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# SOME INSIGHTS ON WHY ROMANIA SHOULD BE DOWNGRADED TO JUNK STATUS IN 2025

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**Abstract***: In 2025, Romania's potential downgrade to junk status could be driven by a combination of worsening fiscal health, political instability, economic slowdown, and external challenges. A downgrade would likely reflect a loss of confidence in the country's ability to maintain economic stability, service its debt, and attract investment. However, such a scenario would likely be preceded by warning signals, such as increased debt levels, budget deficits, economic contraction, or growing political unrest. Downgrading a country's credit rating to «junk» status is a serious financial move and would typically be based on a range of economic, fiscal, and political factors. If Romania were to face such a downgrade in 2025, the reasons could stem from several issues. Rising government debt level, which is today almost 54% of the GDP, it could become a concern for investors, especially if the country struggles to meet its debt obligations or service the debt. The 7% annual budget deficit negotiated with the European Commission could be in peril and if it increases, it could create uncertainty around the ability to manage public finances effectively. The fail to enact sufficient reforms to stabilize Romania's finances combined with a lack of political will to implement harsh fiscal consolidation measures could lead to a downgrade. If the economy slows down significantly or enters a recession, it could raise doubts about the country's future economic prospects, and the USA tariffs are a big push in that direction, hitting the country traditional European trade partners, due to the fact that more than 70% of goods and services are traded with the EU. Due to these factors, the paper addresses the possibility of a downgrade to JUNK status for the Romanian economy, and what the economic impact should be, plus the necessary measures that have to be addressed in order to put the economy back on track. The paper will analyze statistical data from Eurostat, UNCTAD statistical data base, and TradingEconomics in order to assess the impact and possible measures in comparison the what Greece and Argentina did in order to improve their countries rating. Romania doesn't have to invent the weal; it can learn from other countries best case scenarios and the good case measures that those economies have taken. Despite some credit agencies downgrade, the Romanian economy has the potential to recover quickly, supported by strong domestic measures, resilient growth sectors, and a proactive governmental approach to economic stability.*

**Keywords:** *rating agencies, junk downgrade, reforms, economic outlook*

**JEL Classification:** *F33, F34, H18*

## 1. Some insights on the impact of rating agencies downgrading process

When a country's credit rating is downgraded by the top three rating agencies—Moody's, Standard & Poor's (S&P), and Fitch—it can have a domino effect on its economy. These downgrades indicate that the country is now viewed as a higher risk for lenders and investors, which directly impacts its financial health.

Credit ratings essentially act as a signal to investors about the likelihood that a country will repay its debts. A downgrade means that the country is seen as less trustworthy. To compensate for the perceived risk, international lenders demand higher interest rates on loans. This makes borrowing money more expensive for the government, which can strain its budget.

A downgrade often triggers a lack of confidence among foreign investors, leading to a sell-off of the country's currency. This devaluation means the currency loses value compared to others, such as the US dollar or the euro. While a weaker currency can benefit exports by making them cheaper for foreign buyers, it also makes imports more expensive. This can drive up the cost of living for citizens.

The financial markets react quickly to credit rating downgrades. Investors tend to pull their money out of riskier markets, leading to a drop in stock prices. Domestic businesses that rely on loans to grow may face higher borrowing costs, making expansion difficult. This loss of confidence can lead to reduced investments in the country's economy overall, causing a slowdown in economic activity.

With increased borrowing costs, governments often have to tighten their belts. This could mean reducing spending on essential public services, education, healthcare, and infrastructure projects. Such cuts can lead to slower long-term growth and worsen the quality of life for ordinary citizens.

If borrowing costs remain high and economic activity slows, the country may face the risk of a recession. A recession is a period of economic decline, often marked by rising unemployment and reduced consumer spending. In this scenario, businesses may shut down or downsize, creating further hardship for citizens.

Perhaps one of the most damaging effects of a downgrade is the loss of trust from global investors. A poor credit rating can deter foreign companies and institutions from investing in the country. It can also discourage potential trade partners, complicating the country's efforts to stimulate growth.

These factors combined slow economic growth and can even push an economy into recession, affecting businesses, governments, and citizens alike

## 2. Literature review

This literature review examines existing research on the economic impact of sovereign credit downgrades, focusing on its immediate and long-term effects on the economies of various countries. Researchers have studied the role of rating agencies in financial markets, focusing on their impact on investor behavior and the macroeconomic implications of their decisions. The Standard & Poor's (2011) report on downgrading the US credit rating sparked a debate on the role of rating agencies in global financial stability. Kiff et al. (2012) examined the history of government bond downgrades and highlighted the economic significance of these events.

The immediate impact of a downgrade is often felt in financial markets, particularly in bond yields, stock market performance, and currency values. Cantor and Packer (1996) found that ratings downgrades can lead to large bond price movements, with the short-term effects being more pronounced in emerging markets than in developed markets. Eichengreen and Mody (2004) argue that ratings downgrades, especially in emerging markets, can lead to currency depreciation, which can worsen current account balances. In addition to the immediate market impact, downgrades can also have lasting effects on a country's economy. These effects include lower foreign direct investment (FDI), slower economic growth, and higher unemployment. Reinhart and Rogoff (2010) highlight the negative correlation between sovereign ratings downgrades and GDP growth, with the severity of the downgrade being a key factor in determining the magnitude of the downgrade. Afonso et al. (2011) studied the relationship between sovereign credit and FDI inflows and concluded that rating downgrades tend to lead to a reduction in FDI, especially in emerging markets.

Countries that experience a credit rating downgrade often take a range of policy measures to stabilize their economies. Beetsma and Giuliodori (2013) study how eurozone countries face greater tightening pressures after a rating downgrade, which in turn affects their macroeconomic stability. Ardagna (2009) studies the effectiveness of monetary and fiscal policies after sovereign credit rating downgrades and finds mixed results: some countries benefit from stimulus measures, while others face tightening fiscal constraints.

Critics argue that rating agencies often fail to adequately assess risks and that their downgrades can have an exaggerated impact on the economy, especially in times of crisis. Hilscher and Nosbusch (2010) found that markets tend to overreact to rating changes. Investors adjust their portfolios based on rating announcements, even if such actions are not fully consistent with underlying economic fundamentals.

## 3. Short term pain

In the short term, there will be some contraction in economic activity. Based on economic literature, it has been demonstrated that the probability of the following effects manifesting themselves is extremely high when the economy is downgraded from the perspective of international rating agencies:

Increase in borrowing costs. Central government bond yields with around 10 years' residual maturity are crucial because these yields reflect the cost of borrowing for governments and are often used as benchmarks for long-term interest rates. They provide insights into the economic health and stability of a country. The paper analyses the difference between Greece and Romania regarding 10 year bond yields between 2005 and 2024.

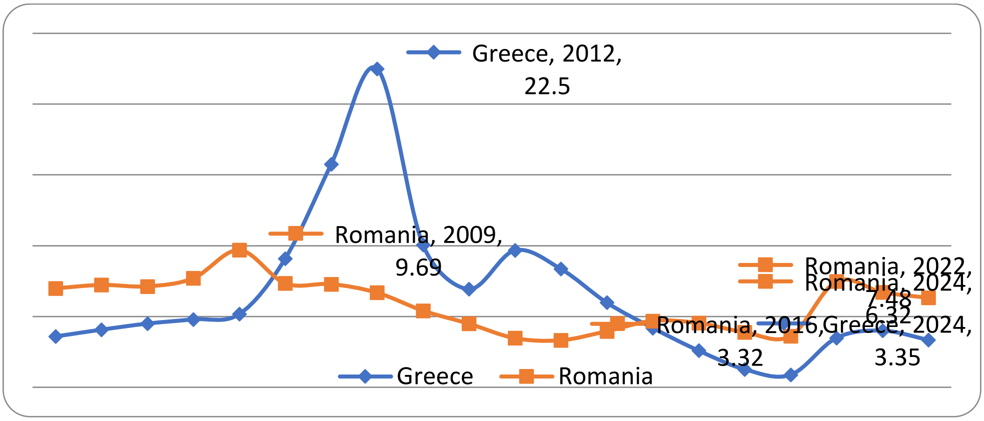


**Figure 1:** EMU convergence criterion bond yields evolution between 2005 and 2024, expressed in percentages
***Source:*** Eurostat, link https://shorturl.at/Z4olE accessed on 14.04.2025

Based on Figure 1, the bond yield rate that Romania is paying now which is situated at 6.32% but after a downgrading episode, it will increase even more. The evolution will be somewhat similar with what Greece suffered between 2009 and 2012 when bond yields turned 22,5%. But after that spike in borrowing costs, the evolution tends to go down. Accompanied by harsh economic measures and a close eye on spending, the bond yield in Greece's case came down to 3.35%. The opposite happens when Romania's economy is analyzed. The date shows that in 2021, 2022, 2023 and 2024 the bond yield interest rate is high due to high inflation rates which have led investors to demand higher yields to compensate, plus the fiscal deficit has remained elevated, raising concerns about the country's ability to manage the debt.

If Romania should be downgraded, for the economy this cost is going to put a pressure on government borrowing, impacting its spending, meaning it will increase the cost for the government to function normally, to pay all the salaries, pensions, health benefits and most important, investments. The interest rates for all the municipalities and companies operating in Romania will increase also, due to the country downgrade.

The downgrading will create an outflow in foreign portfolio investment especially from the Romanian Stock Exchange. This outflow will be done by the portfolio investors in the first couple of seconds, minutes and hours after the downgrade has been issued. It usually takes a few couple of days to register a negative outflow due to the negative news that the Romanian economy has been downgraded to JUNK status.

It will further put a pause on several key foreign direct investments. If big companies see that the reputation of the country is being downgraded, they will reconsider if they will do business in this economy in the short and medium term.

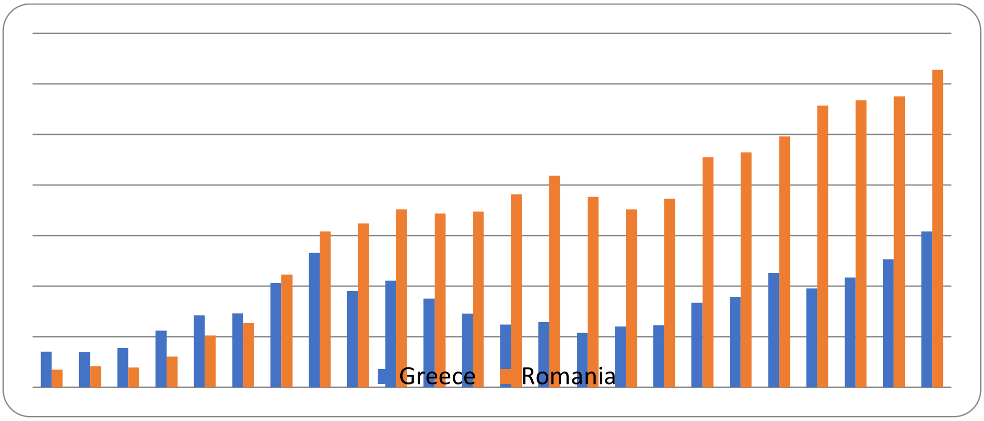


**Figure 2:** FDI instock evolution by economy between 2000 and 2023, expressed in millions of dollars
***Source:*** UNCTAD, link https://unctad.org/topic/investment/world-investment-report accessed on 14.04.2025

It is worth noticing what happened in Greece between 2008 and 2014. There is a significant outflow of Foreign Direct Investment (FDI) from Greece between 2008 and 2014 that can be attributed to high debt levels, austerity measures, and economic instability, plus investors sought safer markets within or outside the region.

**Table 1:** Growth rate evolution and the Compound annual growth rate (CAGR) FDI instock evolution by economy between 2000 and 2023, expressed in percentages

| | 2000-2023 | 2000-2008 | 2008-2014 | 2014-2023 |
|---|---|---|---|---|
| Greece | 336,4% | 13,2% | -9,1% | 12,4% |
| Romania | 1705,8% | 32,2% | 2,5% | 5,8% |

***Source:*** UNCTAD, link https://unctad.org/topic/investment/world-investment-report accessed on 14.04.2025

Looking at the growth rate evolution and the Compound annual growth rate (CAGR) FDI instock evolution by economy between 2000 and 2023, the situation depicts almost to the same conclusions. But the most interesting thing is not the outflow between 2008 and 2014, but the future inflows that occur in Greece between 2014 and 2023. After reaching a bottom, the only way from there is up.

Then it will put a pressure on the National Bank of Romanian, because it will have to fight on two fronts:

1. The first problem will focus its attention on the currency depreciation. Due to this severe downgrade, people and companies will switch their Ron to the Euro, the Dollar or the Swiss Franck. The National Bank of Romanian of Romania will have to intervene in the market in order to stabilize its depreciation.

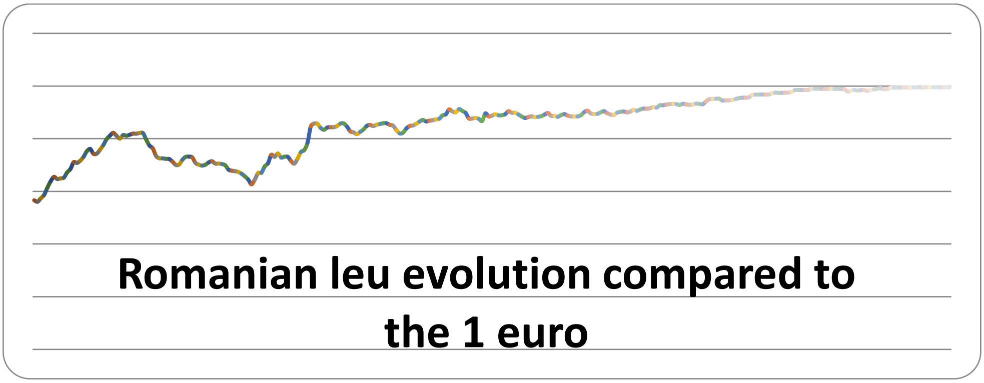


**Figure 3:** Romanian RON evolution compared to the 1 euro between 2002 and 2025
***Source:*** Eurostat, link https://shorturl.at/4coH3 accessed on 14.04.2025

The RON depreciated against the euro in 2008-2009 with almost 15%. It was one of the biggest depreciations in our country's history. This depreciation was correlated to the global financial crisis which reduced investor confidence and capital outflows from emerging markets, including Romania. In addition, Romania faced domestic economic challenges, such as a widening trade deficit and inflationary pressures, which further weakened the RON, and a coordinated attack on the RON in October 2008 when the RON depreciated by 11% only in one week.

2. The second problem will be to assess the impact of a rising inflation due to an increase in prices. Because the currency will depreciate, the people and businesses will need more Ron in order to pay for the imports that they need, which in the short run will create an inflationary spike. It is the moment when the monetary policy decision will focus on an increase of the interest rate, due to an increase in inflation, or keep the current interest rate level for a longer period of time.

Imports will become more expensive due to the currency depreciation and in the short to medium term will cause an increase in the balance of payments and current account deficit. All the goods and services imported from abroad will be more expensive.

## 4. Time to reform

The government is forced to take action in order to reduce all the unnecessary costs. A thorough approach to the government wasteful spending will be imperiously necessary. All activities that before were money draining for the taxpayers should be squashed and eliminated. The word of the day will be REFORM. For the expenses side, the following measures should apply.

- Decentralizing Romania. The processes of decentralization can begin in Romania. It will be one of the biggest territorial reorganizations since the 1950s. It will be the best moment to reduce the numbers of counties, municipalities, communes. By this reorganization, a large number of communes will disappear, and they will be ascribed to a nearby city. This measure will drastically reduce the number of mayors, secretaries, local councilors, and other employees. Romania has a dire situation where certain cities and communes cannot afford to function due to the gap between low own incomes and high functioning expenses.

- Reorganization of central and local government agencies. All nonessential personnel or government agencies will be erased, reduced in staff or reallocated to a bigger institution. This measure will reduce spending with: salaries due to a reduction of medium and top-level employees; procurement due to a reduction in stationary products or other acquisitions;
- Centralization of acquisitions will increase spending efficiencies, due to large quantities that can be addressed either by big production companies, or by consortiums of companies that can fill all the big orders. Big volumes will bring prices down for all acquisitions;

On the revenues side, the following measures should apply.

- Combat tax evasion. All economic fields of activity with a high probability of tax evasion should receive electronic payments through credit or debit cards. Cash money should be limited to a small quantitative figure. Because the e-factura system is already implemented, it will be easier to follow the ins and the outs for every business by simply following the money trail.
- Less spending with salaries due to territorial decentralization will create a debouche that can be redirected to investments.
- Less spending with salaries due to reorganization of central and local government agencies will create a debouche that can be redirected to investments.
- Less spending due to the centralization of acquisitions will create a debouche that can be redirected to investments.

The outflow of portfolio investors from the Romanian Stock Exchange will be significant in the first seconds, minutes, hours and couple of days after the downgrade. The short-term effect will be determined by the following:

- Because the Romanian Stock Exchange is a marginal trading floor at the outskirts of the EU and does not offer a series of extra buying and selling options like futures, calls, puts, or other trading options, the amount of money traded daily is limited.
- The vast majority of investments are done by local companies or individuals through local brokers
- The biggest pension funds own a vast proportion of the stock issued on the stock exchange

Based on these assumptions, the initial outflow will be followed by a process called ”buy the deep”. When local traded assets become cheaper, other companies or individuals will buy. This effect will ease the stock exchange exit pain and will offer a short- and medium-term bandage.

Regarding foreign direct investments returns Romania should proceed the same way Greece did regarding subsidies. Based on the Figure below, the subsidies that Greece is offering are way higher than those that Romania. Greece is awarding in the last 4 analyzed years subsidies raging from 3.1% to 7% of its GDP. At this level, the foundation for future development is real solid.

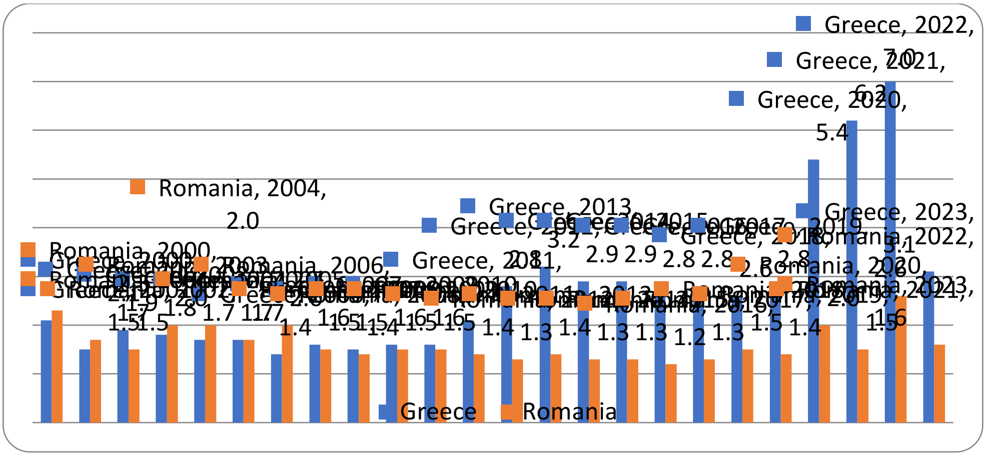


**Figure 4:** Subsidies evolution given by Greece and Romania between 2000 and 2023, as a percentage of GDP
***Source:*** Eurostat, link https://shorturl.at/tsqLc accessed on 14.04.2025

For the currency depreciation and the increase in inflation the National Bank of Romania has a couple of monetary policy options:

- Direct currency intervention to sell euro in the market in order to cool down demand but only after the initial depreciation tsunami. Perhaps even an overnight interest rate increases for the RON in order to discourage further speculation on the currency.
- Increase the monetary policy interest rate in order to attract more Ron in the commercial banks savings deposits, fix the currency exchange course and tame inflation at the same time.

## 5. Long term gain

Due to decentralization and with the help of digitalization and automatization, the transition to a more supple and flexible central and local government agencies and bodies can be done, minimizing the effects on the ordinary people that benefit from their services.

Due to the centralization of acquisitions, the budget deficit will be drastically trimmed and will have an immediate effect on the necessity for borrowing money on the internal or foreign markets. A more judicious spending will bring Romania's budget deficit in place in a short and medium time and will shine a more positive outlook for the medium and longer time objectives.

Due to the harsh government reforms, redirecting fresh liberated capital from wasteful spending to necessary infrastructure investments, Romania's accession to the OECD, will not only bring back the lost portfolio investors but it will attract even more. The short- and medium-term bandage will transform in a long-term solid increase for the stock exchange.

The same impact is being addressed to the in-doubt investors that may postpone foreign direct investments in the Romanian economy. A purge in government waste combined with an increase in incomes should bring to light investments and create a solid foundation for future economic development. This should become the basis in attracting more FDI.

Romania should compare its future FDI attractiveness after a downgrade episode with Argentina. The new president and his regime introduced the "Ley de Bases" an omnibus bill that enacted pro-business initiatives and structural reforms. Incentive Regime for Large Investments program provided generous incentives for investments exceeding $200 million in sectors like forestry, tourism, infrastructure, mining, technology, steel, energy, and oil and gas. Benefits included reduced taxes, elimination of export taxes, and removal of capital controls. It cut government spending and deregulated the private sector, leading to Argentina's first quarterly fiscal surplus since 2008. The country reached agreements with the International Monetary Fund (IMF) to stabilize the economy, and managed this year to repay debts without issuing new ones. The regime depreciated the Argentine Peso to address inflation and improve international competitiveness. The results can be seen in the MERVAL index below, were the Argentinean stock exchange registered a fantastic upward trend, meaning that the international investors appreciated the regime actions.


**Figure 5:** Romania’s BET Index and Argentina’s MERVAL Index between 2015 and 2025, nominal value expressed in points
***Source:*** TradingEconomics, link https://shorturl.at/4QVBk accessed on 14.04.2025

Due to currency depreciation, it will cause a short to medium term deficit in the balance of trade and current account. But in the long term, on one hand imports will decrease due to high costs and on the other hand exports will increase due to currency depreciation, becoming more competitive in the region.

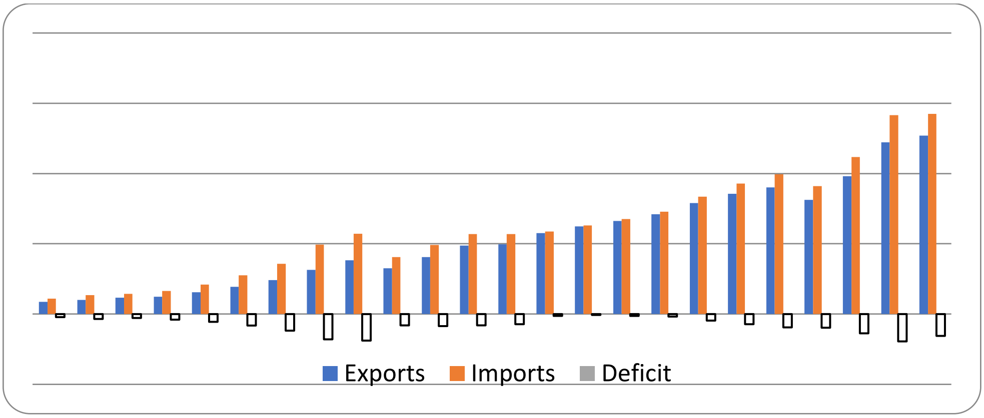


**Figure 6:** External balance of goods and services with the exports, imports and deficit of Romania between 2000 and 2023, expressed in millions of euros
***Source:*** Eurostat, link https://shorturl.at/tsqLc accessed on 14.04.2025

The figure 6 shows what happens in an economic crisis and a pandemic with the exports, imports and deficit. If Romania will be downgraded to JUNK status by the rating agencies, a plunge in imports will occurs in the next couple of years, as it happened between 2008 and 2013. But on the export side, due to the depreciation of the RON, Romania's exports will cost competitive in the region, implying that the volume and value of the exports will increase, resulting a balancing situation for the actual huge and growing balance of trade deficit.

## 6. Conclusions, paper limitations and recommendations

Even if at first it will be a turbulent economic period, with time and the right economic measures already tested by other countries and taken as cases of good practice, the situation can turn into a movie with a happy ending.

All the tough economic measures taken by Greece and Argentina in the recent period have changed the image of these countries in the eyes of international investors, improving economic activity, a fact also shown in the evolution of the main stock market indices in the 2 countries.

Even if Romania were to be downgraded to the JUNK category by the rating agencies in 2025, this aspect should not be seen as a fateful event. With the right measures tested by others, plus the completion of infrastructure investments and accession to the OECD, it would represent the most solid foundations for future growth.

The paper limitations that have to be addressed in future works are as follows: The value of total Romanian private or public ownership at the companies listed on the stock exchange. This value is important because of the initial exit in a future downgrade moment. First the institutional investors are selling their stock, and only after the retail investors will sell. The theory is that if the stock is owned by the owner of the company, pension funds or the state, the downslide for the selling of shares should be moderate to high, and not see a fire sale in the first couple of minutes.

The impact of downgrades on other economies. All the countries of the world are experiencing cyclical movements for their economies, so at one time, when the cycle registers a downturn and the economies are downgraded, it is important to take into consideration all the measures that those countries took in order to recover and improve their country rating.

The biggest impact which now is not computed is the introduction of new tariffs by one of the largest economies in the world, the United States of America. This episode will impact Romania's economy directly with our exports towards the American market, but also indirectly due to our exports towards other European nations that export on the American market. Future works should focus on the linkages created by this global value chain and try to find solutions in order to hedge better the future risks that can arise.

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