

Treasury Sales Team

Alina Elena Vrabioiu

+4021 307 58 17

alina.vrabioiu@otpbank.ro

Irina Ananiese

+4021 307 58 17

irina.ananiese@otpbank.ro

Tania Fantana

+4021 307 58 17

tania.fantana@otpbank.ro

Capital Markets Sales Team

Alexandru Ilisie

+4021 307 58 27

alexandru.ilisie@otpbank.ro

Teodor Alexandru Tibuleac

+4021 307 58 27

alexandru.tibuleac@otpbank.ro

Weekly Report

Romania

26 October 2012



The leu started to appreciate; The Treasury successfully sold euro denominated bonds

Macroeconomics: CA deficit continues to shrink (3.1 bn EUR during first 8M); private loans advanced by 4.2% YoY in September (5.7% in August) (Page 3-4)

The current account deficit reached 3.1 bn EUR during the first 8M in 2012. It is lower by 24.8% YoY compared to the same period and it has been shrinking in the past 4M. During the first 8M we have witnessed a decrease of the trade gap deficit (goods and services) by 296 mn EUR, an improvement of the income balance by 274 mn EUR and an increase in current transfers by 462 mn EUR. Compared to last year, current transfers to other sectors (containing mostly workers' remittances) have increased by 15% YoY and stand at 2 bn EUR during the first 8M. The financing of the CA deficit has been done by net FDI up to 30% but FDI remain essentially low. The weak inflows of FX currency due to low investment appetite and low absorption of EU funds likely to put pressure on the leu. Private lending continues to slow down. Loans denominated in leu are seeing a rapid advance, especially mortgage loans. However in absolute terms, the biggest chunk is attributed to corporations.

FX markets: The liquidity cap starts to show effect on the leu (Page 5)

The leu is strengthening against the euro as the Central Bank is persistent in capping liquidity. However, looking , taking a step back and looking at a longer period, risks are for the downside. The IMF believes that currently the real exchange rate is in line with fundamentals (possibly undervalued up to 5%). According to their expectations total factor productivity will only increase slowly up to 2017 compared to pre- crisis levels. This in turn implies that sustainable real exchange rate appreciation is not likely for quite a while.

Government securities: RON yields stopped climbing; the Treasury sold 3Y bonds in EUR at 3.76% (Page 6-7)

After the jumps witnessed in the first two weeks of October, yields have stabilized for the moment. The 12M fixing stands close to 6% while the 5Y is at 6.5%. the Fiscal Council released its opinion on the second budgetary revision this year and the feedback is generally positive regarding the figures, with some warnings regarding EU funds revenues and arrears. The current revision does not change the final budget deficit figure (2.25% of the GDP). The Council notes that investment expenditures were changed again and upped by 1 bn RON, excluding the effect of the swap schemes (after being cut down at the first budgetary revision by 1.7 bn RON). The cash budget deficit during the first 9M remains unchanged since July (1.2%). Monday's 3Y bond auction recorded a huge success: the Treasury sold 421 mn EUR (3 times more than planned) at an average yield of 3.76%.

MM: Base rate hike is not expected in November (Page 8)

As the leu is not yet at a comfortable level, we expect the cap to continue next week too. At the latest poll conducted by Reuters (23-25th Oct), none of the analysts pointed to an increase in the base rate in 2012. For Q1 2013 however, a few expected a hike of 25 bp. The pass through of the policy rate to MM rates is of 80% in the short term (IMF).

Chief Economist

Gergely Tardos

+36 1 374 7273

tardosg@otpbank.hu

FX/FI Strategist

Levente Pápa

+36 1 354 7480

papal@otpbank.hu

Macro Analysts

Gábor Dunai

+36 1 374 7272

dunaig@otpbank.hu

Győző Eppich

+36 1 374 7274

eppichgyo@otpbank.hu

Szilárd Kondora

+36 1 374 7275

kondorasz@otpbank.hu

Bálint Szaniszló

+36 1 374 7271

szaniszllob@otpbank.hu

Mihaela Neagu

+4021 307 58 64

mihaela.neagu@otpbank.ro

Rodion Lomivorotov

+7 495 783-5400 (2761)

r.lomivorotov@otpbank.ru

Sector Analyst

Piroska Szabó

+36 1 374 7276

szabopb@otpbank.hu

Dávid Rácz

+36 1 374 7270

raczd@otpbank.hu

Technical Analyst

András Salamon

+36 1 374 7225

salamona@otpbank.hu

Macroeconomics: CA deficit continues to shrink (3.1 bn EUR during first 8M); private loans advanced by 4.2% YoY in September (5.7% in August)

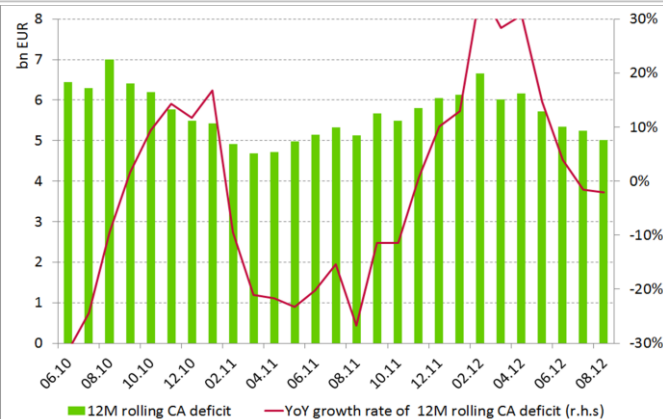
	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
15 Oct	Aug	CA balance (EUR mn, YTD)	-3.123		-2.929
15 Oct	Aug	net FDI (EUR mn, YTD)	906		1.011
23 Oct	Sep	M3 aggregate (y-o-y, %)	5,7		7,2
23 Oct	Sep	Non -governmental loans (y-o-y, %)	4,2		5,7
23 Oct	Sep	Non -governmental deposits (y-o-y, %)	7,3		8,8

The current account deficit reached 3.1 bn EUR during the first 8M in 2012. It is lower by 24.8% YoY compared to the same period and it has been shrinking in the past 4M.

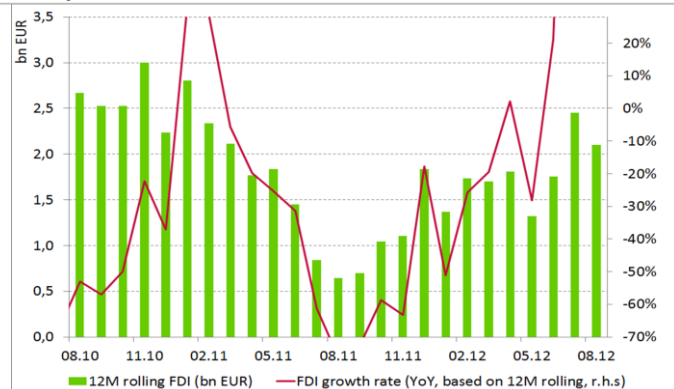
During the first 8M we have witnessed a decrease of the trade gap deficit (goods and services) by 296 mn EUR, an improvement of the income balance by 274 mn EUR and an increase in current transfers by 462 mn EUR. The latter mostly reflects the increase in workers' remittances. **Compared to last year, current transfers to other sectors (containing mostly remittances) have increased by 15% YoY** although GDP growth in EU will be much lower than last year (-0.5%YoY according to latest Reuters poll versus 1.5% YoY in 2011). Given that next year growth outlook in EU is not much better than the current one, with expected growth of 0.3% YoY (Reuters poll) and that unemployment is continuously rising in Europe, **we expect workers' remittances to perform worse. This year, most likely they contributed to the increase of retail trade.**

In the case of trade balance, the services category witnessed a surplus while the goods widened their deficit. The latter is due to a faster pace of imports growth and it is in line with the pick up in internal demand. This year, demand has been helped by public capital expenditure and the increase in public employees wages, which may not be key growth drivers next year (especially the latter). Romania had 0.35% market share of total exports in the world and the figure has been continuously increasing since 2000. However, cheap labour force will not be an advantage for long.

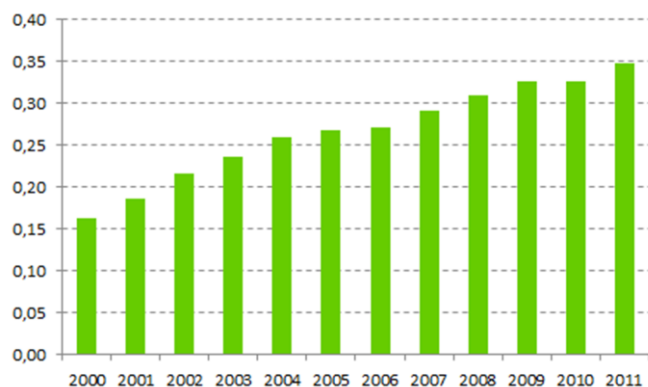
The financing of the CA deficit has been done by net FDI up to 30% and cumulated 8M figure stands at 906 mn EUR. Portfolio investments, which are more volatile, are 465 mn EUR. The capital account balance is at 1.2 bn EUR (mainly general government transfers). **The main concern is that low FDI inflow and difficulty to attract EU funds may put pressure on the currency (especially in view of IMF loan repayment of 5 bn/year in 2013-2014).** For the moment, there has not been a significant advance in the FDI and payments from the EU are being withheld between 10% and 25% for four EU programs, according to the Romanian PM.

Current Account deficit continues to shrink


Source: NBR, OTP Research

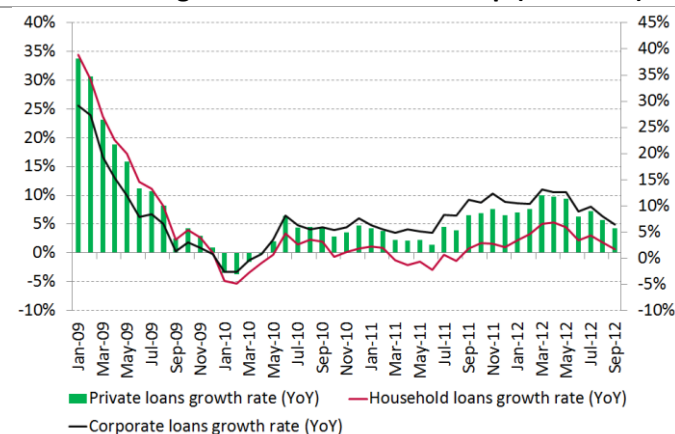
12M rolling FDI data points to marginal improvement this year, after the decline in H2 2011


Source: NBR, OTP Research

Romania's share in world's exports increased to 0.35% in 2011


Source : Eurostat, OTP Research

The September banking statistics data was released. **Private loans advanced less than last month, by 4.2% YoY compared to 5.7% YoY in August.** Private deposits saw a lower growth pace as well: 7.3% YoY in September compared to 8.8% YoY in August. We notice that **RON lending is advancing rapidly, especially in the case of loans to corporations (+11.5% YoY) and mortgage loans (+12.1% YoY).** In the case of corporations, a large share of loans (41%) is in RON. **The actions taken by the Central Bank starting in 2011 (cutting rates, providing more liquidity to the market through weekly repo) are starting to bear fruit as lower interest rates in RON cumulated with no FX risk is an incentive for corporations to take loans in RON. In the case of households, FX lending has been limited by NBR regulation so the advance we see in RON lending is expected.**

Private loans growth rate declines in Sep (4.2% YoY)


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%	0,9%	1,9%
Actual individual consumption of households	10,6%	10,5%	8,9%	-9,1%	-0,3%	0,7%	1,7%	1,8%
Households consumption expenditure	12,9%	12,0%	9,0%	-10,4%	-0,4%	1,4%	1,8%	1,8%
Government consumption	-11,5%	2,5%	6,2%	9,5%	-10,0%	-3,4%	-0,5%	1,1%
Gross fixed capital formation	19,9%	30,3%	15,6%	-28,1%	-2,1%	6,3%	9,9%	4,6%
Exports	10,4%	7,8%	8,3%	-6,4%	14,0%	9,9%	0,0%	7,1%
Imports	22,6%	27,3%	7,9%	-20,5%	11,9%	10,5%	1,3%	7,1%
Consumer prices (avg.)	6,6%	4,8%	7,8%	5,6%	6,1%	5,8%	3,0%	4,1%
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%	35,0%	36,6%
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	-6,1	-6,6
Unemployment	7,3%	6,4%	5,8%	6,9%	7,3%	7,4%	7,1%	6,9%
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%*	1,5%	0,3%
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	4,45	4,47
EUR/RON (e.o.p.)	3,38	3,61	3,99	4,23	4,28	4,32	4,50	4,43

Source: Eurostat, OTP Research

Note: * forecast

FX markets: The liquidity cap starts to show effect on the leu

The Central Bank continued to cap liquidity at the weekly repo auction with the clear intention to help the leu and finally the leu gives some signals of appreciation. As we said in the previous report, we believe the cap will continue until it reaches fully its initial purpose which is the EUR/RON at a level previous to the second cap. While for the very short term expectations are for leu's strengthening, taking a step back and looking at a longer period, risks are for the downside.

Recently, the IMF has published a report in which it examined more carefully the macroeconomic outlook, the fiscal and monetary policy. A few findings relevant for the exchange rate caught our attention:

- first, the report finds that growth prospects in the coming years are significantly deteriorated. According to one estimation method (multivariate filter), the potential output growth stands at 2% YoY until 2014 and it is set to rise gradually until 2017, up to 3.1%. The IMF presents the growth decomposition until 2017 (growth does not exceed 5% YoY) and it shows that total factor productivity increases very slow compared to the pre-crisis years. This in turn implies that sustainable real exchange rate appreciation is not likely for quite a while. Currently, the IMF assesses that the real exchange rate is in line with the fundamentals (it may be undervalued between 0.6% and 4.7%)
- Romania is vulnerable to the deepening of the financial crisis in the eurozone, as asset prices in certain periods are very correlated with GIIPS countries and European risk premia; if we add the findings of the IMF in its latest World Economic Outlook report released in October and namely that the risk of recession in the euro area increased to above 80% in 2013 (up from around 50% estimated earlier in April) we could draw the conclusion that risks for RON depreciation are not insignificant. On the upside, for the moment the FX reserves remain high by all measures and fiscal and monetary policy worked well enough post crisis: the fiscal deficit declined considerably while the impact of monetary policy decisions is much stronger.

Last data: 25.10.2012

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4,56	↓	-0,31	↑ 5,53
USDRON	3,53	↑	0,70	↑ 5,81
CHFRON	3,77	↓	-0,46	↑ 6,08
RONJPY	4,39	↓	-0,60	↑ 1,38
RONPLN	1,10	↓	-1,70	↑ 6,37
100HUFRON	1,63	↓	-1,00	↑ 19,06
RONCZK	0,18	↓	-1,08	↑ 8,37
RONRUB	0,11	↓	-1,06	↑ 8,69
RONRSD	0,04	↓	-0,48	↓ -0,71
RONBGN	2,33	↓	-0,32	↑ 5,76

Source: Reuters

Major RON FX rates (03.01.2011=100)



Sources: Reuters, OTP Research

Regional RON FX rates I. (03.01.2011=100)



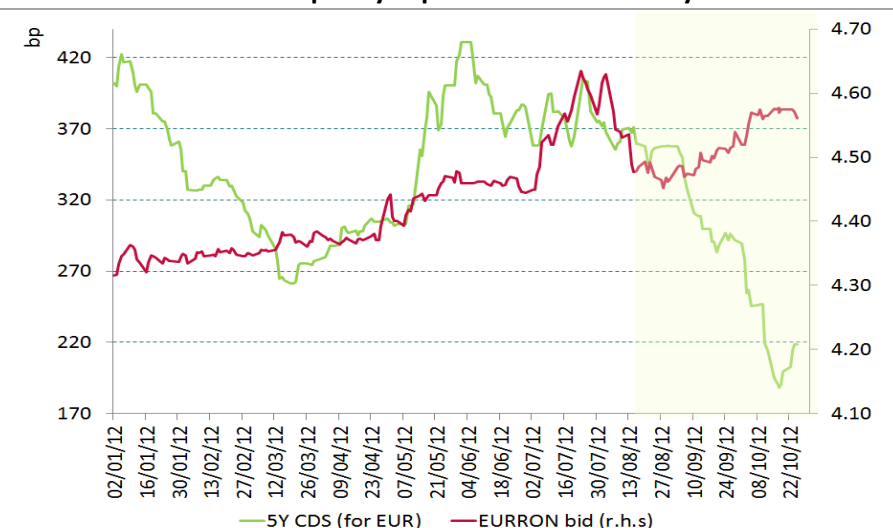
Sources: Reuters, OTP Research

Regional RON FX rates II. (03.01.2011=100)



Sources: Reuters, OTP Research

Leu 's resilience to the liquidity cap started to fade away this week



Sources: Reuters, OTP Research

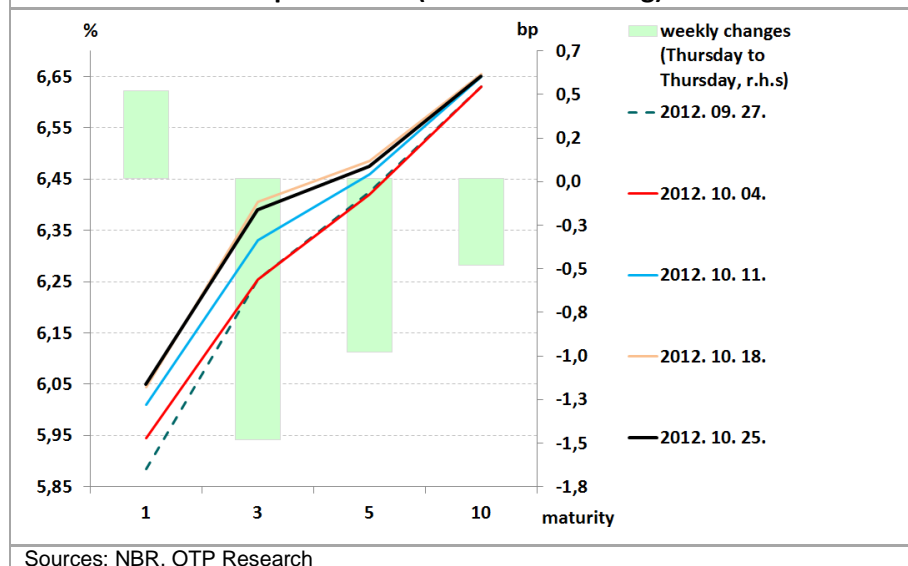
Government securities: RON yields stopped climbing; the Treasury sold 3Y bonds in EUR at 3.76%

After the jumps witnessed in the first two weeks of October, yields have stabilized for the moment. The 12M fixing stands close to 6% while the 5Y is at 6.5%. Term premium increases moderately again and the 3Y-10Y / 5Y-10Y spreads are higher by 7 / 10bp compared to the end of December 2011. Increased inflation has raised expectations for base rate hike next year compared to the end of 2011 when we would have rather seen the base rate falling in 2013. Volumes traded on the secondary market (without the Central Bank) have increased this week especially for euro denominated securities. The latter happened after the success of this week's bond auction in euro.

On another note, the Fiscal Council released its opinion on the second budgetary revision this year and the feedback is generally positive regarding the figures, with some warnings. The Council appreciates that the projection of revenues is realistic except for an increase in the revenues from EU funds compared to the first revision (but the sum is small). On expenditures side, the Council warns about the capital expenditures from the government's own funds and it advises that this figure should not be exceeded based on higher expectations about revenues from EU for capital investments, as this could endanger the realization of the deficit target for 2012. **During the first 9M, the cash budget deficit stood at 1.2% YoY, unchanged since July.** In what concerns the accrual based deficit target, the Council admits there are risks, especially in the context of higher arrears.

The current revision does not change the final budget deficit figure (2.25% of the GDP). However, revenues and expenditures projection are higher by 1.5 bn RON (excluding the effect of swaps made to eliminate the effect of outstanding obligations to the budget). The increase in revenues is explained by additional income from renting frequency bands to mobile operators, non tax revenues (i.e. increased payments from NBR profit, claw back tax, excise duties). Expenditures are revised upwards for categories related to programs financed from post accession EU funds. **The Council notes that investment expenditures were changed again and upped by 1 bn RON, excluding the effect of the swap schemes (after being cut down at the first budgetary revision by 1.7 bn RON).**

Yield curve over the past weeks (Central Bank fixing)



Last data: 25.10.2012

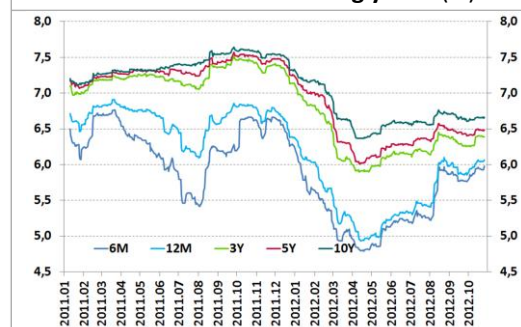
RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	5.95	↔ 0,0	↓ -31	
12M	6.05	↑ 0,5	↓ -33	
3Y	6.39	↓ -1,5	↓ -75	
5Y	6.48	↓ -1,0	↓ -78	
10Y	6.65	↓ -0,5	↓ -68	

SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	619	↓ -1,5	↓ -68	
GERROM 5Y	584	↓ -1,0	↓ -66	
GERROM 10Y	502	↓ -0,5	↓ -49	
3Y-5Y	8	↑ 0,5	↓ -3	
5Y-10Y	18	↑ 0,5	↑ 10	
3Y-10Y	26	↑ 1,0	↑ 7	
FLY 3-5-10	9	↔ 0,0	↑ 12	

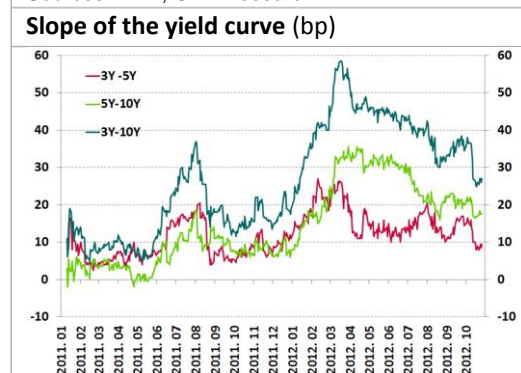
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	154	↑ 21,5	↓ -218	
5Y EURO	212	↑ 21,5	↓ -190	

Source: Reuters

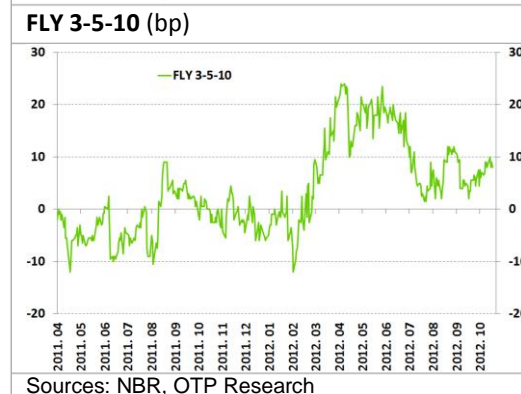
Central bank benchmark fixing yields (%)

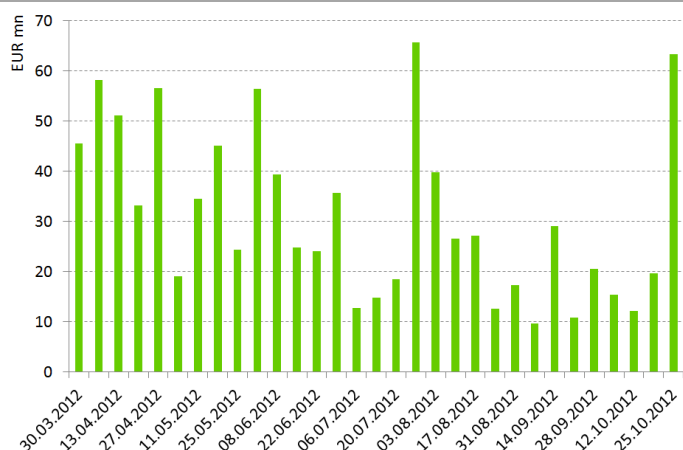


Slope of the yield curve (bp)



FLY 3-5-10 (bp)



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


Sources: NBR, OTP Research

Note: the last week's daily average does not contain Friday

Auctions

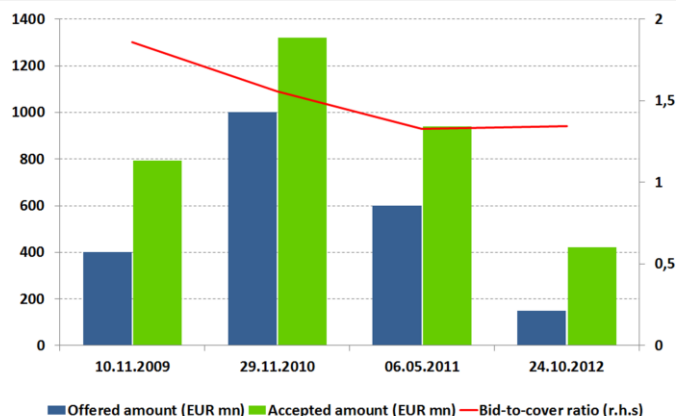
There were two auctions this week and the results were good. The Treasury sold 3 times more than the planned amount of 3Y (remaining maturity) bonds. It sold 421.5 mn EUR at an average accepted yield of 3.76%. The 3Y CDS was at 145 bp on Monday. At the previous similar auction in May 2011, Romania attracted 939 mn EUR at 4.89% (113 bp higher) and back then the 3Y CDS was a bit higher, around 170 bp. The auction was a success, especially in view of the Romania's external funding needs in the coming 2 years. The Finance Ministry plans to issue FX debt even for covering this year's funding needs.

At the 5Y bonds auction, the Treasury paid an average accepted yield of 6.56% and sold 200 mn RON. The yield is 41 bp higher than at the end of May.

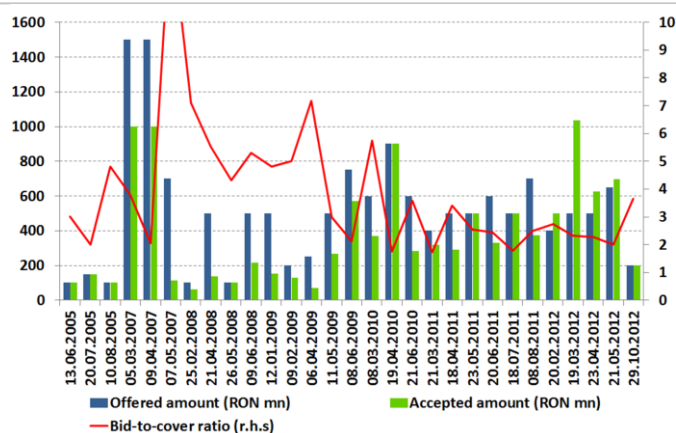
Results of this week's auction

	RO1217DBN046	RO1115DBE025
Offered amount	200 mn RON	150 mn EUR
total bids	733 mn RON	566,4 mn EUR
accepted amount	200 mn RON	421,5 mn EUR
average accepted yield (%)	6,56	3,76
coupon	5,90	4,70

Sources: NBR, OTP Research

3Y Auctions data (EUR)


Sources: NBR, OTP Research

5Y Auctions data (RON)


Sources: NBR, OTP Research

T-bills auction in October

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1213CTN0M2	01.10.2012	03.10.2012	03.04.2013	6	1.000.000.000
RO1213CTN0N0	08.10.2012	10.10.2012	11.09.2013	11	1.000.000.000
RO1213CTN0O8	15.10.2012	17.10.2012	23.09.2013	11	1.000.000.000

Source: Ministry of Finance, OTP Research

Bonds auctions in October

ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
RO1214DBN068	04.10.2012	08.10.2012	28.07.2014	2	5,85	400.000.000
RO1215DBN073	11.10.2012	15.10.2012	26.10.2015	3	5,80	250.000.000
RO1214DBN068	18.10.2012	22.10.2012	28.07.2014	2	5,85	300.000.000
RO1217DBN046	25.10.2012	29.10.2012	26.07.2017	5	5,90	200.000.000

Sources: Ministry of Finance, OTP Research

Euro-denominated bonds

ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (EUR)
RO1115DBE025	22.10.2012	24.10.2012	29.07.2015	4	4,70	150.000.000

Sources: Ministry of Finance, OTP Research

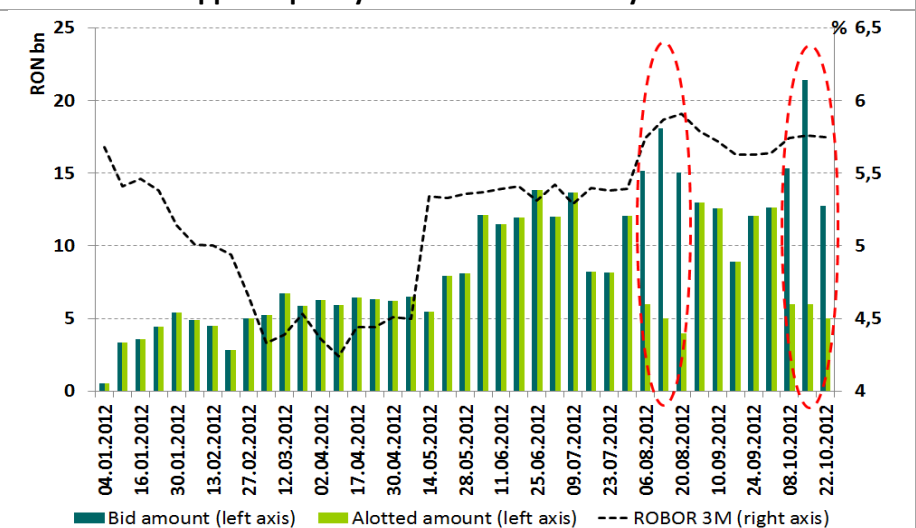
MM: Base rate hike is not expected in November

As expected, the Central Bank maintained the liquidity cap this week as well. However, the total amount asked by the banks was significantly lower compared to the previous week (12.7 bn RON compared to 21.4 bn RON). This week ended the observation period for the required reserves (on 23rd) which is why we saw ROBOR ON falling as low as 1.66% on 23rd October.

As the leu is not yet at a comfortable level, we expect the cap to continue next week as well.

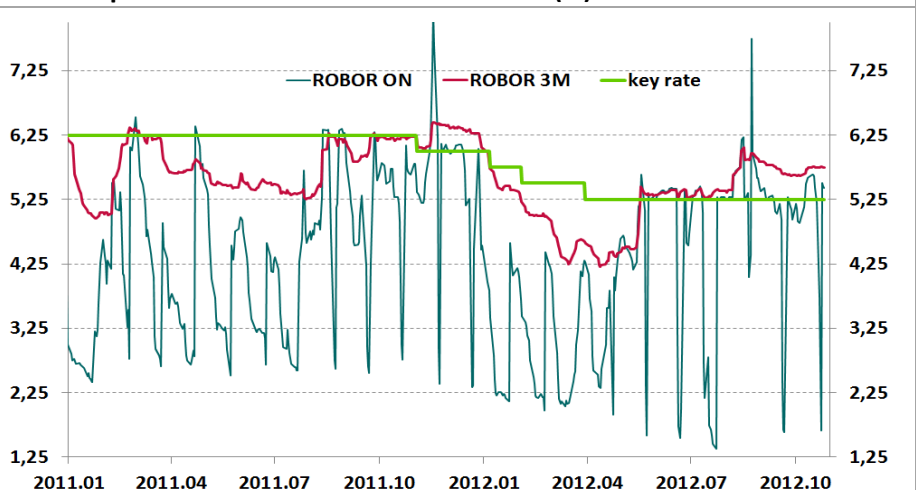
At the latest poll conducted by Reuters (23-25th Oct), none of the analysts pointed to an increase in the base rate in 2012. For Q1 2013 however, a few expected a hike of 25 bp. According to the latest research report released by the IMF in October operated on a sample of monthly data from August 2005 to April 2012, the pass through of the policy rate to MM rates is of 80% in the short term, while at the beginning of the analyzed period, only 30% was transmitted in the first 2M.

Central Bank capped liquidity the second time this year



Sources: NBR, OTP Research

Most important MM instruments from 2011 (%)



Sources: NBR, OTP Research

Last data: 25.10.2012

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	0	-75
ROBOR ON	5,46	23	93
ROBOR 3M	5,75	1	-30
ROBOR 6M	6,10	-2	-43
ROBOR 9M	6,14	0	-47
ROBOR 1Y	6,18	0	-48

REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	4,999,9	-999,4	-1711,1

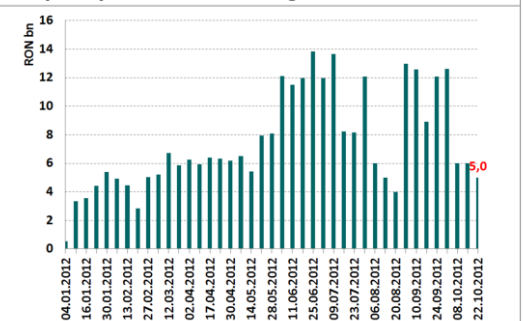
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	3,611,2	425,8	-416,3

MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USD RON 1W	35	4	10
USD RON 1M	156	-2	7
USD RON 3M	415	-4	169
EUR RON 1W	46	-3	5
EUR RON 1M	206	1	61
EUR RON 3M	629	1	118

MID EUR BASIS SWAPS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EUR RON 1Y	-88	0	68
EUR RON 3Y	-88	0	68
EUR RON 5Y	-88	0	63

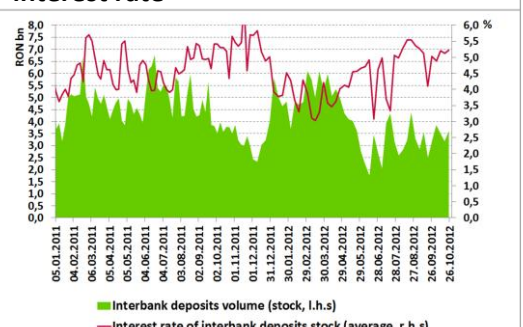
Source: Reuters

Repo operations during 2012



Sources: NBR, OTP Research

Interbank deposits stock and average interest rate



Sources: NBR, OTP Research

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