

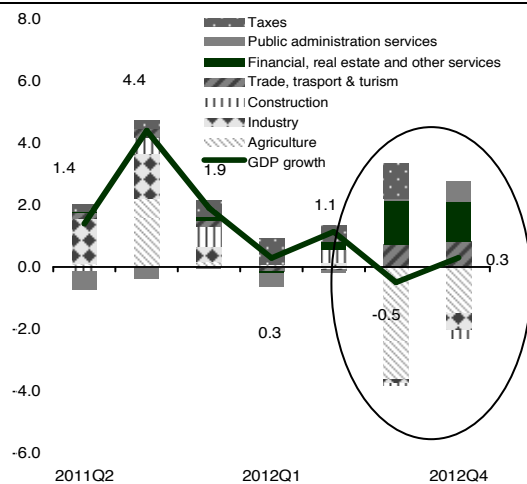
# Romania to keep its promises

## KEY EVENTS

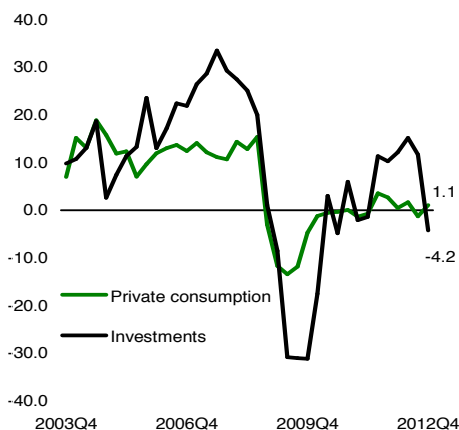
28<sup>th</sup> of March, 2013: NBR Key rate decision  
 Mid-April, 2013, Transgaz SPO, the first event of privatization plan  
 End-June, 2013: IMF visit, end of precautionary SBA

**Moody's: Baa3 negative / S&P: BB+ stable / Fitch: BBB- stable**

## SECTORS' CONTRIBUTION TO GDP



## INVESTMENTS REBOUND IS NECESSARY



Source: NIS, Garanti Bank Research

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**Outlook** – We began the year on a positive tone despite the recent downward revisions of growth at European level. Our expectations for Romania are relying on a modest recovery of the agricultural production and on the potential of implementing the announced privatization plans, re-launch of infrastructural projects and increase of EU structural funds' absorption rate, for which we see strong commitments from government.

GDP growth is projected to remain subdued in Q1 with 0.4% yoy but to accelerate in the second half of the year with full year growth of 1.7% yoy in 2013. Investments should be the main driver relying on the planned structural changes. Inflation is expected to stay in the range of 5%-6% till mid-2013, and to decelerate towards 3.9 for the end-year. The Central Bank is likely to soften its monetary stance relying on alternative monetary instruments, given the persistent negative output gap and lowering depreciation risk. The accumulated FX buffer of Ministry of Finance and improved regional sentiment at the beginning of the year reduces significantly the pressures on external financing costs despite the increased debt service in 2013. A budget deficit below 3% of GDP achieved already in 2012 puts less pressure on further fiscal consolidation for 2013. Confidence should further improve once the first steps of the privatization plan are implemented.

### Main Topics:

- GDP – Infrastructural projects and improved business confidence should be the driver
- Country risk profile – Improved risk profile with possible rating upgrade and the IMF support but Romania should keep its promises
- Inflation– energy price liberalization is the major driver of prices during 2013
- Monetary policy – To cut but when...
- Fiscal Policy – So far, so good but how will the micro-firms survive the new fiscal code?
- Public financing – Improved financing profile, window of opportunity still open
- External Accounts and Financing – Improved portfolio investments already visible; FDI to follow
- FX outlook – RON to strengthen helped by improved country risk profile
- Bank flows – What should boost lending?

## Economic Growth

### GDP – Infrastructural projects and improved business confidence should be the driver

Real GDP expanded by 0.3% yoy in Q4 while for the full year 2012 it grew by merely 0.3%. The drops in agriculture (-21.2% yoy<sup>1</sup>) and industry (-2.1% yoy) were counterbalanced by the good performance of the service sectors. The information and communication (+29.4% yoy) and the scientific and technical activities (+8.4%) were the major drivers of growth in 2012. The poor agricultural output took its toll on economic activity while the industrial production dropped on the back of weak industrial output in the whole EU (-1.7% yoy drop of real value added). On the demand side, the worrisome figures are related to investments' contraction (-4.2% yoy) in Q4, since they were the driver of the growth in the first 9 months of the year (+13% yoy). This drop is related to the infrastructural works that started to decrease in the last quarter of the year (see graph bellow). On the positive side, private consumption accelerated to 1.1% from 0.3% yoy growth in the first 9 months of the year. Moreover, just as expected, after three months of contraction, the public administration services expanded (+5.6% yoy) contributing by around 0.7 percentage points to the total GDP given the parliamentary elections held in December.

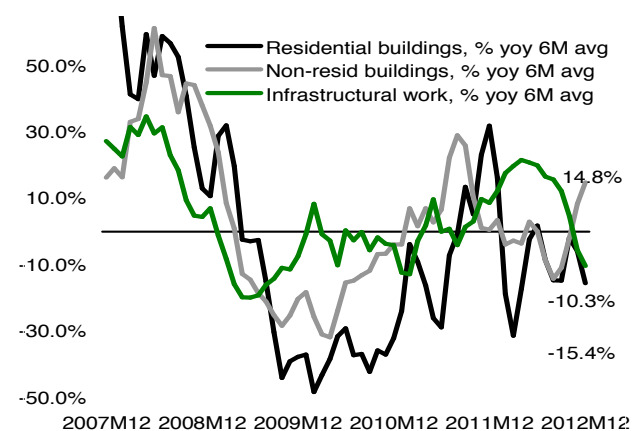
Despite the recent downward revisions to Euro area growth forecast<sup>2</sup> (-0.3% instead of 0.1% growth expected initially), the outlook for Romanian growth remains positive, although modest, for 2013. During Q1 2013 only minor recovery is expected. Retail sales in January 2013 (seasonally adjusted) recovered from the previous month's contraction with 2.4% yoy growth that bodes well for the first quarter GDP. Private consumption might be boosted by higher wages in the public sector (+8% in June 2012, and 7.4% in December that resulted in around 16% yoy growth as of January 2013), although there is a downside risk on consumption coming from further layoffs in the public sector that have been announced for this year. The private sector real wages are expected to stay at the previous level, given also the higher inflation in 2013.

### DOMESTIC CONSUMPTION STILL HOLDS UP WELL IN Q3



Source: NIS, Eurostat, Garanti Bank Research

### INFRASTRUCTURAL WORKS - THE MAJOR SUPPORT FOR 2012 GDP SHOWS SIGNS OF WEAKENING



Source: NIS, Garanti Bank Research

<sup>1</sup> Real value added annual growth of the given sector.

<sup>2</sup> EC Winter Forecasts 2013

## Economic Growth

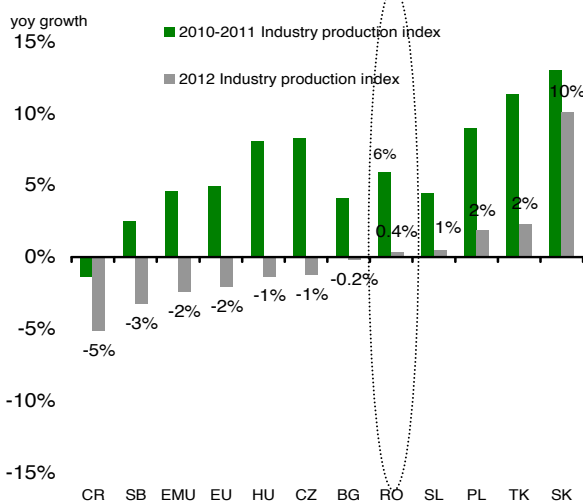
Furthermore, the re-launch of major infrastructural projects is expected to become visible in the second half of the year.

For the whole year 2013 we expect GDP to accelerate to 1.7% yoy real growth relying on the domestic demand, especially investments, helped also by EU funds. Such expectations are realistic keeping in mind that Romania would have grown 1.8% during 2012 if we exclude the 1.5 percentage point negative contribution of agriculture.

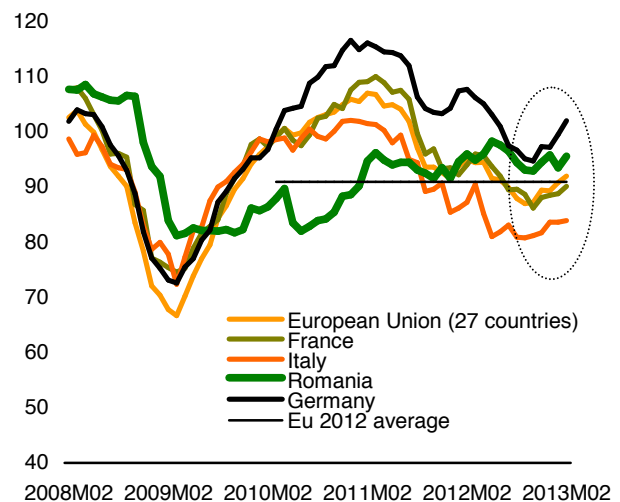
The business climate figures started to trend higher in the late autumn of last year, thus recovery should gain some traction with Germany leading the pack. Based on latest figures of Manufacturing Purchasing Managers' Index (PMI), Germany started to expand while the new export orders for the Eurozone jumped to 51.7 in February from 49.5 - its first time above 50 since June 2011<sup>3</sup>. This is also promising for Romania, given the high correlation of its external trade with Eurozone, especially Germany, the major export partner of the country (19% of total export).

Romanian manufacturing industrial production performed poorly during 2012 with 0.4% yoy drop compared to the 6% yoy growth in 2011. Still, it should be noted that poor performance is just comparable with other EU peers. Strategic sectors of Romania like machinery and auto industry (summing up around 40% of total export) hold up relatively well. Among the best performer industries in 2012 in terms of output growth are the other transport equipments (+21% yoy), repairing and maintenance of machinery and equipments (+20% yoy) and computers, electronic and optical products (+6% yoy). Despite these positive developments of the industrial sectors, probably they will still fail to be the driver of the growth next year and net external demand contribution will likely stay negative.

**INDUSTRIAL PERFORMANCE OF ROMANIA COMPARABLE WITH OTHER EU COUNTRIES**



**INDUSTRIAL ACTIVITY TO ACCELERATE IN 2013, FOLLOWING THE IMPROVED BUSINESS CLIMATE**



Source: Eurostat, Garanti Bank Research

Source: NIS, Eurostat, Garanti Bank Research

<sup>3</sup> Above 50 means expansion and below 50 means contraction.

Stronger rebound should come from investments, both public and private side. The new government allocated more than RON 10 bn (EUR 2.3 bn, including EU funds) for infrastructural projects this year (270 km new highway construction). Based on our estimations, EU structural funds in 2013 should amount to around EUR 2.5 bn (reaching 37% absorption rate from the current 23.4% as of February 2013, based on final payments to beneficiaries) and around EUR 2 bn rural and agriculture development fund (absorption rate to increase from the current 59% to 80%).

Private investments through privatization are expected to attract also external funds, estimated at around EUR 1.5 bn. Still, there is a lag between attracting new capital and the launch of investment projects, so we might not see their impact on this year's GDP figures but for sure it should contribute to sustainable growth on the longer term (please see the details on the privatization calendar in the appendix).

## Country risk

### **Improved risk profile with possible rating upgrade and the IMF support but Romania should keep its promises**

Political risk of the country improved significantly after the December 2012 Parliamentary elections. The Social Liberal Union (USL) won two-thirds of the seats in Parliament which assure them the constitutional majority. With around 60% of the popular vote, the USL holds 68% of the seats in Parliament based on the redistribution of mandates<sup>4</sup>. Based on its latest report, the European Commission criticised Romania for failing to fully meet its demands on protecting democracy and the rule of law, during the summer, after a dispute between the Romanian Government and the President. The EU executive considers that although the authorities had taken steps to uphold constitutional law, some political pressure still exists on the justice system. During the summer, it was proved how sensitive the market is to such political turbulence<sup>5</sup> that resulted in significant capital outflows and currency depreciation.<sup>6</sup>

Challenges to the political stability are related to the ideological discrepancy among the ruling coalition partners formed by socialists PSD and liberals PNL but we rather see the risk of a split on the longer-term. On the short term both partners have more benefits from staying together, especially for achieving their objectives of constitutional changes announced even before elections as a governance plan and for which they need to keep their absolute majority. Moreover, we faced a consensus and strong commitment of the ruling government to finalize the privatization plan and other structural changes stipulated under the New Letter of Intent to IMF, following the last IMF visit at the end of January 2013.

The upcoming months, however, will be critical to see whether Romania will succeed in keeping its promises and this would count also for the country's risk profile, through its weighting importance in the IMF evaluation and the overall assessment of the country in terms of structural improvements. The IMF experts have agreed to prolong Romania's

<sup>4</sup> Opposition parties: ARD hold 13.4%, PPDD 11.2% and UDMR 4.6% of the seats. There are also additional 18 seats for other minorities, which represents 3.1% of total seats in Parliament.

<sup>5</sup> The Government passed emergency ordinances limiting the powers of the Constitutional Court in matters concerning the impeachment of the country's President and amending referendum laws although, following the strong reaction of the European Commission and other countries, the Parliament restored the powers of the Constitutional Court and reverted to the previous quorum required for referendum validation.

<sup>6</sup> Around EUR 2 bn net outflow of portfolio investments and short term debt and around 4.4% depreciation in July but re-appreciating by around 3.5% till the beginning of September.

current stand-by arrangement by three months until July to carry out the privatisations plan.

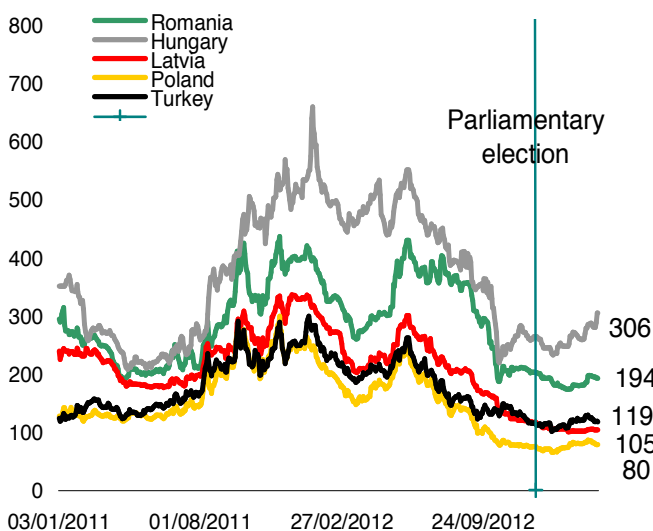
### Country risk

The full completion of the targets will be evaluated in July and a possible follow-up agreement will be decided. Based on the announced privatization calendar, although the list is longer, three companies have been highlighted: Oltchim, one of the largest chemical companies in Romania with 54.8% state ownership (new strategy to be finalized by mid-April for restructuring its debts and to prepare for privatization<sup>7</sup>), Transgaz, the technical operator of the national gas transmission system with 73.5% state ownership (SPO of 10% to be launched by mid-April) and CFR Marfa, the main railway cargo company owned 100% by state (a 51% majority stake to be sold till end June).

The possible new precautionary stand-by agreement after the finalization of the current one would be more like a safeguard for the structural reform. If the Government proved to be committed to reforms with clear results already visible in the next months, country profile would improve while the importance of IMF might lower, considering that no balance of payments support is needed at the current stage.

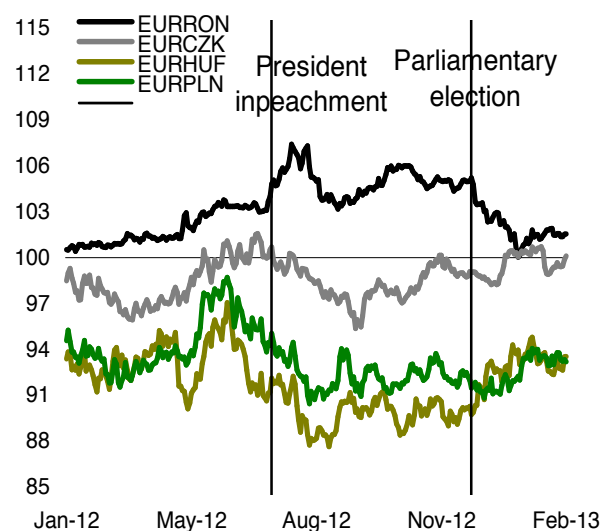
The advantages of the country due to its relatively low governmental debt ratios, improved public financing outlook and continued improvement in the fiscal balance despite political volatility of last year might bring a rating improvement from S&P which is currently the only major agency that is rating Romania below investment grade. Moody's confirmed the Baa3 sovereign debt rating in October 2012.

**IMPROVED COUNTRY RISK DRIVEN BY BOTH REGIONAL AND DOMESTIC TENDENCIES, 5Y EUR CDS**



Source: Reuters, Garanti Bank Research

**YIELDS FOR EUROBONDS**



Source: NIS, Garanti Bank Research

<sup>7</sup> The Court has approved the insolvency request filed in January 2013. Insolvency, including also personnel dismissal, is considered to be the proper solution before privatization, a strategy agreed with the IMF.

## Inflation

### Energy price liberalization will be the major driver of prices during 2013

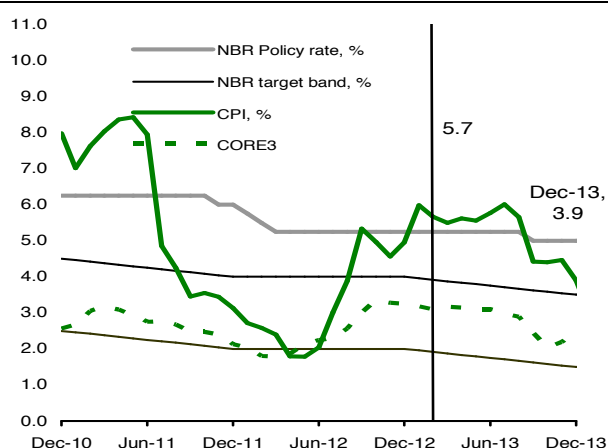
Following the January jump in consumer prices, CPI annual inflation rate decelerated to 5.7%. Prices increased by 0.3% mom, tempering from the previous two months' average growth of around 1%. The major drivers of the January price hike are the electrical energy price adjustment by 10%, excise adjustments on fuels and tobacco (0.5% and 3.5% mom, respectively) while fruit and vegetable prices accelerate again at 4.6% and 7.9% mom.

Based on our expectations, the food-price component of the inflation will be eliminated mostly from the headline inflation, helped by the base effect but also by better harvest this year (to be visible starting September).

For the upcoming period further price pressure is expected to come from energy prices. The electrical energy price liberalization<sup>8</sup> agreed with the IMF will start this year with 10% in July and reaching 100% liberalized prices at the end of 2017. Additionally, green energy subvention will increase electric energy prices by 8% this year. Overall, our expectations on major inflation drivers are summarized below:

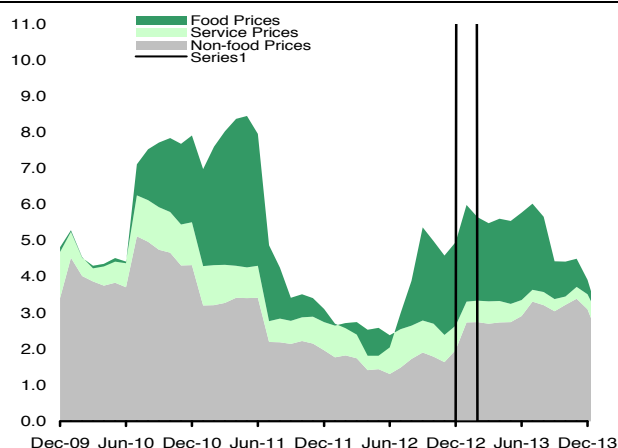
Data	Fruits, vegetables and eggs			CORE3 <sup>9</sup>	CPI inflation
	Energy prices	Fuel prices			
	yoy%	yoy%	yoy%	yoy%	yoy%
Mar-13	15.0%	4.2%	15.7%	3.2%	5.5%
Jun-13	15.0%	5.1%	19.2%	3.1%	5.8%
Sep-13	17.4%	3.1%	4.6%	2.4%	4.4%
Dec-13	<b>13.6%</b>	<b>7.0%</b>	<b>1.7%</b>	<b>2.5%</b>	<b>3.9%</b>

### INFLATION ABOVE TARGET BAND



Source: NIS, Garanti Bank Research

### ENERGY PRICE LIBERALISATION ADDING TO FOOD PRICE SHOCK



Source: NIS, Garanti Bank Research

<sup>8</sup> Based on the Quarterly Report on European Electricity markets households in Romania currently pay around 10.5 cents/kWh, 3 times lower than the most expensive EU member. When correcting household consumer prices of electricity for purchasing power parity (PPS) the picture changes: Romania pays 21 cents/kWh, two times more than the cheapest and two times lower than the most expensive price paid by an EU member state.

<sup>9</sup> Core3 refers to prices excluding volatile food prices (vegetable, fruits and eggs), oil, tobacco and alcohol, and regulated prices (energy prices, urban and railway transportation and water, sewerage, sanitation).



The core inflation, which is actually more relevant for monetary policy decisions and which excludes volatile, administrated prices, fuels, beverages and alcohol, softened to 3.1% yoy from 3.2% yoy in January. Still, NBR's target inflation is determined by the headline inflation and values significantly above the target have been the major reason of not cutting the key policy rate from the actual level. The Central Bank sees inflation at 3.5% yoy in December this year (bellow our 3.9% yoy projection) and decreasing to 3.2% yoy in December next year. So NBR is optimistic in reaching its upper target band already at the end of this year.

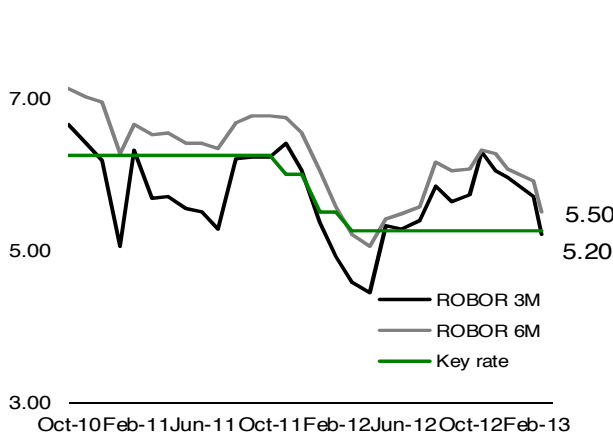
## Monetary Policy

### Monetary policy - To cut but when...

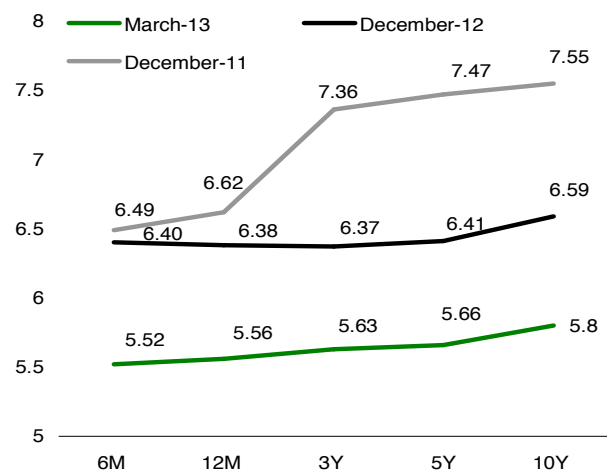
NBR refrained from cutting rates from 5.25% in its last meeting due to persistently high inflation but made statements regarding the direction of the next move, that it will be a cut. Still, the question is when to start cutting the interest rate. We expect the softening of the monetary stance to come in the following months but first relying on alternative instruments rather than key rate cut (open market operations and minimum reserve requirements).

Indeed, the Central Bank eliminated the cap on the regular weekly repo at the beginning of March that resulted in some improvement in liquidity conditions with lower rates, a trend which might continue till market rates get close to the key rate. Furthermore, the huge output gap in Romania and contracting lending activity are among the major reasons to start the rate cut cycle with a 0.25 basic points already at the end of this year despite the headline inflation slightly above the target band. If the inflationary expectations and second-round effects of food and energy price hike will prove to be anchored by the demand shortage, economy should receive a helping hand through softer monetary stance. We expect reduction of reserve requirements in a 1-2 percentage point steps to reach 10% for RON and 15% for FX liabilities by mid 2014.

### FIRST STEP SOFTENING: IMPROVING INTERBANK MARKET LIQUIDITY



### THE BETTER LIQUIDITY HELPS ALSO MF REFINANCING AT LOWER COSTS



Source: NIS, Garanti Bank Research

Source: NBR, Garanti Bank Research

## Fiscal Policy

### **So far, so good but how will the micro-firms survive the new fiscal code?**

Romania ended 2012 with 2.5% deficit based on cash term, slightly above the target of 2.2% set by IMF agreement, and 2.8% on accrual terms. The really good news however is that the fiscal imbalances that built up before the global financial crisis have been largely corrected and Romania will exit the excessive deficit procedure in the upcoming months. Fiscal consolidation is budgeted to continue but with a lower pace, that should enhance also economic growth.

Romania registered a public budget surplus of 0.17% of GDP (RON 1.04bn) in January, close to the surplus reported in the same month of the previous year from which we can highlight the higher excise levels enforced as of January, which resulted in a revenue increase by 27.7% yoy. The collection of income tax also increased by 16% yoy partly due to the higher wages paid in the public sector as of January.

The Parliament adopted the 2013 budget in February facing no significant setback with ruling coalition holding absolute majority. General budget deficit target is set at 2.1% of GDP this year, in cash-based terms. The consolidated budget incomes are budgeted to rise in 2013 by 8% while expenditures are planned to be higher by 7.4%. On the expenditure side some additional funds have been allocated for the public wages, to cover the 7.4% hike in December 2012 (RON 4.5 bn), for a 4% growth of pensions (RON 2.9 bn) and for reducing the payment periods in healthcare to 60 days (RON 3.1 bn). An additional amount of RON 4 bn is allocated for co-financing the EU funds with the scope of increasing the absorption rate.

On the revenue side the Government had to enforce new taxes as of 1st of February 2013 based on which the Government expects to bring additional 0.5%-of-GDP (RON 3 bn) in revenue in 2013. The excise duties hike, taxation of revenues coming from price liberalization and energy transportation and temporary taxation of exploitation of natural resources can be considered as good alternatives for revenue hike. Moreover, the Government budgeted the minimum wage increase from RON 700 by RON 50 on February 1, and then by another RON 50 on July 1. This will probably not increase the revenue of low-income population but rather move a part of undeclared income to the taxable area, which is positive for the public revenue.

A more controversial measure of new revenue sources is the mandatory turnover tax of 3% on small enterprises with turnover up to EUR 65 thousands per year. These companies will no longer have the 16% profit tax option (so far they were allowed to choose between the two). The increase of the tax base in agriculture targets also small farmers, who will pay taxes based on the size of the farm – and not on the revenues declared. Both measures put micro firms in a disadvantaged position in comparison to bigger counterparts that do not pay taxes in case of declared losses. The measure is particularly harsh under the condition of recession and financing difficulties of real sector. Micro firms with temporary financing difficulties might be forced to liquidate their activity while small start-ups, that might be the engine of growth, are discouraged to start any activity.

Ambitious plans have also been announced regarding the local administrations that have to cut their outstanding arrears (overdue more than 90 days) by 85% within two months and by 100% by the end of 2013. Municipalities will further reduce their debt by 3-5% per month



afterwards. The stock of local administrations' arrears was RON 840 mn (EUR 189 mn) at the end of 2012, more than EUR 120 mn above the RON 300 mn (EUR 67) target but still significantly below the RON 1.3 bn (EUR 292 mn) at the end of September.

## Public Financing

### Improved financing profile, window of opportunity still open

During last year the Ministry of Finance (MF) increased successfully its foreign currency buffer by selling USD 2.25 bn (Jan -Feb 2012) and EUR 2.25 bn (Sept-Oct 2012). The MF announced also that the external financing this year would be achieved under the EMTN Programme, which will be increased and extended up to 2015, by issuing an indicative volume of EUR 2.5 bn.

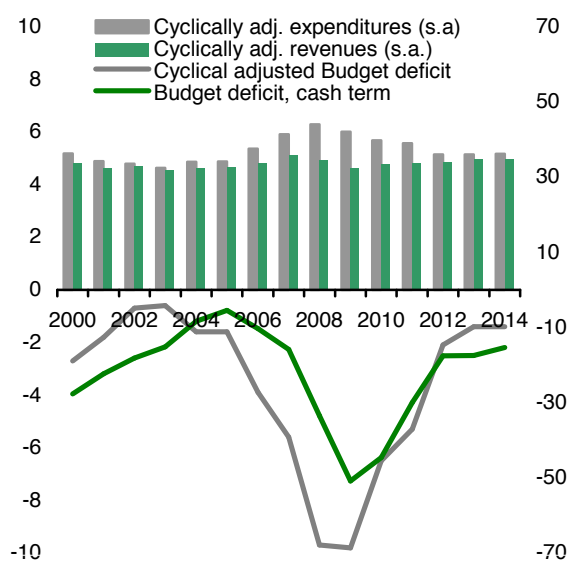
MF tapped external market in February 2013 by selling USD 1.5 bn worth of 10Y USD-denominated bonds on the U.S. market. Yields were at 4.5%, lower by around 200 bp compared to yields one year ago driven by hefty demand amid improved country risk profile.

The Government drained in the first two months of the year around RON 21 bn (including EUR 500 mn Eurobond for local markets and USD 1.5 bn on external markets) exceeding the indicative volume of between RON 18 and 20 bn announced for the first quarter. Currently, the FX buffer stays at a more than comfortable level of EUR 7.5 bn that covers already one third of total public debt service. Overall, pressures on the refinancing of the IMF loan decreased; still, the macro stability of the country should be enforced to assure cheap financing. IMF repayments schedule for 2013:

### IMF reimbursement calendar (EUR mn):

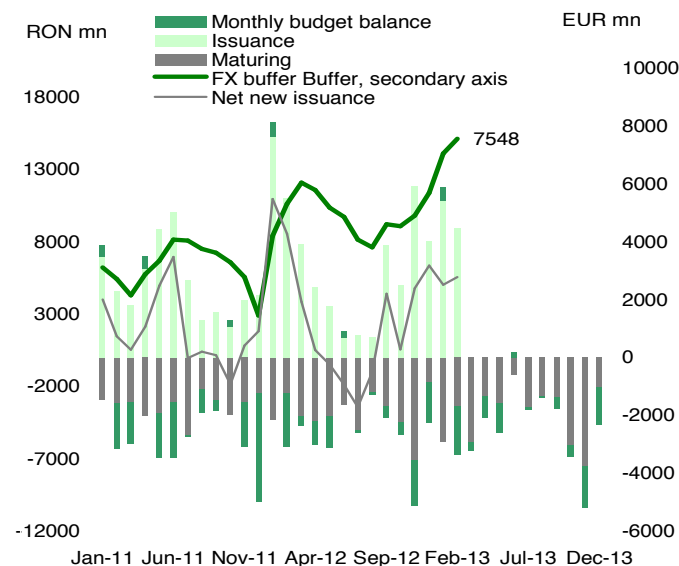
Q1 2013	Q2 2013	Q3 2013	Q4 2013
991	1302	1293	1508

### MAJOR INBALANCES CORRECTED



Source: MF, Garanti Bank Research

### CONFORTABLE FX BUFFER OF MF TO FINANCE DEFICIT



Source: MF, Garanti Bank Research

## External Accounts and Financing

**Improved portfolio investments to cover debt payments, but results also in higher sensitivity to country risk**

### Current Account

The 2012 Current Account (CA) external shortfall stood at EUR 5 bn, (3.8% of GDP) some 15% narrower compared to the one recorded last year. Its major component, the goods trade deficit (FOB-FOB) narrowed to EUR 7.3 from 7.4 bn, with imports drop (-0.5% yoy) slightly below the exports drop (-0.6%). Such figures highlight the very weak performance of international trade during 2012, with stagnating external demand and some reorientation of consumption towards domestic versus imported products that resulted in a slight adjustment of the deficit. After the 2009 fall of international trade, 2012 proved to be the most difficult year (last year Romanian exports and imports increased by 21% and 17% respectively). The CA adjustment has been also helped by higher positive income balance (24%) and service balance (70%). Moreover, the net current transfers continued to grow slightly (1% yoy), representing an important share of CA, totaling EUR 3.4 bn net.

We expect the CA deficit to slightly adjust to 3.5% in 2013 amid some trade acceleration in both import and export (around 5% yoy). Some good news has been already provided by the January trade data. Exports outside of EU increased strongly by 17.4% yoy (6.1% yoy total export growth), which would be the proper strategy for Romania to follow this year amid stagnating EU.

### External Debt

Romania's total medium- and long-term external debt increased moderately in 2012 by 3.7% yoy to EUR 78.7 bn. Out of this, EUR 8.66 bn was the Central Bank's debt to the IMF, which decreased by 15.4% (by EUR 1.6 bn) during 2012. The private sector's external debt increased moderately by 3.1% last year to EUR 37.3 bn, reversing the two years of decline. External public medium- and long-term debt had the strongest growth by 20.3% yoy to EUR 23.6 bn (17.4% of GDP) at the end of 2012. The EUR 4 bn rise in public indebtedness last year was prompted by Eurobond issues in amount of EUR 2.25 bn and USD 2.25 bn. The short-term debt of EUR 20.5 bn dropped by 10.2% yoy at end-2012. The total external debt of Romania thus edged up slightly by 0.5% in 2012 to EUR 99.2 bn.

### FX reserves

The NBR foreign exchange reserves increased further in February by EUR 0.7 bn to EUR 32.2 from EUR 31.5 mn, at the end of January. Inflows include also the Euro equivalent amount of approximately EUR 1.1 bn resulted from the issuance of bonds denominated in USD by the MF on the foreign market, while outflow include also the amount of approximately EUR 0.7 bn, representing the payment of the fourth principal installment and interest on the IMF loan. During February, the RON stayed relatively stable while interest of foreigners in Romanian securities was strong, giving the opportunity to the NBR to consolidate its reserves. FX reserves stay at a comfortable level by covering 7 months of imports.

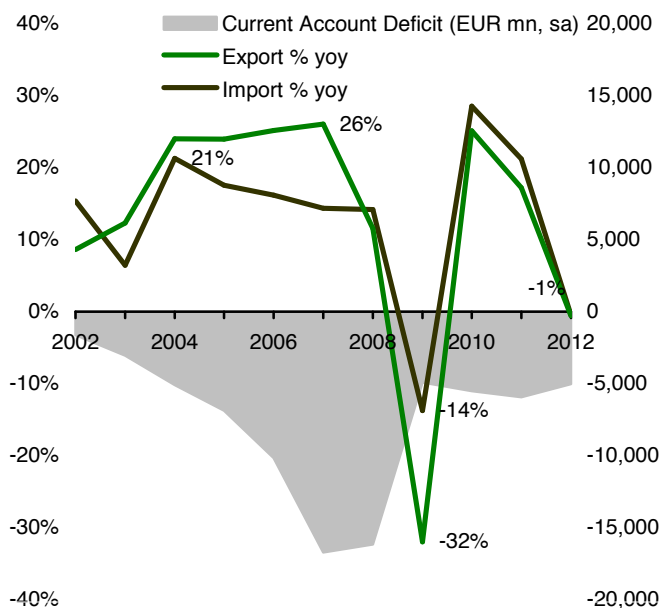
### FDI and other financing sources

The FDI coverage of the external deficit stayed in 2012 at 32% with EUR 1.6 bn compared to the 1.8 bn in 2011 (31% coverage). For this year, we expect an increase of FDI to 2.5 bn EUR driven by capital increases (on some instance enforced by registered losses in supervised sectors like the financial institutions), but also representing some new investment projects amid reacceleration of the economic activity.

Nevertheless, the short-term capital might play even a higher role in the near future, just as it did during 2012. After the outflow of around EUR 1.9 bn during the political instability in summer 2012, the last four months of the year brought back around EUR 3 bn, being one of the major financing sources of the country beside current transfers. A positive event enforcing this trend at the end-2012 and beginning of 2013 were the announcements of inclusion of Romanian bonds in Barclays EM Local Currency Government Index and JP Morgan's GBI-EM Indices, respectively. Portfolio investments in January doubled compared to the previous month with EUR 2 bn. We expect two channels of attracting further short-term capital during this year. Firstly, the governmental debt market still offers an interesting opportunity for foreign investors with relatively higher yield amid stabilizing macro environment. Secondly, the major part of proposed privatization will imply IPO or SPO deals that should bring fresh capital on stock exchange.

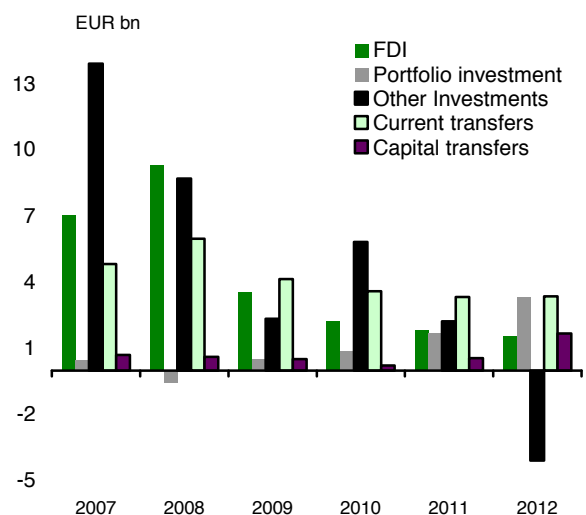
Portfolio investments and current transfers (including both transfers of Romanians working abroad and EU funds) play an important role in the upcoming period to mitigate the financing pressure deriving from IMF reimbursement and banking system cutting gradually their external financing (in 2012 EUR 4 bn net repayments of external loans).

**INTERNATIONAL TRADE FROZEN, CURRENT ACCOUNT STABILISED IN 2012**



Source: Eurostat, Garanti Bank Research

**PORTFOLIO INVESTMENT BOOSTED BY IMPROVED COUNTRY RISK**



Source: NBR, Garanti Bank Research

## FX Outlook

### RON to appreciate helped by improved country risk profile

We expect RON to appreciate by around 2% during 2013 driven by the improved country risk and the new investment alternatives. We see also some higher vulnerability given the increased reliance on short-term financing amid limited FX interventions (FX reserves to be affected by the EUR 4 bn IMF reimbursement) and the expected country performance depending on political commitments. Currency evolution will strongly depend on Romania's ability to attract new foreign capital for its securities and state owned enterprises included in the privatization list and implicitly on the success of the privatisation projects.

We expect the EUR/RON to stabilize at around 4.35 by the year-end and 4.25 for 2014, under the assumption that the political environment stays calm. Still, some political risk remains on the success of major governmental projects of structural reform and on any contagion from the Euro area crisis amid less space for FX intervention of NBR.

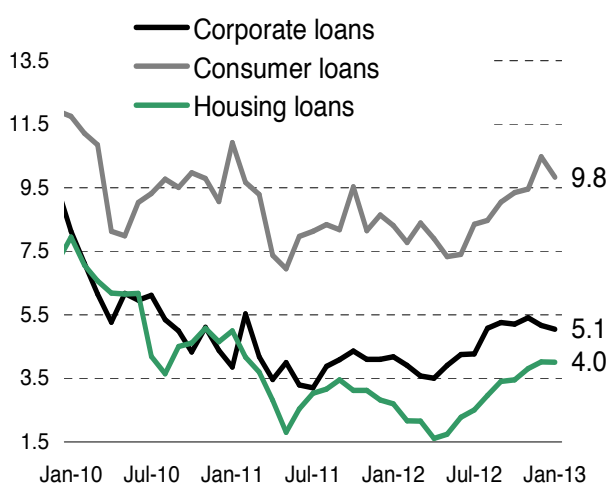
## Bank flows

### What should boost lending?

The banking system's non-governmental loan to deposits ratio, stayed at 114% in January 2013, just as at the end of the last year. The loans portfolio contracted by 0.5% mom, which is the fourth consecutive drop in the row. On an annual basis the total non-governmental loans contracted by 0.2% (FX adjusted). The housing loans and the RON denominated corporate loans (40% of total corporate loans) are the only ones experiencing positive growth rates, with 9.5% yoy and 10.8% yoy, respectively while all other type of loans registered contraction. Overall, corporate loans outperformed the household loans during the last year.

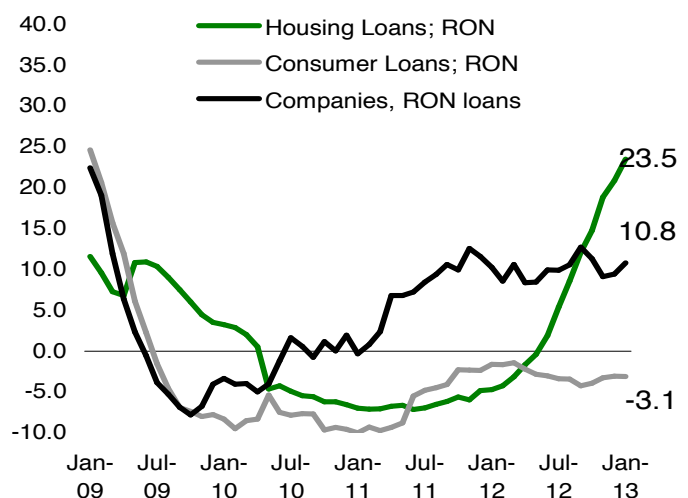
### LENDING IN DOMESTIC CURRENCY STILL EXPENSIVE

Difference in percentage points between RON and EUR interest rates



### PRICE SENSITIVE BANKING CUSTOMERS

% yoy growth



Source: NBR, Garanti Bank Research

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On the liabilities side, total non-governmental deposits in January recorded contraction as well after three months of growth, clearly driven by the contraction of RON deposits. Except a slight increase during December (driven by the end-of-year seasonal effect), the RON denominated deposits registered a continuous drop during 2012, resulting in 1.9% contraction in January 2013 compared to January 2012. There is a clear trend of keeping deposits in hard currency, protecting against any depreciation. RON denominated deposits decelerated from 15% yoy registered in April last year to 2% yoy drop in January 2013 while both population and companies kept their savings in hard currency. The deposits of non-financial corporations contracted by 3.4% compared to the same month of last year, given the hard economic conditions and drop of their activity and liquidity. Nevertheless, the deposits of general Government increased significantly by 26% during January 2013 (additional EUR 1.8 bn) due to the strong over-issuance of Ministry of Finance on the local market.

Demand for loans remained very weak mainly as a result of tighter lending conditions. With some constraints on the external funding and volatile country liquidity risk, there has been no space for the EUR interest rate to drop. Moreover, the tightening liquidity conditions on money market pushed RON rates above the key interest rates starting May 2012. The graph below presents the difference in interest rates between RON and FX denominated loans on type of clients. The higher money market rates are clearly reflected in higher RON versus FX interest rates. Still, in the longer term, the RON financing became more attractive for certain type of loans compared to previous year. For example, during 2012 we could see promotion of local currency denominated housing loans through lower RON interest rates (just 1.6 percentage points above the FX interest rate), a product almost non-existent till now (95% of total housing loans are still denominated in FX) that resulted in 23.5% yoy growth. Nevertheless, consumer loans are somehow blocked by the relatively expensive local currency financing (RON interest rates above the FX interest rates with 9.8 percentage points) and by restrictions stipulated by the NBR regulation<sup>10</sup> on FX denominated household loans. Companies also reoriented towards loans denominated in domestic currency (just 4 percentage points above the FX interest rates), which resulted in 10.8% annual growth versus the 4% contraction of FX denominated loans, as of January 2013.

What next? More restriction on FX lending has been enforced as of March 2013, addressing this time companies, whose revenue is not in hard currency<sup>11</sup>. For some clients, the RON lending might become the only alternative, so the RON interest rates are receiving more weight in financing decision. Under these circumstances, the softening monetary policy would be the proper answer to stimulate both consumption and investments by re-launch of lending activity.

<sup>10</sup> NBR Regulation no. 24/2011 enforced as of February 2012.

<sup>11</sup> NBR Regulation no. 17/2012 enforced as of March 2013.

**Main macroeconomic data and forecasts**

	2010	2011	2012	2013F	2014F
<b><i>Economy</i></b>					
Nominal GDP, (EUR bn)	124.1	131.4	131.8	144.2	156.5
GDP per Capita (EUR)	5,773	6,899	6,939	7,591	8,277
Real GDP, (% yoy)	-1.6	2.2	0.3	1.7	2.9
Agriculture, % yoy	-5.5	12.4	-21.2	2.8	3.0
Industry (except construction), % yoy	4.0	0.1	-2.1	1.2	2.9
Construction, % yoy	-4.5	-6.4	0.0	1.6	3.9
Wholesale and retail trade; tourism and transport, % yoy	-2.4	-2.1	0.3	0.9	2.8
Other services, % yoy	-3.1	8.8	8.7	2.3	3.2
Public administration, % yoy	-6.3	0.6	2.4	0.8	1.0
Population, (mn)	21.5	19.0	19.0	19.0	18.9
Avg net monthly wages (EUR, nominal)	334	348	347	378	406
Avg net monthly wages (% yoy, RON)	1.8	4.9	4.8	5.8	6.0
Unemployment rate, ILO, avg	7.3	7.4	7.0	6.9	6.6
<b><i>External Accounts</i></b>					
Current Account (EUR bn)	-5.52	-5.94	-5.04	-5.12	-5.83
Current Account (% of GDP)	-4.44	-4.52	-3.82	-3.55	-3.73
Export (EUR bn)	37.37	45.27	45.04	47.34	51.36
Import (EUR bn)	44.97	52.68	52.36	55.13	60.37
Export (% yoy)	28.49	21.15	-0.51	5.10	8.50
Import (% yoy)	25.07	17.16	-0.62	5.30	9.50
Trade balance FOB-FOB (% of GDP)	-6.12	-5.64	-5.55	-5.40	-5.75
Net FDI (EUR bn)	2.24	1.82	1.61	2.45	3.44
Internat. reserves incl. Gold (EUR bn)	35.16	36.80	35.41	30.90	27.40
Gross Foreign Debt (% of GDP)	74.49	75.15	75.25	69.99	65.82
<b><i>Fiscal Accounts</i></b>					
Budget Balance (% of GDP)	-6.37	-4.28	-2.51	-2.50	-2.20
Public Governmental Debt (% of GDP)	34.93	37.79	38.60	38.50	38.30
<b><i>Inflation/Monetary/FX</i></b>					
Inflation (CPI) yoy, eop	8.0	3.1	5.0	3.9	3.0
Inflation (CPI) yoy, yearly average	6.1	5.9	3.3	4.9	3.3
Central bank reference rate, eop	6.25	6.00	5.25	5.00	4.25
Central bank inflation target	3.50	3.00	3.00	2.50	2.50
1M Bubor, eop	4.05	5.72	6.04	5.17	4.15
1M Bubor, avg	5.90	5.27	5.22	5.61	4.66
EUR/RON, eop	4.28	4.32	4.43	4.35	4.25
EUR/RON, avg	4.21	4.24	4.46	4.33	4.27



**Appendix: Privatisation calendar 2013 - based on the New Letter of Intend to IMF**

Company	Type of Privatisation		Proposed share of priv.	EUR mn (estimated)
Romgaz	IPO	IPO organized only after an independent consultant evaluates the company's natural gas reserves. The evaluation should be completed by the end of June 2013, while the IPO should be completed by the end of October 2013.	15%	250
Nuclearelectrica	IPO	IPO by end-May after a consultant is picked up by end-March 2013. Romania aims to list minority stakes in May 2013.	10%	500
Transgaz (TGN.RO)	SPO	SPO to be launched by mid-April 2013	15%	75
Oltchim	majority stake	The Government expects the new management to come up with a new strategy by mid-April 2013. Insolvency request has been filed in January 2013, which is considered to be the proper solution for restructuring before privatization. They consider also the restructuring of the company's debts (total liabilities EUR 694 mn with total assets of EUR 466 mn as of 2012 H1 report).	51%	40
Hidroelectrica	IPO	The Government will issue by mid-March the decision on the 10% IPO. Hidroelectrica is preparing to exit insolvency on June 26, 2013 (entering insolvency in June 2012).	10%	300-500
CFR Marfa	majority stake	Romania Security's Council has approved the Government's attempt to privatize to a strategic investor, a deal to be done till end-June (total liabilities EUR 438 mn versus total assets of 329 mn as of end 2011 report).	51%	50
Posta Romana	majority stake	Romania's Government published the privatization call, inviting the prospective bidders to submit documents by April 11, 2013.	51%	45
<b>Total</b>				<b>1510</b>
<b>Other companies on the privatization list but with no specific time schedule</b>				
Tarom			20%	50
CupruMin			51%	60
Electrica Serv.			51%	110
Transelectrica			27%	50
OMV Petrom			10%	515

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