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Weekly Report

Romania

9 July 2012

Intervention of the European Commission aggravates the selling pressure on the leu

Macroeconomics: Q1 final consumption revised from - 0.3 YoY to +0.2%YoY (Page 3-5)

Overall data released last week is mainly in the positive territory. The National Institute for Statistics announced the third estimate for Q1 GDP and changed radically the estimation for the final consumption from -0.3% YoY to +0.2% YoY. Other high frequency indicators marked increases in May, showing a faster pace compared to the previous month: retail trade index (+5.9% YoY), industrial turnover index (+7.1% YoY) and constructions index (+21.1% YoY). This supports the view of GDP growth in Q2.

FX markets: Political risks hit the leu; risks have escalated given that Romania's vote in the European Council is questioned (Page 6 -7)

Two factors influenced leu's depreciation last week: first, the domestic turmoil on the political scene and interparty fight triggered a spike of the leu and international markets added to the further fall. The week started with RON insignificantly down, after Moody's revised Romania's Baa3 rating outlook last Friday. Only a few days later, the political scene was heated by USL coalition actions pointed towards obtaining the impeachment of the President. The fact that the European Commission has been put under alert due to worries related to the independence of Justice and the strength of democratic processes in Romania weighs heavily on the short term outlook of the leu. Political leaders had hoped the current events would have only temporary consequences but risks have obviously escalated. Otherwise, we believe that in terms of negotiation of 2013 budget which is one of the most important decisions to be taken in the near future, the current coalition has a very strong saying and all the rest of the events on the political scene should not affect fundamentally the leu.

Government securities: Yields at the short end of the curve spiked last week (Page 8-9)

The yield curve flattened last week, the short end yields going up 1 bp while the 5 and 10Y maturities stagnated (5Y) or went down 1 bp (10Y). The rise in yields in the short term is in line with increased interbanking rates and correctly reflect the deteriorated risk perception in the short term. The latter is due to domestic factors such as the turmoil on the political scene. The Finance Ministry had planned to sell 500 mn RON in 2Y bonds but the final amount stood at only 286 mn RON. Again, the yields asked were too high. The average accepted yield stood at 5.97% and it was higher by 15 bp than the one at the previous similar auction in Mid June. The events that took place last week may have have had an unexpected effect on the country risk premium and it will likely influence the cost of new debt issued in July.

MM: rates jumped this week as the repo volume dropped by 2bn RON last week (Page 10)

Money market rates climbed significantly last week. ROBOR ON was up by 86 bp while the 3M rate advanced by 10 bp. The move came after the NBR injected a smaller volume (12 bn RON) at Monday's repo; this is less by 1.9 bn RON compared to the previous week. We believe rates are going to remain elevated in the following few weeks as a decrease in required reserves ratio is possible only in August. In addition, if the CB supports the leu by selling the euro, it will bite into the tight liquidity that there is.

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Macroeconomics: Q1 final consumption revised from - 0.3 YoY to +0.2%YoY

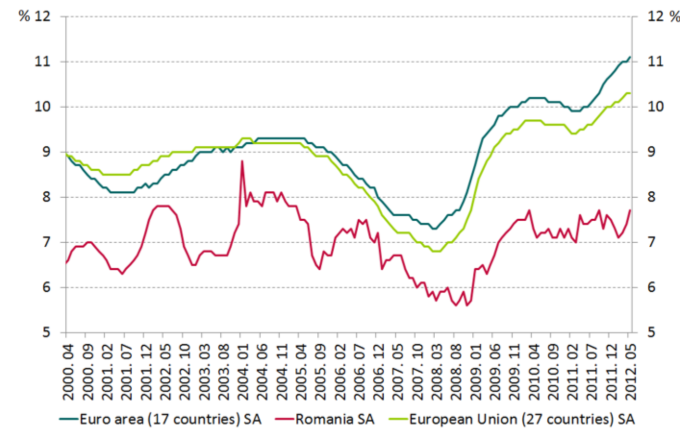
	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
02 Jul	MAY	ILO unemployment rate (%, seasonally adjusted)	7,7		7,4
02 Jul	JUNE	FX reserves (bn EUR)	33,0		33,5
03 Jul	MAY	Retail trade turnover index (y-o-y, %)	5,9		3,4
03 Jul	MAY	Industrial production price indices (y-o-y, %)	6,7		6,5
04 Jul	Q1 2012	Flash GDP growth rate (q-o-q, %, seasonally adjusted)	0,1	0,1	-0,1
05 Jul	MAY	Net wage growth rate (y-o-y, %)	4,9		3,6
06 Jul	MAY	Industrial trade turnover index (y-o-y, %)	7,1		5,0
06 Jul	MAY	Index value of new orders in manufacturing (y-o-y, %)	3,7		-4,9
06 Jul	MAY	Construction works index (y-o-y, %)	21,1		16,4
09 Jul	MAY	Households services turnover index (y-o-y, %)			-5,4
10 Jul	MAY	Wholesale services turnover index (y-o-y, %)			7,6
10 Jul	MAY	Exports (y-o-y, %)			3,4
10 Jul	MAY	Imports (y-o-y,%)			- 0,2
10 Jul	JUNE	Consumer price index (y-o-y,%)			1,8
10 Jul	MAY	Industrial Production Index (y-o-y, %)			0,1
13 Jul	MAY	CA balance (EUR mn, YTD)			-1230

Overall data released last week is mainly in the positive territory. The National Institute for Statistics announced the third estimate for Q1 GDP and changed radically the estimation for the final consumption from - 0.3% YoY to +0.2% YoY. Other high frequency indicators marked increases in May, showing a faster pace compared to the previous month: retail trade index (+5.9% YoY), industrial turnover index (+7.1% YoY) and constructions index (+21.1% YoY). This supports the view of GDP growth in Q2.

The seasonally adjusted unemployment rate spiked to 7.7% in May from 7.4% in April. The jump was again larger than EU (27) average where the increase stood at 0.1% (to 10.3% in May). Firms continued to adjust their size in order to boost profitability, especially after the decrease in business volume that we witnessed in Q1 2012. Average unemployment rate stands at 7% (Jan 2000-May 2012) and during the boom years (2005-2008) it stood at 6.6%. This points to the existence of an output gap and that the economy is running bellow potential. As it is a lagging indicator, unemployment will drop only after the economy has started on a growth path.

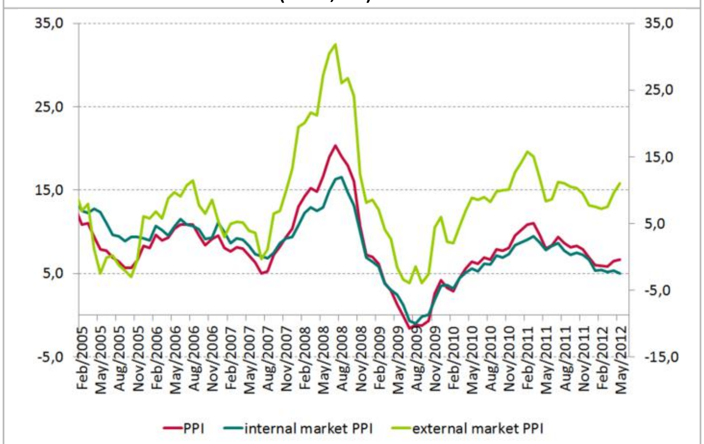
In May, industrial producer prices increased by 6.7% YoY, faster than in the previous month (6.5% YoY in April). **The driver was the external market, where we saw a hike of 11.1% YoY** compared to only 9.6% YoY in the previous month while on the domestic market it even decreased by 0.3% to 5% YoY. The increase in producer prices is only partially transmitted to consumer prices. According to the liberalization schedule established with the IMF**, gas prices**

Unemployment rate



Source : Eurostat, OTP Research

Producer Price Index (YoY, %)



Source: INS, OTP Research

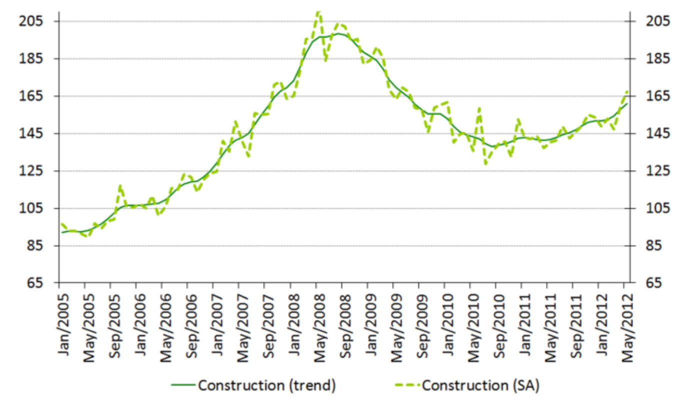
for companies will increase by 5% in December this year and by 18% annually in 2013-2014 (for households it will go up by 10% annually in 2013-2014 and 12% annually between 2015-2018).

Retail trade index posted a strong advance in May; of 5.9% YoY (1.1% MoM, SA) compared to 3.4% YoY (1.1% MoM, SA) in April and the uptrend started in February. In the past three months, the uptrend has been **supported by fuels trade increase. In Q2, we saw an upward trend in durable goods** as well, **so households started to make longer term acquisitions**; this was in line with improved consumer confidence indicator and also with lower loan interest rates. **However for June, the survey published by the European Commission indicates a marginal deterioration**.

Retail trade index (YoY, %)

Source: INS, OTP Research

Construction index evolution (2005 =100)



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%		
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%	6,5%*	**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%	**5,33%**	**5,25%**
Key interest rate (e.o.p.)	8,8%	7,5%	10,3%	8,0%	6,3%	6,0%	**5,25%**	**5,25%**
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: Political risks hit the leu; risks have escalated given that Romania's vote in the European Council is questioned

Two factors influenced leu's depreciation last week: first, the domestic turmoil on the political scene and interparty fight triggered a spike of the leu and just as the depreciation wave was counterbalanced probably by intervention from the Central Bank, **international markets added to the further fall.**

The week started with RON insignificantly down, after Moody's revised Romania's Baa3 rating outlook last Friday. Romania's sovereign rating was changed from stable to negative, just after Fitch had affirmed it one week before. Moody's decision was first of all explained by the Romania's dependence on exports to EU (70% of Romania's exports) and second of all by relatively high external debt. The latter could affect future growth prospects and the balance of payments if the credit markets do not recover sooner rather than later and capital inflows do not resume. Moody's quoted some situations in which the rating would be cut: if economic growth does not accelerate in the medium term, fiscal slippage and policy actions that threaten Romania's loan agreements.

Only a few days later, the political scene was heated by USL coalition actions pointed towards obtaining the impeachment of the President. The fact that the European Commission has been put under alert due to worries related to the independence of Justice and the strength of democratic processes in Romania weighs heavily on the short term outlook of the leu. Political leaders had hoped the current events would have only temporary consequences but risks have obviously escalated. Otherwise, we believe that in terms of negotiation of 2013 budget which is one of the most important decisions to be taken in the near future, the current coalition has a very strong saying and all the rest of the events on the political scene should not affect fundamentally the leu.

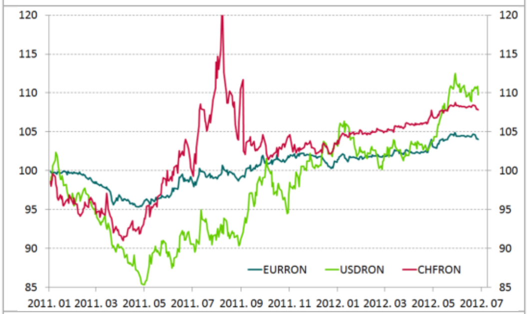
The current sovereign rating is only due to the efforts made in the direction of fiscal consolidation and a significant slippage has been already said to put the rating down. The immediate consequence is a devaluation of Romanian assets, but risks are more complex: indeed, as Moody's also explains in its assessment, deficit financing is made both through domestic and international financing. **Should the euro zone meet further trouble in the future, financing would be harder to find and much more expensive and diverging from the current agreement with the IMF is not an option.** This implicitly means that **caution and effort is required for this year to meet the budget deficit (2.8%, ESA95)** and that the already announced intentions regarding taxation and VAT changes (after November elections) would have to be calibrated according to next year's budget limitations and prospects for economic growth. **The agreed target for 2013 is 2.2% under the accrual basis. Therefore technically, there may be some room for negotiations until the 3% target allowed by the Maastricht Treaty but it does not come without risks if projected GDP growth for next year does not realize. In the coming two years (2013 -2014), Romania has to pay back to the IMF around 5bn EUR/year (principal and interest). First payment this year is in August, of 751 mn EUR. This could add some extra pressure on the leu.** Usually, Romania pays around 100-200 mn

Last data: 5.07.2012

FX BID	Value		Weekly chg. (%)		YTD chg. (%)
EURRON	4,49	↑	0,94	↑	3,53
USDRON	3,62	↑	1,39	↑	7,20
CHFRON	3,74	↑	0,99	↑	4,77
RONJPY	4,53	↑	0,87	↑	3,30
RONPLN	1,06	↑	2,77	↑	2,26
100HUFRON	1,57	↑	2,44	↑	14,26
RONCZK	1,57	↑	2,44	↑	827,49
RONRUB	0,11	↑	3,27	↑	6,78
RONRSD	0,04	↑	0,00	↓	0,00
RONBGN	2,29	↑	0,98	↑	3,73

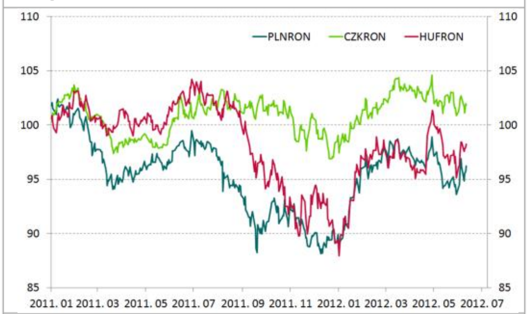
Source: Reuters

Major RON FX rates (03.01.2011=100)



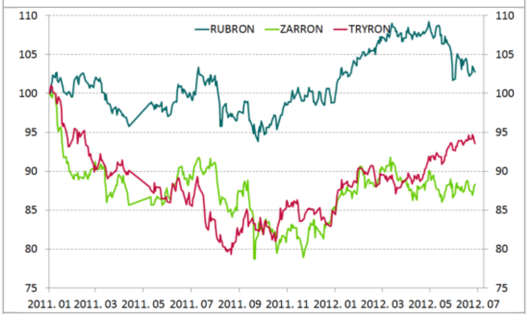
Sources: Reuters, OTP Research

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

EUR monthly in the account of public debt (exceptions are euro bonds repayments and from now on IMF installments). We show bellow a few examples:

The leu tends to depreciate when payments in the account of the public debt are larger

	iul.10	nov.10	iul.11	mai.12
Payments due in the account of public debt, EUR mn	876	1.629	2.649	1.022
EUR/RON changed from	4,24 to 4,26	4,28 to 4,29	4,19 to 4,24	4,4 to 4,44
RON depreciation	0,5%	0,3%	1,1%	0,9%

Source: NBR, OTP Research;
Note: EUR/RON monthly average has been used

Payments due to the IMF this year, EUR mn

1-6 August	1-6 November	21 December	TOTAL
751	767	262	1.781

Source: IMF, OTP Research
Note: XDR= 1,2223 EUR

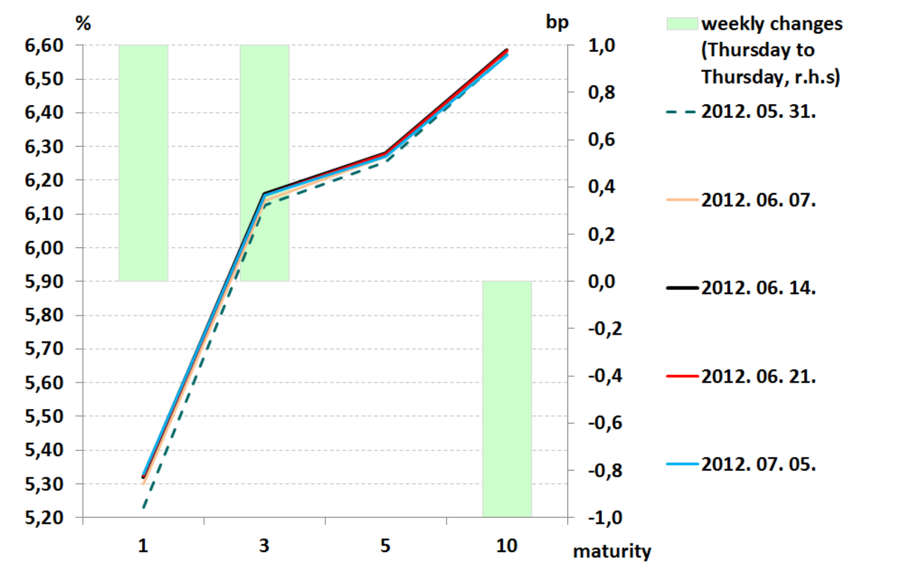
In what concerns international developments that can affect the leu, besides the action decided at the last EU Summit, we recently saw that **three major banks seemed to join forces in triggering increase in lending flows to support the economy.** In response to Europe's debt crisis which has pushed 5 countries to ask for bailout, the ECB cut the base rate from 1% to 0.75% and what is even more important as a signal, it cut the deposit rate to zero. Also, Bank of England resumed QE by restarting bond purchases in a total amount of 50 bn pounds. Bank of China cut down interest rates as signs of weakening affect country as well.

Government securities: Yields at the short end of the curve spiked last week

The yield curve flattened last week, the short end yields going up 1 bp while the 5 and 10Y maturities stagnated (5Y) or went down 1 bp (10Y). The rise in yields in the short term is in line with increased interbanking rates and correctly reflect the deteriorated risk perception in the short term. The latter is due to domestic factors such as the turmoil on the political scene. By comparison, international factors that could modifiy the country risk premium have eased as pointed by the significant decline in the 3Y CDS (-22 bp) and 5Y CDS (-25 bp).

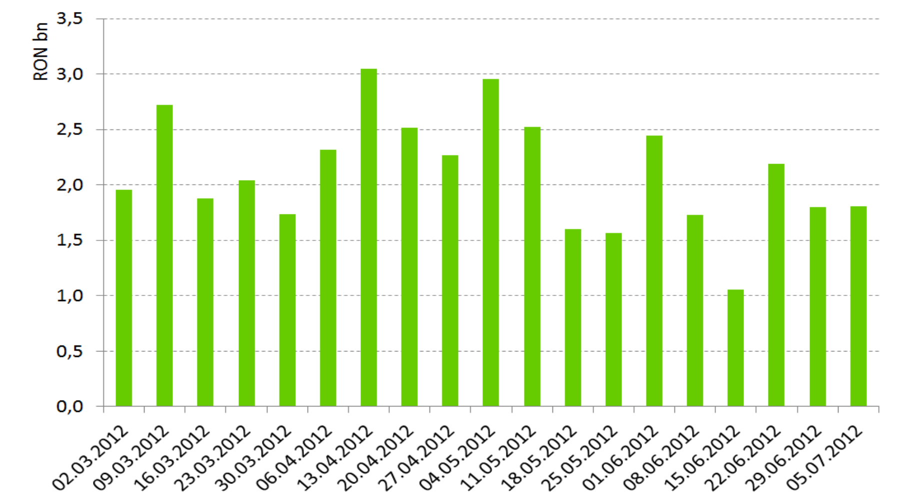
The spread to German bunds advanced 4-5 bp compared to last week, up to 597 bp (for 3Y bonds). Perceived risk aversion is the highest in the medium term as the country is struggling to reenter a solid growth path while maintaining in the same time the direction to fiscal consolidation.

Yield curve over the past weeks (Central Bank fixing)



Sources: NBR, OTP Research

Average daily volume of RON denominated securities traded on the secondary market in the past weeks



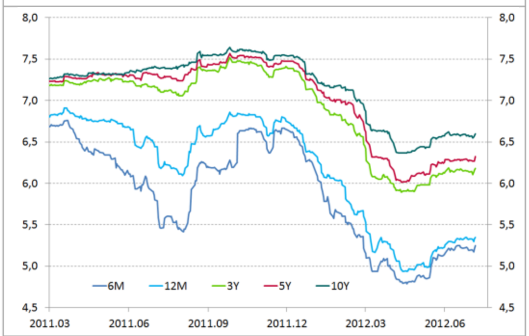
Sources: NBR, OTP Research
Note: the average for the current week does not include Friday;

Last data: 5.07.2012

	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
RON GOVERNMENT SECURITIES			
6M	5,21	↑ 1,0	↓ -105
12M	5,33	↑ 1,0	↓ -105
3Y	6,16	↑ 1,0	↓ -99
5Y	6,27	⇨ 0,0	↓ -98
10Y	6,57	↓ -1,0	↓ -76
EUR GOVERNMENT SECURITIES	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
6MRO0912DBE034	2,54	↓ -10,9	↓ -157
2YRO1013DBE014	4,13	↓ -1,1	↓ -120
SPREADS	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
GERROM 3Y	597	↑ 4,1	↓ -90
GERROM 5Y	570	↑ 4,9	↓ -80
GERROM 10Y	506	↑ 4,2	↓ -45
3Y -5Y	11	↓ -1,0	↑ 0
5Y -10Y	30	↓ -1,0	↑ 22
3Y-10Y	42	↓ -2,0	↑ 23
FLY 3-5-10	19	↑ 0,0	↑ 22
CDS MID SPREADS	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
3Y EURO	324	↓ -21,7	↓ -48
5Y EURO	360	↓ -25,2	↓ -42

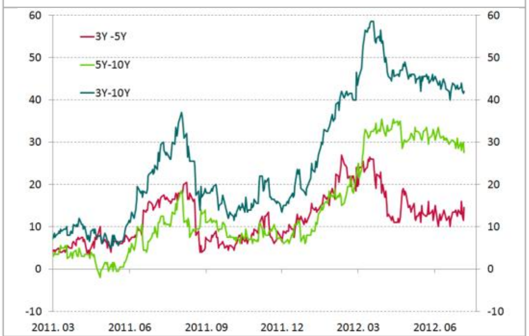
Source: Reuters

Central bank benchmark fixing yields (%)



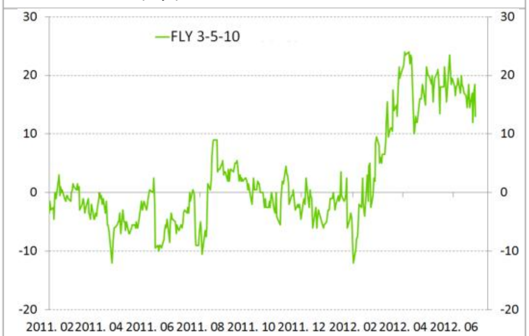
Sources: NBR, OTP Research

Slope of the yield curve (bp)



Sources: NBR, OTP Research

FLY 3-5-10 (bp)



Sources: NBR, OTP Research

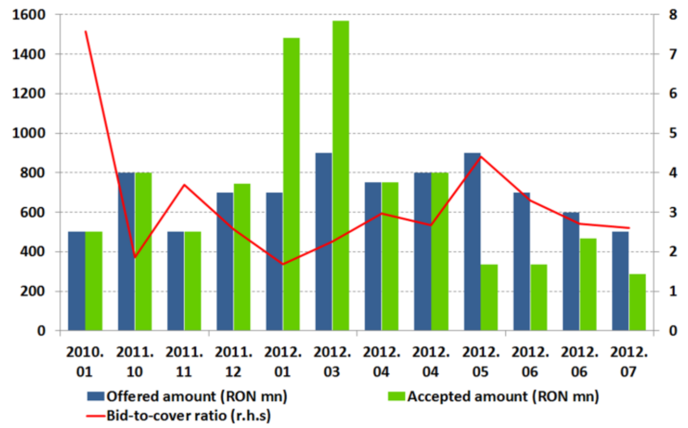
Auctions

This week there was only one auction for 2Y bonds. The Finance Ministry had planned to sell 500 mn RON but the final amount stood at only 286 mn RON. The smaller amount was again due to the fact that the yields asked were too high. **The average accepted yield stood at 5.97% and it was higher by 15 bp than the one at the previous similar auction in Mid June. Compared to the previous similar auction, demand was much lower, as total bids stood at 746 mn RON versus 1.26 bn RON in June. Bid to cover ratio was lower as well this time, at 2.60 versus 2.70 in June.**

The events that took place last week may have have had an unexpected effect on the country risk premium and it will likely influence the cost of new debt issued in July. The announced amount to be sold in bonds in July is planned to be higher in relative terms (higher weight compared to June) which means that hopes were for a cooling down in yields (as a result of diminished external pressure and therefore country risk premium). This time around, the driver for the higher cost that the Treasury has to pay for new issues stems from domestic risks.

The action took by Moody's to change the outlook of the country's sovereign rating is another stepping stone in terms of the cost of public debt, because its meaning is emphasized by the current political situation.

2Y auctions data



Sources: NBR, OTP Research

Results of this week's auction

	RO1214DBN068
Offered amount (RON mn)	500
total bids (RON mn)	746
accepted amount (RON mn)	286
average accepted yield (%)	5,97
coupon	5,85

Sources: NBR, OTP Research

The MinFin plans for more bonds issue in July

	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12
Planned targeted amount (RON bn)	4,5	5,0	5,0	4,3	3,8	3,5	2,3
% of bonds	33%	44%	54%	76%	80%	49%	69%

Source: Ministry of Finance, OTP Research

T –bills auction in July

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1213CTN0E9	09.07.2012	11.07.2012	10.06.2013	11	700.000.000

Source: Ministry of Finance, OTP Research

Bonds auctions in July

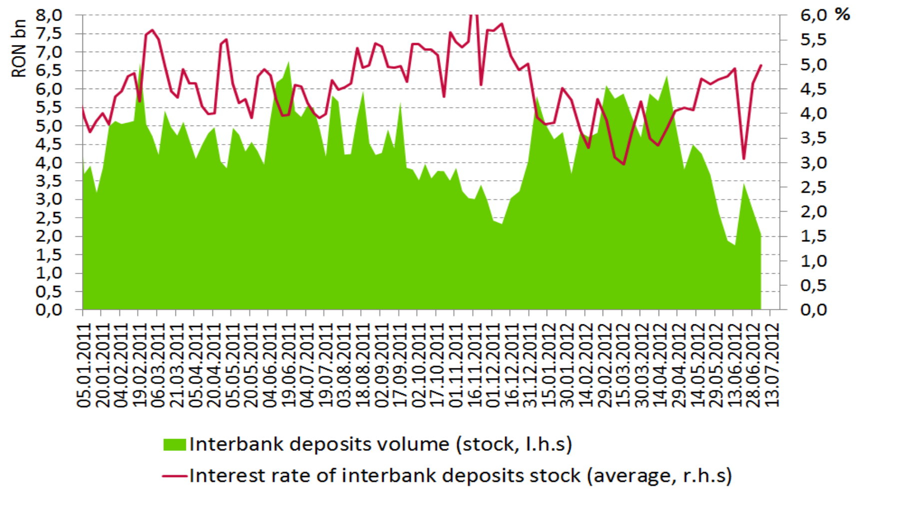
ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
RO1214DBN068	05.07.2012	09.07.2012	28.07.2014	2	5,85	500.000.000
RO1216DBN030	12.07.2012	16.07.2012	27.01.2016	4	5,75	400.000.000
RO1214DBN068	16.07.2012	18.07.2012	28.07.2014	2	5,85	650.000.000

Sources: Ministry of Finance, OTP Research

MM: rates jumped this week as the repo volume dropped by 2bn RON last week

Money market rates climbed significantly last week. ROBOR ON was up by 86 bp while the 3M rate advanced by 10 bp. Meanwhile, interbanking outstanding stock continued to decrease by 688 mn RON in a week. The move came after the NBR injected a smaller volume (12 bn RON) at Monday's repo; this is less by 1.9 bn RON compared to the previous week.

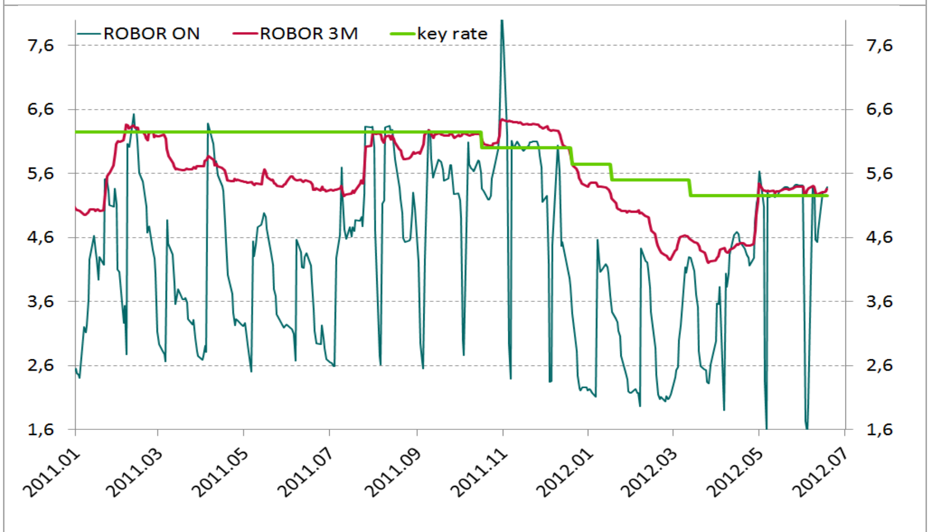
Inter-banking deposits stock is lowest levels this year



Sources: NBR, OTP Research

Given that NBR has stalled the base rate cut cycle and that **the next Board Meeting on monetary policy issues is only in August** and also because the international context remains tense which means banks will still be cautious in lending to each other, **we believe rates are going to remain elevated in the following few weeks.** The Central Bank Governor stated that probably the CB will have to take new measures because the deficit of liquidity is structural. On the other hand, given the current depreciation pressures on the RON, a **tight management of RON liquidity would be appropriate to prevent speculation**, **which means again that MM rates will likely stay up. Also in view of leu's depreciation, if the CB intervenes on the foreign exchange market to support the leu by selling the euro, it swallows again part of liquidity on the market.**

Most important MM instruments from 2011 (%)



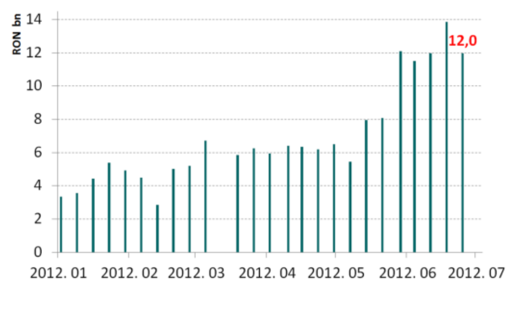
Sources: NBR, OTP Research

Last data: 5.07.2012

MID INTEREST RATES					
	Value (%)		Weekly chg. (bp)		YTD chg. (bp)
repo rate	5,25	→	0	↓	-75
ROBOR ON	5,39	↑	86	↑	86
ROBOR 3M	5,36	↑	10	↓	-69
ROBOR 6M	5,51	↑	5	↓	-102
ROBOR 9M	5,51	↑	5	↓	-110
ROBOR 1Y	5,52	↑	4	↓	-114
REPO					
	Value (mn RON)		Wly chg. (mn RON)		YTD chg. (mn RON)
repo amount	11.975,9		-1881,3		5264,9
INTERBANK DEPOSITS					
	Value (mn RON)		Wly chg. (mn RON)		YTD chg. (mn RON)
outstanding	2.057,2		-687,9		-1970,3
MID SWAP POINTS					
	Value (bp)		Weekly chg. (bp)		YTD chg. (bp)
USDRON 1W	38	↑	18	↑	13
USDRON 1M	146	↑	5	↓	-4
USDRON 3M	428	↑	15	↑	182
EURRON 1W	43	↑	7	↑	2
EURRON 1M	181	↑	9	↑	36
EURRON 3M	528	↑	26	↑	17
MID EUR BASIS SWAPS					
	Value (bp)		Weekly chg. (bp)		YTD chg. (bp)
EURRON 1Y	-30	→	0	↑	125
EURRON 3Y	-60	→	0	↑	95
EURRON 5Y	-60	→	0	↑	90

Source: Reuters

Repo operations during 2012



Sources: NBR, OTP Research

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