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# Weekly Report

## Romania

8 June 2012



## Compared to last week, less tension is felt on the MM and FI markets

Risk aversion was at high levels last week as pointed by the 5Y CDS and Central Bank officials stepping out to oppose speculation regarding the EUR/RON level in case of Greek exit. Expectations about households demand falling on a quarterly basis in Q1 were confirmed this week. The turnaround in sentiment could come from EU leaders advancing more serious discussions to end crisis: i.e. fiscal union (long-term expected improvement) and direct support to Spanish banks (short-term expected result).

### Macroeconomics: Unemployment rate rose to 7.2% in April; PPI up at 6.5% YoY (Page 3 -4)

In April, the unemployment rate continued to climb from 7.2% (March) to 7.4%, seasonally adjusted data show. During the boom years (2005-2008), the average unemployment rate stood at 6.6%. The turning point was in 2009, when the economy reached rock bottom and unemployment rose from 5.7% in December 2008 to 7.5% in December 2009. We may be looking for the new turning point but on the upside this time, observing when the unemployment rate stabilizes below the 7% long-term average. Producer price index rose to 6.5% YoY in April, driven by the large price hike of 9.6% YoY on the external markets. As demand is still weak, increases in producer prices take longer to be incorporated in consumer prices.

### FX markets: NBR opposes the view according to which EUR/RON could hit 5 (Page 5 - 6)

While admitting that a disorderly Greek exit would affect all European currencies, not only the euro and implicitly the RON, CB officials opposed firmly to the view according to which the EUR/RON could hit 5.

### Government securities: moderate increase in yields (max. 4 bp); new CB rule will boost demand for treasuries (Page 7-8)

Last week, RON-denominated securities increased again moderately (1-4 bp) but the 5Y CDS jumped 31 bp, the highest level this year. This week we saw some relief and a falling CDS, below 400 bp. The Central Bank issued a new rule by which it allows a number of 5 different issues to be brought as collateral for its open market operations, instead of 3. This is an incentive to hold more treasuries and it will act towards depressing the yields especially since local banks are the majority holders of treasuries.

### MM: The Central Bank facilitates the use of collateral for its Repo operations (Page 9-10)

After two consecutive weeks in which repo volume stood at 8bn RON and MM rates were still climbing, the Central Bank took a measure targeted at boosting liquidity on the interbanking market, without decreasing the mandatory reserves ratio. This allows more flexibility regarding the collateral that banks bring for the repo operations and, in the medium term, should act towards decreasing the MM rates.

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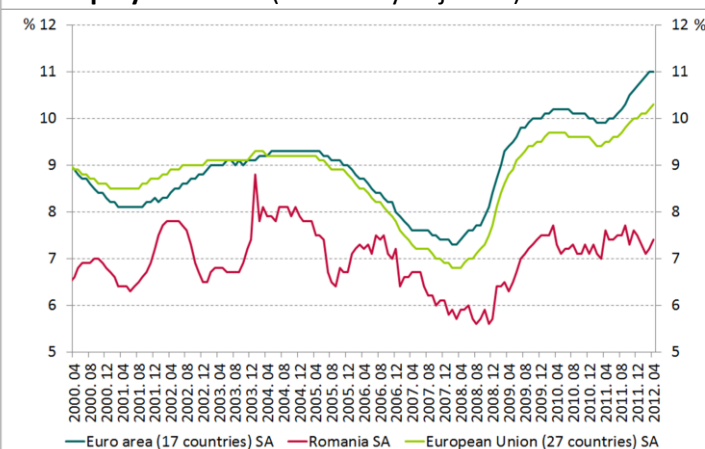
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**Macroeconomics: Unemployment rate rose to 7.2% in April; PPI up at 6.5% YoY**

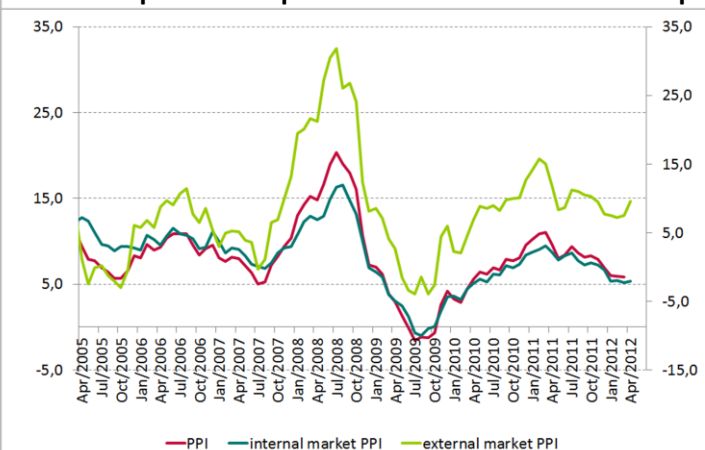
	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
30 May	APR	Licenses for residential buildings (y-o-y, %)	-2,0		-6,8
01 Jun	MAY	FX reserves (bn EUR)	33,5		34,3
01 Jun	APR	Industrial production price indices (y-o-y, %)	6,5		5,8
01 Jun	APR	ILO unemployment rate (% , seasonally adjusted)	7,4		7,2
05 Jun	APR	Turnover in retail trade (y-o-y, %)			1,8
06 Jun	APR	Net wage growth rate ( m-o-m, %)			4,8
08 Jun	APR	Industrial trade turnover index (y-o-y, %)			1,4
08 Jun	APR	Index value of new orders in manufacturing (y-o-y, %)			4,1

**In April, the unemployment rate continued to climb from 7.2% (March) to 7.4%**, seasonally adjusted data show. The hike was higher than the figure for the EU27 where the advance was only 0.1%, to 10.3%. In absolute terms, the number of unemployed increased by 4,000 in April, after having declined continuously in January-March. As this is a lagging indicator, the increase is in line with the decline in the economic activity that we saw in Q1 2012. Therefore, we expect some more adjustments in the coming months. During the boom years (2005-2008), the average unemployment rate stood at 6.6% and the long-term average is around 7% (January 2000-April 2012). **The turning point was in 2009, when the economy reached rock bottom and unemployment rose from 5.7% in December 2008 to 7.5% in December 2009.** We may be looking for the new turning point, but on the upside this time, observing when the unemployment rate stabilizes below the 7% long-term average.

**Unemployment rate (seasonally adjusted)**


Source: NBR, OTP Research

**Producer price index rose to 6.5% YoY in April, driven by the large price hike of 9.6% YoY on the external markets.** By comparison, the increase was lower by 2 percentage points in March. On average, the RON depreciated by 6.8% YoY in April against the euro and this may have contributed to the large jump we saw. On the domestic market, the price increase was 5.3% YoY, slightly higher than in March (5.2% YoY). **As demand is still weak, increases in producer prices take longer to be incorporated in consumer prices.** Analysing the price hike by industrial sections, we notice that the main price increase is the water supply & sewerage price (+28.9% YoY) due to investments made by producers to keep to EU regulations. We already saw a passthrough to CPI on this segment, to a great extent (approximately 20% YoY was the price increase of the CPI component). Manufacturing producer prices increased as well, a bit more than the average: 6.9.% YoY. **Looking at the main industrial groups, the main driver was energy goods: +11.3% YoY. The smallest hike was noticed at durable consumer goods: +1.99%.**

**Industrial production price index rose to 6.5% YoY in Apr**


Source : INS, 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%	0,0%	0,0%
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	-6,0	-6,4
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%*	4,5%	4,4%
Real wage growth	9,0%	14,7%	16,5%	-1,5%	-3,7%	0,2%*	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	4,44	4,60
EUR/RON (e.o.p.)	3,38	3,61	3,99	4,23	4,28	4,32	4,50	4,59

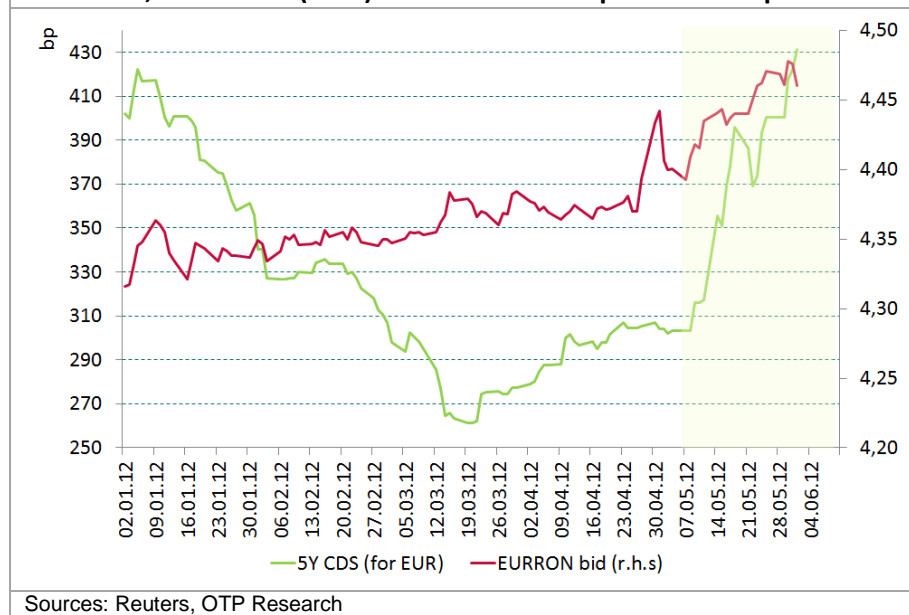
Source: Eurostat, OTP Research

Note: \* forecast;

**FX markets: NBR opposes the view according to which EUR/RON could hit 5**

The RON appreciated last week by 0.2%, contrary to its peers: the Polish zloty shrank 0.9% against the euro, the Czech crown and Hungarian forint lost 1.7% each. Risk indicators were close to the highest historical levels, with the 5Y CDS hitting 431 bp on Friday. The bid-ask spread returned to its long-term average, pointing to the fact that the markets got used to EUR/RON new trading range.

Last week, the 5Y CDS (euro) close to historical peak at 431 bp

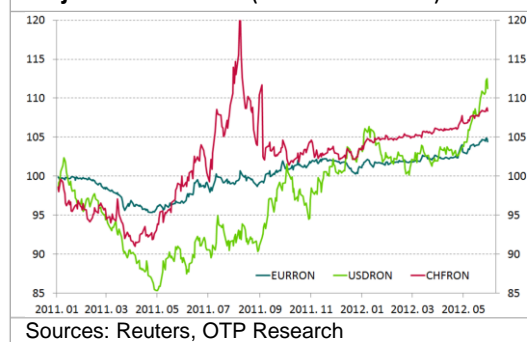


From the FX interbanking market figure for May, we see that the volume of transactions per day increased to 1.9 bn EUR from a monthly average of 1.65 bn EUR during first four months in 2012. Looking back from 2008, we see that **each time we noticed a spike in the interbanking market volume, the EUR/RON jumped in a new trading range from which it did not slide back** (only temporarily, due to volatile capital inflows as it happened last year in Q1 due to non-residents' buying government securities). For example, in August 2008-November 2008, the EUR/RON jumped from 3.5 to 3.7, then in January 2009 it jumped from 3.9 to 4.2; in April 2010-June 2010 it climbed from 4.14 to 4.24 and in September 2011-November 2011 it rose to 4.35 from 4.28. The last spike was in May 2012, to 4.44 from 4.4 in April 2012. While the 2008 episode is widely known, when the Central Bank intervened to stop speculation on the RON, the moments when the CB intervenes are not known with precision. However, since the higher volumes cannot be attributed to increased activity resulting from needs of economic agents, they are a sign of increased tensions on the FX markets when the CB probably had to intervene to temper the RON's volatility. The question worth answering is to what extent can the CB intervene to prevent an abrupt appreciation. While admitting that a disorderly Greek exit would affect all European currencies, not only the euro and implicitly the RON, CB officials opposed firmly to the view according to which the EUR/RON could hit 5. **Regarding the importance of the Greek exit scenario we will publish a detailed analysis about it soon.**

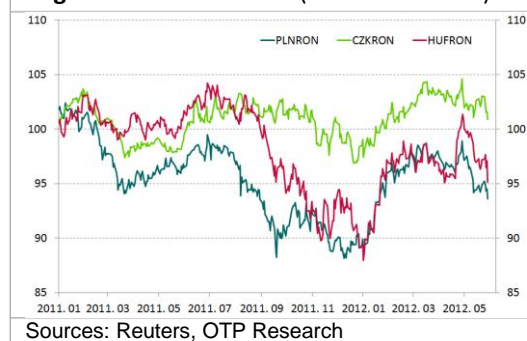
FX BID			
	Value	Weekly chg. (%)	YTD chg. (%)
EURRON	4,46	↓ -0,24	↑ 3,22
USDRON	3,59	↑ 0,28	↑ 7,61
CHFRON	3,72	↓ -0,09	↑ 4,62
RONJPY	4,59	↑ 2,43	↑ 6,13
RONPLN	1,01	↓ -1,30	↓ -1,99
100HUFRON	1,46	↓ -2,15	↑ 6,72
RONCZK	0,17	↓ -2,10	↑ 2,55
RONRUB	0,11	↓ -4,40	↑ 2,96
RONRSD	0,04	↓ 0,00	↑ 0,00
RONBGN	2,28	↓ -0,40	↑ 3,38

Source: Reuters

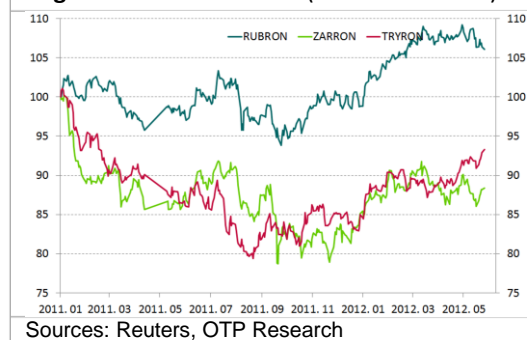
Major RON FX rates (03.01.2011=100)



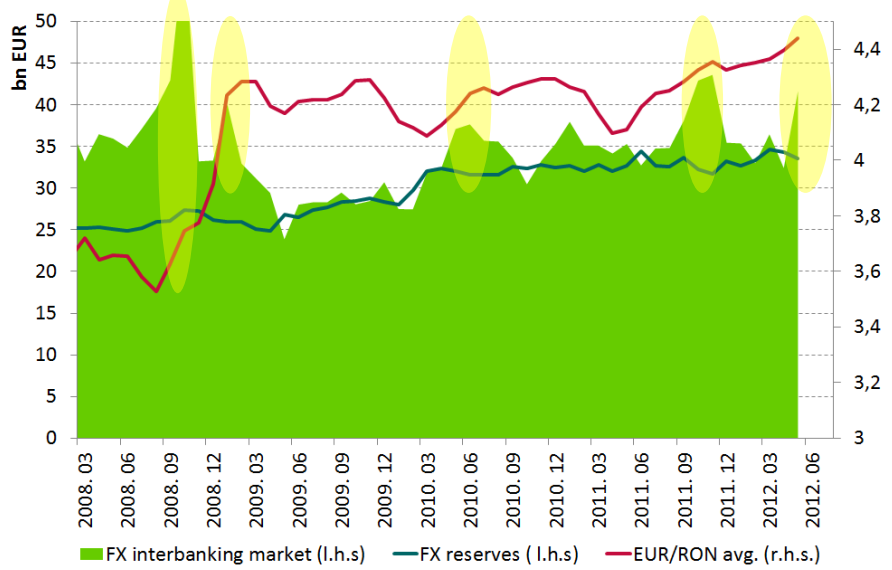
Regional RON FX rates I. (03.01.2011=100)



Regional RON FX rates II. (03.01.2011=100)



**In May, FX interbanking market rose in close to levels seen in Oct-Nov 2011, when markets were tense on Greek 2<sup>nd</sup> bailout discussions;**



Sources: NBR, OTP Research

**Government securities: moderate increase in yields (max. 4 bp); new CB rule will boost demand for treasuries**

Last week, RON-denominated securities increased again moderately (1-4 bp) but the 5Y CDS jumped 31 bp, the highest level this year. Consequently, we noticed further widening of the spread to German bunds.

Treasuries' market revived last week as the daily average volume traded on the secondary market and recorded by SaFir increased 60% WoW to 2.4 bn RON (for RON-denominated securities) from 1.6 in the previous 2 weeks. What may have boosted trading is the new rule issued by the Central Bank by which it allows a number of five different issues to be brought as collateral, instead of three for its open market operations. On the one hand, the high cost of funds and the risk premium reaching close to the highest historical levels keeps the yields up. On the other hand, this CB rule is an incentive to hold more treasuries and will act towards depressing the yields especially since the local banks are the majority holders and there are several reasons for which demand-side factors could have a lesser negotiation power than supply-side factors:

- The present liquidity buffer that the Treasury holds decreases the pressure to sell more treasuries in the short term
- The Treasury is willing to tap international markets;

On the supply side:

- Treasuries are attractive for local banks (and not only) due to high real rates and low probability of default (for the worst-case scenario, Romania has a precautionary agreement with the IMF until 2013 worth 5 bn EUR)
- Very liquid investment as it can be used as collateral for open market operations; this will diminish liquidity premium
- As lending pace is slowing and new loans' generation decreases, treasuries are an attractive investment on a risk-reward basis.

RON GOVERNMENT SECURITIES				
	Value		Weekly chg. (bp)	YTD chg. (bp)
6M	5,16	↑	2	↓ -110
12M	5,26	↑	4	↓ -113
3Y	6,14	↑	1	↓ -101
5Y	6,29	↑	4	↓ -97
10Y	6,59	↑	3	↓ -74

EUR GOVERNMENT SECURITIES				
	Value		Weekly chg. (bp)	YTD chg. (bp)
6MRO0912DBE034	3,09	↓	0	↓ -102
2YRO1013DBE014	4,26	↑	0	↓ -107

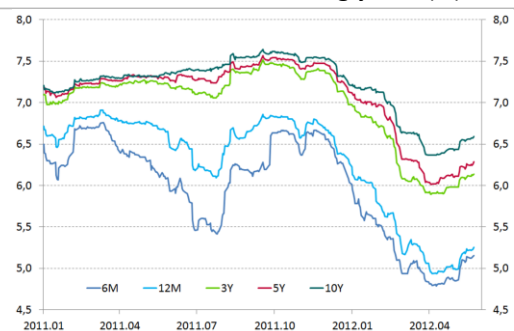
SPREADS				
	Value (bp)		Weekly chg. (bp)	YTD chg. (bp)
GERROM 3Y	604	↑	4	↓ -82
GERROM 5Y	586	↑	6	↓ -64
GERROM 10Y	522	↑	4	↓ -29
3Y -5Y	15	↑	2	↑ 4
5Y -10Y	31	↓	-1	↑ 23
3Y-10Y	46	↑	1	↑ 27
FLY 3-5-10	15	↓	-3	↑ 18

CDS MID SPREADS				
	Value (bp)		Weekly chg. (bp)	YTD chg. (bp)
3Y EURO	395	↑	31	↑ 23
5Y EURO	431	↑	31	↑ 29

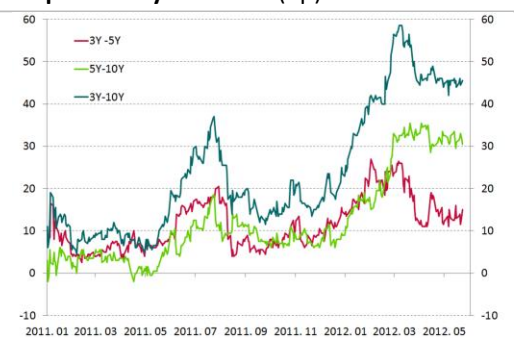
Source: Reuters

**Central bank benchmark fixing yields (%)**



Sources: NBR, OTP Research

**Slope of the yield curve (bp)**



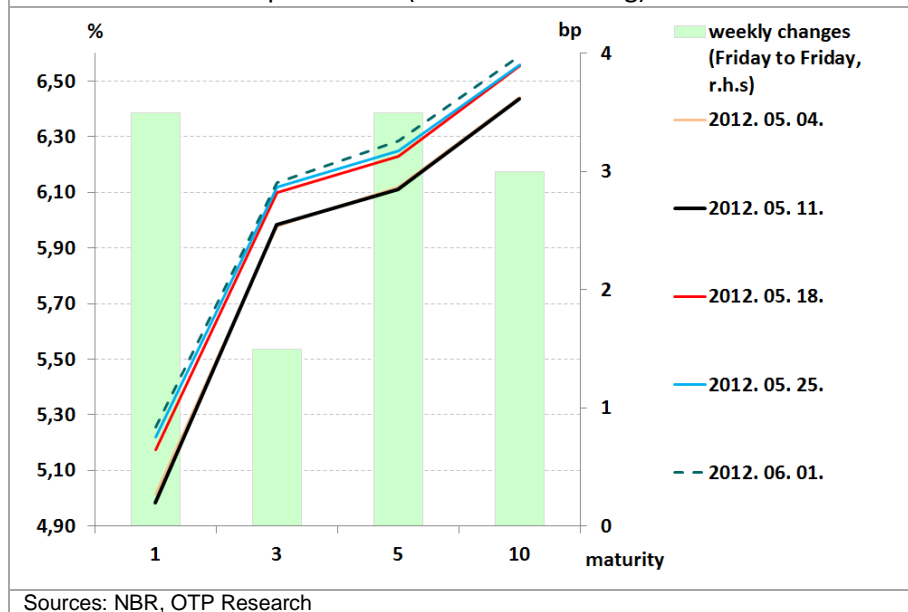
Sources: NBR, OTP Research

**FLY 3-5-10 (bp)**

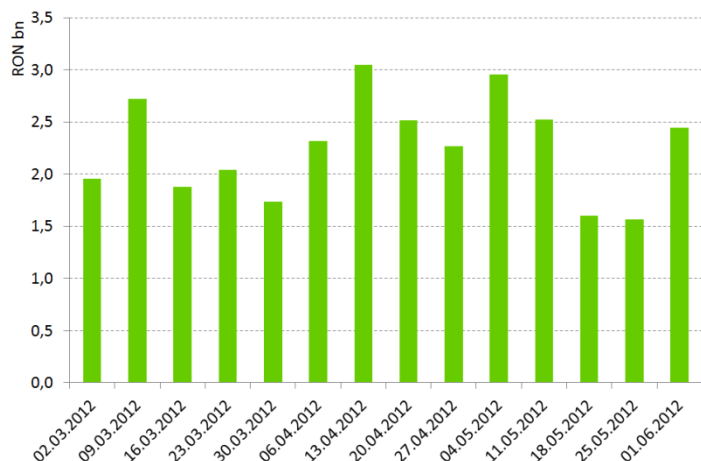


Sources: NBR, OTP Research

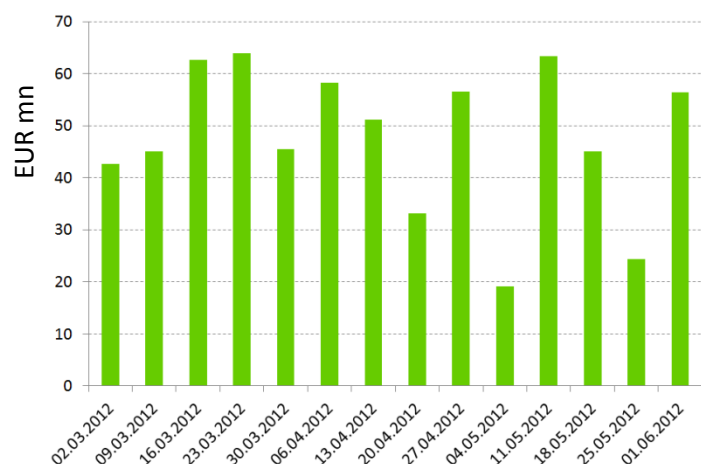
Yield curve over the past weeks (Central Bank fixing)



Sources: NBR, OTP Research

**Average daily volume of RON denominated treasuries traded on the secondary market increased last week**


Source: NBR, OTP Research

**Average daily volume of euro-denominated treasuries traded on the secondary market increased last week**


Source: NBR, OTP Research

**T-bills auction in June**

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
R01213CTNOC3	11.06.2012	13.06.2012	12.06.2013	12	1.000.000.000
R01213CTNODI	18.06.2012	20.06.2012	19.06.2013	12	800.000.000

Source: Ministry of Finance, OTP Research

**Bonds auctions in June**

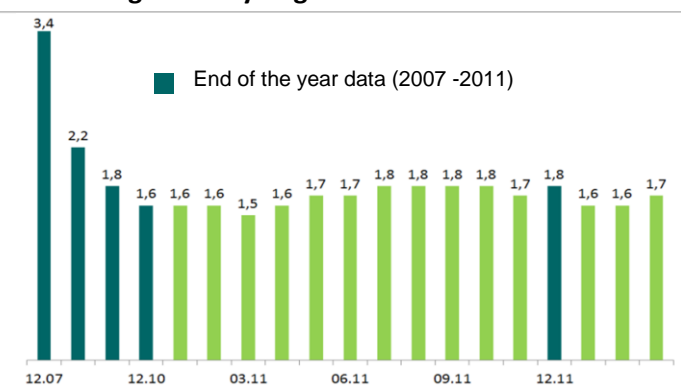
ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
R01214DBN027	07.06.2012	11.06.2012	23.04.2014	2	5,95	700.000.000
R01214DBN027	14.06.2012	18.06.2012	23.04.2014	2	5,95	600.000.000
R01216DBN030	21.06.2012	25.06.2012	27.01.2016	4	5,75	400.000.000

Source: Ministry of Finance, OTP Research

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

Q1 2012		Q2 2012		Q3 2012		Q4 2012	
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

**Remaining maturity of government securities**


Source: Ministry of Finance, OTP Research

Note: the Eurobonds were not included

**The MinFin plans for less bonds issue in June**

	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12
Planned targeted amount (RON bn)	4,5	5,0	5,0	4,3	3,8	3,5
% of bonds	33%	44%	54%	76%	80%	49%

Source: Ministry of Finance, OTP Research



### MM: The Central Bank facilitates the use of collateral for its Repo operations

After two consecutive weeks in which repo volume stood at 8bn RON and MM rates were still climbing, the Central Bank took a measure targeted at boosting liquidity on the interbanking market, without decreasing the mandatory reserves ratio which, as we said in a previous report, would have an uncertain effect on the interbanking market, given the risk of capital flight. Consequently, the CB decided to accept for its open market operations (including repo) a number of 5 options (issues) instead of 3 as before. This allows more flexibility regarding the collateral that banks bring for the repo operations and in the medium term, should act towards decreasing the MM rates. As a result, this week the volume hit a historical level at 12.1 bn RON but rates fail to drop. Meanwhile, we observe a continuous decline of outstanding interbanking deposits: they were down at 2.6 bn RON last Friday, this year's daily average being 4.9 bn RON.

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	↔ 0	↓ -75
ROBOR ON	5,32	↑ 9	↑ 79
ROBOR 3M	5,32	↔ 0	↓ -73
ROBOR 6M	5,43	↓ -1	↓ -110
ROBOR 9M	5,43	↓ -2	↓ -118
ROBOR 1Y	5,45	↓ -1	↓ -121

REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	8.077,4	134,1	1366,4

INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	2.634,8	-1041,6	-1392,7

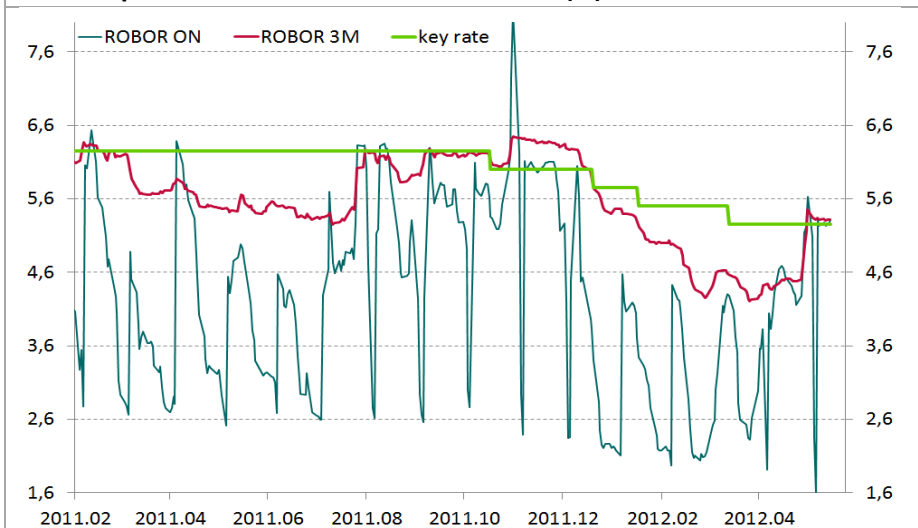
MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USD RON 1W	38	↓ 2	↑ 14
USD RON 1M	143	↓ -5	↓ -6
USD RON 3M	409	↑ 35	↑ 162
EUR RON 1W	44	↑ 0	↑ 3
EUR RON 1M	182	↑ 51	↑ 37
EUR RON 3M	554	↑ 21	↑ 43

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

Source: Reuters

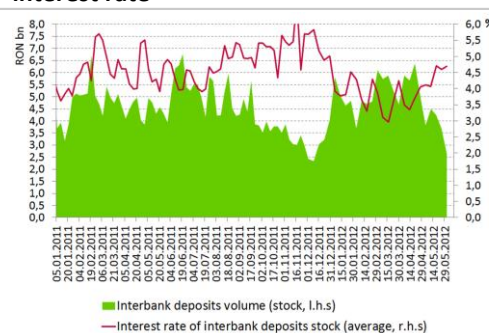
Most important MM instruments from 2011 (%)



Sources: NBR, OTP Research

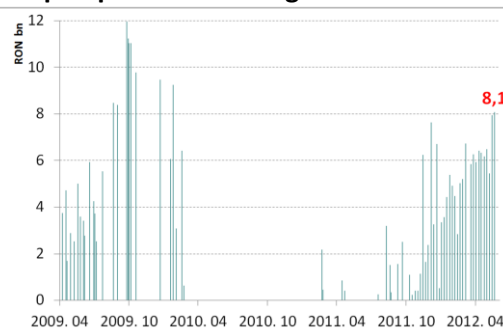
This year, the excess liquidity that the overall banking system held dropped continuously as the evolution of the total amount of money placed in the deposit facility/month at the CB shows. In May, the amount placed with the CB dropped by 30% MoM (6 bn RON or on average 273 mn RON/day) and banks did not use the credit facility. After hovering around 3% in January-April, average daily ROBOR ON jumped by 130 bp in May and ROBOR 3M by 60 bp. If compared to May, banks get an additional liquidity of 4 bn RON per week through the repo operations, then we should see the rates drop but judging by the speed of adjustment, most likely the effect will be felt in July if no extraordinary event happens (please see the graph below).

Interbank deposits (stock) and average interest rate



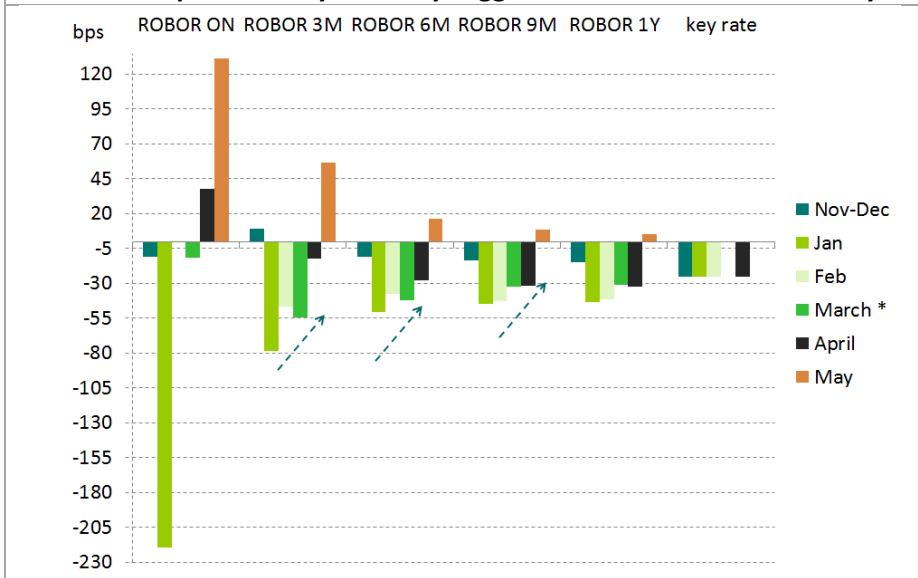
Sources: NBR, OTP Research

Repo operations during 2009 -2012



Sources: NBR, OTP Research

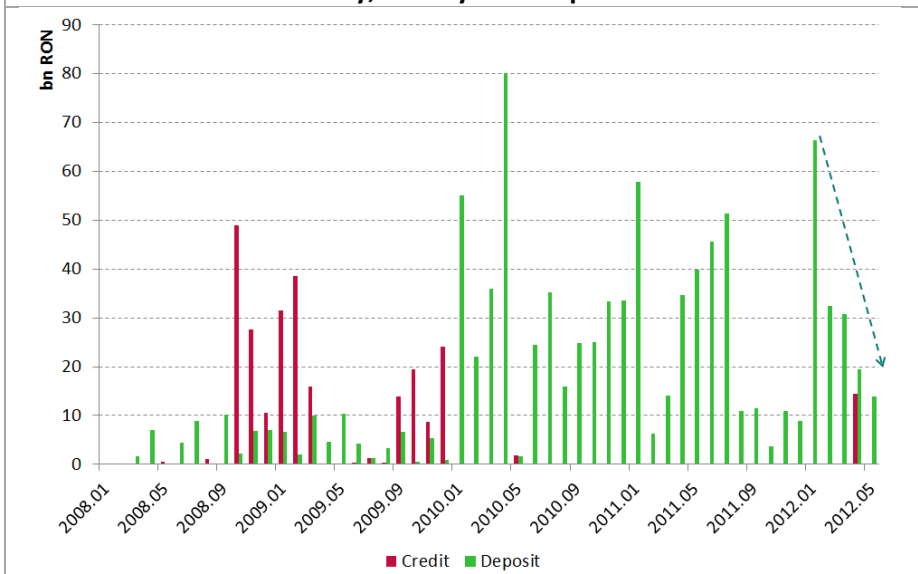
The effect on MM rates of each base rate cut lowers each month; the last base rate cut was mostly effective in April; at the same time, the liquidity level fell in April and May and they triggered hikes in MM rates in May



Sources: NBR, OTP Research

\*In April we showed the base rate rate cut which was effective on 30<sup>th</sup> March

Standing facilities: in May, banks placed a lower amount of deposits and did not use the credit facility, as they did in April



Sources: NBR, OTP Research

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