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Weekly Report

Romania

16 July 2012



Fitch sees no risk to the country rating in the midterm; Romanian assets priced lower last week

Macroeconomics: Industrial production down by 0.6% MoM in May; Inflation lower than expected in June (2% YoY) (Page 3-5)

The macroeconomic data released last week shows deceleration in the case of services households' services turnover and industrial production in May; however, the latter remained in the positive territory on an annual basis. The trade balance shrank further due to a weaker internal demand which dragged down imports. Indeed, the consumer economic sentiment indicator (ESI) for June is down compared to May confirming the lower demand, which is probably why we saw lower than expected inflation in June. Up to now, the data released in Q2 signals that GDP has grown but that activity pace is slowing down again.

FX markets: weaker leu as euro loses against the dollar (Page 6)

The leu lost almost 1% in a week but all the depreciation cannot be attributed only to the turmoil on the political scene. We see that the EUR/USD pair is also lower (-1.6%) at 1.2196 while it stood at 1.2392 last Thursday and currently, the EUR/RON is more correlated with the EUR/USD as one of the fundamental drivers is growth in the region. Meanwhile, Fitch ratings said that the country BBB- rating is not threatened by the political turmoil in the midterm because the government is committed to keep the current arrangement with the IMF and EU institutions. From a birds' view, we would say that the leu has come lower even before the worst case scenario came true, which would probably imply countries exiting the euro zone.

Government securities: sharp increases in yields last week due to higher country risk premium (Page 7-8)

The yield curve has moved upwards last week and treasuries yields have gained between 2bp -13 bp. It flattened as short end yields increased the most in reaction to deteriorated risk perception as a result of domestic political factors. It is one of the highest increases in a week this year. As bond prices go down and liquidity on the money markets became tighter in the past weeks, the total weekly volume traded on the secondary market dropped. Unlike the previous weeks, the Treasury sold the targeted sums, despite the fact that yields were still higher compared to previous issues. In the case of the 11M T-bills auction, the average accepted yield stood at 5.53%, higher by 24 bp while 4Y bonds, the average accepted yield stood at 6.41%, higher by 13 bp than the one at the previous auction in Mid-June.

MM: rates fell on higher weekly repo volume (Page 9)

Money market rates reacted to the higher weekly liquidity injection by decreasing some 40 bp (in the case of ROBOR ON) until Wednesday and on Thursday, the drop was sharp: ROBOR ON fell to 2.7%, well ahead of the entering the final week of the mandatory reserves building period. The repo volume was higher by 2 bn RON compared to previous week. Banks may have asked for more cash than needed last week, for fear that the Central Bank will squeeze liquidity during its currency interventions. However, the CB may have intervened less and therefore for the moment the banks have had more cash than needed. Otherwise, rates continue to be pressured and we believe the fall is temporary.

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Macroeconomics: Industrial production down by 0.6% MoM in May; Inflation lower than expected in June (2% YoY)

PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR	
09 Jul	MAY	Households services turnover index (y-o-y, %)	-2,2	-2,6	
10 Jul	MAY	Wholesale services turnover index (y-o-y, %)	7,1	8,7	
10 Jul	MAY	Exports (y-o-y, %)	3,9	3,4	
10 Jul	MAY	Imports (y-o-y, %)	- 1,9	- 0,2	
10 Jul	JUNE	Consumer price index (y-o-y, %)	2,0	2,2	1,8
10 Jul	MAY	Industrial Production Index (y-o-y, %)	2,7		0,0
13 Jul	MAY	CA balance (EUR mn, YTD)	-1920		-1230
no data					

The macroeconomic data released last week shows deceleration in the case of households services turnover and industrial production in May; however, the latter remained in the positive territory on an annual basis. The trade balance shrank further due to a weaker internal demand which dragged down imports. Indeed, the consumer economic sentiment indicator (ESI) for June is down compared to May confirming the lower demand, which is probably why we saw lower than expected inflation in June. Up to now, the data released in Q2 signals that GDP has grown but that activity pace is slowing down again.

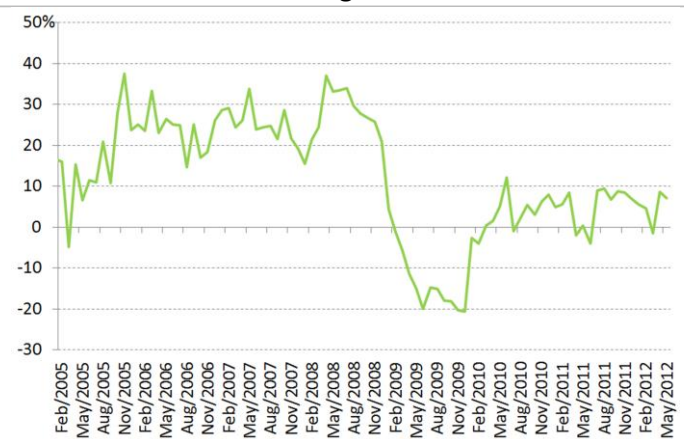
In May, household services turnover index was down by 2.2% YoY and by 1.4% MoM (seasonally adjusted). On a monthly basis, most affected were the hotels and restaurants activity (-2.6% MoM, seasonally adjusted). This branch brings 1.9% (2009) to the gross value added (GVA) in the economy. Support came from washing & cleaning textiles and furs (+6.4% MoM, SA) and activities of travel agencies and tour operators (2.6% MoM, SA). The latter brought 0.4% to the value added in 2009. The two branches that we mentioned sum up to 2.3% of the GVA, which is close to the value added brought by telecommunications for example. The ESI is down in June, in the case of services, but much improved compared to March and April.

Wholesale services turnover index were up by 7.1% YoY (-0.2% MoM, SA) in May. The monthly decline witnessed in May came after a very significant advance of 6% MoM in April, therefore overall Q2 evolution has been very good until now.

Industrial production was up at 2.7% YoY in May, but it declined by 0.6% (MoM, SA) on a monthly basis. The monthly performance was below the one recorded by the EU27 (+0.5% MoM, SA). The decline in domestic production was expected given that in April the new orders index had fallen by 4.9% YoY. However in May, new orders index was

Household services annual growth rate


Source : NIS, OTP Research

Wholesale services annual growth rate


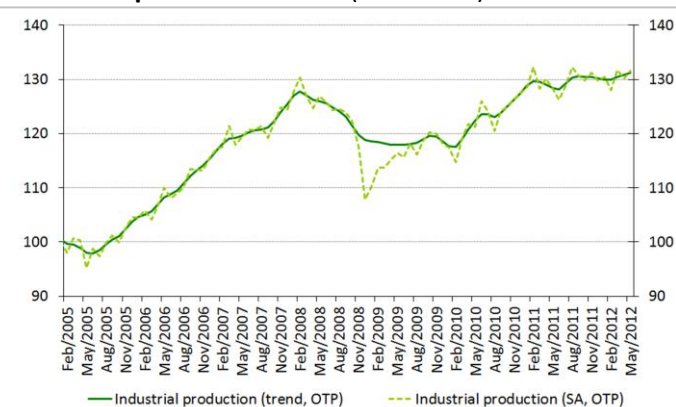
Source: NIS, OTP Research

up by 3.7% YoY. Consumer durables and capital goods production were down in the month, which means that **both households and companies refrain from making long term investments for the moment**. In the case of capital goods production, they have declined during Q1 and showed a temporary improvement in April. More worrisome is what we see in the case of durable consumer goods which declined on a monthly basis in May, after gaining strength during the previous consecutive 5 months. Therefore, **consumer confidence is at a crossroads again. Luckily, the increase in wages of public employees in June may offer some support in this direction.**

June inflation stood at 2.04% YoY, lower than market's expectations of 2.2% YoY. It was dragged down by food prices which posted a negative growth rate of -0.93% YoY which is an effect of the last year's good agricultural production but this is a volatile component of inflation and expectations are that it will increase as this year's agricultural production will be lower by 7% according to media sources. Food products make up to 37% of consumption basket, non-food goods are 44% and 19% go to services. Nonfood goods prices rose by 2.96% YoY and services prices by 5.77% YoY. Core2 inflation, which gives a better picture of inflationary processes continued to decline from 2.41% YoY (May) to 2.33% YoY in June. CB forecast of Dec. 12 inflation is 3.2% YoY but it will likely go higher due to more than expected leu's depreciation.

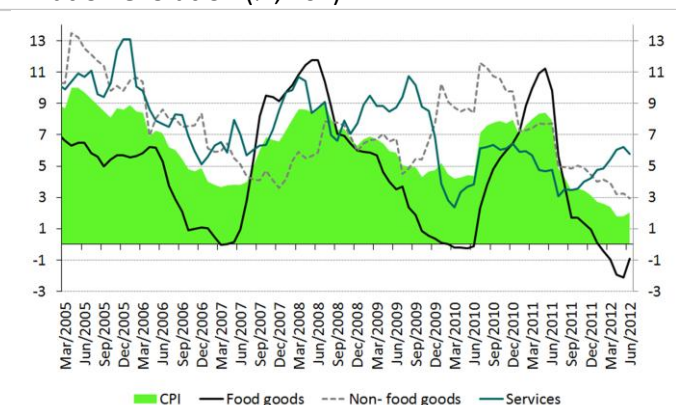
In May, the trade deficit shrank by 21% YoY as imports were down (-1.9% YoY, in euro) on a yearly basis for the third month in a row as the effect of leu's depreciation kicked in. The leu was weaker by 8% YoY against the euro in May. Exports on the other hand benefited from this effect: they were up for the second consecutive month: +3.9% YoY in May (+3.4% YoY in April). While the decline helps fixing the external imbalances, it also points to the weakness of the economy for the moment. Otherwise, the existence of a structural deficit means that once the economy starts recovering, we will see again a higher trade gap.

Industrial production index (2005=100)



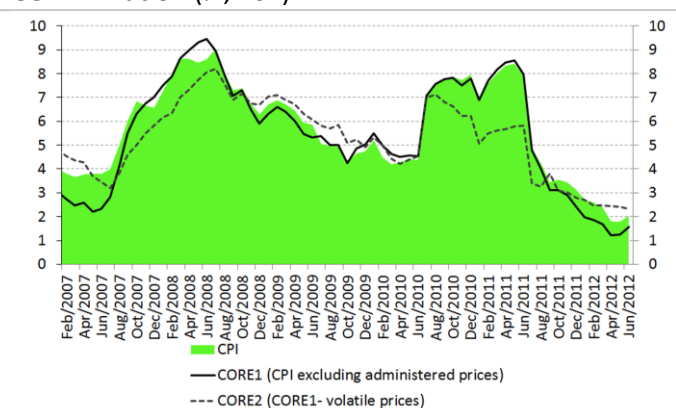
Source: Eurostat, OTP Research

Inflation evolution (% YoY)



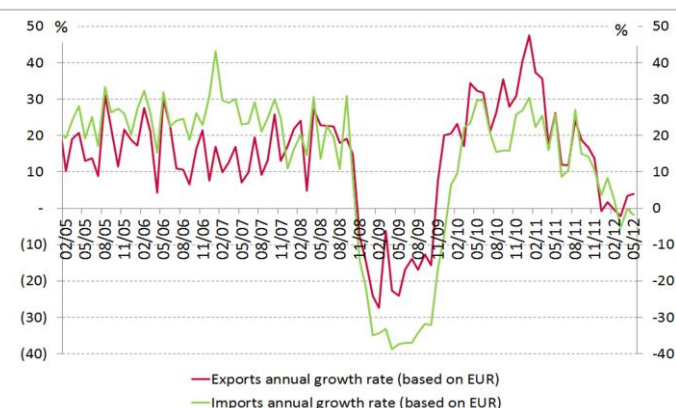
Source: NIS, OTP Research

CORE inflation (% YoY)



Source: NIS, OTP Research

External trade evolution



Source : NIS, 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: weaker leu as euro loses against the dollar

The leu lost almost 1% in a week but all the depreciation cannot be attributed only to the turmoil on the political scene. We see that the EUR/USD pair is also lower (-1.6%) at 1.2196 while it stood at 1.2392 last Thursday and currently, the EUR/RON is more correlated with the EUR/USD as one of the fundamental drivers is growth in the region.

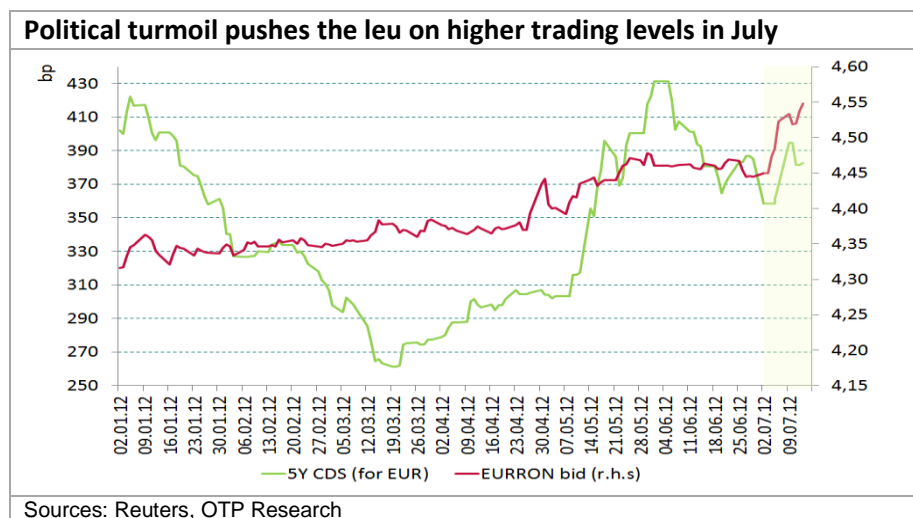
	1 Jan 2007 -12 July 2012	3 Jan 2012 -12 July 2012	2 April 2012 -12 July 2012
correlation (EUR/USD, EUR/RON)	-0,30	-0,81	-0,92

Source: Reuters, OTP Research

The euro fell against the dollar as markets were expecting more monetary easing signs from the Federal Reserve, but the Fed said in the minutes released that the US economy had to deteriorate further until such a measure can be taken.

Meanwhile, Fitch ratings evaluated that the country BBB- rating is not threatened by the political turmoil in the midterm because the government is committed to keep the current arrangement with the IMF and EU institutions. Romania's problem continues to be the structural reforms and its dependence on the euro zone growth prospects. The main concern seems to be the delay in structural reforms negotiated with the IMF, including privatization of state owned enterprises. Also, the agency says that risks stemming from the 2013 budget are greater, given the coming elections in November.

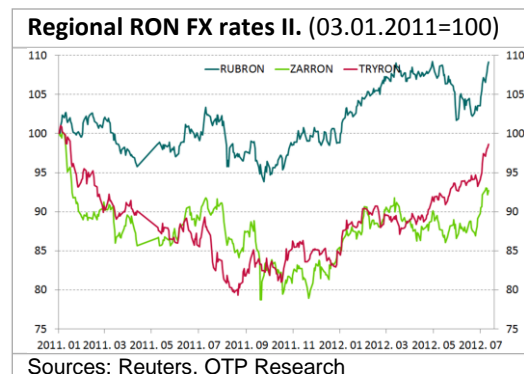
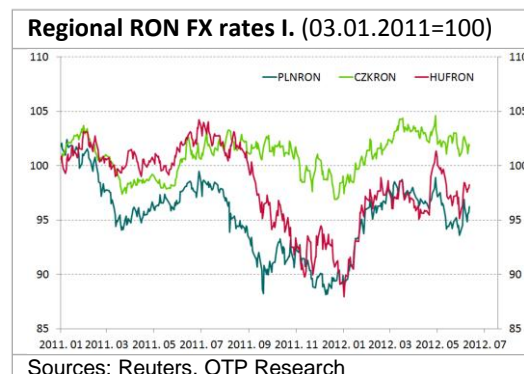
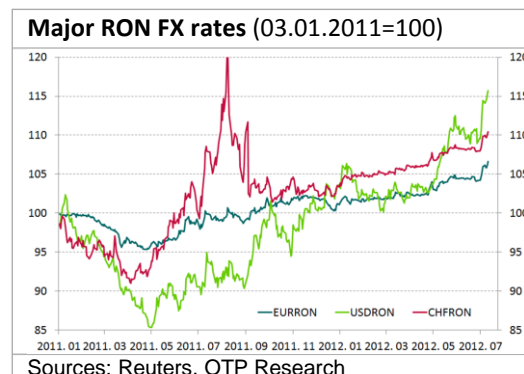
From a birds' view, we would say that the leu has come lower even before the worst case scenario came true (which would imply at least one exit from the euro zone). Fresh current account data at May, when the leu jumped above 4.4 (monthly average) shows FDI decreasing significantly: in Jan -April, they were lower by 9% YoY and in Jan- May they dropped by 45% YoY. To this, we would add that the Central Bank may be less willing to intervene for leu's sustainability for the moment: we believe that the Central Bank is more likely to intervene when the leu is falling due to intense speculation. Otherwise, if drivers for RON depreciation are fundamental, the CB may allow a weaker RON. Moreover, FX reserves will start sliding as Romania starts repaying the debt to IMF.



Last data: 12.07.2012

	Value	Weekly chg. (%)	YTD chg. (%)
EURRON	4,54	↑ 1,09	↑ 5,00
USDRON	3,72	↑ 2,68	↑ 11,65
CHFRON	3,78	↑ 1,11	↑ 6,36
RONJPY	4,69	↑ 3,45	↑ 8,36
RONPLN	1,08	↑ 1,34	↑ 4,59
100HUFRON	1,57	↓ -0,04	↑ 14,49
RONCZK	0,18	↑ 2,12	↑ 6,00
RONRUB	0,11	↑ 2,04	↑ 9,84
RONRSD	0,04	↑ 0,00	↓ 0,00
RONBGN	2,32	↑ 1,09	↑ 5,22

Source: Reuters

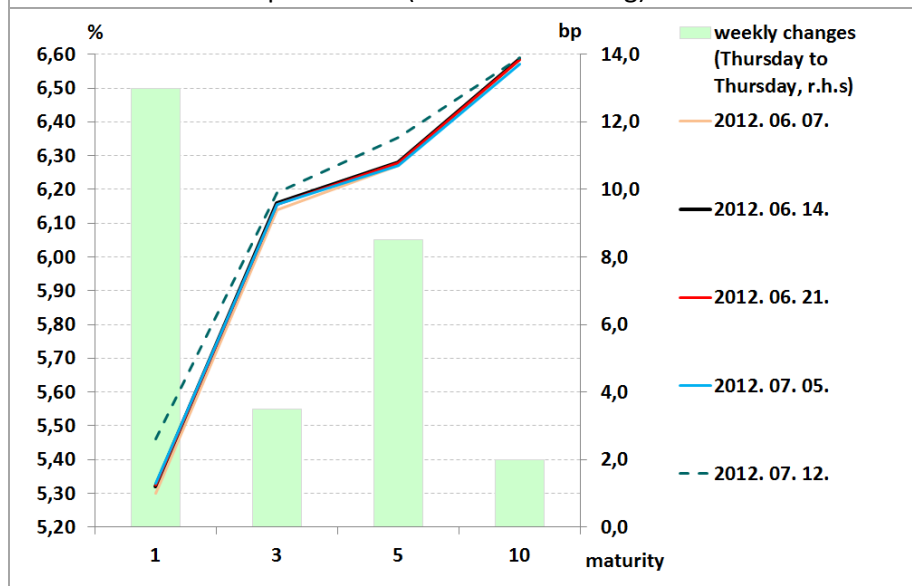


Government securities: sharp increases in yields last week due to higher country risk premium

The yield curve has moved upwards last week and treasuries yields have gained between 2bp -13 bp. It flattened as short end yields increased the most in reaction to deteriorated risk perception as a result of domestic political factors. It is one of the highest increases in a week this year. Last time we have witnessed such a hike was in Mid May, when speculations about an imminent Greek exit became more intense. This time around, the driver is domestic and the impact can be seen also in the rise of the CDS by approximately 20 bp. The spread to the German bunds widened as well by 8-15 bp reaching 610 bp for the 3Y maturity.

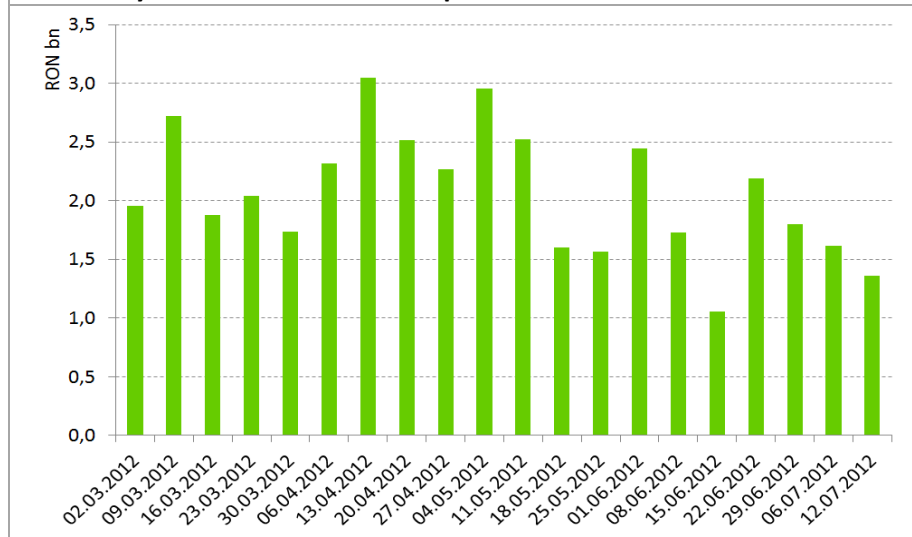
As bond prices go down and liquidity on the money markets became tighter in the past weeks, the total weekly volume traded on the secondary market dropped.

Yield curve over the past weeks (Central Bank fixing)



Sources: NBR, OTP Research

RON denominated securities (avg. daily volume) traded on the secondary market declined in the past weeks



Sources: NBR, OTP Research

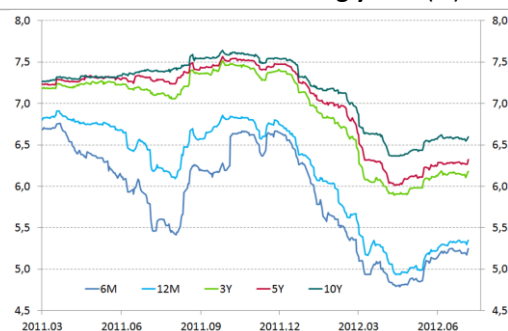
Note: the average for the current week does not include Friday;

Last data: 12.07.2012

RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	5,28	↑ 7,5	↓ -97	
12M	5,46	↑ 13,0	↓ -92	
3Y	6,19	↑ 3,5	↓ -95	
5Y	6,36	↑ 8,5	↓ -90	
10Y	6,59	↑ 2,0	↓ -74	
EUR GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M _{RO0912DBE034}	2,56	↑ 1,5	↓ -156	
2Y _{RO1013DBE014}	4,10	↓ -2,8	↓ -123	
SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	610	↑ 9,3	↓ -76	
GERROM 5Y	593	↑ 15,2	↓ -56	
GERROM 10Y	519	↑ 7,6	↓ -32	
3Y -5Y	17	↑ 5,0	↑ 6	
5Y -10Y	23	↓ -6,5	↑ 15	
3Y-10Y	40	↓ -1,5	↑ 21	
FLY 3-5-10	7	↓ -11,5	↑ 10	
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	337	↑ 18,6	↓ -35	
5Y EURO	382	↑ 20,5	↓ -20	

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)

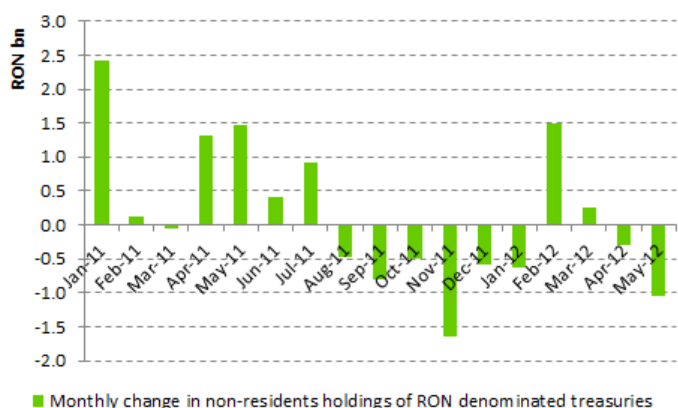


Sources: NBR, OTP Research

Auctions

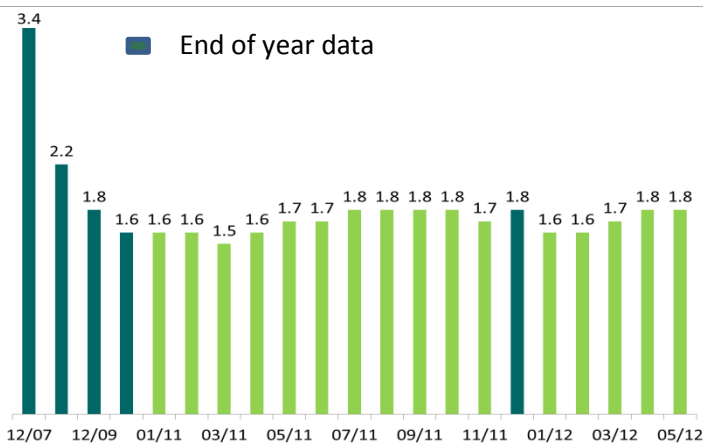
There were two auctions last week for 11M T-bills and 4Y bonds. The planned amount was 700 mn RON in the first case and 400 mn RON, respectively. **Unlike the previous weeks, the Treasury sold the targeted sums, despite the fact that yields were still higher compared to previous issues. In the case of the 11M T-bills auction, the average accepted yield stood at 5.53%, higher by 24 bp than the one at the previous tender in Mid June. In the case of the 4Y bonds, the average accepted yield stood at 6.41%, higher by 13 bp than the one at the previous auction in Mid June.**

In May, foreigners reduced by 1 bn RON their holdings on RON denominated treasuries



Source: Ministry of Finance, OTP Research

Average remaining maturity of treasuries remained unchanged in May



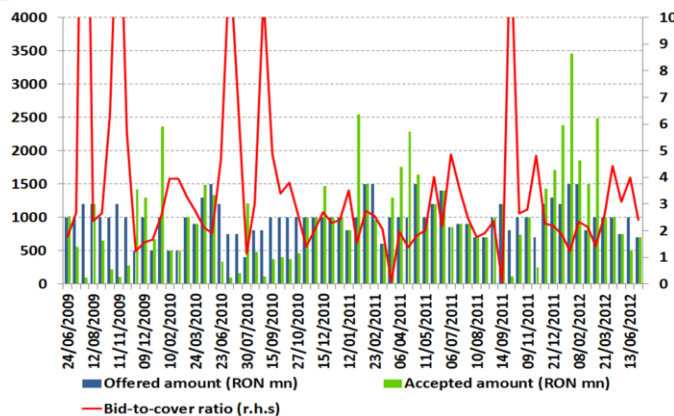
Source: Ministry of Finance, OTP Research
Note: it does not include the euro bonds

Results of last week's auctions

	RO1213CTN0E9	RO1216DBN030
Offered amount (RON mn)	700	400
total bids (RON mn)	1684	1107
accepted amount (RON mn)	700	400
average accepted yield (%)	5.53	6.41
coupon	-	5.75

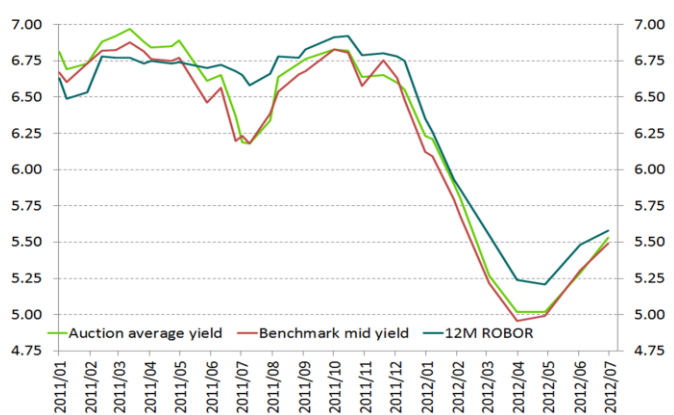
Source: Ministry of Finance, OTP Research

12M auctions data



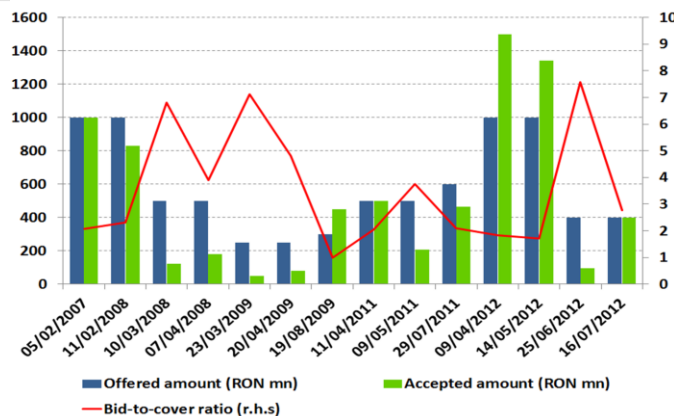
Sources: NBR, OTP Research

12M rates



Sources: NBR, OTP Research

4Y auctions data



Sources: NBR, OTP Research

The MinFin increased the weight of 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 fell on higher weekly repo volume

Money market rates reacted to the higher weekly liquidity injection by decreasing some 40 bp (in the case of ROBOR ON) until Wednesday and on Thursday, the drop was sharp: ROBOR ON fell to 2.7%, well ahead of the entering in the final week of the mandatory reserves building period. The repo volume was higher by 2 bn RON compared to previous week.

Banks may have asked for more cash than needed last week, for fear that the Central Bank will squeeze the liquidity during its currency interventions, especially last week when pressures on the leu were expected, following the previous Friday's event when the President was suspended. However, the CB may have intervened less and therefore for the moment the banks have had more cash than needed.

Otherwise, rates continue to be pressured and we believe the fall is temporary. The Central Bank increased the number of treasuries' issues accepted as collateral for its open market operations from 3 to 5 at the end of May and this helped improve liquidity conditions in June. Banks did not use the Lombard facility in June. However, since the deficit of liquidity is deepening, the CB is likely to take some measures like cutting the reserves requirement ratio for RON liabilities with residual maturity lower than 2 years at the next Board meeting on the monetary policy issues in August. A 2% cut would probably free up to 3bn RON which will take a few pressure from the rates provided that no major event would take place on international markets. In any case, we do not expect ROBOR 3M to fall below 5% after such a cut (it stood at 5.35% in June).

Last data: 12.07.2012

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	→ 0	↓ -75
ROBOR ON	2,70	↓ -269	↓ -183
ROBOR 3M	5,29	↓ -7	↓ -76
ROBOR 6M	5,54	↑ 3	↓ -99
ROBOR 9M	5,54	↑ 3	↓ -107
ROBOR 1Y	5,56	↑ 4	↓ -110

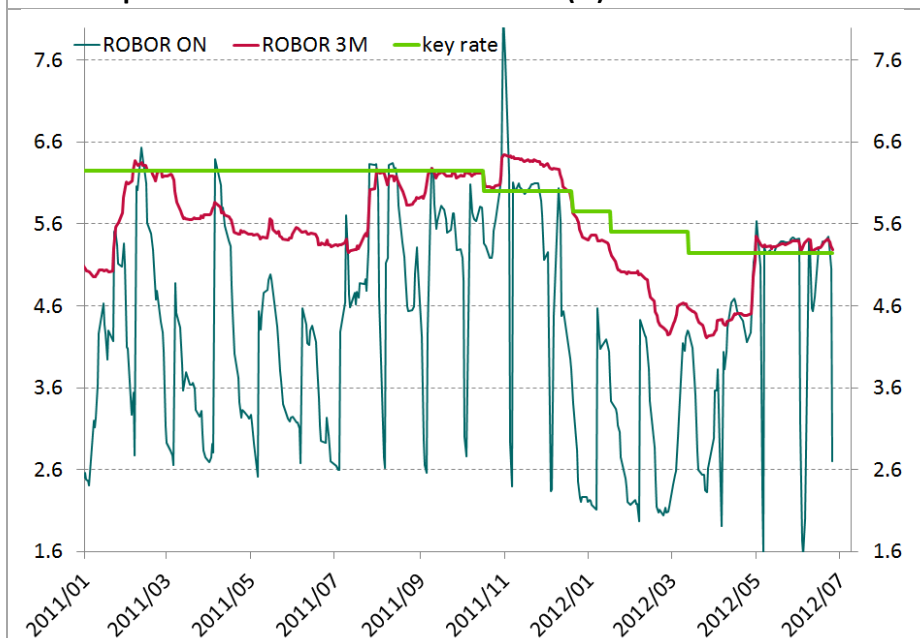
REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	13.645,9	1670,0	6934,9

INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	3.927,7	1870,5	-99,8

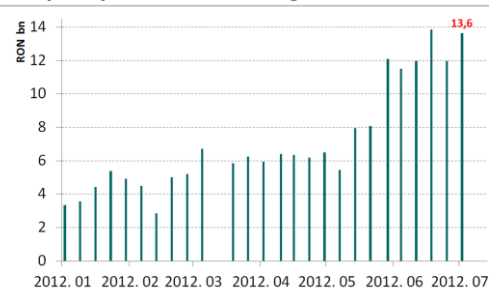
MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	25	↓ -13	↑ 1
USDRON 1M	145	↓ -1	↓ -5
USDRON 3M	417	↓ -11	↑ 170
EURRON 1W	21	↓ -22	↓ -20
EURRON 1M	175	↓ -6	↑ 30
EURRON 3M	527	↓ -1	↑ 16

MID EUR BASIS SWAPS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EURRON 1Y	0	↑ 30	↑ 155
EURRON 3Y	-20	↑ 40	↑ 135
EURRON 5Y	-40	↑ 20	↑ 110

Source: Reuters

Most important MM instruments from 2011 (%)


Sources: NBR, OTP Research

Repo operations during 2012


Sources: NBR, OTP Research

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