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Weekly Report

Romania

22 June 2012



Risk aversion was marginally down this week

Macroeconomics: CA deficit shrank in April; FDI in the month close to zero; industrial production up in April; Core2 adjusted advanced in May by 0.1 % since the last base rate decision (Page 3-5)

In Jan- April, the CA account deficit stood at 1230 mn EUR and it shrank by 23.8% YoY. The main reason of the shrinkage is the higher surplus in current transfers (+24.3% YoY). the shrinking of the trade balance deficit is due to a slowing down in imports pace, as internal demand weakened. Net FDI were close to zero, after having shown a small recovery during first two months this year. In April, industrial production index was up by 0.1% YoY, compared to the previous two months when we had seen declines. Unfortunately, confidence in industry deteriorated in May. Although inflation remains subdued and inside it's variation band of 2%-4%YoY, *Core2 adjusted inflation* has been marginally advancing since the base rate decision (from 2.03% YoY in March to 2.15% in May). Consequently, we expect end of the year figure, to be higher than the CB forecast of 3.2% by 0.1 - 0.2 %.

FX markets: Even the little volatility that we see in the RON remains driven by international events (Page 6)

In the past week, the RON remained connected to the EUR/USD pair and we saw it appreciate against the EUR and falling below the 4.46 level for a few days. The EUR/USD broke above the 1.27 level after Greek elections and on hopes that the FED will announce more monetary stimulus. Instead, the FED only chose to prolong its "Operation Twist" program. Since worries related to Greek vote on the euro started in May, the CDS climbed from around 300 bp to around 430 bp. Consequently, risk perception related to Romanian assets deteriorated and hit the fixed income assets and the RON as well. Sentiment improved and the CDS is now at 370 bp. However, it remains high compared to the level seen in Mid-March, which means that risks for the RON remain therefore tilted downwards.

Government securities: This week, yields fell marginally as the risk premium and funding costs were down (Page 7-8)

After the increase in the previous weeks, this week yields slid down marginally, especially at the low end of the yield curve in line with lower funding costs and decreased risk aversion. This week there were two auctions in which the Finance Ministry tried to sell 800 mn RON in 12M T-bills and 400 mn RON in 4Y bonds. Both auctions were undersold. Just as the latest auctions have proved to be unsuccessful in selling new treasuries amounts, the NBR published a proposal to modify the rule regarding the functioning of the primary bonds markets by which it modifies evaluation criteria for primary dealers.

MM: The Central Bank will remain cautious on 27th June (Page 9 -10)

The result of this week-end's elections in Greece released the immediate perceived risk aversion against Romanian assets and took off some pressure from the interbanking markets as well. Since the last Board meeting on monetary policy issues, which was almost two months ago, on 2nd of May, the political local environment and international financial settings changed significantly. In view of the coming base rate decision on 27th of June, given that risks regarding the international environment intensified in past one and a half months, the Central Bank will most likely remain cautious.

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Macroeconomics: CA deficit shrank in April; FDI in the month close to zero; industrial production up in April; Core2 adjusted advanced in May by 0.1 % since the last base rate decision

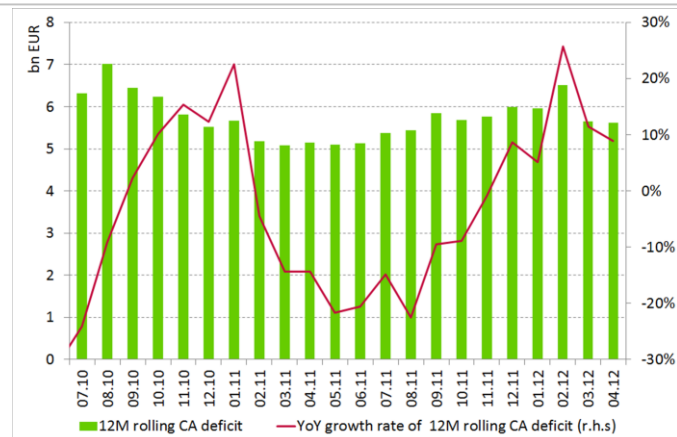
	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
11 Jun	APR	Households services turnover index (y-o-y, %)	-5,4		-0,8
11 Jun	MAY	Consumer price index (y-o-y,%)	1,8		1,8
11 Jun	APR	Industrial Production Index (y-o-y, %)	0,1		-0,9
12 Jun	APR	Wholesale services turnover index (y-o-y,%)	7,6		-1,4
18 Jun	APR	CA balance (EUR mn, YTD)	-1.230		- 544
27 Jun	MAY	M3 aggregate (y-o-y, %)			11,2
27 Jun	MAY	Non -governmental loans (y-o-y, %)			9,8
27 Jun	MAY	Non -governmental deposits (y-o-y, %)			12,0
27 Jun	MAY	Base rate decision (%)		5,25	5,25

In Jan- April, the CA account deficit stood at 1230 mn EUR and it shrank by 23.8% YoY. The main reason of the shrinkage is the higher surplus in current transfers (+24.3% YoY), followed by the reduction in the deficit of the trade balance (-4% YoY) and income balance (-4.3% YoY). The decomposition of the CA deficit is 1768 mn EUR trade gap, 850 mn EUR income gap and 1387 mn EUR surplus of current transfers.

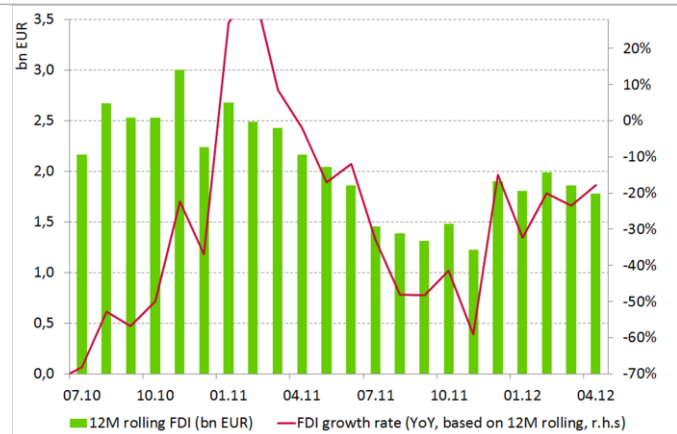
Looking separately, the shrinking of the trade balance deficit is due to a slowing down in imports pace: in Jan – Apr, exports were up 2.4% YoY and imports only 1.7% YoY as internal demand weakened. In April only exports' pace was unexpectedly high (+4.3% YoY) and imports continued to decline (-1.3% YoY) but at a smaller pace than in the previous month (-3.1% YoY). Therefore, this signals internal demand is still at low levels (we saw a decline in consumption in Q1 2012). Judging by the steep decline in the level of new orders in manufacturing for external markets (-11.5% YoY) we will probably see a weakening of exports too, as industrial products have a high weight in exports. This means that the trade gap will widen again soon.

The current transfers jump of 24.3 YoY in Jan –April is due mostly to the advance of transfers for the public administration (mainly EU funds). Inflows amount to 1.2 bn EUR during the first 4M (+32% YoY) but for the entire year, the government has planned a total figure of 6 bn EUR. Other transfers (mainly workers' remittances) show a progress as well: +11% YoY (or a net balance of 888 mn EUR).

On the financing side, we notice that FDI (411 mn EUR) cover only 33% of the CA deficit and the trend is descending (-23% YoY) after having shown a small recovery during first two months this year.

CA evolution


Source : INS, OTP Research

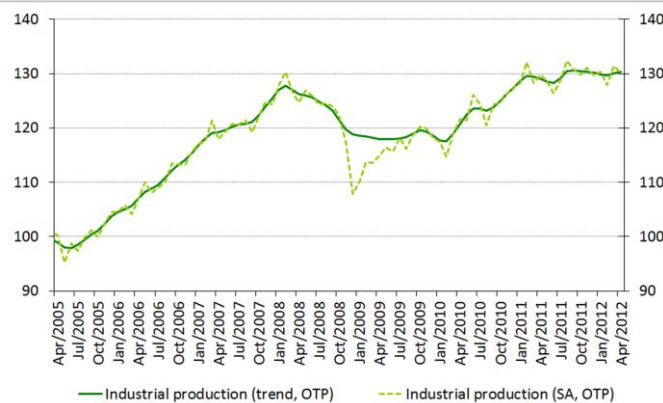
FDI evolution


Source: INS, OTP Research

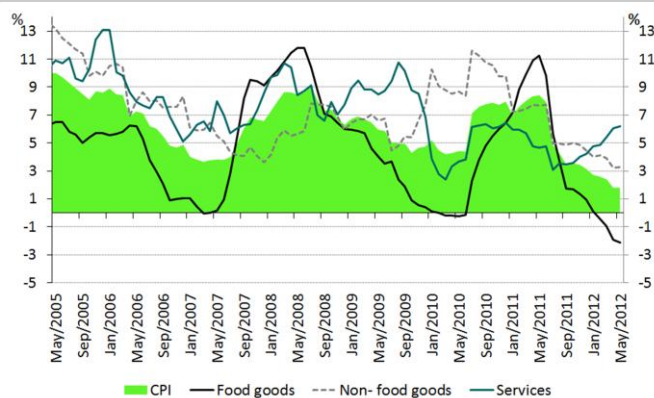
In April, industrial production index was up by 0.1% YoY, compared to the previous two months when we had seen declines. Growth drivers were the capital goods industries (+10.8% YoY) and the durable consumer goods (+5.2% YoY). The strongest decline was seen in the case of intermediate goods (-8.3% YoY) which has been down in the past 4M and consumer goods (except food, beverages and tobacco) with a slump of 5.4% YoY. **Unfortunately, confidence in industry deteriorated in May**, compared to the previous month (according to the survey published by the European Commission). This was due to the managers' negative assesment of current level of order books.

In May, inflation rate remained stable at 1.8% YoY. Food goods continued their decline (-2.13% YoY) while non food goods and services prices were up by 3.3% YoY and 6.2% YoY respectively. **However, although inflation remains subdued and inside it's variation band of 2%-4%YoY, Core2 adjusted inflation has been marginally advancing since the last base rate decision (from 2.03% YoY in March to 2.15% in May).** It is a measure that refers to CPI from which we exclude the volatile prices, administered prices and tobacco&alcohol. This parameter is under the radar at each base rate decision. **Central Bank's assumptions regarding the inflation rate were that Core2 adjusted will decline further in Q2 2012 but this has not happened, to the contrary. Consequently, we expect end of the year figure to be higher than the CB forecast of 3.2% by 0.1 - 0.2 %.**

The INS also released data related to the **turnover index of services for households and for companies (wholesale).** The data showed **divergent evolution for these two types of consumers.** In April, turnover for **services adressed to households dropped by 5.4% YoY** while in the case of companies, the turnover went up by 7.6% YoY.

Industrial production (2005 =100)


Source : INS, OTP Research

CPI evolution


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;

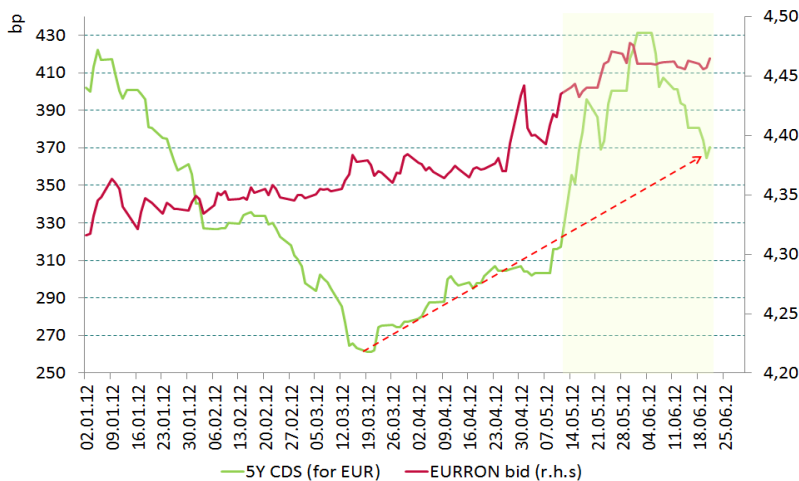
FX markets: Even the little volatility that we see in the RON remains driven by international events

In the past week, the RON remained connected to the EUR/USD pair and we saw it appreciate against the EUR and falling below the 4.46 level for a few days. The EUR/USD broke above the 1.27 level, after Greek elections and on hopes that the FED will announce more monetary stimulus. Instead, the FED only chose to prolong its “Operation Twist” program, by which it prolongs the maturity of its treasuries portfolio.

Even the little volatility we see for the moment is due to international context. The next bump in the road seems to be June 29, when the last session of the German Parliament takes place ahead the summer recess. It is then when **Angela Merkel needs** to unite forces with the opposition **to get the German’s Parliament support for the Fiscal Pact and the European Stability Mechanism (ESM)** which is set up to become functional in July. The bailout funds agreed for Spain are only available if the ESM becomes functional. One of the conditions imposed by the opposition is the implementation of the financial transactions tax (on shares, bonds transactions and derivatives). It appears that Angela Merkel agreed to the financial tax and struck a deal with the opposition: even if it is not going to be accepted on all 27 states, then they count on a coalition of at least 9 member states to accept this tax. **Failure to get this support from the German Parliament would send a wrong signal to the markets, but for the moment at least, risks are being contained.**

Besides international markets’ influences, a look at the fundamentals tells us the **net FDI were close to zero in April and we expect no improvement in May either**, given that the Greek exit issue was the word of the day and businesses started making doomsday scenarios. **Since worries related to Greek vote on the euro started in May, the CDS climbed from around 300 bp to around 430 bp.** Consequently, risk perception related to Romanian assets deteriorated and hit the fixed income assets and the RON as well. **Sentiment improved and the CDS is now at 370 bp. However, it remains high compared to the level seen in Mid-March, which means that risks for the RON remain therefore tilted downwards.**

The additional increase in the 5Y CDS due to the imminence of Greek elections cleared, but the level remains high compared to Mid-March



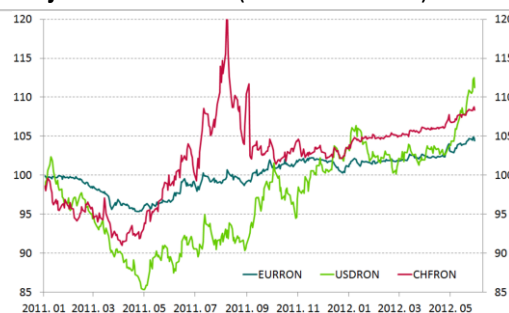
Sources: Reuters, OTP Research

Last data: 21.06.2012

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4,46	↑	0,12	↑ 3,15
USDRON	3,56	↑	0,81	↑ 5,35
CHFRON	3,71	↑	0,16	↑ 4,47
RONJPY	4,43	↓	-0,13	↑ 2,03
RONPLN	1,04	↓	-0,10	↑ 1,47
100HUFRON	1,55	↑	2,58	↑ 13,55
RONCZK	0,17	↓	-0,98	↑ 3,44
RONRUB	0,11	↓	-1,13	↑ 4,17
RONRSD	0,04	↑	0,00	↓ 0,00
RONBGN	2,28	↑	0,19	↑ 3,42

Source: Reuters

Major RON FX rates (03.01.2011=100)



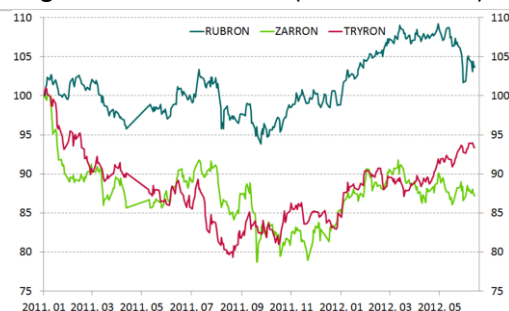
Sources: Reuters, OTP Research

Regional RON FX rates I. (03.01.2011=100)



Sources: Reuters, OTP Research

Regional RON FX rates II. (03.01.2011=100)



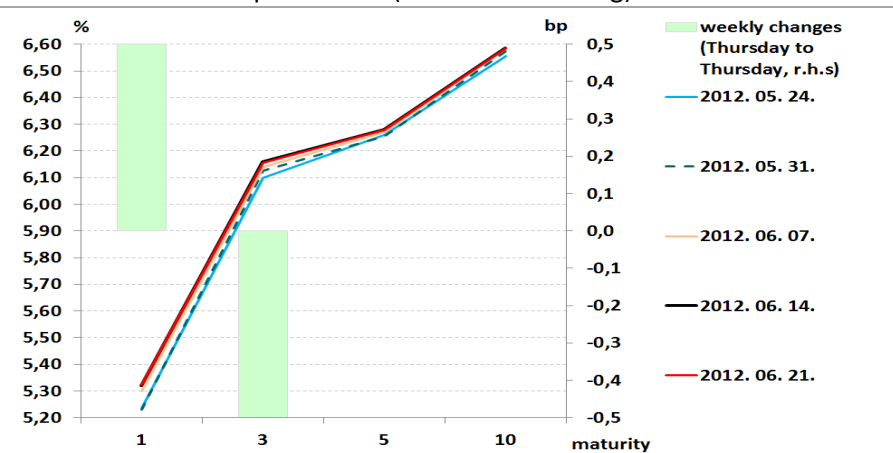
Sources: Reuters, OTP Research

Government securities: This week, yields fell marginally as the risk premium and funding costs were down

After the increase in the previous weeks, this week yields slid down marginally, especially at the low end of the yield curve in line with lower funding costs and decreased risk aversion, as showed by the 3Y and the 5Y CDS (by 22 -24 bp). Tensions on the international markets have affected Romanian assets, treasuries included, in the previous weeks but they cleared for the moment this week, after two positive news regarding Greek elections and the bailout for the Spanish banks. **The evolution of treasuries yields in the coming weeks is related to a large extent to risk perception related to emerging markets and this perception is very sensitive to rumours related to the sufficiency of the bailout fund for Spain (at first glance more than enough) and also to the succes of the last session of the German Parliament (29th June) in which it has to approve the Fiscal Pact and the ESM.** The spread to German bunds paints a different picture compared to the CDS, as it widened 3bp to 596 bp for the 3Y maturity. The term premiums for 3Y-5Y and 3 Y-10 Y widened as well.

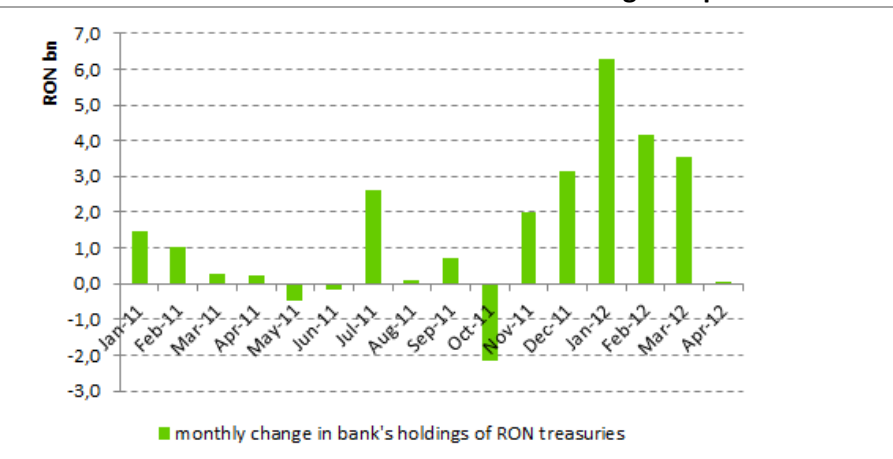
The average daily volumes traded on the secondary marked and recorded by SaFir increased significantly compared to last week while the primary auctions did not put new bonds into the market due to high yields asked by the participants.

Yield curve over the past weeks (Central Bank fixing)



Sources: NBR, OTP Research

Banks did not increase their RON treasuries holdings in April



Sources: The Finance Ministry, OTP Research

Last data: 21.06.2012

RON GOVERNMENT SECURITIES			
	Value	Weekly chg. (bp)	YTD chg. (bp)
6M	5,22	↓ -2	↓ -103
12M	5,33	↑ 0	↓ -106
3Y	6,16	↓ -1	↓ -99
5Y	6,28	↔ 0	↓ -97
10Y	6,59	↔ 0	↓ -75

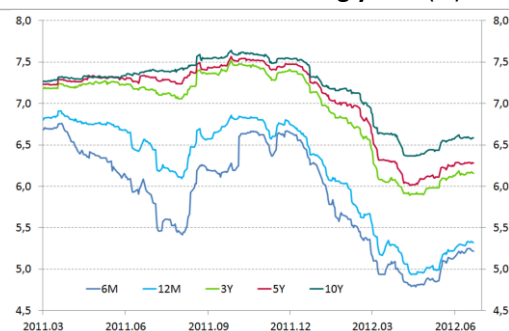
EUR GOVERNMENT SECURITIES			
	Value	Weekly chg. (bp)	YTD chg. (bp)
6MRO0912DBE034	2,89	↓ -2	↓ -123
2YRO1013DBE014	4,16	↓ -8	↓ -117

SPREADS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
GERROM 3Y	596	↑ 3	↓ -91
GERROM 5Y	572	↑ 3	↓ -78
GERROM 10Y	509	↑ 1	↓ -42
3Y -5Y	13	↑ 1	↑ 2
5Y -10Y	31	↔ 0	↑ 23
3Y-10Y	43	↑ 1	↑ 24
FLY 3-5-10	18	↓ -1	↑ 21

CDS MID SPREADS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
3Y EURO	333	↓ -22	↓ -39
5Y EURO	369	↓ -24	↓ -33

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

Auctions

This week there were two auctions in which the Finance Ministry tried to sell 800 mn RON in 12M T-bills and 400 mn RON in 4Y bonds. Both auctions were unsuccessful (undersold) as in the first case all bids were rejected and in the second case the sold amount was a quarter of the planned sales. The results were due to the high required yields. As the ministry holds a buffer of liquidity, for the moment it can postpone selling of new debt. Up to now, the Treasury sold 35.5 bn RON in government securities this year out of which if we subtract the amount it needed to roll over during first 6M, it still holds 13 bn RON which are enough to cover almost 4M of debt which comes to maturity.

At the second auction on Thursday, the sold amount was 95 mn RON at an average accepted yield of 6.28%, which was higher by 19 bp than the one at the previous similar auction in May. The bid to cover ratio was very high, at 7.58 suggesting that demand was healthy.

Just as the latest auctions have proved to be unsuccessful in selling new treasuries amounts, the NBR published a proposal to modify the rule regarding the functioning of the primary bonds markets. New elements and modifications regard:

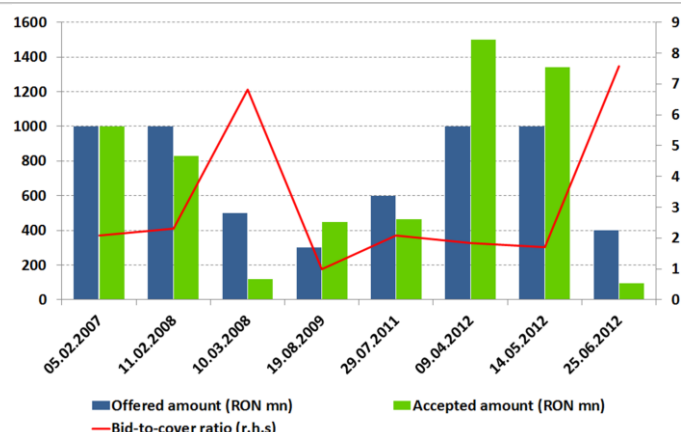
- the evaluation criteria for the primary dealers
- the setting of a ratio that connects the validity of the status of primary dealer to its performance; new criteria is established for the acceptance of new primary dealers
- introduction of a session for non competitive offers only for the primary dealers that meet certain criteria
- setting of the commission level charged by NBR for its operations with the primary dealers.

Summary of last week's auctions

	RO1213CTN0D1	RO1216DBN030
Offered amount (RON mn)	800	400
total bids (RON mn)	1060	718
accepted amount (RON mn)	0	95
average accepted yield (%)	0,00	6,28
coupon	-	5,75

Source: Ministry of Finance, OTP Research

4Y auctions data



Sources: NBR, 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
Feb-12	2.459	May-12	4.030	Aug-12	1.902
Mar-12	4.012	Jun-12	3.275	Sep-12	3.053
				Oct-12	4.475
				Nov-12	2.676
				Dec-12	1.713

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

T –bills auction in June

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1213CTN0C3	11.06.2012	13.06.2012	12.06.2013	12	1.000.000.000
RO1213CTN0D1	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)
RO1214DBN027	07.06.2012	11.06.2012	23.04.2014	2	5,95	700.000.000
RO1214DBN027	14.06.2012	18.06.2012	23.04.2014	2	5,95	600.000.000
RO1216DBN030	21.06.2012	25.06.2012	27.01.2016	4	5,75	400.000.000

Sources: Ministry of Finance, OTP Research

MM: The Central Bank will remain cautious on 27th June

The result of this week-end's elections in Greece released the immediate perceived risk aversion against Romanian assets and took off some pressure from the interbanking markets as well.

The Central Bank injected more liquidity at the weekly repo operation this week (+446 mn RON) compared to last week, amounting to a total of 11.96 bn RON. **MM rates fell before the end of the mandatory reserves building period ending this week.** The stocks of interbank deposits was up by 1.7 bn RON, a significant amount considering the decrease witnessed lately. The fact that banks did not use their liquidity at the Monday's auction this week has positively influenced the interbanking liquidity as well this week.

Since the last Board meeting on monetary policy issues, which was almost two months ago, on 2nd of May, the political local environment and international financial settings changed significantly. Last time, local factors regarding the change of the Government and the incertitude related to the continuation of Romania's agreement with the IMF were most imminent whereas international risks were in the background. Since then, expectations about the political stage and its desired fiscal targets have been put into the light. The USL coalition will most likely win this year's elections. They agreed to keep the current fiscal deficit agreed for this year and already negotiated the increase in wages. Other significant measures will be renegotiated after November Parliamentary elections. In what concerns the international environment, May has been the month during which clear signals emerged for the first time regarding the possible Greek exit which put pressure on emerging market currencies, inflated treasuries' yields and increased the attention on debt sustainability of core economies like Italy and Spain. Already, Spain's banking system was approved a bailout package and yields are still up, at levels considered by some analysts unsustainable for developed economies. Regarding Greece, talks are that it will be declassified from the status of "developed economy" to probably "emerging economy". As we said in the previous weekly report, the risks stemming from the international context feed into future inflation through expectations about the inflation rate and the FX impact. Therefore, **in view of the coming base rate decision on 27th of June, given that risks regarding the international environment intensified in past one and a half months, the Central Bank will most likely remain cautious.**

Last data: 21.06.2012

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	→ 0	↓ -75
ROBOR ON	1,55	↓ -383	↓ -298
ROBOR 3M	5,34	↓ -3	↓ -71
ROBOR 6M	5,46	→ 0	↓ -107
ROBOR 9M	5,46	→ 0	↓ -115
ROBOR 1Y	5,47	↓ -1	↓ -119

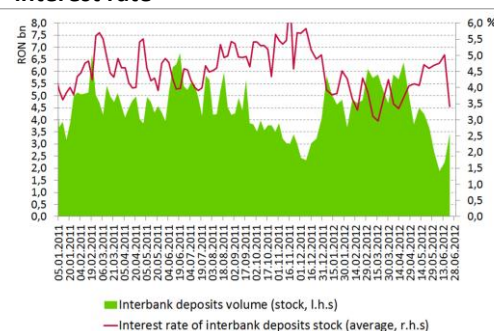
REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	11.957,2	446,0	5246,2

INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	3.452,9	1694,8	-574,6

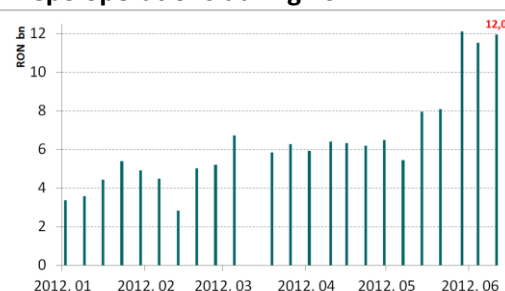
MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	30	↓ -6	↑ 6
USDRON 1M	142	↑ 2	↓ -7
USDRON 3M	435	↑ 28	↑ 189
EURRON 1W	43	↑ 2	↑ 3
EURRON 1M	185	↑ 17	↑ 40
EURRON 3M	525	↑ 14	↑ 14

MID EUR BASIS SWAPS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EURRON 1Y	-45	↑ 30	↑ 110
EURRON 3Y	-80	→ 0	↑ 75
EURRON 5Y	-80	→ 0	↑ 70

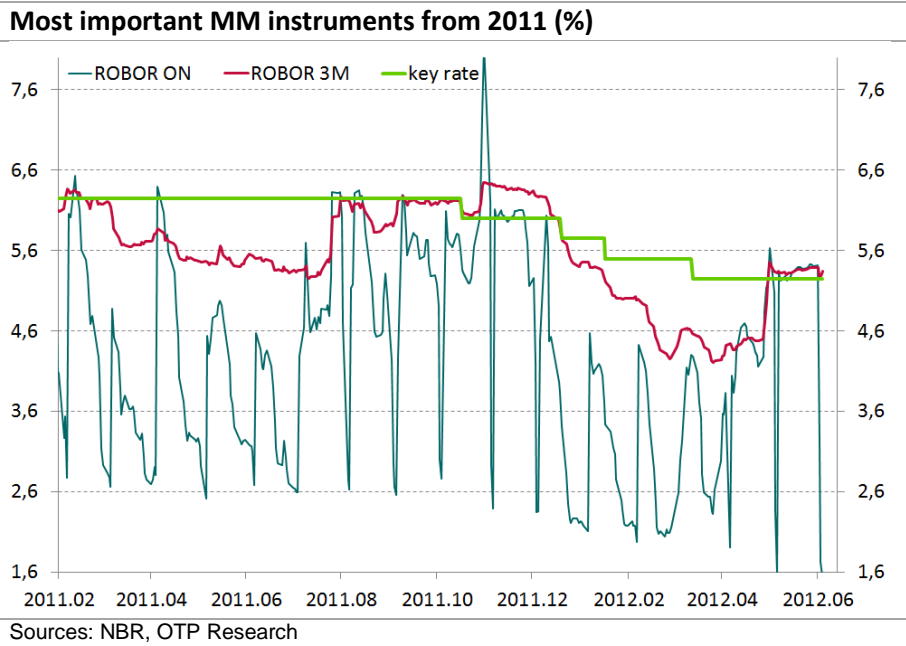
Source: Reuters

Interbank deposits (stock) and average interest rate


Sources: NBR, OTP Research

Repo operations during 2012


Sources: NBR, OTP Research



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