Weekly Report

Romania

19 April 2012

Treasury Sales Team

Alina Elena Vrabioiu
+4021 307 58 17
alina.vrabioiu@otpbank.ro

Irina Ananiesei
+4021 307 58 17
irina.ananiesei@otpbank.ro

Tania Fantana
+4021 307 58 17
tania.fantana@otpbank.ro

Capital Markets Sales Team

Alexandru Ilisie
+4021 307 58 27
alexandru.ilisie@otpbank.ro

Teodor Alexandru Tibuleac
+4021 307 58 27
alexandru.tibuleac@otpbank.ro

The effect of the base rate cuts continues to ease RON funding; no growth support from external markets

The monetary policy actions have significantly decreased the cost of debt for both the government and the private sector this year. However, economic growth remains subdued to the advance in the EU where 74% of the Romanian exports go.

Macroeconomics: in February, industrial production was down by 1.4 MoM; CPI stood at 2.4% YoY in March (Page 3-5)

In February, external demand was much weaker than in January and exports' growth rate entered again in the negative territory: -0.4% YoY (Feb) compared to +1.6% YoY (Jan). The visible weakening of economic activity in the European Union had a strong impact. The deterioration of the trade balance, together with a negative figure for the current transfers, widened the CA deficit to 626 mn EUR in February. The EU transfers related to the absorption of EU funds were therefore disappointing. Foreign direct investment continued to trend down: -25% YoY during the Jan–Feb period. Industrial production fell by 1.4% MoM, as expected, and the prior figure was revised downwards. Together with commerce, the total value added made up to 45% of GDP in 2011. We believe these two sectors could contribute negatively to real GDP growth in Q1 2012. March inflation stood at 2.4% YoY, higher than the forecast made by the Central Bank (CB), of 2% YoY. However, CORE2 adjusted was in line with the CB's calculations, at 2.03% YoY, and it is not expected to go above 2% YoY in the rest of the year.

FX markets: deteriorated risk perception weakened the RON, in line with peer currencies (Page 6)

Last week, the RON lost 0.07% to the EUR while its peers exhibited higher volatility, as usual: the Polish zloty lost 0.7%, the Czech crown was down by 0.2% and the Hungarian forint by 0.4%. The main influence came again from the eurozone and the evolution of Spanish debt yields. The market is not expecting the RON to bounce back significantly below 4.3 this year.

Government securities: yields continued to decline moderately; only the 12M maturity fell significantly (-13 bp) (Page 7-8)

The high demand for the 12M T-bills that we noticed during last Monday's auction pushed down the yield for this maturity last week: -13 bp. Otherwise, for the rest of the maturities, the weekly yield decline was modest, between 1-5 bp. There were two bond auctions last week: one for 12M T-bills on Monday and the second one on Thursday when the Ministry of Finance sold 2Y bonds. Absolute demand (total bids) was higher for the T-bills. The average accepted yield for the 12M T-bills was 5.02% and 5.5% for the 2Y bonds.

MM: rates declined further between 11-50 bps, offsetting the hike that took place at the end of March (Page 9)

In only two weeks, ROBOR 3M bounced back to the level seen before the last week of March when ROBOR ON jumped above 4%. NBR injected 5.9 bn RON at the weekly repo. The fact that CORE2 adjusted was in line with NBR's forecast for March may suggest that the Central Bank will not stop the base rate cut cycle, especially since RON real rates are high at 2%, compared to negative real rates for the EUR.

Chief Economist

Gergely Tardos
+36 1 374 7273
tardosg@otpbank.hu

FX/FI Strategist

Levente Pápa
+36 1 354 7490
papal@otpbank.hu

Macro Analysts

Gábor Dunai
+36 1 374 7272
dunaig@otpbank.hu

Győző Eppich
+36 1 374 7274
eppichgyo@otpbank.hu

Szilárd Kondora
+36 1 374 7275
kondorasz@otpbank.hu

Bálint Szaniszló
+36 1 374 7271
szaniszlob@otpbank.hu

Mihaela Neagu
+4021 307 58 64
mihaela.neagu@otpbank.ro

Rodion Lomivorotov
+7 495 783-5400 (2761)
r.lomivorotov@otpbank.ru

Sector Analyst

Piroska Szabó
+36 1 374 7276
szabopb@otpbank.hu

Dávid Rácz
+36 1 374 7270
raczd@otpbank.hu

Technical Analyst

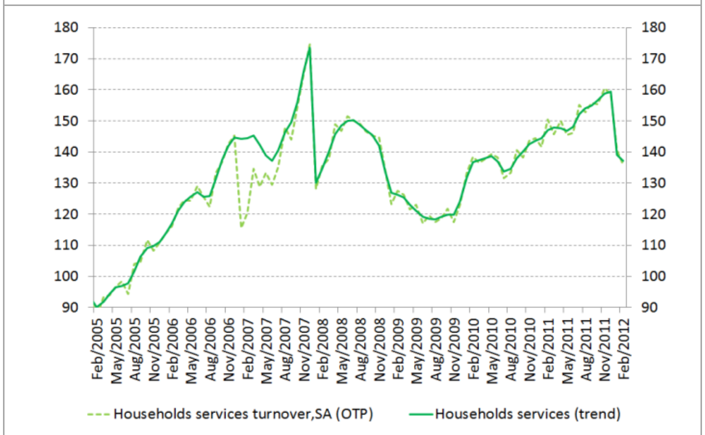
András Salamon
+36 1 374 7225
salamona@otpbank.hu

Macroeconomics: in February, industrial production was down by 1.4 MoM; CPI stood at 2.4% YoY (March)

	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
09 Apr	FEB	Households services turnover index (y-o-y, %)	-9,8		-0,7
09 Apr	FEB	Trade balance (EUR, mn)	511,7		-458,5
09 Apr	FEB	Exports (y-o-y, %)	-0,4		1,6
09 Apr	FEB	Imports (y-o-y,%)	2,2		8,3
10 Apr	FEB	Wholesale services turnover index (y-o-y,%)	4,9		5,9
10 Apr	MAR	Consumer price index (y-o-y,%)	2,4	2,4	2,6
10 Apr	FEB	Industrial Production Index (y-o-y, %)	-1,1		1,6
12 Apr	FEB	CA balance (EUR, mn)	-626,2		-37,3
12 Apr	FEB	net FDI (EUR, mn)	249,2		-7,8
12 Apr	FEB	External debt (bn EUR)	75,5		75,1
26 Apr	MAR	M3 aggregate (y-o-y, %)			9,9
26 Apr	MAR	Non -governmental loans (y-o-y, %)			7,6
26 Apr	MAR	Non -governmental deposits (y-o-y, %)			9,4
30 Apr	MAR	Licenses for residential buildings (y-o-y, %)			-12,4

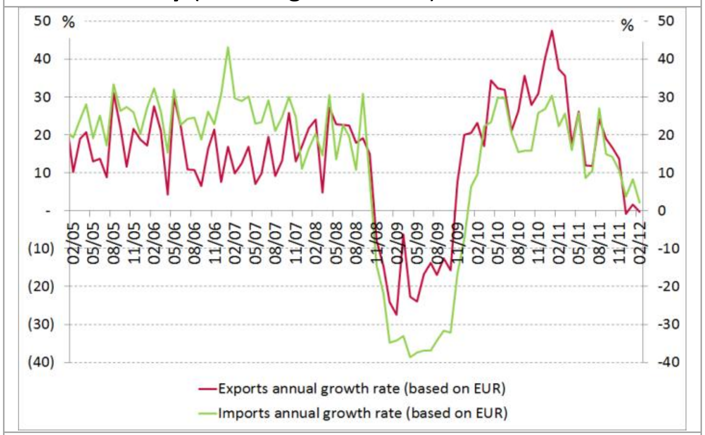
In February, external demand was much weaker than in January and exports' growth rate entered again in the negative territory: -0.4% YoY (Feb) compared to +1.6% YoY (Jan). Imports' pace declined even more, from 8.3 YoY (Jan) to only 2.2% YoY in February. Given that 74% of Romania's exports go to the EU, the visible weakening of economic activity in the European Union had a strong impact, together with weather conditions, which may have affected delivery. Looking on destinations, intra-EU commerce dipped by 1.3% YoY (Feb) while in the previous month there was a strong advance (4.2% YoY, Jan). In structure, we noticed an improvement of the trade balance of mineral fuels &lubricants in February as opposed to January. Whereas on a monthly basis, rthe overall trade balance deteriorated, for this category of goods it improved due to a faster pace in exports. They were supported also by the weaker RON: according to BIS, the real effective exchange rate index was 99.01 in February versus 99.3 in January (the base year being 2010).

Household services index (2005=100)



Source: Eurostat, OTP Research

Trade activity (annual growth rate)



Source: Eurostat, OTP Research

In March, annual inflation was 2.4% YoY. Looking on the good types, food goods' prices were down by 0.94% YoY and the top price increases were seen in the price of services: +5.4% YoY, while non-food goods' inflation stood at 3.93% YoY. However, on a monthly basis, food prices saw above-average increase: **CPI was 0.4% MoM** but food prices rose by 0.64%, non-foods by 0.3% MoM and services by 0.2% MoM. Looking at the yearly CORE2 adjusted (CPI without administered, volatile, tobacco and beverages prices), it has continued on a downward path: it stood at 2.05% YoY in February and now 2.03% YoY in March. This is the indicator that the Central Bank is mentioning and monitoring at every monetary policy decision and it has resulted according to expectations 2% YoY. For the rest of the year, NBR expects it not to exceed the 2% YoY level, also in the context of lower import prices due to RON's appreciation. There are high chances that the forecast realizes, given that prospects of growth in Europe are positive for H2 2012, therefore supporting growth in Romania as well and consequently RON's appreciation to a certain extent. However, as external demand is only marginally improving, it will not pose upward pressure on inflation.

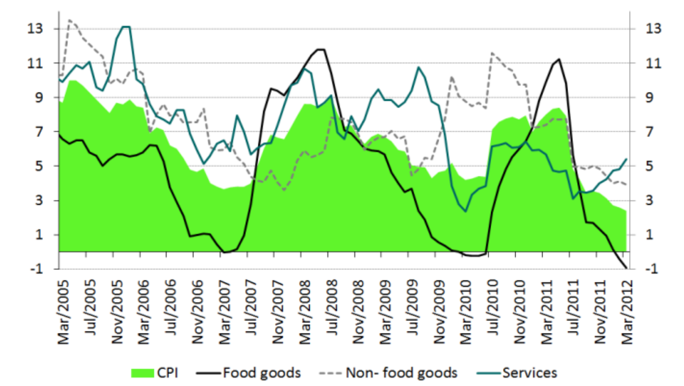
The current account deficit stood at 626 mn EUR in February, decomposed in a trade balance of -333mn EUR, an income balance of -172 mn EUR and current transfers balance of -121mn EUR. On a 12M rolling basis, the monthly growth rate was 9.1% compared to much slower rhythm in the previous months. Two factors widened the CA deficit: on the one hand, exports pace was negative and on the other hand, current transfers were negative as well which is very rare. Since 2005, we noticed only once a negative balance (except for Feb 2012) in February 2010 (-16 mn EUR). This item refers to transfers to public administration (including transfers from the European Commission) and transfers to other sectors (which include non-resident worker's remittances). The main problem was with transfers to public administration which turned negative: -313 mn EUR, while the average of the previous three months stood at +337 mn EUR. Therefore, the EU transfers related to the absorption of EU funds were disappointing.

Looking at the financing side of the CA deficit, we observe that foreign direct investments remained weak. During the first two months, FDI stood at 241 mn EUR, compared to 321 mn EUR last year, so it was lower by 25% YoY. Therefore it financed only 37% of the deficit during Jan- Feb 2012.

As expected, industrial production declined in February. According to seasonally adjusted data, it fell by 1.4% MoM and the previous January figure was revised downwards. Up to now, average monthly industrial production index in Q1 2012 is lower by 0.9% than in Q4 2011 which suggests that industry will have a negative contribution to GDP. Wholesale and retail turnover index is down 3.7% QoQ (based on monthly averages). Industry's value added made up to 26% of the GDP last year, while commerce's value added was 19% of GDP. Together they could push real GDP growth into negative territory in Q1 2012.

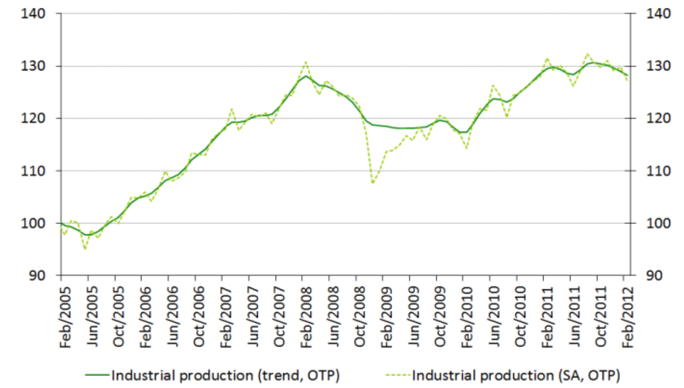
Other data released last week was the wholesale services index which fell by 0.4% MoM (seasonally adjusted data) and household services' turnover which was down 5.8% MoM (seasonally adjusted data), reemphasizing that households'demand remained week.

CPI (annual, %)



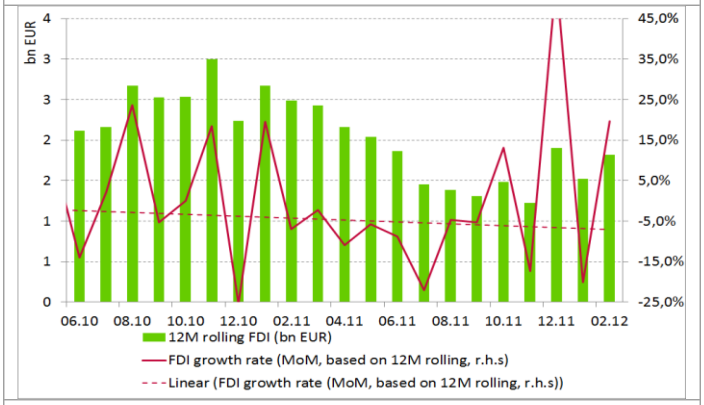
Source: Eurostat, OTP Research

Industrial production index(2005=100)



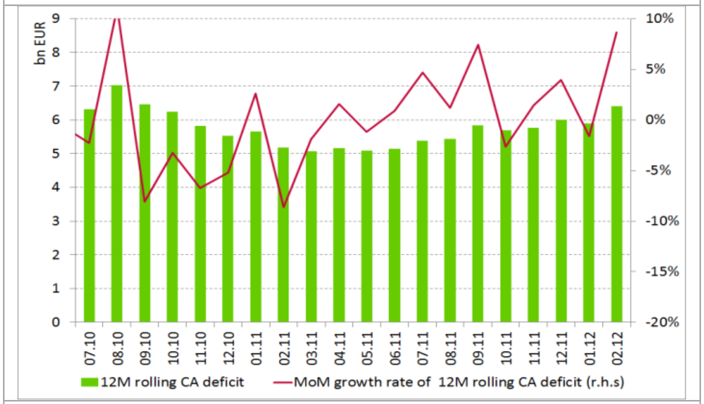
Source: Eurostat, OTP Research

Foreign direct investment



Source: Eurostat, OTP Research

Current account deficit



Source: Eurostat, OTP Research

Medium-term macroeconomic forecast

Main macroeconomic indicators	Fact						Forecast	
	2006	2007	2008	2009	2010	2011	2012	2013
Real GDP	7,9%	6,3%	7,3%	-6,6%	-1,6%	2,5%	**1,4%**	**2,8%**
Final consumption of households	12,9%	12,0%	9,0%	-10,4%	-0,4%	1,4%	**2,3%**	**2,9%**
Households consumption expenditure	12,7%	11,9%	9,0%	-10,1%	-0,4%	1,3%		
Government consumption	-11,5%	2,5%	6,2%	9,5%	-10,0%	-3,4%	**-0,7%**	**1,7%**
Gross fixed capital formation	19,9%	30,3%	15,6%	-28,1%	-2,1%	6,3%	**5,2%**	**6,2%**
Exports	10,4%	7,8%	8,3%	-6,4%	14,0%	9,9%	**3,3%**	**8,4%**
Imports	22,6%	27,3%	7,9%	-20,5%	11,9%	10,5%	**4,2%**	**8,8%**
Consumer prices (avg.)	6,6%	4,8%	7,8%	5,6%	6,1%	5,8%	**3,5%**	**3,0%**
Budget Balance (GDP%, ESA 95)	-2,2%	-2,9%	-5,7%	-9,0%	-6,9%	-4,3%*	**-3,6%**	**-3,3%**
Public debt (GDP %)	12,4%	12,8%	13,4%	23,6%	31,0%	33,3%	**35,3%**	**36,7%**
CA balance (% GDP)	-10,5%	-13,4%	-11,6%	-4,2%	-4,4%	-4,2%	**-4,4%**	**-4,6%**
CA balance (bn EUR)	-10,2	-16,8	-16,2	-4,9	-5,5	-5,7	**-6,2**	**-6,9**
Unemployment	7,3%	6,4%	5,8%	6,9%	7,3%	7,4%	**6,8%**	**6,6%**
Nominal wage growth	18,4%	21,8%	26,1%	4,8%	3,1%	6,5%	**4,5%**	**4,4%**
Real wage growth	9,0%	14,7%	16,5%	-1,5%	-3,7%	0,5%	**0,3%**	**1,4%**
Key interest rate (avg.)	8,6%	7,5%	9,7%	9,1%	6,5%	6,2%	**5,1%**	**4,6%**
Key interest rate (e.o.p.)	8,8%	7,5%	10,3%	8,0%	6,3%	6,0%	**5,0%**	**4,5%**
EUR/RON (avg.)	3,52	3,34	3,68	4,24	4,21	4,24	**4,34**	**4,27**
EUR/RON (e.o.p.)	3,38	3,61	3,99	4,23	4,28	4,32	**4,30**	**4,25**

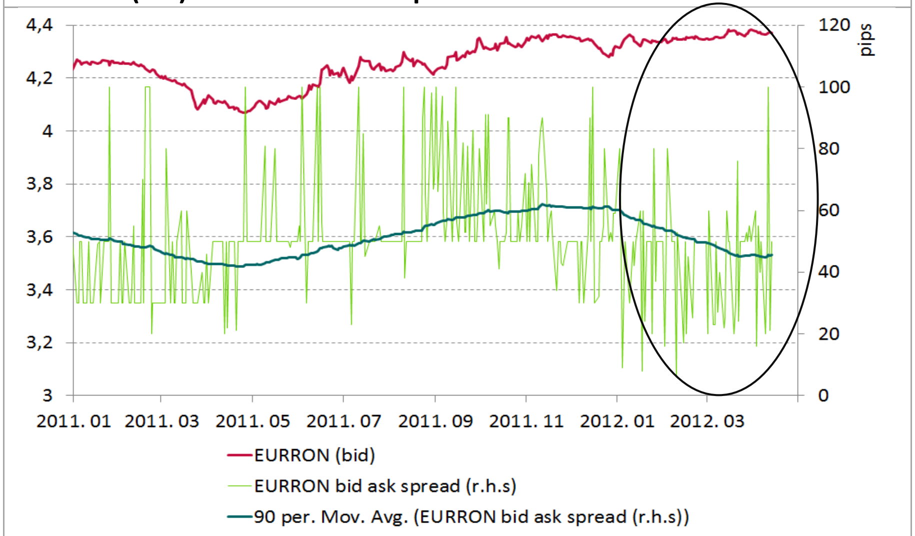
Source: Eurostat, OTP Research
Note:* OTP Research forecast

FX markets: deteriorated risk perception weakened the RON, in line with peer currencies

Last week, the RON lost 0.07% to the EUR while its peers exibited higher volatility, as usual: the Polish zloty lost 0.7%, the Czech crown was down by 0.2% and the Hungarian forint by 0.4%. The main influence came again from the eurozone and the evolution of Spanish debt yields. This deteriorated the risk perception related to emerging European countries and their future growth in the medium term. This implies that expectations related to their GDP growth worsen and consequently, the expected evolution of their respective currencies is for them to depreciate.

Also, wee noticed that bid-ask spread widened to 100bp on 11 April, when the CDS exceeded the 300 bp level for the first time since 7 March 2012. The daily bid-ask spread is usually 50bp and a divergence from this level suggests increased uncertainty on the FX market. However, this week the spread has turned back to normal levels as there was no macroeconomic data released and the international context eased: the main event up to now was the Spanish bond auction and it turned out to be a succes. Looking at the correlation between 90-day moving average of the EUR/RON bid-ask spread and EUR/RON rate, we notice that in 2011 it was close to 1 while in 2012, it turned negative. This means that while the RON was depreciating last year, we also witnessed higher spreads but this year the spreads fell back, although RON continued to depreciate. The spreads depend on market conditions and larger spreads compensate dealers for dealing in volatile currencies. This tells us that the market is perceiving this level of the EUR/RON to be adequate for the medium term (less uncertainty) and that it is not expecting the RON to bounce back significantly below 4.3 this year.

EURRON (bid) and the bid –ask spread



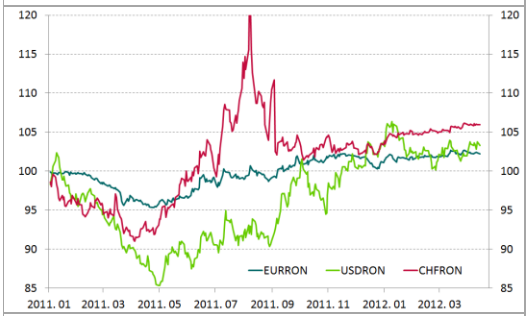
Sources: Reuters, OTP Research

FX BID

	Value		Weekly chg. (%)		YTD chg. (%)
EURRON	4,37	↑	0,07	↑	1,24
USDRON	3,34	↑	0,26	↓	-0,52
CHFRON	3,64	↓	-0,05	↑	2,38
RONJPY	4,13	↑	1,12	↓	-5,35
RONPLN	1,04	↓	-0,31	↑	1,47
100HUFRON	1,47	↓	-0,21	↑	7,72
RONCZK	0,18	↑	0,45	↑	4,57
RONRUB	0,11	↑	0,24	↑	8,95
RONRSD	0,04	↓	0,00	↑	0,00
RONBGN	2,24	↑	0,12	↑	1,39

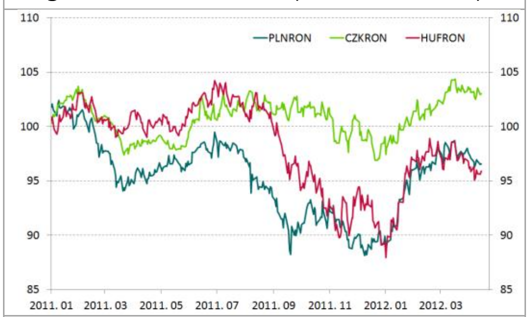
Source: Reuters

Major RON FX rates (03.01.2011=100)



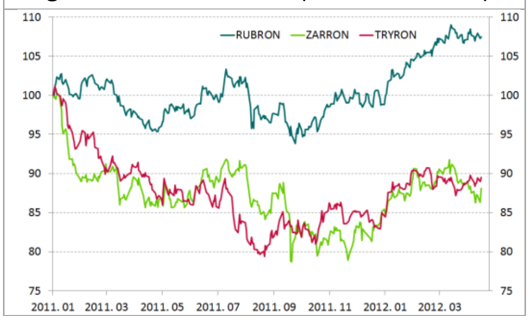
Sources: Reuters, OTP Research

Regional RON FX rates I. (03.01.2011=100)



Sources: Reuters, OTP Research

Regional RON FX rates II. (03.01.2011=100)

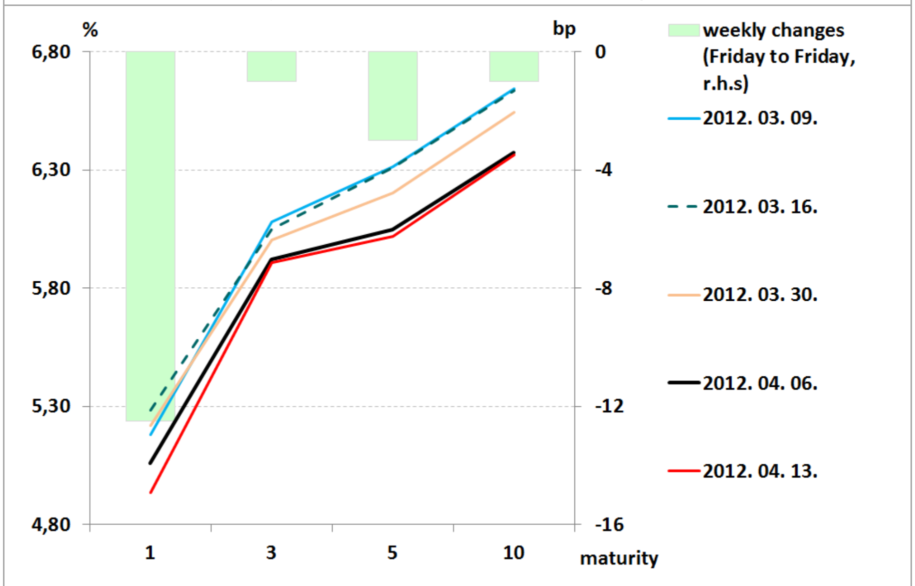


Sources: Reuters, OTP Research

Government securities: yields continued to decline moderately, only the 12M maturity fell significantly (-13 bp)

The high demand for the 12M T-bills that we noticed during last Monday's auction pushed down the yield for this maturity last week: -13 bp. Otherwise, for the rest of the maturities the weekly yield decline was modest, between 1-5 bp. It becomes more obvious that the driver of the change in yields will cease to be the change in expected short-term rates (especially in H2 2012). Instead, we may be seeing that the change in yields will depend more on supply and demand in these securities. More precisely, we noticed that the Ministry of Finance is starting to sell more bonds than before in order to increase the average remaining maturity (1.6 years in Feb 2012) of the government securities. In this sense, there is room for maneuver even if the liquidity premium is not high: for example the 3Y-10Y spread is 46 bp, the 5Y-10Y spread lower at 35 bp and 3Y-5Y spread stands at 11 bp. By comparison, the 3Y-10Y spread of the Germand bunds is close to 150 bp. We believe that the yield curve still has some room to move downwards in the coming months, in line with the assumption that the Central Bank will operate one last base rate cut up to June, of 25 bp.

Yield curve over the past weeks (Central Bank fixing)

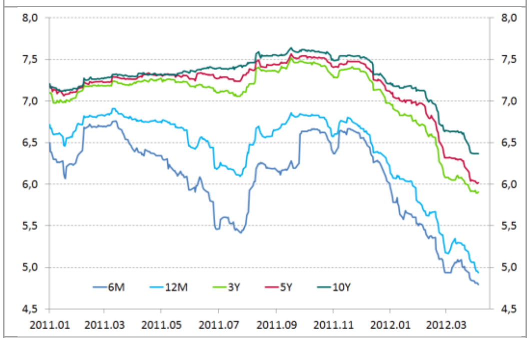


Sources: NBR, OTP Research

GOVERNMENT SECURITIES	Value	Weekly chg. (bp)	YTD chg. (bp)
6M	4,80	-5	-146
12M	4,94	-13	-145
3Y	5,91	-1	-123
5Y	6,02	-3	-123
10Y	6,37	-1	-97
SPREADS	**Value (bp)**	**Weekly chg. (bp)**	**YTD chg. (bp)**
GERROM 3Y	564	-1	-123
GERROM 5Y	531	-3	-119
GERROM 10Y	463	-1	-88
3Y -5Y	11	-2	0
5Y -10Y	35	2	27
3Y-10Y	46	0	27
FLY 3-5-10	24	4	27
CDS MID SPREADS	**Value (bp)**	**Weekly chg. (bp)**	**YTD chg. (bp)**
3Y EURO	258	9	-113
5Y EURO	297	9	-105

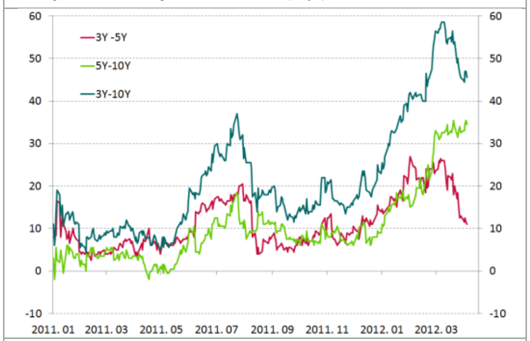
Source: Reuters

Central bank benchmark fixing yields (%)



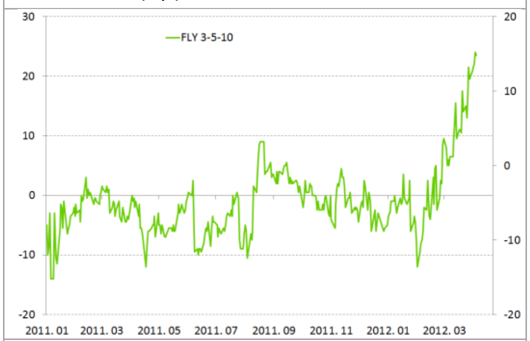
Sources: NBR, OTP Research

Slope of the yield curve (bp)



Sources: NBR, OTP Research

FLY 3-5-10 (bp)



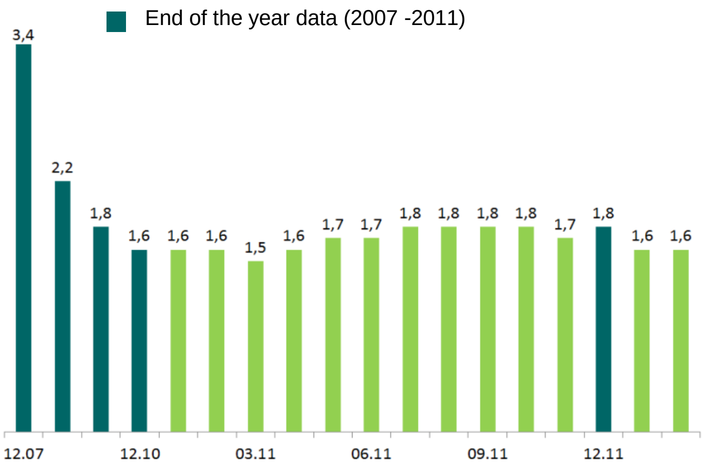
Sources: NBR, OTP Research

Auction results

There were two bond auctions last week: one for 12M T-bills on Monday and the second one on Thursday when the Ministry of Finance sold 2Y bonds. Demand for the 12M T-bills was high, as the total bids were 4.42 times higher than the planned amount of 1bn RON. The allotted amount was not higher than the targeted amount and the average accepted yield stood at 5.02%, down 25 bp compared the previous similar tender in March. The difference is equal to the base rate cut at the end of March (25 bp).

The second auction had a final allotted amount of 800 mn RON, equal to the planned amount. Demand was half compared to Monday's amount and the average accepted yield stood at 5.5%, which is 10 bp lower than the one at the previous tender at the beginning of April. Total bids were 2.67 times higher than the planned targeted amount (800 mn RON).

Remaining maturity of government securities



Source: Ministry of Finance, OTP Research

T -bills

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1213CTN0A7	09.04.2012	11.04.2012	10.04.2013	12	1.000.000.000

Source: Ministry of Finance, OTP Research

Bonds

ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
RO1214DBN027	02.04.2012	04.04.2012	23.04.2014	2	5,95	750.000.000
RO1216DBN030	05.04.2012	09.04.2012	27.01.2016	4	5,75	1.000.000.000
RO1214DBN027	12.04.2012	17.04.2012	23.04.2014	2	5,95	800.000.000
RO1217DBN046	19.04.2012	23.04.2012	26.07.2017	5	5,9	500.000.000
RO1227DBN011	26.04.2012	30.04.2012	26.07.2027	15	5,8	200.000.000

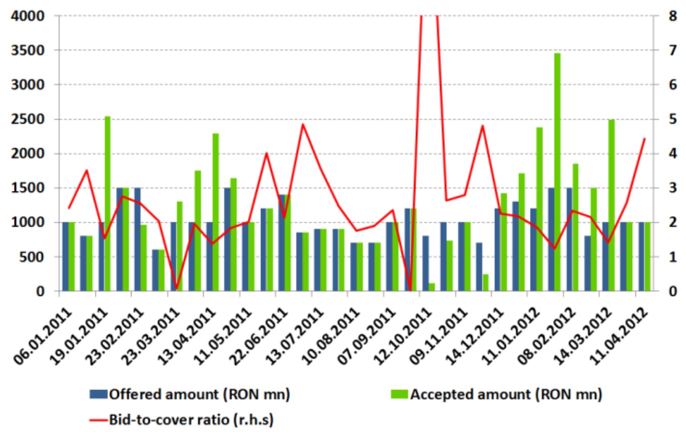
Source: Ministry of Finance, OTP Research

T-Bills in RON, monthly maturity schedule (mn RON)

Q1 2012		Q2 2012		Q3 2012		Q4 2012	
ian.12	4.341,4	apr.12	4.391,3	iul.12	3.715,5	oct.12	4.474,5
feb.12	2.459,0	mai.12	4.029,7	aug.12	1.902,3	nov.12	2.675,9
mar.12	4.012,1	iun.12	3.275,2	sep.12	3.052,5	dec.12	1.713,4

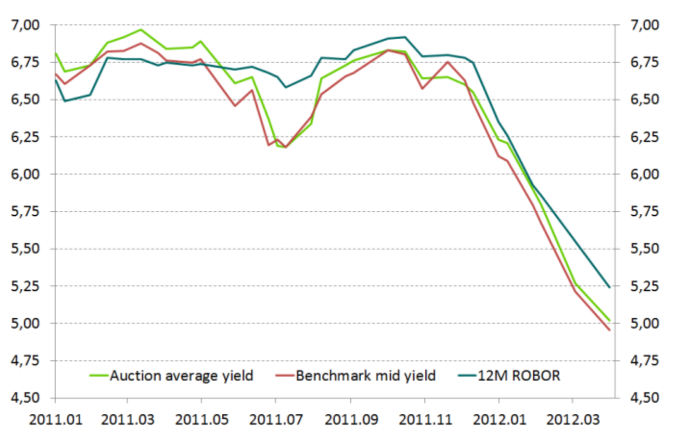
Sources: Ministry of Finance, OTP Research

12M auctions data



Sources: NBR, Ministry of Finance, OTP Research

12M interest rates



Sources: NBR, Ministry of Finance, OTP Research

2Y auctions data

Sources: NBR, Ministry of Finance, OTP Research

Summary of last week's auctions

	RO1213CTN0A7	RO1214DBN027
Offered amount (RON mn)	1.000	800
total bids (RON mn)	4.424	2.140
accepted amount (RON mn)	1.000	800
average accepted yield (%)	5,02	5,50
coupon	-	6,0

Source: Ministry of Finance, OTP Research

MM: rates declined further between 11-50 bps, offsetting the hike that took place at the end of March

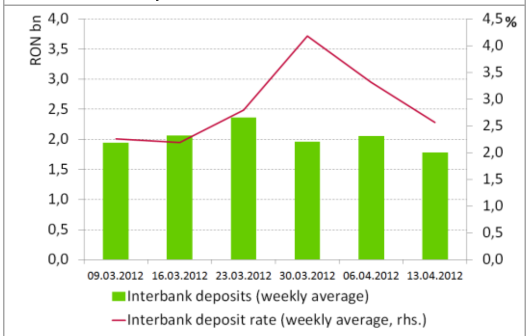
Liquidity conditions were at good levels last week and rates continued to fall, still adjusting downwards after the relative hike at the end of March. In only two weeks, ROBOR 3M bounced back at the level seen before the last week in March when ROBOR ON jumped above 4%. As the ON rate was back at low levels (in the interval 2%-2.5%), suggesting that liquidity conditions are not tense, the NBR decreased the 1W repo volume by 322 mn RON last week, to 5.9 bn RON.

Annual inflation rate stood at 2.4% YoY in March, higher than Central Bank's forecast for the end of the quarter, 2% YoY respectively. Although the difference is rather significant in itself but also relative to the size of the steps of the base rate cuts that the NBR has operated in the past few months (25 bp), this should not endanger a further cut in the base rate by the end of Q2, as RON real rates are still high: for example ROBOR3M stood at 4.5% in March, therefore implying a real rate of 2.1%, whereas EURIBOR3M was 0.86% and eurozone inflation at 2.7% YoY in March, therefore resulting in a -1.8% real rate. Consequently, we still expect MM rates to fall some more this year, even if weekly average may see some temporary jumps when tensions on the international markets increase due to concerns related to the euro zone debt crisis.

MID INTEREST RATES	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	0	-75
ROBOR ON	2,32	-50	-221
ROBOR 3M	4,21	-25	-184
ROBOR 6M	5,02	-11	-151
ROBOR 9M	5,14	-14	-147
ROBOR 1Y	5,23	-15	-143
REPO	**Value (mn RON)**	**Wly chg. (mn RON)**	
repo amount	5.933,1	-321,8	
INTERBANK DEPOSITS	**Value (mn RON)**	**Wly chg. (mn RON)**	**YTD chg. (mn RON)**
outstanding	5.676,7	-205,0	1.649,2
MID SWAP POINTS	**Value (bp)**	**Weekly chg. (bp)**	**YTD chg. (bp)**
USDRON 1W	4	0	-21
USDRON 1M	62	3	-87
USDRON 3M	184	3	-63
EURRON 1W	11	-11	-30
EURRON 1M	134	8	-11
EURRON 3M	393	23	-118
MID EUR BASIS SWAPS	**Value (bp)**	**Weekly chg. (bp)**	**YTD chg. (bp)**
EURRON 1Y	-155	0	-25
EURRON 3Y	-165	0	-10
EURRON 5Y	-155	0	-35

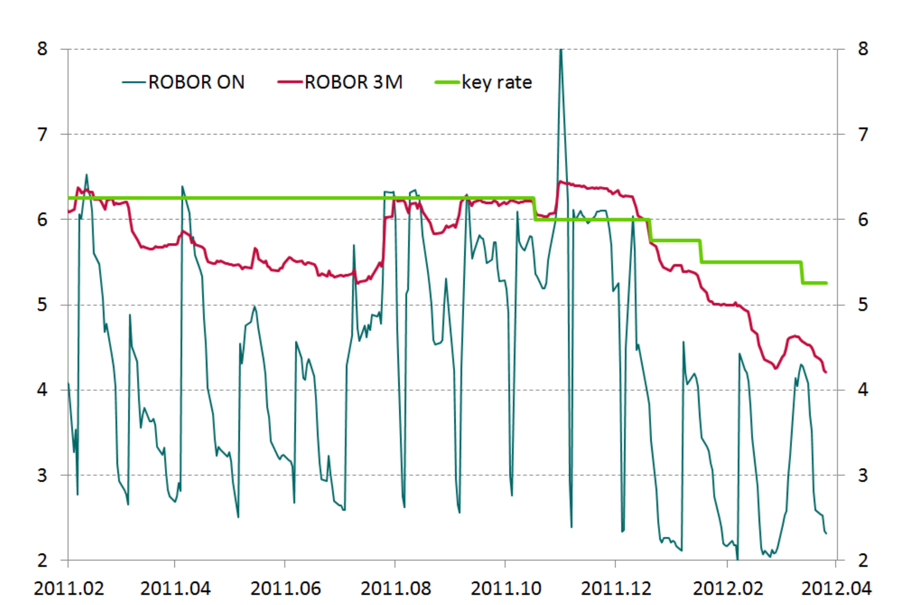
Source: Reuters

New interbank deposits (flow) and average interest rate, last 6 weeks



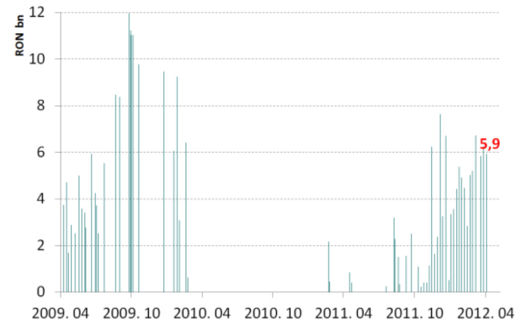
Sources: NBR, OTP Research

Most important MM instruments from 2011 (%)



Sources: Reuters, NBR, OTP Research

Repo operations during 2009 -2012



Sources: NBR, OTP Research

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