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# Weekly Report

# Romania

## 25 March 2014

# Yields eased and the leu touched 4.47

## Macroeconomics: CA deficit shrank to 1% of GDP in January
(Page 3- 4)

The current account posted a surplus of EUR 388 mn in January, larger than EUR 268 mn recorded one year ago, mainly due to continuingly shrinking trade gap. This led the external imbalance to 1% of GDP according to our estimations, lower from 1.1% in December 2013. As internal demand picks up, we expect the CA deficit to broaden to 2% this year and the most recent macro data shows that indeed consumption is growing. The financing side reveals rising foreign direct investments: on a 12M rolling basis, the growth rate is 23.4%YoY. By comparison, portfolio investments were much more significant, at EUR 1bn, reversing the net outflows witnessed the previous two months. Short term external debt shrank by EUR 1.2 bn to EUR 18.3 bn in January.

## FX market: The leu firmed to 4.47 (Page 5 -6)

The EUR/RON is trading below its 20 days moving average, after having strengthened continuously in the past week. All eyes are now turned to Ukraine and Russia. A threatening scenario would be one in which other parts of Eastern and Southeastern Ukraine separate from the country. This would disrupt energy supply in the region via Ukraine and bear significant consequences in the region, affecting economic growth. Capital flows would be compromised. The initial sanctions imposed to Russia for annexing Crimea were mild and more actions are expected to be taken, but they will have to be carefully calibrated as imposing economic restrictions on Russia, which is the world's second largest oil producer is a lose - lose game and could affect the global economy as well. We therefore remain cautious regarding geopolitical risks. Also, we turn our attention to another external factor playing down on the leu: the Fed went on with tapering as forecasted and what is more, dollar interest rates are now seen climbing faster than expected. The latest data released for March, showed that US consumer confidence hit 6 years high in March, reemphasising Fed's actions.

## Fixed income markets: Non-residents reduced their government debt holdings by ~ RON 1 bn in January (Page 6-7)

The local debt market has a moment of relief and yields at the long end of the curve (where we saw larger swings when risks related to Ukraine appeared more significant) have eased in a week. Last week, the Treasury managed to sell 5Y bonds in RON and EUR at an average accepted yield of 4.94% and 3.3%, respectively. In the case of the latter, the yield was unchanged compared to the previous similar tender at the end of February. The RON yield was 16 bps lower than the one of previous tender at the end of February. Considering that the base rate cut cycle has likely ended, the bond price potential appears very limited. To this, we add the perspective of foreigners who rebalance their portfolios given the new risk/reward assumptions triggered by the tapering process.

## Money markets: The Central Bank will likely keep the base rate unchanged (Page 8)

After the last monetary policy decision, NBR officials signaled that the base rate cycle may have ended but should more easing measures follow, they will likely envisage the reserve ratio requirements. On 28th March, the market and we expect no change in the level of the base rate. Also, we do not see a change in the reserves ratio level either at the moment, as this move affects the banking system liquidity in the long term, unlike the central bank's open market operations and FX interventions. The Central Bank already operated a reduction in the mandatory reserves ratio for both RON and FX liabilities in January. In the past, the Central Bank timed this kind of action and did not change RON reserves quickly.


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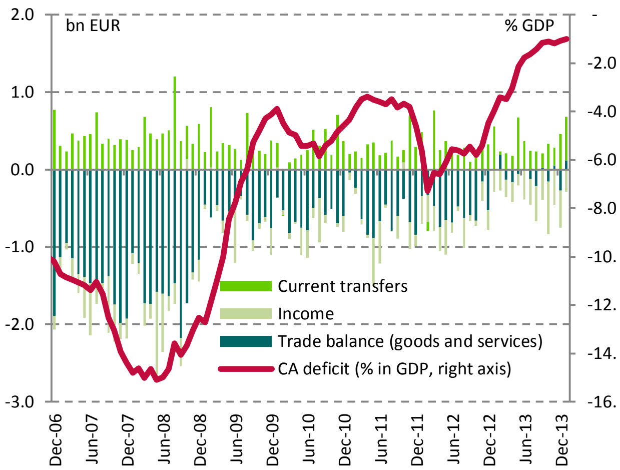
## Macroeconomics: CA deficit shrank to 1% of GDP in January

| | PERIOD | INDICATOR | FACT | CONSENSUS | PRIOR |
|---|---|---|---|---|---|
| 17 Mar | Jan | CA balance (EUR mn, YTD) | 388.0 | | 1505.0 |
| 25 Mar | Feb | Non -governmental loans (y-o-y, %) | -2.0 | | -2.1 |
| 25 Mar | Feb | Non -governmental deposits (y-o-y, %) | 10.7 | | 9.9 |
| 25 Mar | Feb | M3 aggregate (y-o-y, %) | 10.7 | | 9.7 |
| 28 Mar | Feb | Bulding permits (y-o-y, %) | | | -7.1 |
| 28 Mar | March | Base rate decision (%) | | 3.5 | 3.5 |

**The current account posted a surplus of EUR 388 mn in** January, larger than EUR 268 mn recorded one year ago, mainly due to **continuingly shrinking trade gap.** This led the **external imbalance to 1% of GDP according to our estimations,** lower from 1.1% in December 2013. As internal demand picks up, we expect the CA deficit to broaden to 2% this year and the most recent macro data shows that indeed consumption is growing.

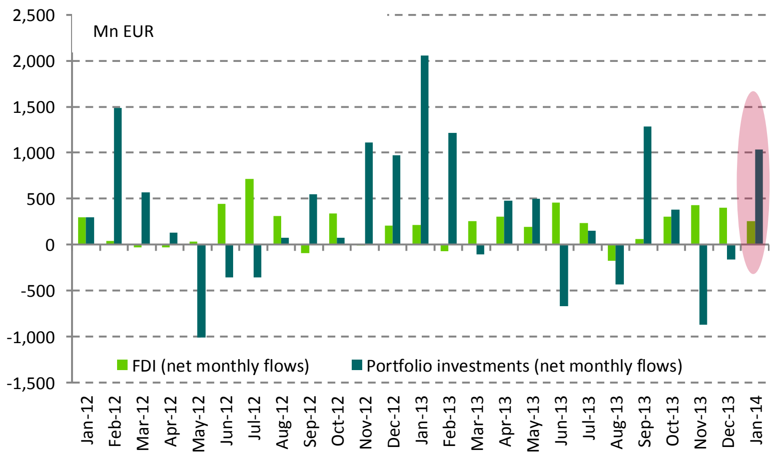
The financing side reveals rising **foreign direct investments: on a 12M rolling basis, the growth rate is 23.4%YoY** while during the month net flows were EUR 257 mn. By comparison, **portfolio** investments were much more significant, **at EUR 1bn**, reversing the net outflows witnessed the previous two months. Quite significant outflows (EUR 1.8 bn) were recorded by the other capital investments component and we think the **continuation of deleveraging by banks** explains this to great extent.This is also in line with the witnessed decline of **short term external debt by EUR 1.2 bn to EUR 18.3 bn in January.**

**CA deficit shrank further to 1% in January**



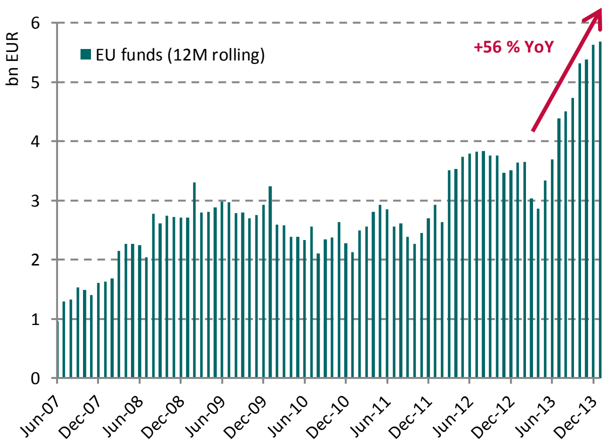

Source: NBR

**In January, portfolio inflows revived after two dry months**



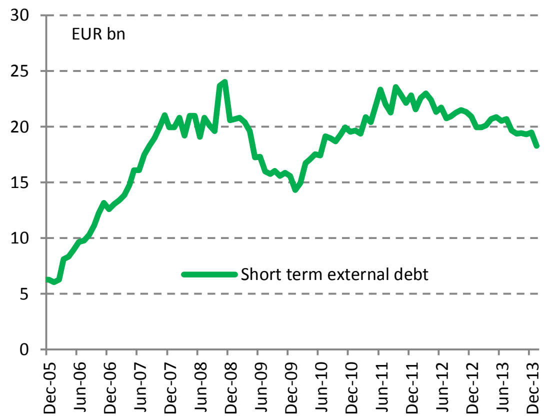

Source: NBR

**EU funds annual pace marginally down in January**




Source: NBR

**Short term external debt fell to EUR 18.3 bn in January, by EUR 1.2 bn in one month**




Source: NBR

| Main macroeconomic indicators | Fact | | | | | | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| Nominal GDP (EUR mn) | 124729 | 139765 | 118196 | 124328 | 131327 | 131747 | 142973 | 148085 | 157310 |
| Real GDP | 6.3% | 7.3% | -6.6% | -1.1% | 2.3% | 0.6% | 3.5% | 2.3% | 3.0% |
| Households consumption expenditure | 12.0% | 9.0% | -10.4% | -0.2% | 1.6% | 1.1% | 1.4% | 2.1% | 2.1% |
| Government consumption | 2.5% | 6.2% | 9.5% | -13.7% | -3.0% | 0.7% | -4.1% | -2.3% | 10.0% |
| Gross fixed capital formation | 30.3% | 15.6% | -28.1% | -1.8% | 7.7% | 3.8% | -5.7% | 3.4% | 6.9% |
| Exports | 7.8% | 8.3% | -6.4% | 13.2% | 11.6% | -1.5% | 12.8% | 6.6% | 4.3% |
| Imports | 27.3% | 7.9% | -20.5% | 11.1% | 10.5% | -0.2% | 2.3% | 7.1% | 4.8% |
| Consumer prices (avg.) | 4.8% | 7.8% | 5.6% | 6.1% | 5.8% | 3.3% | 4.0% | 2.5% | 3.0% |
| Budget Balance (GDP%, ESA 95) * | -2.9% | -5.7% | -9.0% | -6.8% | -5.6% | -3.0% | -2.9% | -2.8% | -2.5% |
| Public debt (GDP %) * | 12.8% | 13.4% | 23.6% | 30.5% | 34.7% | 37.9% | 38.5% | 39.1% | 39.5% |
| CA balance (% GDP) | -13.4% | -11.6% | -4.2% | -4.4% | -4.5% | -4.4% | -1.1% | -2.0% | -2.0% |
| CA balance (bn EUR) | -16.8 | -16.2 | -4.9 | -5.5 | -5.9 | -5.8 | -1.5 | -3.0 | -3.1 |
| Unemployment | 6.4% | 5.8% | 6.9% | 7.3% | 7.4% | 7.0% | 7.3% | 7.0% | 6.8% |
| Nominal wage growth | 21.8% | 26.1% | 4.8% | 3.1% | 4.1% | 4.6% | 5.0% | 4.3% | 5.0% |
| Real wage growth | 14.7% | 16.5% | -1.5% | -3.7% | -1.9% | 1.2% | 1.0% | 1.7% | 1.9% |
| Key interest rate (avg.) | 7.5% | 9.7% | 9.1% | 6.5% | 6.2% | 5.3% | 4.8% | 3.5% | 3.5% |
| Key interest rate (e.o.p.) | 7.5% | 10.3% | 8.0% | 6.3% | 6.0% | 5.3% | 4.0% | 3.5% | 3.5% |
| EUR/RON (avg.) | 3.34 | 3.68 | 4.24 | 4.21 | 4.24 | 4.46 | 4.41 | 4.48 | 4.45 |
| EUR/RON (e.o.p.) | 3.61 | 3.99 | 4.23 | 4.28 | 4.32 | 4.43 | 4.46 | 4.44 | 4.45 |

| | 1Q 2013 | 2Q 2013 | 3Q 2013 | 4Q 2013 | 1Q 2014 F | 2Q 2014 F | 3Q 2014 F | 4Q 2014 F | 1Q 2015 F |
|---|---|---|---|---|---|---|---|---|---|
| EUR/RON (end of period) | 4.39 | 4.48 | 4.46 | 4.46 | 4.51 | 4.48 | 4.46 | 4.44 | 4.43 |
| Central Bank Rate ( %) | 5.25 | 5.25 | 4.50 | 4.00 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| 3-Month Robor (%) | 5.35 | 4.45 | 3.65 | 2.58 | 3.53 | 3.33 | 3.3 | 3.21 | 3.31 |
| Ten-Year Bond (%, mid yield, NBR fixing) | 5.64 | 5.45 | 5.16 | 5.28 | 5.60 | 5.47 | 5.43 | 5.33 | 5.44 |

Source: Eurostat, NIS, NBR, OTP Research

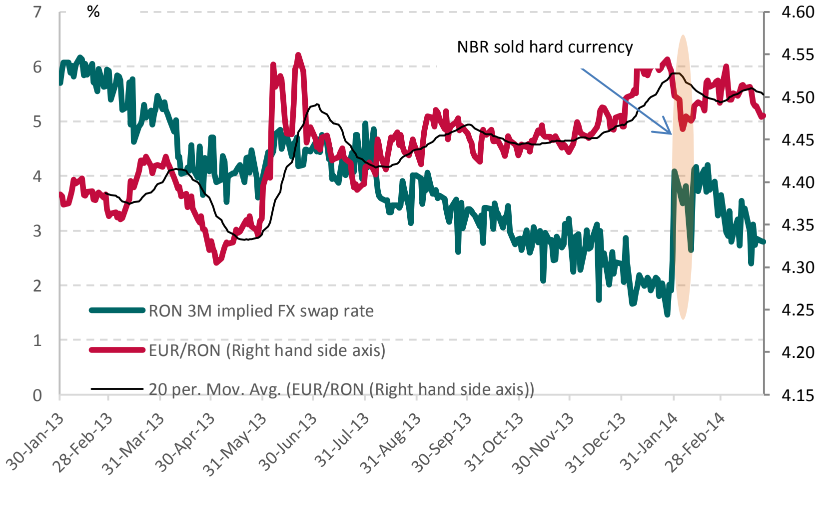
Note: * 2013 budget balance and public debt to GDP data are forecasts

## FX markets: The leu firmed to 4.47

**The EUR/RON is trading below its 20 days moving average, after having strengthened continuously in the past week.** Last time we saw this level was in the beginning of February, when the currency got a boost as NBR reportedly sold hard currency and reduced the excess liquidity in the market, in a moment when 3M ROBOR rate was around the 2% level. All eyes are now turned to Ukraine and Russia.

The regional weakness comes from the region's dependency to energy imports from Russia. By comparison with other countries in the region, **Romania is better off because it is less dependent on Russia's gas and 85% of its needs are covered from domestic production.** Other links involve Romania's exports to Russia which affect mostly the transport and electric equipment industries. Moving on, a **threatening scenario would be one in which other parts of Eastern and Southeastern Ukraine separate from the country and disrupt energy supply in the region via Ukraine. This would have significant consequences in the region, affecting economic growth. Capital flows would be compromised**. An even more severe scenario, but less likely, would be imposition of serious economic sanctions on Russia and armed conflict. The initial sanctions imposed to Russia for annexing Crimea were mild, but the US and the EU advanced further measures: more names close to the president Vladimir Putin and one Russian bank (Rossiya) are under restrictions. More actions are expected to be taken, but they will have to be carefully calibrated as imposing economic restrictions on Russia, which is the world's second largest oil producer is a lose - lose game and could affect the global economy as well. By now, Ukrainian troops have left Crimea and the Russian flags have taken place of the Ukrainian ones at the military units. Russia has been expelled for the moment from G8 and the meeting planned for June at Sochi has been rescheduled to take place in Brussels and comprise the rest of 7 industrialized countries. Given the above, **we remain cautious regarding geopolitical risks**.

**EUR/RON trades at levels last seen in early February, after the excess liquidity was significantly reduced**



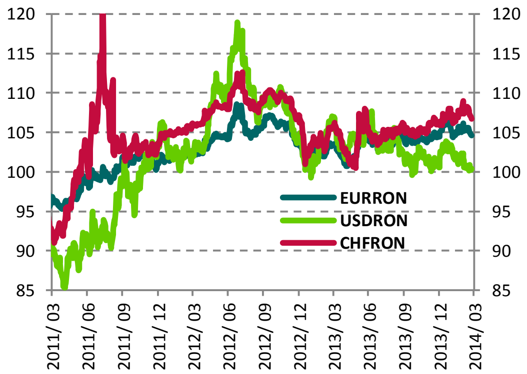

Source: Reuters

Date: 21.03.2014

| FX BID | | | | | |
|---|---|---|---|---|---|
| | Value | | Weekly chg. (%) | | YTD chg. (%) |
| EURRON | 4.48 | ↓ | -0.47 | ↑ | 0.92 |
| USDRON | 3.25 | ↑ | 0.27 | ↓ | -3.57 |
| CHFRON | 3.68 | ↓ | -0.99 | ↑ | 0.01 |
| RONJPY | 3.17 | ↓ | -0.65 | ↓ | -18.19 |
| RONPLN | 1.07 | ↑ | 0.06 | ↓ | -1.93 |
| 100HUFRON | 1.43 | ↓ | -0.96 | ↓ | -6.30 |
| RONCZK | 0.16 | ↓ | -0.91 | ↓ | -7.86 |
| RONRUB | 0.09 | ↑ | 1.11 | ↓ | -18.74 |
| RONRSD | 0.04 | ↓ | -0.30 | ↓ | -2.10 |
| RONBGN | 2.29 | ↓ | -0.58 | ↑ | 0.80 |

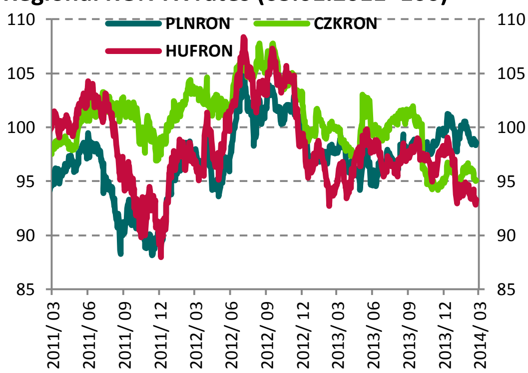
Source: Reuters

**Major RON FX rates (03.01.2011=100)**



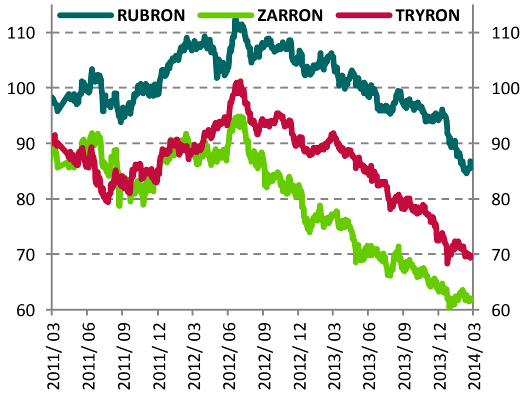

Sources: Reuters

**Regional RON FX rates (03.01.2011=100)**




Sources: Reuters

**Regional RON FX rates (03.01.2011=100)**



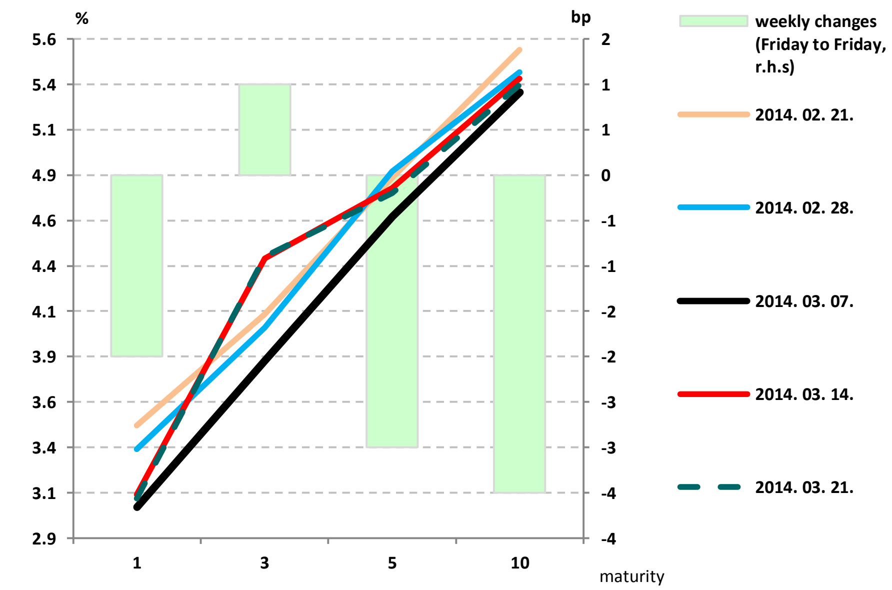

Sources: Reuters

Additionally, we mention that **the current firming of the leu is not an expression of increased preference of non-residents for portfolio investments**, as domestic stocks are lower on a weekly basis and bond prices are less significantly changed (less than 10 bps). Also, we turn our attention to other external factor playing down on the leu: the **Fed went on with tapering as forecasted** and what is more, **dollar interest rates are now seen climbing faster than expected.** The latest data released for March, showed that **US consumer confidence hit 6 years high in March, reemphasising Fed's actions.**

## Government securities: Non-residents reduced their debt holdings by ~ RON 1 bn in January

**The local debt market has a moment of relief and yields at the long end of the curve** (where we saw larger swings when risks related to Ukraine appeared more significant) have eased in a week. Last week, t**he Treasury managed to sell 5Y bonds in RON and EUR at an average accepted yield of 4.94% and 3.3%,** respectively. In the case of the latter, the yield was unchanged compared to the previous similar tender at the end of February. **The RON yield was 16 bps lower than the one of previous tender at the end of February**. Considering that **the base rate cut cycle has likely ended, the bond price potential appears very limited.** To this, we add **the perspective of foreigners who rebalance their portfolios given the new risk/reward assumptions** triggered by the tapering process: **non-residents reduced their holdings of RON debt by RON 0.9 bn** and their total share is declining as well. In January, their RON debt holdings amounted to 19%, down from a peak of 25% in May 2013.

**Yield curve over the past weeks (Central Bank fixing)**

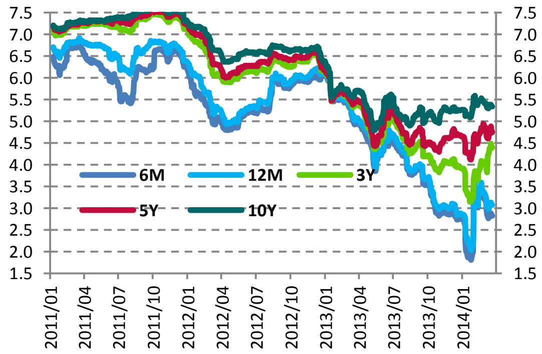



Sources: NBR

Date: 21.03.2014

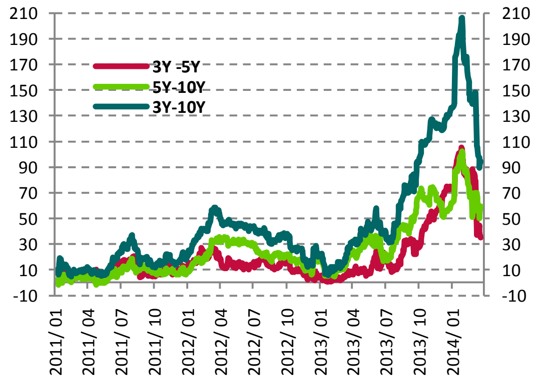
| RON GOVERNMENT SECURITIES | Value (%) | Weekly chg. (bp) | | YTD chg. (bp) | |
|---|---|---|---|---|---|
| 6M | 2.83 | ↓ | -2 | ↑ | 8 |
| 12M | 3.07 | ↓ | -2 | ↑ | 21 |
| 3Y | 4.40 | ↑ | 1 | ↑ | 49 |
| 5Y | 4.75 | ↓ | -3 | ↑ | 10 |
| 10Y | 5.35 | ↓ | -3 | ↑ | 8 |
| **SPREADS** | **Value (bp)** | **Weekly chg. (bp)** | | **YTD chg. (bp)** | |
| GERROM 3Y | 418 | ↓ | -1 | ↑ | 64 |
| GERROM 5Y | 415 | ↓ | -10 | ↑ | 43 |
| GERROM 10Y | 380 | ↓ | -3 | ↑ | 47 |
| 3Y -5Y | 35 | ↓ | -4 | ↓ | -39 |
| 5Y -10Y | 60 | ↓ | 0 | ↓ | -2 |
| 3Y-10Y | 95 | ↓ | -4 | ↓ | -41 |
| FLY 3-5-10 | 25 | ↑ | 3 | ↑ | 37 |
| **CDS MID SPREADS** | **Value (bp)** | **Weekly chg. (bp)** | | **YTD chg. (bp)** | |
| 3Y EURO | 104 | ↑ | 5 | ↓ | -13 |
| 5Y EURO | 158 | ↑ | 4 | ↓ | -13 |

**Government benchmark yields** (%)



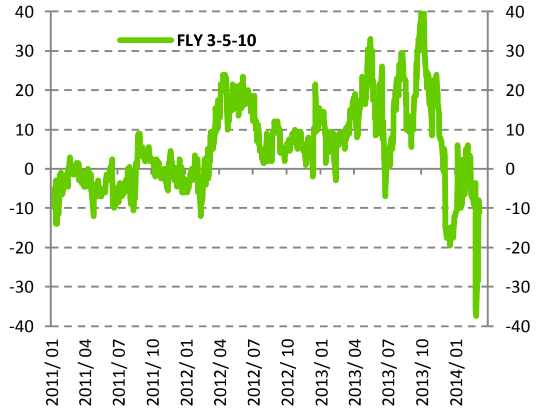

Source: NBR

**Slope of the yield curve** (bps)




Source: NBR

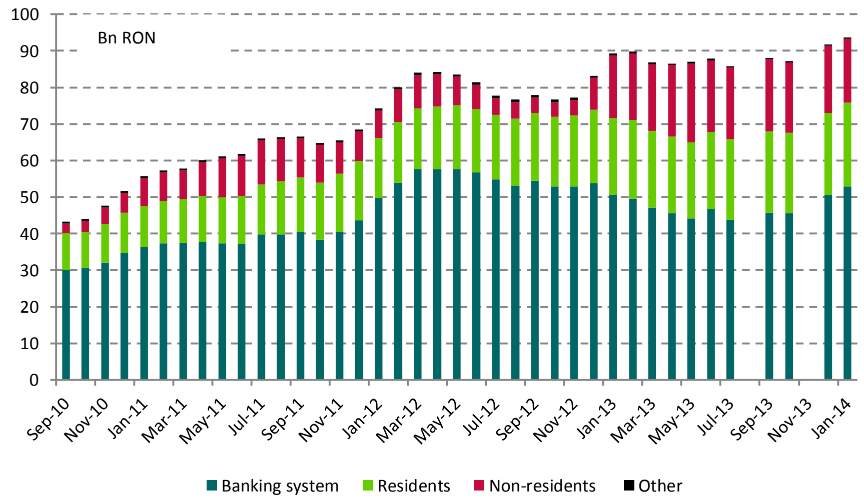
**FLY 3-5-10 (bp)**




Source: NBR

## Holdings of RON government debt (bn RON)

*Foreigners reduced their debt holdings by RON 0.9 bn in January*




Sources: The Ministry of Finance

## Auctions

### T-bills auctions in March (in RON)

| ISIN | Auction date | Settlement date | Maturity | Months | Indicative target amount (RON) |
|---|---|---|---|---|---|
| RO1415CTN040 | 3/27/2014 | 3/31/2014 | 3/31/2015 | 12 | 500,000,000 |

Source: The Ministry of Finance

### Bonds auctions in March (in RON)

| ISIN | Auction date | SSON auction date | Settlement date | Maturity | Years | Residual Maturity | Indicative target amount (RON) | Indicative target amount SSON* (RON) |
|---|---|---|---|---|---|---|---|---|
| RO1216DBN030 | 03/03/14 | 03/04/14 | 05/03/14 | 27/01/16 | 4.0 | 1.92 | 400,000,000 | 60,000,000 |
| RO0717DBN038 | 06/03/14 | 07/03/14 | 10/03/14 | 11/06/17 | 10.0 | 3.29 | 700,000,000 | 105,000,000 |
| RO1323DBN018 | 10/03/14 | 11/03/14 | 12/03/14 | 26/04/23 | 10.0 | 9.17 | 100,000,000 | 15,000,000 |
| RO1419DBN014 | 17/03/14 | 18/03/14 | 19/03/14 | 24/06/19 | 5.0 | 5.33 | 400,000,000 | 60,000,000 |
| RO1121DBN032 | 24/03/14 | 25/03/14 | 26/03/14 | 11/06/21 | 10.0 | 7.3 | 300,000,000 | 45,000,000 |

Source: The Ministry of Finance

### Bonds auctions in March (in EUR)

| ISIN | Auction date | Settlement date | Maturity | Years | Coupon | Indicative target amount (EUR) |
|---|---|---|---|---|---|---|
| RO1419DBE013 | 20/03/2014 | 24/03/2014 | 21/01/2019 | 5 | 3,40 | 200,000,000 |

Source: The Ministry of Finance

### Last week's auctions

| | RO1419DBN014 |
|---|---|
| Offered amount (mn RON) | 400 |
| Total bids (mn RON) | 640 |
| Accepted amount (mn RON) | 400 |
| Average accepted yield (%) | 4.94 |
| Coupon | 4.75 |

| | RO1419DBE013 |
|---|---|
| Offered amount (mn EUR) | 200 |
| Total bids (mn EUR) | 313 |
| Accepted amount (mn EUR) | 200 |
| Average accepted yield (%) | 3.30 |
| Coupon | 3.40 |

Source: NBR

## MM: The Central Bank will likely keep the base rate unchanged

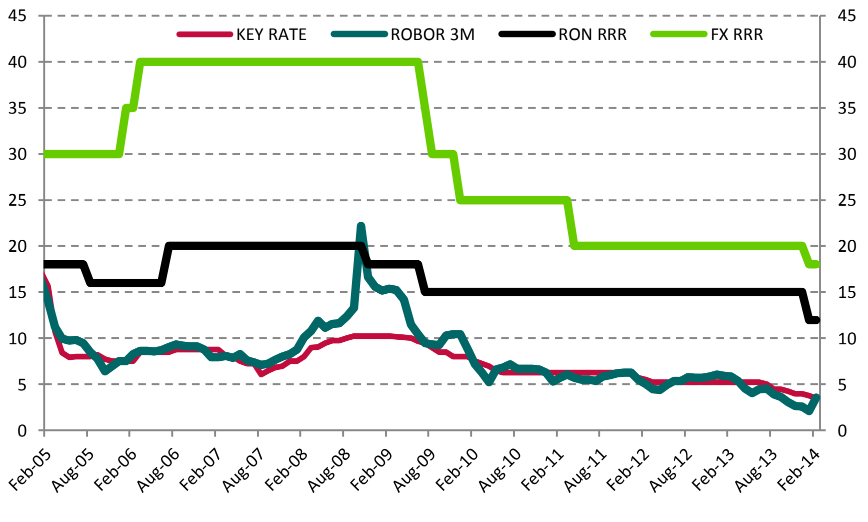
After the episode seen in the beginning of the year, when MM rates jumped rapidly as the NBR absorbed liquidity by selling hard currency, the 3M -1Y rates settled between 3% and 3.5%. After the last monetary policy decision, NBR officials signaled that the base rate cycle may have ended but should more easing measures follow, they will likely envisage the reserve ratio requirements. **On 28th March, the market and we expect no change in the level of the base rate. Also, we do not see a change in the reserves ratio level either at the moment,** as this move affects the banking system liquidity in the long term, unlike the central bank's open market operations and FX interventions. The Central Bank already operated a reduction in the mandatory reserves ratio for both RON and FX liabilities in January. In the past, the Central Bank timed this kind of action and did not change RON reserves quickly.

Date: 21.03.2014

| MID INTEREST RATES | Value (%) | Weekly chg. (bp) | YTD chg. (bp) |
|---|---|---|---|
| repo rate | 3.50 | 0 | -50 |
| ROBOR ON | 0.78 | -23 | -96 |
| ROBOR 3M | 3.07 | 7 | 63 |
| ROBOR 6M | 3.47 | 1 | 48 |
| ROBOR 9M | 3.48 | 2 | 38 |
| ROBOR 1Y | 3.48 | 0 | 33 |
| **INTERBANK DEPOSITS** | **Value (mn RON)** | **Wly chg. (mn RON)** | **YTD chg. (mn RON)** |
| outstanding | 3,197.7 | -517.3 | -1441.5 |
| **MID SWAP POINTS** | **Value (bp)** | **Weekly chg. (bp)** | **YTD chg. (bp)** |
| USDRON 1W | 5 | 0 | -2 |
| USDRON 1M | 49 | 15 | 17 |
| USDRON 3M | 181 | 8 | 65 |
| EURRON 1W | 19 | 12 | 8 |
| EURRON 1M | 67 | 21 | 23 |
| EURRON 3M | 259 | -41 | 57 |
| **MID EUR BASIS SWAPS** | **Value (bp)** | **Weekly chg. (bp)** | **YTD chg. (bp)** |
| EURRON 1Y | -80 | 0 | 30 |
| EURRON 3Y | -70 | 0 | 40 |
| EURRON 5Y | -70 | 0 | 40 |

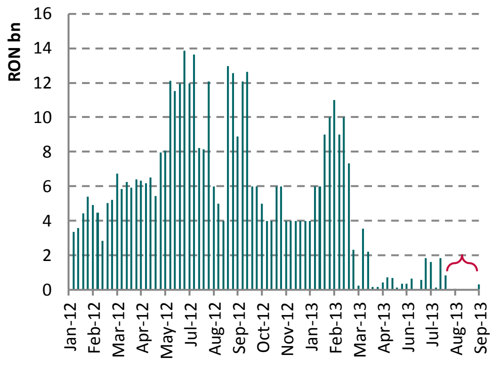
Sources: Reuters

### The Central Bank cut the reserve ratio for FX and LCY liabilities in January 2014



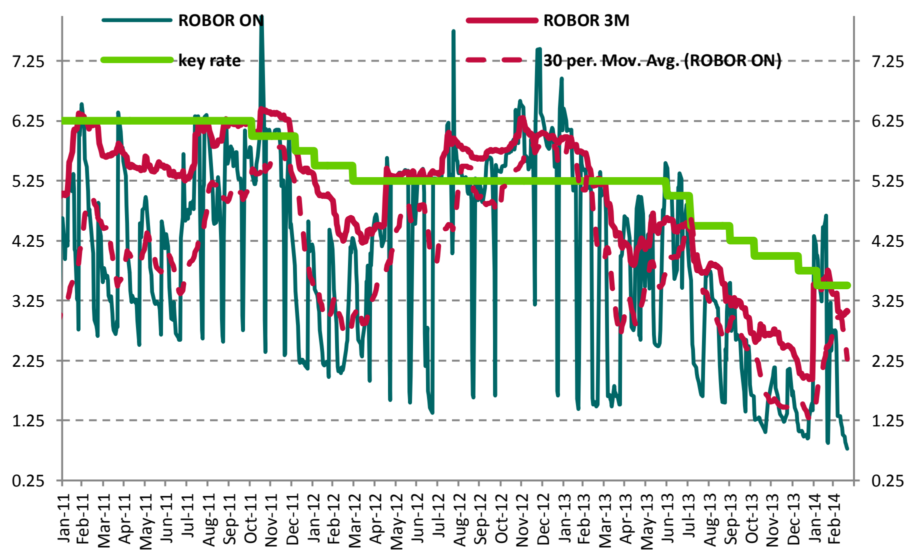

Sources: NBR
RRR = required reserve ratio

### Repo operations since 2012




Sources: NBR

### The most important MM instruments




Sources: NBR

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