Weekly Market Letter

International Developments pg. 2

- ECB kept its main refinancing rate on hold at 0.75% and cautioned about impact of EUR strength on economic outlook.
- EU leaders are nearing an agreement on the 2014-2020 EU multi-annual budget.

Romania Developments pg. 2

FX market

- Most CEE FX peers ended in the positive territory on idiosyncratic triggers following a rather volatile week, while RON year-to-date stellar evolution had its first significant hiccup.

Bond market

- The Ministry of Finance stuck to its issuance schedule this week, despite having tendered two high profile papers (DBN073, DBN046); yields went into reverse as bullish mood stumbled.

Economic data

- Total public debt rose by 0.8% m/m to RON 240.9 bln in Nov or 41.16% of 2012 expected GDP.
- PPI dropped further in December by 0.2% m/m (+4.9% y/y).
- NBR Board decided to keep key rate on hold at 5.25%.
- NBR maintained its year-end inflation projections to 3.5% y/y.
- Registered unemployment (national methodology) rose to 5.82% in January.
- The average nominal net wage rose by 7.7% m/m in Dec.
- Construction activity (sa) plummeted 2.8% m/m (-9.5% y/y) in Dec.
- Industrial output (sa) stagnated in December (+0.0% m/m; -0.6% y/y).

Romania Economic Previews pg.7

- We estimate that CPI will increase by 0.4% m/m and pick up slightly to 5.1% y/y in January, below market expectations. Potential Impact: Positive/Neutral
- We expect Q4'12 GDP to inch up by 0.2% q/q (sa) and 0.3% y/y (nsa). Potential impact: Neutral

Economic Releases – February 2013 pg. 8

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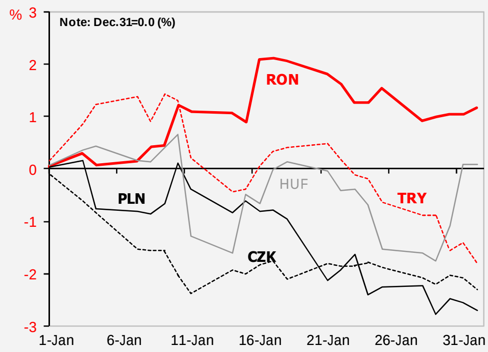
International Developments

In line with expectations, ECB kept its main refinancing rate on hold at 0.75% on Thursday, while the Bank's economic projections regarding EMU recovery remained unchanged. However, Pres. Draghi alluded to the recent EUR rally and earmarked a sustained appreciation as a downside risks to the outlook, even though the exchange rate was not, in itself, a policy target. The comments hammered down EURUSD, down 0.9% d/d.

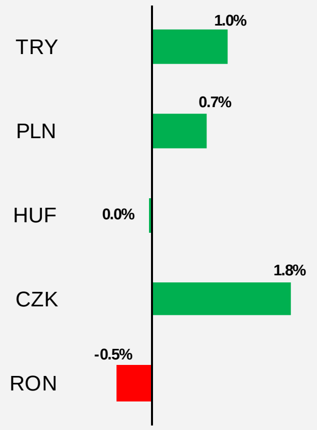
EU leaders are nearing an agreement on the 2014-2020 EU multi-annual budget. Should it be approved, the EUR 960bln long-term budget would entail the first ever decline in EU expenditure (-3% vs. 2007-2013 allocation). Note that EC initial proposal was EUR 1,033 bln and most cuts would stem from cross-border infrastructure projects, funding cuts for tackling youth unemployment and agriculture. The lower figure, while palatable for the UK and Germany, remains at odds with the French position supporting stronger "solidarity". The draft budget would also translate in a cutback in structural funds allocation for Romania.

Romania Developments

Performance of regional currencies
(spot y-t-d, NBR fixing)



Weekly currency evolutions versus EUR



Source: NBR, BRD-GSG

FX Market

Most CEE FX peers overcame the rough start, marked by renewed concerns about the political scenery in Spain and Italy, and rebounded on idiosyncratic triggers. CZK rallied 1.8% w/w, bolstered by Wednesday MPC decision. CNB expectedly remained on hold at technical zero but signalled that the "need for monetary easing may be less urgent", clamping down expectation of FX intervention. PLN added 0.7% w/w as NPB cut key rate in an effort to revive the economy but changed its tone regarding MP to indicate that interest rate path will depend on incoming data and inflation. In absence of fresh headlines about the MNB successor, HUF was little changed over the week, despite dismal December industrial output reading. The RON ytd stellar evolution had its first significant hiccup, shedding 0.5% w/w. Contrary to our call, the local currency broke through the 4.4 threshold in absence of stringent liquidity backstop and significant net inflows for the 3Y and 5Y auctions.

Next week view: EURRON to trade between 4.37-4.41.

	RON vs EUR		RON vs USD	
Friday NBR ref.	4.3970		3.2773	
	ch. pips	ch. %	ch. pips	ch. %
1 week	-199	-0.5	-740	-2.3
1 month	-168	-0.4	237	0.7
ytd	183	0.4	910	2.7

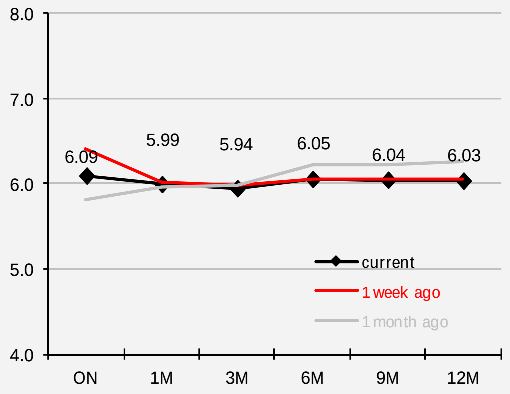
Source: NBR, BRD-GSG

Money Market

In line with the change of tone at last month's MPC and its reaffirmed objective to strengthen monetary transmission mechanism, NBR loosened further the cap on the repurchase agreement auction to RON 10bln (vs. RON 9bln previously). Bids surged further to a record-high RON 38.5 bln compared to RON 37.47 bln the week before, such that allotment barely edged up at 26% of bids.

As a consequence of the looser liquidity conditions, O/N rates retrenched by a solid 30 bps, while the longer end of the curve remained virtually unchanged. NBR's move impacted EURRON pair volatility, which sprung right out of the 4.35-4.38 tight variation band to exceed the 4.41 threshold.

ROBOR rates(%)

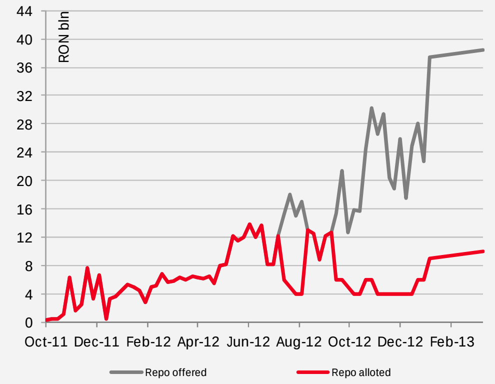


Source: NBR

Bond Market

Due to the frail and more volatile external sentiment, Treasury debt managers have stuck to the issuance schedule, allotting the planned RON 1.73 bln since Febr 1st. MinFin tendered two high profile papers this week (DBN073 and DBN046), but none of them managed to attract nearly the level of interest seen back in Jan, as investors curtailed their bullish positions and paced down exposure to frontier markets. The rough month start does not change our fundamental view on the ROMGB, in absence of country specific events driving the correction. We view NBR confirmation of a 3.5% y/y year-end inflation projection and the relatively smooth Parliament vote on the 2013 budget as FI-positive.

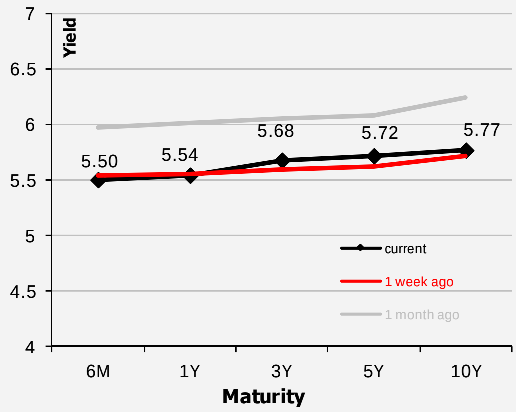
NBR repo auctions (RON bln)



Source: NBR

MinFin tapped markets to issue the target amount of RON 0.5 bln in 1Y ROMTB0 2/14 and RON 0.74 bln (planned RON 0.5 bln) in 3Y ROMGB5.8 10/15. Average paid yield for the 1Y note came at 5.51%, a hefty 34 bps lower than a similar auction on Jan.14th. MinFin sold RON 0.74 bln in the keenly-watched 3Y fixed rate bonds DBN073 series, just slightly higher than the planned amount of RON 0.5 bln. Given its compliance with the liquidity criterion, the DBN073 series is earmarked for inclusion in both Barclays EMLCI and JPM GBI-EM Indices. Average yield fell to 5.69%, compared to 5.95% at a previous auction on Jan 14th. On Thursday, MinFin sold RON 0.5 bln in 5Y T-bonds (ROMGB5.9 07/17). Despite this being February's first bond tender that will be included in the JPM GBI-EM, demand came below expectations (bid-to-cover 1.7x), which impacted the allotment. Average paid yield came at 5.79% (in line with secondary market yields), edging higher compared to the strong 5.40% paid at a similar auction on Jan.17th, while tail was slightly narrower (5 bps vs 15 bps prev.).

Treasury benchmarks (fixing mid, %)



Source: NBR

Front-end secondary market yields inched down marginally compared to last week (1-3bp), while longer-tenure yields advanced by avg 0.7 bp. MinFin officials announced the start of a roadshow next week with a view to issue an international USD bond, depending on market conditions.

Auctions - February 2013

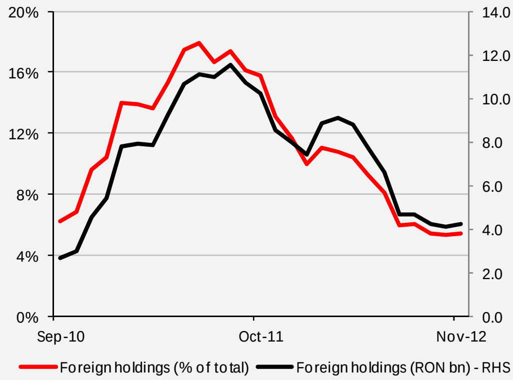
ISIN code	Date	Maturity	Amount planned (RONm)	Total Bids (RONm)	Amount Allotted (RONm)	Average yield (%)	Maximum yield (%)
RO1314CTN045	4-Feb	1Y	500	1,247	500	5.51%	5.59%
RO1215DBN073	4-Feb	3Y	500	857	737	5.69%	5.75%
RO1217DBN046	7-Feb	5Y	500	852	500	5.79%	5.84%
RO1214DBN068	11-Feb	2Y	600				
RO1216DBN030	14-Feb	4Y	300				
RO1314CTN052	18-Feb	1Y	500				
RO1116DBN024	21-Feb	5Y	800				

Source: Ministry of Finance

Economic Data

Total public debt rose by 0.8% m/m to RON 240.9 bln in Nov (41.16% of 2012 GDPe); PPI dropped in Dec by 0.2% m/m (+4.9% y/y); NBR Board decided to keep key rate on hold at 5.25%; NBR maintained its year-end inflation projections to 3.5% y/y; Registered unemployment rose to 5.82% in Jan; Average nominal net wage rose by 7.7% m/m in Dec; Construction activity plummeted 2.8% m/m (-9.5% y/y) in Dec; Industrial output stagnated in December (+0.0% m/m).

Non-resident holdings (nominal and % of total)

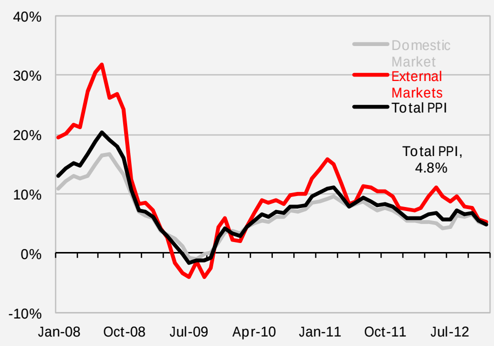


Source: MinFin, BRD-GSG

Total public debt (% of GDP)

Source: MinFin, BRD-GSG

PPI still decelerating



Source: NIS, BRD-GSG

Total public debt (central and local government) rose by 0.8% m/m to RON 240.9 bln in Nov or 41.16% of 2012 expected GDP (revised down to RON 585.2 bln). Central government debt reached 38.8% of proj GDP (vs. 38.5% of GDP in Oct'12). As expected, the advance resulted from November's net issuance on international debt markets (EUR 1.5 bln EMTN, ROMANI4 7/8 11/19). As a consequence, EUR-denominated debt stock advanced to an equivalent of RON 102.42 bln in Nov (vs. RON 97.5 bln prev), despite a relative nominal appreciation of the LCY. Local debt edged lower as MinFin sold as little as RON 3.5 bln in RON-denominated securities ahead of Parliamentary elections, versus total redemptions of RON 2.7 bln and EUR 0.8 bln. The maturity profile of the government securities (excluding ROMANI) inched higher (following the 15Y benchmark tender) to 1.73 years in November (vs 1.68 yrs in Oct).

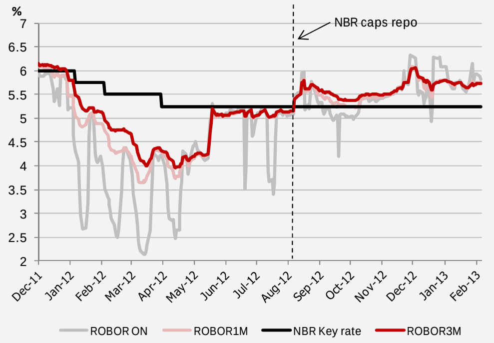
According to ESA95 calculation methodology, total government debt reached 37.2% of GDP in November, as a consequence of the sharp downward revision of the 2012 GDP figure. However, indebtedness remains comfortably below the Maastricht limit of 60% of GDP. Total public debt should increase further in December on the back of hefty local issuance, while mitigated by the EURRON appreciation.

Non-resident exposure to local bonds edged upwards to RON 4.2 bln in November (little over to 5.5% of total) from RON 4.08 bln in October. Moreover, we expect November to have been a turning point in terms of foreigners' appetite for local debt, marked by Barclays' announcement on November 5th 2012 that Romania will be included in its EM Local Currency Government Index as of March 31st, 2013. As a consequence of expectations of improved visibility and higher liquidity, we conjecture appetite for high-yield Romanian assets to have already resumed forcefully, which will be reflected with a lag in official statistics starting December's release.

PPI dropped further in December by 0.2% m/m (vs. -0.5% m/m in Nov.) and decelerated to +4.9% y/y (vs. +5.5% y/y previously). The evolution was buttressed by price contractions on external markets (-0.4% m/m) augmented by inch-reductions on domestic markets (-0.2% m/m). Broken down by industries, Power distribution and sewage prices held steady (0.0%, +6.5% y/y), while Mining (-1.3% m/m, -0.7% y/y) and Manufacturing recorded price drops (-0.2% m/m, ++5.6% y/y). Despite the recent retrenchment, PPI dynamics remains elevated in European comparison (EU27: -0.2% m/m, +1.9% y/y).

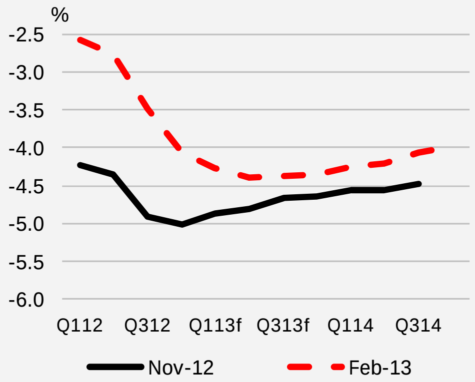
Looking forward, while industry and services confidence indicators ominously point to a retreat in expectations about selling prices, the deregulation schedule of administrated prices will weigh heavily on businesses. Nevertheless, due to the moderate recovery in demand, we continue to regard PPI dynamics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

Money market rates



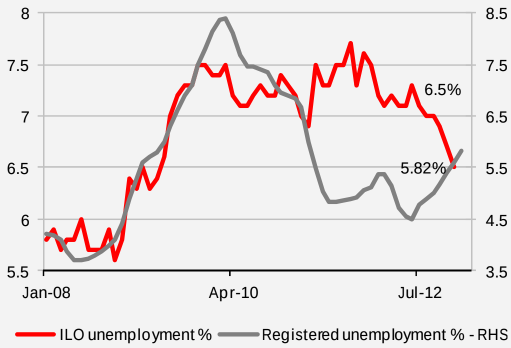
Source: Bloomberg, BRD-GSG

NBR Output gap projections



Source: NBR

Unemployment measures diverging



Source: NIS, BRD-GSG

NBR Board decided to maintain the monetary policy key rate unchanged at 5.25% in line with our expectations and Bloomberg consensus (19 estimates). Moreover, NBR Board decided to keep the minimum reserves requirements unchanged at 15% for RON and 20% for FX liabilities and to maintain an *adequate* management of liquidity. Since the previous MPC meeting (on Jan. 7th), the domestic environment remained stable, while the external environment continued to be supportive of risky assets. However, headline inflation picked up to 4.95% y/y in Dec'12 (vs. 4.6% y/y in Sep'12) on the back of accelerating food and energy prices. NBR maintained a prudent stance – endorsed by the IMF - with regards to both key interest rate and minimum reserve requirements, against the CEE regional easing bias. However, the favourable backdrop has allowed liquidity conditions to be gradually lightened.

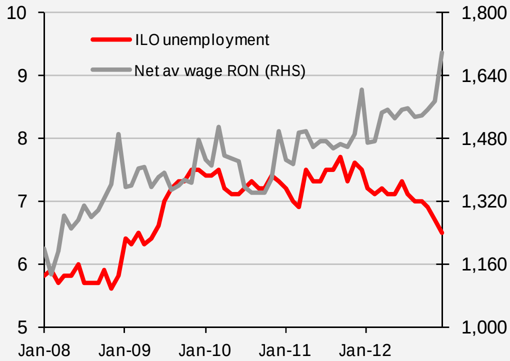
With economic growth projected to run below potential over the medium-term, NBR will continue to shun from employing the interest rate channel and resort to liquidity management measures. However, as long as EURRON maintains a good momentum, the need for managing liquidity supply to fight depreciation will be less stringent, such that one-week caps on the repos will remain at "adequate" levels (as reflected in the easing repo ceilings).

NBR maintained its year-end inflation projections to 3.5% y/y in 2013 and 3.2% y/y in 2014 in its February Inflation Report. However, the Central Bank re-calibrated its projections regarding the individual components' contributions to reflect higher contribution from administered prices (1.5pp vs. 1.2pp prev) and alcohol and tobacco (0.4pp vs. 0.3pp prev), offset by a significantly smaller contribution from adjusted CORE2 (1.2pp vs. 1.7pp prev). The agri-food component continues to entail a large uncertainty, but projections rely on the assumption of a favourable statistical base and normal harvest. Headline CPI is now seen to peak at 5.9% y/y in Q2'13 before stabilizing around 3% in 2014, while adjusted CORE2 should settle around 2.2% next year. The assessment of the risks to the current inflation rate projection reveals a balance still tilted to the upside, but less so compared to November's projections due to abating political noise. The Central Bank cautioned about risks stemming from potentially higher volatility of capital flows.

NBR projections for the output gap were also revised downwards with IMF and EC current forecasts. This reflects a substantially lower potential growth envisaged for 2013 as a consequence of lower contribution from main factors. The Central Bank now envisages the economy to run substantially below potential for the next year (-4.48% in Q4'13 vs. -3.4% prev.)

Registered unemployment (national methodology) rose from 5.59% in December to 5.82% at end-January. Total jobless headcount registered with the National Labour Agency added a hefty 19,574 to reach 513,349 last month. The calculation continues to draw upon a total of 8.82 m employees - a number reported by NIS as active population, which includes self-employed subsidence farmers. The number remains of little significance and bears a minimum impact on the market, in absence of international comparability. January's increase is at odds with the improvement signs conveyed by ILO jobless measure (at 6.5% in Dec), while both tend to underestimate the real jobless rate across business economy. We envisage labour slack to stabilize as the economy recovers gradually towards year-end.

Labour slack and wages

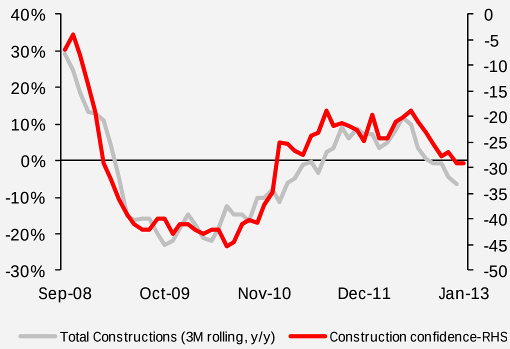


Source: NIS, BRD-GSG

The **average nominal net wage** rose by 7.7% m/m, while annual dynamics accelerated to +5.8% y/y (vs. +1.5% m/m, +5.6% y/y in Nov) to reach RON 1,697 in December. For the economy as a whole, the strong monthly advance was mainly driven by the implementation of a 7.4% public wage hike for employees in public administration and a 2.2% hike across the education sector, according to the Government Ordinance 19/2012. Meanwhile, the highest positive readings across the business sector were reported in the coal mining companies (+26.5% m/m), pharmaceuticals (+24.5% m/m) and financial intermediation (+21.5% m/m) as a consequence of low-earners layoffs and higher contractual revenues. The most notable negative evolution was recorded in the airline transportation sector (-2.0% m/m).

The advance in nominal net wage offset inflationary developments, such that net real wages remained in the positive territory, +0.8% y/y (vs. +1.0% y/y in Nov) and +7.1% m/m (vs. +1.5% m/m in Nov). Looking forward, unemployment expectations for the next 12 months expressed by consumers improved in January (37.3 vs. 39.8 previously). However, surveys of the corporate sector convey mixed signals about the labour force, with industrial companies envisaging the number of employees to stabilize, while services and construction enterprises expecting a lower number of employees over the next quarter. We project the moderate pace of economic recovery to cap hiring activity, which will temper average earnings (in the private sector).

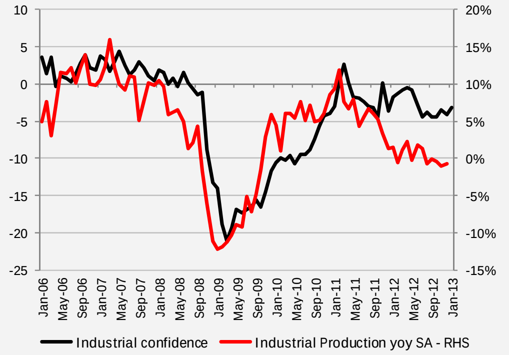
Construction activity faltering



Source: NIS, Eurostat, BRD-GSG

Construction activity (sa) plummeted 2.8% m/m (-9.5% y/y) in December, having further deteriorated compared to Nov performance (-0.8% m/m, -7.0% y/y, revised). Broken down by structural elements, Current repair works (-19.0% y/y vs. -5.0% in Nov) were augmented by the fallout in New construction (-10.2% y/y vs. -7.1% y/y in Nov), dampened by the harsher season. Looking at construction objects, residential building fell off a cliff (-27.9% y/y), while non residential building activity index continued to grow (+19% y/y). More worrisome, Civil engineering, the main conduit bolstering construction dynamics in H1'12, plummeted by 15.5% y/y. This mirrors the drop in Capital expenditures from the general consolidated budget (-14.9% y/y in 12M'12). Overall, in 2012, Construction activity edged higher by 1.6% y/y, supported by publicly-funded infrastructure projects. Looking forward, Construction confidence flattened in January at -29.1, as companies in the sector envisage the number of employees to decline, while the gauge for orders books edged higher. The 2013 budget envisages capital expenses to be cut further by a nominal proj. 9.5% y/y. This bodes badly for large scale projects, unless EC funds absorption picks up sharply to offset the cut-backs.

Industrial output



Source: NIS, Eurostat, BRD-GSG

Industrial output (sa) stagnated in December (+0.0% m/m) and edged lower compared to Dec'11 (-0.6% y/y), as demand from main exports markets remained feeble. The inch-increase in Manufacturing (+0.1% y/y) was counteracted by sharp contractions in Mining (-0.8% y/y) and Electricity, gas, steam and air conditioning (-0.7% y/y). Broken down by major industrial groups, Durable Consumer Goods dropped 1.9% y/y, while Capital goods contracted 1.0% y/y.

For 2012 as a whole, industrial output was flat, with Manufacturing ominously dropping 0.7% y/y, while Mining and quarrying advancing by 1.5% y/y. Looking forward, Factory Orders remain slanted into the negative (-0.9% y/y in Dec), hit by fewer working days effect, whereas businesses' expectations are on the rebound, boosted by positive signals conveyed by EMU recovery (-3.2 vs. -4.1 in Dec).

Romania Economic Previews

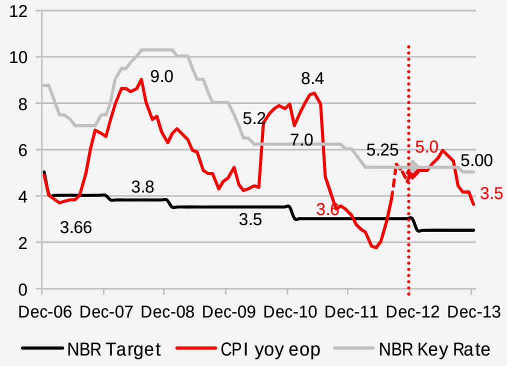
Event	Period	Date	BBG Survey	BRD-GSGf	Actual	Prior
Consumer Prices (m/m)	Nov	12-Feb	0.8%	0.4%	--	0.6%
Consumer Prices (y/y)	Nov	12-Feb	5.4%	5.1%	--	5.0%

According to our estimates, **CPI** increased by 0.4% m/m and accelerated to 5.1% y/y in Jan'13, following the 0.6% m/m uptick recorded in Dec'12 (+4.95% y/y). The advance will mainly stem from higher excise price calculations and a scheduled hike in regulated electricity prices, only partially buffered by the 1% nominal appreciation in EURRON. Overall, our expectations fall below market consensus (BBG median: +5.4% y/y, +0.8% m/m).

We see Food prices quickening by 0.6% m/m, stoked by seasonality effects. Non-food component dynamics should pick up and contribute as a noteworthy pro-inflationary factor throughout H1'12. Non-food inflation should advance by as much as 0.9% m/m in Jan'13, spurred by upwards adjustments in administered prices, only partially mitigated by lower international oil prices (-1.06% m/m in RON). Looking forward, in line with liberalisation commitments to the IMF, the Romanian Energy Regulatory Authority has announced gas price hikes for households (Jul, Oct) and for corporates (Apr, Jul and Oct). As Romania takes steps towards deregulating the electricity market, final prices will rise twice (in Jul and Sep) for households and 3 times for corporates (Apr, Jul, Sep). We envisage services inflation to paint at -0.2% m/m on EURRON nominal appreciation. Note that the projections rely on a very modest rebalancing of the consumption basket towards lowering the weight of food components in line with EU average.

We maintain that supply side risks remain considerable over the next months, temporarily fuelling inflationary pressures over the near-term. Administered price increases (outside those already planned) and fuel price gyrations remain noteworthy upside risks. On the other hand, the virtual lack of demand-pulled pressures will contain the propagation of inflation through second-round effects and will contain the pass-through of cost-push factors. In light of recent developments, we project inflation to remain above the upper limit of the NBR target interval throughout H1'13 and retrench steeply thereafter, hinging strongly on a bumper harvest as opposed to last year.

CPI Inflation

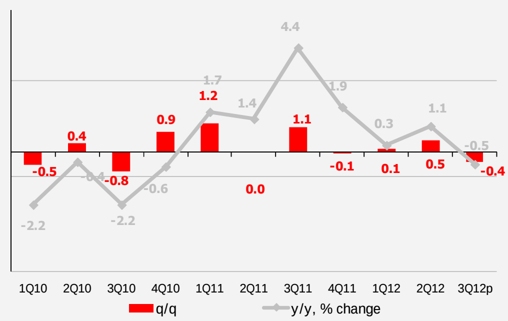


Source: NIS, BRD-GSG

Event	Period	Date	BBG Survey	BRD-GSGf	Actual	Prior
GDP (q/q, sa)	Q4'12	14-Feb	-0.1%	0.2%	--	-0.4%
GDP (y/y, nsa)	Q4'12	14-Feb	0.2%	0.3%	--	-0.5%

We expect **Q4'12 GDP** to have crossed into the positive territory, while having recorded a subdued performance (+0.2% q/q, +0.3% y/y). On the demand-side, high frequency monthly data shows that Exports likely continued to perform poorly and contracted also in Q4'12, as the EMU recessionary environment cut back demand for Romania's products. Investments (supported in H1'12 by public funded infrastructure projects) likely slowed down considerably towards year-end on fiscal tightening. The sole counterbalancing force could have been Final consumption, propped by Private consumption. In terms of supply, value added likely inched lower in industry and constructions, and continued to plummet in agriculture. On the other hand, services maintained a marginal positive edge. For 2013, we have revised downwards our expectations to 1.3% y/y (from 2.0% y/y previously) on a protracted EMU adjustment, continued deleveraging and pro-cyclical domestic fiscal stance weighing on growth outlook.

Quarterly GDP (%, q/q and y/y)



Source: NIS, BRD-GSG

Economic Releases – February 2013

Date	Event	Period	BBG Survey	BRD-GSGf	Actual	Prior
2/1/2013	Retail Sales (MoM)	Dec	--		-3.2%	2.0%
2/1/2013	Retail Sales (YoY)	Dec	--		-2.3%	3.0%
2/1/2013	International Reserves (Total)	Jan	--		35.6B	35.4B
2/4/2013	Producer Prices (MoM)	Dec	--		-0.2%	-0.9%
2/4/2013	Producer Prices (YoY)	Dec	--		4.9%	5.4%
2/5/2013	Interest Rate Announcement	2/5/2013	--	5.25%	5.25%	5.25%
2/6/2013	Net Wages (YOY)	Dec	--		5.8%	5.6%
2/6/2013	Industrial Sales (MoM)	Dec	--		-17.5%	-2.8%
2/6/2013	Industrial Sales (YoY)	Dec	--		-3.5%	4.6%
2/8/2013	Industrial Output (MoM)	Dec	--		0.0%	-0.8%
2/8/2013	Industrial Output (YoY)	Dec	--		-0.6%	-1.3%
2/11/2013	Trade Balance (Mln Euros)	Dec	--			-409.00
2/12/2013	Consumer Prices (MoM)	Jan	0.80%	0.40%		0.6%
2/12/2013	Consumer Prices (YoY)	Jan	5.40%	5.10%		5.0%
2/12/2013	Current Account (EUR)(YTD)	Dec	--	-4.59M		-4245M
2/14/2013	GDP YoY%	4Q A		+0.3%		-0.5%
2/14/2013	GDP SA QoQ	4Q A		+0.2%		-0.4%
2/25/2013	Money Supply (YoY)	Jan				2.0%

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

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