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Weekly Report

Romania

29 August 2012



The new budget revision risks a negative impact on GDP growth

Macroeconomics: Non-governmental loans increased by 7.2% YoY in July; deposits were up by 9.9% YoY (Page 3-4)

July banking statistics data revealed higher annual rhythm than in June, both in case of non-governmental loans and deposits. However, this result was influenced by an important FX effect: while in June, the RON depreciated by 5.1% YoY against the euro, in July the effect was much stronger: the leu was weaker by 7.7% YoY. Our in house seasonally adjusted data reveals that the annualized loan flows were weaker in July than in June, especially in the case of retail loans. Non-governmental loans increased by 7.2% YoY in July: loans to companies advanced by 9.8% YoY and loans to households were up by 4.3% YoY. Looking at the currency split, RON loans marginally decreased on the back of retail sector. However, we notice an uptrend of mortgage loans denominated in RON.

FX markets: strong leu, weak fundamentals (Page 5-6)

During the last week, the leu gained marginally against the euro, influenced by the maintenance of the liquidity cap by the NBR. Additionally, the EUR/RON followed the correlation with the EUR/USD pair last week. Forward looking, the proposed budget revision (cash) which was already approved by the Government last week made changes in the structure of the expenditures which puts pressure on GDP growth. The new plan cuts investment expenditures by 2 bn RON.

Government securities: yield curve flattened last week; Prices started rising this week, more clarity post referendum (Page 7-8)

Since the referendum (29th of July) and until the end of last week, yields have increased from 17 bp (5Y and 10Y bonds) to 65 bp (12M T-bills). Last Monday, the Constitutional Court ruled on the validity of the vote expressed at the referendum, after having changed the date of the results' announcement several times. The volume of RON denominated government securities traded on the secondary market (without the NBR) increased significantly last week compared to the previous two weeks (post referendum) as there was more clarity regarding the political risk which could have pushed bond prices further lower in the short term. This week already we started seeing prices rising. There were two auctions last week for 12M T-bills (500 mn RON) and 4Y bonds (200 mn RON) but the Treasury rejected all bids.

MM: ROBOR ON reached the maximum of the year last week, at 7.75% (Page 9-10)

Last week, the Central Bank injected only 4 bn RON at the weekly repo, an amount lower by 1 bn compared to the previous week. This pushed ROBOR ON to 7.75% on Thursday, the highest since last November when it touched the maximum of the month at 8.15%. We noticed a significant downward move in the EUR/RON cross currency basis swap quotations again and the EUR/RON 1Y reached zero, same as in July. That month we believe that local banks were in need of RON liquidity and part of it was received from foreigners who probably initiated some cross currency swaps and sold the leu as the political tension was building up.

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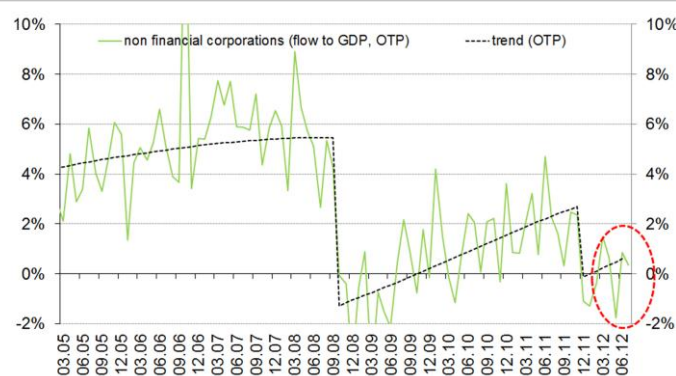
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Macroeconomics: Non- governmental loans increased by 7.2% YoY in July; deposits were up by 9.9% YoY

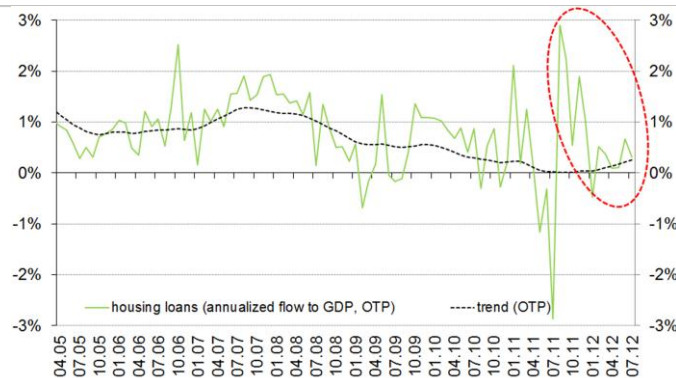
	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
24 Aug	July	M3 aggregate (y-o-y, %)	8,3		8,5
24 Aug	July	Non -governmental loans (y-o-y, %)	7,2		6,3
24 Aug	July	Non -governmental deposits (y-o-y, %)	9,9		9,6
28 Aug	July	Licenses for residential buildings (y-o-y, %)	-0,7		-5,6
31 Aug	July	ILO unemployment rate (% , seasonally adjusted)			7,6

July banking statistics data revealed higher annual rhythm than in June, both in case of non-governmental loans and deposits. However, this result was influenced by an important FX effect: while in June, the RON depreciated by 5.1% YoY against the euro, in July the effect was much stronger: the leu was weaker by 7.7% YoY. Given that 64% of non-governmental loans are denominated in foreign currencies, the impact of leu's depreciation from one month to another can be significant. **Our in house seasonally adjusted data reveals that the annualized loan flows were weaker in July than in June, especially in the case of retail loans.** According to our calculation, corporate loan flows were positive while in the case of retail, they fell in the negative territory, from a previous flat monthly evolution. **During the first 7M, the monthly average annualized flow is flat in the case of corporations and negative for households.** The latter basically means that new sales are lower than installments paid by customers.

Non-governmental loans increased by 7.2% YoY in July: loans to companies advanced by 9.8% YoY and loans to households were up by 4.3% YoY. Looking at the currency split, RON loans annual growth rate marginally decreased in July versus June, on the back of retail sector. More specifically, debt repayment in the case of consumer loans does not cover new sales. Consumer loans include home equity loans which have come under the effect of NBR regulation which limits their maximum maturity up to 5 years. Given this, the ticket size for this type of loans has decreased significantly. However, **we notice an uptrend of mortgage loans denominated in RON:** after constantly dropping since May 2010, in June and July we started seeing positive annual growth rates: +1.9% YoY in June and +5.4% YoY in July. NBR regulation became much more restrictive in the case of FX loans in the past year and additionally, leu's weakening and FX risk has prompted an advance of RON denominated loans. **However, the current squeeze of liquidity raises interest rates in RON, therefore threatening RON lending.**

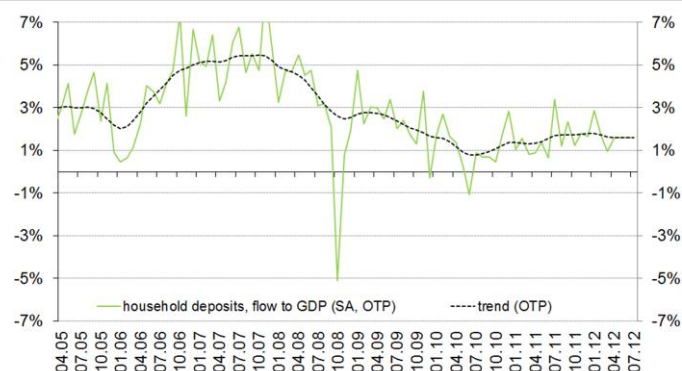
Non-financial corporations annualized loan flow to GDP


Source : NBR, OTP Research

Housing annualized loan flow to GDP


Source : NBR, OTP Research

Non-governmental deposits advanced by 9.9% YoY in July: companies savings increased slower than households' deposits: 6.8% YoY and 11.9% YoY respectively. Foreign currency deposits are only 35% of the total. According to our seasonally adjusted data, monthly average annualized deposit flows are positive. The average interest rate for RON denominated deposits declined from 6.13% in Dec.2011 to 5.2% in June. Even after tax, real rates were higher than 2% during the first 6M, thereby providing a good incentive to save.

Household deposits, annualized flow to GDP


Source : NBR, 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: *under revision; ** forecast

FX markets: strong leu, weak fundamentals

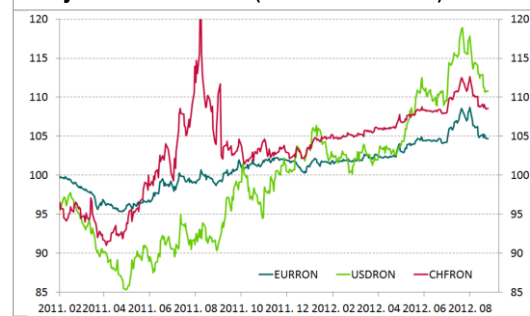
During the last week, the leu gained marginally against the euro, influenced by the maintenance of the liquidity cap by the NBR. Additionally, the EUR/RON followed the correlation with the EUR/USD pair last week: during the analyzed period, the euro gained a strong 1.7% against the dollar as investors expect tension in the European bond market to be released by the ECB bond buying programme and also, as the Fed pointed more clearly to a future QE3. The advance of the euro was also backed by the better than expected Purchasing Managers' Index in France and Germany.

Forward looking, the proposed budget revision (cash) which was already approved by the Government last week made changes in the structure of the expenditures which puts pressure on GDP growth. The new plan cuts investment expenditures by 2bn RON. This is likely to have a negative effect on the GDP growth rate. In H1 2012 infrastructure works most likely have had a positive significant impact on the GDP growth. The Fiscal Council provided an evaluation of below data (please see the table) and warned among others, that the base of this calculations stands on a GDP growth of 1.2% YoY in 2012, which may be optimistic.

Last data: 23.08.2012

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4,48	↑	0,10	↑ 3,75
USDRON	3,57	↓	-1,59	↑ 7,05
CHFRON	3,73	↑	0,01	↑ 5,04
RONJPY	4,54	↓	-0,49	↑ 4,96
RONPLN	1,09	↓	-1,03	↑ 6,00
100HUFRON	1,61	↑	0,12	↑ 17,97
RONCZK	0,18	↓	-0,28	↑ 6,71
RONRUB	0,11	↓	-1,12	↑ 8,79
RONRSD	0,04	↑	0,70	↓ -5,12
RONBGN	2,29	↑	0,05	↑ 3,94

Source: Reuters

Major RON FX rates (03.01.2011=100)


Sources: Reuters, OTP Research

The revised budget (cash) cuts investment expenditures by 2 bn RON

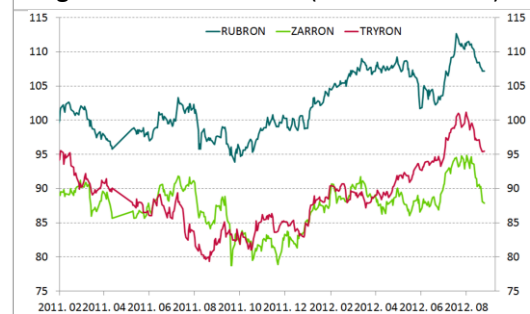
% in GDP	Initial Budget	Revised Budget	Difference (Initial/Revised)	Difference (without the swap effect)
Total revenues	33.7%	32.3%	-1.4%	-1.8%
Current revenues	31.1%	30.2%	-0.9%	-1.3%
Fiscal revenues	19.0%	18.9%	-0.1%	-0.6%
Non fiscal revenues	3.3%	2.9%	-0.4%	-0.4%
Capital revenues	0.3%	0.1%	-0.2%	-0.1%
Donations	0.2%	0.2%	0.0%	0.0%
EU funds	2.2%	1.8%	-0.4%	-0.4%
Total expenditures	35.6%	34.5%	-1.1%	-1.5%
Current expenditures	32.0%	31.0%	-1.0%	-1.0%
Personnel expenditures	6.9%	6.7%	-0.2%	-0.1%
Goods and services	5.5%	5.4%	-0.1%	-0.1%
Interest	1.8%	1.8%	0.0%	0.1%
Subsidies	0.9%	0.9%	0.0%	0.0%
Transfers	16.5%	15.7%	-0.8%	-1.1%
Between units of the public administration	0.3%	0.3%	0.0%	-0.2%
Other transfers	2.2%	2.0%	-0.2%	-0.3%
Projects financed by foreign non reimbursable funds. post accession	2.0%	1.8%	-0.2%	-0.2%
Social transfers	11.7%	11.2%	-0.5%	-0.5%
Other expenditures	0.4%	0.4%	0.0%	0.0%
Reserve fund	0.0%	0.1%	0.1%	0.1%
Expenses for programs with reimbursable funds	0.4%	0.3%	-0.1%	-0.1%
Capital expenditures	3.6%	3.5%	-0.1%	-0.2%
SURPLUS(+)/DEFICIT(-)	-1.9%	-2.2%	-0.3%	-0.3%
Investment expenditures	6.4%	6.0%	-0.4%	-0.6%

Sources: The Fiscal Council, OTP Research

The 7M budget deficit (cash) stood at 1.15% of the GDP and we already see the pattern projected by the budget revision in the case of revenues from VAT and excises. During the first 7M, total revenues were higher than in 2011 by 8% YoY while during the first 6M, they were higher by 8.9% YoY. The pace of growth of VAT& excises revenue has visibly slowed down, in line with weaker pace of economic activity. These two

Regional RON FX rates I. (03.01.2011=100)

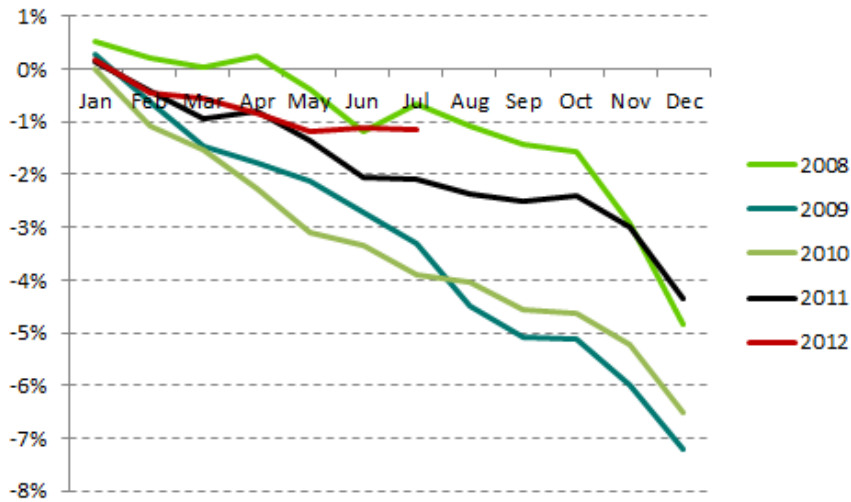

Sources: Reuters, OTP Research

Regional RON FX rates II. (03.01.2011=100)


Sources: Reuters, OTP Research

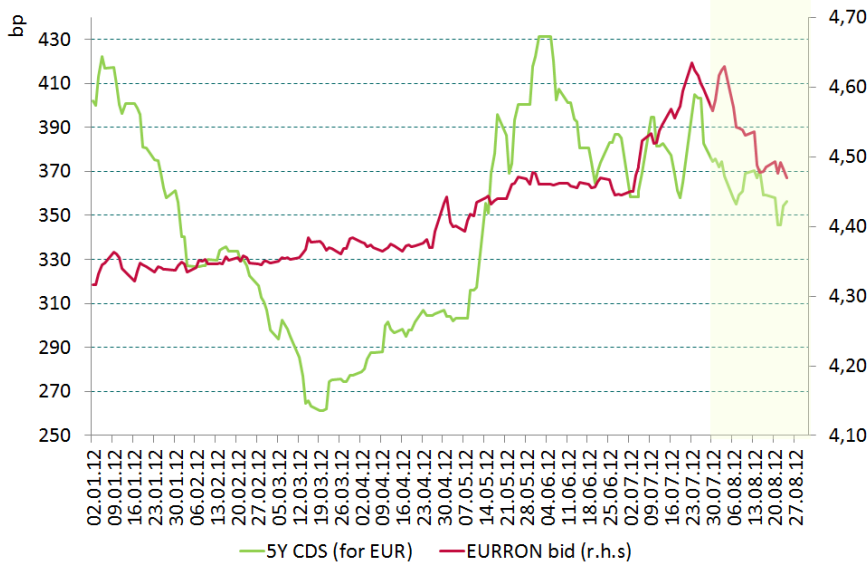
categories make up to 36% of total budget revenues. The target of 2.2% budget deficit imposed by the IMF remains a challenge, given parliamentary elections this year and downside risks to GDP growth.

Budget deficit (cash basis) stood at 1.15% during the first 7M



Sources: The Finance Ministry, OTP Research

The leu grew stronger due to liquidity squeeze; the CDS is at relatively lower levels compared to the end of May



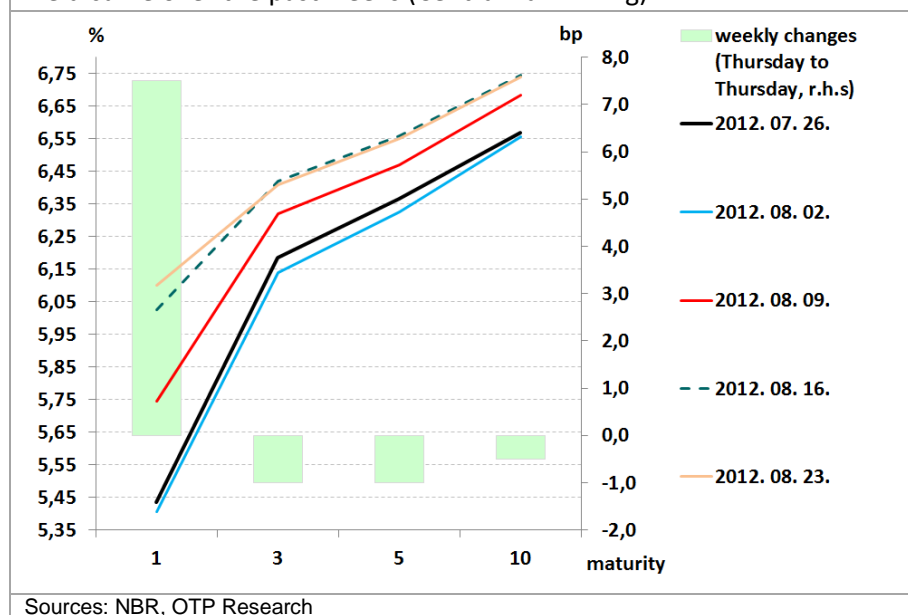
Sources: Reuters, OTP Research

Government securities: yield curve flattened last week; Prices started rising this week, more clarity post referendum

The yield curve continued to flatten last week, with yields still rising at the low end (+7 bp in the case of 12M T-bills) and dropping at the high end.

Since the referendum (29th of July) and until the end of last week, yields have increased from 17 bp (5Y and 10Y bonds) to 65 bp (12M T-bills). Last Monday, the Constitutional Court ruled on the validity of the vote expressed at the referendum, after having changed the date of the results' announcement several times. The volume of RON denominated government securities traded on the secondary market (without the NBR) increased significantly last week compared to the previous two weeks (post referendum) as there was more clarity regarding the political risk which could have pushed bond prices further lower in the short term. This week already we started seeing prices rising. We look forward to the auctions announcement for September.

Yield curve over the past weeks (Central Bank fixing)

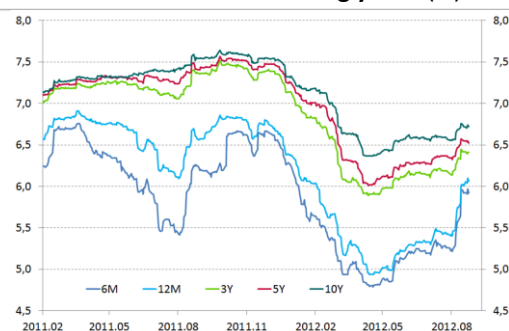


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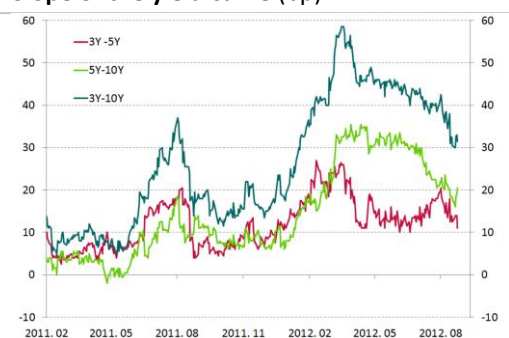
RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	5,97	↑ 1,0	↓ -28	
12M	6,10	↑ 7,5	↓ -28	
3Y	6,41	↓ -1,0	↓ -73	
5Y	6,55	↓ -1,0	↓ -70	
10Y	6,74	↓ -0,5	↓ -59	
SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	636	↑ 1,0	↓ -51	
GERROM 5Y	609	↑ 0,8	↓ -41	
GERROM 10Y	521	↑ 0,9	↓ -30	
3Y -5Y	14	↓ 0,0	↑ 3	
5Y -10Y	19	↑ 0,5	↑ 11	
3Y-10Y	33	↑ 0,5	↑ 14	
FLY 3-5-10	5	↑ 0,5	↑ 8	
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	303	↓ -5,7	↓ -69	
5Y EURO	354	↓ -4,9	↓ -48	

Source: Reuters

Central bank benchmark fixing yields (%)

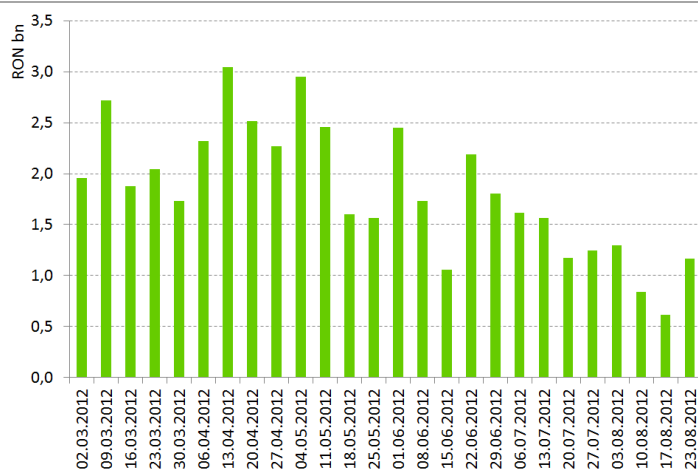


Slope of the yield curve (bp)



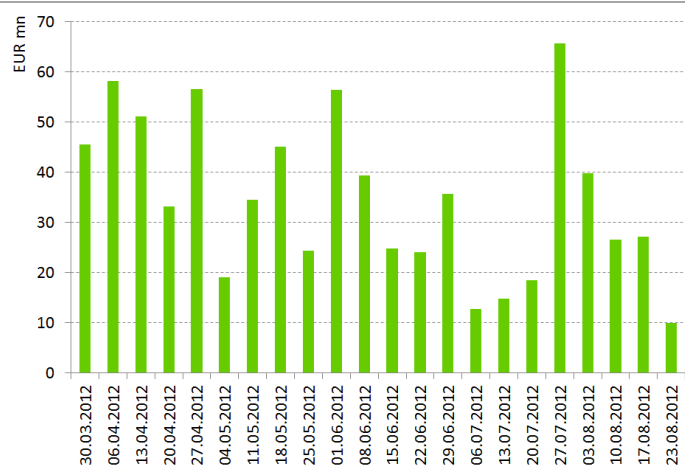
FLY 3-5-10 (bp)



RON denominated securities (avg. daily volume) traded on the secondary market (without NBR) picked up last week


Sources: NBR, OTP Research

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

EUR denominated securities (avg. daily volume) traded on the secondary market (without NBR) slid last week


Sources: NBR, OTP Research

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

T –bills auction in August

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1213CTN0F6	06.08.2012	08.08.2012	07.08.2013	12	700.000.000
RO1213CTN0G4	13.08.2012	16.08.2012	24.04.2013	8	700.000.000
RO1213CTN0H2	20.08.2012	22.08.2012	21.08.2013	12	500.000.000

Source: Ministry of Finance, OTP Research

Bonds auctions in August

ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
RO1214DBN068	09.08.2012	13.08.2012	28.07.2014	2	5.85	400.000.000
RO1216DBN030	23.08.2012	27.08.2012	27.01.2016	4	5.75	200.000.000

Sources: Ministry of Finance, OTP Research

The MinFin decreased the weight of bonds issue in August

	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12
Planned targeted amount (RON bn)	4,5	5,0	5,0	4,3	3,8	3,5	2,3	2,5
% of bonds	33%	44%	54%	76%	80%	49%	69%	24%

Source: Ministry of Finance, OTP Research

Auctions

There were two auctions last week for 12M T-bills (500 mn RON) and 4Y bonds (200 mn RON). The Ministry of Finance rejected all bids due to high yields.

MM: ROBOR ON reached the maximum of the year last week, at 7.75%

Last week, the Central Bank injected only 4 bn RON at the weekly repo, an amount lower by 1 bn compared to the previous week. This pushed ROBOR ON to 7.75% on Thursday, the highest since last November when it touched the maximum of the month at 8.15%. We noticed a significant downward move in the EUR/RON cross currency basis swap quotations again (please see the graph below) and the EUR/RON 1Y reached zero, same as in July.

In July, we noticed several simultaneous events:

- Daily average of repo transactions was marginally lower than in June
- Average ROBOR ON dropped to 4.08% from 4.61%
- The deposits placed with NBR (permanent facility) were almost double compared to the previous month
- The Treasury sold much less of the planned amount at the monthly auctions (1.6 bn RON compared to 2.3 bn RON that was planned, so banks had some extra liquidity)
- EUR/RON cross currency basis swaps decreased

Therefore in July, liquidity conditions improved (if we look at the level of ROBOR ON), even if the Central Bank did not make any obvious change of monetary policy. On one hand, it could be that the extra liquidity was available due to lower than expected sold Government securities and on the other hand, foreigners may have entered in cross currency swaps, selling the RON to local banks (which needed RON liquidity anyway), as the political environment became more tensioned. If this is the case, given that NBR capped liquidity at the weekly repo later on in August, some swaps were probably rolled over and this pushed down again the EUR/RON cross currency basis swaps in August. They can close the swaps later on, if RON liquidity will improve.

Last data: 23.08.2012

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	0	-75
ROBOR ON	7,75	155	322
ROBOR 3M	5,96	-9	-9
ROBOR 6M	6,26	4	-27
ROBOR 9M	6,26	4	-35
ROBOR 1Y	6,27	5	-39

REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	3.999,3	-1000,0	-2711,7

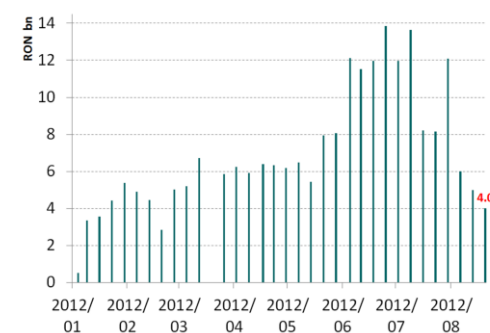
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	3.213,4	391,8	-814,1

MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	45	4	20
USDRON 1M	163	-10	14
USDRON 3M	488	-64	241
EURRON 1W	50	5	9
EURRON 1M	214	-1	69
EURRON 3M	628	21	117

MID EUR BASIS SWAPS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EURRON 1Y	0	60	155
EURRON 3Y	-10	50	145
EURRON 5Y	-20	35	130

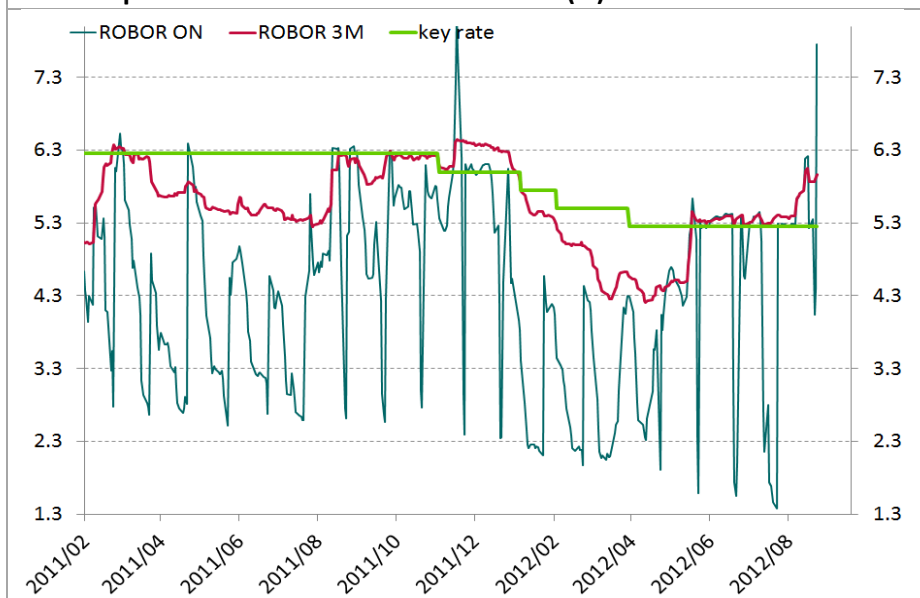
Source: Reuters

Repo operations during 2012



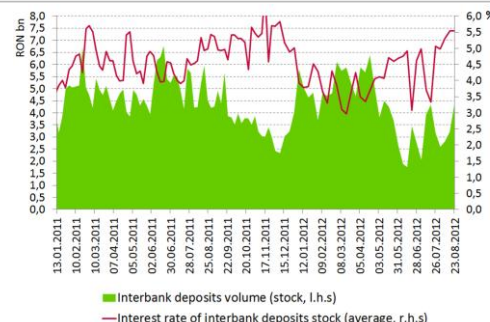
Sources: NBR, OTP Research

Most important MM instruments from 2011 (%)



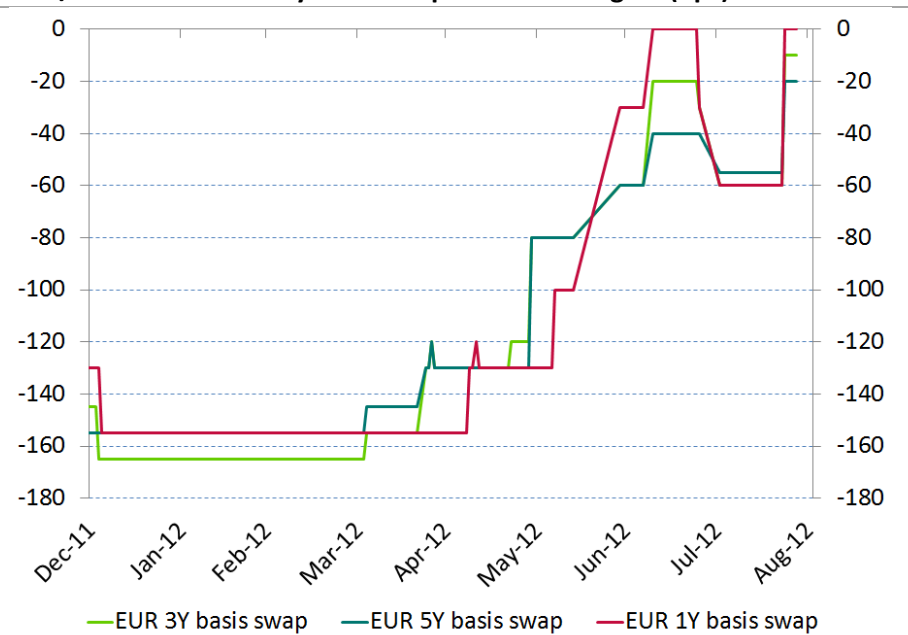
Sources: NBR, OTP Research

Interbank deposits stock and average interest rate



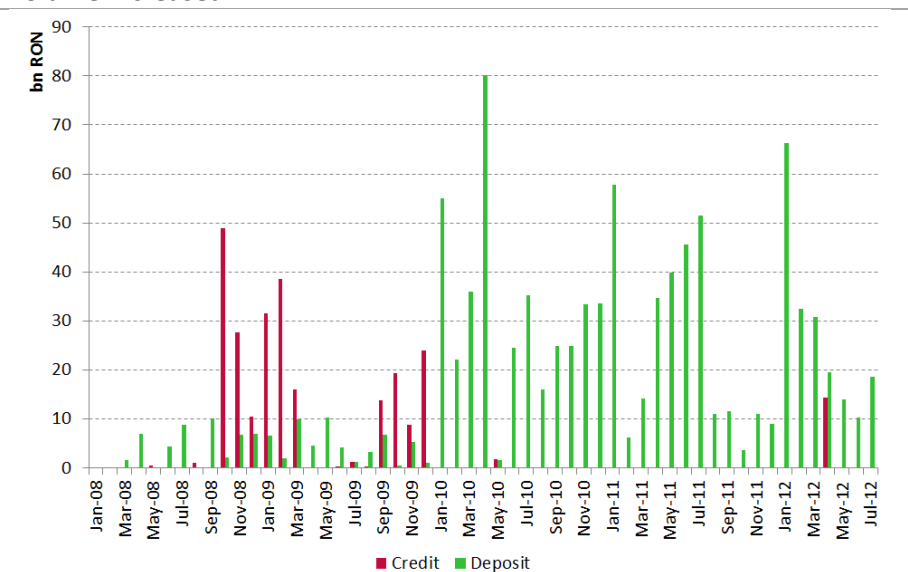
Sources: NBR, OTP Research

EUR/RON cross currency basis swaps decreased again (bps)



Sources: Reuters, OTP Research

Permanent facilities at The Central Bank. Deposits rose in July, as repo volume increased



Sources: NBR, OTP Research

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