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Weekly Report

Romania

11 Aug 2014

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RON yields are rising

Macroeconomics: Business cycle indicators not so rosy in Q2

(Page 3- 5)

Constructions activity declined by 13% YoY in June and nearly 10% YoY on average in Q2. The only segment that thrives is the residential one, which posted an advance of 78% YoY on average in Q2. Retail sales grew by 10.2% YoY in June and the weakest component was trade with fuels, possibly as an effect of the fuels excise introduced in April. The performance of retail trade shows that households consumption was less impressive than in Q1 even if the growth of real wage has been significant: +3.7% YoY/month in Q2. Industrial sales advanced nicely, at 8.2% YoY per month in Q2. New orders are much slower though, -1.5%YoY/month in Q2 compared to 15.7% YoY/month in Q1. So far, industry has been the main supporter of GDP growth: we expect it to contribute positively in Q2 as well, whereas constructions and trade could enter negatively. In Q2, we look for 0.2% QoQ and 3.3% YoY GDP growth.

FX market: Unfavorable external macro background (Page 6)

Most of the factors that continue to weigh on the leu and its peers too seem to be external: indeed, the US is advancing far more rapidly and it is about to lead a less and less accommodative monetary policy and even tighten it in 2015, while in the euro-zone, the weakness of the core countries is the word of the day. Italy already unveiled a quarterly GDP drop which puts it into recession. The consensus of analysts expects a dynamics of 0.5% QoQ and 3.4% YoY in the case of Romania and a much lower figure will translate into a negative surprise. We see no large movements of the leu for the moment and the current level is a “neutral” one, also the average of the past 3 years.

Fixed income markets: The Treasury lowered the planned debt issuance to RON 2 bn (Page 7 - 8)

The yield curve moved up between 4 -22 bps last week even if the surprise correction of December 2014 inflation forecast was significant and the first reaction was supportive for bond prices. However, what moved the market was a deteriorated risk perception towards the region, with most asset prices being hit. The 5Y CDS rose 7 bps in a week. The Treasury lowered their issuance plan for August from RON 2.9 bn to RON 2 bn, according to an announcement made by the finance minister on Friday.

Money markets: Upside pressure on money market rates in Q4

(Page 9)

Given the stream of events that are going to take place in the last quarter, there are good chances that upward pressures will be felt on interbanking rates. Such events are related to geopolitical risks, proximity of presidential elections, developments in the US. Already, we are witnessing a higher degree of risk aversion to regional assets and the 5Y CDS quotations at more elevated levels. Therefore, MM rates could move closer to the base rate as they are likely to rise. In line with the above arguments on liquidity, the last quarter could prove a good timing for a reserve ratio cut, for RON liabilities. Additionally, there is also the possibility of a further base rate cut, but the signals from NBR are mixed on this issue. Should this happen however, the variation band around the base rate could shrink, from the current +/- 3 pp around the base rate, otherwise the interest rate of the deposit facility with NBR will drop to zero (under the assumption of a 25 bps base rate cut). Should the rate cut cycle continue this year, the probability of a base rate hike in 2015 rises considerably. A key factor for this decision will be the data on September inflation when the effect of the decline in VAT for bread will be disappear. The NBR will not have these figures at the next board meeting in September. The last meeting of the board is on 4th November.

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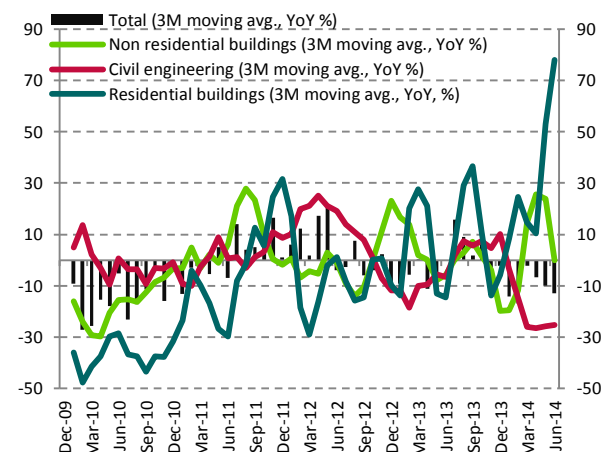
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Macroeconomics: Business cycle indicators not so rosy in Q2

	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
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, %)	5.0		4.4
07 Aug	June	Industrial trade turnover index (y-o-y, %)	6.8		11.2
07 Aug	June	Index value of new orders in manufacturing (y-o-y, %)	1.3		0.4
08 Aug	June	Construction works index (y-o-y, %)	-12.9		-9.9
11 Aug	July	Consumer price index (y-o-y,%)	1.00	1.00	0.7
11 Aug	June	Exports (y-o-y, %)	5.4		7.9
11 Aug	June	Imports (y-o-y,%)	9.2		8.1
11 Aug	June	Industrial Production Index (y-o-y, %)	10.4		12.7
13 Aug	June	CA balance (EUR mn, YTD)			-351
14 Aug	Q2 2014	Flash GDP growth rate (YoY, %)		0.5	0.1

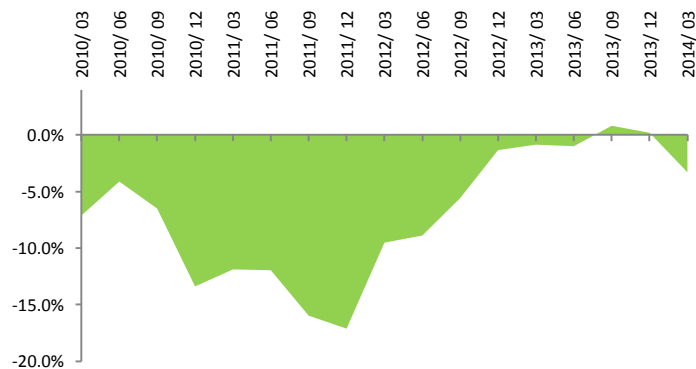
Constructions activity declined by 13% YoY in June and nearly 10% YoY on average in Q2. The only segment that thrives is the residential one, which posted an advance of 78% YoY on average in Q2. From the National Institute of Statistics, we see that residential prices started to fall again in Q1 2014 (on an annual basis) after they saw a mild uptake in H2 2013. This could have been also the result of new legislation on the “First House” program which allowed only RON denominated loans to be granted in most of the second half of 2013. This likely pressured down house prices as the monthly installments were significantly higher in RON. Moving forward, considering the correction from 2008 highs(NIS calculated a decline of around 30% from 2009 when prices were already partially adjusted), the mid term perspectives are improved in the residential segment and the business permits leading indicator confirms this view.

Constructions dipped 13% YoY in June; only the residential segment has a strong lift



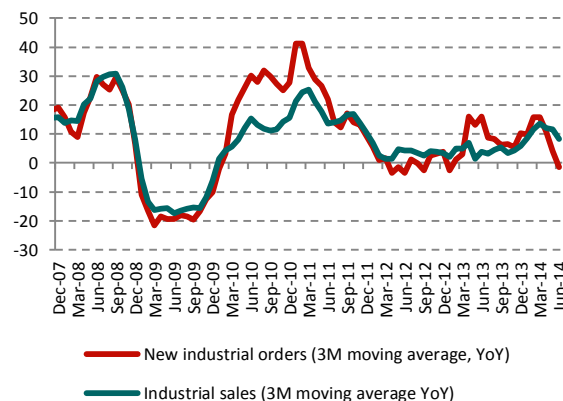
Source: NIS

Residential property prices continue to fall, after a small uptake in H2 2013 (YoY growth rate)



Source: NIS

New industrial orders were slower in Q2, compared to Q1 (annual dynamics)



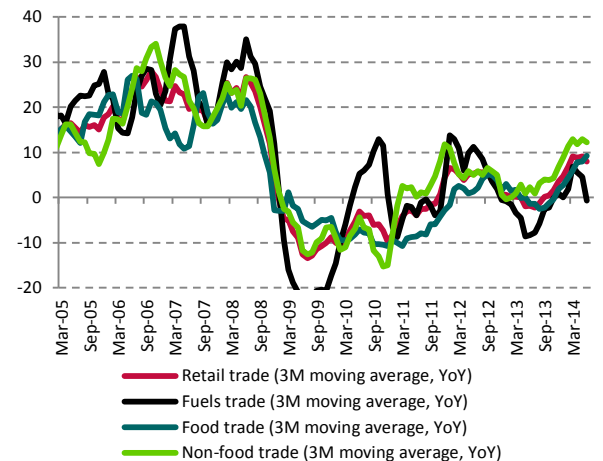
Source: NIS

Industrial sales advanced nicely (+6.8% YoY) in June and 8.2% the average annual growth/month in Q2. New orders are much slower though, -1.5%YoY/month in Q2 compared to 15.7% YoY/month in Q1. So far, industry has been the main supporter of

GDP growth: we expect it to contribute positively in Q2 as well, whereas constructions and trade could enter negatively. **In Q2, we look for 0.2% QoQ and 3.3% YoY GDP growth.**

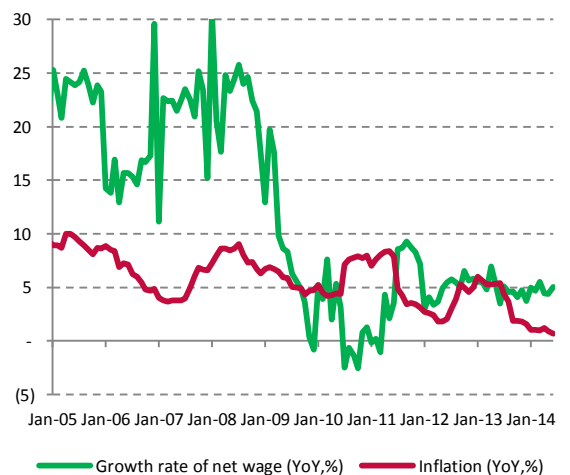
Retail sales grew by 10.2% YoY in June and 0.3% MoM s.a. Again, the non-food category performed the best (+14% YoY). **The weakest component was trade with fuels**, which dropped on a yearly basis in Q2, by an average of 0.7% per month even if **car registrations rose by 12% YoY in Q2.** We explain it mainly as an effect of the additional excise on fuels which pushed up fuel prices. In Q2, fuels prices rose by 3% QoQ. The performance of retail trade on a seasonally adjusted basis shows that households **consumption was less impressive than in Q1 even if the growth of real wage has been significant: +3.7% YoY/month in Q2.**

Retail sales added 10.2% YoY and the non-food component maintains the strongest (+14% YoY)



Source: NIS

Net wage grew by 5% YoY and real wage by 4.3% YoY



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

Note: * under revision

FX markets: Unfavorable external macro background

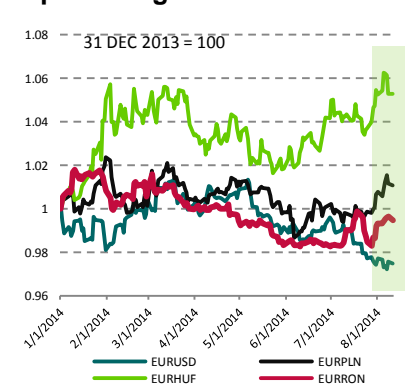
Most of the factors that continue to weigh on the leu and its peers too seem to be external: indeed, the US is advancing far more rapidly and it is about to lead a less and less accommodative monetary policy and even tighten it in 2015, while in the euro-zone, weakness in the core countries is the word of the day. Italy already unveiled a quarterly GDP drop which puts it into recession. Later this week, the figures from Germany will be available and expectations point to a 0.1% QoQ fall, against a leap of 0.8% QoQ in Q1. The consensus of analysts expects a dynamics of 0.5% QoQ and 3.4% YoY of Romanian GDP and a much lower figure will translate into a negative surprise. We see no large movements of the leu for the moment and the current level is a rather “neutral” one, also the average of the past 3 years.

The EUR/RON in the comfort zone



Source: Reuters

Leu's peers are also depreciating

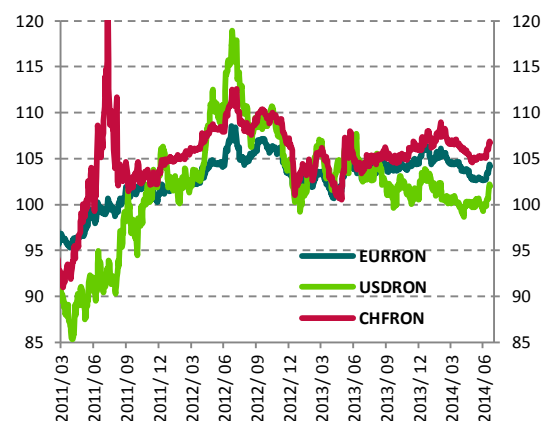


Date: 08.08.2014

	Value	Weekly chg. (%)	YTD chg. (%)
EURRON	4.44	↑ 0.30	↑ 0.01
USDRON	3.31	↑ 0.45	↓ -1.60
CHFRON	3.66	↑ 0.45	↓ -0.55
RONJPY	3.25	↑ 1.01	↓ -16.34
RONPLN	1.06	↓ -0.30	↓ -2.89
100HUFRON	1.42	↑ 0.29	↓ -6.95
RONCZK	0.16	↓ -0.38	↓ -9.95
RONRUB	0.09	↓ -0.65	↓ -16.83
RONRSD	0.04	↑ 0.25	↓ -4.30
RONBGN	2.27	↑ 0.29	↑ 0.02

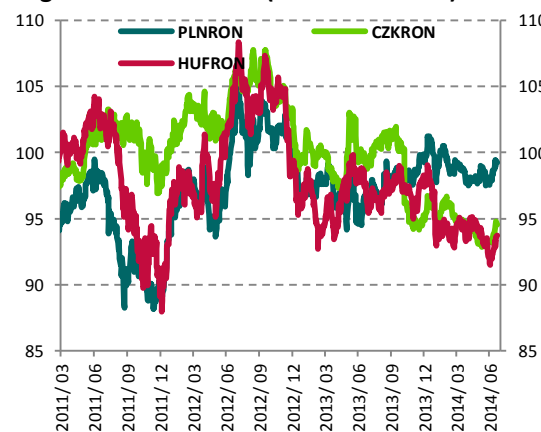
Source: Reuters

Major RON FX rates (03.01.2011=100)



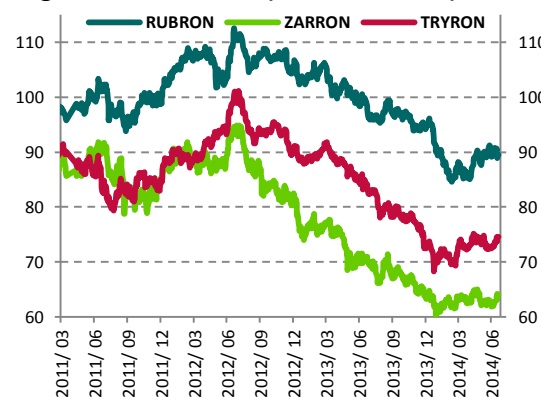
Sources: Reuters

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: 4.4480	S1: 4.4370
R2: 4.4540	S2: 4.4330
R3: 4.4650	S3: 4.4220
RSI: neutral	

Government securities: The Treasury lowered the planned debt issuance to RON 2 bn

The yield curve moved up between 4 -22 bps last week even if the surprise correction of December 2014 inflation forecast by NBR was significant and the first reaction was supportive for bond prices. However, as we said in other reports as well, especially the 3Y-5Y maturity looked already overpriced even considering a downward revision for 2015 inflation rate: the quarterly inflation average moved down from 3.2% to 2.6% in this August version, with December 2015 forecast at 3% YoY. **What moved the market as well was a deteriorated risk perception towards the region, with most asset prices being hit.** The 5Y CDS rose 7 bps in a week.

The Treasury lowered the issuance plan for August from RON 2.9 bn to RON 2 bn, according to an announcement made by the finance minister on Friday. Last Monday, the Treasury rejected all bids at the 5Y bonds auction.

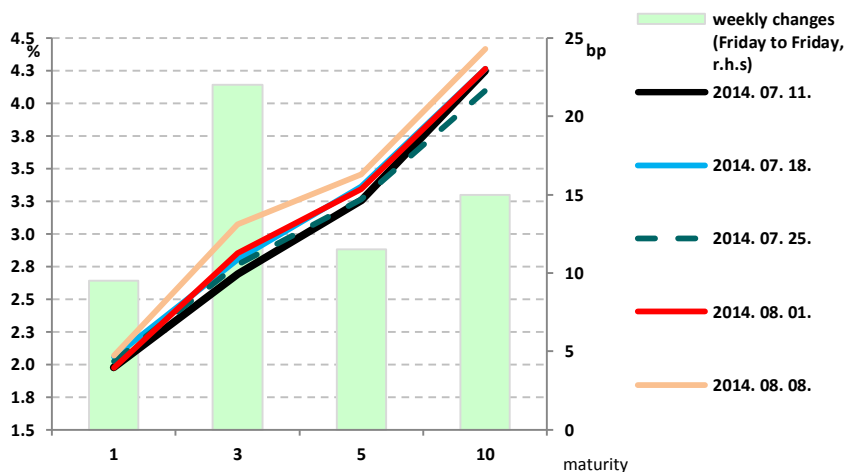
Date: 08.08.2014

RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	1.95	↑ 4	↓ -80	
12M	2.07	↑ 9	↓ -79	
3Y	3.07	↑ 22	↓ -84	
5Y	3.46	↑ 12	↓ -120	
10Y	4.42	↑ 15	↔ 0	

SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	303	↑ 22	↓ -52	
GERROM 5Y	314	↑ 12	↓ -58	
GERROM 10Y	325	↑ 15	↑ 77	
3Y -5Y	39	↓ -11	↓ -36	
5Y -10Y	96	↑ 3	↑ 120	
3Y-10Y	135	↓ -7	↑ 84	
FLY 3-5-10	57	↑ 14	↑ 155	

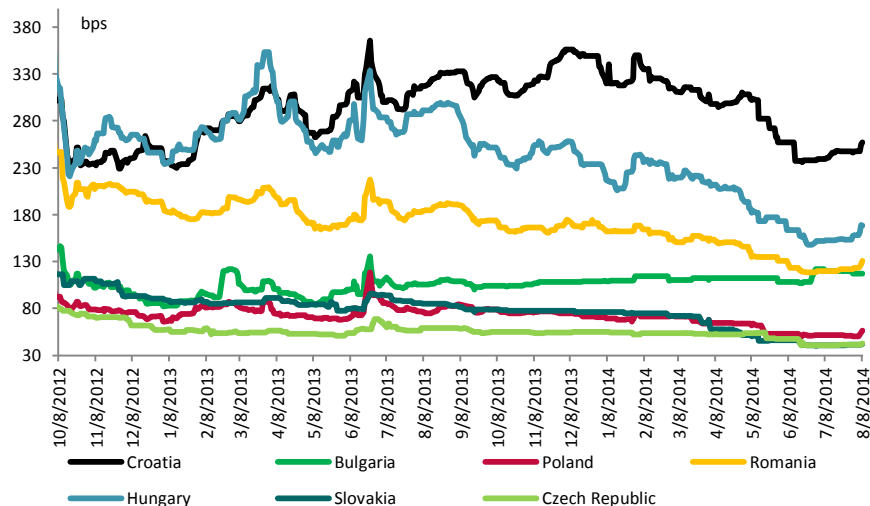
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	81	↑ 9	↓ -36	
5Y EURO	131	↑ 7	↓ -40	

Yield curve over the past weeks (Central Bank fixing)



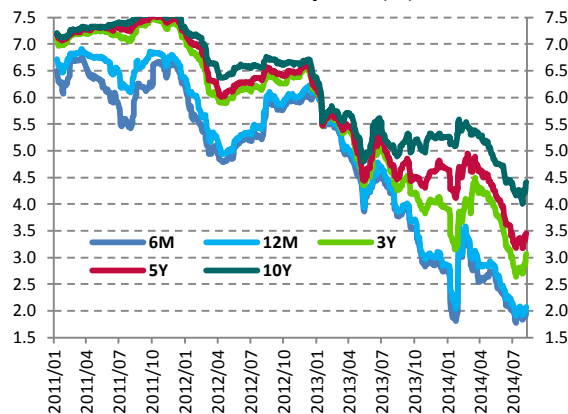
Source: NBR

Evolution of 5Y CDS (euro)



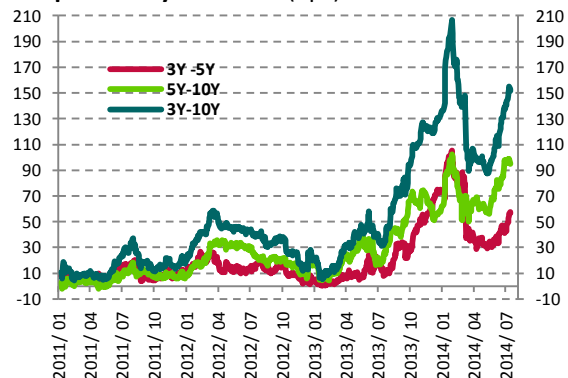
Source: Reuters

Government benchmark yields (%)



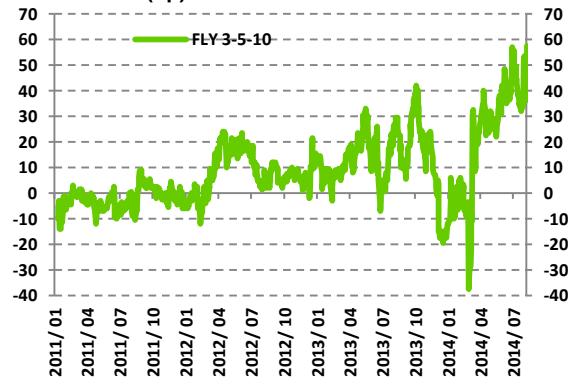
Source: NBR

Slope of the yield curve (bps)



Source: NBR

FLY 3-5-10 (bp)



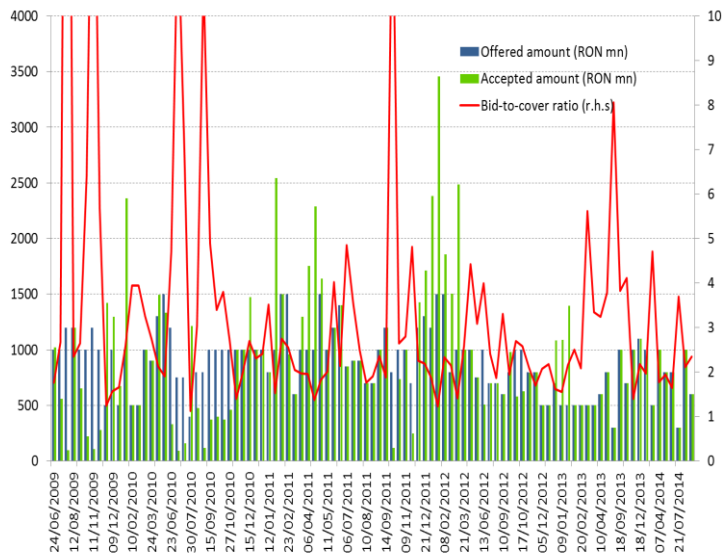
Source: NBR

Last week's auctions

	RO1419DBN014	RO1415CTN0B1
Offered amount (mn RON)	600	600
Total bids (mn RON)	780	1405
Accepted amount (mn RON)	0	600
Average accepted yield (%)	0.00	2.09
Coupon	4.75	-

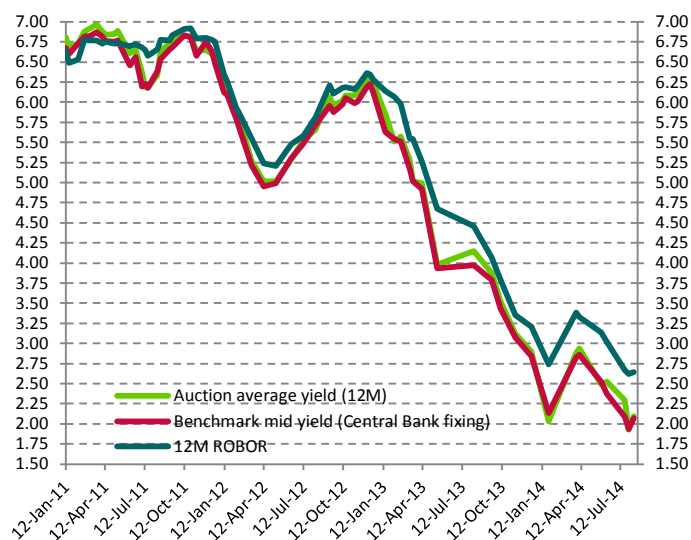
Source: NBR

12M Auctions



Source: NBR

12M Interest rates



Source: NBR

MM: upside pressure on money market rates in Q4

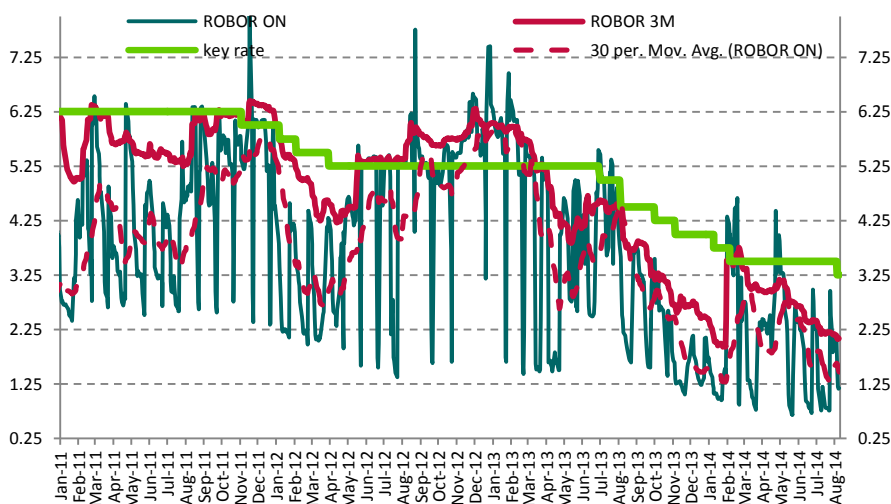
On the occasion of presenting the new Inflation Report, the NBR governor made a few important statements:

- Money market rates will have to come closer to the base rate
- Banks need more stable interbanking rates to be able to sustain lending
- The mandatory reserve ratio will be decreased when there is no more excess liquidity. At the moment, the banking system has a surplus
- The effect of the depreciation of the leu on inflation is twice as high as when the leu appreciates
- The inflation forecast for 2015 has a high degree of uncertainty; the base rate could be modified in either direction.

As we said in previous reports, considering the stream of events that are going to take place in the last quarter, both domestic and external, there are **good chances that upward pressures will be felt on interbanking rates**. Such events are related to geopolitical risks, proximity of presidential elections, developments in the US. Already, we are witnessing a higher degree of risk aversion to regional assets and the 5Y CDS quotations at more elevated levels. Therefore, **money market rates could move closer to the base rate as they are likely to rise**. In line with the above arguments on liquidity, the last quarter could prove a good timing for a reserve ratio cut, for RON liabilities.

Additionally, there is also the possibility of a further base rate cut, considering the new inflation forecast but the **signals from NBR are mixed on this issue**. Should this happen however, the **variation band around the base rate could shrink, from the current +/- 3 pp around the base rate**, otherwise the interest rate to the deposit facility with NBR will drop to zero (under the assumption of a 25 bps base rate cut). The lower corridor will help achieve a higher stability of the money market rates as well. **Should the rate cut cycle continue this year, the probability of a base rate hike in 2015 rises considerably**. A key factor for this decision will be the data on September inflation when the effect of the decline in VAT for bread will disappear. The NBR will not have these figures at the next board meeting in September. The last meeting of the board is on 4th November.

Most important MM rates



Sources: NBR

Date: 08.08.2014

MID INTEREST RATES

	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	3.25	↓ -25	↓ -75
ROBOR ON	1.18	↓ -93	↓ -56
ROBOR 3M	2.09	↓ -7	↓ -35
ROBOR 6M	2.49	↓ -3	↓ -50
ROBOR 9M	2.58	↓ -2	↓ -52
ROBOR 1Y	2.64	↔ 0	↓ -51

INTERBANK DEPOSITS

	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	2,987.2	-284.7	-1652.0

MID SWAP POINTS

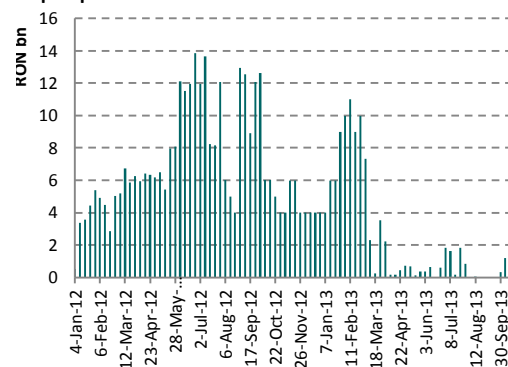
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USD RON 1W	6	↓ -6	↓ -1
USD RON 1M	35	↓ -13	↑ 2
USD RON 3M	152	↑ 4	↑ 36
EUR RON 1W	9	↓ -7	↓ -2
EUR RON 1M	76	↑ 7	↑ 33
EUR RON 3M	144	↓ -49	↓ -57

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

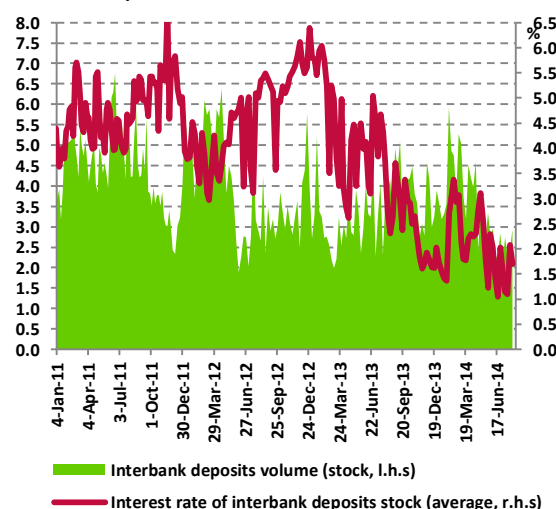
Sources: Reuters

Repo operations since 2012



Sources: NBR

Interbank deposits and interest rate evolution



Sources: NBR

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