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Weekly Report

Romania

9 April 2014

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Strong macro data

Macroeconomics: Strong retail and industrial sales in February

(Page 3- 5)

All signs point to increased optimism consumption-wise. Retail trade started Q1 strongly and we witnessed a 5.4% monthly average hike during the first 2M compared to Q4 2013. According to the economic sentiment indicator (ESI), retail trade confidence is getting even stronger in March. Gross wages added 4.8% YoY in February and most importantly, real wages grew by 3.6% YoY. This gives more traction to consumption recovery. The unemployment rate fell to 7.2% in February from 7.3%. Industrial sales and new orders showed a healthy progress in February, posting a hike of 11.5% YoY and 20.4% YoY, respectively. Therefore, our base scenario in which the industry is going to be main supporter to GDP growth this year, just like in 2013, has good grounds. The industrial production sentiment is improving in March as well. Building permits rose by 2.7% YoY in February, reinforcing the recent uptrend.

FX market: Calm trading (Page 6 - 7)

The leu trades in a very narrow range and stood around 4.46 level in the past week. Investors waited for the ECB decision and US non-farm payrolls data last week which kept risk on movements at bay. The US jobs data was in line with expectations so this keeps the assumptions about tapering intact so far, which means depreciation pressures from foreigners exiting the fixed income market are to be considered. On the other hand, the revised GDP figures for Q4 2013 showed better underlying dynamics and the headline figure was marginally revised up, to 5.4% from 5.2% YoY. If we add to this the already witnessed CA shrinking and higher FDI, the macro picture makes the case for a relatively strong leu. However, the short term risks (political, external) are significant enough to not be ignored. The technical picture shows the EUR/RON is not in the oversold territory anymore.

Fixed income markets: Inflation at a minimum (Page 8 - 9)

At the moment, annual inflation is seen to be at a minimum and start rising in March and until the end of the year (the market consensus is at 1.2% YoY, implying a hike from 1.1% seen in February). Money market rates are also expected to witness an uptrend at least in Q2 and Q3. Therefore, we expect some upside pressure on yields compared to Q1. At the same time, we do not lose sight of NBR's forward guidance regarding the MM rates, which should be just below the base rate of 3.5%, implying a limited upside potential. Additionally, the rest of drivers come from other types of risks, such as political and external risk and they too weigh on government debt prices in the short term. The Treasury sold government debt at higher yields last week (+6-10 bps) and demand was good.

Money markets: After having stopped in September 2013, the Central Bank restarted weekly repo auctions (Page 10-11)

Liquidity is unevenly distributed in the banking system, despite the overall surplus. To address this issue, the Central Bank scheduled a weekly repo auction, which is part of the bank's open market operations tool but had been stopped in September 2013 given the excess liquidity (banks could still opt for repo on bilateral basis). Money market rates are significantly below the base rate, especially the 3M rate which is often used as a benchmark for private RON lending. Despite the 3 percentage point reduction for RON reserves ratio, some banks still witness liquidity shortage. This could be further addressed later on this year, when conditions are more favorable to another reserve ratio cut for RON liabilities. Meanwhile, at the latest review of the stand by agreement, the IMF advised that the monetary policy should not be eased further. Additionally, the perspective of fiscal slippage that could follow the new tax cuts measures to be potentially applied from July 2014 are a further threat to more easing and could put upward pressure on rates especially next year.

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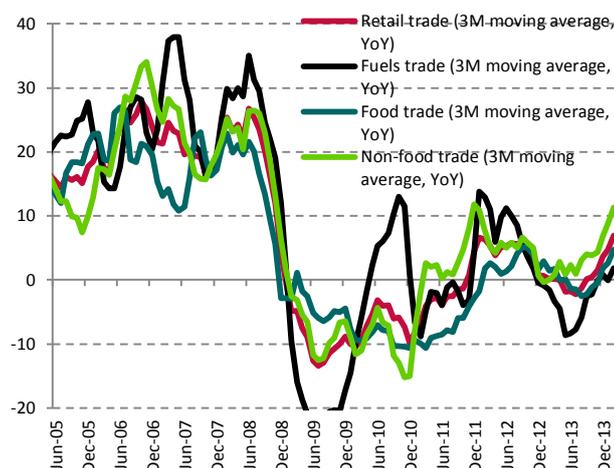
Macroeconomics: Strong retail and industrial sales in February

	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
01 Apr	March	FX reserves (bn EUR)	31.3		31.7
01 Apr	Feb	ILO unemployment (seasonally adjusted, %)	7.2		7.3
02 Apr	Feb	Retail trade turnover index (y-o-y, %)	8.7		5.3
02 Apr	Feb	Producer Price Index (y-o-y, %)	-1.2		-0.6
02 Apr	Feb	Net wage growth rate (y-o-y, %)	4.7		5.0
07 Apr	Feb	Industrial trade turnover index (y-o-y, %)	11.5		11.4
07 Apr	Feb	Index value of new orders in manufacturing (y-o-y, %)	20.4		8.8
09 Apr	Feb	Construction works index (y-o-y, %)	-14.7		-14.3
09 Apr	Feb	Exports (y-o-y, %)	12.0		6.3
09 Apr	Feb	Imports (y-o-y, %)	14.0		4.6
10 Apr	March	Consumer price index (y-o-y, %)		1.2	1.1
10 Apr	Feb	Industrial Production Index (y-o-y, %)			10.1

Retail trade started Q1 strongly and we witnessed a 5.4% monthly average hike during the first 2M compared to Q4 2013. This shows household consumption is indeed getting stronger, with consumer sentiment enlivened by the numerous hikes of the minimum wage, by disinflation, relatively stable exchange rate and prospects of a change on the political stage that started back in mid 2012 and will continue this year as well, with presidential elections (November). According to the economic sentiment indicator (ESI), **retail trade confidence is getting even stronger in March**. On an annual basis, **retail sales mounted 8.7% YoY in February** (5.3% YoY in January) and were driven by all the main 3 categories and **especially by non-food goods (+13.1% YoY)**, where income elasticity of demand is likely higher than the rest.

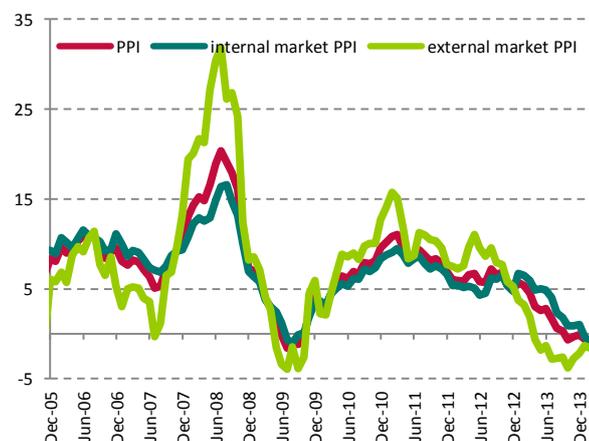
Industrial producer prices fell by 1.2% YoY, continuing a downtrend started three years ago. For the past 5M, they have been in the negative territory, mostly due to the external component. Only this February, the domestic prices sank as well by 1% YoY. The falling prices underline the still fragile pick up in economic growth.

Retail sales jumped 8.7% YoY (NSA) and 1.3% MoM (SA); non-food trade is thriving (+13%YoY)



Source: NIS

Industrial producer prices fell by 1.2% YoY in February, both due to domestic and external market



Source: NIS

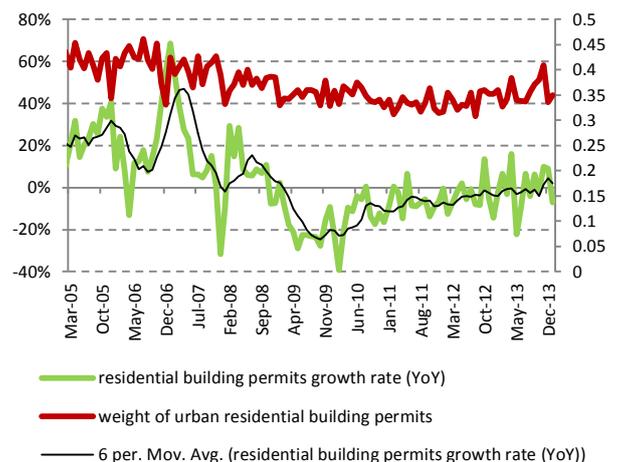
Building permits rose by 2.7% YoY in February, reinforcing the recent uptrend. The 6M moving average has been positive in the past 4M. Additionally, we see that the urban component is improving, whereas in the past two years it has been consistently lagging behind the rural developments.

Industrial sales and new orders showed a healthy progress in February, posting a hike of 11.5% YoY and 20.4% YoY, respectively. Therefore, our base scenario in which the industry is going to be **main supporter to GDP growth this year**, just like in 2013, has good grounds. **The industrial production sentiment is improving in March as well**, after the advance of the previous month.

Gross wages added 4.8% YoY in February and most importantly, **real wages grew by 3.6% YoY**. This gives more traction to consumption recovery. Annual inflation is going to increase in H2 by around 200 -250 bps though, affecting the real wages. We are looking forward to see the goods types to which a new VAT cut will apply, which has been announced recently by the finance minister.

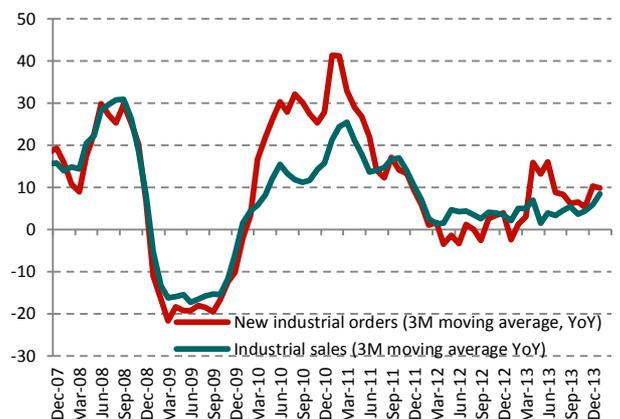
The unemployment rate fell to 7.2% in February from 7.3% in the previous two months. Again, all signs point to increased optimism consumption-wise.

Residential building permit climbed 2.7% YoY in February, confirming the recent uptrend



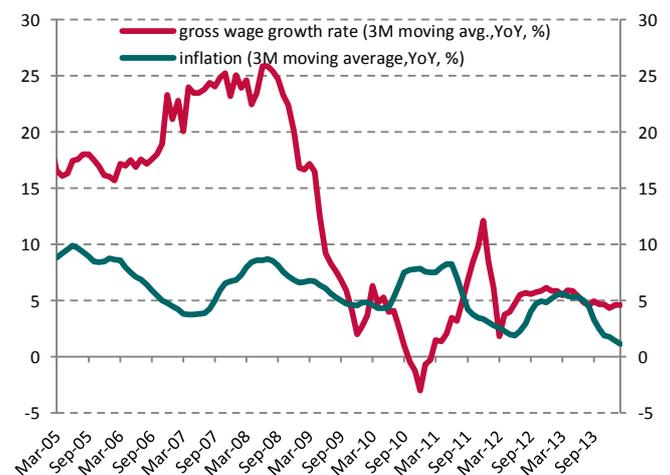
Source: NIS

Industrial orders and sales continued to be strong in February



Source: NIS

Gross wages rose by 4.8% and real wages by 3.6% YoY in February



Source: NIS

Macroeconomic forecast **

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	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	4.46	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	2.97	3.33	3.3	3.21	3.31
Ten-Year Bond (% , mid yield, NBR fixing)	5.64	5.45	5.16	5.28	5.27	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

** under revision

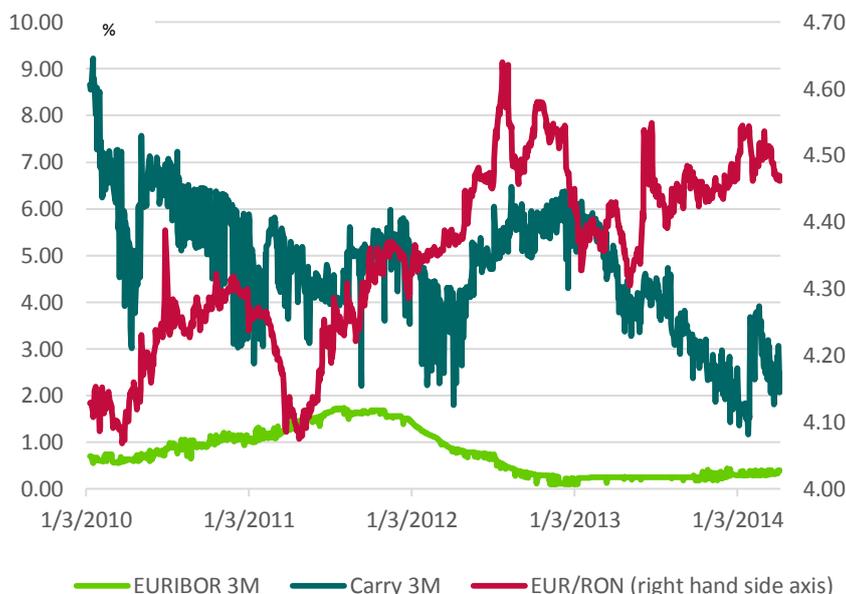
FX markets: Calm trading

The leu traded in a very narrow range and stood around 4.46 level in the past week. Investors waited for the ECB decision and US non-farm payrolls data last week which kept risk on movements at bay. The US jobs data was in line with expectations so this keeps the assumptions about tapering intact so far, which means depreciation pressures from foreigners exiting the fixed income market are to be considered.

On the other hand, the revised GDP figures for Q4 2013 showed better underlying dynamics and the headline figure was marginally revised up, to 5.4% from 5.2% YoY. The change that we are most impressed with is the rhythm of fixed capital formation revised at -2.6% YoY compared to the steeper fall of 10.8% YoY. This shows an improved aggregate demand and calls for an upward revision of 2014 estimation of GDP growth. If we add to this the already witnessed CA shrinking and higher FDI, the macro picture makes the case for a relatively strong leu. However, the short term risks (political, external) are significant enough to not be ignored.

Also, we see risks to the fiscal consolidation in 2014 given that the government plans to cut several taxes, among which the most important is the 5 percentage points decrease in social contributions. The finance minister says that the government remains committed to deficit reductions but the cited measures are not convincing enough: one is improvement of tax collection which has a bad track record. Another one is reduction of other types of expenditures, but so far the most powerful cuts regarded public investments and a further reduction would contradict the other electoral promises (included in the budget as well) on infrastructure works.

The leu trades in a narrow range



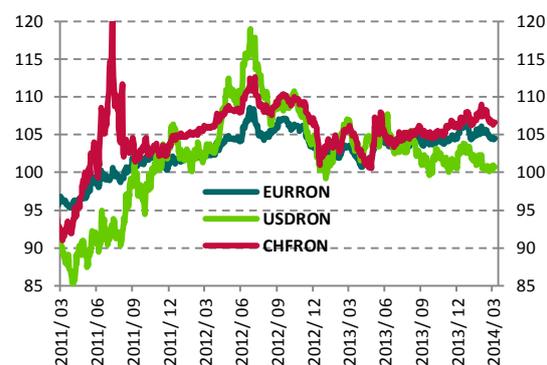
Source: Reuters

Date: 04.04.2014

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4.46	↓	-0.07	↑ 0.32
USDRON	3.25	↑	0.30	↓ -3.41
CHFRON	3.65	↓	-0.29	↓ -0.88
RONJPY	3.15	↓	-0.13	↓ -18.84
RONPLN	1.07	↑	0.08	↓ -1.63
100HUFRON	1.45	↑	0.85	↓ -4.62
RONCZK	0.16	↑	0.06	↓ -8.20
RONRUB	0.09	↑	1.69	↓ -16.46
RONRSD	0.04	↓	-0.75	↓ -2.43
RONBGN	2.28	↓	-0.04	↑ 0.32

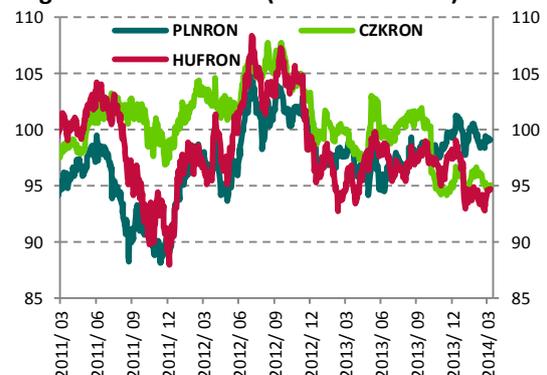
Source: Reuters

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

Daily EUR/RON Chart



Source: Reuters

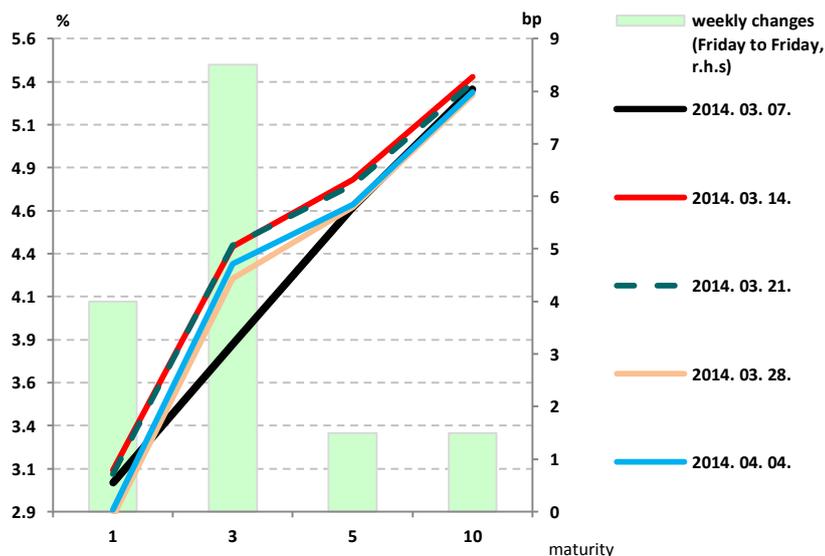
Major trend: consolidation	
Minor trend: consolidation	
R1: 4.475	S1: 4.45
R2: 4.49	S2: 4.44
RSI: neutral	

Government securities: Inflation at a minimum

At the moment, annual inflation is seen to be at a minimum and start rising in March and until the end of the year (the market consensus is at 1.2% YoY, implying a hike from 1.1% seen in February). Money market rates are also expected to witness an uptrend at least in Q2 and Q3. Therefore, we expect some upside pressure on yields compared to Q1. At the same time, we do not lose sight of NBR's forward guidance regarding the MM rates, which should be just below the base rate of 3.5%, implying a limited upside potential. Additionally, the rest of drivers come from other types of risks, such as political and external risk and they too weigh on government debt prices in the short term.

The Treasury completed two successful auctions last week but yields were marginally higher. It sold 12M T-bills at an average accepted yield of 2.94%, higher by 6 bps than the one at the previous auction at the end of March. Demand was good and bid to cover stood at 1.8X. The second auction was for bonds with a residual maturity of 3Y and the average accepted yield of 4.35% was 10bps higher than the one in early March.

Yield curve over the past weeks (Central Bank fixing)



Sources: NBR

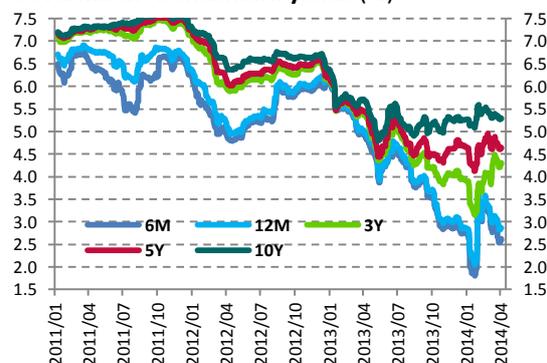
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RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	2.60	↑ 6	↓ -15	
12M	2.86	↑ 4	↔ 0	
3Y	4.29	↑ 9	↑ 38	
5Y	4.64	↑ 4	↓ -2	
10Y	5.29	↑ 2	↑ 2	

SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	407	↑ 9	↑ 53	
GERROM 5Y	402	↑ 4	↑ 30	
GERROM 10Y	374	↑ 2	↑ 41	
3Y -5Y	35	↓ -5	↓ -40	
5Y -10Y	66	↓ -1	↑ 4	
3Y-10Y	100	↓ -6	↓ -36	
FLY 3-5-10	31	↑ 4	↑ 43	

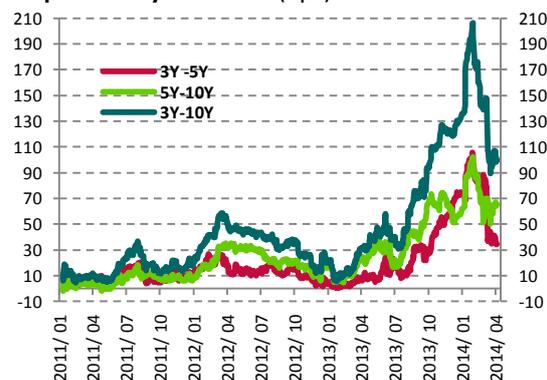
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	99	↓ -1	↓ -18	
5Y EURO	153	↓ -1	↓ -17	

Government benchmark yields (%)



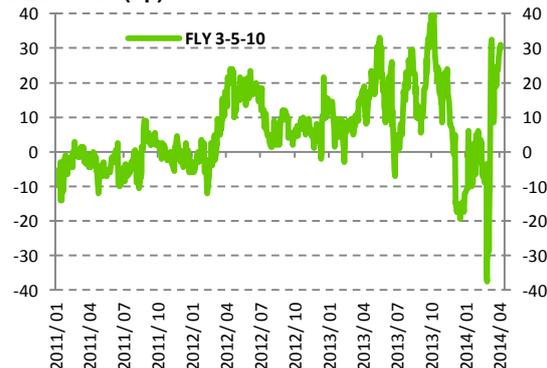
Source: NBR

Slope of the yield curve (bps)



Source: NBR

FLY 3-5-10 (bp)



Source: NBR

Auctions

T-bills auctions in March (in RON)

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1415CTN057	4/3/2014	4/7/2014	3/30/2015	12	1.000.000.000
RO1414CTN068	4/24/2014	4/28/2014	11/5/2014	6	800.000.000

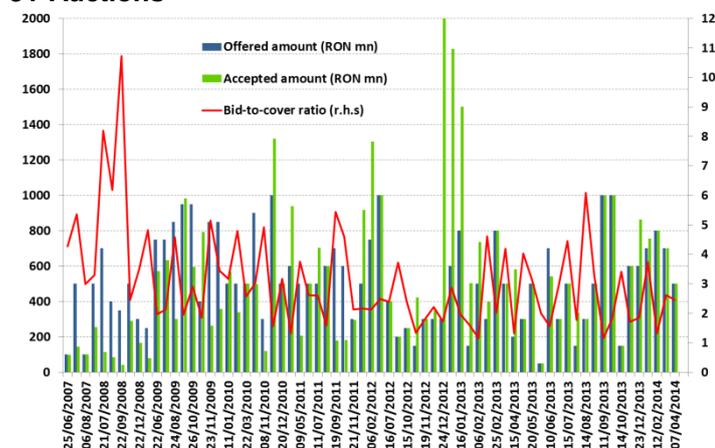
Source: The Ministry of Finance

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)
RO0717DBN038	03/04/14	04/04/14	07/04/14	11/06/17	10.0	3.2	500.000.000	75.000.000
RO1323DBN018	07/04/14	08/04/14	09/04/14	26/04/23	10.0	9.1	200.000.000	30.000.000
RO1316DBN053	10/04/14	11/04/14	14/04/14	29/08/16	3.0	2.4	500.000.000	75.000.000
RO1419DBN014	14/04/14	15/04/14	16/04/14	24/06/19	5.0	5.2	500.000.000	75.000.000
RO1121DBN032	24/04/14	25/04/14	28/04/14	11/08/21	10.0	7.1	500.000.000	75.000.000

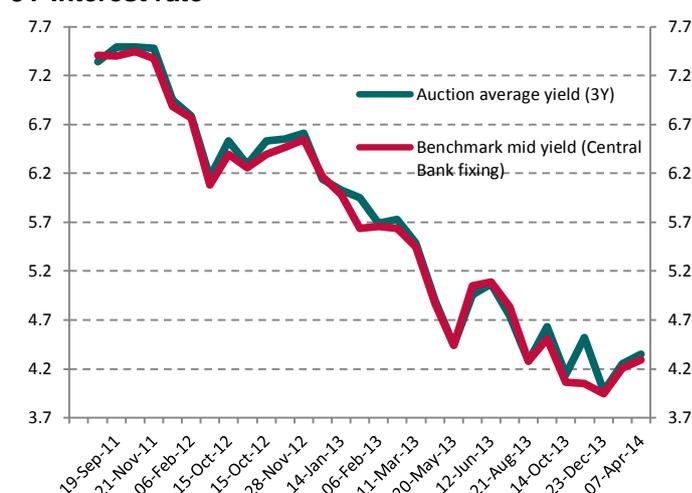
Source: The Ministry of Finance

3Y Auctions



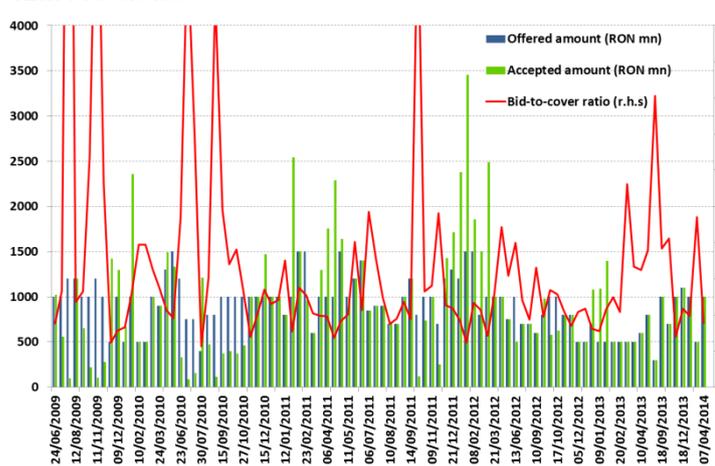
Source: NBR

3Y Interest rate



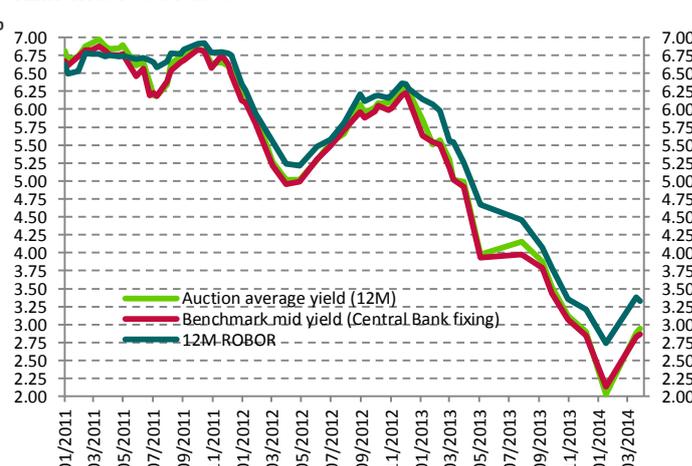
Source: NBR

12M Auctions



Source: NBR

12M Interest rates



Source: NBR

Last week's auctions

	RO0717DBN038	RO1415CTN057
Offered amount (mn RON)	500	1000
Total bids (mn RON)	1229	1773
Accepted amount (mn RON)	500	1000
Average accepted yield (%)	4.35	2.94
Coupon	6.75	-

Source: NBR

MM: After having stopped in September 2013, the Central Bank restarted weekly repo auctions

Liquidity is unevenly distributed in the banking system, despite the overall surplus. To address this issue, the Central Bank scheduled a weekly repo auction, which is part of the bank's open market operations tools but had been stopped in September 2013 given the large excess liquidity (banks could still opt for repo on bilateral basis) that existed at the moment.

In March, the daily flows of deposits placed at the ON standing facility with NBR grew to RON 2.5 bn/day compared to RON 0.8 bn in February. Money market rates are significantly below the base rate, especially the 3M rate which is often used as a benchmark for private RON lending. In January, the CB has cut the reserve ratio for both LCY and FX liabilities. Despite the 3 percentage point reduction for RON, some banks still witness liquidity shortage. This could be further addressed later on this year, when conditions are more favorable to another reserve ratio cut for RON liabilities. Meanwhile, at the latest review of the stand by agreement, the IMF advised that the monetary policy should not be eased further. Additionally, the perspective of fiscal slippage that could follow the new tax cuts measures to be potentially applied from July 2014 are a further threat to more easing and could put upward pressure on rates especially next year.

Date: 04.04.2014

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	3.50	↔ 0	↓ -50
ROBOR ON	2.34	↑ 8	↑ 60
ROBOR 3M	2.93	↓ -5	↑ 49
ROBOR 6M	3.30	↓ -4	↑ 31
ROBOR 9M	3.33	↓ -5	↑ 23
ROBOR 1Y	3.33	↓ -5	↑ 18

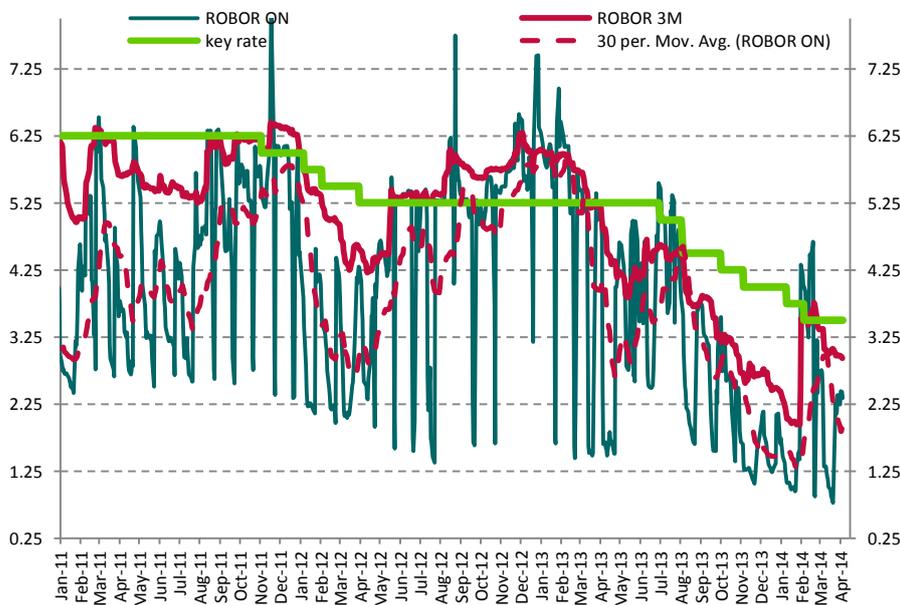
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	4,195.4	-327.8	-443.8

MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	15	↑ 2	↑ 8
USDRON 1M	58	↑ 1	↑ 25
USDRON 3M	191	↑ 18	↑ 75
EURRON 1W	12	↓ -5	↑ 1
EURRON 1M	84	↑ 16	↑ 41
EURRON 3M	288	↑ 60	↑ 87

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

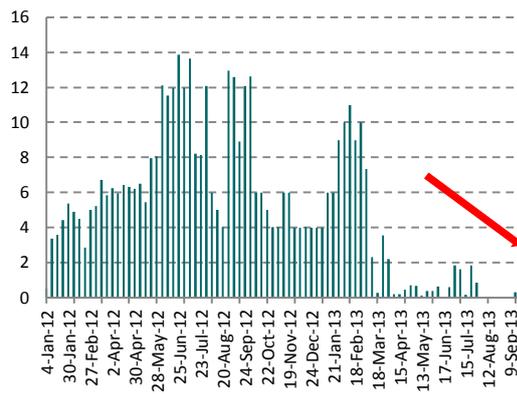
Sources: Reuters

The most important MM instruments



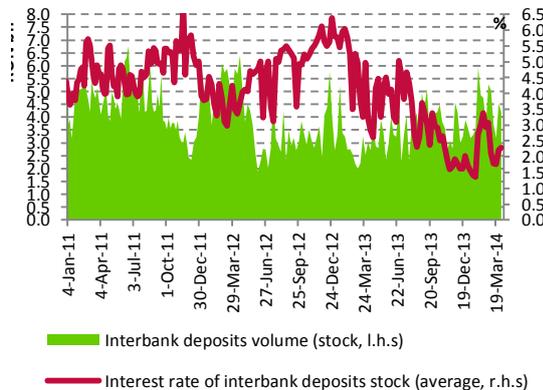
Sources: NBR

Repo operations since 2012



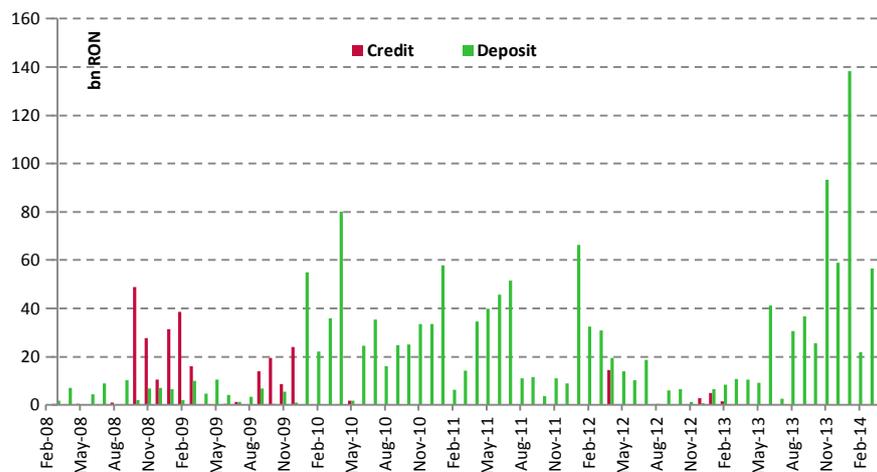
Sources: NBR

Interbank deposits and interest rate evolution



Sources: NBR

The daily average deposits placed at the standing facility rose 3 times in March; ROBOR 3M was 3.1% in March, under surplus liquidity conditions



Sources: NBR

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