ANALYSIS OF ROMANIA'S RATING FROM THE PERSPECTIVE OF THE CREDIT RATING AGENCIES MOODY'S, STANDARD AND POOR'S AND FITCH IN THE 2013-2014 PERIOD

BÂLDAN FLORENTINA CRISTINA[1]
[1]***University of Pitești, baldan.cristina@gmail.com***

Abstract: *In this paper I presented the analysis of Romania's rating from the perspective of the main credit rating agencies assessing the country risk for the 2013-2014 period. The rating improvement by the credit rating agencies might increase foreign investors' appetite for Romanian foreign currency bonds, but also for those in lei (the Romanian currency), to a lower extent. The review of the country rating reflects Romania's rapid progress towards reducing the external imbalances, as well as S&P's opinion that the fiscal situation will continue to be strengthened and the stability of the financial sector will be improved. S&P expects that Romania maintains a constant economic growth rate of 3% on average in the 2014-2017 period.*

Key words: *rating, credit risk agency, country risk*

INTRODUCTION

In relation to Moody's Investment Service, this agency is positioned first in providing risk rates, risk research and analysis. Moody's commitment and its expertise contribute to transparent and integrated financial markets. The firm's ratings and analysis track debt covers more than 115 countries, 22,000 financial issuers and 80,000 structured finance obligations.

The second agency is Standard and Poor's is a highly important risk assessment agency, with offices in 23 countries, more than 1,400 analysts, managers and economists working to identify the variables that affect investments and a history that dates back more than 150 years. It is known by investors worldwide as an intelligence leader on the financial market. Nowadays, Standard and Poor's aims at providing investors worldwide the information required to make profitable investments, which information is provided in the form of credit ratings, indicators, economic research and risk in assessments and solutions.

On the other hand, there is Fitch. The Fitch Group is a global leader in financial information services with operations in more than 30 countries. Fitch Group comprises, in addition to Fitch Ratings and Fitch Solutions, a provider of country risk and industry analysis, Fitch Learning, a prominent and professional training firm.

It has a rating scale very similar to that of Standard and Poor's, the difference being that, in the short term, ratings B and C correspond to speculative securities.

MATERIALS AND METHODS

The paper was prepared based on the reports published by the main credit rating agencies assessing the country risk: Moody's, Standard and Poor's and Fitch for the analysed period.

I presented in this paper a few characteristics of the above-mentioned agencies and the ratings given to Romania in the analysed period as they are presented in the reports published by the three credit rating agencies.

RESULTS AND DISCUSSIONS

The credit rating agency Fitch deems that Romania has consolidated its public finances successfully under two consecutive international financial assistance programmes, and consequently believed that the Romanian Government is to meet its medium term objective of a structural deficit of 1 per cent of GDP in 2014. Also, gross general government debt is expected to stabilise under 40% of GDP in 2013-2015, in line with the category median", Fitch analysts estimate.

In relation to the reduction of the external imbalances, Fitch forecast that in 2013 Romania's current account will be close to balance, a notable improvement from average deficits of 11 per cent of GDP in 2005-2008. However, the agency warned that a projected recovery in domestic demand will produce current account deficits in 2014-2015, albeit at lower levels than the pre-crisis norm.

In relation to the economic growth, Fitch improved its estimates related to the GDP increase up to 2% and expected the growth rate to accelerate in 2014-2015. Nevertheless, average GDP growth appeared insufficient to reduce meaningfully the gap with average EU incomes. Among the reasons for this, there are inefficient state-owned enterprises in key sectors such as transport and energy, and underperforming healthcare and public administration.

The banking sector remains well capitalised and supervised, and has returned to profitability. Fitch does not judge it to represent a significant contingent liability for the sovereign. The absence of an effective framework to clean up banking balance sheets combined with ongoing deleveraging impairs monetary policy transmission and represents a significant obstacle to the resumption of credit growth.

The stable outlook associated to the country risk reflects Fitch's assessment that upside and downside risks to the rating are currently balanced.

In Fitch's opinion, the main risk factors that could individually, or collectively, trigger a positive rating action are: Stronger trend economic growth, as a result for instance of sustained structural reforms to SOEs, as well as Faster reduction in external debt ratios than Fitch currently expects.

The following risk factors individually, or collectively, could trigger negative rating action are a significant fiscal loosening that jeopardises the stability of public finances; A sustained loss of momentum in the implementation of key structural reforms, for instance as a result of political instability; External macroeconomic or geopolitical shocks that erode significantly Romania's fiscal and external buffers.

Moody' and Fitch are the two main financial assessment agencies placing Romania among the countries with low investment risk.

The financial assessment agency Standard & Poor's Ratings Services (S&P) confirmed in May 2013 Romania's "BB plus/B" ratings for long- and short-term debts, the associated outlook being a stable one. The "BB plus" rating given by S&P is the main in the speculative investment category (junk). Standard&Poor's removed Romania from the category of countries with a low investment risk (investment grade) in 2008.

In the Ziarul Financiar newspaper of 20 December 2013 at page 6 we can find the article according to which Fitch refers to the provisions made by our country starting with the first month of 2014, but the risks related to foreign currency loans remain high.

The quality of the assets in the Romanian banking sector will continue to deteriorate in the first half of the year, and additional provisions will be necessary which will affect the capital adequacy ratios, and the profitability of banks will continue to be low in 2014, according to Fitch's report.

In a difficult economic environment, with a fragile recovery, profitability showed a slight improvement compared to 2013 as soon as the non-performing loan level was stabilised.

Contrary to the estimates presented by Fitch, one year ago, the situation in the Romanian banking system continued to deteriorate in the first nine months of 2013, with an increase in the non-performing loans similar to that of the first nine months of 2012. At the same time, the non-performing loan increase pace was accelerated by a decrease in credit balance.

Fitch anticipated that the non-performing loan growth rate would slow down in 2014. At the same time, a broader recovery seems likely, given that the revival of economic activity will be moderate, and banks focus on solving the problem of bad loans, instead of focusing on lending.

Risks concerning the high share of hard currency credits will not go down soon, considering that most of these loans represent consumption or mortgage credits, while crediting, mostly in the national currency is rather slow at present, the report shows.

Capital adequacy rates are at present 2-3% under IFRS levels in Romania (calculated according to international standards of financial report) on the background of prudential mechanisms imposed by Romanian authorities, Fitch notes. The Agency anticipates that the difference will decrease while the level of compulsory reserves will be reduced.

At the same time the financing profile of the Romanian banking sector is improving gradually, the credit-deposit ratio dropping by 10% in the third quarter to 108%, compared to the previous year.

The cash reserve is comfortable, while the financing deficit in foreign exchange is still significant but is gradually closing.

Incomes from overall interest rates of the banks will be affected by the drop of interest rates in lei, the delayed return of crediting and banks focus on local financing sources. Although the appearance of non performing credits is expected to slow down next year, provisions will probably remain at high level, considering the need to increase the coverage rate of existing non performing rates. In this context banks will concentrate on expense and achievement, which may lead to reconsider come credit institutions and to consolidate this sector.

Prospects of the banking sector in Central and Eastern Europe is a stable one, affected by fragile economic recovery and problems with the quality of stock in some markets. In Romania and Hungary negative risks predominate while banks from Poland, Czech Republic and Slovakia will continue to have good performances.

For 2013, Fitch gives Romania the BBB- rating, with a stable perspective. BCR and BDR, the largest banks in Romania, got BBB+ with stable perspective. Transylvania Bank has BB- with stable perspective, while UniCredit Tiriac Bank has BBB with negative perspective.

A top made by Ziarul Financiar in its 28.11.2013 issue concerning the main companies with a low investment risk for foreign investors is as follows:

Table 1.

Top 20 companies with low investment risk

Company position	**Field**	**Value (mil euro)**		**Dynamics 2013 vs. 2012 (%)**	**Value (mil euro)**		
		2013	**2012**		**2011**	**2010**	**2009**
OMV PETROM	Oil & gas	5708	4980	15	3726	4513	3576
ROMGAZ	Oil & Gas	2595	3078	-16	2713	2578	2739
ORANGE ROMÂNIA	Telecommunications	2502	2316	8	2864	3151	3513
FONDUL PROPRIETATEA	Others	2472	1593	55	1410	3800	3500
VODAFONE ROMÂNIA	Telecom	1891	1683	12	2004	2683	3085
BRD	Banks	1450	1328	9	1783	2008	2092
HIDROELECTRICA	Energy	1363	1242	10	3490	3357	3287

AUTOMOBILE DACIA	Automotive components	1331	1079	23	999	866	775
ROMTELECOM	Telecommuni cations	1141	696	18	943	1100	1093
RCS&RDS SA	Telecommuni cations	1056	975	8	567	412	372
BCR	Banks	1018	1088	-6	1802	1898	2263
NUCLEARELEC-TRICA	Energy	729	1030	-44	1344	1747	1800
KAUFLAND ROMÂNIA	Trade	722	552	31	496	421	417
BANCA TRANSILVANIA	Banks	698	660	6	386	491	399
AEROPORTURI BUCUREȘTI	Transports	670	656	2	536	422	500
GDS SUEZ ENERGY ROMÂNIA	Energy	641	515	24	594	621	557
ENEL DISTRIBUȚIE MUNTENIA	Energy	627	560	12	601	640	746
INTERAGRO	Agriculture	613	571	7	237	231	255
ELECTROCEN-TRALE BUCUREȘTI	Energy	598	533	12	423	469	524
BAT (ROMÂNIA)	Cigarettes	592	532	11	434	452	431

Source: Ziarul Financiar, 28.11.2013, page 9

The credit rating agency Standard & Poor's doesn't have better prognoses in our case either. Moreover, this agency deems that Romania's outlook will improve only after five years, Ziarul Financiar notes.

S&P showed that the domestic demand continues to be low, being limited by the reductions in the public spending, the modest wages evolution and the poor investment activities, also resulted from the financial disinterest of the banking sector. The economy would gradually recover by 2016, the GDP advance would reach 2.8% in 2016 compared to 2.2% in 2013.

According to the statement made by BCR chief analyst, the improvement of the positive rating prospect opens the way for an increase of the rating to the category recommended for investments at the end of 2014. The main impediment that keeps Romania's country rating at low levels is an economic growth for too low a successful convergence in the Euro Zone. We can say that we left behind the current account deficit and the budget deficit, we had a major challenge for 2014, namely the acceleration of the economic growth while maintaining financial stability.

From the other two major credit rating agencies, namely Fitch and Moody's, we have in 2013 the "investment grade" rate. While Moody's did not change Romania's rating in these years of crisis, Fitch Rating downgraded our country in the autumn of 2008, and at mid-2011 it upgraded the Romania's rating by one notch, which meant reverting to the investment grade level.

The budget minister declared in October 2013 for the newspaper Ziarul Financiar that he had met, in Washington, members of the top management of the credit rating agencies Standard & Poor's and Moody's. He highlighted that the progress made at economic level should also be emphasized in Romania's rating upgrading, supporting that "it's impossible not to have a rating upgrading for five years".

Romania's rating could be further improved by S&P if the budgetary consolidation programme, the public finance reform, and the restructuring of the state-owned enterprises will be performed in line with this agency's expectations, concomitantly with keeping external imbalances and the stability of the financial sector under control. On the other hand, the rating prospects could be downgraded again to stable if, contrary to the S&P expectations, in the context of the 2014 elections, the budget deficit will increase significantly or the government will back down on the restructuring of the state-owned enterprises. The rating could also be under pressure if external imbalances reappear in Romania's case or if the stability of the financial sector decreases, according to the information communicated by the credit rating agency.

Romania's evolution until 2016 as seen by S&P is exemplified in the table below:

Table 2.

Romania's evolution forecast for the next 5 years by S&P

	2012	2013*	2014*	2015*	2016*
PIB nominal GDP (mld. dollars)	169	183	192	204	216
GDP per capita (dollars)	7.932	8.599	9.036	9.630	10.202
GDP increase (%)	0.7	2.2	2.2	2.5	2.8
GDP share in the budget deficit (%)	-3	-2.5	-2.2	-1.9	-1.8
GDP share in the governmental debt (%)	37.9	38.4	38.5	38.9	39
Inflation rate (%)	3.3	2.4	2.9	2.7	2.7
GDP share in the current account deficit (%)	-4.4	-1.4	-1.4	-1.5	-2.1

**estimates*

Source: Ziarul financiar, 25 November 2013, page 3

In relation to the report for the first quarter of 2013, it highlights that Romania's fiscal problems are far less severe than in other countries which want to adhere to the Euro Zone. The general governmental deficit was reduced by more than a third starting with 2009 at barely more than 3% of GDP and of its debts, and despite the increase it is just 38% of GDP.

CONCLUSIONS

The financial assessment agency Standard & Poor's Ratings Services (S&P) confirmed in May 2013 Romania's "BB plus/B" ratings for long- and short-term debts, the associated outlook being a stable one. The "BB plus" rating given by S&P is the main in the speculative investment category (junk). Standard&Poor's removed Romania from the category of countries with a low investment risk (investment grade) in 2008.

The rating improvement by the credit rating agencies might increase foreign investors' appetite for Romanian foreign currency bonds, but also for those in lei (the Romanian currency), to a lower extent.

Erste analysts believe that: "Regaining the investment grade status from S&P could lead to higher capital inflows in the Romanian Eurobonds and to a certain extent in the leu bonds".

The review of the country rating reflects Romania's rapid progress towards reducing the external imbalances, as well as S&P's opinion that the fiscal situation will continue to be strengthened and the stability of the financial sector will be improved, the communication of the financial assessment agency mentions.

S&P expects that Romania maintains a constant economic growth rate of 3% on average in the 2014-2017 period. Although the rate is slower than that recorded before the 2009 crisis, it is faster than that of the neighbouring countries with a comparable situation.

This evolution highlights the return to relatively healthy bases, even if Romania's income per capita in 2014 is approximately equal to the maximum reached in 2008.

"In 2013 and 2014, the economic growth was supported by the external demand and we expect a gradual shift towards the domestic demand, while net exports will have a slight negative impact on the increase in 2016-2017", S&P's communication specifies.

This evolution should not lead to a dramatic reversal of the progress related to the current account, which we view as being largely structural, the agency notes. The rapid increase in exports and the low demand for imports brought the current account deficit to 1.1% of GDP last year, the lowest level in two decades.

A lower current account deficit also impacts the profile of Romania's external debt, the foreign investments exceeding deficits at least until 2017.

The increased rate of attracting European funds should also provide un surplus of the current account of 1.7% each year, supporting the further reduction of the external debt. Partly, Romania's foreign debt decline is due to the financial sector, where foreign banks have significant funds repatriated since 2009.

Since the signing of the stand-by arrangement with the International Monetary Fund (IMF), Romania underwent two assessments that confirmed the fiscal consolidation trend. Romania also seems to have made progress in the payment of arrears, among which most of the outstanding ones are to state-owned enterprises, in the total amount of approximately 1% of GDP.

Taking into account the "anchor" of the arrangement with IMF, S&P estimates a budgetary deficit maintained at almost 2% of GDP in the medium-term, while the state indebtedness will remain largely unchanged throughout the next three years.

The agency does not expect the burden of the interests on the Government to be reduced, because the improvements in the Romanian yields compared to those of certain reference countries will be annulled by the global interest uptrend of the central banks.

The current interest expenses of 5.5% of the state income, and the net debt of 33% of GDP have a neutral impact on the current rating level and could even provide support for an improvement.

More than 60% of the governmental debt is in a foreign currency, showing a certain vulnerability to the exchange rate variations, S&P warns.

Romania has a flexible regime of the exchange rate, but the independent monetary policy is constrained by the high rate of use of the currency in economy, especially in banking lending. The political uncertainties have not affected the evolution of the economy lately, according to S&P.

The geopolitical risks should stay under control, if the Romania's economic links with Ukraine remain relatively limited, according to S&P analysts, who add that they do not expect direct security implications for Romania.

S&P could improve Romania's rating if the budgetary consolidation program, the reform of the public finance and the restructuring of the state-owned enterprises are successfully implemented, without a change in the current trends in terms of external imbalances and stability of the financial sector.

Romania's country rating could trigger negative rating action if external imbalances reappear or if the stability of the financial sector decreases, or if the budgetary deficit increases significantly.

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