

Weekly Focus

Current account deficit shrank in first eight months; government note yields on primary market edged higher

Macro forecasts					
% y/y, unless o.s.	2009	2010	2011	2012f	2013f
GDP	-6.6	-1.6	2.5	0.7	1.9
Private consumption	-9.1	-0.3	0.7	0.9	1.9
Investments	-28.1	-2.1	6.3	4.0	4.6
C/A / GDP - %	-4.2	-4.4	-4.2	-4.1	-4.3
FDIs/GDP - %	3.0	1.8	1.4	1.2	1.3
BDI/GDP (ESA) - %	-9.0	-6.8	-5.2	-3.8	-3.3
EURRON (eop)	4.23	4.28	4.32	4.55	4.50
CPI (eop)	4.7	8.0	3.1	5.5	4.7

Source: BCR Research, NIS, central bank

Market forecasts					
	Spot	Dec-12	Mar-13	Jun-13	Sep-13
EURRON	4.583	4.55	4.53	4.52	4.51
USDRON	3.512	3.70	3.78	3.77	3.76
EURUSD	1.304	1.23	1.20	1.20	1.20
Key rate	5.25	5.25	5.25	5.25	5.25
ROBOR 3m	5.8	6.1	6.2	6.3	6.1
5y T-bonds	6.7	6.8	7.0	7.0	6.9

Source: BCR Research, Erste Group Research

Macro developments					
% y/y, unless o.s.	7M '11	8M '11	6M '12	7M '12	8M '12
Industry	6.6	7.0	0.2	0.6	0.3
New orders	17.8	17.6	0.7	0.5	0.5
Construction	-1.8	-0.3	7.5	4.7	4.9
Retail sales	-4.8	-4.7	4.1	4.2	4.3
Exports	26.1	25.9	0.9	0.7	0.7
Imports	19.3	20.2	0.9	0.9	1.2
CPI	4.85	4.25	2.04	3.00	3.88
BDI/GDP (cash)	-2.1	-2.4	-1.1	-1.2	-1.2
EURRON (eop)	4.24	4.22	4.45	4.57	4.46

Note: Unadjusted series for industry, construction, retail sales

Source: NIS, BCR Research

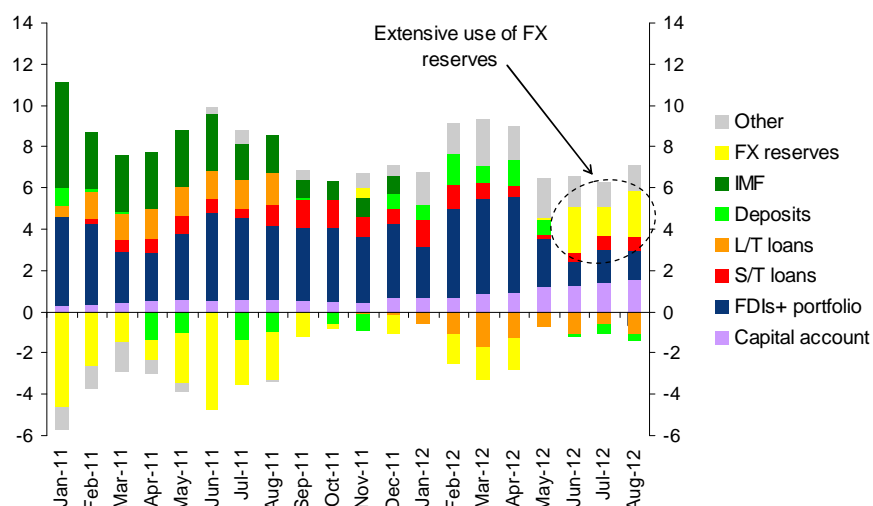
Country ratings				
Agency	Current		Previous	
S&P	BB+	25-May-12	BB+	29-Nov-11
Moody's	Baa3	20-Mar-09	Baa3	6-Oct-06
Fitch	BBB-	28-Jun-12	BB+	9-Aug-10

Source: Reuters

Current account gap narrowed in first eight months

The current account deficit moderated its contraction pace (-25% y/y) during January-August to stand at EUR 3.1bn. The trade deficit (FOB-FOB) widened slightly to EUR 4.8bn (+2.6%) in the first eight months, as exports lost momentum more visibly against imports (FOB) in August. Services consolidated their surplus to a robust EUR 452mn during January-August (the positive impact was generated by 'transportation' as well as 'other services'). Net current transfers rose a healthy 23% to EUR 2.5bn in the first eight months, whereas the private sector – mainly remittances from Romanians working abroad – took the lion's share (~EUR 2bn). Unlike the previous years, however, the private component of the net current transfers was down 5% m/m in August, when a large part of Romanian expats come to spend their vacation with their families. This time, they either spent less money (lean times in Italy and Spain) or did not come in such great numbers as they used to.

Funding structure of C/A deficit – EUR bn. (annualized series)



Note: FX reserves ('+' decrease/ '-' increase)

Source: BCR Research, central bank

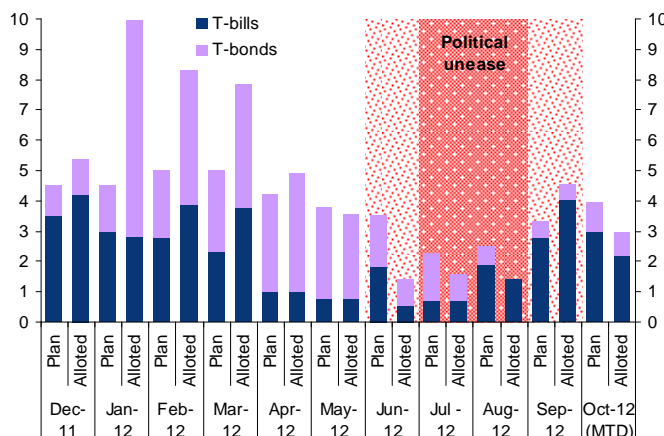
Net inflows of foreign direct investments (FDIs) amounted to EUR 941mn in the first eight months, up 55% against the similar period of 2011. But the situation is far from sweetness and light, due to the low base of comparison in y/y terms – despite the uplift in FDIs, the coverage rate of the C/A deficit dropped to 30% during January-August, from more than 35% in the first seven months. Inter-company lending made up the bulk of the incoming FDIs (EUR 801mn). The funding structure of the current account deficit did not reveal too much of an improvement, while the C/A coverage continued to eat into the FX reserves for the fourth straight month in August.

Rising yields keep new government debt issuance on ropes

Yields remained on a firming streak this week, while the central bank continued to restrict the liquidity injection into the market through 1-week repo (RON 6bn) in a bid to contain the recent weakening bout of the national currency. Moreover, the sweeping statement of PM Ponta last weekend – backtracked upon later – that the funding needs for the last 45 days of 2012 are not covered by the current budget is likely to stoke uncertainty, while investors will not shrink from bidding higher in the remainder of this year and even beyond. This will also make it more difficult for the MinFin to stand its ground in front of investors (yield-wise). Inflation will keep bond prices under pressure most likely until mid-2013 and we now see the yields on 5-year government notes topping 7% in the first half of 2013.

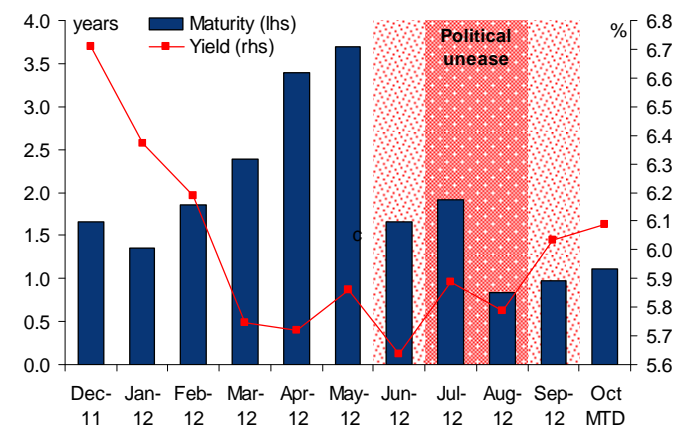
At Monday's T-bill auction, the MinFin had to settle for less, issuing just RON 625mn (the plan was RON 1bn) at a marginally higher average yield than at a previous tender two weeks earlier (6.08% vs. 6.02%). The picture was only slightly different on Thursday, when the MinFin managed to sell 2-year T-bonds according to plan (RON 300mn), but at a markedly elevated average yield of 6.35% (+15bp). So far, the average yield on the primary market ground higher in October (6.1%) compared to September, whereas the actual sales fell so far short of the October issuance target.

Issuance of government notes: plan vs allocation – RON bn.



Source: BCR Research, central bank

Average maturity and yields (primary market)



Source: BCR Research, central bank

The MinFin's issuance strategy has shifted towards short maturities (up to two-year), while bonds with residual maturities of five years or longer are few and far between. Unlike January-April 2012, when the market conditions allowed a great part of the 2012 public debt to be pre-financed, the repayment of the outstanding 1/3 of the public debt will not come easy. If we add the budget deficit to cover in the remainder of this year, we can easily conclude that further budget trimming looks inevitable for the MinFin. But will Romania be able to run a tight ship in an election year? The MinFin has bent over backwards and so far succeeded in keeping expenditures in check, at the expense of cutting down on capital expenditures.

Although economic growth is cooling this year to 0.7% (0.9% is the revised forecast of the IMF), the chances of meeting the budget deficit target of 2.3% of GDP (cash standards) have increased somewhat. However, we still see the budget deficit overshooting 3% of GDP for 2012 (ESA standard) as the issue of arrears – especially those of local administrations – remains thorny. Proceeds from privatizations in late 2012, if any, will be meager (the SPO for Transgaz seems more likely) and will not provide a significant leg up to funding the public debt. Besides, privatization procedures are laborious and the interest of foreign investors has seen better days.

However, the substantial narrowing of the 5-year CDS spread to a four-year low of around 200bp may prompt the MinFin to tap fresh funds from the international market (around EUR 0.75-1bn). The MinFin has raised this year USD 2.3bn in medium-term notes (MTN) and EUR 750mn in Eurobonds in early September. For the time being, the most likely short-term scenario is for local yields to drift higher, as inflationary expectations are biased upwards and the parliamentary election campaign is entering the final stretch.

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