anchored by strong economic growth potential in the medium-term, which we estimate at 4% annually, raised by the considerable allocation of EU investment funds. We project the Romanian economy to continue growing in 2023 by 2.2%, after an estimated growth of 4.8% in 2022, representing a more moderate slowdown compared to that in most peer economies.

Still-moderate public debt: Under our baseline, the expected gradual deficit reduction will result in a measured increase in Romania's government debt-to-GDP ratio, to 51% by 2023 and 53% by 2024, from 48.9% in 2021, before stabilising at close to 55% medium-run, thus remaining below the euro convergence ceiling of 60%.

Rating challenges include: i) a rigid budget structure and a weak tax base constrain the budgetary outlook and have resulted in structural budget deficits; ii) Romania observes elevated current-account deficits, due, in part, to fiscal imbalance; and iii) moderate reserves to cover foreign-currency liabilities under more stressed economic scenarios, representing a balance of payment risk.

Romania's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	bbb+	RON [+0]	+1/3	BBB-
Public Finance Risk		20%	bbb+		-2/3	
External Economic Risk		10%	cc		-2/3	
Financial Stability Risk		10%	aaa		0	
ESG Risk	Environmental Factors	5%	aa+		0	
	Social Factors	7.5%	b+		-1/3	
	Governance Factors	12.5%	b		0	
Indicative outcome			**bbb**		**-1**	
Additional considerations					**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment 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 Rating Methodology. Source: Scope Ratings

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
• Sustained and strengthened fiscal consolidation anchors debt-to-GDP trajectory • Sustained reduction in current-account deficit, build-up of reserves and/or tangible steps in the adoption of the euro curtail external sector risks • Strengthened capacity for reform, including improvements in EU fund absorption	• Weaker fiscal metrics result in substantive deterioration in medium-run debt outlook • Curtailed capacity to absorb EU investment funds undermines growth and public finance outlooks • Elevated current-account deficit, intensified financing pressures and/or shrinking reserves increase external vulnerabilities

Ratings and Outlook

Foreign currency

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

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

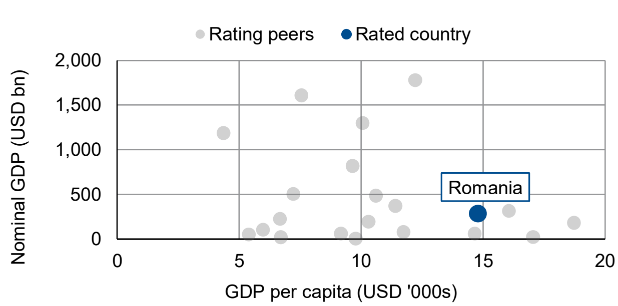
Domestic economic risk

- **Growth outlook:** We project the Romanian economy to continue growing in 2023 by 2.2%, after an estimated growth of 4.8% in 2022, which represents a more moderate slowdown compared to that in most peer economies. Romania's ratings are supported by strong growth potential in the medium-term, estimated at 4% annually, bolstered by the considerable allocation of EU investment funds. Romania has been allocated EUR 27.1bn (9.5% of 2022 GDP, out of which EUR 12.1bn in grants and EUR 14.9bn in loans) via the EU Recovery and Resilience Facility (RRF), alongside EU structural funds of around EUR 50bn (17.5% of GDP). This substantial allocation of EU monies enhances the authorities' reform agenda and anchors strategic medium-run investment projects, including development of physical infrastructure and digitalization of the economy, while reducing near-term pressure on public finances. Scope, however, notes the relatively weak historical absorption rate of EU funds (only 73% of 2014-20 ESIF funds were spent by end-2022), which remains a continued bottleneck. The ability to utilize the considerable EU investment will be a key determinant for Romania's medium-term socio-economic development.
- **Inflation and monetary policy:** Headline inflation (HICP) has likely peaked at 14.6% Y-o-Y in November 2022, with the February figure coming in at 13.4% Y-o-Y. However, we expect elevated inflationary pressures to persist in the near-term due to highly volatile European commodity prices. Average headline inflation is forecast at 10.6% in 2023, after 12% in 2022, falling to 6% in 2024, thus remaining above target (2.5% ± 1pp) for the entire forecast horizon. Elevated inflation highlights a challenging environment for the Romanian central bank (NBR) amid moderating economic growth. The NBR adequately initiated a rate-hiking cycle since October 2021, raising the policy rate to 7% as of January 2023 from 1.25%. Additional rate hikes are not excluded if prices grow faster than expected and depending on the peak rates of the European Central Bank and the Federal Reserve.
- **Labour market:** While labour shortages have intensified in some sectors following the recovery from the Covid-19 crisis, the unemployment rate stabilized at 5.6% as of January, slightly above the pre-crisis level of 4.9% in 2019. Scope does not expect major pressures in the labour market in 2023. However, emigration and ageing population remain key constraints on labour-market performance long run.

Overview of Scope's qualitative assessments for Romania's *domestic economic risk*

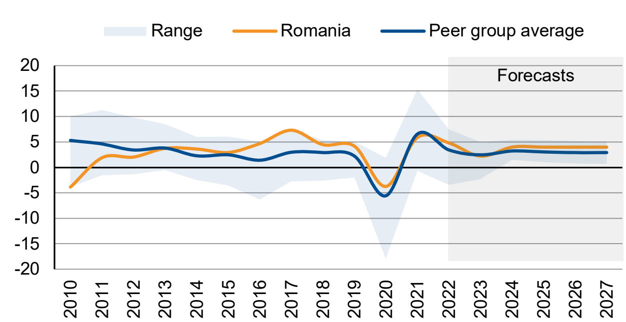
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Growth potential of the economy	Strong	+1/3	Strong growth potential, but challenges from adverse demographics and slow progress on structural reform
	Monetary policy framework	Neutral	0	Adequate monetary policy response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

Nominal GDP and GDP per capita



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

Public finances risk

- **Fiscal outlook:** Romania's ratings are supported by moderate but vital consolidation measures introduced in the budget since 2021, mostly on the expenditure side in respect to public sector pensions and wages, which have reduced immediate fiscal policy risks. This pulls back on multiple years of strongly expansionary fiscal policy. The authorities plan to reduce the budget deficit to 4.4% of GDP in 2023 (in ESA terms) and further to 3% of GDP in 2024 from 6.2% of GDP in 2022 by means of fiscal consolidation through comprehensive fiscal reform, which the government hopes would enable Romania to exit the Excessive Deficit Procedure (EDP). We, however, view the authorities' fiscal plans as ambitious and project a more gradual narrowing of budget deficit, to 5.4% of GDP in 2023 and 4.6% of GDP in 2024 given the challenging macroeconomic environment. We note that the authorities' implementation of pensions reform by 2023 and raising of tax revenue by at least 2.5pps of GDP by 2025, key components for unlocking the generous EU funding under the RRF, will be crucial for Romania's fiscal stability and a credible commitment for budget consolidation. Spending on public pensions and wages together uses up more than 90% of budget tax revenue. Without significant expansion of the tax base (total receipts from taxes and social contributions, at 26.4% of GDP in 2021, are the EU's second lowest after that of Ireland), the health of the medium-run fiscal outlook will remain overly contingent upon sustained high economic growth as well as unsustainable prudence of expenditure policy.

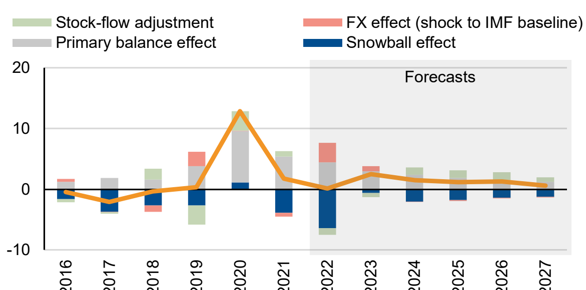
- **Debt trajectory:** Under our baseline, the expected gradual deficit reduction will result in a measured increase in government gross debt-to-GDP ratio, to 51% by end-2023 and 53% by end-2024, from 48.9% in 2021, before stabilising at close to 55% medium-run, thus remaining below the euro convergence ceiling of 60%. Public debt net of liquid financial assets is estimated to stabilise at around 50% in the medium-term. We thus assume a scenario broadly in line with medium-run fiscal consolidation plan of authorities, although with government plans envisaging gross government debt medium run remaining below 50% of GDP.

- **Market access:** Romania's ratings are furthermore helped by Romania's established access to domestic and external funding sources on relatively favourable terms in current difficult market conditions. As of end-February, Romania managed to frontload more than 35% financing planned for 2023 via bond issuances on both domestic and external markets. Scope estimates the gross government financing needs for 2023 at over 10% of GDP, which remain large but still lower than the IMF's 15% high-risk benchmark. Most funds will come from the domestic market, despite already tight sovereign-banking system nexus, with local banks holding around half of the government domestic securities.

Overview of Scope's qualitative assessments for Romania's *public finances risk*

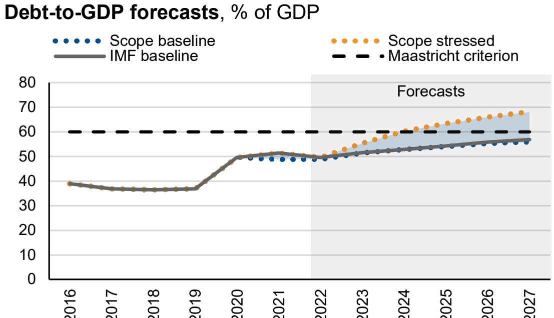
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Fiscal policy framework	Weak	-1/3	Track record of expansionary fiscal policies and excess deficits, rigid budgetary structure; recent introduction of fiscal consolidation
	Debt sustainability	Weak	-1/3	Rising public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

Contributions to changes in debt levels, pp of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

External economic risk

- **Current account:** Romania is set to post another elevated current-account deficit, at around 7.5% of GDP in 2023 after 9.3% of GDP in 2022, affected by highly volatile energy and agricultural commodity prices in the context of the war in Ukraine. Such external deficits are the result, in part, of fiscal imbalances, and high investment needs of the economy with relatively low domestic savings. In the past three years, the current-account deficits have been increasingly covered by debt-financing inflows. However, we project non-debt-financing inflows to cover most of the current-account deficit in the medium-term, benefiting from a front-loaded absorption of EU grants and resumed FDI flows.

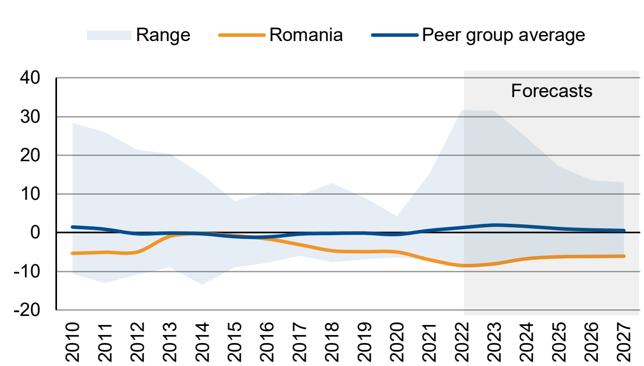
- **External position:** As a result of large current-account deficits, Romania's net external debtor position (negative net international investment position) at 40% of GDP as of Q4 2022 remains higher than that of other central and eastern European EU member states. At the same time, 54% of Romania's gross external liabilities relate to inward foreign direct investment, with this share up from 38% in 2012. This curbs the risk of the external balance sheets deteriorating extensively during periods of global stress and supports long-term sustainability of Romania's external position.

- **Resilience to shocks:** The Covid-19 and the energy crises have exposed Romania to higher exchange rate risk**. T**he NBR's foreign-exchange reserves stood at an all-time high of EUR 52bn in February, compared to EUR 41.9bn a year before. While the level of reserves covers 82.7% of short-term (by remaining maturity) external debt as of end-2022, up from 79.4% a year before, the coverage ratio remains below an IMF adequacy threshold of 100%. Romania's available reserves, thus, could come under pressure under more stressed economic scenarios, representing a balance of payment risk. At the same time, we expect the NBR to continue its measured interventions in foreign exchange market, if needed, to ensure currency stability. About half of Romania's government debt and a third of banking sector deposits are denominated in foreign currency. We note positively that the ECB and the NBR agreed on a euro liquidity line of up to EUR 4.5bn (nearly 9% of the NBR's foreign-exchange reserves), extended until January 2024, which serves as a buffer for addressing possible liquidity needs due to market instability and regional spillover risks in the context of the war in Ukraine.

Overview of Scope's qualitative assessments for Romania's *external economic risk*

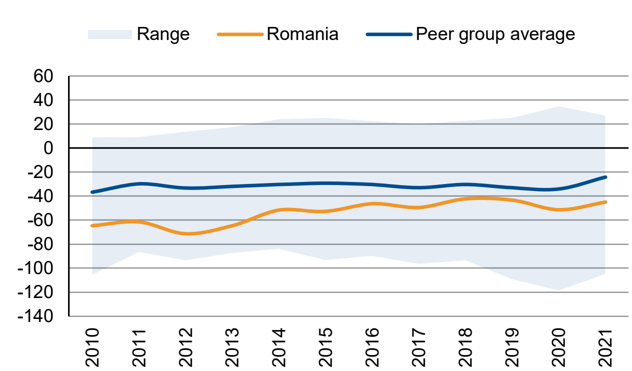
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
cc	Current account resilience	Weak	-1/3	Structural current account deficits, high investment needs of the economy with relatively low domestic savings
	External debt structure	Neutral	0	Sizeable (over 50%) share of direct investments in external liabilities
	Resilience to short-term external shocks	Weak	-1/3	Moderate available reserves to cover foreign currency liabilities under more stressed scenarios

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

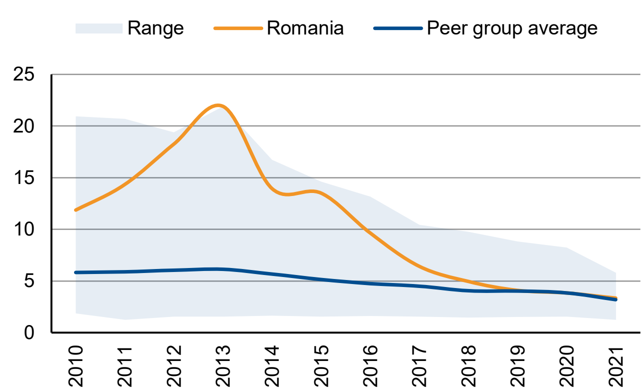
Financial stability risk

- **Banking sector:** In our view, Romania's mostly foreign-owned banking system presents a moderate contingent liability risk to the sovereign balance sheet. Romania's banking system remains stable and well-capitalised with a tier 1 capital ratio of 18.8% at end-2022 and an NPL ratio at a historical low of 2.7%. However, the fact that local banks hold around half of all Romanian government securities issued on domestic markets increases risks from the sovereign-bank nexus. Furthermore, despite significant reduction in foreign-currency exposure in the banking system, the share of foreign-currency denominated loans in total loans remains substantial at around 29% as of Q3 2022, nonetheless, down from around 50% in end-2015.
- **Private debt:** Private-sector (non-financial corporations and households) debt stood at 47.9% of GDP as of end-2021, the lowest in the EU, and only slightly above end-2019 lows (46.5%) but below peaks of 73% of GDP in 2010. Debt of the private sector increased slightly since the Covid-19 crisis in part due to the government's discretionary support measures to households and businesses. Credit risk in the corporate sector could rise due to build-up of structural vulnerabilities and uncertainty over near-term 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 a relatively 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 around 26% of GDP in 2022. As a result, there is a sizeable share of underbanked Romanian market, which weighs on economic activity. Nonetheless, the banking system benefits from low NPL ratio, under 3%, and solid profitability. Some deterioration in asset quality is likely due to a negative impact of the energy crisis on the financial standing of firms and households.

Overview of Scope's qualitative assessments for Romania's *financial stability risks*

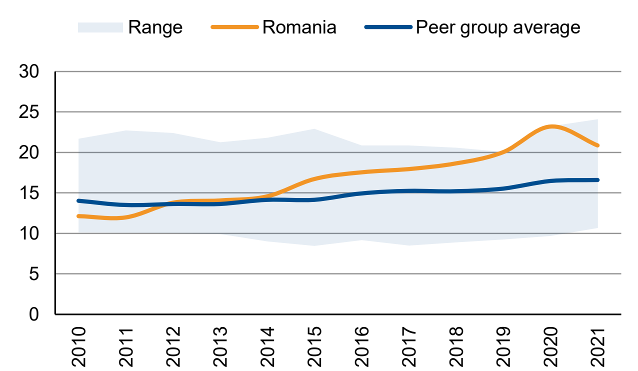
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Well-capitalised and liquid banking sector; profitability and asset quality impacted by crises
	Banking sector oversight	Neutral	0	Effective supervision; timely and comprehensive regulatory measures
	Financial imbalances	Neutral	0	Still-elevated but declining foreign-currency exposure in the banking system; low financial intermediation

Non-performing loans (NPLs), % of total loans



Source: World Bank, Scope Ratings

Tier 1 capital, % of risk-weighted assets



Source: IMF, Scope Ratings

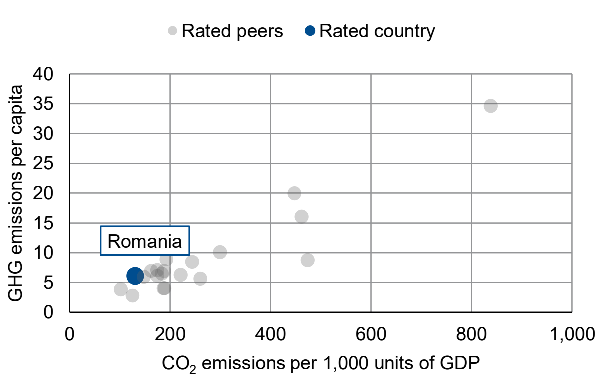
ESG risk

- **Environment:** Environment-related credit risks of Romania remain material. 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 policymakers in a context of tighter financing conditions and needed economic transitions towards the green economy. Romania has estimated 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 facilitate the transition to a lower-carbon economic model. Romania is much less dependent on Russian energy compared to regional peers due to local production and is expected to increase investment in offshore gas production in the Black Sea.
- **Social:** Social factors are captured via unfavourable demographic trends reflecting an ageing population and significant emigration, high income inequality and poverty, that will constrain longer-term growth prospects of Romania, while posing 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 around 35% by 2035, from over 29% in 2021. Romania continues to be an emigration country, albeit net emigration declined to a little over 16 thousand in 2021 from 76 thousand in 2016.
- **Governance:** The improved near-term political stability under the majority coalition government led by the Social Democrats (PSD) and the Liberals (PNL) strengthens credibility of the government's medium-run fiscal programme with a higher likelihood that this programme could see a lengthier period of implementation. However, Romania's uneven track record with respect to sustained fiscal consolidation, record of unstable government, which increases incentives for periods of expansionary fiscal policy around electoral periods, plus governance bottlenecks in spending control present challenges to its debt sustainability. Acknowledging risks, any reversal in fiscal discipline 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 risk*

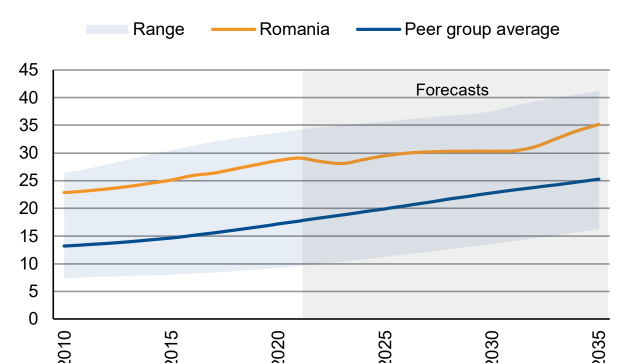
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Environmental factors	Neutral	0	High carbon and energy intensity of the economy, higher energy self-sufficiency compared to peers
	Social factors	Weak	-1/3	Elevated poverty and income inequality, adverse demographic trends
	Governance factors	Neutral	0	Enhanced political stability in the near-term

CO_2 emissions per GDP, $mtCO_2e$



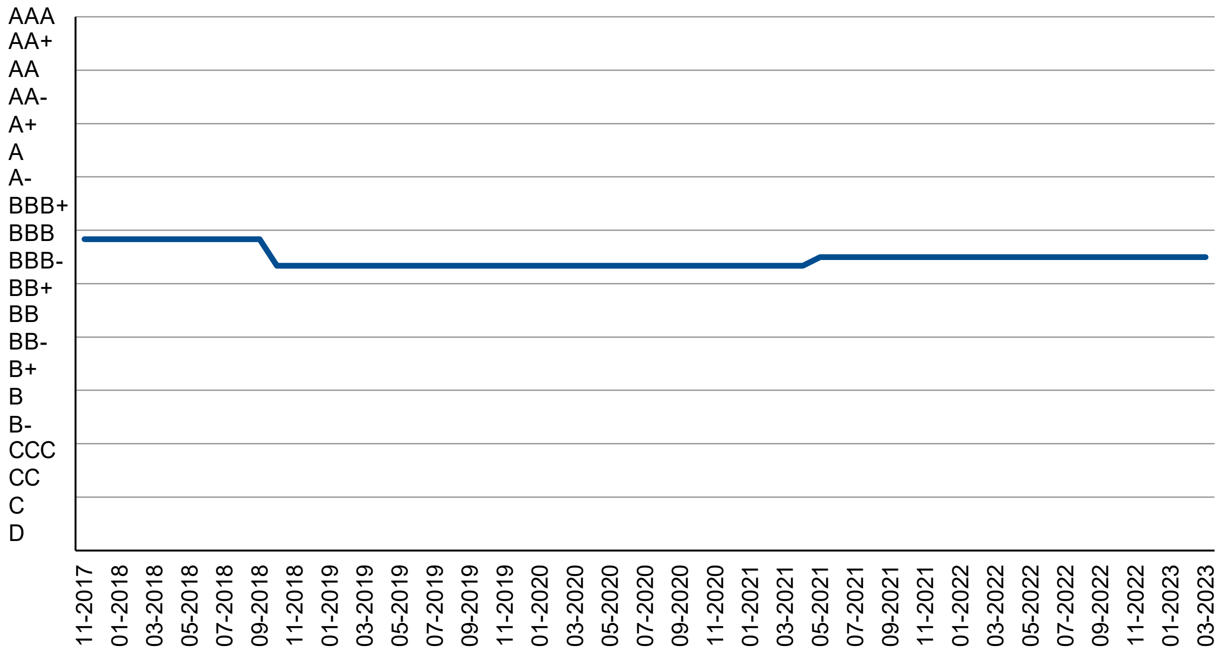
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or adjacent categories, with Scope's core variable scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Bulgaria
Hungary
Turkey

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 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the core variable scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021	2022E
Domestic economic	**GDP per capita, USD '000s**	IMF	10.8	12.4	12.9	12.9	14.8	15.6
	Nominal GDP, USD bn	IMF	211.7	241.5	249.9	249.5	284.1	299.9
	Real growth, %	NIS	8.2	6.0	3.9	-3.7	5.8	4.8
	Inflation, %	IMF	1.1	4.1	3.9	2.3	4.1	12.0
	Unemployment rate, %	Eurostat	6.1	5.3	4.9	6.1	5.6	5.6
Public finance	**Public debt, % of GDP**	IMF/MinFin	35.1	34.5	35.1	46.9	48.9	47.2
	Net interest payment, % of revenue	IMF	3.9	4.6	3.9	4.6	4.8	5.4
	Primary balance, % of GDP	IMF	-1.9	-1.6	-3.8	-8.5	-5.4	-4.7
External economic	**Current account balance, % of GDP**	IMF	-3.1	-4.6	-4.9	-4.9	-7.2	-9.3
	Total reserves, months of imports	IMF/NBR	5.3	4.8	4.5	5.6	4.9	4.4
	NIIP, % of GDP	IMF/NBR	-47.1	-43.5	-43.3	-47.4	-47.0	-40.1
Financial stability	**NPL ratio, % of total loans**	IMF	6.4	5.0	4.1	3.8	3.4	2.7
	Tier 1 capital, % of risk-weighted assets	IMF	18.0	18.6	20.1	23.2	20.9	18.8
	Credit to private sector, % of GDP	WB/NBR	27.4	26.3	25.3	26.5	27.4	25.8
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	152.3	147.8	139.0	131.2	133.5	-
	Income share of bottom 50%, %	WID	16.7	15.3	15.1	15.2	15.2	-
	Labour-force participation rate, %	Eurostat	61.8	62.4	63.3	64.1	65.6	-
	Old-age dependency ratio, %	UN	26.7	27.5	28.1	29.0	29.7	30.3
	Composite governance indicators*	WB	0.2	0.2	0.3	0.3	0.3	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging market and developing economy
5y USD CDS spread (bps) as of 17 March 2023	201

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