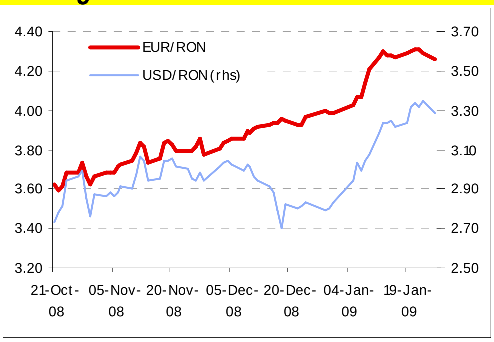
Economic overview
Romania

January 2009

Exchange rates



Source: National Bank of Romania

NBR's interest rates

		Data as of:
NBR key interest rate	10.25%	
NBR depo rate (avg.)	10.25%	22-Dec-08
NBR CD rate (avg.)	6.96%	14-Sep-07

Source: National Bank of Romania

Money market interest rates

	1 M	3 M	6 M	12 M
ROBID	14.02%	13.82%	13.68%	13.56%
ROBOR	15.68%	15.31%	15.36%	15.37%

Data as of: 27 January 2009
Source: National Bank of Romania

Exchange rate outlook

	Current	Mar-09	Jun-09	Sep-09	Dec-09
EUR/RON	4.2634	4.20	4.00	3.95	3.80
USD/RON	3.2890	3.23	2.96	2.72	2.53
EUR/USD	12963	130	135	145	150

Data as of: 26 January 2009
Source: Raiffeisen RESEARCH

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This report was completed on 27 January 2009.

Highlights

- Consolidated budget deficit jumped from 3% of GDP in November to 4.8% of GDP in December. When the European Commission methodology is used, the budget deficit climbed to 5.2% of GDP. At the moment, the government is struggling to find ways to reduce public spending in order to cut the budget deficit at only 2% in 2009. We think this is very difficult and we expect the budget plan for 2009 which is to be released by the end of January.

- Economic activity decelerated rapidly in the ending months of 2008. Industrial output contracted by 11.5% yoy in November. Growth rate of retail sales (in real terms) decelerated from 17.6% yoy in Q3 2008 to only 2.8% yoy in November. Construction sector expanded by 13.5% yoy in November, down from 28.5% yoy in Q3 2008. These data point to a low GDP growth rate in Q4 2008 (close to 3.5% yoy according with our expectations).

- Monthly inflation rate came in at 0.23% in December, below market expectations. Annual inflation rate stood at 6.3% yoy at the end of 2008, above the NBR's target of 3.8% with a band of +/-1%.

- Imports decelerated faster than exports in last months and the foreign trade deficit (as % of GDP) started to decrease. We expect now to see the current account deficit at 13.1% of GDP at the end of 2008, down from 13.9% of GDP at the end of 2007.

- NBR hold unchanged the monetary policy rate at 10.25% on 6 January. It hold also unchanged the minimum reserve requirements both for leu and foreign currencies.

- The leu remains under depreciation pressure. It lost close to 8% against euro since the beginning of the year.

Credit ratings (FCY long-term)

	S&P	Moody's	Fitch
Rating / Outlook	BB+ / Negative	Baa3 / Stable	BB+ / Negative

Key economic figures

	2006	2007	Oct-08	Nov-08	Dec-08	*2008f*	*2009f*
Real GDP (%, yoy)	8.2	6.0				*7.2*	*2.5*
Industrial output (%, yoy)	7.1	5.4	(2.8)	(11.5)		*1.3*	*1.0*
CPI eop (%, yoy)	4.9	6.6	7.4	6.7	6.3	6.3	*4.5*
CPI avg (%, yoy)	6.6	4.8	7.9	7.9	7.9	7.9	*5.7*
Unemployment (%, avg)	5.4	4.3	4.0	4.0	4.0	4.0	*5.5*
Budget balance (% of GDP)*	(1.5)	(2.3)	(1.6)	(3.0)	*(4.8)*	*(4.8)*	*(3.8)*
Trade balance (EUR bn, ytd)	(11.8)	(17.6)	(15.6)	(16.9)		*(18.5)*	*(14.6)*
CA balance (EUR bn, ytd)	(10.2)	(16.9)	(14.4)	(16.0)		*(17.5)*	*(14.7)*
FDI (EUR bn, ytd)	8.7	7.0	8.2	8.6		*8.7*	*4.5*
Official FX reserves (EUR bn)	21.3	25.3	27.3	27.2	26.2	26.2	*25.0*

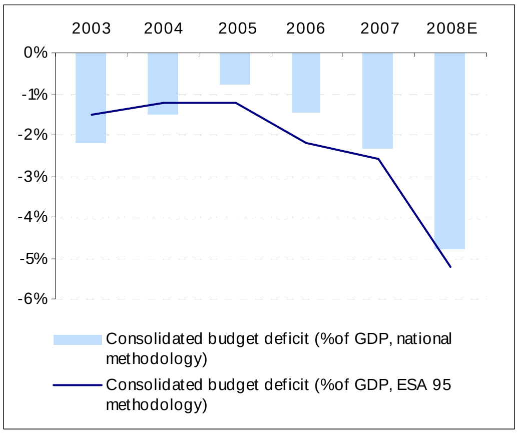
** national methodology*
Source: National Bank of Romania, National Institute of Statistics, Raiffeisen RESEARCH

Raiffeisen RESEARCH
RZB Group

Key events of the month

Large jump in budget deficit in 2008

Public spending increased rapidly in December 2008. Consolidated budget deficit jumped from 3% of GDP in November to 4.8% of GDP in December. The deficit climbed to 5.2% of GDP at the end of 2008 when the European Commission methodology (ESA 95) is used. In our opinion, recent rapid deterioration of the budget deficit is a straightforward consequence of the pro-cyclical fiscal policy in last years.



Source: Finance Ministry, Raiffeisen RESERACH

Recent important events

CNP and EC released new forecast for Romania

■ The National Commission of Prognosis (CNP) and the European Commission (EC) released last week new forecasts for Romania. Both of them revised downward their expectation regarding economic growth in 2008 and 2009. They also expect inflation and current account deficit to decrease in the next two years.

■ The EC forecasts a very large budget deficit in 2009 and 2010. But the EC stressed that its forecast doesn't take into account the corrective measures to be taken by the new government in the new budget plan (which is still under discussion). The forecast was based only on the measures approved by the former government in 2008. In the EC forecast, the rapid deterioration of the budget deficit in 2009 is explained probably by the planned increase in pensions and wages in the education sector, by the full impact of the 2008 cuts in the social security contributions, by the cost related to the second pension pillar, recent tax cuts (removal of taxes on certain capital and interest gains, preferential tax treatment for R&D expenditure, reduced VAT for social housing) and by the expected decrease in revenues due to lower GDP growth rate. In our opinion, the large expected figures reflects nothing else than the large slippage in the fiscal policy in last years. We think that it would be very difficult for the new government to reduce the budget deficit to 2-2.5% of GDP in 2009 unless very radical measures would be taken. Based on the information available at this moment, we expect to see the budget deficit decreasing to around 4% of GDP in 2009 (ESA95).

	CNP			EC			Raiffeisen		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Real GDP (%yoy)	7.9	2.5	4.5	7.8	1.8	2.5	7.2	2.5	3.5
GDP deflator (%yoy)	15.3	10.1	8.9	13.5	7.3	6.4	13.5	8.6	6.3
Nominal GDP (%yoy)	24.4	12.9	13.8	22.4	9.2	9.1	21.7	11.3	10.0
Inflation (%yoy, average)	7.9	5.0	3.7	7.9	5.7	4.0	7.9	5.7	4.0
Current account balance (%of GDP)	-12.2	-10.3	-9.5	-12.9	-11.9	-11.1	-13.1	-10.7	-9.5
Budget deficit (%of GDP)	n.a.	n.a.	n.a.	-5.2	-7.5	-7.9	-5.2	-4.0	-3.0

CNP = National Commission of Prognosis (forecasts as of 19 January 2009)
EC= European Commission Interim Forecast (forecasts as of 19 January 2009)

Key upcoming events and data releases

Date	Indicator/ Event	Next release		Recent developments			
		Reference date	Own forecast	Dec-08	Nov-08	Oct-08	Sep-08
27-Jan-09	Non-government credit, %yoy	Dec-08		33.7	38.3	44.8	50.5
29-Jan-09	Economic Sentiment Indicator, s.a.	Jan-09		84.6	91.4	103.7	105.0
02-Feb-09	FX official reserves, EUR bn	Jan-09		26.2	27.2	27.3	26.0
03-Feb-09	PPI, %yoy	Dec-08	10.4		11.7	16.7	18.6
04-Feb-09	Monetary policy meeting, key rate %	Feb-09	10.25	10.25	10.25	10.25	10.25
04-Feb-09	Gross wages in economy, %yoy	Dec-08			19.8	22.0	24.1
04-Feb-09	Gross wages in industry, %yoy	Dec-08			18.3	19.2	25.4
09-Feb-09	FOB/FOB foreign trade deficit, EUR bn, last 12 months	Dec-08			-18.7	-19.2	-19.4
12-Feb-09	CPI, %yoy	Jan-09	6.4	6.3	6.7	7.4	7.3
12-Feb-09	Industrial output, %yoy	Dec-08			-11.5	-2.8	3.8
12-Feb-09	Output in construction, %yoy	Dec-08			13.5	16.7	28.1
12-Feb-09	Current account deficit, EUR bn, last 12 months	Dec-08			-18.1	-18.4	-18.6
12-Feb-09	FDI inflows, EUR bn, last 12 months	Dec-09			9.0	8.7	8.5
13-Feb-09	Retail sales, %yoy	Dec-08			2.8	8.4	16.8
24-Feb-09	Non-government credit, %yoy	Jan-09		33.7	38.3	44.8	50.5
26-Feb-09	Economic Sentiment Indicator, s.a.	Feb-09		84.6	91.4	103.7	105.0

Source: National Institute of Statistics, National Bank of Romania, Eurostat

Economic activity decelerated rapidly in Q4 2008

while short-term perspectives are negative

■ Deceleration of economic activity in the Euro Area was not reflected in the Romanian economy in the first half of 2008. Growth rate of exports remained high, industrial output expanded also rapidly, while economic growth was also high (8.8% yoy in H1 2008). But the things changed in the second half of 2008 when the recession in the Euro Area became more severe and the international credit markets stopped functioning normally. So, the economic growth in Romania started to decelerate visible in Q3 2008 (GDP without agriculture advanced only by 5.9% yoy in Q3 2008, down from 9.1% yoy in H1 2008), while the most recent data point to a gloomy picture in Q4 2008. Monthly growth rates already switched to the negative territory in industry, while they decelerated substantially in the case of the other GDP components (construction, services). Household expenditures, which remained resilient until Q3 2008, are also decelerating (as reflected by weaker retail sales figures in October and November). The economic sentiment indicator deteriorated also rapidly at the end of 2008.

■ In this context, economic growth perspectives for 2009 deteriorated substantially. We expect now the real GDP to expand only by 2.5% yoy in 2009 and the risks are on the downside (which means we don't exclude even a lower figure). We expect weak GDP figures in 2008 Q4 and 2009 H1, but we still see a slight recovery in the economic activity in the second half of 2009. The uncertainty is very high, but nevertheless we expect the GDP growth to remain most likely in the positive territory.

Recent developments in industry

■ Major world economies and Euro area countries (which are the main trading partners of Romania) are currently in recession. As a result, the external demand for Romanian products has decreased rapidly. This is putting downward pressures on the Romanian exports and on the domestic industrial output which is the main source of the exports. In Romania, exports accounted only for 29.5% of the GDP in 2007, which is a low level among the EU member countries. Theoretically, the impact of the decreasing external demand on the Romanian economy should be lower than in the case of other countries. But metallurgy and automotive industry output account for a large part of the total domestic industrial output. Given that these sectors were hit the most by the current crisis, the Romanian industrial output was also largely affected. There are also other important factors that led to the contraction of industry at the end of 2008: the change in the legislation regarding the pollution tax that had a negative impact on the automotive industry, and the tightening of lending condition by local banks which hit a large part of industries.

■ After a good growth figure in H1 2008 (+6.1% yoy), growth rate of industrial output decelerated rapidly in Q3 2008 (+2.4% yoy) and entered in the negative territory in Q4 2008 (-2.8% yoy in October and -11.5% yoy in November). Among the sectors the most severely hit in the ending months of 2008 are: *metallurgy* (NACE DJ 27), *transport means and equipment* (NACE DM 34 and DM 35), *chemicals* (NACE DG 24 and NACE DH 25), *electric machinery and apparatus* (NACE DL 31), and *non-metallic mineral products* (NACE DI 26).

Changes in real terms, % yoy

	Q3-07	Q4-07	Q1-08	Q2-08	Q3-08	Oct-09	Nov-08
Industrial output	5.5	6.4	2.5	6.4	2.5	-2.8	-11.5
Manufacturing	6.1	7.3	1.7	7.3	1.7	-4.4	-12.8
Construction	32.2	33.7	28.5	33.7	28.5	16.7	13.5
Market services	9.9	12.9	-3.7	12.9	-3.7	-11.5	-11.9
Retail sales	15.6	16.7	17.4	16.7	17.4	8.4	2.8

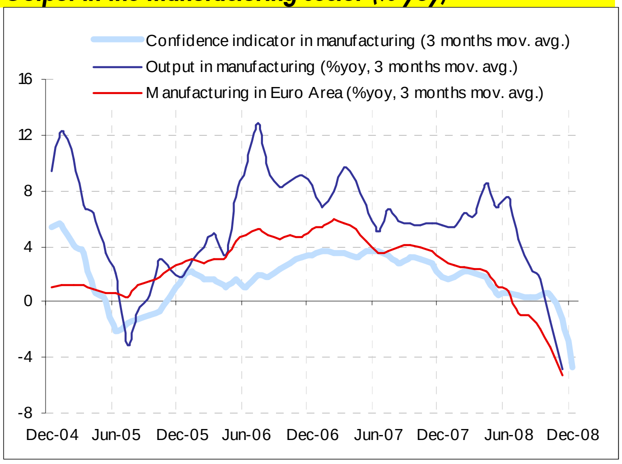
Note: turnover in real terms for market services and retail sales
Source: National Institute of Statistics, Raiffeisen RESEARCH

National accounts aggregates, % yoy

	Q2-07	Q3-07	Q4-07	Q1-08	Q2-08	Q3-08	Q4-08*
GDP	5.7	5.7	6.6	8.2	9.3	9.1	3.5
Domestic demand	14.9	14.9	13.4	17.1	16.1	17.3	10.0
GDP without agriculture and net taxes	7.8	10.8	10.8	8.3	9.7	5.7	2.0
GVA in agriculture	-9.9	-22.4	-16.5	-0.5	3.7	34.8	15.0

Note: Own estimations for 2008 Q4
Source: Eurostat, National Institute of Statistics, Raiffeisen RESEARCH

Output in the manufacturing sector (% yoy)



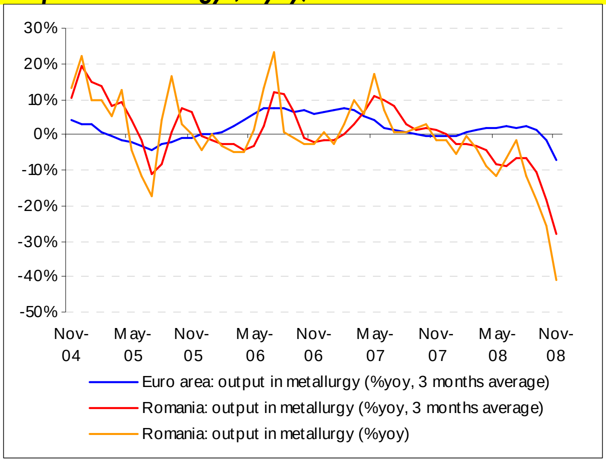
Source: Eurostat, National Institute of Statistics, Raiffeisen RESEARCH

Industry - Worst performers in last months (% yoy)

	Sep-08	Oct-08	Nov-08
Metallurgy	-18.3	-25.7	-41.1
Textiles	-33.0	-39.5	-34.3
Transport means (vehicles)	12.6	-3.2	-29.7
Chemicals	11.7	-6.2	-28.3
Electric appartus, machinery	-16.4	-21.9	-25.3
Other transport means	-11.3	-23.8	-19.7
Radio, television, optical	0.9	-10.5	-15.3
Fabricated metal products	-4.3	-12.2	-12.1
Pulp and paper products	-10.6	-9.4	-11.4

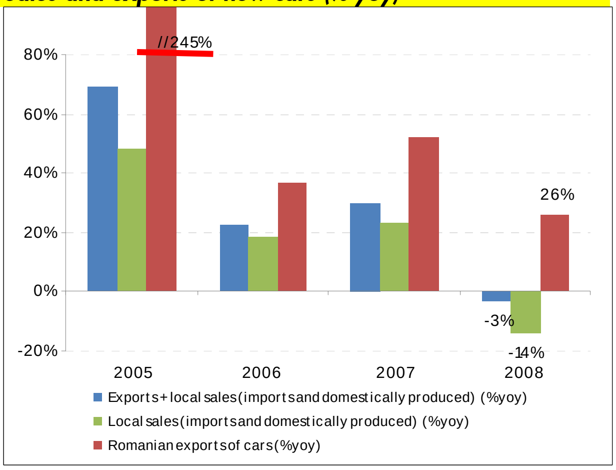
Note: Annual growth rates computed using seasonally adjusted data
Source: Eurostat, Raiffeisen RESEARCH

Output in metallurgy (% yoy)



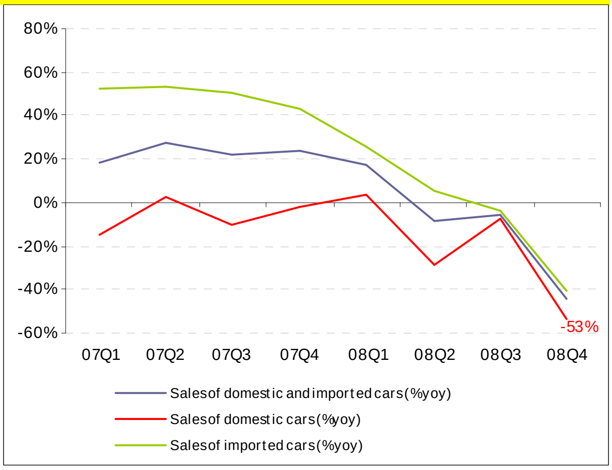
Source: Eurostat, Raiffeisen RESEARCH

Sales and exports of new cars (% yoy)



Source: APIA, Raiffeisen RESEARCH.

Sales of new cars on the local market



Source: APIA, Raiffeisen RESEARCH

■ On the external markets, demand for metallurgical products decreased sharply (putting also downward pressures on prices) as the developed countries entered into recession. Romanian could not escape to these negative developments, especially given the large share of metallurgical products in total exports. **Output in metallurgy (NACE DJ 27)** decreased sharply in the ending months of 2008 (-24.6% yoy in October and -43.9% yoy in November). The most important player on the domestic market is ArcelorMitall. In November-December, the company decided to stop the production in Hunedoara and reduced substantially the activity in Iasi and Galati. Mechel Targoviste and TMK Resita, two other important players in the sector, also cut the production in November and December. Lack of new orders and accumulation of production stocks were the main reasons for reductions in production. All these companies sent the employees temporary home (technical unemployment), hoping to see an improvement in the demand at the beginning of 2009. However, the perspectives remains negative as the recession on the external markets continue to deepen and the domestic demand is also deteriorating (as construction sector is slowing down). For instance, ArcelorMittal Galati announced additional layoffs for 2009 (on voluntary basis for the moment). Also, Alro Slatina - the biggest aluminium producer in the Central and Eastern Europe - said it might cut the production by 25-50% and it might layoff up to 50% of the workforce in 2009. In Romania, metallurgy accounts for around 15% of the total gross value added in the manufacturing sector and for around 13% of total exports (the highest share in the exports). As a result, dynamics of output in metallurgy has a strong impact both on the industrial output but also on the exports. Accordingly, the negative perspectives of the metallurgical sector suggest weak industrial output data for December 2008 and for the first half of 2009 at least.

■ Recession in the European economies and the international financial crisis had also a strong negative impact on the **automotive industry** (including here manufacturers of motor vehicles but also the suppliers of parts and accessories). Although not as dependent on credit purchases as in the US, European automotive industry sales have been impaired by the tightening lending standards and low liquidity levels in financial markets.

■ Low demand for cars on the external markets started to put downward pressures on the Romanian exports of cars (especially in the last months of 2008) but also on the sector of suppliers of parts and accessories (here the impact seems to be stronger). Sharp fall in the local demand for new cars due to changes in the pollution tax and due to a tightening of lending conditions had also a strong negative impact on the domestic automotive industry. The government changed three times the pollution tax in 2008. Following these changes, the sales of new cars (domestic and imported) plunged, while the imports of used cars boomed. Additional pressures on the domestic car producers came at the end of 2008 when the lending growth decelerated rapidly and the consumer confidence deteriorated. Decline of cars sold on the domestic market and produced in Romania was abrupt in Q3 2008 (-40% yoy in October, -59% yoy in November and -61% yoy in December). Data at the beginning of 2009 should be also disappointing. Local car-maker Automobile-Dacia decided to send temporary the employee home for two weeks and it said layoffs in the coming months are not excluded.

■ Looking forward, the most affected sector from the car sales decline (both on the domestic and on the external market) would be the suppliers of car parts and accessories. This is due to the relative high degree of operating and financial leverage of this sector – a higher proportion of fixed costs, mainly interest and depreciation expenses – when compared to the rest of the supply chain. The competitive environment for suppliers of auto parts and accessories as well as for trading companies environment – low industry concentration, high competition – would make them more sensitive to a potential downturn in aggregate demand than in case of manufacturers of motor vehicles (where industry is highly concentrated, being dominated by Automobile-Dacia). Thus, in case of scaling down the production they would be able to reduce only a relatively small part of their operating expenses. The negative demand perspectives coupled with rising borrowing costs would put additional burden on interest servicing capacity of indebted companies. The growing uncertainties regarding future economic outlook have also reduced planning capacity – Takata Petri, the third largest manufacturer of automotive parts, announced recently that it is able now to estimate order flows only for up to two weeks, down from up to three month last year on the back of much more volatile client orders. Suppliers of auto part and accessories accounts for around 37% of the gross value added in the electric machinery and apparatus section (NACE DL 31). Output in this section started to shrink in 2007. Much more, the deceleration accentuated in last months of 2008 (-22.7% yoy in October and -31.3% yoy in November). The most important tire producers on the domestic market (Continental, Pirelli, Michelin) halted also temporary the production in December.

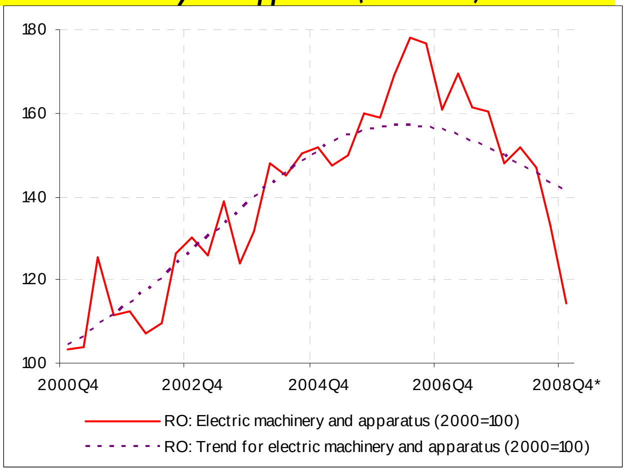
■ Layoffs are now being considered by companies as an option to adjust to the new market conditions, after they have resorted to technical unemployment in the last two month of 2008: (i) Takata Petri has planned to layoff up to 5% of the total workforce (5500 employees), (ii) Automobile-Dacia is also considering cutting the workforce if the current sales trend continues. Romanian automotive industry plays a key role and has a systemic importance: (i) it contributes 4.7% to GDP formation, (ii) it holds 4.2% of real sector's total assets and (iii) it employs 4.5% of total workforce. Short-term negative perspectives of the sector point also to weak industrial output and GDP figures in the next quarters.

■ Output in the **sector of chemical products (NACE DG 24)** decelerated also rapidly in November (-33.6% yoy). In our opinion, the deceleration reflects mainly a decrease in the output at the chemical producer Oltchim and a decrease of output in the fertilizers industry (Azomures, Interagro, Doljchim). Much more, the situation in the sector deteriorated further in December and in January. Azomures halted the production at the beginning of December and it started to operate only this week. Doljchim also halted the production at the beginning of January. So, we should see weak output figures for this sector in December and in the first months of 2009 as well.

■ Not in the last, **the sector of textiles and clothing articles (NACE DB 17)** is still in freefall. Output in this sector decreased by 20.3% yoy in October and by 16.7% yoy in November. The downward trend was established at the end of 2004 when the international markets were liberalized for the Asian textiles products, which are very competitive in terms of pricing. Current decrease in the external demand is putting additionally downward pressure on the sector.

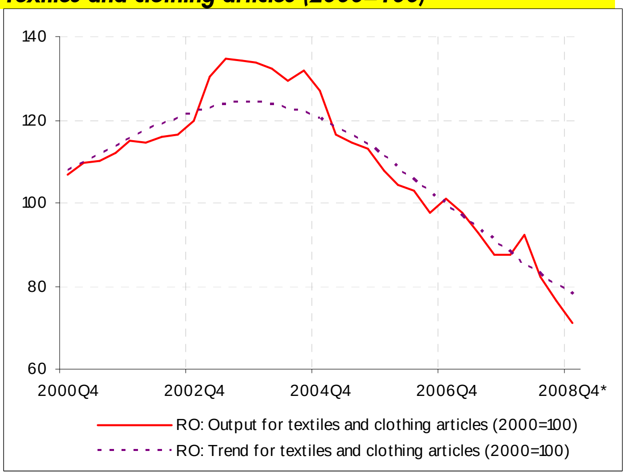
■ Given the negative perspectives of economic activity in the Euro area and the financing constraints on the domestic market, the perspectives for the above sectors remains negative in short term. This means weak figures for growth rate of industrial output in the next months (in the negative territory in annual terms) and downward pressures on the GDP growth rate.

Electric machinery and apparatus (2000=100)



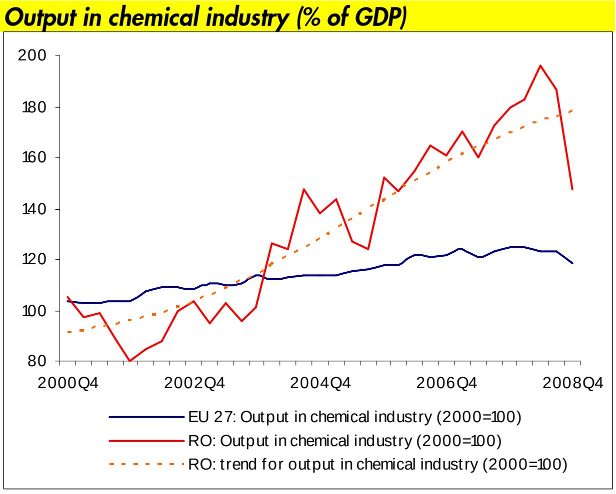
Note: Data for 2008Q4 refers only to October and November
Source: ECB, Raiffeisen RESEARCH

Textiles and clothing articles (2000=100)



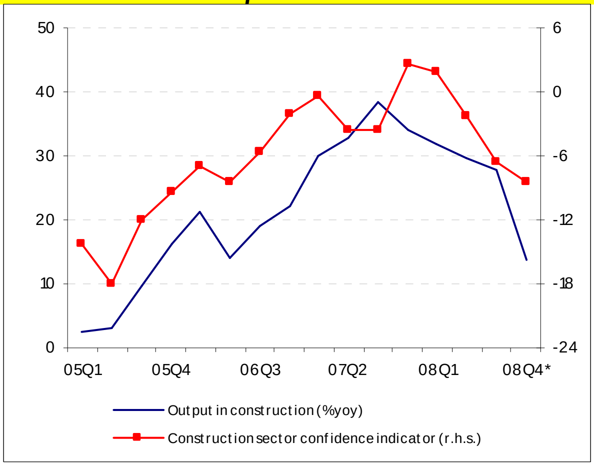
Note: Data for 2008Q4 refers only to October and November
Source: Eurostat, National Institute of Statistics, Raiffeisen RESEARCH

Output in chemical industry (% of GDP)



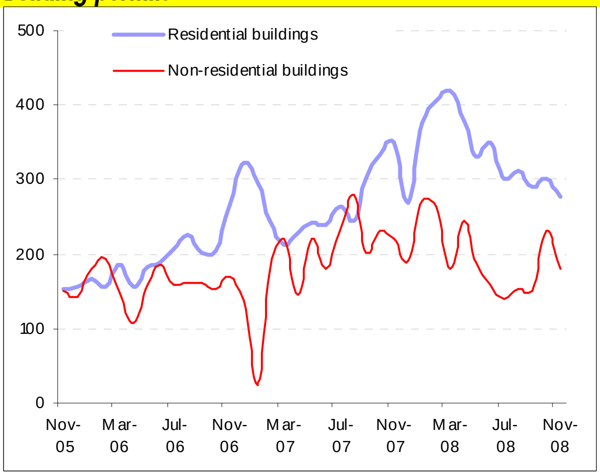
Note: Data for 2008Q4 refers only to October and November
Source: Eurostat, National Institute of Statistics, Raiffeisen RESEARCH

Construction sector: output and confidence indicator



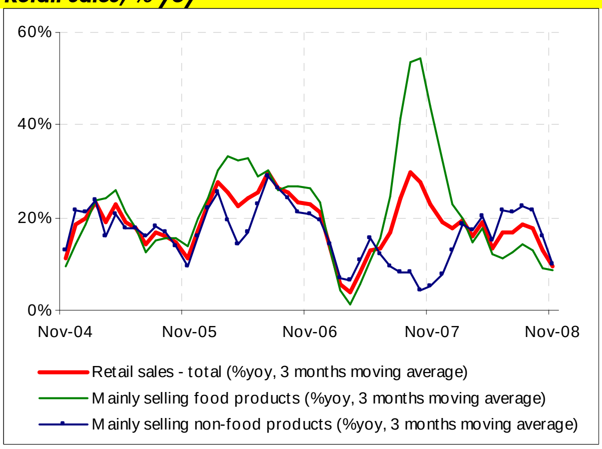
Note: Data for 2008 Q4 refers only to October and November
Source: Eurostat, Raiffeisen RESEARCH

Building permits



Note: Building permits – in 1 000 m2 of habitable/usable floor area (2000=100) – seasonally adjusted
Source: Eurostat, Raiffeisen RESEARCH

Retail sales, % yoy



Source: National Bank of Romania, Raiffeisen RESEARCH

Recent development in the construction sector

■ Building sector has been one of the main drivers of economic growth in the last two years, with relatively high double digit growth rates peaking at 38% in third quarter of 2007. Since then growth rates have been declining, decelerating rapidly in the last quarter of 2008 (+16.7% yoy in October and only +13.5% yoy in November). In November, deceleration of the construction sector was supported by the low growth rate of the residential sector (4.1% yoy in November 2008). On the other hand, new construction works (residential, non-residential, and civil engineering) advanced by a poor 0.4% yoy in November.

■ Confidence in the building sector weakened in the first nine months of 2008 based mainly on decreasing building activity optimism, triggered by increasing financing constraints, in the context of financial crisis, and mounting labour shortages. However the latter have started to ease somehow, on the back of decreasing demand perspectives. Also, the building permits, seasonally adjusted, showed signs of weakness in last half of 2008 both in the case of residential and non-residential sector.

■ Given the adverse financing condition on the external markets (which limits the ability of the major international players in real estate sector to raise funds for new and existing projects) and the slowdown in the domestic lending (which restrain the demand for houses), the performance of the construction sector should deteriorate further in the next period. Also, we should see a lower number of start-up projects. Building of public infrastructure would be more resilient to a potential weakening of aggregate demand than the building sector as whole, as it represents a strategic objective to be financed by government resources and EU funds in the future. However it depends on the governments' action plan if the public infrastructure will be able to provide such a buffer for the whole construction supply chain (especially manufacturing of construction materials) – public infrastructure makes up roughly 20% of building sector's value added.

■ Deceleration of construction sector would reduce its contribution to the GDP growth rate over the next quarters, putting so downward pressures on the economic growth.

Retail sales and market services for population

■ Growth of household expenditures was resilient until Q3 2008 as growth rates of wages (and also pensions) and lending were fast. But things changed in the last quarter of 2008. Growth rate of retail sales turnover (in real terms) decelerated to only 2.8% yoy in November from 16.4% yoy in H1 2008. Sales of non-foods products decelerated the fastest from 19% yoy in H1 2008 to 6.8% yoy in October and -1.3% yoy in November. Turnover for market services rendered to population also decreased by 11.7% yoy in real terms in October-November.

■ The weak figures for retail sales and for market services for population suggest that household expenditures slowed down in the ending months of 2008. The decrease in the consumer confidence indicator from -13 in Q3 2008 to -31 in December 2008 points also to weaker consumption demand in the months ahead. Deceleration in growth of wages, difficult access to consumer loans and higher interest rates would have also a negative impact on the consumption expenditures in the next period.

Exports' growth deteriorated in November

But the current account deficit is shrinking

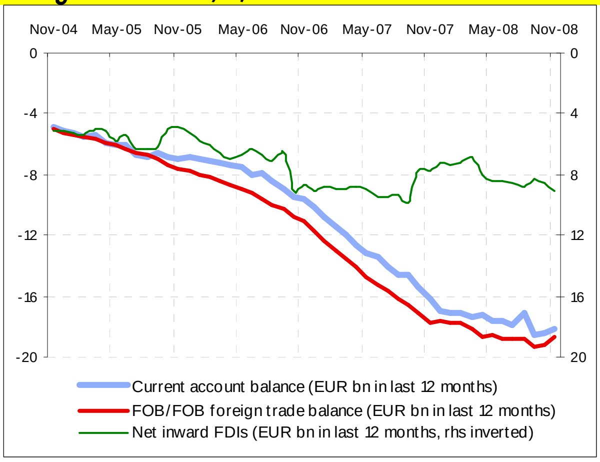
■ Exports' growth remained healthy until October in spite of the rapid deceleration of economic activity on the external markets and of the decrease in commodities prices. However, November's data were negative: total exports decreased by 9% yoy. In November, exports towards EU countries (which accounts for 69% of Romania's total exports) decreased by 11.6% yoy, while exports towards non-EU countries decreased by 4.6% yoy. So, Romanian exports started to be hit strongly by the weak demand coming from the euro area countries, in line with developments in the exports of other CEE countries. In addition, sharp fall in oil price (and in gasoline prices) had a negative impact on the exports of chemical products and mineral products (in EUR equivalent).

■ But the imports' growth rate decelerated also rapidly in November, moving deeply in the negative territory (-17% yoy). Imports from non-EU countries decreased by 11.1% yoy mainly due to the sharp fall in the oil price on the international markets. At the same time, the imports from EU countries decreased much faster (-19.4% yoy in November). Last months' data show deterioration in the imports of capital goods and transport means on the back of a weaker domestic investments. Changes in the legislation regarding the pollution tax for cars and the tightening of lending conditions resulted in a sharp plunge in the imports and sales of new cars at the end of 2008. Another factor which explains the sharp fall in the imports from EU-countries is the lower external demand for Romanian exports, because a large part of the exports is the result of active processing of imported goods. In this case, the decrease in the exports comes hand in hand with a decrease in the imports. For instance, the ongoing decline of the textile and clothing sectors is putting downward pressure not only on the exports but also on the imports. The crisis in the European automotive sector has a similar impact on the Romania exports and imports of auto parts and accessories.

■ In Jan-Nov, exports increased by 15.9% yoy, while imports increased by 12.2% yoy. As a result, the foreign trade deficit expanded only by 6% yoy in Jan-Nov and its GDP share started to decrease (pushing down the current account deficit as well). We expect now to see the current account deficit also decreasing towards 13.1% of GDP at the end of 2008 from 13.9% of GDP at the end of 2007. The saving-investment gap in the private sector already adjusted substantially in the second half of 2008, which is good news. Much more, we think that the deceleration of domestic demand and the leu depreciation would result in a further improvement in the foreign trade deficit and current account deficit in 2009 (towards 10.7% of GDP). Both the growth rates of exports and imports are expected to decelerate in the next period, but deceleration of imports would be much faster (now we expect the imports to decrease by around 5% in 2009).

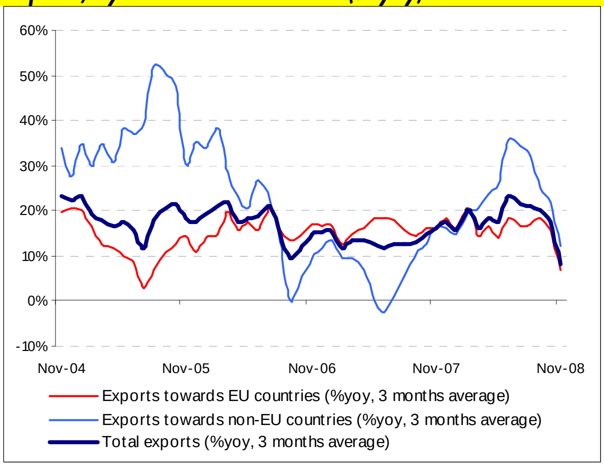
■ FDI inflows amounted to EUR 488 mn in November and to EUR 8.6 bn in Jan-Nov 2008. In Nov, around EUR 250 mn came from equity increases and reinvested earnings, while EUR 238 was due to intra-company lending. FDI inflows in Nov were relatively high given the turmoil on the external markets in Oct and in Nov. FDI inflows covered also 54% of the current account deficit in Jan-Nov. However, looking forward we expect to see lower FDI inflows in the coming months due to increasing risk aversion for Romanian economy and due to deleveraging process in the external markets.

Foreign trade deficit, C/A deficit and FDI inflows



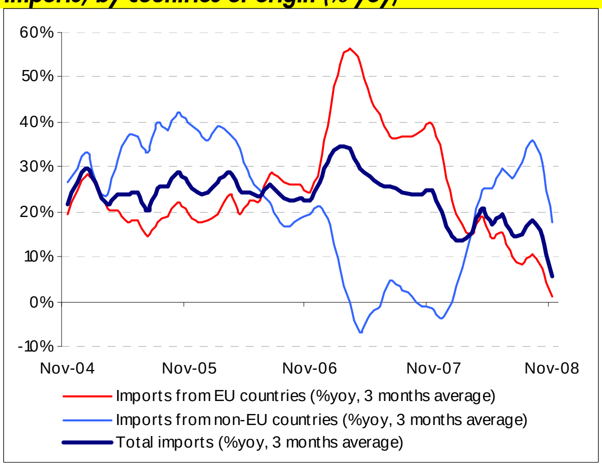
Source: NBR, National Institute of Statistics, Raiffeisen RESEARCH

Exports, by destination countries (% yoy)



Source: Eurostat, Raiffeisen RESEARCH

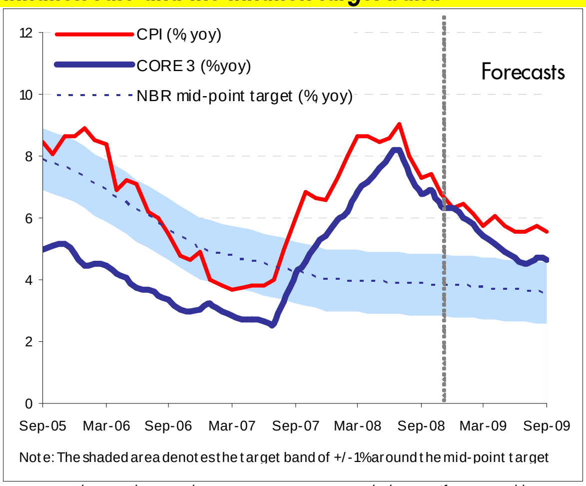
Imports, by countries of origin (% yoy)



Source: Eurostat, Raiffeisen RESEARCH

Inflation to remain on a downward trend
although the risks are still high

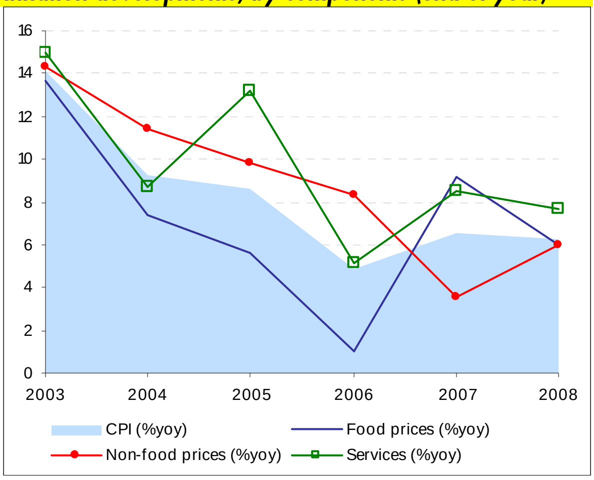
Inflation rate and the inflation target band



Core1 = Total CPI – Administered prices; CORE 2= CORE 1 – Volatile prices (fruits, vegetables, eggs and fuels); CORE 3 = CORE 2 – Tobacco – Alcohol

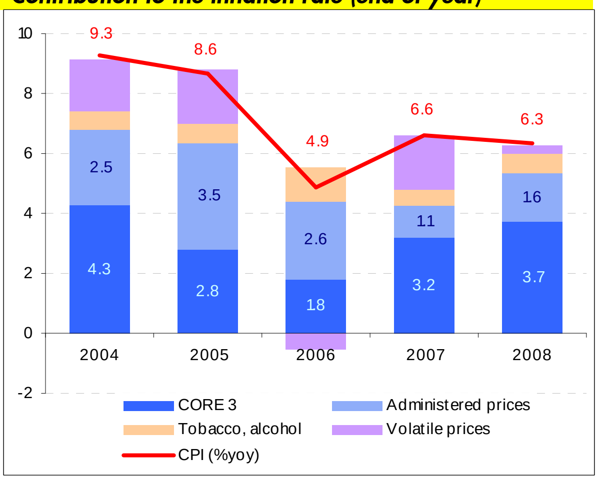
Source: National Institute of Statistics, NBR, Raiffeisen RESEARCH

Inflation developments, by components (end of year)



Source: National Institute of Statistics, Raiffeisen RESEARCH

Contribution to the inflation rate (end of year)



Source: National Institute of Statistics, Raiffeisen RESEARCH

■ Monthly inflation rate came in at 0.23% mom in December, below market expectations (+0.5% mom). It was the second month in a row in which the inflation rate was lower than expected. As a result, the annual rate of inflation decreased from 6.7% yoy in November to 6.3% yoy in December. Nevertheless, the inflation rate in 2008 was above the NBR's inflation target of 3.8% with a band of +/-1%.

■ Lower than expected inflation rate was explained by a larger than expected decrease in fuel prices (-8.9% mom in the case of gasoline), and by a slight decrease in the fruits prices (-0.5% mom). So, the figures suggest that the lower than expected inflation rate was due mainly to volatile prices. CORE 3 measure of inflation (total CPI excluding administered, volatile and tobacco prices) increased by 0.5% mom in December. It advances by 6.3% yoy in December, down from 6.7% yoy in November. At the same time, depreciation of the leu by around 3.8% against the euro in December was fully reflected in a similar increase in the phone tariffs and it triggered also a large increase in the services tariffs (+1.3% mom in December).

■ Looking forward, the inflation rate in 2009 would be driven by two main factors: (1) exchange rate depreciation which would raise inflationary pressures and (2) rapid deceleration of the economic activity which would limit the increase in prices (or would put downward pressures on prices). We think that the upward pressures on prices stemming for the leu depreciation would be the most important driver of the inflation rate in short-term, while the downward pressures stemming from the deceleration in the aggregate demand would be the most important driver factor for inflation dynamics starting Q2 2009. Taking into account the impact of these two divergent factors, we expect the annual rate of inflation to remain on a downward trend in 2009.

■ The leu depreciated rapidly in the ending months of 2008. Much more, leu depreciation accelerated in January. Accordingly, we should see the depreciation reflected in higher consumer prices (instantly in the phone tariffs which are invoiced in euro and with a delay in the case of prices for imported consumer goods). This should put upward pressures on the monthly inflation rates at the beginning of 2009, as the exchange rate pass-through is quite fast. So, even though there was no hike in the regulated prices in January 2009, the monthly inflation rate should be high (around 0.9% mom).

■ Economic activity decelerated rapidly in the last two months of 2008 and it would continue to weak further. Although the growth rate of wages is still at a very high level (+19.8% yoy in November), it should also decelerate over the next months. The unemployment rate will also increase given the layoffs announced by many companies. So, growth of disposable income would decline substantially in the future. With lending slowing down rapidly and with household confidence decreasing (consumer confidence decreased to -31 in December from -15 in October), there should be a substantial deceleration in household consumption. This would become more evident in the next months and this should hamper the increase in prices.

■ In the baseline scenario, we expect the inflation rate to be at 4.5% at the end of 2009, with upside risk. In our opinion the risk came mainly from the exchange rate depreciation which might result in stronger inflationary pressures.

Market interest rates would decrease
as NBR is expected to inject liquidity in the market

■ The NBR hold unchanged the monetary policy rate at 10.25% on 6 January. The decision was in line with market expectations. Also, the NBR hold unchanged the required reserve ratios for banks' liabilities in RON at 18% and for banks' liabilities in FCY at 40%. Also, the NBR's statement following the monetary policy meeting stressed more than usually the downside risks to the economic growth in the next period.

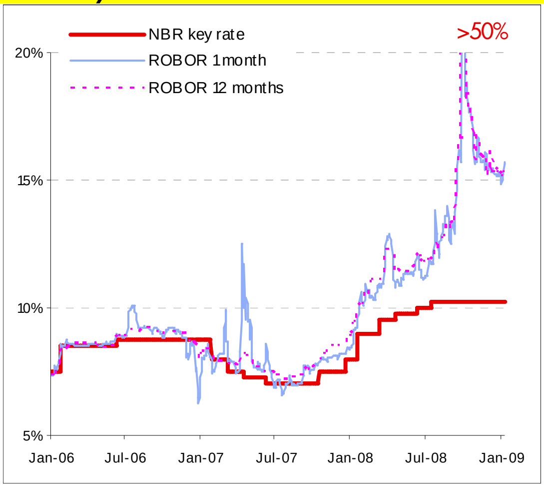
■ Central banks in developed countries cut aggressively the monetary policy rates in last quarters (we have rates closed to zero in US, Japan, and Switzerland). Some central banks in emerging markets also started to cut interest rates aggressively as the economic growth perspectives deteriorated sharply, the risk for recession being very high. Now, when the economic growth is slowing down rapidly in Romania as well, more and more peoples expect also the NBR starting to cut the monetary policy rate. However, we think that the first step to be expected from NBR should be liquidity injections in the system in order to lower the effective interest rate in the money market towards the level of key policy rate. There is a large discrepancy between the money market interest rates and the monetary policy rate. The monetary policy rate is at 10.25% since 1 August 2008. But the market interest rates are much higher. In last month, the effective interest rate for the transactions in the money market was 13%, while the ROBOR 1 month stood at 15.2%. The second step NBR should consider in the next period would be also a cut in the key rate. Nevertheless, there is a strong constraint allowing interest rate to go down related to the depreciation pressure of the leu, which already becomes excessive.

■ We think that market interest rates cannot decrease too much in the next period unless the NBR cuts again the minimum reserve ratio for banks liabilities in domestic currency (injecting more liquidity in the banking system). So, a cut in the minimum reserve requirements should prevail in the face of a cut in the monetary policy rate at the next monetary policy meetings. In this context, we expect the NBR to cut the minimum reserve requirements for RON at the next monetary policy meetings (possible to 16% at the next monetary policy meeting on 4 February). The moves would add to the liquidity in the market and would push down the market interest towards the level of the monetary policy rate.

■ There is another factor which argues for injection of additional liquidity in the market. Growth rate of non-government credit (both in RON and in foreign currency) decelerated rapidly in the last quarter of 2008. A credit crunch might have a strong negative impact on the real economy. Given that banks cannot anymore extend the loans in foreign currency (because of lack of additional funding from abroad), the increase in non-government credit could be fuelled only by the domestic currency component. In order to avoid a credit crunch, the central bank would have to stimulate the loans in domestic currency and this can be due by cutting RON reserve requirements.

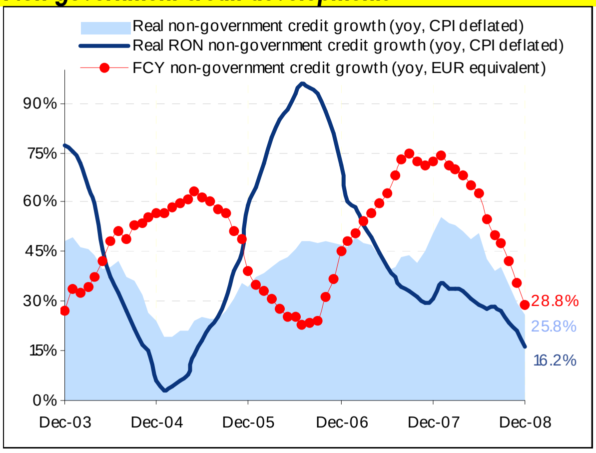
■ At the moment, the main impediment in lowering the market interest rates is the pressures for leu depreciation. Allowing the interest rates to move too fast down might result in depreciation pressures for leu. The depreciation of the leu is an important concern for the central bank due to the large share of loans in foreign currency and due to the large exchange rate pass through to inflation. This is why the NBR said it would provide gradually the appropriate liquidity in the banking system but "in a manner that would not encourage exchange rate volatility".

NBR's key interest rate and market interest rates



Source: NBR, Raiffeisen RESEARCH

Non-government credit developments



Source: National Bank of Romania, Raiffeisen RESEARCH

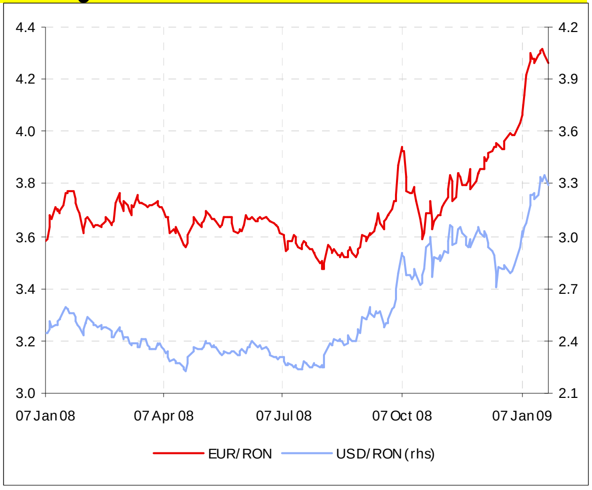
Interest rate outlook (%)

	Current	Mar-09	Jun-09	Sep-09
Domestic markets				
NBR key rate	10.25	10.25	10.00	10.00
ROBID 1 month	14.02	12.00	10.40	10.00
ROBID 3 months	13.82	12.00	10.50	10.00
T-bonds 3 years	11.95	10.90	10.20	9.80
T-bonds 5 years	11.46	10.50	9.80	9.80
T-bonds 10 years	8.64	8.00	7.80	7.50
External markets				
FED key rate	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25
ECB key rate	2.00	1.50	1.25	1.25
EURIBOR 1 month	1.81	1.65	1.40	1.40
LIBOR USD 1 month	0.41	0.40	0.40	0.30

Source: Raiffeisen RESEARCH

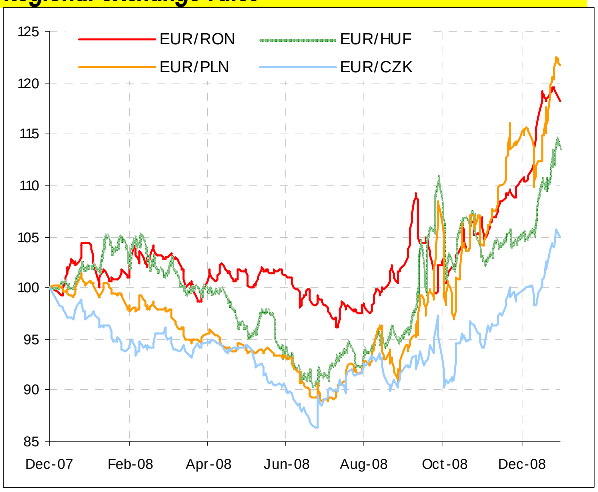
The regional sentiment is negative
pushing up the exchange rate of leu

Exchange rates



Source: National Bank of Romania, Raiffeisen RESEARCH

Regional exchange rates



Note: Fixed base index, 28 Dec 2007 = 100
Source: National Bank of Romania, Raiffeisen RESEARCH

Exchange rate outlook

	Current	Mar-09	Jun-09	Sep-09	Dec-09
EUR/RON	4.2634	4.20	4.00	3.95	3.80
USD/RON	3.289	3.23	2.96	2.72	2.53
CHF/RON	2.837	2.84	2.60	2.63	2.44
GBP/RON	4.5535	4.33	4.00	3.83	3.69
EUR/USD	1.2963	1.30	1.35	1.45	1.50
EUR/CHF	1.5028	1.48	1.54	1.50	1.56
EUR/GBP	0.9363	0.97	1.00	1.03	1.03

Source: Raiffeisen RESEARCH

■ Depreciation pressures for the regional currencies were very strong in last weeks. Since the beginning of the year, the Polish zloty weaken by 5% against euro, the Hungarian forint lost 7.5% against the euro, while the Czech koruna weakened by 4.7% against the euro. The leu has not made an exception ant it has lost 6.6% against the euro since the beginning of the year.

■ At the end of 2008, there were rumours that the NBR stepped in the FX market to defend the leu, the official exchange rate regime in Romania being managed floating. As a result, the NBR succeeded to keep the EUR/RON official quotation below 4 by the end of the year, despite the strong speculative depreciation pressures. However, we don't know exactly how much of the FX reserves were spent to defend the leu. The data showed that the NBR's FX reserves decreased by EUR 1 bn in December to EUR 26.2 bn. However, around EUR 974 mn out of the total outflows in December were due to revaluations of reserves in US dollars (32,5% of total reserves) and British pounds (4% of total reserves).

■ The NBR's behaviour at the beginning of 2009 changed a little bit. The NBR allowed the leu to depreciate faster against the euro (although there were also rumours regarding interventions in the FX market) and the EUR/RON exchange rate is trading now at 4.25, after reaching a historical high level above 4.3. We think that the NBR took into account the strong pressures for depreciation of regional currencies when it eased the support for the leu. In fact, the depreciation seems to be driven in a large extent by flows related to real sector activities (although in last week the speculative positions increased as well). Also, the NBR started to offer much more importance to protecting its FX reserves. Although the reserves are at a very high level and quite comfortable (EUR 26.2 bn or more than 5.5 months of imports), the perspectives of the domestic economy have deteriorated and the crisis on the international markets is far to be over. Moreover, due to the lack of response from Government policies, the exchange rate is playing now the main role in the macroeconomic disequilibria adjustment (especially the current account deficit). With corrective measures on the Government policies, the pressure on the leu would ease substantially.

■ The NBR needs to be concerned about the leu depreciation due to the large share of loans in foreign currencies (55% of total loans) and also due to the high exchange rate pass-through to inflation. We think that the NBR would try to limit as much as possible the leu depreciation, but need support from Government policies to restore the confidence for leu. However, without a strong and credible signal from Government policies, the sentiment for leu would continue to be negative, especially if the regional negative sentiment will persist. Also, a financing and/or precautionary agreement with an international financial institution (European Commission, European Investment Bank, World Bank, or even IMF), dependent on political will, could improve the sentiment for RON.

■ The risk for our exchange rate forecast is on the upside. Nevertheless, the leu is over depreciated now, and the depreciation already adjusted and will continue to adjust quickly the CA deficit. There are a lot of uncertainties this year, and we will adjust accordingly our forecasts if necessary.

Budget deficit climbed to 5% of GDP in 2008

Government borrowed a lot of money in last months

■ Consolidated budget deficit increased rapidly in December. According to preliminary data, the deficit climbed to 4.8% of GDP when the national methodology is used and it climbed to 5.2% of GDP when the European Commission's methodology (ESA 95) is used.

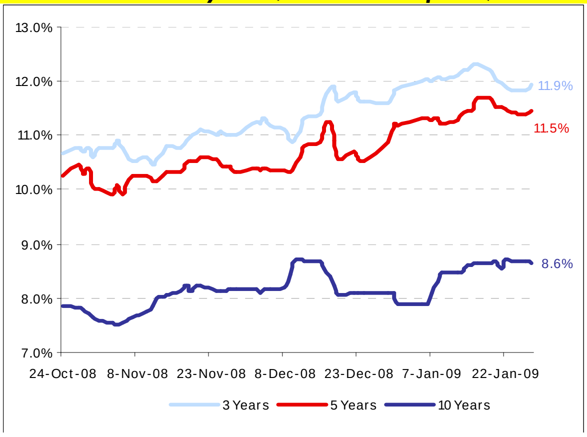
■ We expected the budget deficit to climb above 3% of GDP by the end of 2008, but we find these figures as extremely high. In line with the tendency from the previous years, the government continued to spend a lot of money in the ending months of the year (even though the spending was strong over the year as well). Much more, collection of revenue deteriorated substantially in the last three months of 2008, as companies refrained to pay taxes with the budget due to decreasing demand for their products, tighter liquidity conditions and poorer access to loans. In fact, the development in the budget deficit was the result of the pro-cyclical fiscal policy from the previous years, the very high level of expenses (especially current expenditures, including wages and pensions) and of the overestimation of the public revenues.

■ The new government announced its intentions to limit substantially public spending in 2009 in order to reduce the budget deficit. This was good news and it was a positive signal for the market. However, the adoption of the budget plan for 2009 was delayed and this raised the uncertainty in the business community, diminishing the initial positive signal. The government is still struggling to reduce public spending and we might have the budget plan for 2009 by end of January. At the same time, the large budget deficit limits the capacity of the government to adopt a stimulus package for the economy. In this case, is not excluded that the government would ask for a financial package from the European Commission and IMF in the next future.

■ We think that it would be very difficult for the new government to reduce the budget deficit to 2-2.5% of GDP in 2009 unless very radical measures would be taken. Based on the information available at this moment, we expect to see the budget deficit decreasing to around 4% of GDP in 2009 (ESA95).

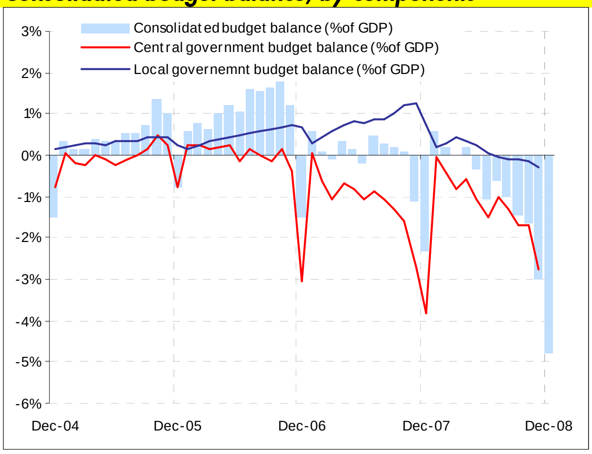
■ Meanwhile, the government increased the debt raised from the domestic market by issuing T-bills (RON 5.9 bn since the beginning of the year) and by taking a lot of money from banks in short-term deposits (up to 2 weeks maturity). In the primary market, the NBR's interest for the credit facility (14.25%) remained a cap for the T-bills yields, while the yields of the bonds remained capped by the 13% level.

Government bonds yields (based on ask prices)



Note: five days moving average
Source: Reuters, Raiffeisen RESEARCH

Consolidated budget balance, by components



Source: Ministry of Public Finance and Economy, Raiffeisen RESEARCH

Auctions in Government securities

Discount T-Bills

Auction date	Tenor (Months)	Amount (RON mn) Intended	Amount (RON mn) Effective	Average Yield	Maximum yield
08-Oct-08	6	1000	503	12.45%	13.00%
22-Oct-08	12	1000	509	13.55%	14.20%
12-Nov-08	6	800	771	13.69%	14.25%
19-Nov-08	3	700	597	14.19%	14.25%
26-Nov-08	12	800	402	14.23%	14.24%
03-Dec-08	3	1000	591	14.23%	14.25%
10-Dec-08	6	1000	1035	14.22%	14.25%
17-Dec-08	3	500	619	14.23%	14.25%
22-Dec-08	12	800	405	14.23%	14.24%
05-Jan-09	1	1000	567	14.24%	14.25%
14-Jan-09	3	2000	1929	13.46%	13.60%
19-Jan-09	1	1000	1554	12.75%	12.90%
22-Jan-09	3	1500	1700	12.36%	12.50%
28-Jan-09	12	500			

** the amounts for the next period are only indicative.*

Benchmark T-Bonds

Auction date	Tenor (years)	Cupon (%)	Amount (RON mn) Intended	Amount (RON mn) Effective	Average Yield	Maximum yield
02-Oct-08	5	8.25%	500	411.23	10.61%	11.00%
16-Oct-08	3	8.00%	500	291.47	12.04%	13.00%
06-Nov-08	5	8.25%	700	190.82	12.65%	13.00%
04-Dec-08	5	8.25%	300	220.7	13.00%	13.00%
18-Dec-08	3	8.00%	300	166.45	13.00%	13.00%
08-Jan-09	5	11.00%	500	152.19	12.99%	13.00%

Source: Ministry of Public Finance

Main indicators

	2001	2002	2003	2004	2005	2006	2007	2008E	2009F	2010F
Nominal GDP (EUR bn)	44.9	48.5	52.6	60.8	79.5	97.8	121.3	133.7	137.0	163.0
Real GDP (%, yoy)	5.7	5.1	5.2	8.5	4.2	8.2	6.0	7.2	2.5	3.5
Industrial production (%, yoy)	8.3	4.4	3.1	5.3	2.0	7.1	5.4	1.3	1.0	3.0
Unemployment rate (%)	8.8	10.0	7.5	6.7	5.8	5.4	4.3	4.0	5.5	5.7
ILO unemployment rate	6.6	8.5	7.0	8.1	7.2	7.3	6.4	6.0	7.5	8.0
Monthly average gross wage (EUR)	165	174	179	204	267	326	422	471	477	567
CPI (%, yoy, eop)	30.3	17.8	14.1	9.3	8.6	4.9	6.6	6.3	4.5	4.0
CPI (% yoy, avg)	34.5	22.5	15.3	11.9	9.0	6.6	4.8	7.9	5.7	4.2
PPI (%, yoy, avg)	38.1	23.0	19.6	19.1	10.6	11.6	8.1	16.0	10.5	7.5
GDP deflator (%, yoy)	37.4	23.4	24.0	15.0	12.2	10.6	10.8	13.5	8.6	6.3
Non-government credit (%, yoy)	57.7	51.1	69.5	35.4	45.8	54.5	60.4	33.7	n.a	n.a
Non-government credit (% of GDP)	10.1	11.8	15.3	16.6	20.8	26.8	36.6	40.2	n.a	n.a
Public budget balance (% of GDP)	-3.2	-2.6	-2.2	-1.5	-0.8	-1.5	-2.3	-4.8	-3.8	-3.0
Public budget balance (ESA95, % of GDP)	-3.3	-2.0	-1.5	-1.2	-1.2	-2.2	-2.6	-5.2	-4.0	-3.0
Public revenues (ESA95, % of GDP)	36.7	37.6	32.1	32.4	32.3	33.1	34.7	35.0	35.0	36.0
Public spending (ESA95, % of GDP)	40.0	39.6	33.6	33.6	33.5	35.3	37.3	40.2	39.0	39.0
Public debt (ESA 95, % of GDP)	26.0	25.0	21.5	18.8	15.8	12.4	12.9	14.5	16.0	17.0
External debt (EUR bn)	14.8	16.2	17.8	21.5	30.9	41.2	58.5	71.5	81.5	94.5
External debt (% of GDP)	33.0	33.4	33.9	35.4	38.9	42.1	48.3	53.5	59.5	58.0
Current account balance (EUR bn)	-2.5	-1.6	-3.1	-5.1	-6.9	-10.2	-16.9	-17.5	-14.7	-15.5
Current account balance (% of GDP)	-5.5	-3.3	-5.8	-8.4	-8.7	-10.4	-13.9	-13.1	-10.7	-9.5
Trade balance (FOB/FOB, EUR bn)	-3.3	-2.8	-4.0	-5.3	-7.8	-11.8	-17.6	-18.5	-14.6	-15.3
Trade balance (FOB/FOB, % of GDP)	-7.4	-5.7	-7.5	-8.8	-9.8	-12.0	-14.5	-13.8	-10.6	-9.4
FOB exports (%, yoy)	12.9	15.4	6.4	21.3	17.5	16.2	13.7	14.0	4.0	15.0
FOB imports (%, yoy)	22.1	8.6	12.3	24.0	23.9	25.1	24.9	10.7	-5.0	12.0
Net FDI inflows (EUR bn)	1.3	1.2	1.9	5.1	5.2	8.7	7.0	8.7	4.5	6.0
FX official reserves (EUR bn)	4.4	5.9	6.4	10.8	16.8	21.3	25.3	26.2	25.0	25.0
NBR key rate (%, avg)	n.a.	22.47	19.27	19.95	11.53	8.52	7.50	9.68	10.00	8.50
NBR key rate (%, eop)	n.a.	19.75	21.25	17.00	7.50	8.75	7.50	10.25	9.00	8.00
EUR/RON (eop)	2.7881	3.4919	4.1117	3.9663	3.6771	3.3817	3.6102	3.9852	3.8000	3.6500
EUR/RON (avg)	2.6027	3.1255	3.7556	4.0532	3.6234	3.5245	3.3373	3.6827	4.0000	3.7000
EUR/USD (eop)	3.1597	3.3500	3.2595	2.9067	3.1078	2.5676	2.4564	2.8342	2.5333	2.6071
EUR/USD (avg)	2.9061	3.3055	3.3200	3.2637	2.9137	2.8090	2.4383	2.5189	2.8169	2.6429

Source: NBR, NIS, EUROSTAT, Raiffeisen RESEARCH

Disclosure appendix