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Weekly Report

Romania

7 July 2014

Regional Treasury Sales

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Excess liquidity persists

Macroeconomics: Strong retail sales in May (Page 3- 4)

Macro data released last week was largely positive. The residential building permits advanced by 6.6% YoY in May and have been on an uptrend in the past half of year. So far we have seen indeed the residential constructions inching up and expectations are that this trend continues, given that permits data is a leading indicator. Also on the upside, retail sales continue to be strong, pacing up at 9.2% YoY in May. Especially the non-food component is racing (+15.8% YoY), a sign that consumption decisions do not only affect the inferior goods category. For the moment, the low inflation rate remains supportive as well as the relative strength of the leu. Industrial producer prices dynamics remained unchanged at 0.8% YoY in May.

FX market: The leu strenghtens (Page 5 - 6)

Just like its peers, the domestic currency was resilient to changes last week. The Hungarian forint was the most volatile, depreciating 0.2% in a week against the euro, following country specific drivers, while the Czech crown and Polish zloty appreciated marginally. The news of FX reserve ratio cut by 2 percentage points left the market unimpressed. The lively interest in the local bond market supported the leu in the past few months, as the Fed remained accommodative, as well as the ECB. However in the first case, we see macro data in US becoming stronger: last week, the increase in employment (June) surpassed expectations by far. Also, the latest inflation figures were higher than expected. This questions whether the Fed will turn more hawkish by autumn, which can be a game changer and have a negative impact on European emerging market currencies. This week, the release of FOMC minutes will give more insight to Fed's potential next move.

Fixed income markets: Yield compression continues (Page 7 - 8)

Yields compression continued, especially on the 3Y-5Y maturity where we have seen declines of around 20 bps in a week. Since the beginning of the year, bond yields shrank by more than 100 bps driven by the easing of the monetary policy accompanied also by an excess of liquidity, rating upgrade and the inclusion of local debt in international bond indexes. In the short term yields are likely to be under pressure but they are expected to rise by the end of the year considering changes in inflation rate and probably also changes of strategy of non residents. Compared to January, non-residents have about the same holdings of RON denominated debt (RON 17.6 bn in April) after they started decreasing their holdings in Q1. During this period, the term spread had dropped. Since April, the term spread increased again, simultaneously with a higher presence of foreign investors on the buying side.

Money markets: The FX reserve ratio was cut by 2 pp (Page 8-9)

NBR decided to cut the reserve ratio for FX liabilities from 18% to 16%, thereby releasing some half a billion euro. The governor commented that there is an excess liquidity for both RON and FX at the moment. Therefore, lack of liquidity is not the root of the scarce lending and pointed to the fact that in Q2 banks have increased their offer moderately. The second part of the decision was to keep the base rate unchanged at 3.5%. No abrupt move was decided considering that in what regards the inflation rate, „the consolidation of this path in the medium term is still uncertain”. The uncertainty about oil prices was brought up and also, the governor mentioned the fact that the favorable base effect from the VAT decrease from bread and bakery items will disappear in September. To our understanding, further reserve ratio cut for both RON and FX remains on the cards by the end of the year, possible a base rate cut as well if views on inflation change substantially and expectations are that it will fall below 3%. Mr. Isarescu emphasized that at the moment, the proper management of liquidity is more effective than a change in the base rate.

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Macroeconomics: Strong retail sales in May

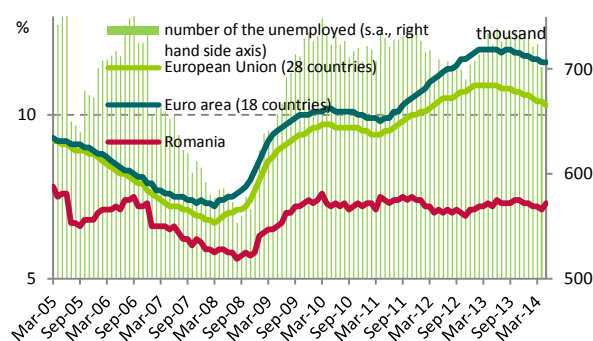
	PERIOD	INDICATOR	FACT	CONSENSUS	PRIOR
30 Jun	May	Building permits (y-o-y, %)	6.6		-6.2
01 Jul	May	ILO unemployment (seasonally adjusted, %)	7.3		7.1
02 Jul	May	Retail trade turnover index (y-o-y, %)	9.2		4.5
02 Jul	May	Producer Price Index (y-o-y, %)	0.8		0.8
07 Jul	May	Net wage growth rate (y-o-y, %)			4.5
07 Jul	May	Industrial trade turnover index (y-o-y, %)			6.0
07 Jul	May	Index value of new orders in manufacturing (y-o-y, %)			-6.4
09 Jul	May	Construction works index (y-o-y, %)			-6.9
10 Jul	June	Consumer price index (y-o-y, %)			0.9
10 Jul	May	Industrial Production Index (y-o-y, %)			2.6

Macro data released last week was largely positive. The residential building permits advanced by 6.6% YoY in May and have been on an uptrend in the past half of year. So far we have seen indeed the residential constructions inching up and expectations are that this trend continues, given that permits data is a leading indicator.

Also on the upside, retail sales continue to be strong, pacing up at 9.2% YoY in May. Especially the non food component is racing (+15.8% YoY), a sign that consumption decisions do not only affect the inferior goods category. For the moment, the low inflation rate remains supportive as well as the relative strength of the leu.

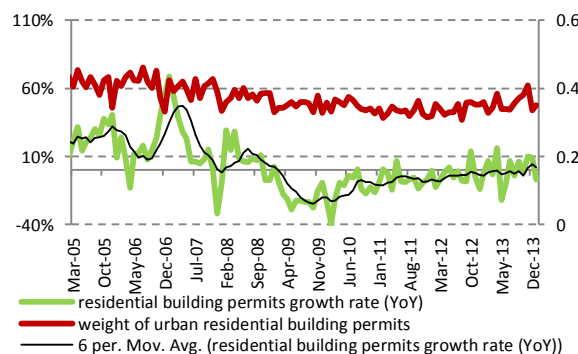
Industrial producer prices dynamics remained unchanged at 0.8% YoY in May. Domestic and external industrial price inflation have converged after almost one year (April 2013 –March 2014) when prices on external markets have dropped. On large industrial groups, we see that intermediate goods prices have decreased significantly (-1.8% YoY), while top hikes were witnessed in the case of energy (+2.5% YoY) and non-durable consumer goods (+1.8% YoY).

The unemployment rate mounted higher to 7.3% in May, from 7.1% in April



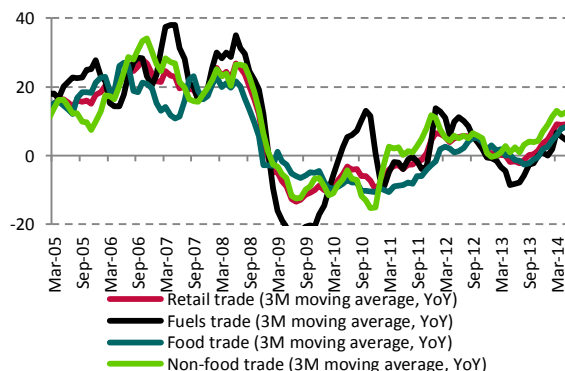
Source: Eurostat

The residential building permits are on the rise (+6.6% YoY) in May



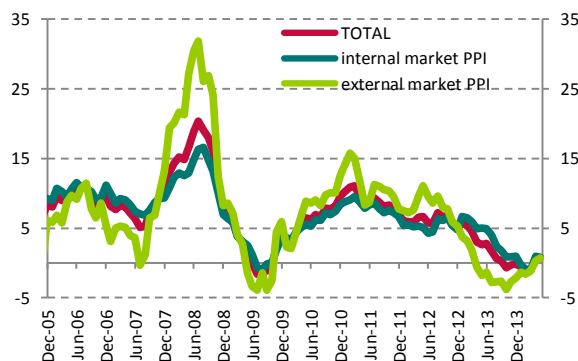
Source: NIS

Retail trade: strong pickup (9.2%YoY in May), especially the non-food component (+15.8% YoY)



Source: NIS

Industrial production prices dynamics remained unchanged in May at +0.8% 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

FX markets: the leu moves in tight range, around 4.39

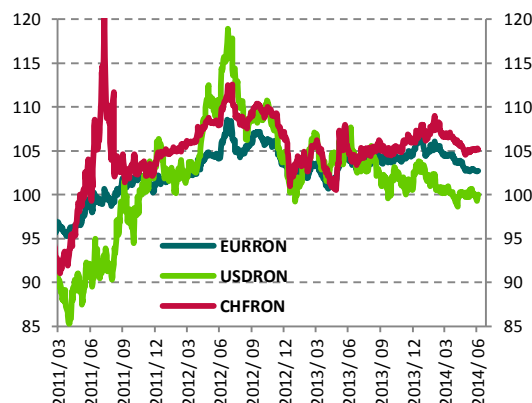
Just like its peers, the domestic currency was resilient to changes last week. The Hungarian forint was the most volatile, depreciating 0.2% in a week against the euro, following country specific drivers, while the Czech crown and Polish zloty appreciated marginally. The news of FX reserve ratio cut by 2 percentage points left the market unimpressed. The lively interest in the local bond market supported the leu in the past few months, as the Fed remained accomodative, as well as the ECB. However in the first case, we see macro data in US becoming stronger: last week, the increase in employment (June) surpassed expectations by far. Also, the latest inflation figures were higher than expected. This questions whether the Fed will turn more hawkish by autumn, which can be a game changer and have a negative impact on European emerging market currencies. This week, the release of FOMC minutes will give more insight to Fed's potential next move.

Date: 03.07.2014

FX BID				
	Value		Weekly chg. (%)	YTD chg. (%)
EURRON	4.39	↓	-0.02	↓ -1.31
USDRON	3.21	↓	-0.24	↓ -4.64
CHFRON	3.61	↑	0.21	↓ -1.81
RONJPY	3.15	↓	-0.16	↓ -18.71
RONPLN	1.06	↓	-0.22	↓ -2.76
100HUFRON	1.40	↓	-1.58	↓ -7.82
RONCZK	0.16	↓	-0.13	↓ -9.78
RONRUB	0.09	↓	-1.73	↓ -14.99
RONRSD	0.04	↓	-0.30	↓ -4.37
RONBGN	2.24	↓	-0.01	↓ -1.27

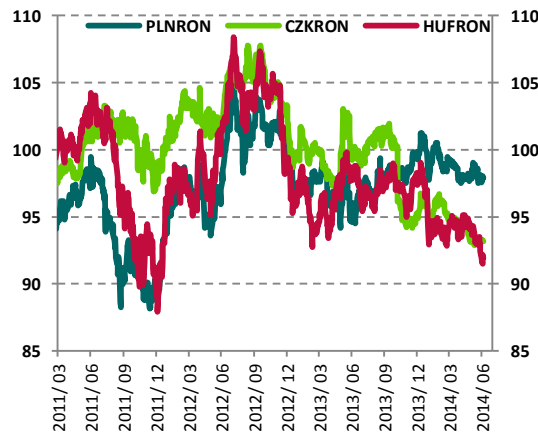
Source: Reuters

Major RON FX rates (03.01.2011=100)



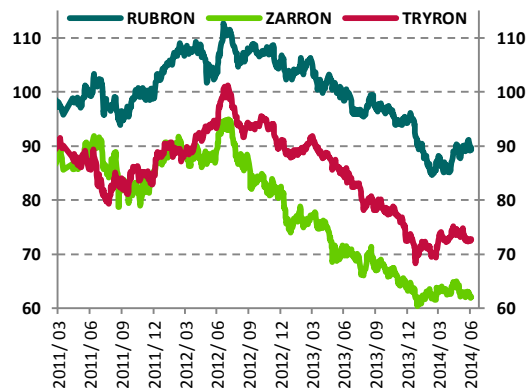
Sources: Reuters

Regional RON FX rates (03.01.2011=100)



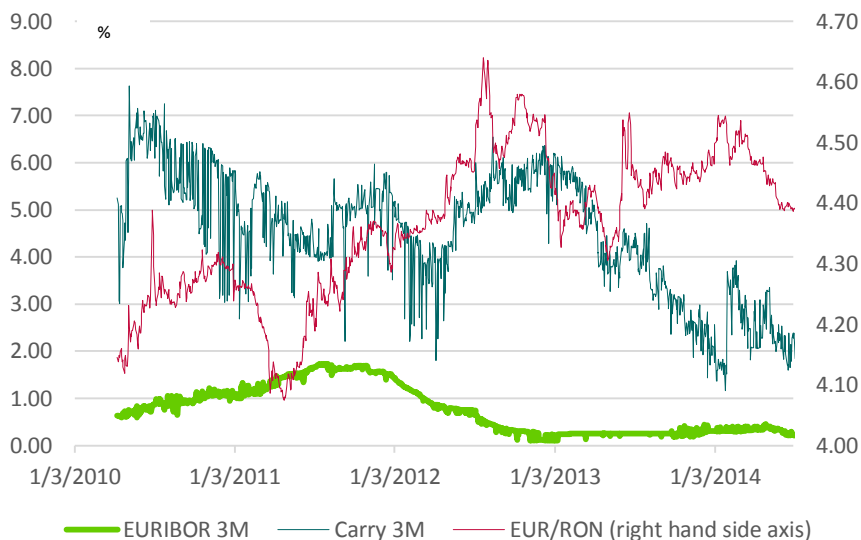
Sources: Reuters

Regional RON FX rates (03.01.2011=100)



Sources: Reuters

The leu moved in a very tight range, around the 4.39 level



Source: Reuters

Daily EUR/RON Chart



Source: Reuters

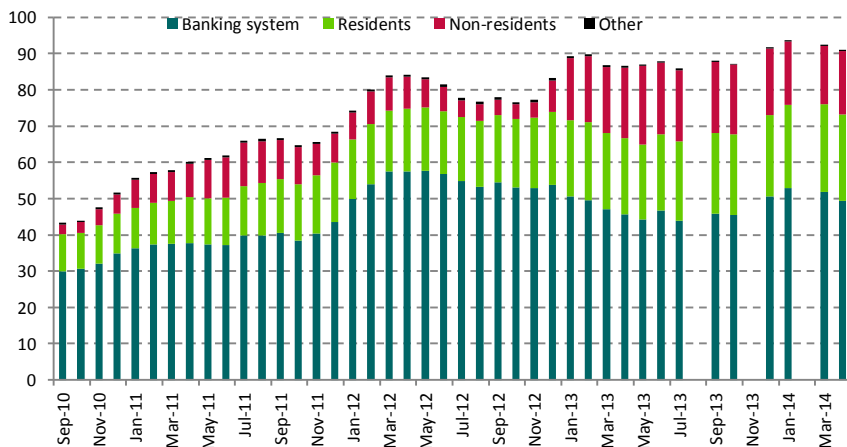
Major trend: ↓	
Minor trend: ↓	
R1: 4.3920	S1: 4.3870
R2: 4.3950	S2: 4.3850
R3: 4.40	S3: 4.3810
RSI: neutral	

Government securities: Yield compression continues

Yields compression continued, especially on the 3Y-5Y maturity where we have seen declines of around 20 bps in a week. Since the beginning of the year, bond yields shrank by more than 100 bps driven by the easing of the monetary policy accompanied also by an excess of liquidity, rating upgrade and the inclusion of local debt in international bond indexes. The 5Y CDS declined by 51 bps, reflecting the improved perception about risk. **In the short term, yields are likely to be under pressure but they are expected to rise by the end of the year** considering changes in inflation rate and probably also changes of strategy of non residents. Compared to January, non-residents have about the same holdings of RON denominated debt (RON 17.6 bn in April) after they started decreasing their holdings in Q1. During this period, the term spread had dropped. Since April, the term spread increased again, simultaneously with a higher presence of foreign investors of the buying side.

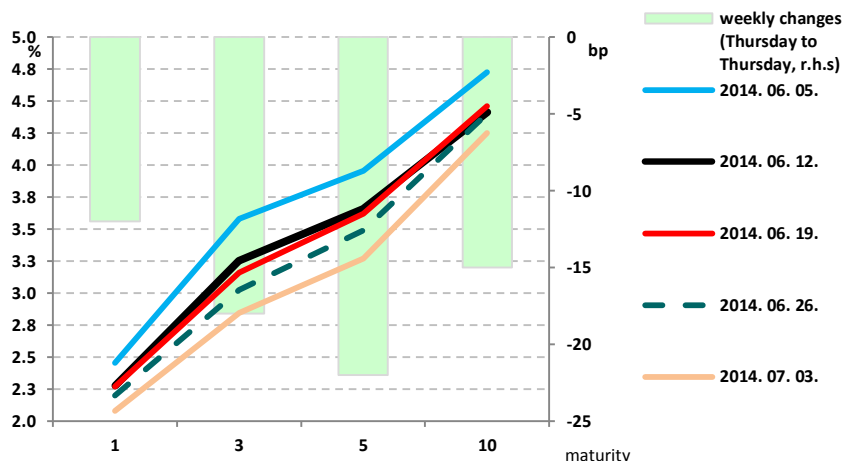
In July, the Treasury plans to sell RON 3.7 bn in debt, of which mostly bonds, to increase maturity of the remaining portfolio. The redemptions are high at RON 6.8 bn. According to the latest official statistic, the government has covered 54.3% of the gross financing needs by May.

Compared to January, the banking system holds less RON government debt by RON 3.5 bn as of April



The Ministry of Finance

Yield curve over the past weeks (Central Bank fixing)

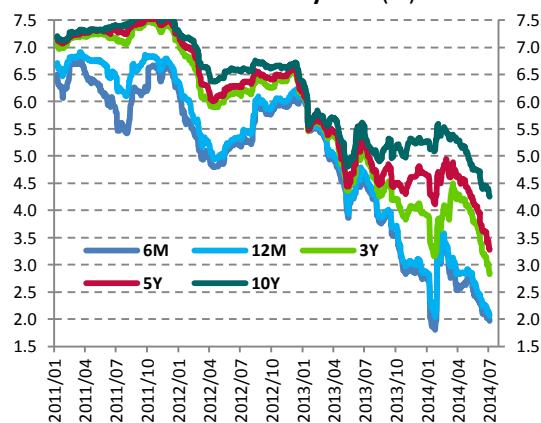


Source: NBR

Date: 03.07.2014

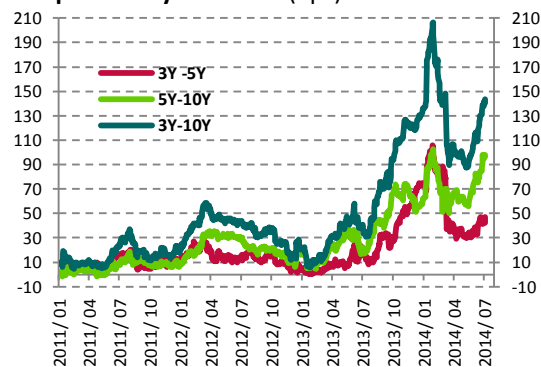
RON GOVERNMENT SECURITIES				
	Value (%)	Weekly chg. (bp)	YTD chg. (bp)	
6M	1.98	↓ -10	↓ -77	
12M	2.08	↓ -12	↓ -78	
3Y	2.85	↓ -18	↓ -107	
5Y	3.27	↓ -22	↓ -138	
10Y	4.25	↓ -15	↓ -102	
SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
GERROM 3Y	279	↓ -18	↓ -76	
GERROM 5Y	293	↓ -22	↓ -80	
GERROM 10Y	301	↓ -15	↓ -32	
3Y -5Y	43	↓ -4	↓ -32	
5Y -10Y	98	↑ 7	↑ 36	
3Y-10Y	141	↑ 3	↑ 5	
FLY 3-5-10	56	↑ 11	↑ 68	
CDS MID SPREADS				
	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)	
3Y EURO	68	↑ 1	↓ -49	
5Y EURO	120	↑ 1	↓ -51	

Government benchmark yields (%)



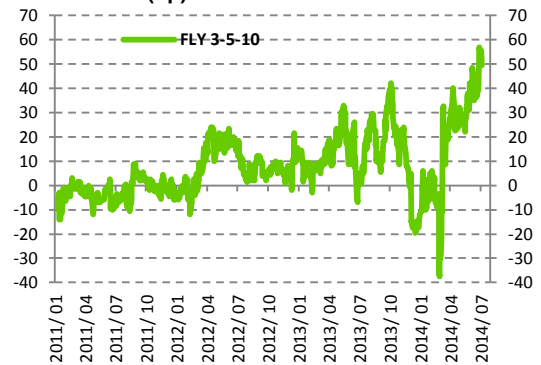
Source: NBR

Slope of the yield curve (bps)



Source: NBR

FLY 3-5-10 (bp)



Source: NBR

Auctions
T-bills auctions in 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)

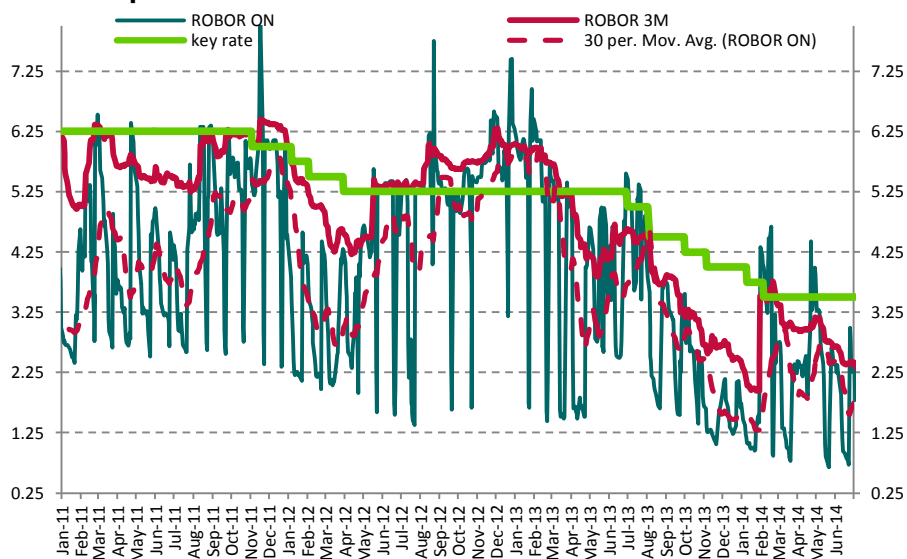
ISIN	Auction date	SSON auction date	Settlement date	Maturity	Years	Residual Maturity	Indicative target amount (RON)	Indicative target amount SSON* (RON)
RO1320DBN022	07.07.2014	08.07.2014	09.07.2014	29.04.2020	7.0	5.8	400.000.000	60.000.000
RO1316DBN053	10.07.2014	11.07.2014	14.07.2014	29.08.2016	3.0	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

MM: The FX reserve ratio was cut by 2 pp

The Central Bank decision was largely expected. NBR decided to cut the reserve ratio for FX liabilities from 18% to 16%, thereby releasing some half a billion euro. The governor commented that there is an excess liquidity for both RON and FX at the moment. Therefore, lack of liquidity is not the root of the scarce lending and pointed to the fact that in Q2 banks have increased their offer.

The second part of the decision was to **keep the base rate unchanged at 3.5%**. No abrupt move was decided considering that in what regards the inflation rate, „the consolidation of this path in the medium term is still uncertain”. The uncertainty about oil prices was brought up and also, the governor mentioned the fact that the favorable base effect from the VAT decrease from bread and bakery items will disappear in September. To our understanding, **further reserve ratio cut for both RON and FX remains on the cards by the end of the year, possibly a base rate cut as well if views on inflation change substantially and expectations are that it will fall below 3%. Mr. Isarescu emphasized that at the moment, the proper management of liquidity is more effective than a change in the base rate.**

Most important MM rates


Sources: NBR

Date: 03.07.2014

MID INTEREST RATES

	Value (%)	Weekly chg. (bp)	YTD chg. (bp)
repo rate	3.50	0	-50
ROBOR ON	1.79	-99	5
ROBOR 3M	2.34	-9	-10
ROBOR 6M	2.66	-11	-33
ROBOR 9M	2.73	-9	-37
ROBOR 1Y	2.76	-11	-39

INTERBANK DEPOSITS

	Value (mn RON)	Wly chg. (mn RON)	YTD chg. (mn RON)
outstanding	2,158.0	48.4	-2481.2

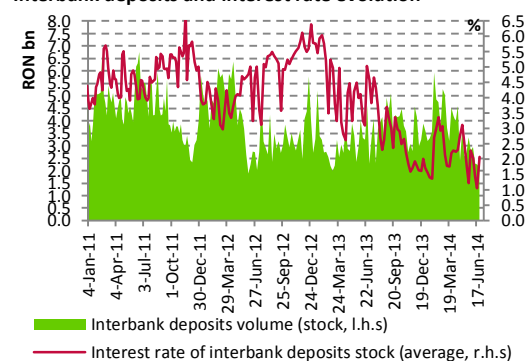
MID SWAP POINTS

	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
USD RON 1W	11	-5	4
USD RON 1M	35	-19	2
USD RON 3M	144	24	28
EUR RON 1W	14	-7	3
EUR RON 1M	72	-5	29
EUR RON 3M	208	30	7

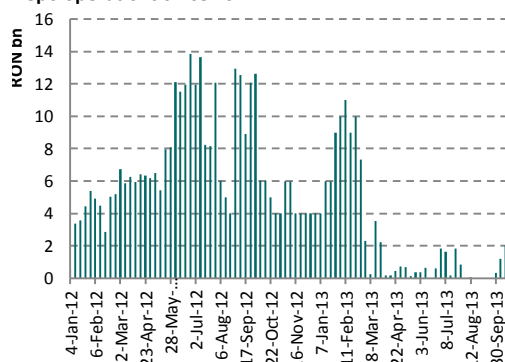
MID EUR BASIS SWAPS

	Value (bp)	Weekly chg. (bp)	YTD chg. (bp)
EUR RON 1Y	-80	0	30
EUR RON 3Y	-70	0	40
EUR RON 5Y	-70	0	40

Sources: Reuters

Interbank deposits and interest rate evolution


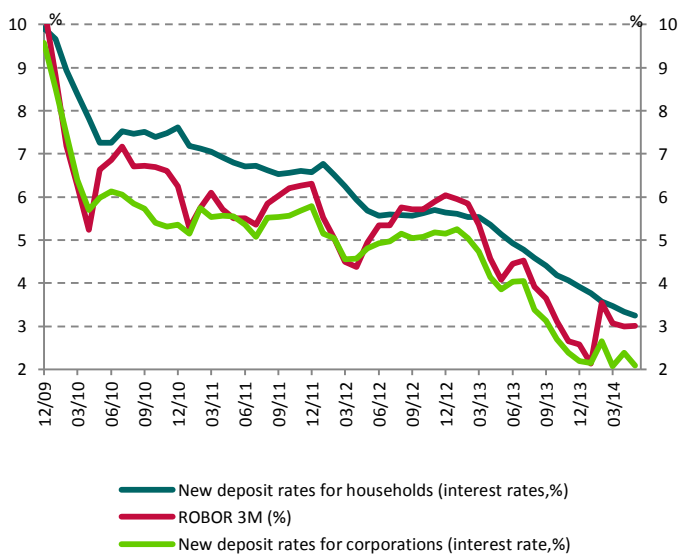
Sources: NBR

Repo operations since 2012


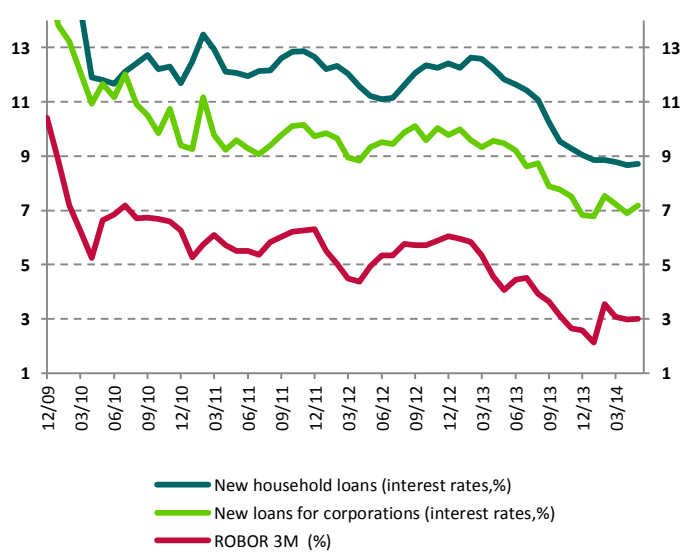
Sources: NBR

In May, the avg. new term deposit interest rate fell by 67 bps compared to Dec 2013

In May, the avg. new loan interest rate for household loans in RON fell 33 bps versus Dec 2013



Sources: NBR



Sources: NBR

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