

Perspectives on Romania's Sovereign Risk in the Context of Regional Political Tensions

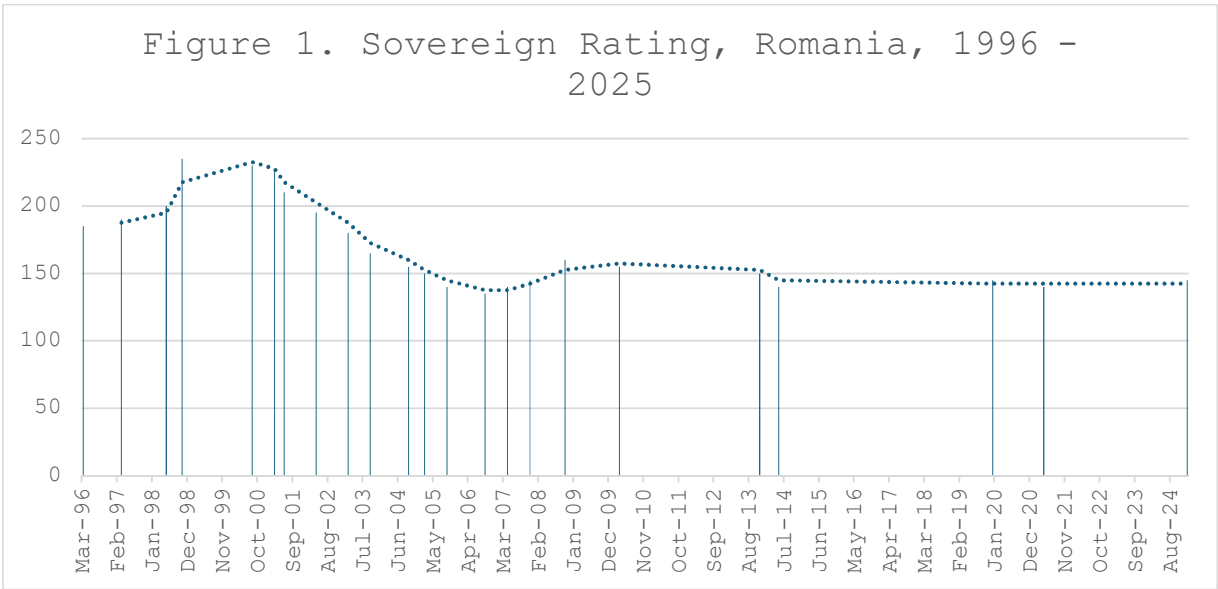
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Introduction

Romania's Sovereign Risk was first assessed in 1996, with the aim of facilitating the attraction of financial resources, in the form of bonds, from external markets. Since then, this risk has been regarded both as an indicator of the likelihood that the country may not be able—or may not be willing—to meet its external debt obligations, and as a synthetic image of the quality of its macroeconomic framework. Sovereign risk is important because it affects capital inflows in the form of foreign investments, influences the volume and cost of external financing, serves as a trigger in prudential supervision, and impacts the rating of private entities. In a global world, where capital seeks the best risk-return ratio, a good sovereign risk rating provides competitiveness and financial stability.

The Evolution of Romania’s Sovereign Risk during the period 1996–2024

To visualize the evolution of sovereign risk, a numerical transformation of the sovereign risk rating was used, based on the evaluation scale employed by the rating agency Standard & Poor’s (S&P). Thus, within each risk class—from AAA to D—three subcategories were detailed, corresponding to the three possible outlooks: positive, stable, or negative. A score of 0 was assigned to the lowest risk, as it corresponds to a historical default rate of 0. The scoring then increased in steps of 5, up to a score of 355, which corresponds to the maximum risk.



Source: Standard&Poor’s, 2025

The chart highlights a downward trend in sovereign risk and the two major crises that Romania has faced: the internal crisis, which began with the collapse of the banking system during 1997–1999, and the international financial crisis of 2007–2009. Since history often serves as a good teacher, it is interesting to highlight the most important factors that worsened sovereign risk at the

end of the 1990s: negative economic growth (-4.57% in 1997), a destabilizing budget deficit (-4.47% in 1997), mainly due to subsidies granted to inefficient state-owned enterprises, quasi-fiscal operations such as subsidized and directed lending from the National Bank to agriculture and the energy sector, banking fraud and tax evasion, a current account deficit (-5.91%), deterioration in relations with the IMF and the World Bank, insufficient foreign direct investment (FDI covering only about 57% of the current account deficit), a sharp increase in external debt (by more than 19% in one year, 1996–1997) and its related interest costs, disinflation driven by restrictive monetary policy rather than structural reforms, incoherent governance associated with a high level of corruption, and the continuation of the political crisis, which led to a change of government in 1999. Many of these factors have reappeared in various forms and levels over the past three decades.

The improvement in sovereign risk from 2000 to 2007 was driven by enhanced macroeconomic management, facilitated by the EU accession process and favorable global economic conditions. Key factors in Romania's transition from speculative to investment-grade risk included: restructuring and privatization of state-owned enterprises (over 7,000 companies, including the largest bank in the system, were privatized), fiscal reform that reduced the budget deficit to below 3% of GDP (through spending cuts, improved tax collection, and the introduction of a flat income tax rate of 16% for both individuals and corporations), financial sector reform (bank capitalization and modernization of prudential supervision), and administrative reform (alignment with EU legislation and establishment of the National Anticorruption Directorate). Average economic growth during this period exceeded 6.5%, increasingly driven by consumption, which in turn was fueled by rapid wage growth and expansion of credit. The 13.7% current account deficit in 2007 became unsustainable with the outbreak of the global financial crisis and was the main cause of Romania's rating downgrade in October 2008, along with the sharp increase in external debt (over 32% in 2008). Political context also played a role: elections and the replacement of a right-wing government with a center-left one were seen as unfavorable for country risk (Block, Schrage and Vaaler, 2003). The international crisis reduced lending and consumption, which positively impacted the current account deficit, while the resumption of economic growth after 2011 helped correct the budget deficit.

In 2014, after six years in junk status, rating agencies upgraded Romania to BBB- investment grade. The factors contributing to this improvement included the slowdown in public debt growth, a sharp adjustment of the twin deficits, and the reduction of arrears in the economy.

In 2019, the upcoming elections again reduced the quality of governance, leading to a negative risk outlook in December 2019 due to fiscal slippages (a budget deficit exceeding 4%, driven by increased wages, pensions, and subsidies, and hesitation in restructuring state-owned companies), a decline in the coverage of the current account deficit by FDI (from 90% to 70%), expectations of rising public debt and its cost, public policy volatility, and political instability related to the elections.

The pandemic did not worsen the situation; on the contrary, in 2021 Romania's rating stabilized, thanks to the resilience shown by the Romanian economy and the government's commitment to the National Recovery and Resilience Plan.

A first conclusion that emerges is that for nearly three decades, three issues have been recurrent in Romania's sovereign risk narrative: the budget deficit, the current account deficit, and political instability, which intensifies during election periods.

Romania's Sovereign Risk: 2025 and Beyond

The year 2024 was an election year in Romania, culminating in an unprecedented event: the annulment of the first round of elections held in December 2024—a decision without precedent in democratic countries or the European Union. Political fragmentation is not new in Romania; for over 15 years, successive governments have relied on fragile parliamentary majorities. Since 2009, the country has had no fewer than 21 prime ministers. What was novel in these parliamentary and presidential elections was the unusually high score of extremist parties, self-proclaimed sovereignist, which received 32.31% of the vote. Another notable element was that this support largely came from the diaspora—Romanians abroad—previously known for defending democracy and being pro-European. Lastly, voter polarization between sovereignists and pro-Europeans echoed the polarization seen in the early post-communist years, particularly the June 1990 miners' riots, when freedom of expression was severely curtailed, and violent miner interventions were used by authorities as both a tool and pretext to crush protests against the neo-communist government. Many historians argue that the 1990 miner intervention significantly delayed Romania's development compared to its regional peers, by stalling reforms and enabling the continuation of governance by former nomenklatura and neo-communists (Berindei et al., 2010).

Following the 2024 parliamentary elections, three extremist parties entered Parliament: The Alliance for the Union of Romanians (AUR), the SOS Romania Party, and the Party of Young People (POT), which together are holding now 154 out of 465 seats in Parliament. Their rise was further validated by the high score in the December 2024 presidential elections of independent candidate Călin Georgescu, backed by sovereignists, who secured 22.94% of the vote, positioning him as the front-runner. Georgescu used legally permissible but manipulative strategies, reminiscent to some older generations (born 1940–1975) of Ceaușescu-era propaganda and the violent 1930s–1940s Iron Guard movement in Romania, which most historians link to Nazism. His campaign program, titled "Food. Water. Energy. A Return to the Roots of the Romanian Nation," employed emotionally charged, often contradictory words like "the people," "traditional family," "love," "Christianity," "national rebirth," "slavery," and "dignity." These appeared in nearly every speech—Georgescu was charismatic, but incoherent and lacking substantive policy. The program mentioned actions to be taken without detailing how they will do, how they would be financed, or what the estimated impact would be. While not explicitly anti-European, it was rife with populist and ambiguous statements open to subjective interpretation. His campaign was emotion-driven, not logic-based, and succeeded in fragmenting society to the point where rational argument was replaced by personality cult. He claimed to have had a zero-budget campaign, raising suspicions about financing sources. His chances were real, as his opponent was poorly prepared, uncharismatic, and backed by a minor party.

The Constitutional Court (CCR) annulled the elections, citing vote manipulation via disinformation, violations of digital electoral laws, and opaque campaign financing. This decision was based on classified reports from Romania's Supreme Defense Council (CSAT), declassified

for CCR judges but not yet available to the public. The annulment further deepened internal social fragmentation and raised both domestic and international concerns about Romania's democratic integrity.

In addition to internal political risk, Romania faces significant external security risks due to the war in Ukraine and international disputes surrounding it. As a NATO and EU member bordering Ukraine and Moldova, Romania stands at the intersection of Western institutions and Eastern instability. This geographic exposure to potential or active conflicts has heightened investor sensitivity to Romania's regional political risk, though its Western alliances act as a stabilizing force.

This is the political context that marked the beginning of 2025 and understandably led to the downgrade of Romania's sovereign outlook from "BBB- stable" to "BBB- negative" between January and March 2025.

Economically, the main vulnerability has been the budget deficit, accompanied by a deteriorating external current account due to slowing economic growth (0.8%). Additional vulnerabilities include the rapid rise in government debt from 48.9% of GDP in 2023 to 54.3% in 2024, increased debt interest payments from 5.7% to 6.3% of revenues in the same period, inflation at 5.8%, low current account deficit coverage by FDI (about 30%), and pro-cyclical economic policies.

The May 2025 elections brought two very different candidates head-to-head: one supported by AUR, and another independent but endorsed by pro-European parties. AUR candidate George Simion adopted the sovereignist's campaign strategy and program, winning the first round decisively with 40.95% of the vote but securing only 46.4% in the runoff. Nicușor Dan, though uncharismatic, had an impressive CV and delivered a rational, balanced, pro-European message, ultimately winning the presidency. The period between the two election rounds was turbulent, marked by capital outflows and depreciation of the Romanian leu. Fears emerged of Romania falling into Russia's sphere of influence, foreign investor withdrawal, and isolationism.

Post-election, Romanian society remained deeply divided between pro-Europeans and nationalists. The large vote share for extremist parties cannot be explained solely by manipulation or the global rise in extremism. Objective factors included high perceived corruption (46/100 on the Corruption Perceptions Index), income polarization (Gini index of 33), regional development disparities (with GDP per capita at 190% of the EU average in Bucharest-Ilfov but only 47% in the North-East), and persistent poverty affecting over 30% of the population—one of the highest rates in the EU.

On the positive side, Romania has reaffirmed its pro-European and pro-NATO orientation, potentially enhancing its credibility and influence among European partners. EU membership anchors Romania in a framework of economic support and oversight, providing access to substantial EU funds that can spur investment and growth if effectively utilized. EU membership also implies a political commitment to market-oriented reforms and rule of law, supporting long-term creditworthiness. NATO membership ensures geopolitical stability and has encouraged Western investment.

The current economic landscape is dominated by the need for fiscal stabilization. Economists believe that credible fiscal consolidation post-2025 elections will be critical to maintain investment-grade status. Romania has the EU's largest fiscal deficit—9.3% of GDP in 2024, far above the Maastricht 3% limit. Rating agencies note this is more than double the median for BBB-rated sovereigns (~3.2%). This deficit was driven by major increases in public wages, pensions, and other expenditures.

A consolidation package adopted in late 2024 (freezing public wages and hiring, improving VAT and income tax collection, state-owned enterprise reform, etc.) is expected to slightly reduce the deficit to 8.6% of GDP in 2025 and 8.4% in 2026. Still, Romania will significantly exceed peer deficit levels without further measures.

The governing coalition is discussing a new fiscal package (not yet public), with rumored measures including:

- Raising VAT from 9% to 19% and 5% to 9% for certain goods, or a general VAT hike to 21% while keeping some exceptions.
- A 20% solidarity tax for high incomes (a high income can be considered 2,000, 3,000, or 3,500 euros) or a progressive income tax.
- Taxation on income from platforms (e.g., TikTok), stock market and real estate transactions.
- A flat or percentage tax on banking transactions.
- Increased excise duties on alcohol and fuel.
- Heavier taxation on gambling.
- Eliminating exemptions from social security contributions.

Corporate taxes are expected to remain stable or see minimal increases. However, these measures could curb consumption and risk recession and heightened poverty. A poorly designed progressive income tax may harm the still-small middle class and encourage labor tax evasion. Given the fragile political backing of the current president and government, these reforms could generate backlash. Without clear communication and effective implementation, political instability, social fragmentation, and the risk of extremism could grow—negatively impacting sovereign risk.

Conclusions

Romania's sovereign risk is now increasingly influenced not only by domestic fiscal and economic dynamics but also by the shifting geopolitical landscape in Eastern Europe. Three vulnerabilities have proven recurrent throughout history: the budget deficit, current account deficit, and political instability. The country is at the bottom of the regional league in credit terms – only non-EU countries are rated lower in Eastern Europe. Yet Romania also possesses major strengths: EU and NATO membership, a track record of growth, the second-largest economy in Central and Eastern Europe, and debt levels that remain manageable—provided decisive action is taken. The next year will be critical. A credible budget adjustment and political stabilization could stabilize the outlook and keep Romania on the investment-grade track.

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