

Executive Summary: Happy New Year?

As the year 2009 ends there is little to cheer about, including the near future. With fiscal income in shambles there is little room for government action (at least in an anti-cyclical manner). The IMF targets of 6% budget deficit and 3.5% inflation will likely be of little help (other than the financial aid coming with them) but at least it appears that elections are a good 3 years away. The lower C/A and trade imbalances, despite reducing financing requirements, have had a negative effect on tax revenue while the fall in inflation is outweighed by serious concerns about unemployment (despite positive growth prospects for 2010).

The International Setting: Not-Much-Hopenhagen

The UN climate summit in Copenhagen failed to reach a binding agreement on tackling global warming carbon permits tumble after 'modest' climate deal. The accord brokered by the US, China and India last week at United Nations talks in Copenhagen, while not legally binding, also calls for international verification. The plan calls for another year of talks for a treaty to tackle global warming by capping emissions and expanding the \$120 billion carbon market. A US law allowing carbon trading would move the market's "center of gravity" from London to New York and Chicago. The EU's absence from the short list of „dealers" is, sadly, a sign of the block's dwindling international clout.

US stocks posted the biggest annual gain since 2003 and commodities rallied as the Federal Reserve kept its benchmark interest rate near zero and governments around the world enacted stimulus programs to halt the first global recession since World War II.

Federal Reserve officials are considering a proposal to schedule limited sales of bonds from the central bank's \$2.2 trillion balance sheet as part of a range of tools for withdrawing record monetary stimulus. Concern that the Fed will consider raising interest rates was also spurred after the latest report on initial US jobless claims fell to 432,000, the lowest since July 2008, following a report from the Institute for Supply Management-Chicago Inc. that showed US companies expanded more than forecast.

The news from Western Europe is less clear but there are some positive signs as manufacturing expanded and German business confidence increased to the highest level in 17 months in December as the global recovery sparked a revival in exports and manufacturing growth. Italian and Finnish business confidence also followed suit on expectations that growing exports will boost the economy's recovery.

In the East Hungary cut the benchmark interest rate on 21 December by 0.25% (to 6.25%) less than economists forecast as the weakening of the forint and a spike in investors' risk aversion prompted the central

bank to slow the pace of rate reductions. This may also have something to do with the fact that, according to Bank of America Merrill Lynch, Hungary is poised to emerge from the global recession as a leader in fiscal health as years of economic pain brought on by government austerity measures pay off. The leu advanced to a three-month high after Romania's Parliament approved a new prime minister, ending a 2 1/2-month political deadlock that delayed bailout loans and put the country at risk of ratings downgrades. Poland's zloty also rose to the strongest level in more than three weeks amid speculation the government may be propping up the currency to lower the amount of foreign- currency debt. In Ukraine the never-ending saga of gas prices haggling with Russia continues but with less collateral damage in the EU as Russia agreed to waive fines on Ukraine for consuming less gas than contracted and said it would renegotiate volumes for next year, easing a threat to shipments of the fuel to Europe.

The Organization of Petroleum Exporting Countries (OPEC) increased crude-oil production in December to the highest level in a year as members took advantage of rising prices, a Bloomberg News survey showed. Output averaged 28.965 million barrels a day this month, up 65,000 barrels from November, according to the survey of oil companies, producers and analysts.

In Asia China's manufacturing expanded at the fastest pace in 20 months in December, cementing the recovery in the world's third-biggest economy. India's exports rose for the first time in 14 months as recovery in the global economy boosted year-end holiday demand for the South Asian nation's products. Japan's industrial production climbed the most in six months in November, while falling wages restrained retail sales, underscoring the nation's reliance on overseas demand to sustain the economy's recovery. South Korea's exports increased at the fastest pace in 17 months, adding to signs that Asia's fourth-largest economy is recovering from the global recession.

In corporate news, GMAC Inc., the auto & home lender bailed out twice by the US, received a third rescue package valued at \$3.79 billion that gives taxpayers a majority stake in the Detroit-based company. Also Airbus SAS is putting pressure on EU governments to contribute more money to the financing of its A400M transport plane, Die Welt reported. Finally Intesa Sanpaolo and UniCredit, Italy's two biggest banks, may face the country's first class-action lawsuit over overdraft fees following new legislation.

With deflation remaining a threat and a slow pace of overall growth, recovery may take at least 6 – 15 months year as opposed to just 2 or 3. The silver lining is that the "Japanese disease" looks much less likely.

GDP Growth: The Long Way Up

The currently available GDP growth data shows that the Romanian economy has fallen sharply in the

third quarter, by 7.1% compared with Q3/2008, light-years away from the +9.2% QoQ in Q3/2008 and even compared to the +2.9% in Q4/2008. This confirms the previous Q3 estimates and, despite the sharp decline, it marks a slight come-back from the 8.7% drop in Q2/2009 and lights-up hope of resuming growth (of course, it is a long way up ...). The IMF scenario for 2010 talks of +0.5% real GDP growths however we believe that a more prudent approach would be to envision a range, which we believe to be between -1% and +1% real GDP growth for 2010, with risks resting more heavily on the downside.

Industrial output (the “great white hope” of late) has made a come-back rising 3.5% in October, following a 17% leap in September after having plummeted 11.5% in August, thus unfortunately showing the same volatility as it has throughout 2009. This volatility still raises the question of whether demand for cheaper goods, which had been previously fuelling growth, is dwindling. Still, combined with a rather bad year in construction, this pick-up in industrial output may break the trend of the past 7 years in which the weights in GDP of industry and agriculture have been steadily decreasing while those of services and construction had increased. Services output was down 0.4% in October after falling 5.5% in September. Agriculture also disappointed as it fell 11.82% in Q3 compared with Q3/2008 (still up some 20% compared with Q3/2007) following a 6.75% decrease in Q2/2009 (in nominal terms). As we anticipated, even if initial predictions of draught were pessimistic, the problems with fuel, seed and subsidies look to have turned agriculture from a possible life-jacket to a dead-weight. Construction, the former “engine” of growth, fell 4.4% after a revised growth of just 0.5% in September following a combined drop 19.3% in July and August, thus showing the lingering signs of the heavy real-estate slump which has gripped Romania despite the more relaxed mortgage loan terms by the NBR and a trumpeted (but still not very effective) “First House” government-guaranteed loan program. Construction permits (in square meters as well as number of units) plummeted some 20% in October (most likely due to seasonality factors) after having increased in September by 6-7%.

In October retail sales marked another fall of 1.5% after a decrease of 1.4% in September. The slow-down in retail commerce is one important factor driving down the Current Account deficit. The interesting fact is that consumer loans were up 0.52% in October after falling 0.39% in September and being nearly flat in August.

We maintain our expectation for sectors that most likely to outperform in the next 3 months: energy (both power & gas), utilities, ecological services (waste management, recycling), basic consumer items (especially food, drinks & hygiene), drugs and healthcare. Consumer discretionary items still look risky on a domestic level, especially since the

seasonality effect will be against them in January (due to the post-Christmas “withdrawal”).

Current Account & Trade Balance: A Mixed Image

High current account and trade balance deficits have been a permanent problem with the Romanian economy during the past 17 years. 2008 was no exception trade balance (as a percentage of Ytd GDP) was at a re-stated -16.92% at 31 December while current account deficit (as a percentage of GDP) was at 12.75% at the same date. Foreign direct investment for 2008 covered some 55% of the C/A deficit but in 2009 it decreased significantly (to some 45% of the nominal amounts recorded in 2008, judging by October levels). However, given the drop in international trade, the FDI at the end of October 2009 still covered 94.08% of the C/A deficit, albeit significantly down from the 128.62% it reached in August. According to September GDP data the C/A balance was at -4.18% of the nominal Ytd GDP while the trade deficit was at 8.69% (almost 2.5 times less than in September 2008). After a re-lapse to the 2008 dynamics in the preceding month exports rose by 4.26% MoM in October while imports were down 1.66%.

There is reason to believe that this decrease in the C/A and trade deficits (which was not expected until at least 2010) may have been so abrupt that it caused serious negative effects such as plummeting tax revenues, unemployment and speculative currency attacks fed by mistrust (in other words “a harsh adjustment”). With this in mid the above evolution in trade activity leaves a mixed image: if exports could be maintained on a moderate upward trend while imports would rise (at a lower rate than exports) there could be hope yet for a sustainable deficit “rebalancing act”.

There is a fear that the price to pay for a steep improvement in C/A & trade deficits will be a further devaluation of the national currency. Still, a currency devaluation would have to “climb” over Central Bank interventions, for which the BNR still has ample means with international reserves rising 1.95% in November.

Inflation and Unemployment: Painful Prospects

Inflation had been picking-up speed again during the first months of this year, reaching some 6.85% in February 2009 (based on CPI) but since April it slowed-down to reach 4.29% in October but picked-up again for an annualized 4.69% in November. This is probably the reason why the National Bank of Romania (the NBR) did not decrease rates again, as expected by some analysts and traders, following the 0.5 percentage points cut at the end of September. Thus the inflation target of 4.5% in 2009 (undertaken by the Central Bank as part of IMF deals) seems in peril (considering that the Holidays tend to push-up prices) but we can hold-up hope for the target of 3.5% in 2010.

Reaching an environment of low but positive inflation (an ideal situation) does however carry a price: the unemployment rate has been increasing by 5.63% to 7.5% in November after also rising in October, September, August & July. Even if stagflation appears to be less likely it is still not off the table completely and, most tragically, it looks like the population will bear more and more of the pain (especially as the current unemployment is significantly under the levels reached in the West). The only silver lining is that an increased unemployment rate, as long as inflation slows down (but does not become negative), together with wages still at a low level compared with Western EU states may just be the starter for a recovery, giving Romania a competitive edge for the next 2-4 years especially in the labor intensive sectors such as construction and services. Still, if demand in the Western EU does not pick-up, domestic demand may not be enough to support this recovery.

Monetary & Fiscal Policy: All That's Old Is New Again

Monetary policy was the main tool used by the authorities in the fight against inflation (between October '07 and August '08 the Central bank had raised rates with 275 bps). The same tool is now used to fight the contraction and since February '09 the NBR cut rates with 225 bps down to 8.00% (with the latest 50 bps cut in late September). If inflation resumes its downward trend more cuts are likely to follow. Fortunately, the lower interest rates are not likely to automatically put downward pressure on the RON's value vs. the major currencies since some of this may

have already been priced-in and the BNR reserve has been increasing slightly (from 30.7 to 31.3 bn. EUR). Unfortunately, the rate-cuts and the Mandatory Reserve Requirements reduction (initially for FX amounts with tenors over 24 months and subsequently for all reserves) are very slow to trickle down into the economy and a possible liquidity trap (low monetary policy rates that fail to increase liquidity available to the real economy) may grip Romania's monetary system.

Finally, after months of political instability, we have a "new" Prime-Minister (oddly enough the same one dismissed by Parliament only a few months ago) and a new government (a modified version of the interim government led by the same PM – Mr. Boc). Hopefully, as the current (and former) President has a new mandate and supports the current government there will be some of the much needed stability and consistency in the country's affairs. Given the September GDP data the budget deficit is 7.65% of the 9M Ytd GDP and, after a small 0.22% recovery in October the November data (conveyed by the press) shows a 16% MoM increase in the deficit. This is concerning since the budget deficit caps negotiated with the IMF is of 7.3% for the year 2009 (and 6% for 2010). This makes the increase in taxation, expected by some analysts, look likely despite the negative side-effect on collection and economic growth (perhaps more effective controls would be a better solution). Also the Government intends to sack some 80,000 state employees by the end of August, a fact which is likely to further dampen domestic consumption as well as a much needed recovery. Overall it would seem that, as the saying goes, "all that's old is new again".

Latest Data

Please find below the latest macroeconomic data we have available on the Romanian economy:

Period	Latest	Previous
GDP & components	RO (data in EUR)	
Date	Sep-09	Jun-09
Real GDP growth (% , vs. same Quarter prv. Yr.)	-7.10%	-8.70%
Quarterly GDP current prices (EUR bn.)	30.30	26.10
Date	Oct-09	Sep-09
Industrial Output growth (% , MoM)	3.50%	16.70%
Date	Oct-09	Sep-09
Construction Output growth (% , MoM)	-4.40%	0.50%
Date	Oct-09	Sep-09
Services Output growth (% , QoQ / MoM)	-0.40%	-5.50%
Date	Sep-09	Jun-09
Agr. Output growth vs. same Q prv. yr. (% , QoQ)	-11.82%	-6.75%
Foreign Trade & State Budget	RO (data in EUR)	
Date	Nov-09	Oct-09
Cons. Budget Balance improvement (% , MoM)	-16.05%	0.22%

Date	Sep-09	Jun-09
Cons. Budget Balance (% of Ytd GDP)	-7.65%	-6.81%
% GDP CBB improvement (% , QoQ)	-12.38%	20.81%
Date	Sep-09	Jun-09
Current Account Balance (% of Ytd GDP)	-4.18%	-4.86%
Date	Sep-09	Jun-09
Trade Balance (% of Ytd GDP)	-8.69%	-9.25%
Date	Oct-09	Sep-09
Current Account improvement (% , MoM)	-19.35%	-35.28%
Date	Oct-09	Sep-09
Trade Balance improvement (% , MoM)	-13.15%	-18.55%
Date	Oct-09	Sep-09
Foreign Direct Investment growth (% , MoM)	6.35%	14.16%
FDI (% of C/A balance, monthly)	94.08%	105.58%
Date	Oct-09	Sep-09
Exports growth (% , MoM)	4.26%	18.80%
Exports growth vs. same month of prv. Yr. (% , PoP)	-16.57%	-12.30%
Date	Oct-09	Sep-09
Imports growth (% , MoM)	-1.66%	25.30%
Imports growth vs. same month of prv. Yr. (% , PoP)	-32.18%	-31.91%
Inflation & Unemployment	RO	
Date	Nov-09	Oct-09
Monthly Inflation (% , CPI-based, MoM)	0.70%	0.44%
Monthly Inflation (% , CPI-based, last 12M)	4.69%	4.29%
Date	Dec-09	Nov-09
Central Bank Money Market rate	8.00%	8.00%
Date	Nov-09	Oct-09
International reserves (EUR, bn)	31.30	30.70
International reserves growth (% , MoM)	1.95%	0.33%
Date	Nov-09	Oct-09
Unemployment rate (%)	7.50%	7.10%
Unemployment rate growth (% , MoM)	5.63%	2.90%
Consumer data	RO (data in EUR)	
Date	Oct-09	Sep-09
Cons. loans % growth (in domestic eqv., MoM)	0.52%	-0.39%
Date	Sep-09	Jun-09
Cons. loans % growth (as % of GDP, QoQ)	1.51%	-0.17%
Date	Oct-09	Sep-09
Housing sqm. authorized growth (% , MoM)	-20.22%	7.58%
Housing units authorized growth (% , MoM)	-20.20%	6.23%
Date	Oct-09	Sep-09
Retail sales growth (% , MoM)	-1.50%	-1.40%

Most data is collected between 31.12.2008 and 31.12.2009.

Information sources: National Bank of Romania, National Statistics Institute, Bloomberg Professional Services, Ziarul Financiar, The Economist, Mediafax, Money.ro.



DISCLAIMER

• This report is issued for information purposes only and should not be interpreted as a suggestion, an invitation or an offer to enter into any transaction. Also it is not and should not be considered a recommendation for investment in financial instruments according to C.N.V.M. Regulations no. 15/2006 and 32/2006.

- This report is not intended to influence in any way or to be considered a substitute to research and advice centered on the specific investment objectives and constraints of the recipient (including tax concerns) therefore investors should obtain individual financial advice.
- The issuer of this report does not claim that the information presented herein is perfectly accurate or complete. However it is based on sources available to the public and widely believed to be reliable. Also the opinions and estimates presented herein reflect a professional subjective judgment at the original date of publication and are therefore subject to change thereafter without notice. Furthermore there can be no guarantees that any market developments will unfold as forecasted.
- OTP Bank Romania SA may have issued reports that are different or inconsistent with the information expressed within this report and is under no obligation to update or keep current the information contained herein.
- This document is intended only for the direct and sole use of the selected customers of OTP Bank Romania SA. Any form of reproduction or redistribution to any other person than the intended recipients, including publication in whole or in part for any purpose, must not be made without the express agreement of OTP Bank Romania SA.
- Please note that the Internet is not a secure environment and OTP Bank Romania SA does not accept any liability for any loss caused by the result of using this report in a form altered or delayed by the willful or accidental interception, corruption or virus infection.

OTP BANK RESEARCH –Treasury & Capital Markets Directorates

Ovidiu-George Dumitrescu, CFA, Analysis Manager / ovidiu.dumitrescu@otpbank.ro / +40 21 307.58.09