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Weekly Report

Romania

19 November 2012



New IMF agreement in January; Treasury sold another 342 mn EUR in 3Y bonds

Macroeconomics: In Q3, GDP dropped by 0.6% YoY (NSA) and 0.5% QoQ (SA); inflation down to 5% YoY in October from 5.3% YoY (Page 3-5)

Flash GDP data pointed to a decline of 0.6% YoY and of 0.5% QoQ (seasonally adjusted data) more than analysts' expectations (+0.1% YoY and -0.3% QoQ). In the third quarter, agriculture and constructions most likely brought a negative contribution to the quarterly growth rate, while industry was flat and public services value added rose following the increase of public employees' wages in June. Expectations in Q4 depend largely on industry's evolution. The support from public services will lack as compared to the previous quarter. Agriculture should not impact too much the quarterly growth rate as the effect of the bad agricultural year already stroke in Q3. According to October's NBR survey, expectations are for an increase in industrial production and flat evolution in constructions.

FX markets: Increased tensions in Europe outweigh domestic efforts to support the leu (Page 6-7)

The EUR/RON continued to go down last week until Friday, when the negative data from Europe outweighed domestic efforts to keep the currency close to the 4.5 level. The next big moments with consequences for the leu are December's elections and the negotiation of a new IMF deal in January. USL's new proposed fiscal measures are not line with the view of the IMF because all of them envisage tax decreases whereas the IMF recently published a research paper in which it was analysing several ways to increase budget revenues which included different tax hikes and estimated effects. While signing a new deal with the IMF could be positive for the leu in the short term, more tightening of the fiscal policy weighs on economic growth, especially since outlook for the eurozone worsens, the country has not recovered and that monetary policy has already been tightened by putting a cap on liquidity.

Government securities: The Treasury sold another 342 mn EUR in 3Y euro denominated bonds (Page 8-9)

The Treasury planned to sell another 150 mn EUR in euro denominated bonds last week. The decision was taken after the initial announcement of auctions to be held this month. It sold 342 mn EUR, so it could sell less than the planned amount of government securities denominated in leu if yields are too high. Last week, there were two successful auctions. The average accepted yields were 6.13% (12M) and 6.55% (3Y) respectively, marginally up from previous tenders. Starting on 31st March 2013, Romanian sovereign bonds are included in the Barclays EM Local Currency Government Index.

MM: Core inflation is still on an uptrend; NBR forecasts inflation to be in the 5-6% YoY range in H1 2013 (Page 10-11)

Last week the repo amount was raised by 2 bn RON as the Central Bank is trying to find a good mix between interest rates and exchange rate. We believe that MM rates will continue to remain under upside pressures in the coming few months. In H1 2013, NBR forecasts that annual inflation will be in the range of 5-6% . NBR changed its forecast for Dec 2012 to 5.1% YoY from 3.2% YoY and to 3.5% YoY in Dec 2013. October inflation came down at 5% YoY but Core 2 adjusted advanced to 3.3% YoY from previous 3% YoY.

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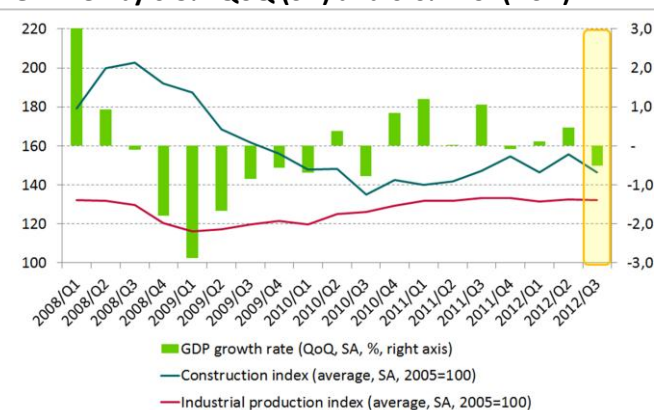
Macroeconomics: In Q3, GDP dropped by 0.6% YoY (gross) and 0.5% QoQ (SA); inflation down to 5% YoY in October from 5.3% YoY

PERIOD		INDICATOR	FACT	CONSENSUS	PRIOR
12 Nov	Oct	Consumer price index (y-o-y, %)	5	5	5,3
12 Nov	Sep	CA balance (EUR mn, YTD)	-3671		-3123
15 Nov	Q3 2012	Flash GDP growth rate (q-o-q, %, seasonally adjusted)	-0,5	-0,30	0,5
26 Nov	Oct	M3 aggregate (y-o-y, %)			5,7
26 Nov	Oct	Non -governmental loans (y-o-y, %)			4,2
26 Nov	Oct	Non -governmental deposits (y-o-y, %)			7,3

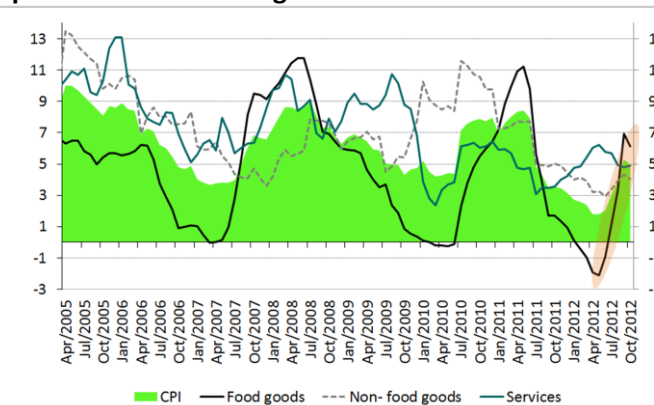
October inflation dropped to 5% YoY from previous 5.3% YoY. Food goods inflation decreased unexpectedly to 6.14% YoY from 6.9% YoY in September, as in the month, a subcategory of the volatile items, fruits and vegetables showed a decline in prices while previously they had been up by 5-10% MoM (in September). Non food goods price increase slowed down to 4.04% YoY and services' prices went up to 4.89% YoY. The outcome was mixed: despite the slowdown in headline inflation, core2 (CPI excluding administered prices and volatile items) pointed to an uptrend: from 3.2% YoY (September) to 3.5% YoY (October). We have already seen that Q3 GDP fell both on quarterly and annual basis and this brings to light the effect of the deficit of demand which should take off part of the inflation pressure in the coming quarters. On the other hand, **the price liberalization of gas and electricity will weigh heavily on inflation next year: NBR estimates that administered prices inflation will be at 6.5% YoY on average in 2013. They explain one third of December 2013 inflation.**

Flash GDP data pointed to a decline of 0.6% YoY and of 0.5% QoQ (seasonally adjusted data) more than analysts' expectations (+0.1% YoY and -0.3% QoQ). In the third quarter, agriculture and constructions most likely brought a negative contribution to the quarterly growth rate, while industry was flat and public services value added rose following the increase of public employees' wages in June. The most negative surprise came from constructions which fell abruptly in September, probably in connection with lower public capital expenditure which could have been adjusted to fit into quarterly budget targets. Following the Q3 data, we will revise downwards our GDP forecast for 2013.

Expectations in Q4 depend largely on industry's evolution. The support from public services will lack as compared to the previous quarter. Agriculture should not impact too much the quarterly growth rate as the effect of the bad agricultural year already stroke in Q3. So back to industry, its evolution depends largely on the economic advance in the EU in Q4. Unfortunately, latest

GDP fell by 0.5% QoQ (SA) and 0.6% YoY(NSA)


Source: NIS, OTP Research

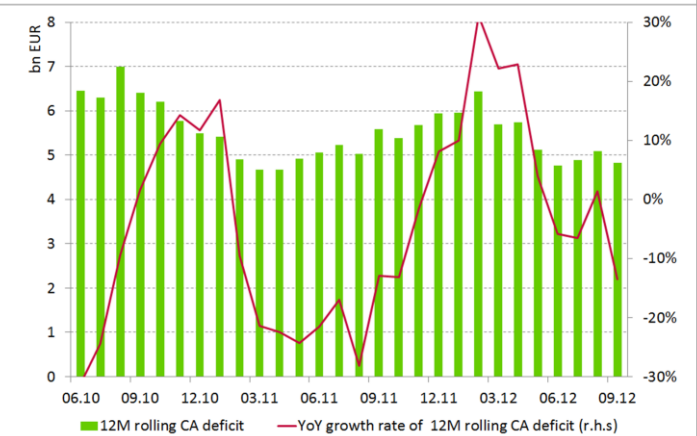
Inflation dropped to 5% YoY in October due drop in price for fruits and vegetables


Source: NIS, OTP Research

polls point to a marginal decrease as well in Q4. However, on the positive side, we share other analysts' opinion that ECB's decision taken back in September to buy bonds of indebted countries unlimitedly is a major step and it makes a key difference compared to previous periods when guidelines lacked. This should relax lending conditions in Europe and prompt commercial banks into supporting the economy more than in the recent quarters. Even if the effect will be felt with a lag in Romania, it will nevertheless support growth.

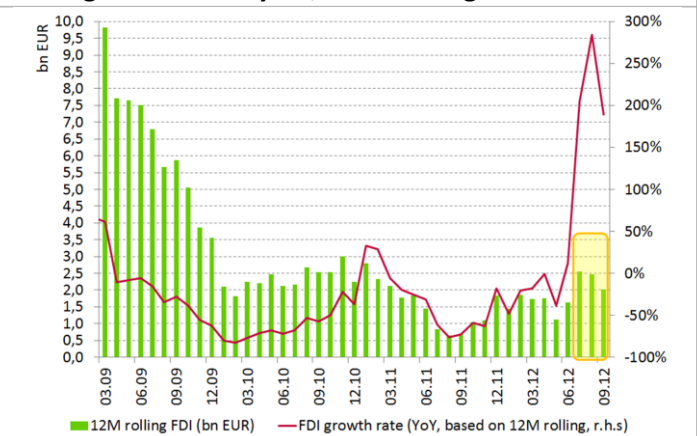
According to October's NBR survey related to outlook in industry and constructions, expectations are for an increase in industrial production and an almost flat evolution in constructions.

CA deficit shrunk further in September



Source: NBR, OTP Research

FDI higher than last year, but trending down



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

** under revision

FX markets: Increased tensions in Europe outweigh domestic efforts to support the leu

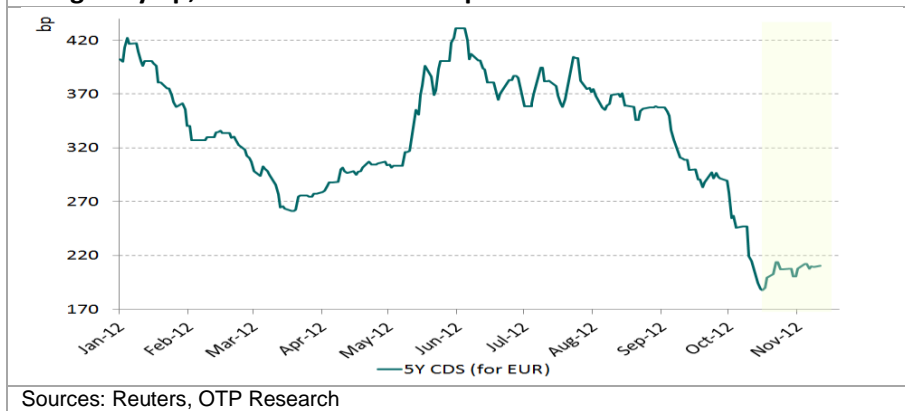
The EUR/RON went up down last week, when the negative data from Europe outweighed domestic efforts to keep the currency close to the 4.5 level. The second liquidity cap had a smaller effect than the first one but it worked nevertheless. Back in August, the international context was different though and supportive for the leu. In August, the eurozone was looking at the future with hopes that further measures to tame the debt crisis will be taken (and this was accomplished). However, now we see that core economies in the EU are hurting, not only the periphery and that outlook is only getting worse for the Q4 2012 and Q1 2013.

Last data: 15.11.2012

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4,53	↑	0,37	↑ 4,95
USDRON	3,55	↑	0,05	↑ 6,47
CHFRON	3,76	↑	0,48	↑ 5,96
RONJPY	4,37	↓	-2,11	↑ 0,96
RONPLN	1,09	↑	0,60	↑ 5,63
100HUFRON	1,59	↑	0,57	↑ 16,45
RONCZK	0,18	↓	-0,11	↑ 5,23
RONRUB	0,11	↓	-0,44	↑ 8,25
RONRSD	0,04	↑	0,45	↑ 0,46
RONBGN	2,32	↑	0,36	↑ 5,16

Source: Reuters

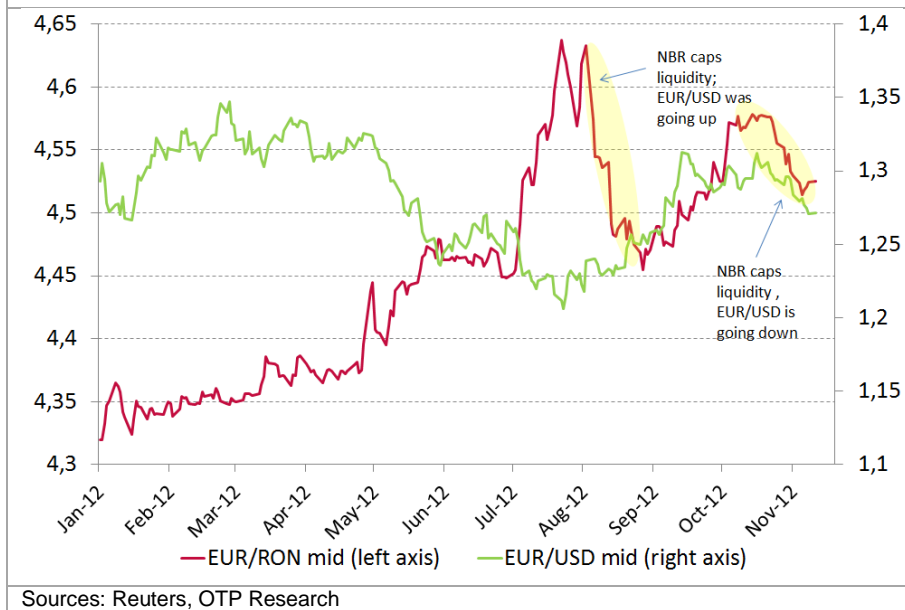
The CDS is not declining anymore and risk aversion in the region marginally up; the “naked CDS” ban period started in November



Major RON FX rates (03.01.2011=100)



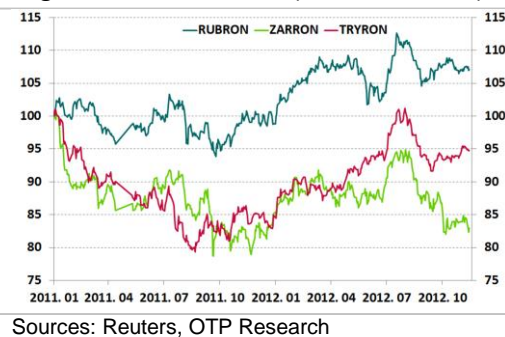
The Leu responds to liquidity cap but international context not favourable



Regional RON FX rates I. (03.01.2011=100)



Regional RON FX rates II. (03.01.2011=100)



The next big moments with consequences for the leu are December's elections and the negotiation of a new IMF deal in January. The current USL coalition is likely to win elections but we believe **USL's new proposed fiscal measures are not line with the view of the IMF because all of them envisage tax decreases whereas the IMF recently published a research paper in which it was analysing several ways to increase budget revenues which included different tax hikes and estimated effects.** However, the proposed tax cuts are targeted to take place in the coming governance cycle (next 4 years), according to USL. They are as follows:

- 16% profit tax; progressive income taxation (16%, 12% and 8%)
- Employer's social contribution tax cut by 5 percentage points
- VAT progressively brought down to 19% from current 24%
- Minimum wage up from 700 RON to 1200 RON

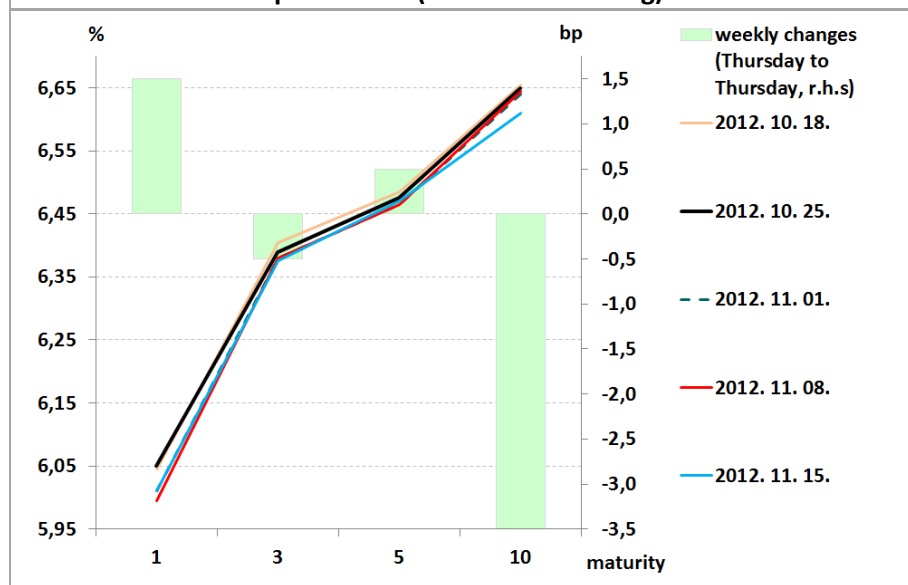
By comparison, the IMF paper estimated the effect of the following suggested tax increases:

- Pre-crisis social contribution tax of 14% from current 10.7% (cumulated for the employer and the employee)
- Increase of personal income tax from 16% to 18%
- Increase of VAT by 1 percentage point.

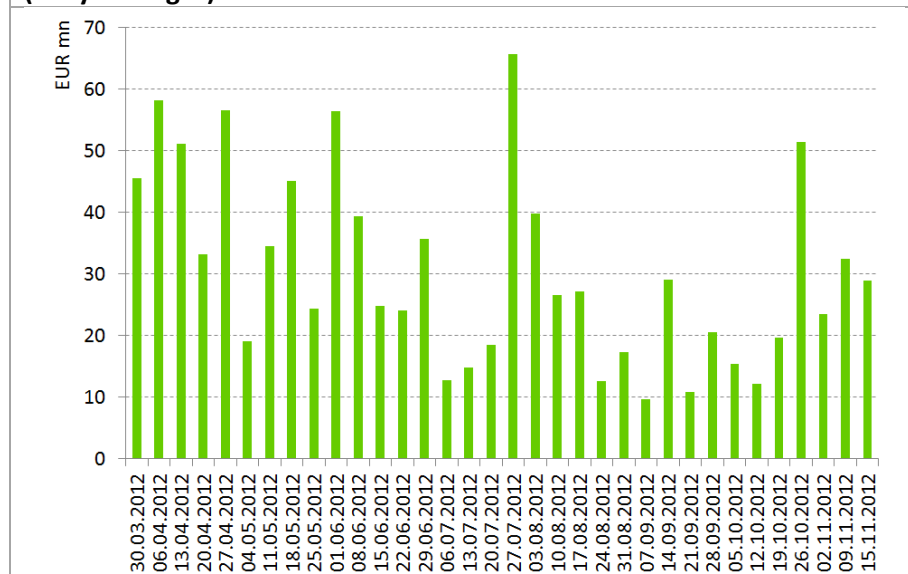
In what concerns a new agreement with the IMF, we believe the Fund will have more margin for negotiation in 2013 given that some important parameters that funded their base scenario for Romania in 2012 have not evolved as expected: EU funds absorption, general government arrears, state owned privatisation schedule, inflation and possibly budget deficit (accrual) and GDP growth rate. **At the same time, the IMF has to receive large instalments from Romania amounting to 11.4 bn EUR in the next 4 years, so laying a safety belt to the country is key.** While signing a new deal with the IMF could be positive for the leu in the short term, more tightening of the fiscal policy weighs on economic growth, especially since outlook for the eurozone worsens, the country has not recovered and that monetary policy has already been tightened by putting a cap on liquidity.

Government securities: The Treasury sold another 342 mn EUR in 3Y euro denominated bonds

Last week, yields posted a pretty mixed evolution at both the short end long end of the curve. **The Treasury planned to sell another 150 mn EUR in euro denominated bonds.** The decision was taken after the initial announcement of auctions to be held this month. **It sold 342 mn EUR, so it could sell less than the planned amount of government securities denominated in leu if yields are too high.** Until now (latest data as of 15th Nov), of the planned 3.6 bn RON the Treasury sold 2.4 bn RON. In October, the Treasury planned to sell 150 mn euro and it managed to sell 421.5 mn euro.

Yield curve over the past weeks (Central Bank fixing)


Source: NBR, OTP Research

Transaction on the secondary market with RON denominated securities (daily averages)


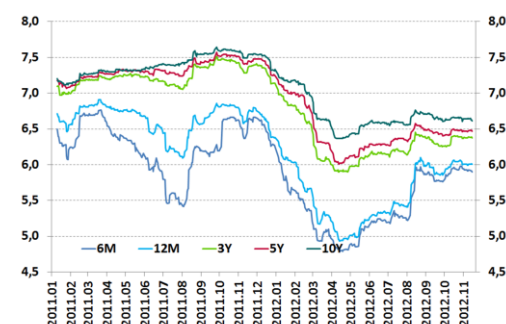
Sources: NBR, OTP Research

Note: the secondary market without NBR; the amounts are daily averages of each week

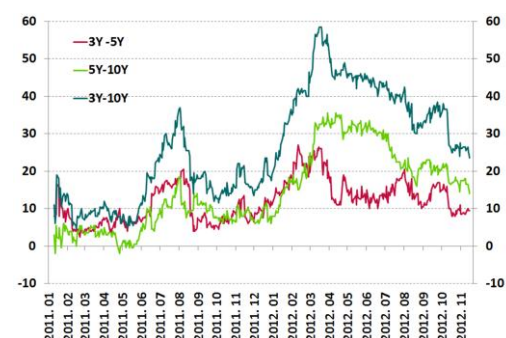
Last data: 15.11.2012

RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	5,90	↓ -2,0	↓ -36	
12M	6,01	↑ 1,5	↓ -37	
3Y	6,38	↓ -0,5	↓ -77	
5Y	6,47	↑ 0,5	↓ -78	
10Y	6,61	↓ -3,5	↓ -72	
SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	635	↓ -0,5	↓ -52	
GERROM 5Y	610	↑ 0,5	↓ -40	
GERROM 10Y	525	↓ -3,5	↓ -26	
3Y -5Y	10	↑ 1,0	↓ -1	
5Y -10Y	14	↓ -4,0	↑ 6	
3Y-10Y	23	↓ -3,0	↑ 4	
FLY 3-5-10	4	↓ -5,0	↑ 7	
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	153	↑ 1,2	↓ -219	
5Y EURO	210	↑ 1,1	↓ -192	

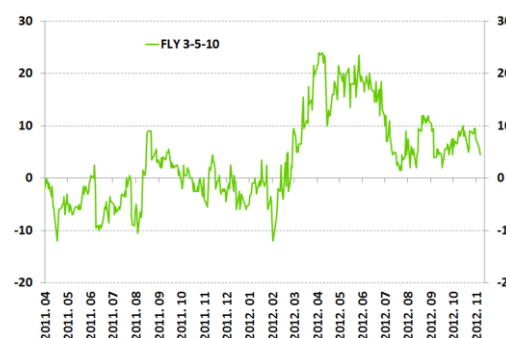
Source: Reuters

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

Last week, there were two succesful auctions. The Treasury sold 800 mn RON in 12M T-bills and 300 mn RON in 3Y bonds. The bills had an average accepted yield of 6.13%, higher than the one at the previous week's tender (6.08%). The subscribed amount was 1.35 bn RON compared to 1.66 bn RON the previous week. **The average accepted yield of the bonds was 6.55%, almost unchanged from the similar tender in October (6.53%).**

Up to now (last data as of 15th Nov), the Treasury sold 49 bn RON in government securities (RON denominated) and total redemptions stood at 40.4 bn RON (including what is due in November). Also, this year, Romania tapped international bond markets (2.25 bn EUR and 2.25 bn USD) and also sold euro-denominated bonds in October (421.5 mn EUR). **Romania sold 342 mn euro denominated bonds (3Y) on November 16th, at an average yield of 3.4%. The residual maturity is 17M.** In October, the 4Y (with residual maturity of 33M) issue had an average yield of 3.76%.

Starting on 31st March 2013, Barclays announced it will include Romanian sovereign bonds into the computation of the Barclays EM Local Currency Government Index. The inclusion is based on 11 issues, totaling 11.5 bn \$ in nominal value and represents 0.7% of the value comprised by the index.

Last week's auction results (RON denominated)

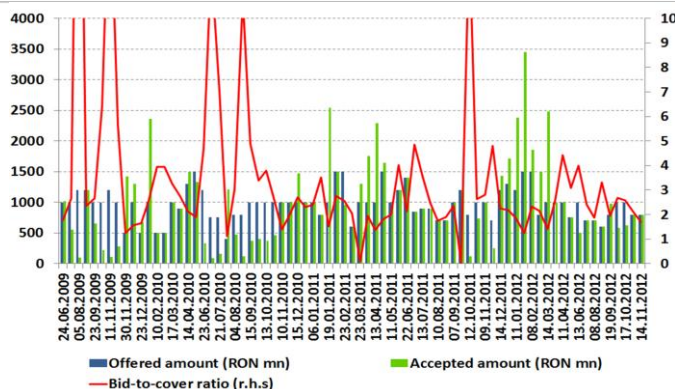
	RO1213CTN0Q3	RO1215DBN073
Offered amount (RON mn)	800	300
total bids (RON mn)	1354	545
accepted amount (RON mn)	800	300
average accepted yield (%)	6,13	6,55
coupon	-	5,80

Source: NBR, OTP Research

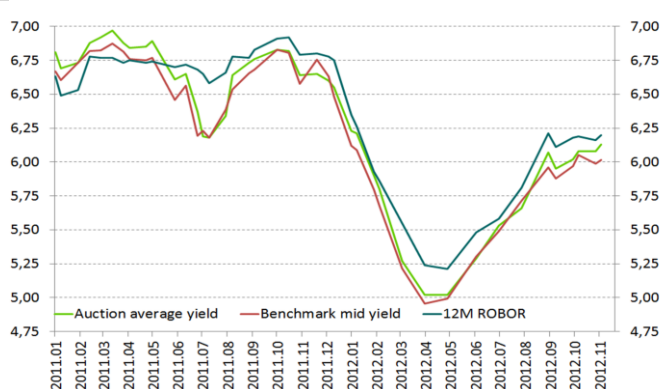
Last week's auction results (EUR denominated)

	RO1114DBE010
Offered amount (EUR mn)	150
total bids (EUR mn)	504
accepted amount (EUR mn)	342
average accepted yield (%)	3,40
coupon	4,50

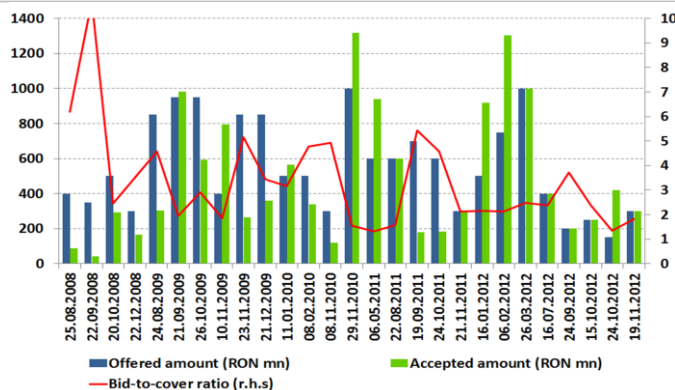
Source: NBR, OTP Research

12M Auctions data


Sources: NBR, OTP Research

12M Interest rates


Sources: NBR, OTP Research

3Y Auctions data


Sources: NBR, OTP Research

T-bills auction in November (in RON)

ISIN	Auction date	Settlement	Maturity	Months	Indicative target amount (RON)
RO1213CTN0P5	05.11.2012	07.11.2012	06.11.2013	12	800.000.000
RO1213CTN0Q3	12.11.2012	14.11.2012	13.11.2013	12	800.000.000

Source: Ministry of Finance, OTP Research

Bonds auctions in November (in RON)

ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
RO1214DBN068	08.11.2012	12.11.2012	28.07.2014	2	5,85	500.000.000
RO1215DBN073	15.11.2012	19.11.2012	26.10.2015	3	5,80	300.000.000
RO1214DBN068	19.11.2012	21.11.2012	28.07.2014	2	5,85	500.000.000
RO1217DBN046	22.11.2012	26.11.2012	26.07.2017	5	5,90	250.000.000
RO1215DBN073	26.11.2012	28.11.2012	26.10.2015	3	5,80	300.000.000
RO1227DBN011	26.11.2012	28.11.2012	26.07.2027	15	5,80	100.000.000

Sources: Ministry of Finance, OTP Research

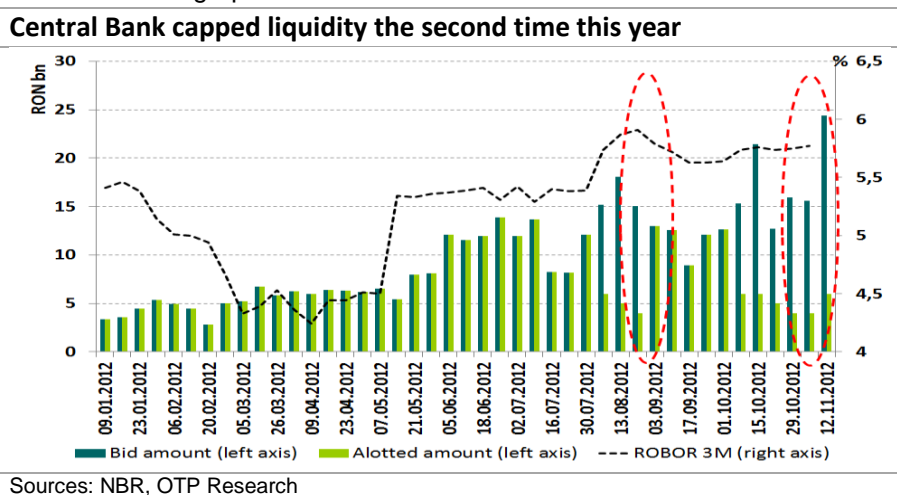
Bonds auctions in November (in EUR)

ISIN	Auction	Settlement	Maturity	Years	Cupon %	Indicative target amount (RON)
RO1114DBE010	16.11.2012	20.11.2012	06.05.2014	3	4,50	150.000.000

Sources: Ministry of Finance, OTP Research

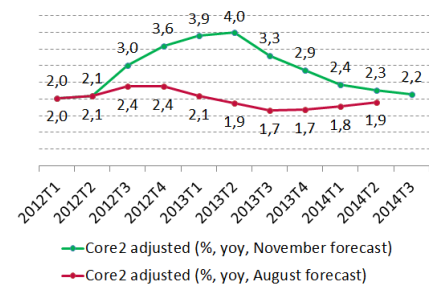
MM: Core inflation is still on an uptrend; NBR forecasts inflation to be in the 5-6% YoY range in H1 2013

Last week, MM rates posted hikes, with ROBOR ON advancing 28 bp ON a weekly basis. NBR maintained the liquidity cap. However, last week the amount was raised by 2 bn RON as the Central Bank is trying to find a good mix between interest rates and exchange rate. There is only so much the Central Bank can do to influence the exchange rate without creating significant upside pressures on the MM rates or affecting the FX reserve. We believe that MM rates will continue to remain under upside pressures in the coming few months. The total bid amount at the last week's repo was this year's record (24 bn RON, last data as of 15th Nov). Please see the graph below:

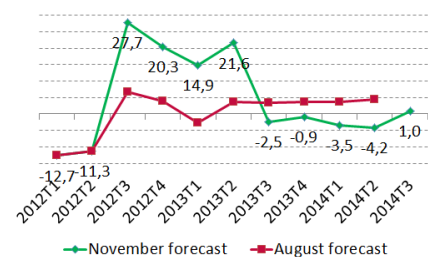


As the Governor himself stated, the Central Bank has a tough choice to make next year in what regards keeping its eyes on inflation while considering the effects in the economy as well, taking into consideration the deficit of demand and the weak external funding sources. If interest jump too high private lending is affected and external sources of funds are scarce. We believe the effect on private lending is more important than the hike of government securities yields in RON, as long as the inflation slippage is not extreme. An inflation above 5% is no longer a small one so close monitoring will be needed in H1 2013 when NBR forecasts that annual inflation will be in the range of 5-6% . NBR changed its forecast for Dec 2012 to 5.1% YoY from 3.2% YoY and to 3.5% YoY in Dec 2013 from 3% YoY. Core2 adjusted inflation (CPI excluding administered prices, volatile items, alcohol and tobacco) was raised significantly and significant changes were operated as well in the volatile items subcategory of vegetables, eggs, fruits. Please see the graphs below.

Revised forecast for Core inflation (end of period)



Revised forecast of inflation of vegetables, fruits, eggs (% , yoy, end of period)



Last data: 15.11.2012

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	5,25	0	-75
ROBOR ON	5,78	28	125
ROBOR 3M	5,83	7	-22
ROBOR 6M	6,12	4	-41
ROBOR 9M	6,15	3	-46
ROBOR 1Y	6,20	4	-46

REPO			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
repo amount	5.999,0	1999,7	- 712,0

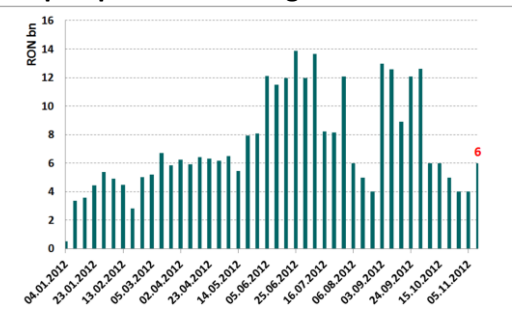
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	3.061,1	187,6	-966,4

MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	36	-3	11
USDRON 1M	156	4	7
USDRON 3M	441	10	194
EURRON 1W	48	12	7
EURRON 1M	209	56	64
EURRON 3M	627	33	116

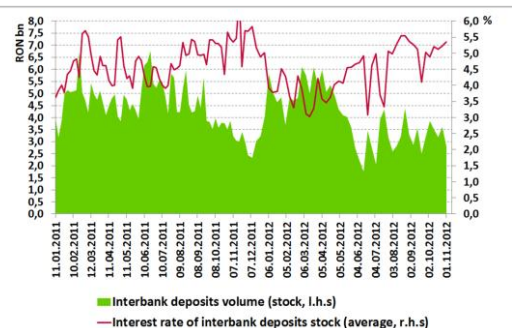
MID EUR BASIS SWAPS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EURRON 1Y	-53	13	103
EURRON 3Y	-53	13	103
EURRON 5Y	-53	13	98

Source: Reuters

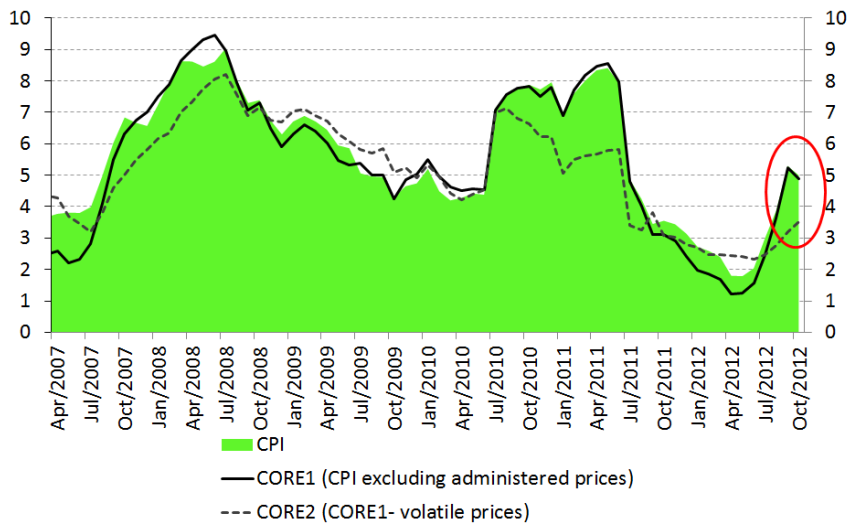
Repo operations during 2012



Interbank deposits stock and average interest rate

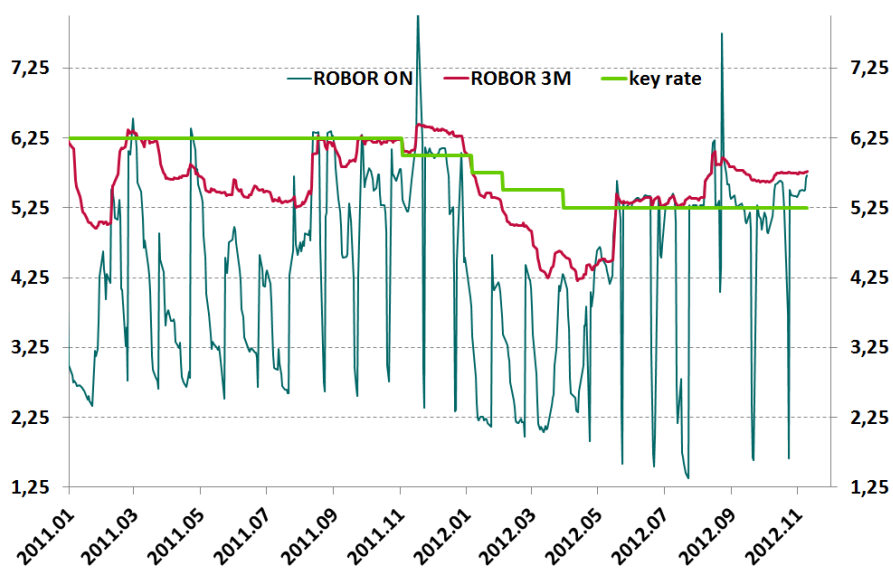


Inflation fell in October but Core inflation still up, in line with NBR's new forecast



Sources: NBR, OTP Research

Most important MM instruments from 2011 (%)



Sources: NBR, OTP Research

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