Weekly Market Letter

- Euro area flash inflation came at 2.2% y/y in December, unchanged compared to November.
- US non-farm payrolls advanced by 155,000 jobs and unemployment rate steadied at 7.8% in December. The most recent employment numbers substantiate the further need for Fed's exceptional policy actions but signal that businesses weathered sufficiently well concerns about the fiscal cliff.
- Minutes of the Dec. 11-12 FOMC meeting revealed that Members were split over the idea of buying assets until end-2013 and several policymakers want to stop purchases, concerned with the effect on Fed balance sheet.

FX market

- Despite the successful resolution of the US fiscal cliff, the post-deal rally faltered quickly for most CEE FX peers. The RON edged higher 0.1% w/w.

Bond market

- In spite of the absence of primary auctions and the lighter holiday schedule, yields continued to edge lower across all maturities.
- NBR maintained the cap on the amount allotted at repo auction at RON 4.0 bln, but bids decreased and liquidity conditions eased.

Economic data

- FX reserves (excluding gold) ticked up to EUR 31.21 bln in December on looser debt service schedule.
- The 7th and the 8th reviews of the SBA will be carried out between Jan 15 – 29.
- PPI dropped in November by 0.9% m/m (vs. +0.6% m/m in Oct.) and decelerated to +5.4% y/y (vs. +6.8% y/y previously).
- NIS revised downwards its assessment for the 2011 nominal GDP, i.e. RON 556.71 bln (vs. RON 578.55 bln).

- We expect NBR to maintain to the monetary policy rate unchanged at 5.25% at its meeting on Monday, in line with consensus.

Potential Impact: Neutral

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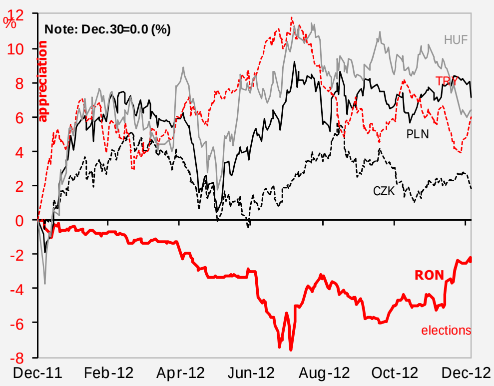
International Developments

Euro area flash inflation came at 2.2% y/y in December, unchanged compared to November. Encompassing this month's release, average HICP reached 2.5% y/y in 2012. The breakdown showed that the decelerating energy prices (+5.2% y/y vs. +5.7% y/y prev.), were offset by a slight fall inch rises in food (3.1% y/y vs. 3.0% y/y prev) and services inflation (1.8% y/y vs. 1.6% y/y in Nov). During the latest GovC, the ECB revised downwards their HICP projections to a mid-point average of 1.6% in 2013 (vs. 1.9% prev).

Minutes of the Dec. 11-12 FOMC meeting revealed that Members were split over the idea of buying assets until end-2013 and several policymakers want to stop purchases before then. Should Fed continue buying at the current pace of USD 85 bln per month for the rest of 2013, it would accumulate another USD 1 tn in long-term assets (vs. USD 2.9 tn currently). While most members considered that the program begun in September had been effective and spurred growth, they saw that the benefits of purchases were uncertain going forward and that the potential costs could rise as the size of the balance sheet increased. Capital markets went into retreat following the publication, while USD gained ground vs. the euro.

US non-farm payrolls advanced more-than-expected in December by 155,000 jobs (vs. BBGf: 152,000) compared to 161,000 (rev.) in November. Jobless rate remained unchanged at 7.8%, following an upwards revision of the previous unemployment figure. Labour participation ominously held steady at 63.6% in December. The most recent employment numbers, including upwards revisions, substantiate the further need for Fed's exceptional policy actions but signal that businesses weathered sufficiently well over the past month concerns about the fiscal cliff in the run-up to its deadline. The labour market release lifted markets' spirits.

Performance of regional currencies
(spot return y-t-d)

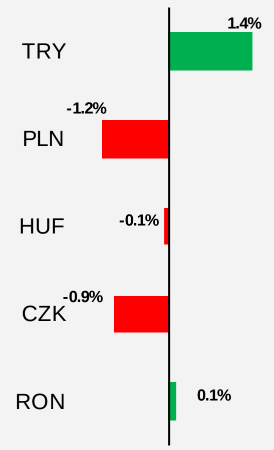


Romania Developments

FX Market

Despite the successful resolution of the US fiscal cliff, the post-deal rally faltered quickly for most CEE FX peers. The PLN relinquished 1.2% w/w, after ending the year in a high note and business confidence recording a slight improvement. The currency was battered by a relatively unsuccessful T-bond auction on Thursday and expectations of a further interest rate cut next Wednesday. The CZK shed 0.9% w/w despite data showing a narrowing in budget deficit in line with target. The HUF inched down 0.1% w/w. The RON edged higher merely 0.1% w/w on the back of higher commercial demand for EUR. NBR continued to pursue a stringent liquidity policy through its regular repo, which supported the exchange rate.

Weekly currency evolutions versus EUR



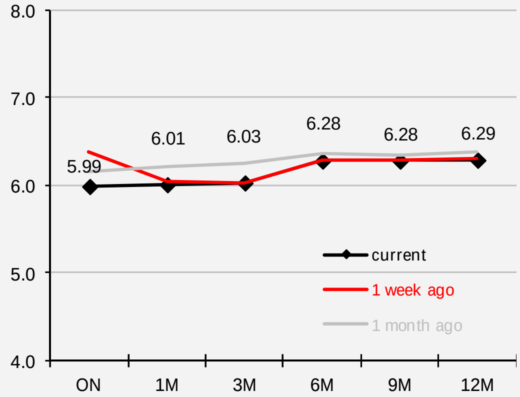
Source: NBR, BRD-GSG

Next week view: EURRON to trade between 4.41-4.44.

	RON vs EUR		RON vs USD	
Friday NBR ref.	4.4251		3.4017	
	ch. pips	ch. %	ch. pips	ch. %
1 week	-20	0.0	-549	-1.6
1 month	940	2.1	649	1.9
vs. Jan.1st 2012	-1,054	-2.4	-624	-1.9

Source: NBR, BRD-GSG

ROBOR rates(%)

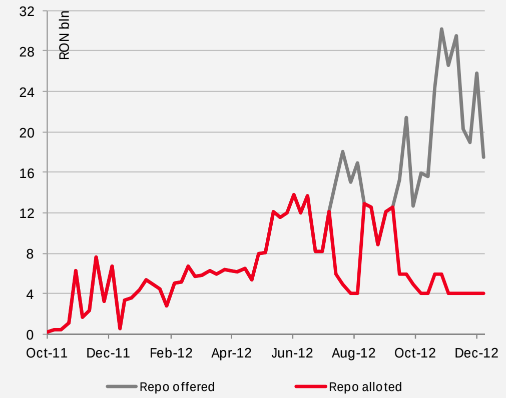


Source: NBR

Money Market

NBR capped again the amount allotted at its weekly repurchase operation at RON 4.0 bln. However, banks' bids dropped to RON 17.5 bln, after surging to RON 25.8 bln at the previous auction before the Christmas break. The number of participants also decreased to merely 13 vs. 17 previously. As a consequence, allotment strengthened to 22.8%, easing pressure on the shorter-end of the curve (particularly overnight and 1W) as a consequence of the more generous liquidity conditions at the start of a new RR period. The longer end of the curve remained flat.

NBR repo auctions (RON bln)



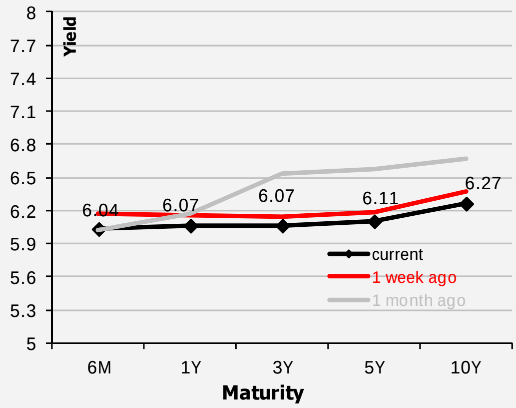
Source: NBR

Bond Market

In spite of the absence of primary auctions and the lighter holiday schedule, yields continued to edge lower across all maturities - by 10 bps (on average).

The yield curve flattened considerably, with substantial adjustments at the tail (10Y maturity). The bulk of investors' interest has targeted selected higher liquidity government paper from the mid part of the curve maturing between 2014-2016 i.e DBN068 (28 Jul 2014), DBN073 (26 Oct 2015) and DBN046 (26 Jul 2017), with positive spillovers onto other maturities. MinFin will hold one T-bill and two T-bond auctions next week, which are expected to be met with success, given the recent rally in investors' appetite for Romanian assets.

Treasury benchmarks (fixing mid, %)



Source: NBR

Auctions - January 2013

ISIN code	Date	Maturity	Amount planned (RONm)	Total Bids (RONm)	Amount Allotted (RONm)	Average yield (%)
RO1314CTN011	7-Jan	1Y	500			
RO1214DBN068	7-Jan	2Y	800			
RO1216DBN030	10-Jan	4Y	600			
RO1314CTN029	14-Jan	1Y	500			
RO1215DBN073	14-Jan	3Y	800			
RO1217DBN046	17-Jan	5Y	500			
RO1313CTN039	21-Jan	1Y	300			
RO1323DBN018	24-Jan	10Y	600			

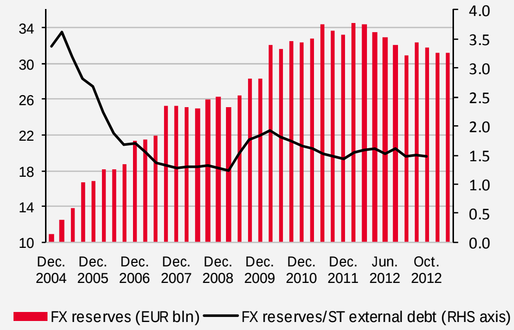
Source: Ministry of Finance

Economic Data

FX reserves (excluding gold) ticked up to EUR 31.21 bln in December on looser debt service schedule; The 7th and the 8th reviews of the SBA will be carried out between Jan 15 - 29; PPI dropped in November by 0.9% m/m (vs. +0.6% m/m in Oct.) and decelerated to +5.4% y/y (vs. +6.8% y/y previously); NIS revised downwards its assessment for the 2011 nominal GDP, i.e. RON 556.71 bln (vs. RON 578.55 bln).

FX reserves (excluding gold) ticked up to EUR 31.21 bln in December from EUR 31.16 in November. Net inflows amounted to EUR 39 m. Total inflows of RON 2.13 bln stemmed from inflows into the MinFin accounts (the proceeds of international issuance), inflows into EC account and changes in the FX reserve requirements of the credit institutions. Total outflows decelerated to EUR 2.09 bln in December from EUR 3.9 bln in November. This amount includes an equivalent of EUR 252.05 m, representing the payment of the third principal instalment and interest of the 2009-2011 SBA.

FX reserves/Short term debt

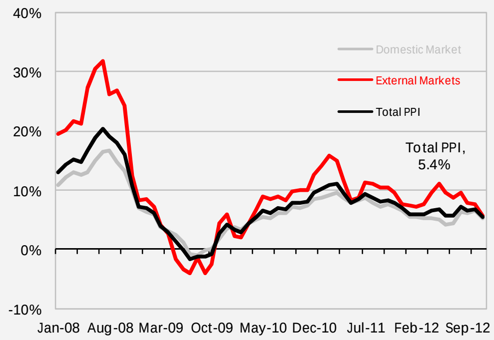


Source MinFin, BRD-GSG

Given the heavy repayment schedule to the IMF/EC/WB until 2015, FX reserves could continue edging lower. Consequently, NBR will likely maintain a judicious balance between keeping the FX/short-term external debt ratio at adequate levels and the need to limit EURRON volatility by indirect interventions.

The **IMF** announced in a communiqué released on Jan.3rd that the 7th and the 8th reviews of the SBA will be carried out from January 15 to 29, 2013. As a reminder, the 7th review of the SBA had been postponed until after the new government would be instated and was replaced with a joint **IMF/EU/WB** delegation on November 6th to discuss economic developments, policies and perspectives. The IMF/EC/WB mission is scheduled to discuss with the Romanian authorities the 2013 budget of the general government, progress on structural reforms, the monetary policy stance and the economic outlook.

PPI lose steam



Source NIS, BRD-GSG

PPI dropped in November by 0.9% m/m (vs. +0.6% m/m in Oct.) and decelerated to +5.4% y/y (vs. +6.8% y/y previously). The evolution was buttressed by substantial price contractions on external markets (-1.8% m/m) augmented by reductions on domestic markets (-0.5% m/m). The only marginal rise was recorded in the Power, gas and air conditioning distribution (+0.1% m/m, 4.0% y/y), while Mining and Manufacturing recorded notable price drops (-0.3% m/m, -1.1% y/y).

Looking forward, while industry and construction confidence indicators ominously point to a retreat in expectations about selling prices, the heavy deregulation schedule of administrated prices will weigh heavily on businesses. Nevertheless, due to the sluggish recovery in demand, we continue to regard PPI dynamics as supportive of a subdued inflationary trend over the medium term, given the limited room for passing-through cost push pressures onto consumers.

The **NIS** revised downwards by RON 20 bln its assessment for the 2011 nominal GDP, i.e. RON 556.71 bln (EUR 131.33 bln) compared to a previous estimation of RON 578.55 bln. As a consequence, the real GDP performance now stands at 2.2% y/y instead of 2.5% y/y. Moreover, as emphasized by the incumbent PM, the knock-on effect of the shortfall will be a further unforeseen spending cut of RON 1 bln to rein in budget deficit at 1.8% of projected GDP.

Romania Economic Previews

Event	Period	Date	BBG Survey	BRD-GSGf	Actual	Prior
Key interest rate		7-Jan	5.25%	5.25%	--	5.25%

We expect NBR to keep the key rate unchanged at 5.25% at its MPC meeting on January 7th, thus maintaining a prudent approach to monetary policy in the context of a lurking supply-side inflationary pressures spiking at the beginning of the year. With economic growth projected to run below potential over the medium-term (we estimate GDP growth at 2.0% in 2013), NBR has only limited space to employ the interest rate channel and is bound to continue deploying liquidity management measures. We do not expect any change in the current levels of minimum reserve requirements (RON liabilities - 15%, FX liabilities – 20%).

We expect the Central Bank to acknowledge the positive effect of the abating domestic turbulence as a positive factor supporting EURRON and limiting private capital outflows.

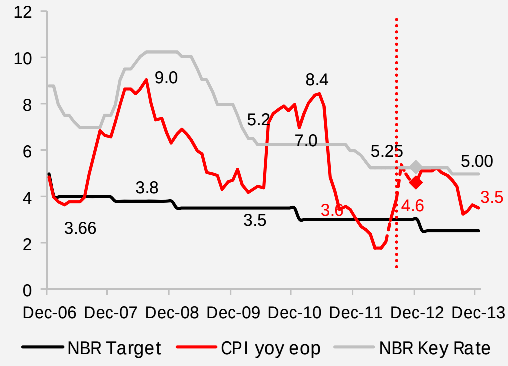
From an inflation perspective, November CPI ground to a near-halt at 0.04% m/m (+4.56% y/y), buttressed by notable decelerations across food prices and favourable developments in Non-food components (i.e. Fuels) and Services. Accounting for November's positive surprise, we now envisage inflation to overshoot the upper limit of the NBR target interval of 2-4% and reach 4.6% y/y by year-end.

For the following months, we see CPI gathering steam again, spurred by temporary supply-side factors. Administered price increases will rattle headline inflation throughout the cold season, spiking in Q1'13 with the implementation of the new excise tax reference exchange rate. For 2013 as a whole, we continue to envisage the brittle recovery in domestic demand as the main determinant taming inflationary developments, whereas temporary supply-side pressures resulting from the heavy schedule of administered price hikes will abate. The large negative output gap (IMF: -3.5% in 2013, NBR: -4.65% in Q1'13) will limit further propagation through secondary round effects, such that CPI will likely end up at 3.5% y/y by end-2013.

As such, we envisage NBR to continue its balancing act between growth and inflation throughout H1'13. Instead of employing the interest rate channel, it is likely that monetary policymakers will continue openly deploying "firm" liquidity management through capping allotted amount at repo operations as a more effective and faster tool to control both rates and limit excessive EURRON moves. Repo operations should also support the adequate redistribution of interbank liquidity.

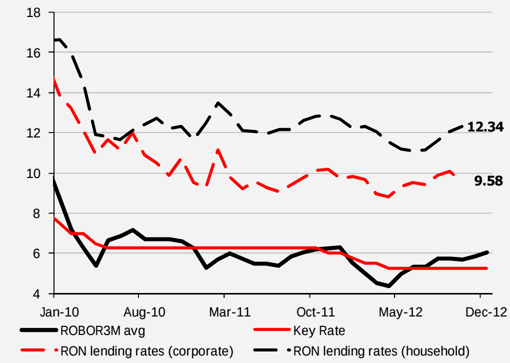
We estimate NBR will keep the key rate at 5.25% at least until Q3'13 to fight off potential second-round inflationary effects from the increases in regulated prices. But as transitory strains taper off and external conditions allow it, the Central bank should seize the window of opportunity and resume the rate-cutting cycle to address growth slowdown.

Inflation and key rate:



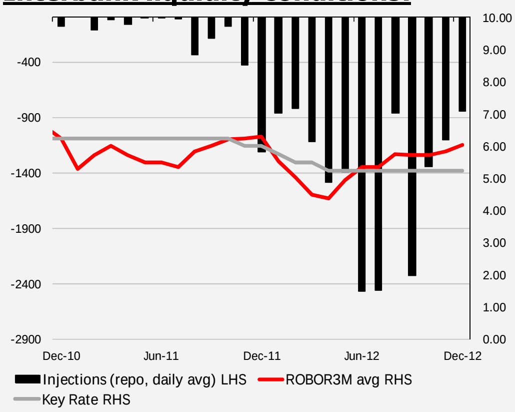
Source NBR, NIS, BRD-GSG

Policy rate pass-through:



Source NBR, BRD-GSG

Interbank liquidity conditions:



Source NBR, BRD-GSG

BRD
GROUPE SOCIETE GENERALE

Economic Releases – January 2013

Date	Event	Period	BBG Survey	BRD-GSGf	Actual	Prior
1/3/2013	International Reserves (Total)	Dec	--		35.4B	35.6B
1/4/2013	Producer Prices (MoM)	Nov	--		-0.9%	0.60%
1/4/2013	Producer Prices (YoY)	Nov	--		5.4%	6.80%
1/7/2013	Interest Rate Announcement		--	5.25%	--	5.25%
1/8/2013	Retail Sales (MoM)	Nov	--		--	-2.00%
1/8/2013	Retail Sales (YoY)	Nov	--		--	0.70%
1/9/2013	Industrial Sales (MoM)	Nov	--		--	6.00%
1/9/2013	Industrial Sales (YoY)	Nov	--		--	9.40%
1/9/2013	Trade Balance (Mln Euros)	Nov	--		--	-1111.1
1/11/2013	Industrial Output (MoM)	Nov	--		--	0.00%
1/11/2013	Industrial Output (YoY)	Nov	--		--	-0.10%
1/11/2013	Consumer Prices (MoM)	Dec	--	0.30%	--	0.00%
1/11/2013	Consumer Prices (YoY)	Dec	--	4.60%	--	4.60%
1/18/2013	Current Account (EUR)(YTD)	Nov		-4730M	--	-4342M
1/24/2013	Money Supply (YoY)	Dec	--	--	--	--

Source: NIS, NBR, BRD-GSG
*Bloomberg survey

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