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Weekly Report

Romania

21 July 2014

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The leu and bond prices suffered corrections

Macroeconomics: EU funds absorption under alert (Page 3- 4)

The current account deficit stood at EUR 351 mn during the first 5M, compared to a surplus of EUR 191 mn in the same period last year. The main source for this difference comes from the nearly double income gap, of EUR 2.3 bn during the first 5M. In fact on a 12M rolling basis, we see that in May net direct investment income outflows reached levels last seen in H1 2008, when the impact of the crisis was not yet felt and FDI funded businesses were posting significant gains. On a 12M rolling basis, we notice the CA deficit rose significantly compared to April, to EUR 2.1 bn. The driver was not the trade gap which widened insignificantly, but the current transfers that have fallen back by EUR 683 mn in May versus the previous month. Basically, there is a setback in the EU funds absorption: the monthly figures for April and May are below the monthly average of H1 2013, when several EU programs were blocked.

FX market: the leu climbed to 4.45 (Page 5 - 6)

Last week's geopolitical events weighed further on the leu. The US - Russia – Ukraine triangle is heating up, after US posed more economic sanctions on Russia and a civil airplane crashed while flying over the Ukrainian territory. At this point, the most negative effect that hits the leu as well is the deteriorated investor perception. However, these events only bring forward a move of the leu that was expected, considering that at this time, bond prices are high and are still bound to suffer more correction. Also, the monetary policy is expected to be further relaxed or at a minimum stay the same in the near term. The current account deficit is also seen to widen moderately. Balance of payments data up to May also points to a worrisome situation, related to the absorption of EU funds which seems to have slowed down. Additionally, ahead of presidential elections in November investors will witness electoral promises that could trigger a pause in fiscal consolidation in 2015.

Fixed income markets: bond prices started to correct (Page 7 - 8)

The yield curve shifted up by 2 to 11 bps in a week marked by several domestic and external events. However, prices have still to adjust from the current levels. The Russian - Ukrainian conflict may have triggered some bonds sell off by foreigners but this move was bound to happen and likely to continue as the appreciation potential for bonds has vanished, especially for the 3Y-5Y maturities. The Treasury sold bonds with residual maturity of 1.3 and 4.9 years at average accepted yields of 2.29% and 3.3%, respectively. Compared to previous auctions they were lower around 20 bps.

Money markets: eyes on liquidity (Page 9)

Liquidity conditions remain good, especially as we entered the final week of the current mandatory reserves period. Looking forward, we expect liquidity to remain under good parameters, given that on 28th July RON 5.8 mn in bonds come to maturity and that this month, net government debt issuance will be negative. However, as we saw from the reading of ON deposits placed by banks at the standing facility of NBR, the excess liquidity is not high. Also, according to the latest official reading that dates back in April, the net liquidity position of the banking system slipped into the negative territory and the NBR even had to inject some liquidity through one week repo operations. Since then, we have not witnessed a drastic improvement. Additionally, July also has a seasonal component due to the quarterly payments to the state budget. Therefore, liquidity conditions could maintain at good levels in the short term, but an increase in risk aversion could send rates significantly higher relatively fast.

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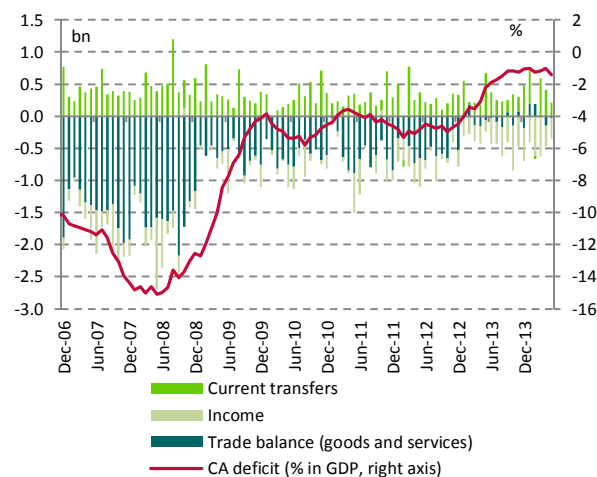
Macroeconomics: EU funds absorption under alert

PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
14 Jul	May	CA balance (EUR mn, YTD)	-351.0	-297.0
14 Jul	May	FDI (EUR mn, YTD)	1091.0	786.0
21 July - 25 July		no data		

The current account deficit stood at EUR 351 mn during the first 5M, compared to a surplus of EUR 191 mn in the same period last year. The main source for this difference comes from the nearly double income gap, of EUR 2.3 bn during the first 5M. In fact on a 12M rolling basis, we see that in May net direct investment income outflows reached levels last seen in H1 2008, when the impact of the crisis was not yet felt and FDI funded businesses were posting significant gains. According to latest detailed data from Eurostat, the level of net losses consolidated in FDI has been dropping significantly and dividends sent abroad by FDI firms have outpaced by far the level of losses (please see graphs below).

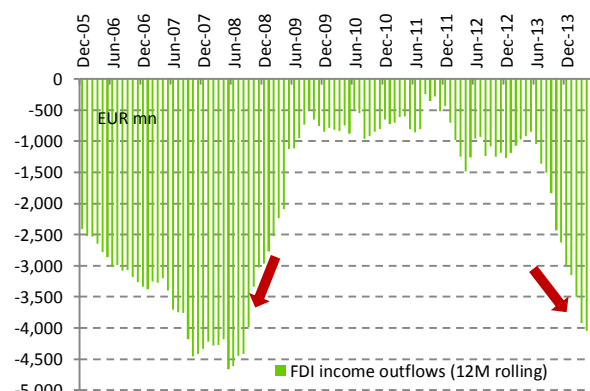
On a 12M rolling basis, we notice the CA deficit rose significantly compared to April, to EUR 2.1 bn. The driver was not the trade gap which widened insignificantly, but the current transfers that have fallen back by EUR 683 mn in May versus the previous month. Basically, there is a setback in the EU funds absorption: the monthly figures for April and May are below the monthly average of H1 2013, when several EU programs were blocked.

The CA deficit widens to EUR 2.1 bn (12M rolling) in May, from EUR 1.5 bn in April



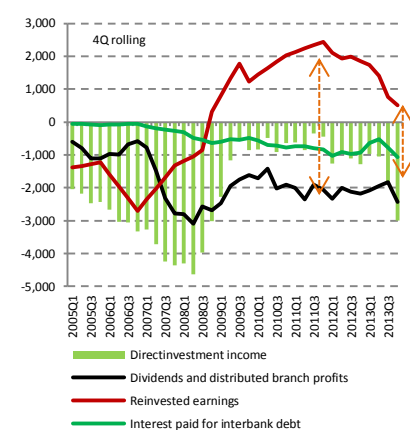
Source: NBR

Income (12M rolling) outflows from FDI funded companies rose to 2008 levels



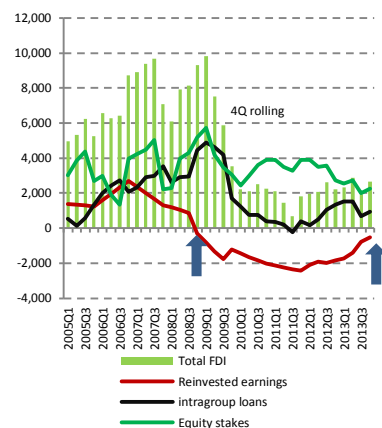
Source: NBR

Direct investment income structure: dividends surpassed by far net losses



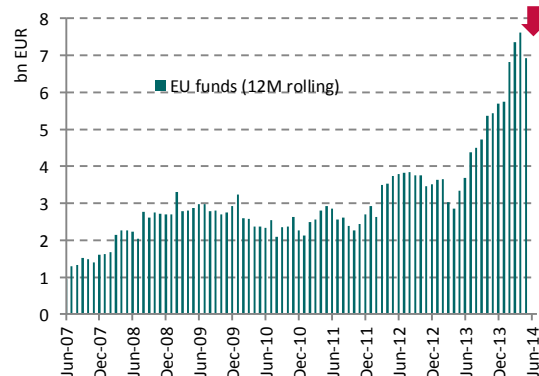
Source: Eurostat

FDI structure: net losses incorporated in FDI are decreasing



Source: Eurostat

EU funds (12M rolling) dropped in May by ~ EUR 700 mn compared to April



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	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

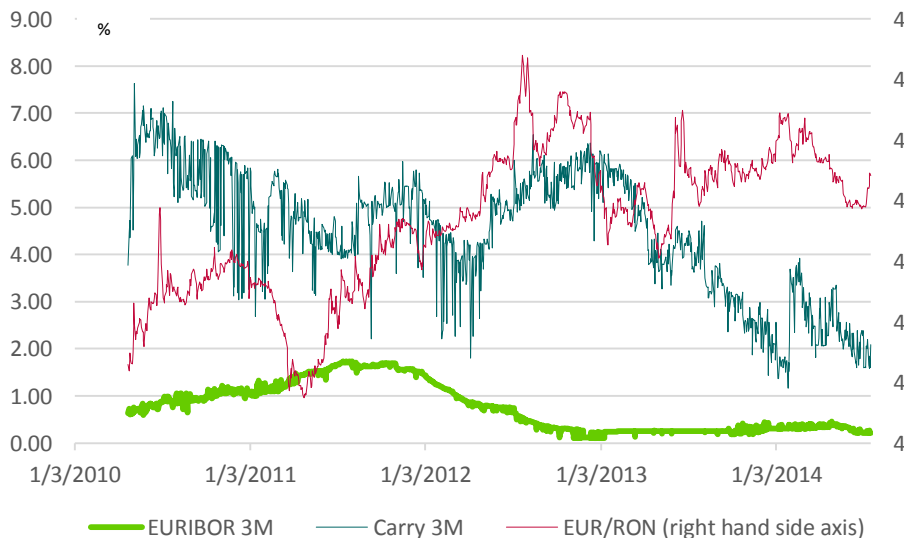
Source: Eurostat, NIS, NBR, OTP Research

FX markets: the leu climbed to 4.45

Last week's geopolitical events weighed further on the leu. The US - Russia – Ukraine triangle is heating up, after US posed more economic sanctions on Russia and a civil airplane crashed while flying over the Ukrainian territory. At this point, the most negative effect that hits the leu as well is the deteriorated investor perception. However, **these events only bring forward a move of the leu that was expected**, considering that at this time, **bond prices are high** and are still bound to suffer more correction. Also, the **monetary policy is expected to be further relaxed** or at a minimum stay the same in the near term. The current account deficit is also seen to widen moderately. Balance of payments data up to May also points to a worrisome situation, related to the **absorption of EU funds which seems to have slowed down**. Additionally, ahead of presidential elections in November investors will witness electoral promises that could trigger a **pause in fiscal consolidation in 2015**.

The solidity of the fiscal promises launched by the current government is being challenged but so far the arguments proved to be weak: the strong measure proposed by the government, to cut the social contributions by 5pp has yet to prove viable. In a meeting held at Cotroceni last week, the PM and the finance minister did not unveil hard numbers that could cover the RON 4.8 bn gap in the 2015 budget.

The leu depreciated 0.9% in one week



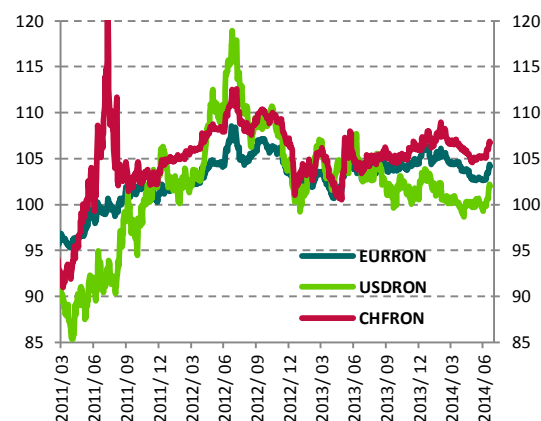
Source: Reuters

Date: 18.07.2014

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4.44	↑	0.87	↓ -0.07
USDRON	3.28	↑	1.48	↓ -2.49
CHFRON	3.66	↑	0.87	↓ -0.52
RONJPY	3.24	↑	1.64	↓ -16.37
RONPLN	1.07	↑	0.63	↓ -1.81
100HUFRON	1.42	↑	0.40	↓ -6.47
RONCZK	0.16	↑	0.87	↓ -8.65
RONRUB	0.09	↓	-2.04	↓ -15.55
RONRSD	0.04	↑	0.54	↓ -3.39
RONBGN	2.27	↑	0.86	↓ -0.04

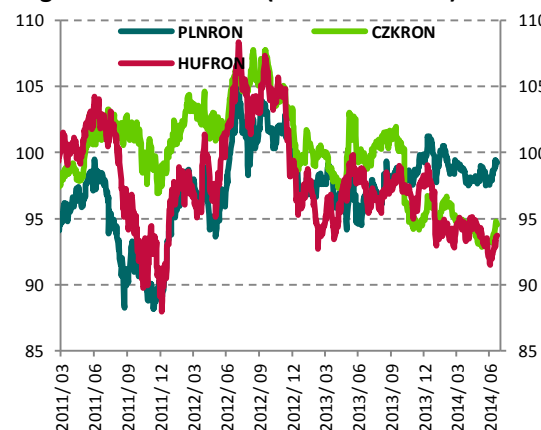
Source: Reuters

Major RON FX rates (03.01.2011=100)



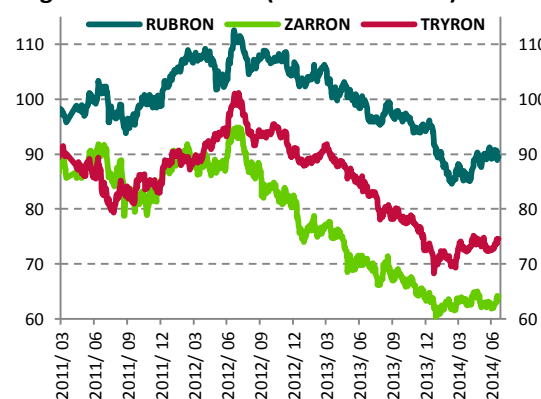
Sources: Reuters

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

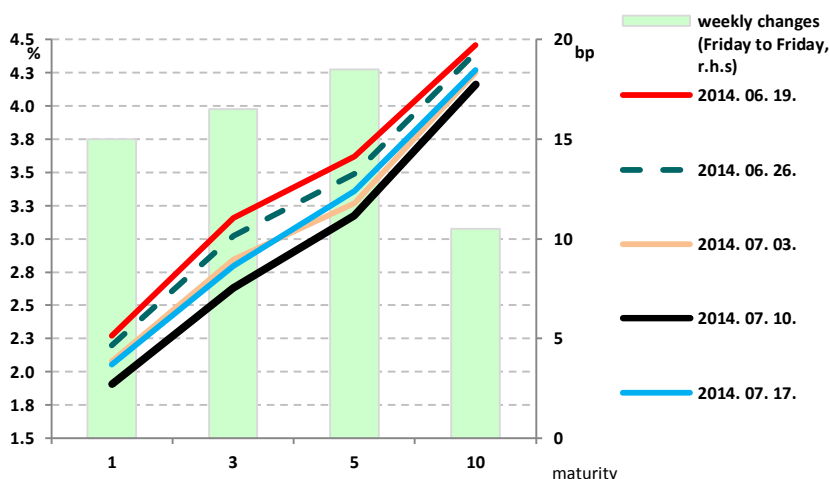
Major trend: ↓	
Minor trend: ↑	
R1: 4.4630	S1: 4.4420
R2: 4.4720	S2: 4.4310
R3: 4.4920	S3: 4.41
RSI: overbought	

Government securities: Bond prices started to correct

The yield curve shifted up by 2 to 11 bps in a week marked by several domestic and external events. However, **prices have still to adjust from the current levels**. Domestically, discussions over the sustainability of the 5pp reduction in social contributions are heating up, considering the significant effect on next year's budget (0.7% of GDP calculated by the government). Against this background, the Russian - Ukrainian conflict may have triggered some bonds sell off by foreigners but this move was bound to happen and likely to continue as the appreciation **potential for bonds has vanished, especially for the 3Y-5Y maturities**.

The Treasury sold bonds with residual maturity of 1.3 and 4.9 years at average accepted yields of 2.29% and 3.3%, respectively. Compared to previous auctions they were lower around 20 bps.

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

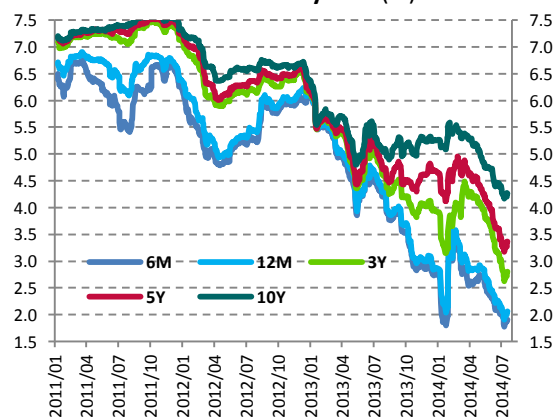
	RO1215DBN073	RO1419DBN014
Offered amount (mn RON)	300	500
Total bids (mn RON)	1108	1083
Accepted amount (mn RON)	300	500
Average accepted yield (%)	2.29	3.30
Coupon	5.80	4.75

Source: NBR

Date: 18.07.2014

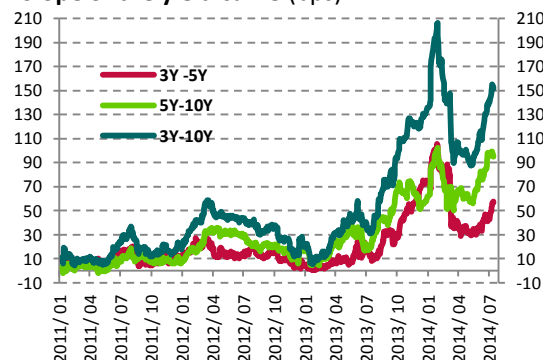
RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	1.91	↑ 7	↓ -84	
12M	2.06	↑ 9	↓ -80	
3Y	2.81	↑ 11	↓ -111	
5Y	3.36	↑ 11	↓ -129	
10Y	4.27	↑ 2	↓ -101	
SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	277	↑ 11	↓ -77	
GERROM 5Y	305	↑ 11	↓ -67	
GERROM 10Y	306	↑ 2	↓ -27	
3Y -5Y	56	↓ 0	↓ -19	
5Y -10Y	91	↓ -9	↑ 29	
3Y-10Y	146	↓ -9	↑ 10	
FLY 3-5-10	35	↓ -8	↑ 47	
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	68	→ 0	↓ -49	
5Y EURO	120	→ 0	↓ -51	

Government benchmark yields (%)



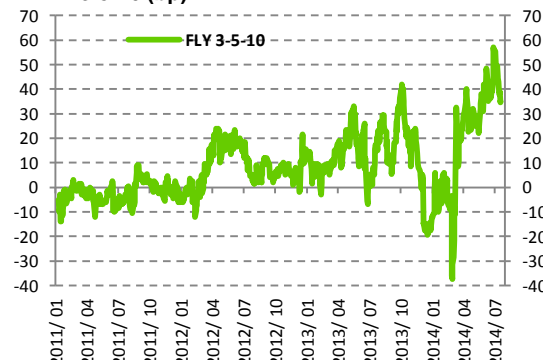
Source: NBR

Slope of the yield curve (bps)



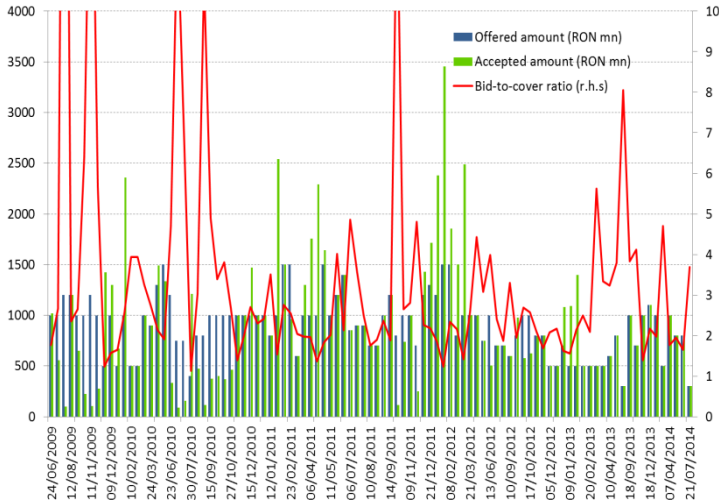
Source: NBR

FLY 3-5-10 (bp)



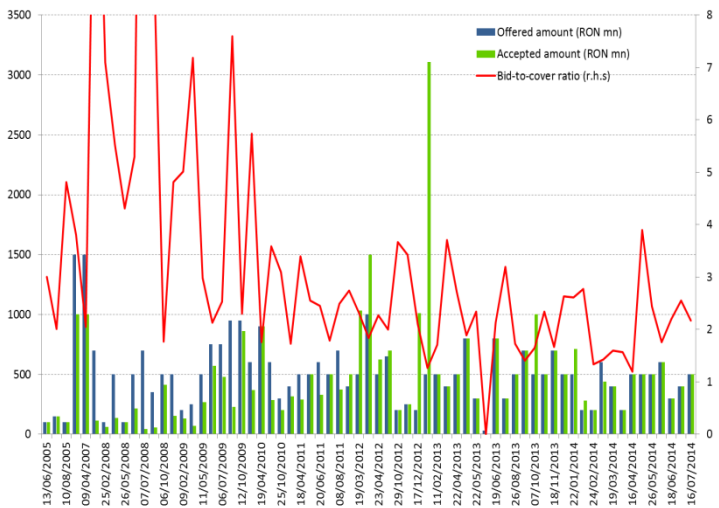
Source: NBR

1Y Auctions



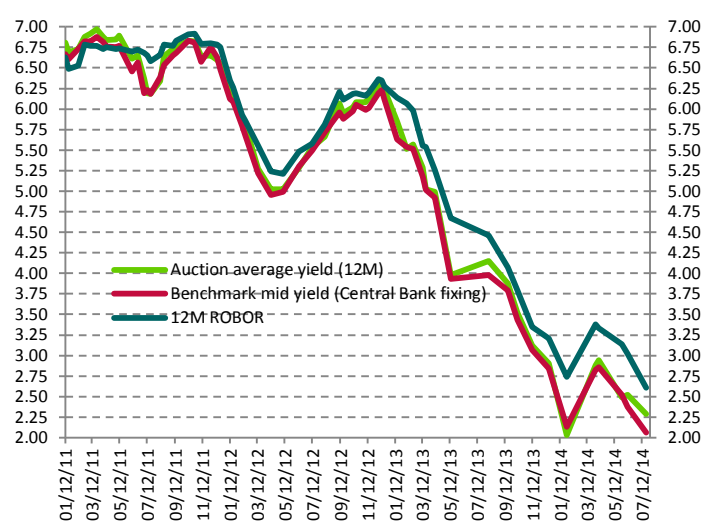
Source: NBR

5Y Interest rate



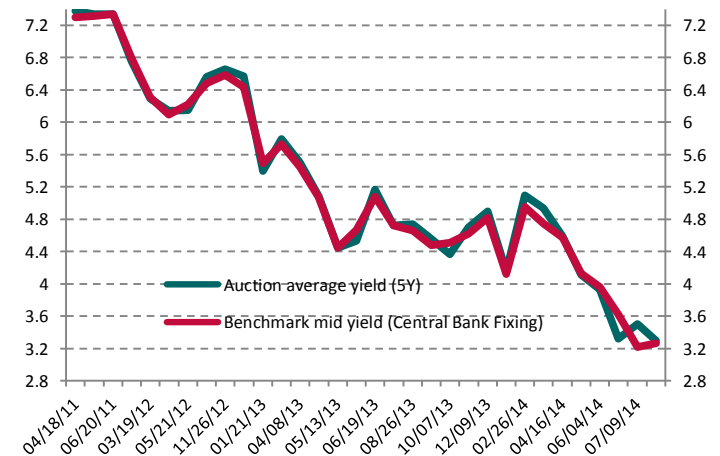
Source: NBR

1Y Interest rate



Source: NBR

5Y Interest rate

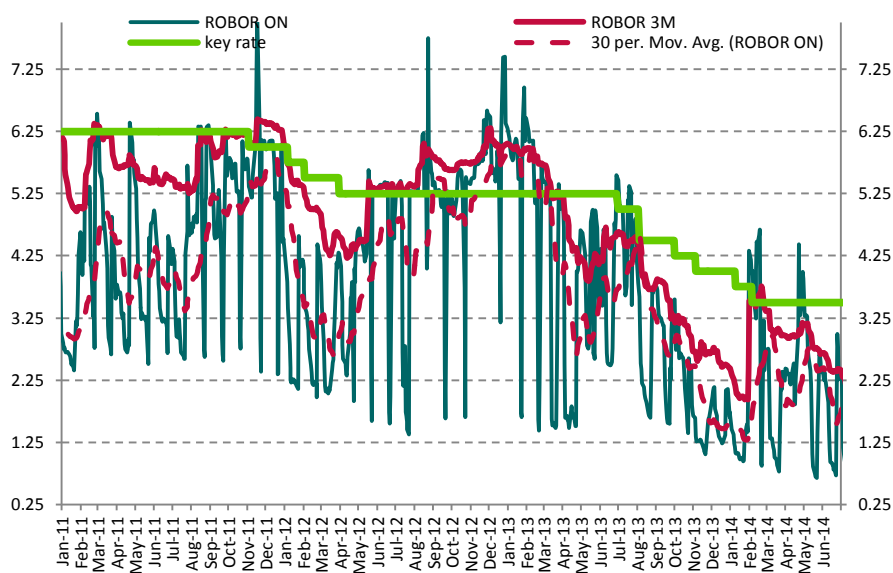


Source: NBR

MM: Eyes on liquidity

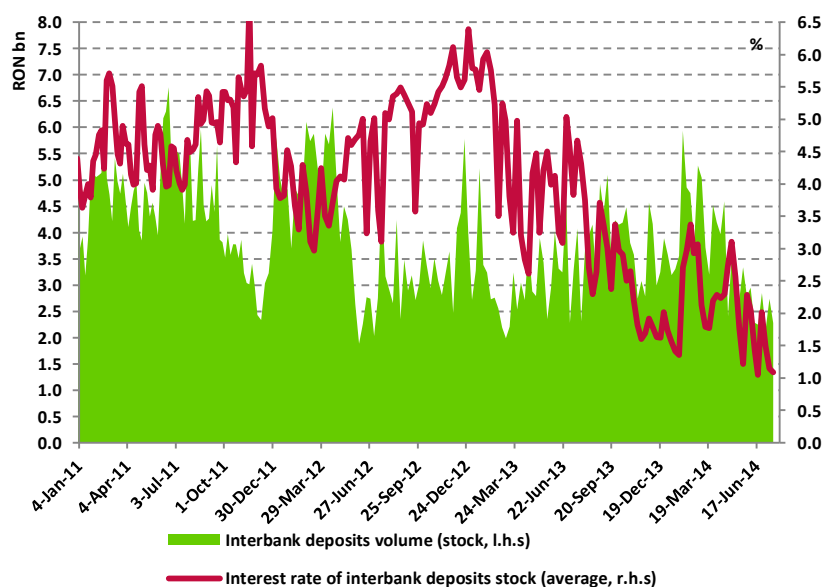
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Most important MM rates



Sources: NBR

Interbank deposits and interest rate evolution



Sources: NBR

Date: 18.07.2014

MID INTEREST RATES

	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	3.50	↔ 0	↓ -50
ROBOR ON	0.81	↓ -39	↓ -93
ROBOR 3M	2.20	↓ -3	↓ -24
ROBOR 6M	2.55	↓ -1	↓ -44
ROBOR 9M	2.64	↑ 3	↓ -46
ROBOR 1Y	2.66	↑ 5	↓ -49

INTERBANK DEPOSITS

	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	2,277.0	-461.5	-2362.2

MID SWAP POINTS

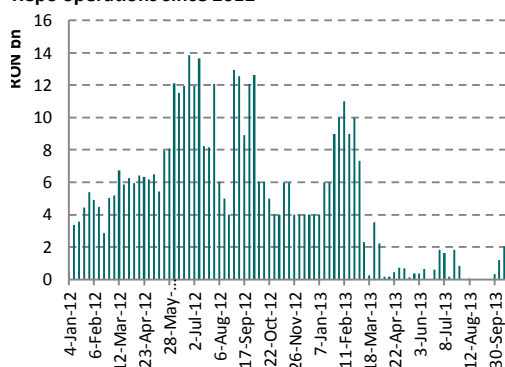
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USD RON 1W	9	↑ 5	↑ 2
USD RON 1M	52	↑ 2	↑ 19
USD RON 3M	141	↑ 10	↑ 25
EUR RON 1W	14	↑ 3	↑ 3
EUR RON 1M	74	↑ 38	↑ 31
EUR RON 3M	161	↓ -48	↓ -40

MID EUR BASIS SWAPS

	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EUR RON 1Y	-70	↔ 0	↑ 40
EUR RON 3Y	-60	↔ 0	↑ 50
EUR RON 5Y	-60	↔ 0	↑ 50

Sources: Reuters

Repo operations since 2012



Sources: NBR

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