
MONTHLY RISK *BRIEF*:
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01 FEBRUARY RISK OUTLOOK AT A GLANCE

TOP 3 POLITICAL RISKS

- 01 President Traian Basescu's less divisive stance since being re-elected in December 2009 may change now that the government received a vote of confidence from multilateral donors. We expect Basescu to become more vocal in the short-term, as political interests are re-aligned at party political and governmental levels.
- 02 A push by the ruling Liberal Democrats (PDL) for constitutional and electoral law changes to implement the results of the November 2009 Referendum to downsize the Parliament may be just the occasion for the President to re-emerge on the political centre stage. This could upset the shaky balance achieved by the current administration through its focus on securing international funding above all political disputes.
- 03 Both main opposition parties - the National Liberals (PNL) and the Social Democrats (PSD) are entering a period of internal change, including a change in the party leadership.

TOP 3 ECONOMIC RISKS

- 01 Romania's main challenge remains the management of the reforms under the IMF Standby Agreement, especially after the disbursement of two tranches under the loan. After the success in securing the funds, the Romanian authorities may lack the incentive to continue public sector reform.
- 02 Complacency is the biggest short-term risk in Romania as international investors' opinion of the country's prospects is improving.
- 03 Romanian authorities may see the recent appreciation of the currency as permanent and may unwisely refuse further tranches from the IMF, following the Hungarian example.

02 POLITICAL RISK

02.1 President likely to re-emerge as a power-broker

President Traian Basescu (Basescu) is likely to turn his attention to the domestic political scene now that he has succeeded in securing the necessary majority to appoint a PDL government. Basescu has a reputation of meddling in government and his recent focus on foreign affairs, in particular Romania's relations with neighbouring Moldova, is generally viewed as a temporary distraction. He recorded a setback in his commitment to justice reform in January when he could not prevent a former secret police informer to be elected head of the Magistrates' Council. We expect that he will start putting pressure for further corruption charges to be brought against some of his political opponents, especially as the European Union interim report on Romania's performance under the cooperation and verification mechanism is due shortly.

02.2 Internal strife within the opposition parties

Both the PSD and the PNL, the two main parliamentary opposition parties, are likely to enter a period of internal change as the national party conventions are approaching, in March 2010. Mircea Geoana (Geoana), the presidential hopeful and current leader of the Social Democrats, is expected to lose his position at the helm of the party. A main opponent is likely to emerge in Adrian Nastase (Nastase), the former premier (2000-2004), also a one-time presidential candidate, who is supported by the party's power broker, Ion Iliescu. Despite numerous attempts to press corruption charges against him, Nastase has succeeded in staying on the front line of domestic politics and is still viewed as a heavyweight in the party. The contest is likely to be intense, as leaders of other groupings within the party have announced their intention to run for the leadership, including Miron Mitrea, a trade unionist by background and currently a senator. The party remains divided following Geoana's surprise defeat in November's presidential contest. The current leader of the liberal party, Crin Antonescu (Antonescu), maintains a strong hold on the party and is expected to stay on as its leader. However, the party remains divided between those who wanted to join the PDL in government, and Antonescu, who maintain that the PNL should remain in opposition. The changes in the opposition parties should be playing in the hands of the coalition government as it allows them to press on with reforms unabated at least until April 2010.

03 ECONOMIC RISK

03.1 New Government secures IMF funding

Key terms of the IMF agreement

- Term of the agreement: 24 months
- Total funding available: EUR12.95 billion
- Disbursement: 8 tranches
- Disbursement to date: 2 tranches totalling EUR 6.5 billion
- Reviews: 7 quarterly reviews. A second review was completed in January 2010, three months later than planned, as a result of the government crisis and the presidential elections
- The agreement includes quantitative criteria on international reserves and budget arrears. The IMF warned about exceeding the arrears benchmark
- The agreement includes 12 structural conditions

The IMF concluded a second review under the Stand By Agreement (SBA) on 27 January 2010 and recommended the release of two further tranches totalling EURO2.3 billion, most probably in late February. As a result, the World Bank and the European Union are also expected to agree to release funds slated for Romania. This positive outcome gives a strong start to the government appointed in December 2009, after the presidential election and headed by Emil Boc, the premier at the centre of last year's political instability. After being re-appointed, Boc swiftly moved the draft budget through the Parliament so as not to incur further delays in obtaining international financial support. The budget was adopted with all the major indicators as requested by the IMF, including a budget deficit of 5.9% for 2010. Another key element of the IMF accords - regarding cutting the pension budget deficit - is currently being addressed by the Parliament, which is debating a new pensions law. Once adopted, as expected, the new pension legislation should result in a reduction of the pension budget deficit.

We expect that the IMF may introduce new structural terms - to supplement the 12 included in the agreement - in order to monitor better the outcome of the public sector reform and the budget arrears. These conditions are subject to monitoring in the period before the fourth review, due at the end of April. Any new conditions bear the risk of increasing the tension between the government and trade unions. However, the new government has a short window of opportunity for bold reforms of around six months. The structure and timetable of job cuts in the public sector. Any delay in setting out a timetable for the reform is likely to result in a weakening of the negotiating power of the government with the unions.

03.2 Trade unions may stall public sector reform

The government will face increased opposition in its public sector reform efforts from March 2010, as trade unions will protest large-scale redundancies. Resisting this opposition is made more difficult by the lack of clarity in the budget law, which does not specify how many public sector jobs should be axed by the year - end. It is clear, however, that job losses will be significant, with several government members suggesting a range of 80,000 to 120,000.

The sectors with most redundancies are education and public administration. Education trade unions have asked for up to two years' redundancy pay and have presented their strike plans.

03.3 Further currency easing on improved investor perception

In January 2010, the Romanian Central Bank (BNR) cut the interest rate by 50 bps giving an early confidence vote to the new government. We expect a further 50 bps cut in the interest rate at the February board meeting. These cuts, in close succession, are aimed at tempering the sharp appreciation of the RON recorded last month. Furthermore, BNR hopes to avert the scenario of 2007, when it was forced to accommodate higher interest rates to fight inflation. The effect of this policy was to attract large inflows of foreign capital resulting in an aggressive appreciation of the currency and large external deficit. We now expect that the Central Bank will allow inflation to hover at the upper margin of the inflation target band (4.5%) whilst aggressively deal with factors that may destabilise the currency.

Nevertheless, the main short-term risk for currency depreciation will come in March, as the inflow of foreign capital will be lower than expected, due to the uncertainty surrounding public sector reform. Investor dithering would coincide with higher forex demand as foreign corporations pay their profit tax in euro in their home countries.

KEY MACROECONOMIC INDICATORS

- 01 GDP is set to grow in Q1 2010 albeit at a very slow 0.2%. These, together with figures for 2009, underline the depth of the recession.
- 02 The budget deficit is not the highest in the EU. Romania's public debt remains one of the lowest in the EU.
- 03 The adjustment of the current account deficit in 2009 has been extraordinary considering that it decreased by 76%.
- 04 Net foreign direct investments in Q1 2010 is set to continue its decline to amount to 1% of GDP, a slight drop on 2009.

	2005	2006	2007	2008	2009 F*	Q1 2010 F*
GDP growth rate (%)	4.1	7.9	6.2	7.1	-7.4	0.2
Nominal, RON (bln)	289.0	344.7	412.8	504.0	497	96.7
Nominal, EUR (bln)	79.7	97.8	123.7	137.1	117	22.5
Per capita EUR	3687.9	4530.4	5742.5	6364.8	5571	
CPI (yoy, %)						
Average	9.0	6.6	4.8	7.8	5.0	4.8
E.o.p.	8.6	4.9	6.6	6.3	4.8	4.6
Budget deficit (% of GDP)	-1.4	-1.9	-2.5	-5.3	-8.0	-2.5
Total public debt (% of GDP)	20.5	18.4	20.2	21.6	28	
Current account balance (% of GDP)	-8.6	-10.4	-13.6	-12.3	-4.4	
Net FDI (% of GDP)	6.5	9.3	5.7	6.6	5	1
Forex reserves (excl. gold, EUR bln)	16.8	21.3	25.3	26.2	28	30
Gross external debt (% of GDP)	38.8	42.0	47.6	52.9	60	62
Central bank key interest rate (%) eop	7.50	8.75	7.50	10.25	8.00	7.50
Broad money supply (yoy %)	33.9	29.4	33.9	17.5	11	5
Exchange rate (RON/EUR)						
Year end	3.68	3.38	3.61	3.99	4.31	4.26
Average	3.62	3.52	3.34	3.68	4.25	4.3

Source: All data from the BNR or the National Institute of Statistics unless otherwise states.

*Marker Global forecast.