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Weekly Report

Romania

17 May 2012



All growth scenarios will suffer from Greek exit

Although March macroeconomic data and prospects were pointing to the right direction, especially if we added the surplus coming from the increase in state employees' wages, outlook can change radically in terms of growth. Government yields and the RON are under pressure in the short term.

Macroeconomics: Q1 GDP growth stood at -0.1% QoQ and 0.3% YoY; April inflation dipped to 1.8% YoY (Page 3-5)

According to the flash estimate, GDP contracted by 0.1% QoQ (seasonally adjusted data) and grew by 0.3% YoY. Annual dynamics fell short of analysts expectations of 0.9% YoY but the most important thing is that Greek exit could impact seriously all growth forecasts whereas the announced increase in wages are a support factor adding some 0.4% to GDP. Looking only at March data and expectations for April, we would say that the painted picture was brighter, before news struck out related to Greece forming a new government and anti austerity leaders coming out with new support and threatening to dismiss bailout terms. Industrial production was up by 0.7% MoM, net wages rose by 4.8% MoM and in the case of constructions, although we witnessed a large fall, we noticed that residential buildings construction restarted after a few months of serious decline. Perspectives for April were better, according to business sentiment indicators. Even if April comes out with good results, the risk of turnaround in the coming months increased.

FX markets: RON to lowest levels as risk aversion increases due to talks of Greek exit (Page 6)

Following last week's events, with talks about Greece's exit from the euro zone, RON depreciated significantly (by 0.8%) against the euro. By comparison, peer currencies lost on average more or less the same, unlike previous weeks when RON used to keep stable. Since RON's depreciation is due to fundamental factors and not to speculative capital, the Central Bank seems less inclined to go against the market trend. Volatility likely to persist in the coming weeks. Next important moment on the political scene seems to be Greece electing a new government in Mid June.

Government securities: Stable yields last week for the RON treasuries but high volatility kicks in this week (Page 7-8)

Last week government securities yields were stable but volatility is up this week. The Treasury can roll over 4M of debt with the existing buffer. Under the scenario of an imminent Greek default, it would still have to go on the market for financing, even if the sold amounts would probably smaller. Therefore, at least in the coming weeks we expect yields to continue to climb.

MM: The Central Bank Governor stated that there was room for a base rate cut but international tensions could postpone it (Page 9)

The CB maintained its inflation forecast at 3.2% (Dec 2012). The CB Governor admitted there is room for a base rate cut, but the tensions in the external environment could put pressure on the RON and determine capital flight. About the RMO (reserve ratio) for RON denominated liabilities, Mr. Isarescu commented that if the CB were to cut, it would be in small steps from 15% to 10% and that currently, the repo amount injects an equivalent amount of liquidity to that released in a case of a drop of the RMO to 10%.

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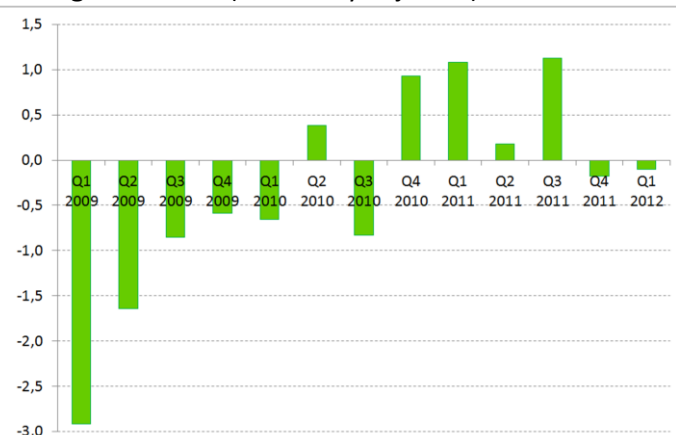
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Macroeconomics: Q1 GDP growth stood at -0.1% QoQ and 0.3% YoY; April inflation dipped to 1.8% YoY

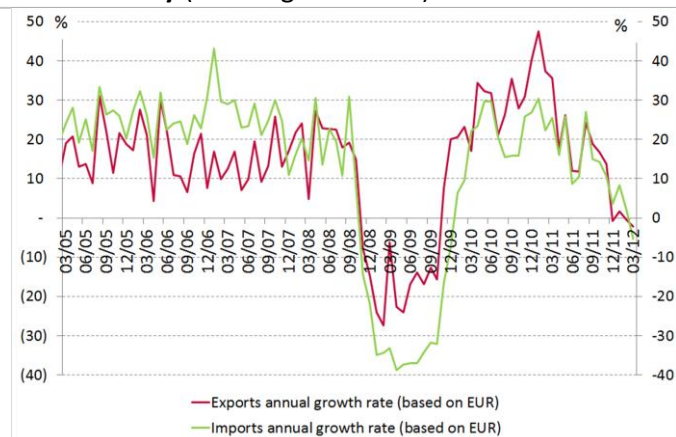
PERIOD		INDICATOR	FACT	CONSENSUS	PRIOR
07 May	MAR	Net wage growth rate (m-o-m, %)	4,8		0,3
09 May	MAR	Trade balance (EUR, mn)	714,2		511,7
09 May	MAR	Exports (y-o-y, %)	-2,2		-0,4
09 May	APR	Imports (y-o-y,%)	-5,3		2,2
09 May	MAR	Industrial trade turnover index (y-o-y, %)	1,4		-1,5
09 May	APR	Index value of new orders in manufacturing (y-o-y, %)	4,1		-0,6
09 May	MAR	Construction works index (y-o-y, %)	-10,2		6,9
11 May	APR	Wholesale services turnover index (y-o-y,%)	-2,1		4,6
11 May	MAR	Households services turnover index (y-o-y, %)	-0,8		-6,9
11 May	APR	Consumer price index (y-o-y,%)	1,8		2,4
11 May	MAR	Industrial Production Index (y-o-y, %)	-1,2		-1,4
15 May	Q1 2012	Flash GDP growth rate (q-o-q, %, seasonally adjusted)	-0,1	0,0	-0,2
16 May	March	CA balance (EUR, mn)	120,0		-626,2
16 May	March	net FDI (EUR, mn)	184,0		249,2
16 May	March	External debt (bn EUR)	76,4		75,5

According to the flash estimate, GDP contracted by 0.1% QoQ (seasonally adjusted data) and grew by 0.3% YoY. The quarterly growth rate was a bit lower than analyst's expectations but the annual rate was significantly different: analysts polled by Reuters had predicted a 0.9%YoY rate. Greece exiting the euro zone could seriously impact all growth scenarios negatively. On the other hand, the increase in wages would add an extra 0.3% -0.4% to the GDP. We maintain ou 1.4% YoY growth scenario but risks are tilted to the downside.

In March, the trade deficit shrank by 19.4% YoY, to 714.2 mn EUR. Looking at the annual dynamics we notice that exports stepped deeper in the negative territory: -2.2% YoY in March compared to -0.4% YoY in February. Imports' pace dropped as well to -5.3% YoY in March compared to +2.2% YoY earlier in February. However, for this month we have a strong base effect from last year and when seasonally adjusting the data we notice that in fact, we see a small increase in exports on a monthly basis. In March last year, the business climate indicator (1.4) was at historical peaks and since then it has deteriorated significantly (-0.28 in March 2012). 72% of Romania's exports go to the European Unions states (UE 27), therefore Romanian exports are highly dependent on the economic development in Europe, especially Germany, Italy and France. Growth estimates (Reuters poll) in these three countries were much lower for Q1 2012 compared to Q2 2012 (see table below). The momentary turnaround on the Greek political scene and on

GDP growth QoQ (seasonally adjusted)


Source: Eurostat, OTP Research

Trade activity (annual growth rate)


Source: Eurostat, OTP Research

German as well (Merkel losing support) could derail growth prospects.

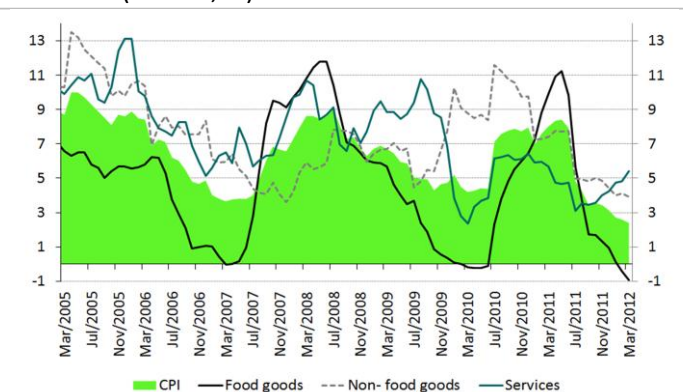
QoQ GDP growth (Reuters poll)	Germany	Italy	France
Q1 2012	0,10%	-0,70%	-0,10%
Q2 2012	0,30%	-0,30%	0%

Source: Reuters, OTP Research

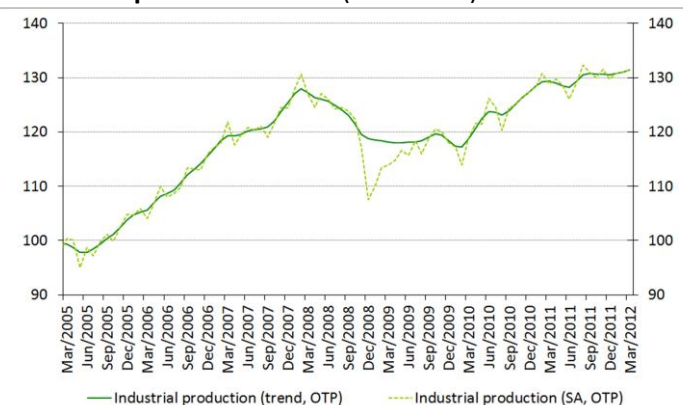
April's inflation stood at 1.8% YoY, significantly lower than the previous month (2.4% YoY). The main driver were food prices which dropped by 1.94% YoY and which make up to 37% of the consumer basket. Services prices topped the increases with 6.03% YoY growth, followed by non foods (+3.21 YoY). However, CORE2 adjusted inflation stood at 2.12% YoY, higher than the previous month (2.03% YoY). This reflects the CPI without administered & volatile prices and without tobacco & alcohol. This is one of the main indicators followed by the Central Bank (CB) for monetary policies purposes. In its inflation report, the CB was expecting that CORE2 adjusted inflation would decline until the end of the year to 1.9% YoY but it looks like we had a small deviation in April. The CB forecasts 3.2% YoY inflation in December and according to comments in the local media, it estimates that the hike of the public employees wages will increase prices marginally: 0.2%-0.3% but it will be compensated by other effects such as a good agricultural year and consequently, smaller hikes in agricultural products' prices.

Industrial production index came up higher by 0.7% MoM (seasonally adjusted data), compared to -1.4% MoM in the previous month. Top hikes were recorded in the mining and quarrying industries (+6.7% MoM), followed by manufacturing (+1.4% MoM); energy production (electricity, gas, steam, air conditioning) was deeply in the negative area (-9.8% MoM). Mining and quarrying held 1.3% of the VA in 2009 while the energy producing industries had 2.7%. Manufacturing, on the other hand stood at 22%. Unfortunately, we noticed that manufacturing industries with higher value added and which make up a large share in exports, declined in March: we envisage production of motor vehicles & trailers and production of machinery and equipment. The indicator of confidence in industry (April) and the new orders in manufacturing index (March) would suggest a further increase in production in April. However, given the international turmoil due to events in Greece, this change of sentiment could turn out to be temporary.

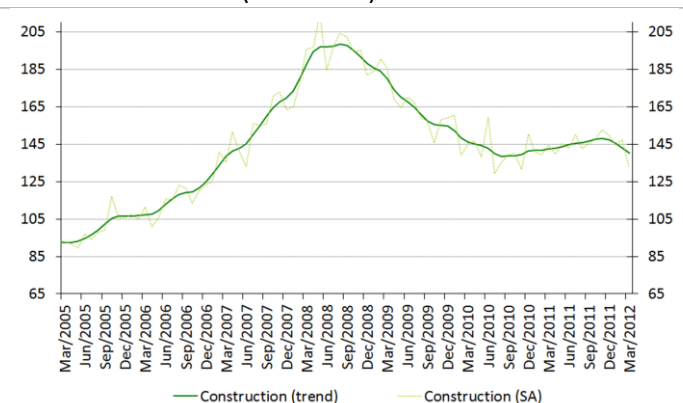
Constructions took a big hit in March (-8.8% MoM, seasonally adjusted data) and they have been falling for 4 months in a row. In Dec 2011 – Feb 2012, support came from civil engineering, but March numbers dropped by 15% MoM. Surprisingly, we noticed an increase of the residential constructions (+16.5% MoM), but this rise compensates part of the large drop that took place between Dec 2011 – Feb 2012 (-39%). Again, the confidence indicator improved in

Inflation (annual, %)


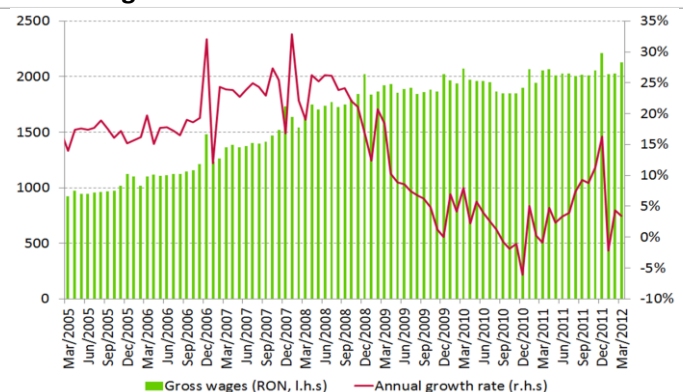
Source: INS, OTP Research

Industrial production index(2005=100)


Source: Eurostat, OTP Research

Construction index(2005=100)


Source: Eurostat, OTP Research

Gross wages


Source: INS, OTP Research

April so we may see growth, but just like in industry, it could be temporary. Wages data for March was encouraging as well: net wages were up 4.8% MoM and gross wages by 3.4% MoM. Moreover, our in-house seasonally adjusted data pointed to a hike also. The announced increase of the state employees wages should help boost consumer confidence before the actual increase takes place in June.

Medium-term macroeconomic forecast

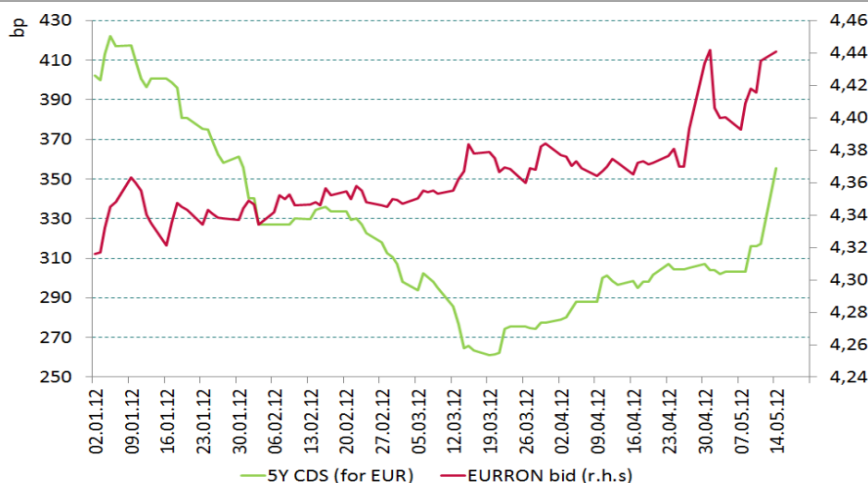
Main macroeconomic indicators	Fact						Forecast	
	2006	2007	2008	2009	2010	2011	2012	2013
Real GDP	7,9%	6,3%	7,3%	-6,6%	-1,6%	2,5%	1,4%	2,8%
Final consumption of households	12,9%	12,0%	9,0%	-10,4%	-0,4%	1,4%	2,3%	2,9%
Households consumption expenditure	12,7%	11,9%	9,0%	-10,1%	-0,4%	1,3%		
Government 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%	-6,8%	-5,2%	-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%	1,0%	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

FX markets: RON to lowest levels as risk aversion increases due to talks of Greek exit

Following last week's events, with talks about Greece's exit from the euro zone, RON depreciated significantly (by 0.8%) against the euro. By comparison, peer currencies lost on average more or less the same, unlike previous weeks when RON used to keep stable. The Polish zloty was down by 1.6%, the Hungarian forint lost 1% and the Czech crown dipped by 0.4%. The euro was hardly hit itself losing 1.3% to the dollar. Risk indicators such as the CDS started to show again positive correlation with the FX rate and the large weekly jumps were mirrored by the RON's depreciation suggesting that external factors become problematic for the RON now, whereas fiscal and monetary policy are on good track, especially if the government maintains fiscal targets previously negotiated.

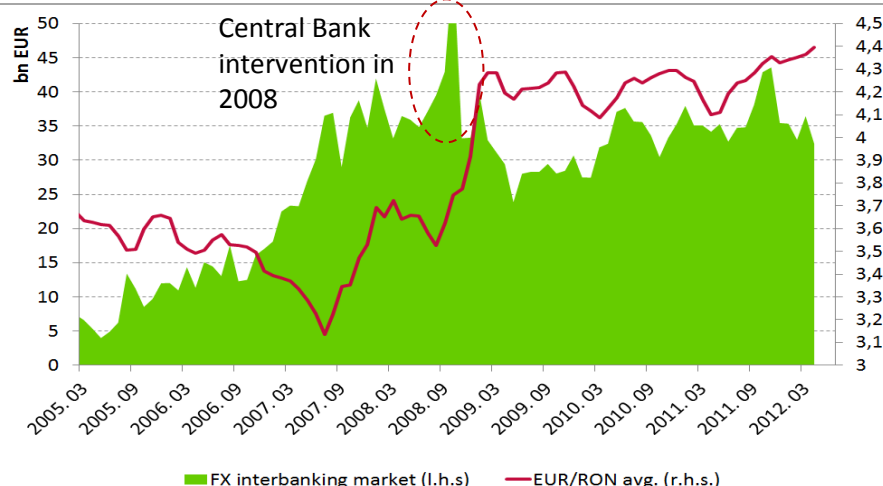
EUR/RON and the 5Y CDS



Sources: Reuters, OTP Research

The above is true especially since trading volumes are low (please see the below chart) and they even decreased in April. The outliers we see in FX interbanking volume can be explained by more significant intervention of the Central Bank. **However, since RON's depreciation is due to fundamental factors and not to speculative capital, the Central Bank seems less inclined to go against the market trend. Volatility likely to persist in the coming weeks. Next important moment on the political scene seems to be Greek elections to form a new government, which could happen as early as 17th June.**

EUR/RON and FX interbanking market

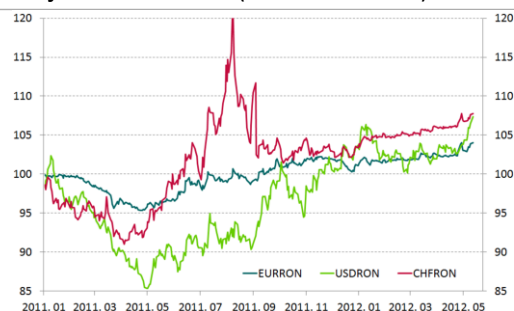


Sources: NBR, OTP Research

FX BID			
	Value	Weekly chg. (%)	YTD chg. (%)
EURRON	4.44	↑ 0.79	↑ 2.19
USDRON	3.43	↑ 2.01	↑ 2.47
CHFRON	3.69	↑ 0.80	↑ 3.43
RONJPY	4.29	↑ 1.86	↓ -1.33
RONPLN	1.04	↓ -0.78	↑ 1.12
100HUFRON	1.53	↓ -0.40	↑ 11.58
RONCZK	0.18	↑ 0.29	↑ 3.80
RONRUB	0.11	↑ 0.64	↑ 9.39
RONRSD	0.04	↓ 0.00	↑ 0.00
RONBGN	2.27	↑ 0.70	↑ 2.42

Source: Reuters

Major RON FX rates (03.01.2011=100)



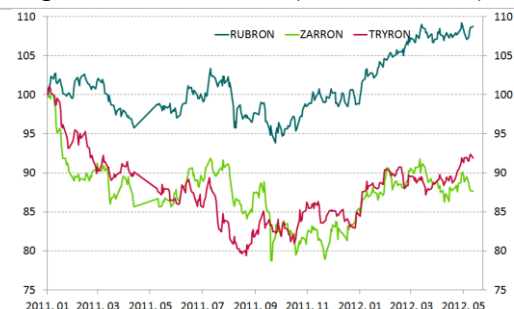
Sources: Reuters, OTP Research

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: Stable yields last week for the RON treasuries but high volatility kicks in this week

RON denominated government securities did not react last week to increased risk perception. The yield curve moved marginally down, up to -3bp in the case of the 12M T-Bills and we noticed that euro denominated bonds reacted faster to change in risk perception: yields moved up by 23 bp (the 6M bill). Looking at volumes traded on the secondary market and recorded by SAFIR, we notice that indeed, average daily volume on the euro denominated securities increased compared to the previous week, whereas the ones in RON were down from 2.9 bn RON/ day to 2.5 bn RON/ day.

This week we already see reactions in yields, the driver is deteriorated risk perception. The Treasury can roll over 4M of debt with the existing liquidity buffer. Under the scenario of an imminent Greek default, it would still have to go on the market for financing, even if the sold amounts would probably smaller. Therefore, at least in the coming weeks we expect yields to continue to climb.

RON GOVERNMENT SECURITIES				
	Value	Weekly chg. (bp)	YTD chg. (bp)	
6M	4,85	↓ -2	↓ -140	
12M	4,99	↓ -3	↓ -140	
3Y	5,99	↑ 0	↓ -116	
5Y	6,11	↓ -1	↓ -114	
10Y	6,44	↓ 0	↓ -90	

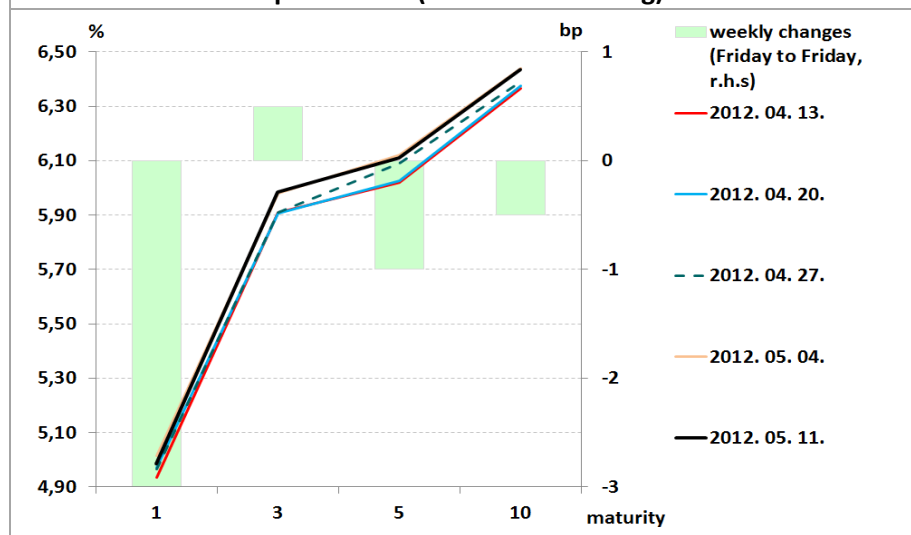
EUR GOVERNMENT SECURITIES				
	Value	Weekly chg. (bp)	YTD chg. (bp)	
6MRO0912DBE034	2,97	↑ 23	↓ -114	
2YRO1013DBE014	4,19	↑ 11	↓ -114	

SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	579	↑ 0	↓ -107	
GERROM 5Y	555	↓ -1	↓ -94	
GERROM 10Y	484	↓ 0	↓ -67	
3Y -5Y	12	↓ -2	↑ 1	
5Y -10Y	33	↑ 1	↑ 25	
3Y-10Y	45	↓ -1	↑ 26	
FLY 3-5-10	20	↑ 2	↑ 23	

CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	280	↑ 16	↓ -92	
5Y EURO	316	↑ 13	↓ -86	

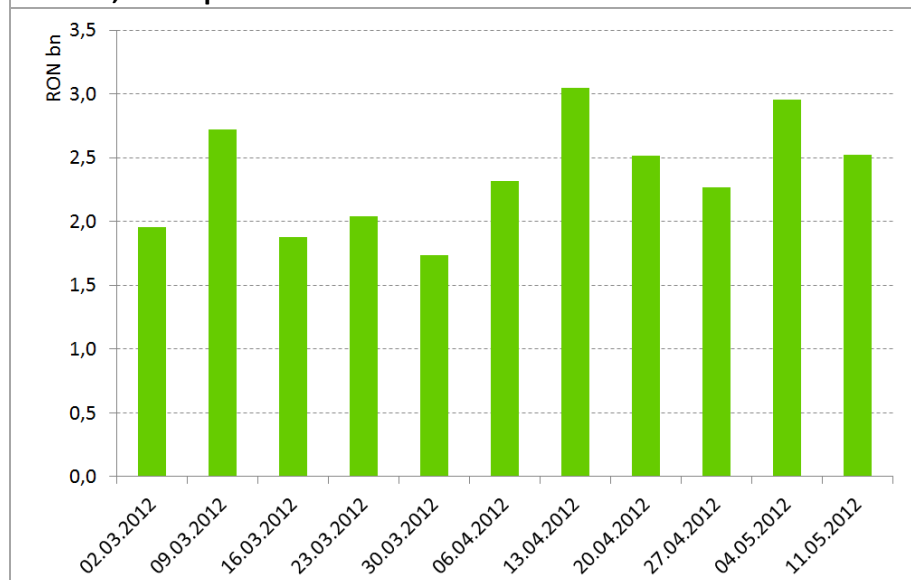
Source: Reuters

Yield curve over the past weeks (Central Bank fixing)



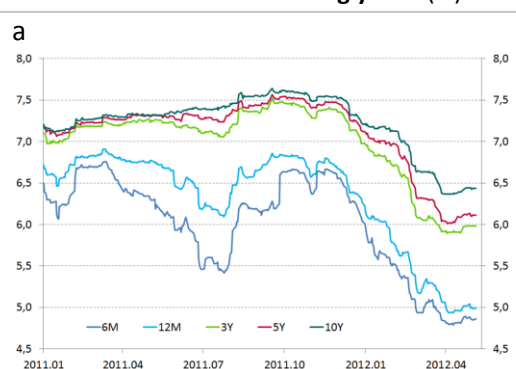
Sources: NBR, OTP Research

Average daily amount of RON denominated securities on the secondary market, in the past weeks



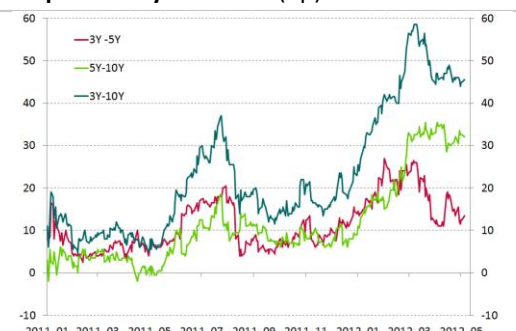
Sources: NBR, OTP Research

Central bank benchmark fixing yields (%)



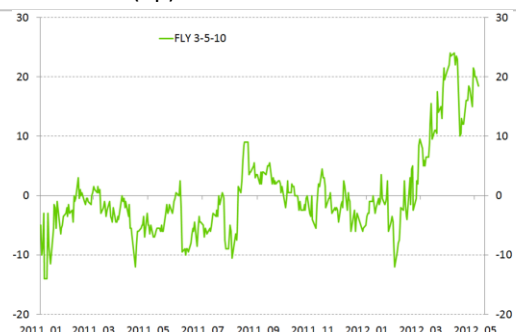
Sources: NBR, OTP Research

Slope of the yield curve (bp)



Sources: NBR, OTP Research

FLY 3-5-10 (bp)

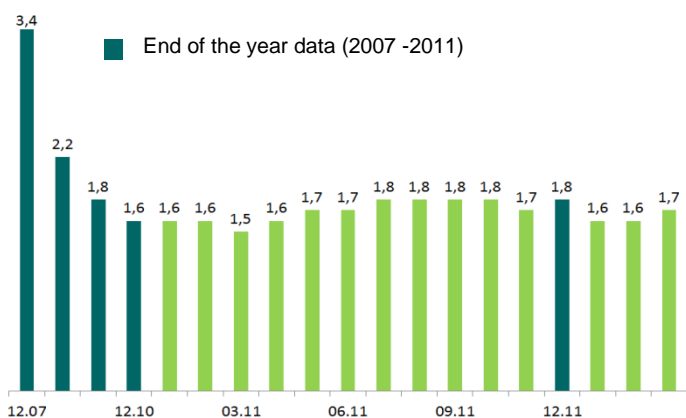


Sources: NBR, OTP Research

Auction results

The Treasury held two auctions last week: one for 12M T-Bills and the second one for 4Y bonds. The Treasury sold the planned amount in 12M bills, of 750 mn RON at an average yield of 5.02%, identical with the yield of the similar auction on 9th of April. Bid to cover ratio stood at 3.08, lower than the previous auction when we saw a 4.42. Demand was lower as total bids amounted 2.3 bn RON compared to 4.4 bn RON in April. At the second auction, the Treasury sold 1.34 bn RON in 4Y bonds, at an average accepted yield of 6.09%, which was 3bp higher than the one recorded at the previous similar auction on 5th of April. Demand was lower as total bid amount stood at 2.3 bn RON, smaller by some 400 mn RON.

According to the Finance Ministry, **the average maturity of the government securities portfolio increased marginally in March to 1.7 years**, so the current strategy of prolonging the maturity by selling more bonds seems to be working. However, **with yields growing due to increased risk premium, the Treasury could be determined to sell fewer bonds for the moment such as to avoid a higher debt service and take advantage of the existing buffer.**

Remaining maturity of government securities


Source: Ministry of Finance, OTP Research
Note: the Eurobonds were not included

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

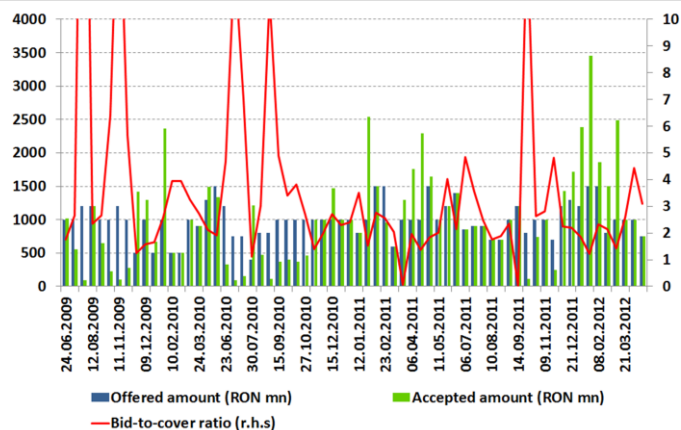
Q1 2012		Q2 2012		Q3 2012		Q4 2012	
Jan-12	4.341	Apr-12	4.391	Jul-12	3.716	Oct-12	4.475
Feb-12	2.459	May-12	4.030	Aug-12	1.902	Nov-12	2.676
Mar-12	4.012	Jun-12	3.275	Sep-12	3.053	Dec-12	1.713

Sources: Ministry of Finance, OTP Research

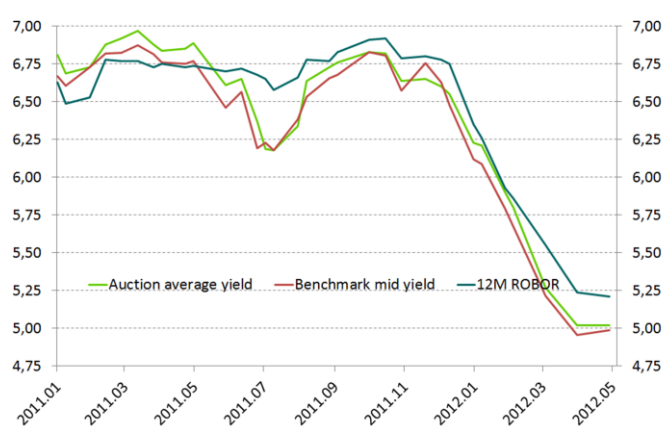
Summary of last week's auctions

	RO1213CTN0B5	RO1216DBN030
Offered amount (RON mn)	750	1000
total bids (RON mn)	2314	2282
accepted amount (RON mn)	750	1340
average accepted yield (%)	5.02	6.09
coupon	-	5.75

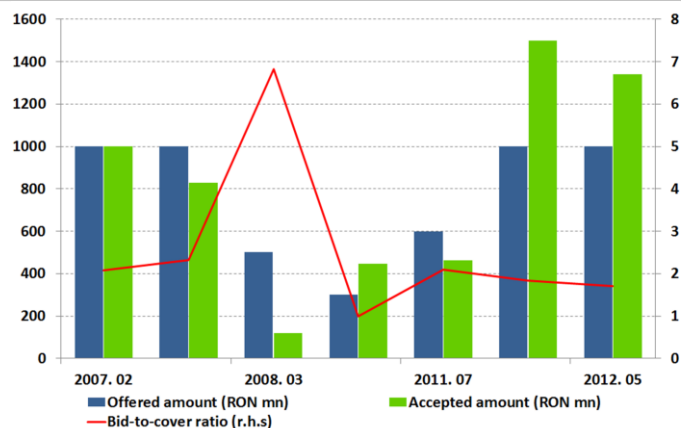
Source: Ministry of Finance, OTP Research

12M auctions data


Sources: NBR, OTP Research

12M interest rates


Sources: NBR, OTP Research

4Y auctions data


Sources: NBR, OTP Research

T –bills auction in May

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1213CTN0B5	07.05.2012	09.05.2012	08.05.2013	12	750.000.000

Source: Ministry of Finance, OTP Research

Bonds auctions in May

ISIN	Auction	Settlement	Maturity	Years	Coupon %	Indicative target amount (RON)
RO1216DBN030	10.05.2012	14.05.2012	27.01.2018	4	5.75	1.000.000.000
RO1214DBN027	14.05.2012	18.05.2012	23.04.2014	2	5.95	900.000.000
RO1217DBN048	17.05.2012	21.05.2012	26.07.2017	5	5.9	850.000.000
RO1220DBN057	24.05.2012	28.05.2012	27.01.2020	7	5.85	500.000.000

Source: Ministry of Finance, OTP Research

MM: The Central Bank Governor stated that there was room for a base rate cut but international tensions could postpone it

Money market rates declined last week as NBR marginally increased its weekly repo amount to 6.5 bn RON (by 306 mn RON). Outstanding interbank deposits were higher as well, by 677 mn RON compared to a week before. This explains why ROBOR ON declined by 17 bp to 4.28%. Headlines related to the Greek exit appeared later last Friday and this put upward pressure on MM rates only this week. Until the end of the day, the EURRON basis swaps had plenty of time to react: +25 bp for the 1Y and 3Y maturities. This means that borrowing euro through swaps became more expensive, as tension on the international market builds in and all eyes are focused on debt roll over in Greece, Spain and Italy.

The Central Bank presented its last inflation report where it kept unchanged the end of the year inflation rate and it remained confident to stay within the target of 2%-4%. During the Q&A session, the **Governor stated that there is room for cutting the base rate but it is uncertain if they will operate the cut at the next Board Meeting** on monetray policy issues. In fact, he seemed more inclined to wait on the cut, main concern being the shaky international environment. **The main reason was tied to the RON's depreciation following intensified external tensions**, which could pressure inflation through import prices. Fear of the flight of capital from Emerging European countries was reiterated, just like at the previous presentation of the inflation report in February. Mr. Mugur Isarescu added this is the reason for which the mandatory reserves ratio in RON were not cut to 10% from the current 15% and that this should have been a "normal" level. Instead, NBR prefers to inject the equivalent liquidity amount, around 6 bn RON on a weekly basis through the repo operation. Also, the Governor added that **if NBR would operate a reduction of the RMO (mandatory reserve ratio), it would be in smaller steps than directly to 10%**.

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	↔ 0	↓ -75
ROBOR ON	4,28	↓ -17	↓ -25
ROBOR 3M	4,50	↓ -1	↓ -155
ROBOR 6M	5,04	↓ -1	↓ -149
ROBOR 9M	5,14	↓ -3	↓ -147
ROBOR 1Y	5,21	↓ -2	↓ -145

REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	6.492,2	306,1	-218,8

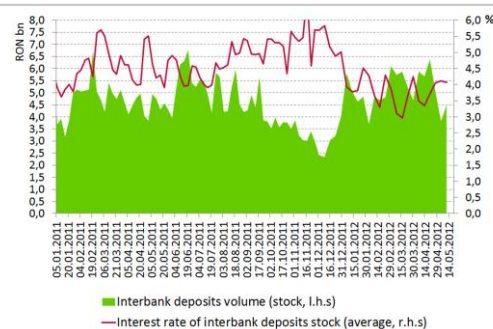
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	4.495,0	676,6	467,5

MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	24	↑ 0	↓ -1
USDRON 1M	91	↑ 10	↓ -58
USDRON 3M	260	↑ 30	↑ 14
EURRON 1W	11	↓ -26	↓ -30
EURRON 1M	105	↑ 27	↓ -40
EURRON 3M	431	↑ 3	↓ -79

MID EUR BASIS SWAPS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EURRON 1Y	-130	↑ 25	↔ 0
EURRON 3Y	-130	↑ 25	↑ 25
EURRON 5Y	-130	↑ 15	↓ -10

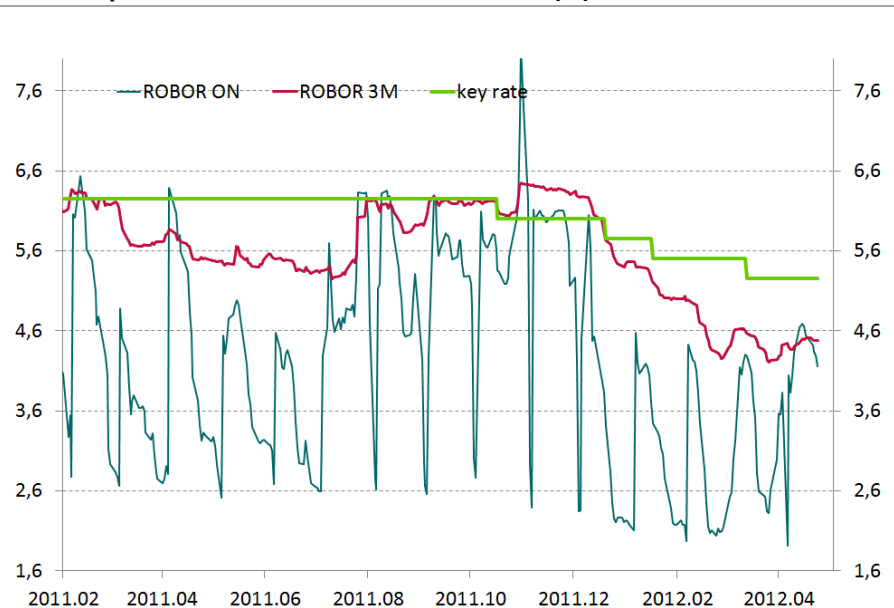
Source: Reuters

Interbank deposits (stock) and average interest rate



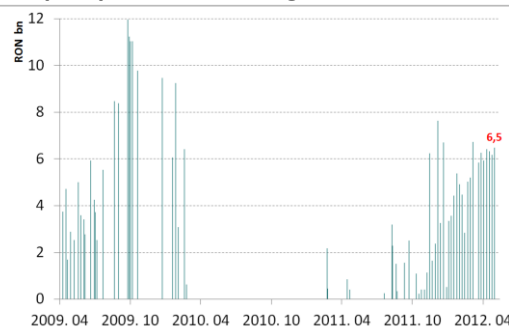
Sources: NBR, OTP Research

Most important MM instruments from 2011 (%)



Sources: NBR, OTP Research

Repo operations during 2009 -2012



Sources: NBR, OTP Research

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