

Headquarter Treasury Sales

Head of Sales

Marius George Ionescu
+40755 000 437
marius.ionescu@otpbank.ro

Tania Fantana

+4021 30758 17
tania.fantana@otpbank.ro

Alexandru Tibuleac

+4021 30758 17
alexandru.tibuleac@otpbank.ro

Alina Vrabioiu

+4021 30758 17
alina.vrabioiu@otpbank.ro

Weekly Report Romania

26 June 2014

Regional Treasury Sales

Cezar Trandafirescu - Iasi

+40755 000 246
cezar.trandafirescu@otpbank.ro

Szilamer Kozma - Cluj

+40755 000 400
szilamer.kozma@otpbank.ro

Valentin Cioraneanu – Brasov

+40755 000 464
valentin.cioraneanu@otpbank.ro

Radu Oprea – Bucharest

+40755000474
radu.oprea@otpbank.ro



The Central Bank in the spotlight next week

Macroeconomics: Private lending still negative but recovering

(Page 3- 5)

The banking statistics data for May showed that private lending annual growth is still in the negative territory (-2.1%YoY) and the most affected is still the corporate sector (-3%YoY) while households loans are close to recovering (-1.2%YoY). If we adjust for the foreign currency effect, we notice that the net loan outflows bottomed in December 2013 and that slowly the market will pick up. According to the May survey operated by NBR, the demand for consumer and mortgage loans increased in Q2 whereas in Q1 it was flat. Demand for loans from companies continues to decline but on the offer side banks were extremely active in Q2, unlike the previous quarter. Mortgage loans have stabilized around 10% YoY, but the RON component exploded. Private deposits rose at 6.6% in May. Based on original currency data, foreign currency and RON denominated deposits annual growth rates are negatively correlated (-0.68). At the moment, the FX deposits are on an uptrend.

FX market: The leu strenghtens (Page 6 - 7)

The leu remains under appreciation spell in the short term. The change in appetite of foreigners for the local bond market plays the biggest role. However, the Central Bank stated several times its cautiousness regarding speculative capital so we can expect it to intervene if the leu threatens to fall outside the much voiced +/- 5% variation band. Considering that the attractiveness of the domestic bond market could change as soon as Q4 2014 and that the proposed fiscal measures threaten the oasis of stability that has been projected so far, the leu could feel depreciation pressures towards the end of the year, when discussions over the 2015 budget and the IMF review will take place.

Fixed income markets: Yield curve shifted down (Page 8 - 9)

The yield curve moved lower again, by up to 14 bps and especially at the long end. What played in this scenario was the new found interest of foreigners who reconsidered the CEE fixed income universe, given the stance of major central banks like the ECB and the Fed which are expected to keep rates lower for longer than previously thought. The Treasury managed to sell bonds with a residual maturity of 8.8 years at 4.5%, 28 bps lower than the similar previous auction held in the end of May. Bid to cover ratio stood at 2.4.

Money markets: Looking forward to reserve ratio cut (Page 10)

Money market rates climbed this week, as the new reserve period started. However, they remain well below the base rate and the excess liquidity appears to persist. The market was expecting a further reduction in the mandatory reserve rate for RON liabilities which is high compared to the region and should be brought lower considering the euro adoption in 2019 (political consensus was achieved). This would help banks of lower scale as well, for which funding costs are still significant. However, Mediafax news agency cited official sources according to which the market could expect a cut in reserve ratio for foreign currency denominated liabilities which is currently at 18%. Another aspect of the tale was that NBR could consider cutting the base rate in the fall provided inflation fell below 3% YoY. In its May projection, the Central Bank forecasted inflation at 2.9% YoY for September and 3.3% YoY for December. While we do not rule out a cut of mandatory reserves for both the RON and FX liabilities, we do not see another base rate cut coming, as the NBR has preferred to keep the base rate moderately decoupled from the MM rates rather than make too frequent changes, especially if the risk of the next move was upward.

Chief Economist

Gergely Tardos

+36 1 374 7273

tardosg@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

Technical Analyst

András Salamon

+36 1 374 7225

salamona@otpbank.hu

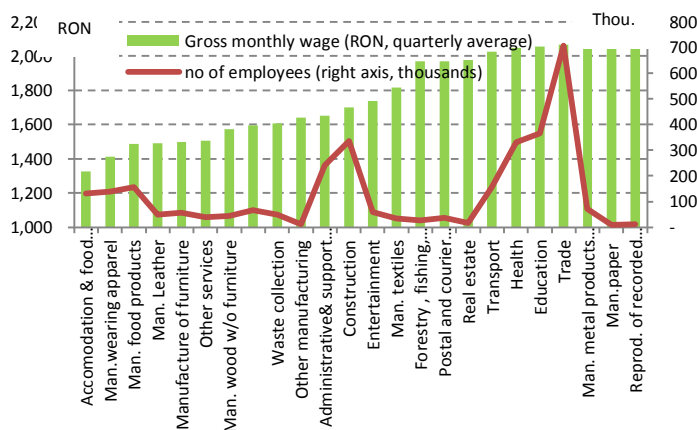
Macroeconomics: Private lending still negative but recovering

PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
26 Jun	May	Non -governmental loans (y-o-y, %)	-2.1	-0.8
26 Jun	May	Non -governmental deposits (y-o-y, %)	6.6	7.1
26 Jun	May	M3 aggregate (y-o-y, %)	6.5	6.7
01 Jul	May	ILO unemployment (seasonally adjusted, %)		7.1
02 Jul	May	Retail trade turnover index (y-o-y, %)		4.5
02 Jul	May	Producer Price Index (y-o-y, %)		0.8

The banking statistics data for May showed that private lending annual growth is still in the negative territory (-2.1%YoY) and the most affected is still the corporate sector (-3%YoY) while households loans are close to recovering (-1.2%YoY). If we adjust for the foreign currency effect, we notice that the net loan outflows bottomed in December 2013 and that slowly the market will pick up. According to the May survey operated by NBR, the demand for consumer and mortgage loans increased in Q2 whereas in Q1 it was flat. Demand for loans from companies continues to decline but on the offer side banks were extremely active in Q2, unlike the previous quarter.

The new proposed governmental measure to restructure loans („Electorata”) which have no delay and which applies to banking clients with gross income or pension of up to RON 2200/month will produce an upward bias to loans’ dynamics. According to data from the National Institute of statistics, two thirds of total number of employess have on average a gross wage below the 2200 RON treshold (based on economic branches). By comparison, all pensioners who are banking clients could potentially benefit from the new legislation, with few exceptions (please see the graph and table below). Initially, when the proposed gross wage was RON 2000 only 1.5 mn employees fit the description and they did not include for example sectors like health, education and trade(according to Q1 2014 average gross wage data)

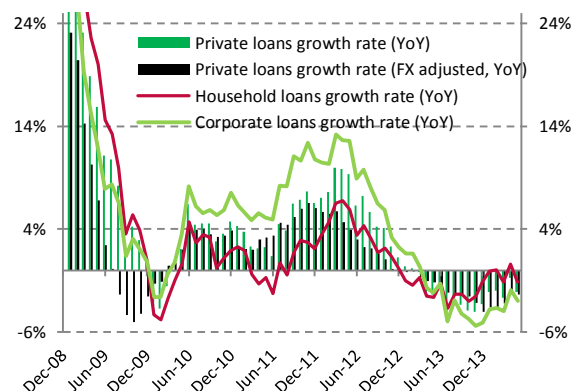
3 mn employees out of 4.4 mn total employees have gross wages below RON 2200/ month (Q1 2014 gross monthly average)



Source: NIS

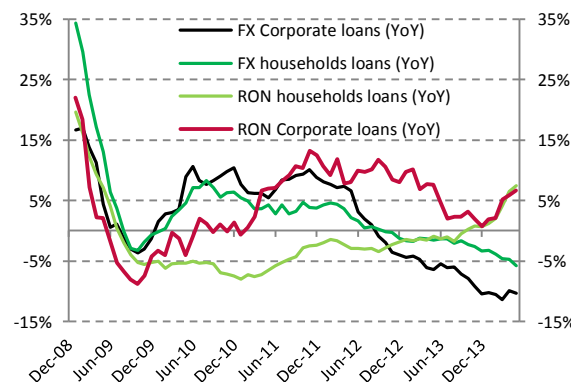
Note: man. = manufacturing

Private lending still negative but the bottom has been reached in December 2013



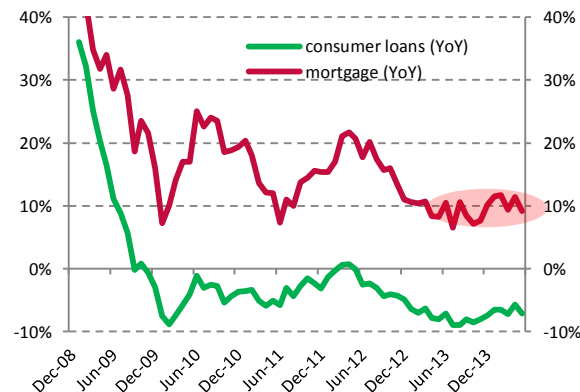
Source: NBR

Household and corporate RON loan dynamics have merged this year; FX corporate loans shrink faster



Source: NBR

Mortgage loans have stabilized around 10% YoY, but the RON component exploded



Source: NBR

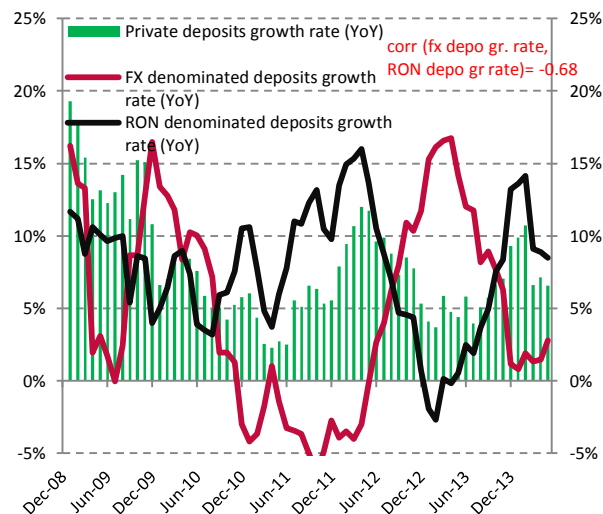
All pensioners can potentially benefit from “Electorata” with few exceptions

Pension system	Leit month	Number (thousands)
With due complete stage	1126	2516
For age limit	996	3418
Anticipated pension	984	14
Social insurance pensioners (excluding farmers)	862	4840
State social insurance pensioners	809	4681
Social insurance pensioners - total	806	5404
With due incomplete stage	632	902
Partial anticipated pension	628	101
II degree	591	344
I degree	581	39
Invalidity	577	737
III degree	563	354
Survivor pension	465	570
Invalidity	381	1
Social insurance pensioners - farmers	327	564
IDVR	234	5
Social benefit - pension type	200	1
Survivor pension	179	4

Source: NIS

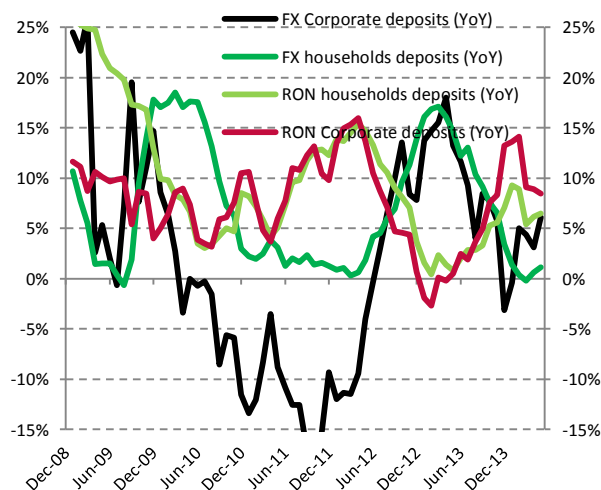
Private deposits rose at 6.6% in May. Based on original currency data, foreign currency and RON denominated deposits annual growth rate are negatively correlated (-0.68). At the moment, the FX deposits are on an uptrend.

FX and RON denominated deposits growth rate are strongly negatively correlated; at the moment FX dynamics is up



Source: NBR, OTP Research calculation

Deposits have positive growth rates, no matter the client category or currency



Source: NBR

Macroeconomic forecast

Main macroeconomic indicators	Fact							Forecast	
	2007	2008	2009	2010	2011	2012	2013	2014	2015
Nominal GDP (EUR mn)	124,729	139,765	118,196	124,328	131,327	131,747	142,395	147,487	156,675
Real GDP	6.3%	7.3%	-6.6%	-1.1%	2.3%	0.6%	3.5%	3.0%	3.0%
Households consumption expenditure	12.0%	9.0%	-10.4%	-0.2%	1.6%	1.1%	1.3%	2.2%	2.9%
Government consumption	2.5%	6.2%	9.5%	-13.7%	-3.0%	0.7%	-1.7%	2.9%	2.7%
Gross fixed capital formation	30.3%	15.6%	-28.1%	-1.8%	7.7%	3.8%	-3.3%	2.2%	6.8%
Exports	7.8%	8.3%	-6.4%	13.2%	11.6%	-1.5%	13.5%	9.4%	6.6%
Imports	27.3%	7.9%	-20.5%	11.1%	10.5%	-0.2%	2.4%	8.3%	6.5%
Consumer prices (avg.)	4.8%	7.8%	5.6%	6.1%	5.8%	3.3%	4.0%	2.2%	2.9%
Budget Balance (GDP%, ESA 95)	-2.9%	-5.7%	-9.0%	-6.8%	-5.5%	-3.0%	-2.3%	-2.8%	-2.5%
Public debt (GDP %)	12.8%	13.4%	23.6%	30.5%	34.7%	38.0%	38.4%	39.4%	39.8%
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	-2.9	-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%	4.6%	5.4%
Real wage growth	14.7%	16.5%	-1.5%	-3.7%	-1.9%	1.2%	1.0%	2.4%	2.4%
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	26-Jun-14	3Q 2014 F	4Q 2014 F	1Q 2015 F
EUR/RON (end of period)	4.39	4.48	4.46	4.46	4.46	4.39	4.41	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	2.43	3.02	3.21	3.31
Ten-Year Bond (% , mid yield, NBR fixing)	5.64	5.45	5.16	5.28	5.27	4.40	4.75	5.05	5.35

Source: Eurostat, NIS, NBR, OTP Research

FX markets: The leu strengthens

The leu remains under appreciation spell in the short term. The change in appetite of foreigners for the local bond market plays the biggest role. However, the Central Bank stated several times its cautiousness regarding speculative capital so we can expect it to intervene if the leu threatens to fall outside the much voiced +/- 5% variation band. Considering that **the attractiveness of the domestic bond market could change as soon as Q4 2014** and that the proposed fiscal measures threaten the oasis of stability that has been projected so far, the leu could feel **depreciation pressures towards the end of the year, when discussions over the 2015 budget and the IMF review will take place.**

As we mentioned in previous reports, **the decrease in social contributions will cause a 0.7% GDP gap in 2015 which could send the final ESA figure above the 3% threshold.** According to the first 5M cash deficit data, the recorded cash deficit stood at 0.2% in GDP but we did not witness a faster pace of fiscal income. Also, current revenues annual dynamics is slowing down (3.7% yoy Jan-May) whereas current expenditures are moving more rapidly (+0.7% YoY). Capital expenditures continue to be sacrificed. Also, on the revenue side, a positive impact was felt from property taxes, which were raised this year by the means of special constructions tax introduced this year. This is paid in two equal tranches, in May and September but the business environment is already voicing concerns, given that the impact is more significant than initially calculated: according to the Budget Minister, total revenues will mount to RON 1.5 bn (0.2% in GDP) compared to RON 0.5 bn expected. All in all, collection does not seem to improve and the severity of the tax cuts will make more noise at the end of the year.

Cash Budget evolution

	2014 budget	May-14 (cumulated)	12M rolling	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Apr-14	May-14
	RON mn	RON mn	RON mn	YoY	YoY	YoY	YoY	YoY	YoY	YoY
Total revenue	215,955	84,075	203,044	3.0%	4.3%	4.4%	3.5%	3.5%	4.4%	3.7%
Current income	200,481	81,491	193,572	4.8%	5.3%	4.8%	3.6%	3.3%	4.4%	3.7%
Fiscal income	125,312	51,992	122,522	6.0%	6.8%	6.2%	4.4%	5.0%	2.0%	7.0%
Income tax	36,725	15,970	35,621	3.0%	4.2%	5.2%	6.5%	1.8%	4.9%	4.5%
Corporate income tax	12,710	5,949	11,530	-10.2%	-5.5%	-1.3%	0.7%	8.1%	12.9%	11.3%
Personal income tax	24,001	9,411	22,642	11.5%	9.3%	7.9%	8.5%	-3.5%	-2.1%	-1.0%
Other tax on income, profit and capital	14	610	1,450	-4.8%	9.5%	21.3%	30.2%	58.4%	41.8%	43.4%
Property tax	5,041	3,498	5,304	4.0%	9.5%	9.7%	8.4%	13.3%	7.3%	34.7%
Taxes on goods and services	82,513	32,085	80,600	7.7%	8.0%	6.7%	3.5%	5.8%	8.3%	6.0%
Value added tax	53,772	20,567	52,104	9.5%	2.3%	4.1%	2.6%	-0.5%	2.7%	1.4%
Excise duties	24,102	9,101	21,921	9.3%	4.2%	2.8%	4.2%	14.0%	15.2%	9.8%
Other	4,639	2,417	6,575	-14.4%	87.5%	55.8%	9.2%	43.6%	43.4%	43.5%
Taxes on international commerce	623	257	622	2.8%	-5.2%	-16.3%	-12.3%	-2.1%	0.4%	0.7%
Other fiscal taxes	411	181	375	16.0%	12.6%	5.8%	0.4%	-5.3%	-3.9%	-5.3%
Social security contributions	57,779	23,297	55,400	3.6%	4.3%	4.7%	5.3%	4.4%	3.2%	4.6%
Non-fiscal revenue	17,390	6,202	15,650	0.5%	-0.8%	-3.8%	-6.4%	-12.7%	-10.7%	-19.6%
Capital revenues	621	305	698	-4.2%	-2.2%	-8.2%	-0.5%	2.0%	10.6%	18.7%
Donations	15	140	303	-78.3%	-45.6%	-45.8%	-54.7%	782.4%	664.4%	267.5%
EU preaccession funds	14,842	2,104	8,511	-33.8%	-1.1%	0.8%	11.7%	-17.7%	-18.2%	-16.0%
Other	0	35	-40	92.2%	74.1%	49.2%	n.a.	n.a.	n.a.	n.a.
Total expenditures	230,448	85,656	213,836	4.4%	4.4%	4.8%	3.8%	-2.9%	-3.8%	-2.3%
Current expenditures	212,653	82,253	199,502	5.4%	5.5%	6.3%	5.1%	0.7%	-0.6%	0.7%
Compensation of public employees	47,786	19,719	46,733	19.9%	18.1%	14.7%	13.5%	2.6%	-4.4%	2.3%
Operating expenditures	39,362	14,588	39,220	11.3%	6.9%	12.1%	12.0%	4.0%	7.3%	4.6%
Interest paid	11,224	4,540	10,444	14.0%	0.7%	5.8%	0.4%	-20.4%	-3.1%	-6.4%
Subsidies	5,742	2,756	4,863	13.9%	9.3%	0.3%	-15.9%	-14.1%	-11.3%	-9.4%
Total transfers	107,262	40,479	97,541	-2.9%	0.9%	2.0%	1.8%	2.9%	0.6%	0.6%
Transfers between units of public administration	549	398	515	84.0%	3.0%	6.7%	-25.4%	-35.7%	-32.3%	-55.6%
Other transfers	11,817	5,782	10,925	15.2%	15.3%	11.1%	-2.6%	7.2%	2.4%	4.0%
Projects financed by foreign non-reimbursable funds	20,251	3,518	13,347	-45.3%	-18.3%	-8.1%	5.9%	-14.7%	-18.7%	-15.5%
Social benefits	71,513	29,416	69,430	1.0%	1.5%	1.9%	2.0%	4.2%	3.6%	3.7%
Other	3,133	1,365	3,324	11.3%	16.4%	15.7%	8.5%	14.0%	0.4%	8.3%
Expenses for programs with reimbursable funds	1,080	172	702	-38.3%	-36.9%	-46.3%	-46.2%	-58.6%	-61.7%	-49.4%
Capital expenses	17,796	3,849	15,511	-7.5%	-9.2%	-10.9%	-7.5%	-48.5%	-42.4%	-37.9%
Payments made in earlier years and recovered in the current year	-447	-1177	-166%	-8.2%	34.8%	52.4%	46.6%	46.6%	38.5%	64.8%
Excessant (y)Deficit (c)	-14,490	-1,880	-10,792	23.6%	-2.4%	13.6%	6.4%	-77.8%	-74.9%	-75.9%

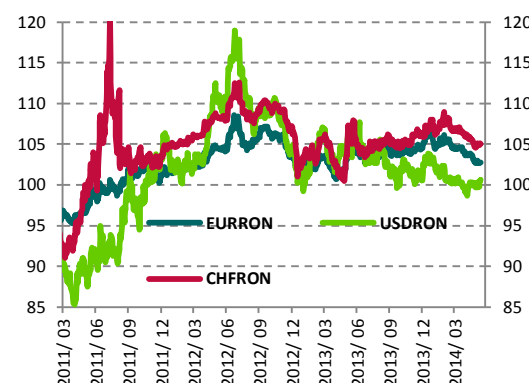
The Ministry of Finance

Date: 26.06.2014

	Value	Weekly chg. (%)	YTD chg. (%)
EURRON	4.39	↓ -0.09	↓ -1.30
USDRON	3.22	↓ -0.09	↓ -4.27
CHFRON	3.61	↓ -0.06	↓ -1.94
RONJPY	3.16	↑ 0.01	↓ -18.43
RONPLN	1.06	↓ -0.21	↓ -2.93
100HUFRON	1.42	↓ -0.95	↓ -6.87
RONCZK	0.16	↓ -0.19	↓ -9.78
RONRUB	0.10	↑ 1.80	↓ -13.34
RONRSD	0.04	↓ -0.24	↓ -4.17
RONBGN	2.24	↓ -0.06	↓ -1.24

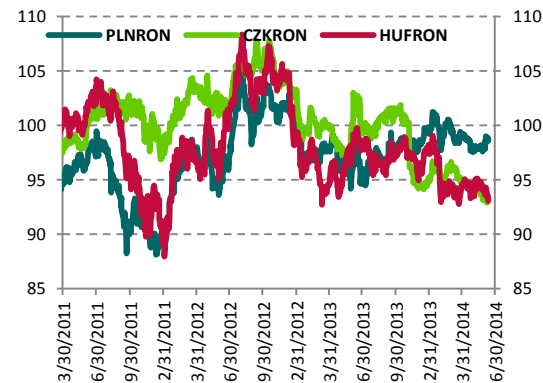
Source: Reuters

Major RON FX rates (03.01.2011=100)



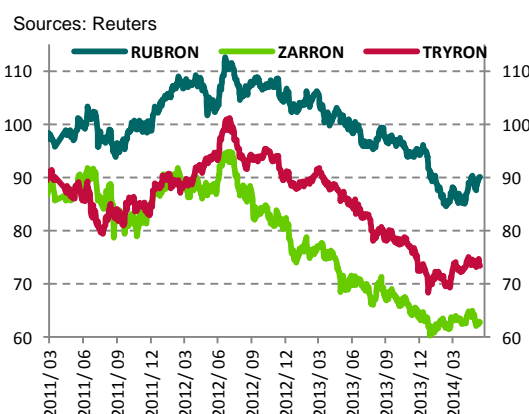
Sources: Reuters

Regional RON FX rates (03.01.2011=100)

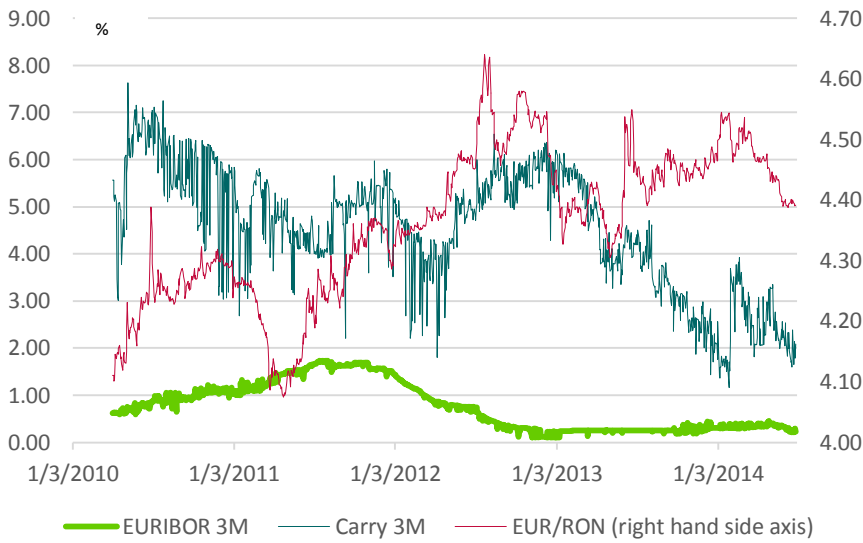


Sources: Reuters

Regional RON FX rates (03.01.2011=100)



The leu continues to appreciate



Source: Reuters

Daily EUR/RON Chart



Source: Reuters

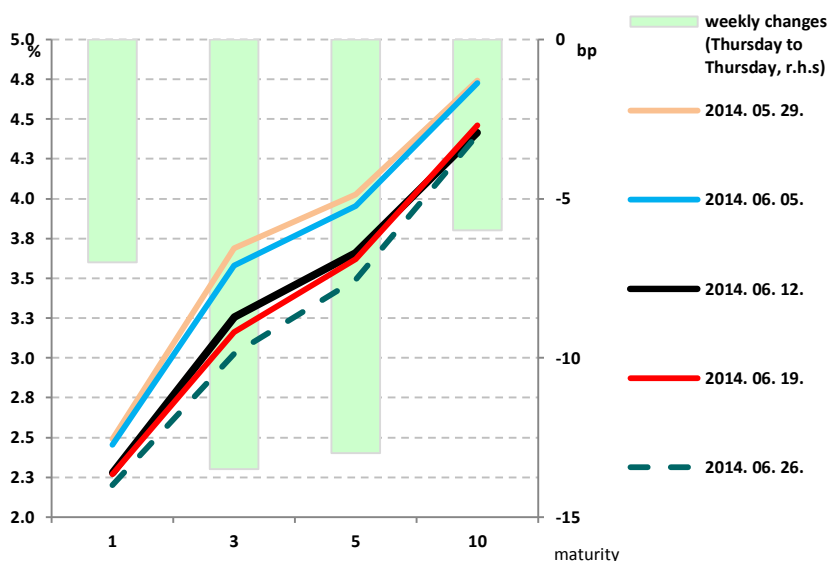
Major trend: ↓	
Minor trend: ↓	
R1: 4.3960	S1: 4.3850
R2: 4.40	S2: 4.3790
RSI: neutral	

Government securities: Yield curve shifted down

The yield curve moved lower again, by up to 14 bps and especially at the long end. What played in this scenario was the new found interest of **foreigners who reconsidered the CEE fixed income universe**, given the stance of major central banks like the ECB and the Fed which are expected to keep rates lower for longer than previously thought.

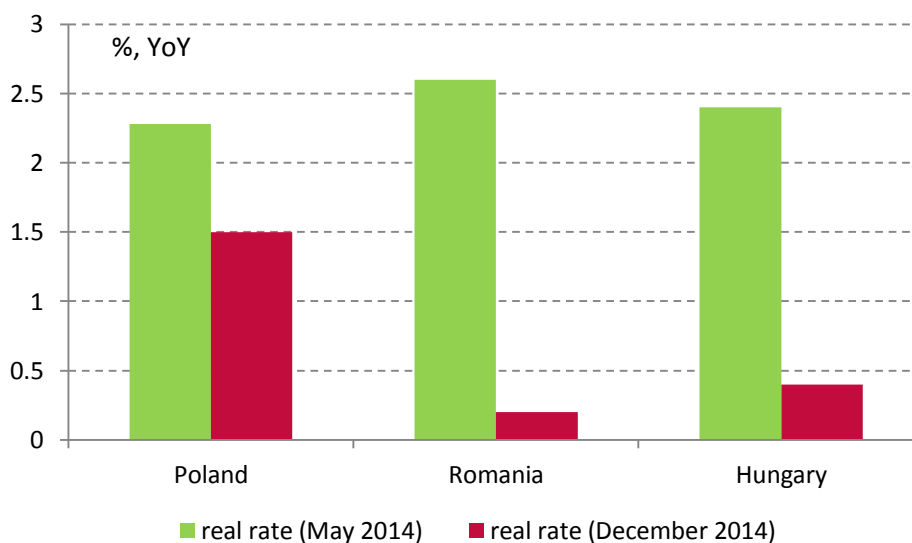
The Treasury managed to sell bonds with a residual maturity of 8.8 years at 4.5%, 28 bps lower than the similar previous auction held in the end of May. Bid to cover ratio stood at 2.4.

Yield curve over the past weeks (Central Bank fixing)



Sources: NBR

The real rate is going to decrease in Romania compared to peer countries



Sources: Reuters

Note: real rate is calculated as base rate minus annual inflation

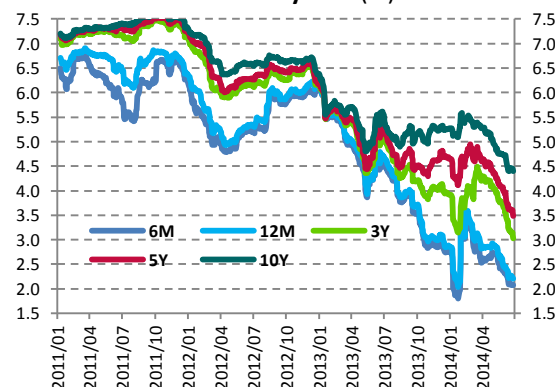
Date: 26.06.2014

RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	2.08	↓ -1	↓ -67	
12M	2.20	↓ -7	↓ -66	
3Y	3.03	↓ -14	↓ -89	
5Y	3.49	↓ -13	↓ -116	
10Y	4.40	↓ -6	↓ -87	

SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	294	↓ -14	↓ -60	
GERROM 5Y	311	↓ -13	↓ -62	
GERROM 10Y	308	↓ -6	↓ -26	
3Y -5Y	47	↑ 0	↓ -28	
5Y -10Y	91	↑ 7	↑ 29	
3Y-10Y	138	↑ 8	↑ 2	
FLY 3-5-10	45	↑ 7	↑ 57	

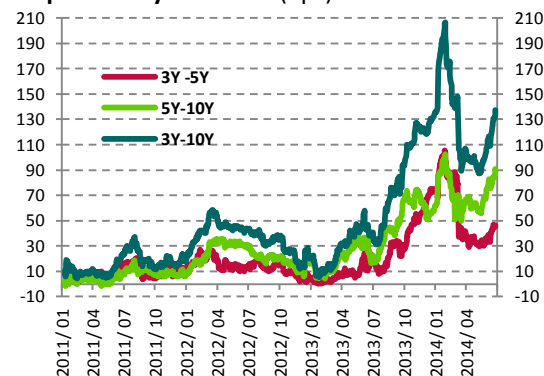
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	67	↑ 1	↓ -50	
5Y EURO	119	↓ -1	↓ -52	

Government benchmark yields (%)



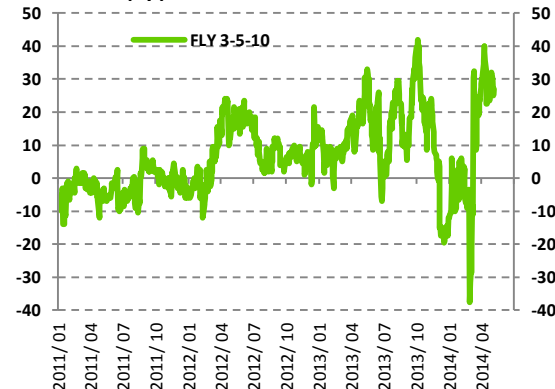
Source: NBR

Slope of the yield curve (bps)



Source: NBR

FLY 3-5-10 (bp)



Source: NBR

Auctions

T-bills auctions in June (in RON)

ISIN	Auction date	Settlement date	Maturity	Months	Indicative target amount (RON)
RO1415CTN081	05/06/14	10/06/14	09/06/15	12	800.000.000
RO1414CTN092	19/06/14	23/06/14	22/12/14	6	500.000.000

Source: The Ministry of Finance

Bonds auctions in June (in RON)

ISIN	Auction date	SSON auction date	Settlement date	Maturity	Years	Residual Maturity	Indicative target amount (RON)	Indicative target amount SSON* (RON)
RO1227DBN011	02/06/14	03/06/14	04/06/14	26/07/27	15.0	13.2	200.000.000	30.000.000
RO1419DBN014	02/06/14	03/06/14	04/06/14	24/06/19	5.0	5.1	600.000.000	90.000.000
RO1316DBN053	12/06/14	13/06/14	16/06/14	29/08/16	3.0	2.2	300.000.000	45.000.000
RO1121DBN032	12/06/14	13/06/14	16/06/14	11/06/21	10.0	7.0	500.000.000	75.000.000
RO1318DBN034	16/06/14	17/06/14	18/06/14	28/11/18	5.0	4.5	300.000.000	45.000.000
RO1323DBN018	23/06/14	24/06/14	25/06/14	26/04/23	10.0	8.8	200.000.000	30.000.000

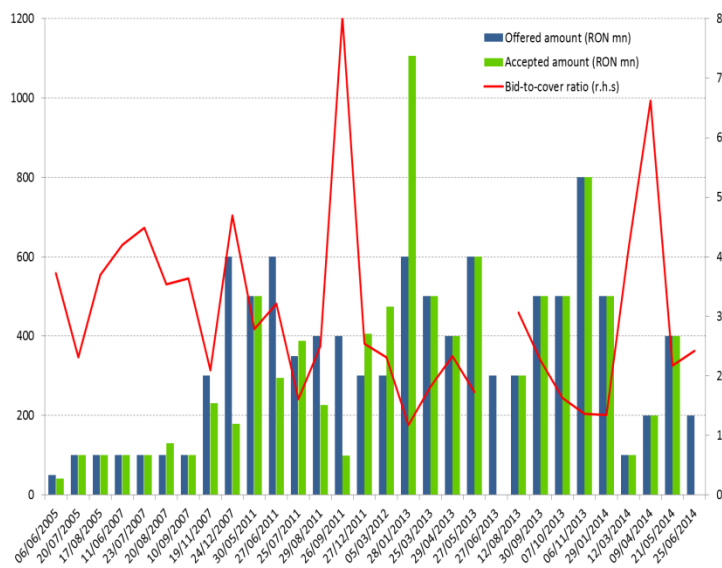
Source: The Ministry of Finance

This week's auctions

RO1323DBN018	
Offered amount (mn RON)	200
Total bids (mn RON)	484
Accepted amount (mn RON)	200
Average accepted yield (%)	4.50
Coupon	5.85

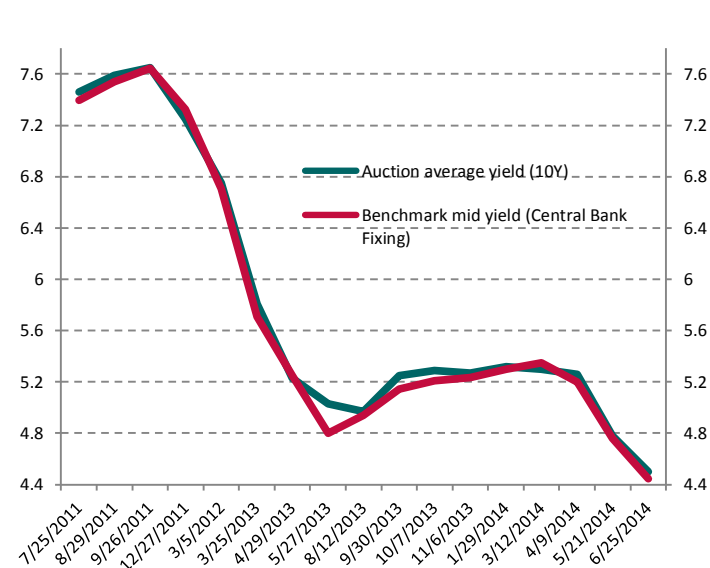
Source: NBR

10Y Auctions



Source: NBR

10Y Interest rate

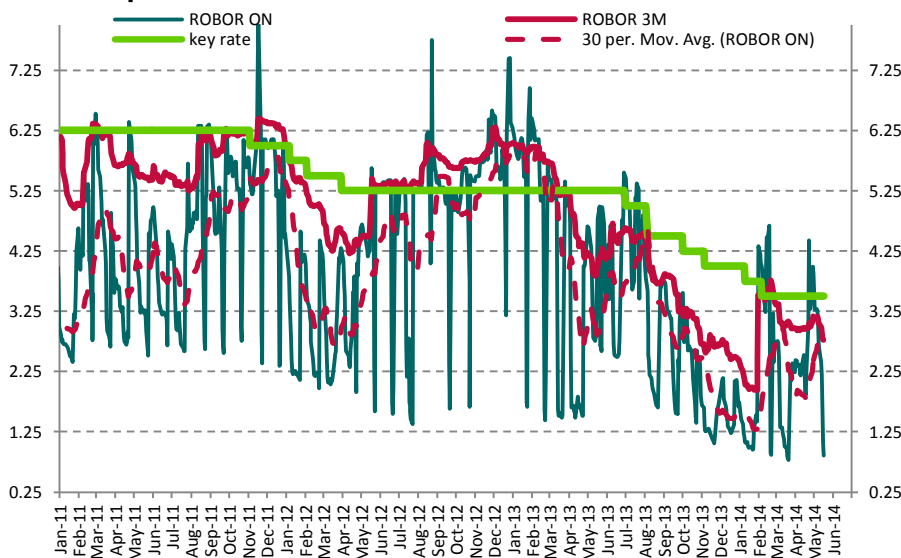


Source: NBR

MM: Looking forward to reserve ratio cut

Money market rates climbed this week, as the new reserve period started. However, they remain well below the base rate and the excess liquidity appears to persist. The market was expecting a further reduction in the mandatory reserve rate for RON liabilities which is high compared to the region and should be brought lower considering the euro adoption in 2019 (political consensus was achieved). This would help banks of lower scale as well, for which funding costs are still significant. However, Mediafax news agency cited official sources according to which the market could expect a cut in reserve ratio for foreign currency denominated liabilities which is currently at 18%. Another aspect of the tale was that NBR could consider cutting the base rate in the fall provided inflation fell below 3% YoY. In its May projection, the Central Bank forecasted inflation at 2.9% YoY for September and 3.3% YoY for December. **While we do not rule out a cut of mandatory reserves for both the RON and FX liabilities, we do not see another base rate cut coming, as the NBR has preferred to keep the base rate moderately decoupled from the MM rates rather than make too frequent changes, especially if the risk of the next move was upward.**

Most important MM rates



Sources: NBR

Date: 26.06.2014

MID INTEREST RATES			
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	3.50	0	-50
ROBOR ON	2.78	197	104
ROBOR 3M	2.43	5	-1
ROBOR 6M	2.77	2	-22
ROBOR 9M	2.82	1	-28
ROBOR 1Y	2.87	1	-28

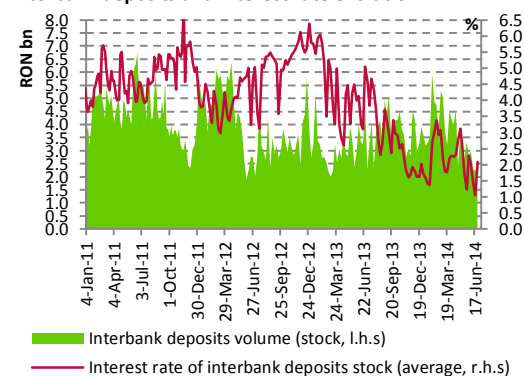
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	2,109.6	98.3	-2529.6

MID SWAP POINTS			
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USDRON 1W	16	8	9
USDRON 1M	53	19	21
USDRON 3M	120	11	4
EURRON 1W	21	8	10
EURRON 1M	77	40	33
EURRON 3M	179	4	-23

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

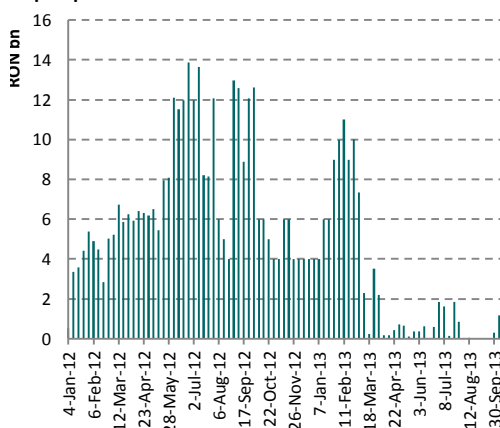
Sources: Reuters

Interbank deposits and interest rate evolution



Sources: NBR

Repo operations since 2012



Sources: NBR

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