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Weekly Report

Romania

4 Aug 2014

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To ease or not to ease further

Macroeconomics: The unemployment rate inched back to 7.1% in June (Page 2- 3)

The unemployment rate fell again in June, to 7.1%, after the sudden hike in May, to 7.3%. Romania has the 9th lowest unemployment rate in the EU. The average duration of unemployment rose to 14.5M in Q4 2013 from 13.8M in Q4 2012, according to our calculations. Residential building permits rose 7.3% YoY in June and they have been advancing strongly in the past 6M. We also continue to notice an advance in residential constructions in the urban areas, the category most hit during the crisis. We therefore expect a sustained performance in this field, after witnessing a strong increase in residential constructions in the first half of the year: the monthly average growth was stood as 36% YoY during the last 6M (until May).

FX market: Monetary and fiscal relaxation? (Page 4 - 5)

The leu weakened again and the EUR/RON pair moved higher to 4.44. The release of Q2 US GDP growth rate was the triggering event as the annualized rate stood at 4%, much higher than the consensus of economists had predicted (3% YoY). This fuelled expectations that the Fed could hike rates faster. Additionally, higher sanctions imposed on Russia contribute to a deterioration of risk perception regarding the region, even if Romania is less affected by such a move. Also, Argentina's first default in 12 years and the rescue of Banco Espirito Santo by Portugal's Central Bank add to this picture. As domestic monetary policy appears to have not decisively ended the easing cycle and as negotiations are held for further relaxation of fiscal policy, we see little scope for appreciation of the leu.

Fixed income markets: Average inflation will be 1 pp higher in 2015 (Page 6 - 7)

Bond yields added between 7-17 bps last week. The immediate reaction to the base rate cut this Monday was a decrease in yields while the Treasury rejected all bids in today's auction. We deem this reaction temporary and still expect yields to shift up, considering the uptrending inflation rate and the fact that on the money market, there is a surplus liquidity at the moment which already exercised downward pressure on yields, while the base rate has been decoupled from MM rates. In August, the Treasury plans to sell RON 2.9 bn in Ron denominated debt and EUR 250 mn in bonds with residual maturity of 4.4 years.

Money markets: The base rate was cut to 3.25% (Page 8-9)

The Central Bank cut the base rate to 3.25% and made no change to the mandatory reserves ratio. The data that tipped the balance in favour of the cut was June inflation, which came out significantly lower than the forecast made by the Central Bank: 0.7% YoY (actual) versus 1.4% YoY (the Central Bank). The average annual inflation is expected at 2.4% YoY in 2015 against 1.4% YoY in 2014. Considering the fresh view, the Governor said there could be additional easing space. However, the excess liquidity of the banking system has already pushed money market rates significantly below the base rate and therefore, this move is not likely to cause a meaningful impact. What is more, the external and domestic risks quoted in the press release are likely to exert upward pressure on money market rates especially in Q4, when presidential elections will be held and negotiations with the IMF over the 2015 budget will take place. The external risks cited by the NBR refer to potential capital outflows. We point especially to the US that is in a different stage of the business cycle and where the monetary policy will start tightening in 2015, determining yields far more attractive for foreign investors. Considering the above quoted risks, we expect another cut of the mandatory reserve ratio in Q4, that could partially offset the effects of increased risk aversion on the MM.

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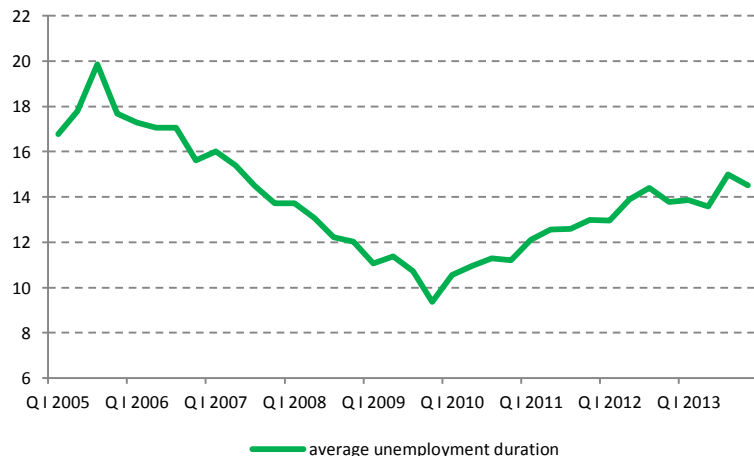
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Macroeconomics: The unemployment rate inched back to 7.1% in June

	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
29 Jul	June	Bulding permits (y-o-y, %)	7.3		6.6
31 Jul	June	ILO unemployment (seasonally adjusted, %)	7.1		7.3
04 Aug	August	Base rate decision (%)	3.25	3.25	3.5
04 Aug	June	Retail trade turnover index (y-o-y, %)	10.2		9.1
04 Aug	June	Producer Price Index (y-o-y, %)	0.3		0.8
06 Aug	June	Net wage growth rate (y-o-y, %)			4.4
07 Aug	June	Industrial trade turnover index (y-o-y, %)			10.9
07 Aug	June	Index value of new orders in manufacturing (y-o-y, %)			0.4
08 Aug	June	Construction works index (y-o-y, %)			-10.6

The unemployment rate fell again in June, to 7.1%, after the sudden hike in May, to 7.3%. The total number of the unemployed is estimated at 700 thousand, lower by 5.3% YoY. Romania has the 9th lowest unemployment rate in the EU. Last time when it was reported in March 2014, total active population was 9048 thousands and employment stood at 8402 thousands. The unemployed were 656 thousand which results in an unemployment rate of 7.2%. The average duration of unemployment rose to 14.5M in Q4 2013 from 13.8M in Q4 2012, according to our calculations.

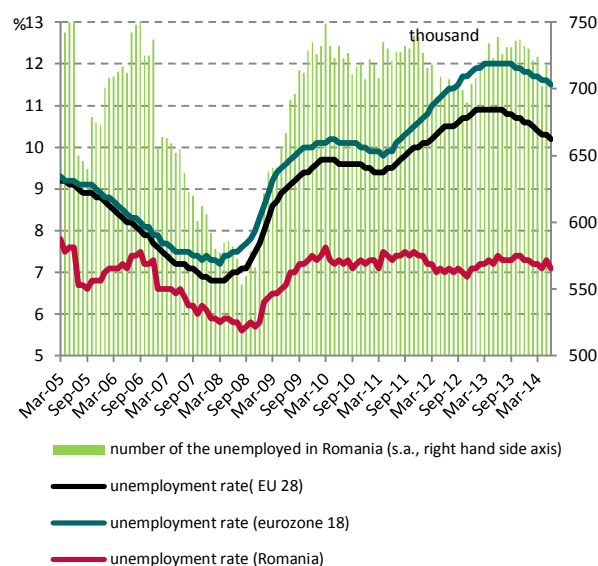
The average unemployment duration started to rise continuously since the end of 2009



Source: NIS, OTP Research calculation

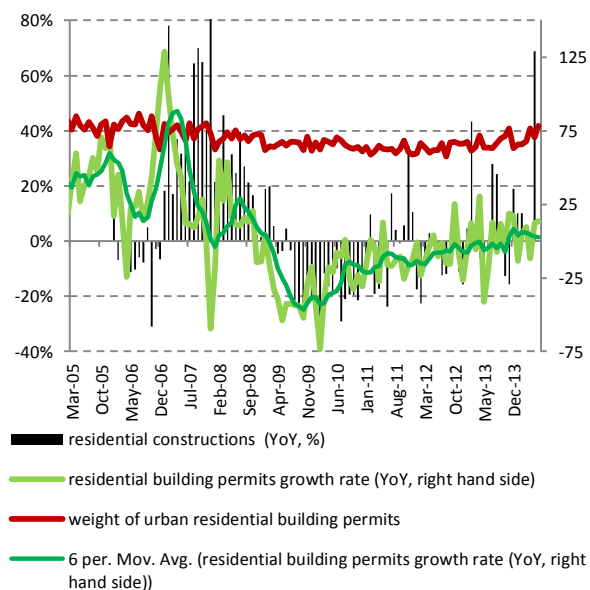
Residential building permits rose 7.3% YoY in June and they have been advancing strongly in the past 6M. We also continue to notice an advance in residential constructions in the urban areas, the category most hit during the crisis. We therefore expect a sustained performance in this field, after witnessing a strong increase in residential constructions in the first half of the year: the monthly average growth was stood as 36% YoY during the last 6M (until May). The latest data published by NIS indicated a stock of dwellings of 8.5 mn, with an annual average increase of only 46 thousand (2010 -2012), drastically reduced post crisis as the peak of 2008-2009 was 65 thousand per year.

The unemployment rate fell again in June to 7.1%



Source: Eurostat

Residential building permits continue to pace up (7.3% YoY in June)



Source:NIS

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

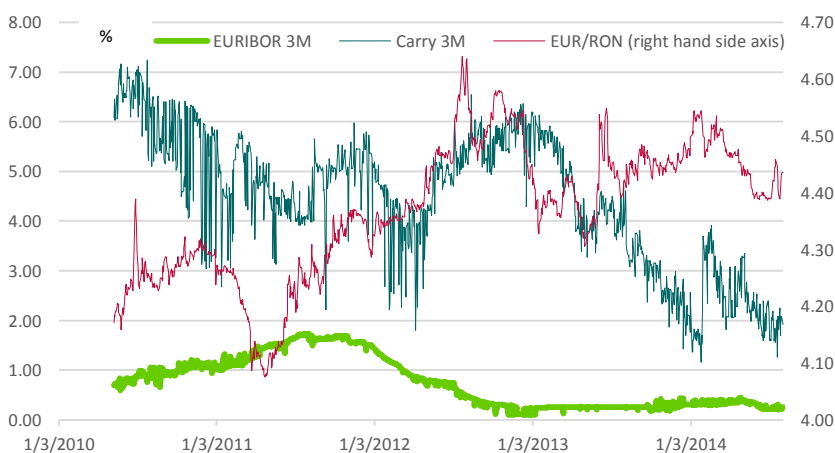
	1Q 2013	2Q 2013	3Q 2013	4Q 2013	1Q 2014	2Q 2014	3Q 2014 F	4Q 2014 F	1Q 2015 F
EUR/RON (end of period)	4.39	4.48	4.46	4.46	4.46	4.39	4.41	4.44	4.43
Central Bank Rate (%)	5.25	5.25	4.50	4.00	3.5	3.5	3.5	3.5	3.5
3-Month Robor (%)	5.35	4.45	3.65	2.58	2.97	2.42	3.02	3.21	3.31
Ten-Year Bond (% , mid yield, 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: Monetary and fiscal relaxation?

The leu weakened again and the EUR/RON pair moved higher to 4.44. The release of Q2 US GDP growth rate was the triggering event as the annualized rate stood at 4%, much higher than the consensus of economists had predicted (3% YoY). This fuelled expectations that the Fed could hike rates faster. Additionally, **higher sanctions imposed on Russia** contribute to a deterioration of risk perception regarding the region, even if Romania is less affected by such a move. Also, Argentina's first default in 12 years and the rescue of Banco Espirito Santo by Portugal's Central Bank add to this picture. **As domestic monetary policy appears to have not decisively ended the easing cycle and as negotiations are held for further relaxation of fiscal policy, we see little scope for appreciation of the leu.**

The EUR/RON back up



Source: Reuters

Daily EUR/RON chart



Source: Reuters

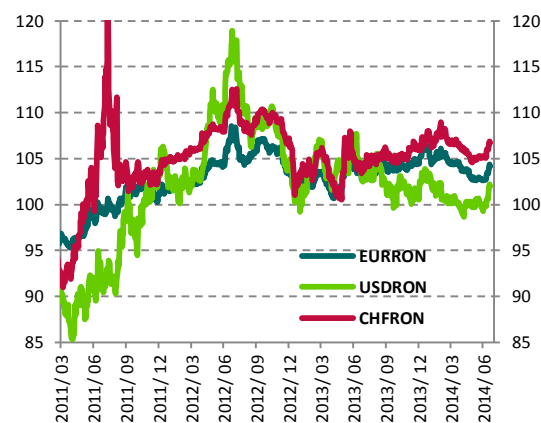
Major trend:	↓
Minor trend:	↑
R1: 4.4390	S1: 4.4280
R2: 4.4450	S2: 4.4230
R3: 4.4560	S3: 4.4120
RSI: neutral	

Date: 01.08.2014

	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

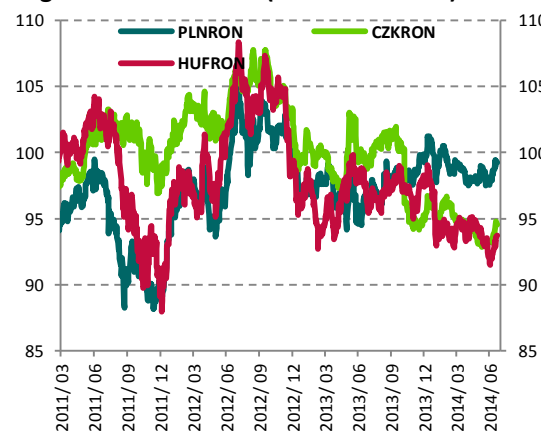
Source: Reuters

Major RON FX rates (03.01.2011=100)



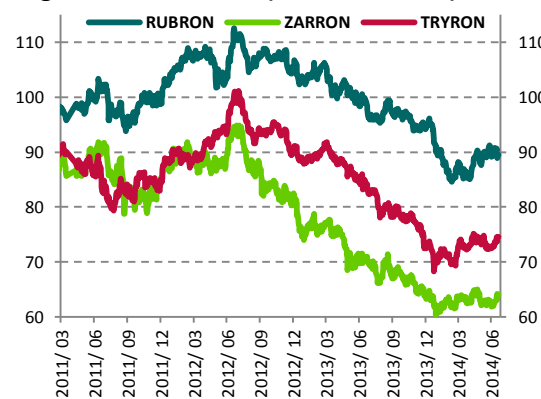
Sources: Reuters

Regional RON FX rates (03.01.2011=100)



Sources: Reuters

Regional RON FX rates (03.01.2011=100)



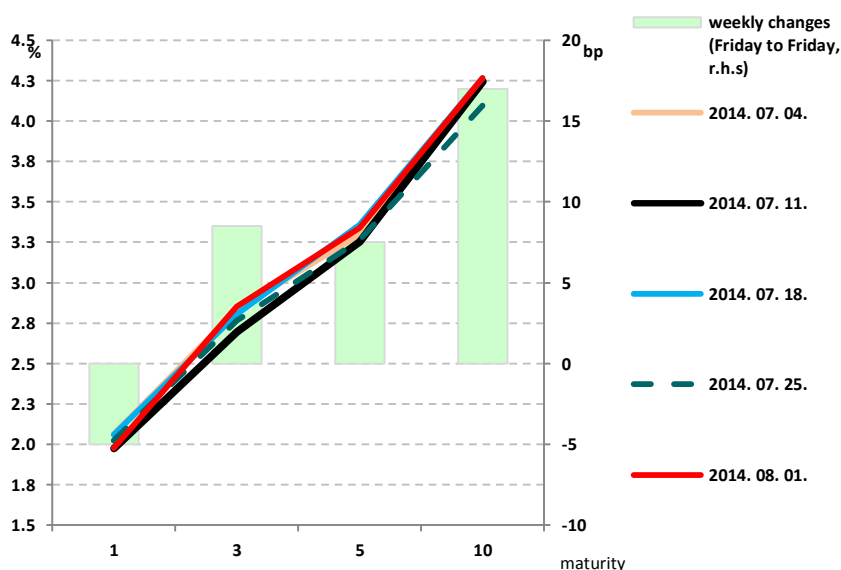
Sources: Reuters

Government securities: Average inflation will be 1 pp higher in 2015

Bond yields added between 7-17 bps last week. What set off the selloff was the expected change in Fed' s policy and the possibility that it would hike interest rate faster than initially thought, which would cause foreign investors to reassess their portfolios on a risk/reward basis. **The immediate reaction to the base rate cut this Monday was a decrease in yields while the Treasury rejected all bids in today's auction. We deem this reaction temporary** and still expect yields to shift up, considering the uptrending inflation rate and the fact that on the money market, there is a surplus liquidity at the moment which already exercised downward pressure on yields, while the base rate has been decoupled from MM rates.

Last week, the Treasury sold bonds with residual maturity of 10.6 years at 4.23%, in line with the secondary market. The 12M t-bills were sold at an average accepted yield of 1.93%. Demand was strong, as banks sought to place at least part of the government securities which came to maturity last week: RON 5.8 bn. **In August, the Treasury plans to sell RON 2.9 bn in Ron denominated debt and EUR 250 mn in bonds with residual maturity of 4.4 years.**

Yield curve over the past weeks (Central Bank fixing)



Source: NBR

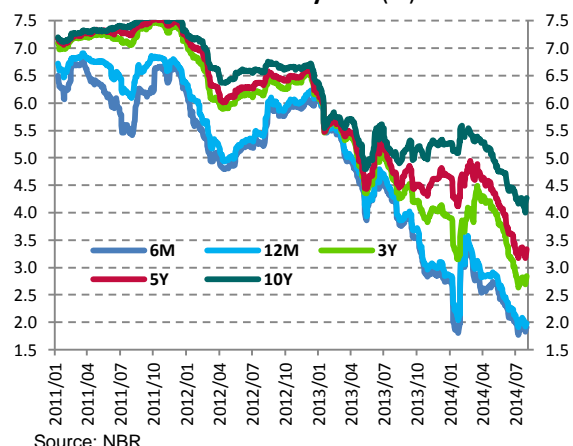
Date: 01.08.2014

RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	1.91	↑ 1	↓ -85	
12M	1.98	↓ -5	↓ -89	
3Y	2.85	↑ 9	↓ -106	
5Y	3.34	↑ 7	↓ -131	
10Y	4.27	↑ 17	↓ -101	

SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	280	↑ 9	↓ -74	
GERROM 5Y	304	↑ 7	↓ -69	
GERROM 10Y	312	↑ 17	↓ -21	
3Y -5Y	49	↓ -1	↓ -25	
5Y -10Y	93	↑ 10	↑ 31	
3Y-10Y	142	↑ 9	↑ 6	
FLY 3-5-10	44	↑ 11	↑ 56	

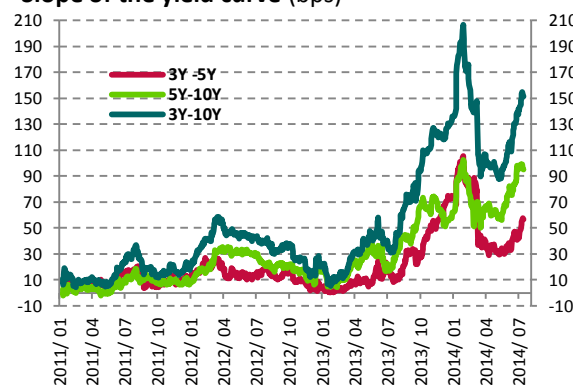
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	72	↑ 1	↓ -45	
5Y EURO	124	↑ 1	↓ -47	

Government benchmark yields (%)



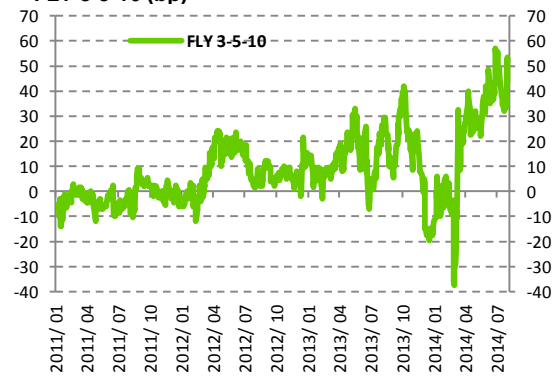
Source: NBR

Slope of the yield curve (bps)



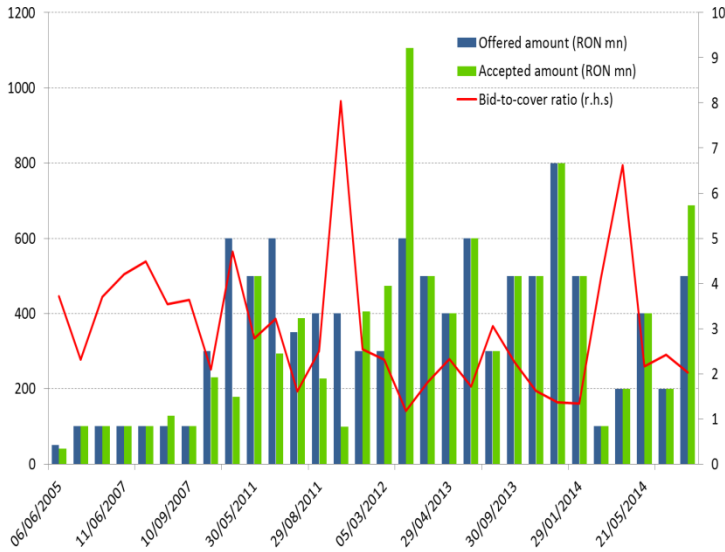
Source: NBR

FLY 3-5-10 (bp)



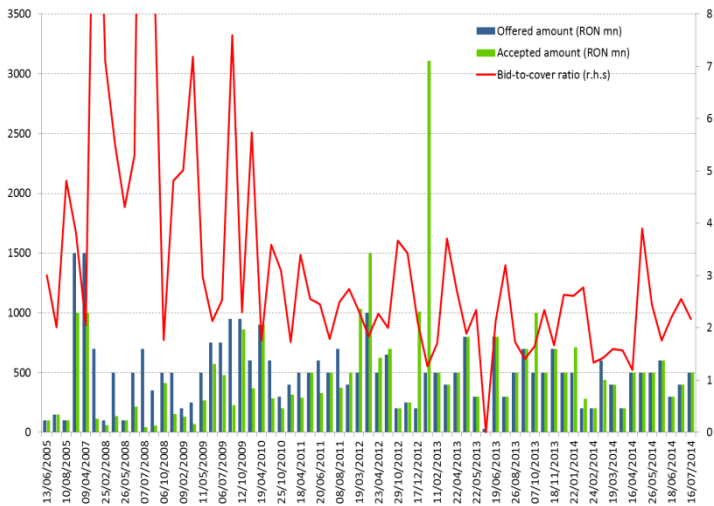
Source: NBR

10Y Auctions



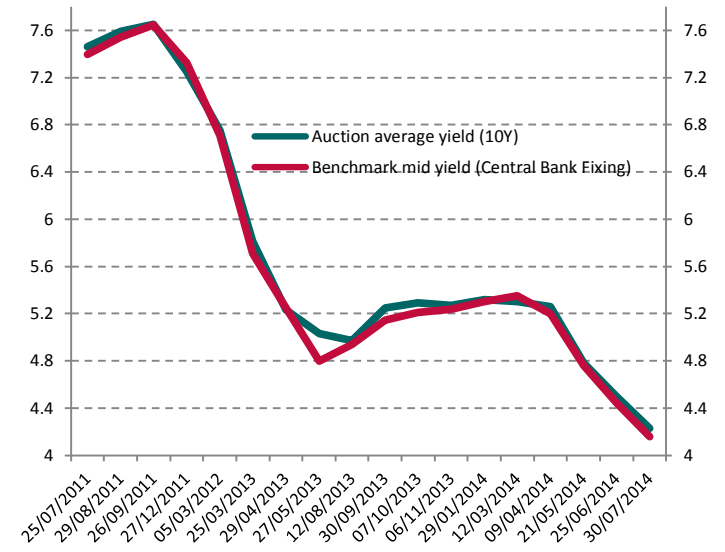
Source: NBR

12M Auctions



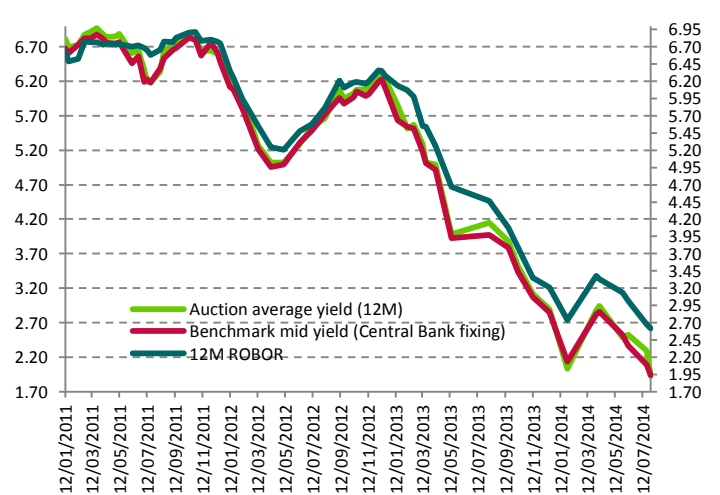
Source: NBR

10Y Interest rates



Source: NBR

12M Interest rates



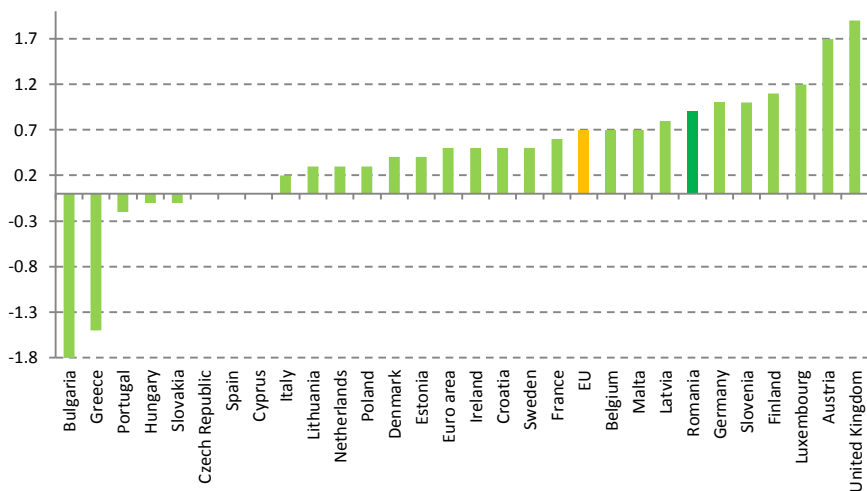
Source: NBR

MM: The base rate was cut to 3.25%

The Central Bank cut the base rate to 3.25% and made no change to the mandatory reserves ratio. The move was expected by most economists including us, according to a Bloomberg survey. The data that tipped the balance in favour of the cut was June inflation, which came out significantly lower than the forecast made by the Central Bank: 0.7% YoY (actual) versus 1.4% YoY (the Central Bank). Core 2 adjusted inflation (excludes volatile items, administered prices, alcohol and tobacco) was lower as well: -0.6% YoY (actual) against -0.3% YoY (the Central Bank). **The phenomenon of low inflation is not characteristic only to Romania:** the highest inflation rate in the EU was recorded in the UK in June, at 1.9% YoY while the lowest was posted by Bulgaria, at -1.8% YoY in June. (please see the graph below).

The Central Bank cut the inflation forecast from 3.3% YoY in December 2014 to 2.2% YoY and from 3.3% YoY in December 2015 to 3%YoY. Most importantly, **the average annual inflation is expected at 2.4% in 2015 against 1.4% YoY in 2014.** Considering the fresh view, **the Governor said there could be additional easing space.** However, the excess liquidity of the banking system has already pushed money market rates significantly below the base rate and therefore, this move is not likely to cause a meaningful impact. **What is more, the external and domestic risks quoted in the press release are likely to exert upward pressure on money market rates especially in Q4,** when presidential elections will be held and negotiations with the IMF over the 2015 budget will take place. The Fiscal Council has already voiced concerns over the proposed fiscal changes that are likely to negatively impact the 2015 budget. The external risks cited by the NBR refer to potential capital outflows. We point especially to the US that is in a different stage of the business cycle and where the monetary policy will start tightening in 2015, determining yields far more attractive for foreign investors. **Considering the above quoted risks, we expect another cut of the mandatory reserve ratio in Q4, that could partially offset the effects of increased risk aversion on the money market rates.**

Annual inflation rate in June (HICP, %)



Sources: Eurostat

Date: 01.08.2014

MID INTEREST RATES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
repo rate	3.50	↔ 0	↓ -50	
ROBOR ON	2.11	↓ -39	↑ 37	
ROBOR 3M	2.16	↓ -4	↓ -28	
ROBOR 6M	2.52	↓ -2	↓ -47	
ROBOR 9M	2.60	↓ -3	↓ -50	
ROBOR 1Y	2.64	↓ -3	↓ -51	

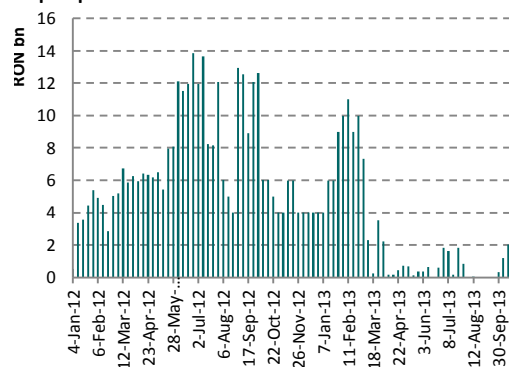
INTERBANK DEPOSITS			
	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	2,930.2	471.9	-1709.0

MID SWAP POINTS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
USDRON 1W	12	↓ 0	↑ 5	
USDRON 1M	48	↑ 3	↑ 16	
USDRON 3M	147	↑ 29	↑ 31	
EURRON 1W	16	↓ -2	↑ 5	
EURRON 1M	69	↑ 4	↑ 26	
EURRON 3M	193	↑ 14	↓ -8	

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

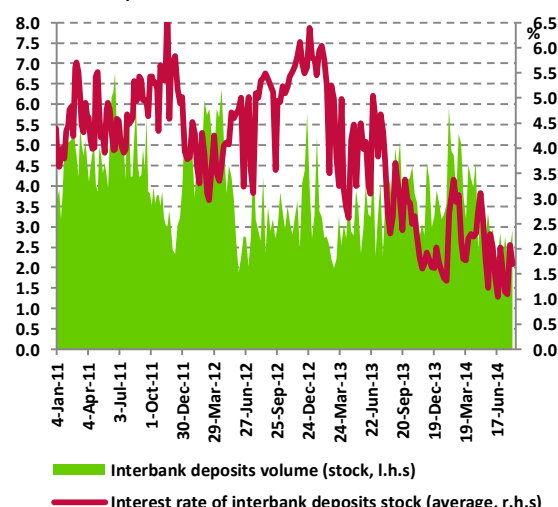
Sources: Reuters

Repo operations since 2012



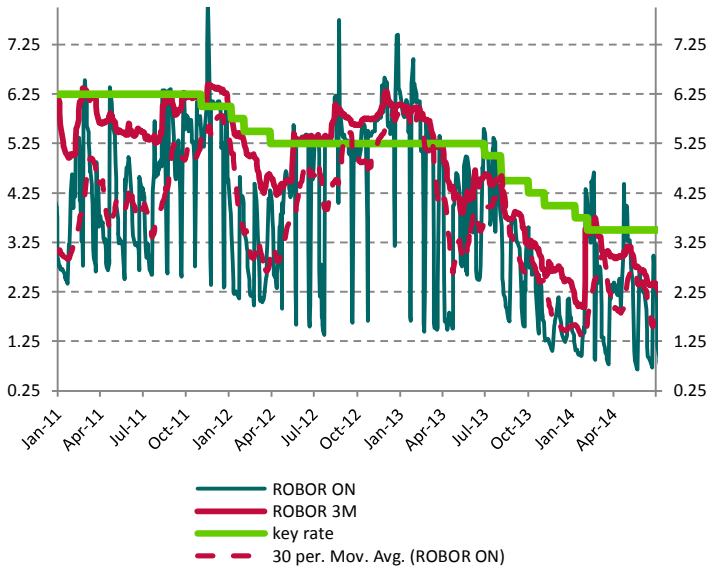
Sources: NBR

Interbank deposits and interest rate evolution



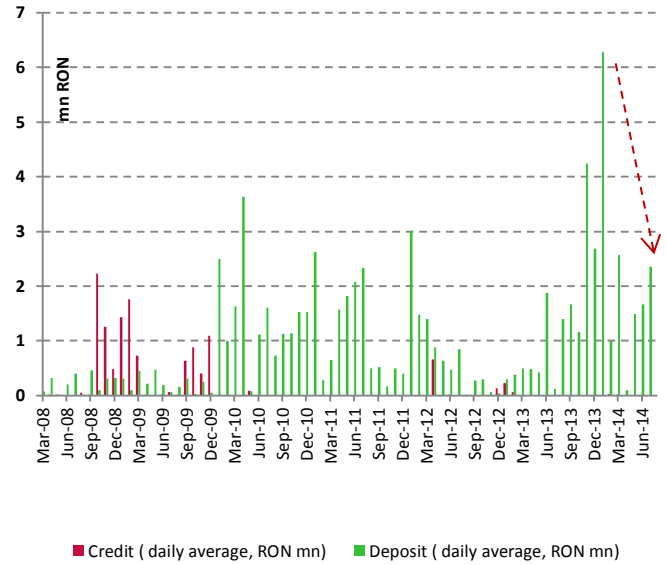
Sources: NBR

Most important MM rates



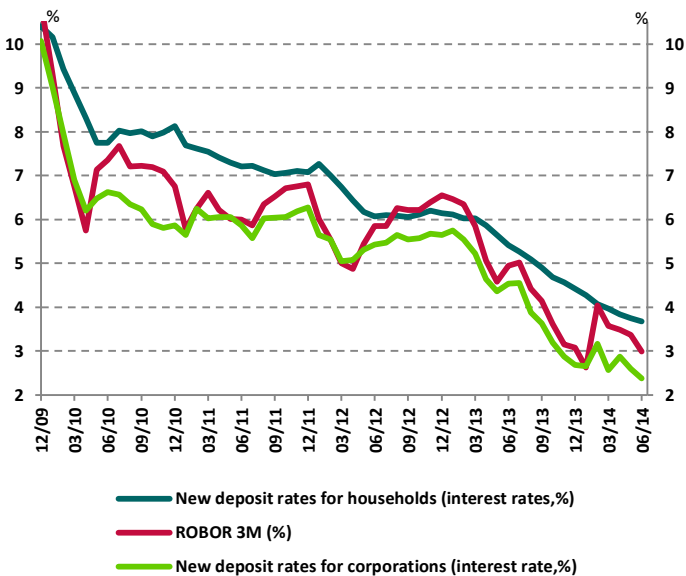
Source: NBR

Deposits placed at the standing facility offered by the CB rose to RON 2.4 bn/day in July, but they are still lower than in January



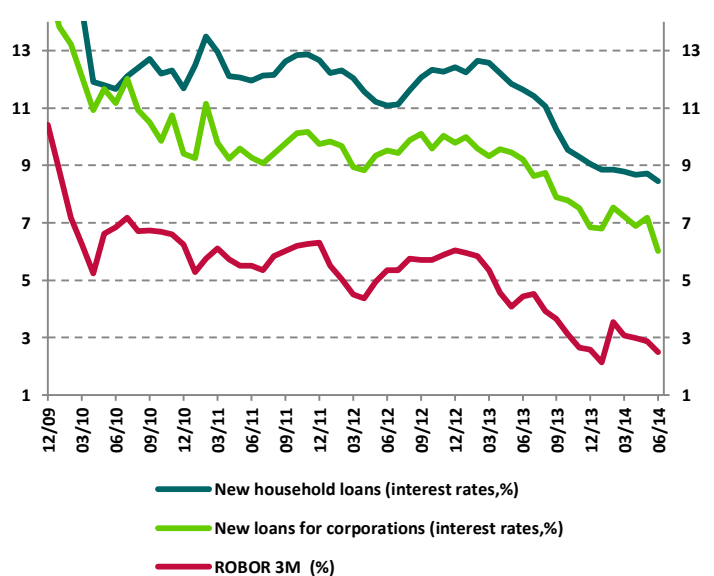
Source: NBR

The average interest rate for household deposits stood at 3.2% in June



Source: NBR

The average interest rate for household loans stood at 8.44% in June



Source: NBR

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