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Weekly Report Romania

14 July 2014

Regional Treasury Sales

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Inflation rate fell significantly below expectations

Macroeconomics: Industry continues to deliver (Page 3- 4)

Industrial production (+12.5% YoY) and sales (+10.9% YoY) moved up in May, continuing the success story presented so far. Of all the large categories, energy production was the only one to slide: -2.2% YoY. During the first 5M industrial production advanced by 8.7% YoY and most of it due to external demand, according to the turnover statistics. In line with industrial sales figure, exports dynamics exhibited a 7.9% YoY uptake after the slower move in April (+2.2% YoY). The focus shifted to the intra EU component, where the bulk of exports go (71%) and which is pacing up more rapidly, unlike in 2013. Imports stepped up in May as well (8.1% YoY). For the moment, the current account deficit is low: the latest figures point to 1.1% as of Q1 2014. Constructions activity continues to contract, in absence of public investments. The only subcomponent where growth was explosive in May is the residential one (+129% YoY).

FX market: the leu lost 0.7% in a week (Page 6)

Last week tested to a small extent investors' sensitivity to negative news related to the European banking system. As soon as worries related to the solvency of Portugal's lender Banco Espirito Santo and its potential contagion effects made it to the market on Thursday, CEE currencies took a hit to the euro. We have seen the EUR/RON pair climbing to 4.42 on the interbanking market and bond yields rising by up to 8 bps, the largest in the case of 5 and 10y bonds. However on a weekly basis, only the leu depreciated against the euro while the Polish zloty and the Hungarian forint strengthened marginally. At this point, bond prices are stretched out and the upside potential of the bond market is likely exhausted, even if the NBR could cut the base rate further this year, by another 25 bps, as money market rates have decoupled from the base rate in the recent months. We therefore see the chances for another rally of the leu rather limited.

Fixed income markets: Bond prices at all-time highs (Page 7-8)

As the yield curve continued to shift lower, the Treasury sold the planned amount of RON 800 mn at decreasing yields. Despite the yield compression, demand remained high, with bid to cover at 2.5 for the 6Y bonds (residual maturity) and 3.9 for the 2Y bonds. The average accepted yield in the first case was 2.32%, 58 bps lower compared with the previous similar auction in mid June. The 6Y bonds sold at an average accepted yield of 3.5%, 43 bps lower than in the beginning of June. At the moment, bond prices are at all time highs and we expect a gradual correction until December. We see the 10Y bond yield around 5% in December.

Money markets: Chances for a base rate cut have increased (Page 9)

The new inflation data came significantly below Central Bank's expectations for June and surprised the market as well. The annual inflation figure stood at 0.7% YoY whereas the official NBR forecast was 1.4% YoY and the market expected 0.9% YoY. Other inflation measures also lagged behind the NBR forecast, by a smaller distance: core 2 adjusted inflation, which gives the trend, stood at -0.6% YoY versus -0.3% YoY. The next monetary policy session is on 4th of August, when a new inflation forecast will also be released. For the moment, the data suggests that inflation could remain below the 3% level by the end of the year, but upward risks remain. In our opinion, the most important one could be the depreciation of the leu. This could follow as a result of some exits from the bond market, cumulated with renewed tensions around presidential elections and the not so rosy fiscal outlook. However, given the latest inflation reading, the chances of NBR cutting the base rate have increased.

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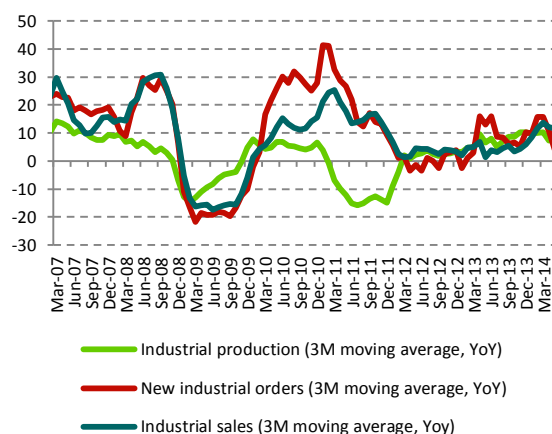
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Macroeconomics: Industry continues to deliver

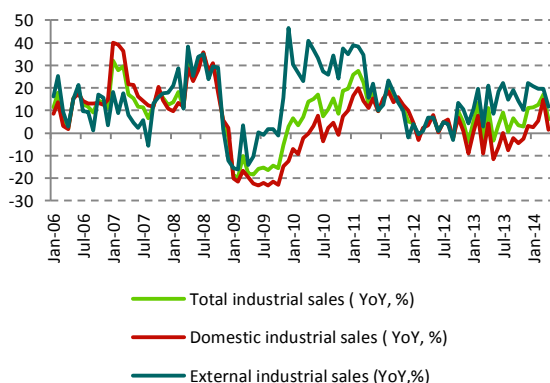
| | PERIOD | INDICATOR | FACT | CONSENSUS | PRIOR |
|--------|--------|---|-------|-----------|--------|
| 07 Jul | May | Net wage growth rate (y-o-y, %) | 4.4 | | 4.5 |
| 07 Jul | May | Industrial trade turnover index (y-o-y, %) | 10.9 | | 6.8 |
| 07 Jul | May | Index value of new orders in manufacturing (y-o-y, %) | 0.4 | | -6.2 |
| 09 Jul | May | Construction works index (y-o-y, %) | -10.7 | | -6.9 |
| 10 Jul | June | Consumer price index (y-o-y, %) | 0.7 | | 0.9 |
| 10 Jul | May | Exports (y-o-y, %) | 7.9 | | 2.2 |
| 10 Jul | May | Imports (y-o-y, %) | 8.1 | | 2.6 |
| 10 Jul | May | Industrial Production Index (y-o-y, %) | 12.5 | | 1.4 |
| 14 Jul | May | CA balance (EUR mn, YTD) | | | -297.4 |
| 14 Jul | May | FDI (EUR mn, YTD) | | | 786.1 |

Industrial production (+12.5% YoY) and sales (+10.9% YoY) moved up in May, continuing the success story presented so far. Of all the large categories, **energy production was the only one to slide: -2.2% YoY**. Mining and manufacturing gained 8.3% YoY and 14.1% YoY, respectively. During the first 5M industrial production advanced by 8.7% YoY and most of it due to external demand, according to the turnover statistics. However, industrial sales on the domestic market are also posting shy increases: during the first 4M (latest data), domestic industrial sales added 6% YoY on average per month while external sales run faster: +17.8% YoY (monthly average).

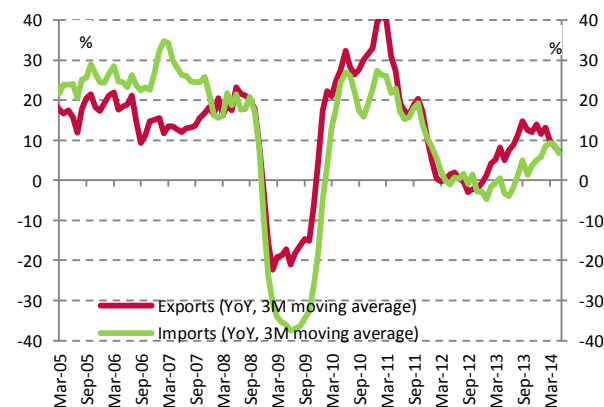
In line with industrial sales figure, exports dynamics exhibited a 7.9% YoY uptake after the slower move in April (+2.2% YoY). **The focus shifted to the intra EU component**, where the bulk of exports go (71%) and which is pacing up more rapidly, **unlike in 2013**. Intra EU exports rose by 8.9% YoY during the first 5M while extra EU added 6% YoY. Imports stepped up in May as well (8.1% YoY). This renews the view that households consumption becomes healthier. For the moment, we are not worried about the overheating of the economy, as the current account deficit is low: the latest figures point to 1.1% as of Q1 2014.

Industrial sales (+10.9% YoY) and new orders continue to deliver


Source: NIS

External sales advance the fastest


Source: NIS

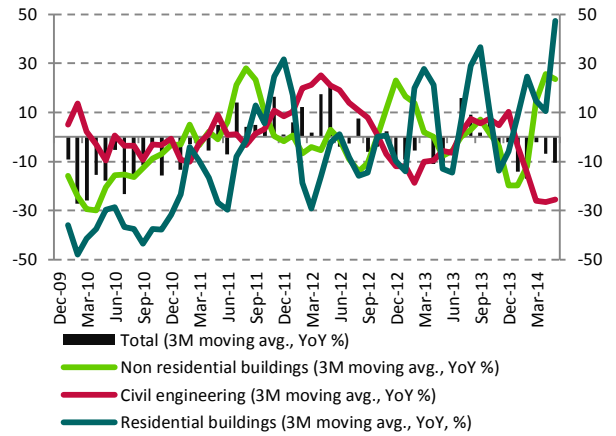
Strong exports (7.9 % YoY) in May, in line with industrial production; imports rose by 8.1% YoY


Source: NIS

Construction works are in free fall (-10.7% YoY) as civil engineering works still bleed (-28.9% YoY) due to falling public investments. Residential buildings are the only subpart that has gained speed in the past 6M and skyrocketed in May (+129.1% YoY). Meanwhile, we see that building permits are still on the rise, which means we can expect further developments in the residential sector.

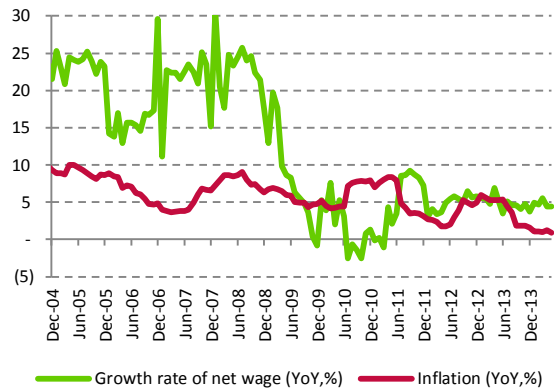
Inflation remained subdued: 0.66% YoY in June. Foods continued to be the only category where prices have been falling in the past 9M. In June, the decline was 3.2% YoY. Non food price inflation was 3% YoY while in the case of services, we are looking at disinflation: the peak was in February (+4.5% YoY) while in June services' inflation fell to 2.77% YoY. This trend has been supported by the downward path of the EUR/RON dynamics. Services' weight in the consumption basket is 18.5%, followed by food goods (37.6%) and non-food (43.9%). The low inflation rate has made possible an advance of 3.4% YoY of real wage, strongly supportive for consumption. Meanwhile, net wages grew by 4.4% YoY.

Stellar growth in the residential segment but overall constructions down by 10.7% YoY in May



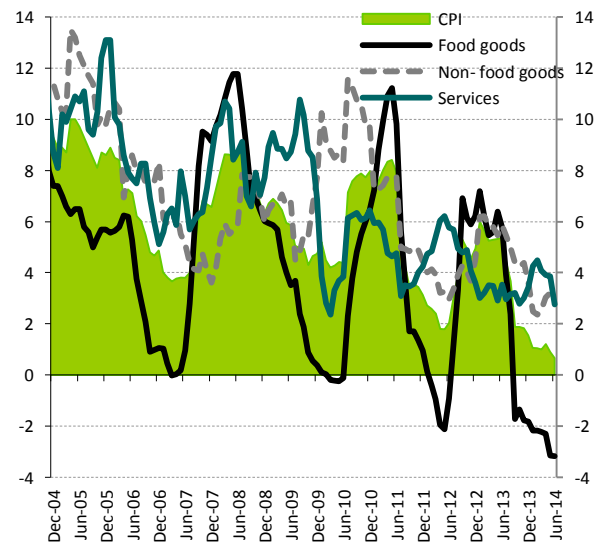
Source: NIS

Net wage advanced by 4.4% YoY in May; real wage up 3.4% YoY



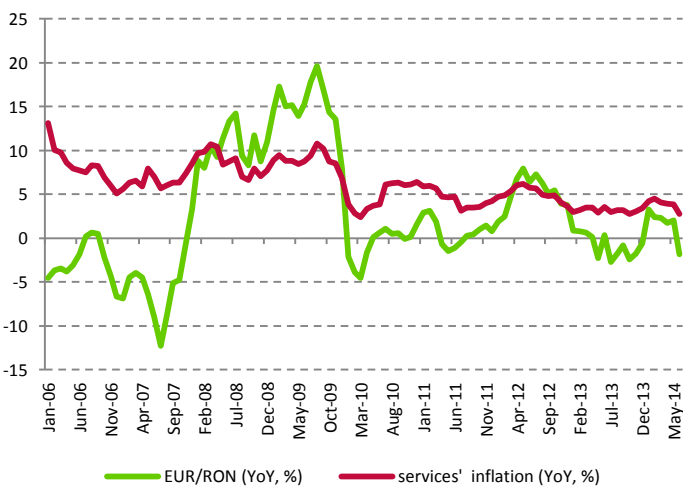
Source: NIS

Inflation stood at 0.66% YoY in June as food prices continue to exert downward pressure



Source: NIS

Correlation between EUR/RON and services' inflation is 0.49



Source: NIS, 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 |

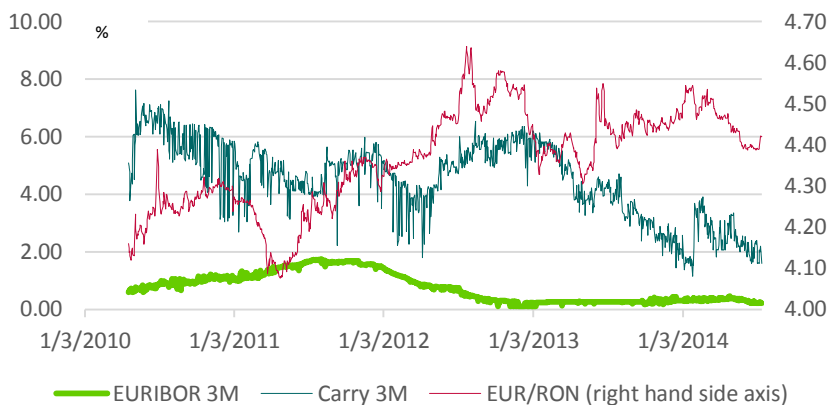
| | 1Q 2013 | 2Q 2013 | 3Q 2013 | 4Q 2013 | 1Q 2014 | 2Q 2014 | 3Q 2014 F | 4Q 2014 F | 1Q 2015 F |
|---|---------|---------|---------|---------|---------|---------|-----------|-----------|-----------|
| EUR/RON (end of period) | 4.39 | 4.48 | 4.46 | 4.46 | 4.46 | 4.39 | 4.41 | 4.44 | 4.43 |
| Central 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 | 2.42 | 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 lost 0.7% in a week

Last week tested to a small extent investors' sensitivity to negative news related to the European banking system. As soon as worries related to the solvency of Portugal's lender Banco Espirito Santo and its potential contagion effects made it to the market on Thursday, CEE currencies took a hit to the euro. We have seen the EUR/RON pair climbing to 4.42 on the interbanking market and bond yields rising by up to 8 bps, the largest in the case of 5 and 10y bonds. However on a weekly basis, only the leu depreciated against the euro while the Polish zloty and the Hungarian forint strengthened marginally. At this point, bond prices are stretched out and the upside potential of the bond market is likely exhausted, even if the NBR could cut the base rate further this year, by another 25 bps, as money market rates have decoupled from the base rate in the recent months. We therefore see the chances for another rally of the leu rather limited.

The EUR/RON moves up to 4.42



Source: Reuters

Daily EUR/RON Chart



Source: Reuters

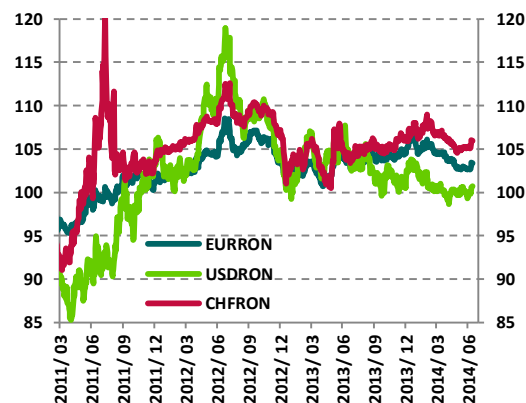
| | |
|---------------------------------|-------------------|
| Major trend: ↓ | |
| Minor trend: ↑ | |
| R1: 4.4245 | S1: 4.4140 |
| R2: 4.4290 | S2: 4.4060 |
| R3: 4.4360 | S3: 4.3990 |
| RSI: close to overbought | |

Date: 11.07.2014

| FX BID | | | | |
|-----------|-------|---|-----------------|--------------|
| | Value | | Weekly chg. (%) | YTD chg. (%) |
| EURRON | 4.42 | ↑ | 0.71 | ↓ -0.60 |
| USDRON | 3.24 | ↑ | 0.51 | ↓ -3.70 |
| CHFRON | 3.64 | ↑ | 0.88 | ↓ -1.06 |
| RONJPY | 3.20 | ↑ | 1.25 | ↓ -17.58 |
| RONPLN | 1.06 | ↑ | 0.71 | ↓ -2.10 |
| 100HUFRON | 1.42 | ↑ | 0.72 | ↓ -6.78 |
| RONCZK | 0.16 | ↑ | 0.63 | ↓ -9.21 |
| RONRUB | 0.09 | ↑ | 1.15 | ↓ -13.93 |
| RONRSD | 0.04 | ↑ | 0.84 | ↓ -3.80 |
| RONBGN | 2.25 | ↑ | 0.49 | ↓ -0.78 |

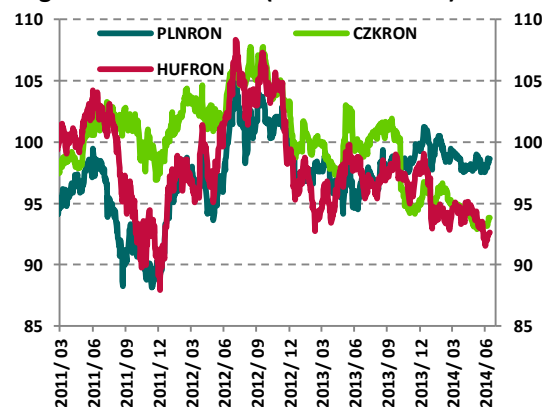
Source: Reuters

Major RON FX rates (03.01.2011=100)



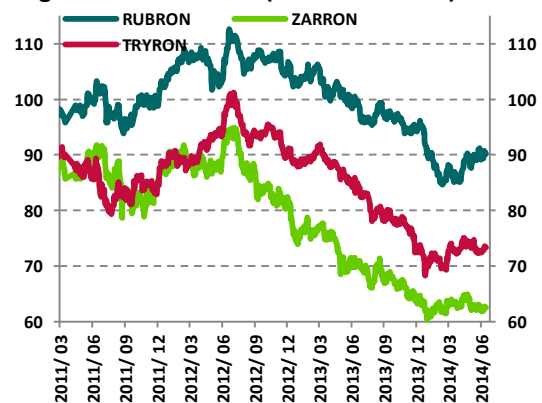
Sources: Reuters

Regional RON FX rates (03.01.2011=100)



Sources: Reuters

Regional RON FX rates (03.01.2011=100)

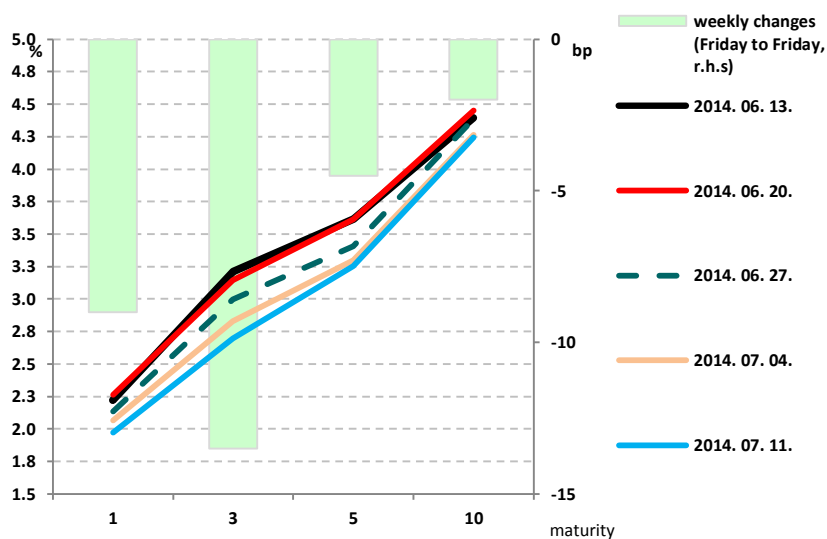


Sources: Reuters

Government securities: Bond prices at all-time highs

As the yield curve continued to shift lower, the Treasury sold the planned amount of RON 800 mn at decreasing yields. Despite the yield compression, demand remained high, with bid to cover at 2.5 for the 6Y bonds (residual maturity) and 3.9 for the 2Y bonds. The average accepted yield in the first case was 2.32%, 58 bps lower compared with the previous similar auction in mid June. The 6Y bonds sold at and average accepted yield of 3.5%, 43 bps lower than in the beginning of June. At the moment, bond prices are at all time highs and we expect a gradual correction until December. We expect the 10Y bond yield around 5% in December.

Yield curve over the past weeks (Central Bank fixing)



Source: NBR

Auctions

T-bills auctions in July (in RON)

| ISIN | Auction date | Settlement date | Maturity | Months | Indicative target amount (RON) |
|--------------|--------------|-----------------|------------|--------|--------------------------------|
| RO1415CTNOA3 | 28.07.2014 | 30.07.2014 | 29.07.2015 | 12 | 1.000.000.000 |

Source: The Ministry of Finance

Bonds auctions in July (in RON)

| ISIN | Auction date | SSON auction date | Settlement date | Maturity | Years | Residual Maturity | Indicative target amount (RON) | Indicative target amount SSON* (RON) |
|--------------|--------------|-------------------|-----------------|------------|-------|-------------------|--------------------------------|--------------------------------------|
| RO1320DBN022 | 07.07.2014 | 08.07.2014 | 09.07.2014 | 29.04.2020 | 7.0 | 5.8 | 400.000.000 | 60.000.000 |
| RO1316DBN053 | 10.07.2014 | 11.07.2014 | 14.07.2014 | 29.08.2016 | 3.0 | 2.1 | 400.000.000 | 60.000.000 |
| RO1419DBN014 | 14.07.2014 | 15.07.2014 | 16.07.2014 | 24.06.2019 | 5.0 | 4.9 | 500.000.000 | 75.000.000 |
| RO1215DBN073 | 17.07.2014 | 18.07.2014 | 21.07.2014 | 26.10.2015 | 3.0 | 1.3 | 300.000.000 | 45.000.000 |
| RO1121DBN032 | 21.07.2014 | 22.07.2014 | 23.07.2014 | 11.06.2021 | 10.0 | 6.9 | 300.000.000 | 45.000.000 |
| RO1318DBN034 | 24.07.2014 | 25.07.2014 | 28.07.2014 | 28.11.2018 | 5.0 | 4.3 | 300.000.000 | 45.000.000 |
| RO1425DBN029 | 28.07.2014 | 29.07.2014 | 30.07.2014 | 24.02.2025 | 10.0 | 10.6 | 500.000.000 | 75.000.000 |

Source: The Ministry of Finance

Last week's auctions

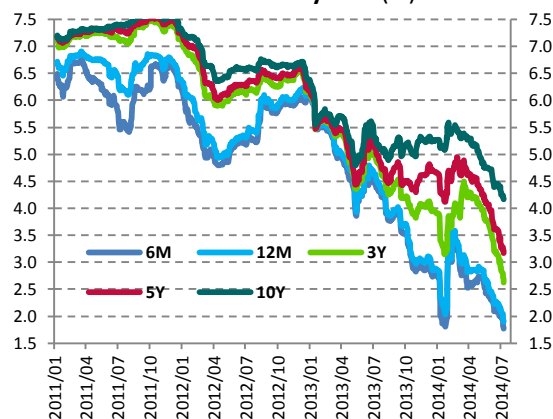
| | RO1316DBN053 | RO1320DBN022 |
|----------------------------|--------------|--------------|
| Offered amount (mn RON) | 400 | 400 |
| Total bids (mn RON) | 1567 | 1019 |
| Accepted amount (mn RON) | 400 | 400 |
| Average accepted yield (%) | 2.32 | 3.50 |
| Coupon | 4.75 | 5.75 |

Source: NBR

Date: 11.07.2014

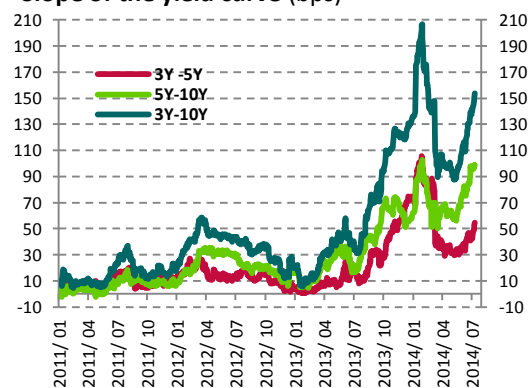
| RON GOVERNMENT SECURITIES | | | | |
|---------------------------|------------|------------------|---------------|--|
| | Value (%) | Weekly chg. (bp) | YTD chg. (bp) | |
| 6M | 1.85 | ↓ -12 | ↓ -91 | |
| 12M | 1.98 | ↓ -9 | ↓ -89 | |
| 3Y | 2.70 | ↓ -14 | ↓ -122 | |
| 5Y | 3.26 | ↓ -4 | ↓ -140 | |
| 10Y | 4.25 | ↓ -2 | ↓ -103 | |
| SPREADS | | | | |
| | Value (bp) | Weekly chg. (bp) | YTD chg. (bp) | |
| GERROM 3Y | 264 | ↓ -14 | ↓ -90 | |
| GERROM 5Y | 291 | ↓ -5 | ↓ -82 | |
| GERROM 10Y | 298 | ↓ -2 | ↓ -35 | |
| 3Y -5Y | 56 | ↑ 9 | ↓ -18 | |
| 5Y -10Y | 99 | ↑ 2 | ↑ 37 | |
| 3Y-10Y | 155 | ↑ 12 | ↑ 19 | |
| FLY 3-5-10 | 43 | ↓ -7 | ↑ 55 | |
| CDS MID SPREADS | | | | |
| | Value (bp) | Weekly chg. (bp) | YTD chg. (bp) | |
| 3Y EURO | 68 | ↑ 0 | ↓ -49 | |
| 5Y EURO | 120 | ↓ 0 | ↓ -51 | |

Government benchmark yields (%)



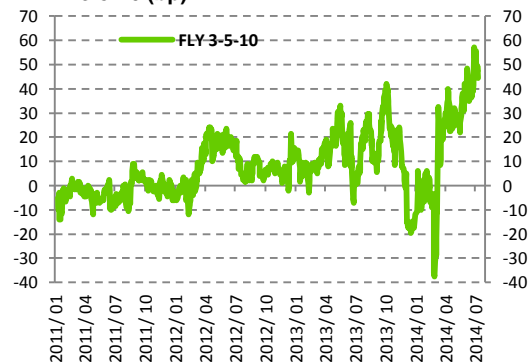
Source: NBR

Slope of the yield curve (bps)



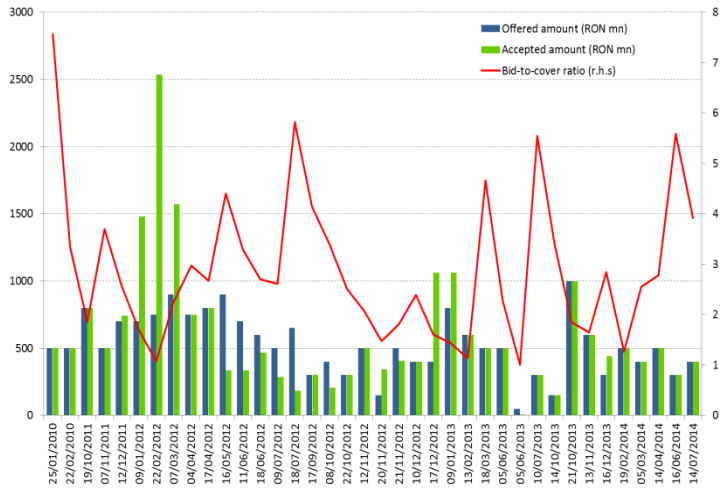
Source: NBR

FLY 3-5-10 (bp)



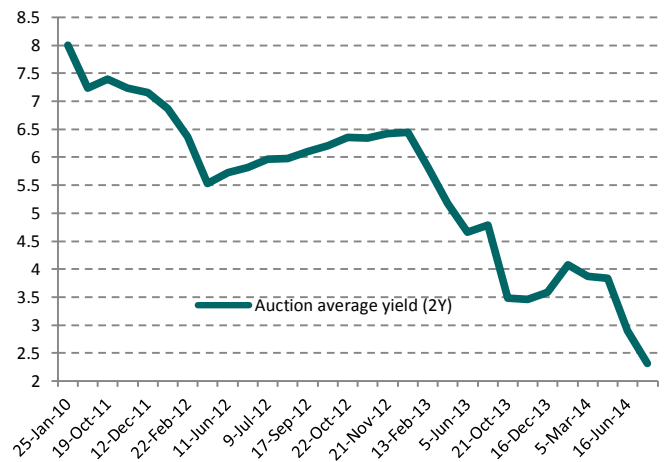
Source: NBR

2Y Auctions



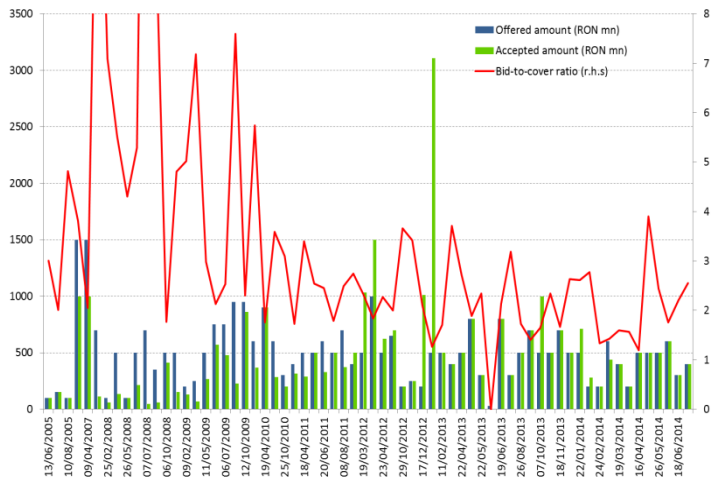
Source: NBR

2Y Interest rate



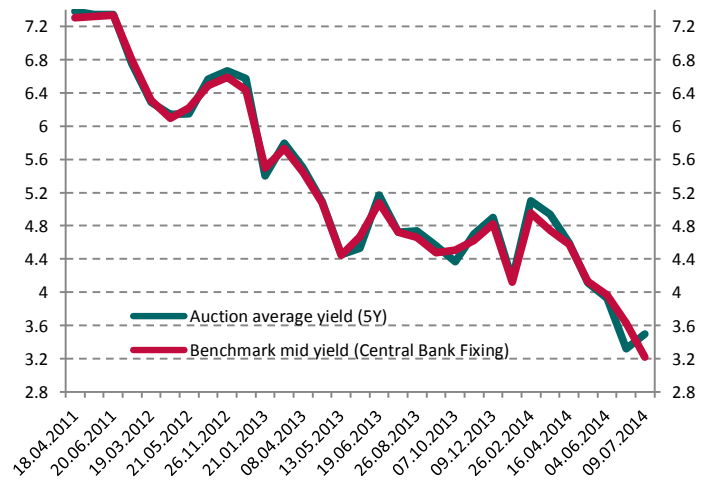
Source: NBR

5Y Interest rate



Source: NBR

5Y Interest rate



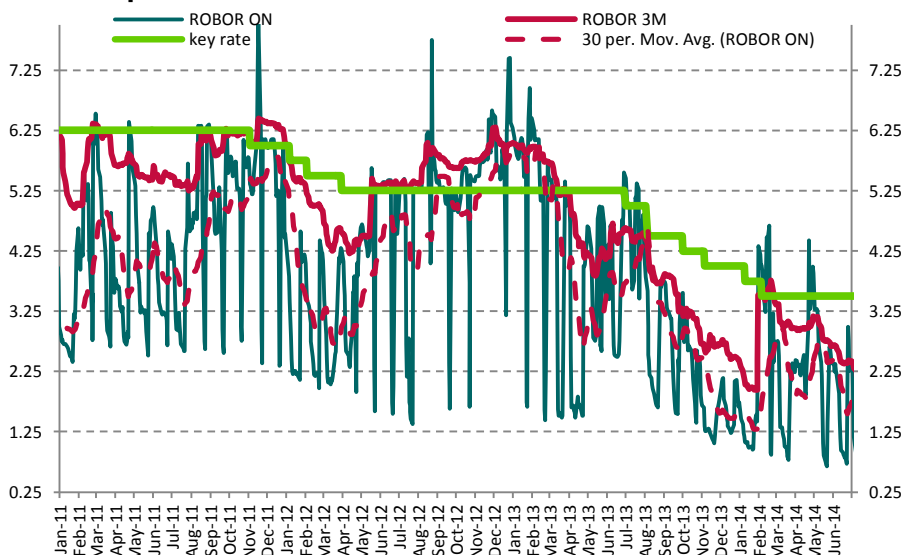
Source: NBR

MM: Chances for a base rate cut have increased

The new inflation data came significantly below Central Bank's expectations for June and surprised the market as well, even if it had already anticipated a much lower figure compared to the NBR. The annual inflation figure stood at 0.66% YoY whereas the official NBR forecast stood at 1.4%YoY and the market was expecting 0.9% YoY. Other inflation measures also lagged behind the NBR forecast, by a smaller distance: core 2 adjusted inflation, which gives the trend, stood at -0.6% YoY versus -0.3% YoY. The next monetary policy session is on 4th of August, when a new inflation forecast will also be released. For the moment, the data suggests that inflation could remain below the 3% level by the end of the year, but upward risks remain. In our opinion, the most important one could be the depreciation of the leu. This could follow as a result of some exits from the bond market, cumulated with renewed tensions around presidential elections and the not so rosy fiscal outlook. However, given the latest inflation reading, the chances of NBR cutting the base rate have increased.

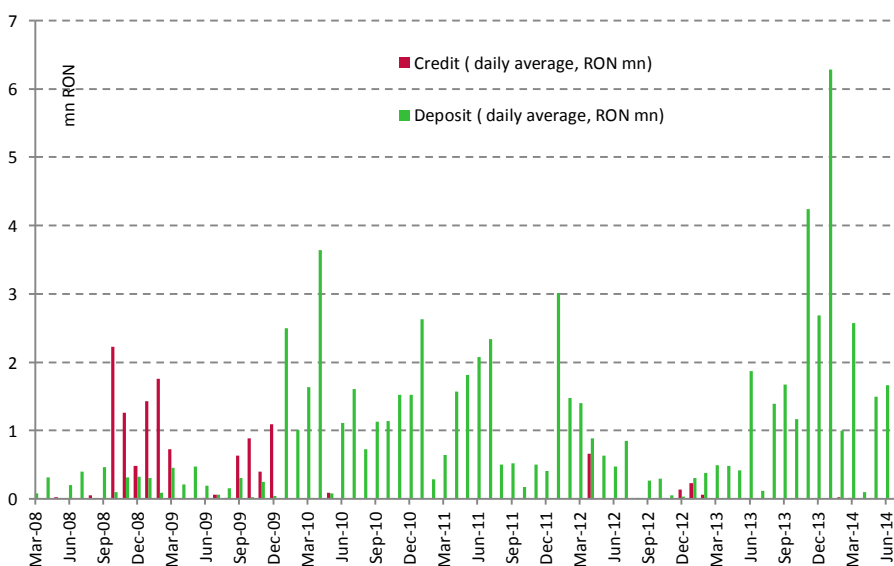
Even if money market rates are significantly below the base rate, the excess liquidity is not so high. The ON deposits placed with NBR stood at RON 1.6 bn/day (flow) in June, compared to RON 6.6 bn/day in January.

Most important MM rates



Sources: NBR

The standing facilities with NBR Excess liquidity is not so high



Sources: NBR

Date: 11.07.2014

| MID INTEREST RATES | | | | |
|--------------------|-----------|------------------|---------------|--|
| | Value (%) | Weekly chg. (bp) | YTD chg. (bp) | |
| repo rate | 3.50 | 0 | -50 | |
| ROBOR ON | 1.20 | 4 | -54 | |
| ROBOR 3M | 2.23 | -7 | -21 | |
| ROBOR 6M | 2.56 | -8 | -43 | |
| ROBOR 9M | 2.61 | -8 | -49 | |
| ROBOR 1Y | 2.61 | -12 | -54 | |

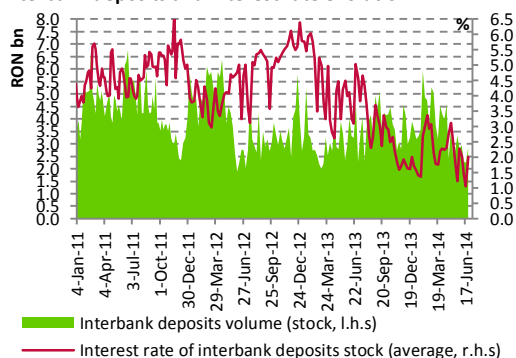
| INTERBANK DEPOSITS | | | |
|--------------------|----------------|-------------------|-------------------|
| | Value (mn RON) | Wly chg. (mn RON) | YTD chg. (mn RON) |
| outstanding | 1,945.9 | -212.1 | -2693.3 |

| MID SWAP POINTS | | | |
|-----------------|------------|------------------|---------------|
| | Value (bp) | Weekly chg. (bp) | YTD chg. (bp) |
| USD RON 1W | 4 | -4 | -3 |
| USD RON 1M | 50 | 11 | 17 |
| USD RON 3M | 131 | 26 | 15 |
| EUR RON 1W | 12 | 2 | 1 |
| EUR RON 1M | 36 | -17 | -7 |
| EUR RON 3M | 209 | 36 | 8 |

| MID EUR BASIS SWAPS | | | |
|---------------------|------------|------------------|---------------|
| | Value (bp) | Weekly chg. (bp) | YTD chg. (bp) |
| EUR RON 1Y | -70 | 10 | 40 |
| EUR RON 3Y | -60 | 10 | 50 |
| EUR RON 5Y | -60 | 10 | 50 |

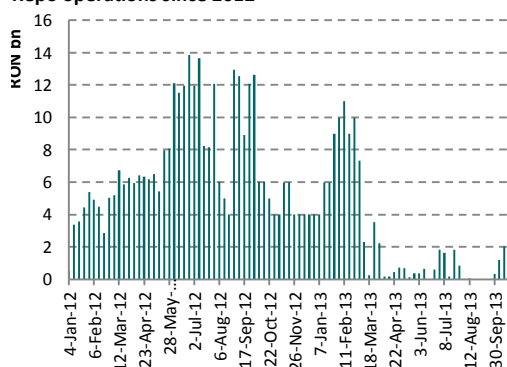
Sources: Reuters

Interbank deposits and interest rate evolution



Sources: NBR

Repo operations since 2012



Sources: NBR

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