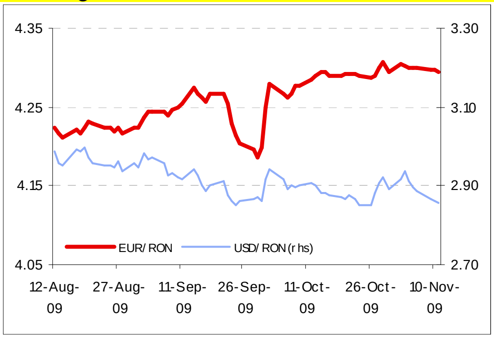
Economic overview Romania

October 2009

Exchange rates



Source: National Bank of Romania

Monetary policy rate

		Data as of:
NBR key interest rate	8.00%	30-Sep-09

Source: National Bank of Romania

Money market interest rates

	1 M	3 M	6 M	12 M
ROBID	9.71%	9.91%	9.61%	9.60%
ROBOR	10.21%	10.41%	10.36%	10.35%

Data as of: 11 November 2009
Source: National Bank of Romania

Exchange rate outlook

	Current	Dec-09	Mar-10	Jun-10	Sep-10
EUR/RON	4.2952	4.35	4.30	4.25	4.20
USD/RON	2.8566	2.90	2.77	2.74	2.90
EUR/USD	15036	150	155	155	145

Data as of: 11 November 2009
Source: Raiffeisen RESEARCH

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This report was completed on 12 November 2009.

Highlights

■ Annual inflation rate decreased form 5% yoy at the end of August to 4.3% yoy at the end of October. Headline inflation rates were high both in September and October (at around 0.4% mom), being fuelled by the increases in tobacco prices and leu depreciation. However, CORE 3 measure of inflation decreased both in September and October, showing that underlying inflationary pressures remained contained.

■ NBR remained on hold on 3 November, keeping the monetary policy rate unchanged at 8%. The central bank is aware of the persistent deceleration of economic activity, but it is probably more concerned about the risks and uncertainty raised by the political turmoil.

■ Money market interest rates increased in last month, as liquidity conditions in the money market tightened. ROBOR 1M climbed above 10.5%, substantially above the level of the monetary policy rate.

■ Industrial output expanded also for the second quarter in a row. It increased by 1.8% qoq in Q3 2009. Retail sales stabilized also in Q3 (+0.1% qoq) after falling in the previous quarters. Output in construction sector decrease further in the third quarter (-7.5% qoq), but at a slower pace as compared with the second quarter. Available data suggest that real GDP has most likely decreased again in the third quarter.

■ IMF mission, together with teams from the European Commission and the World Bank, was in Bucharest between 28 October and 6 November. The IMF representative said that Romania fulfilled nearly all targets set for the end of the third quarter. However, "crucial components" of the program cannot be implemented in the context of current political instability. A new mission will come again in Bucharest after a new government will be established.

Credit ratings (FCY long-term)

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

Key economic figures

	2007	2008	Jul-09	Aug-09	Sep-09	*2009f*	*2010f*
Real GDP (%, yoy)	6.3	6.2				*-7.5*	*1.0*
Industrial output (%, yoy)	5.4	2.5	(6.7)	(5.0)	(4.0)	*-7.0*	*3.0*
CPI eop (%, yoy)	6.6	6.3	5.1	4.9	4.9	*4.5*	*4.0*
CPI avg (%, yoy)	4.8	7.9	6.6	6.4	6.2	*5.7*	*4.2*
Unemployment (%, avg)	4.3	4.0	5.0	5.2	5.5	*6.5*	*8.8*
Budget balance (% of GDP)*	(3.1)	(4.9)	(3.5)	(4.4)	(5.1)	*(7.8)*	*(6.0)*
Trade balance (EUR bn, ytd)	(17.8)	(18.2)	(3.5)	(4.0)	(4.8)	*(6.8)*	*(7.2)*
CA balance (EUR bn, ytd)	(16.7)	(16.9)	(2.6)	(2.5)	(3.3)	*(5.6)*	*(6.2)*
FDI (EUR bn, ytd)	7.0	9.2	2.9	2.9	3.5	*4.5*	*6.0*
Official FX reserves (EUR bn)	25.3	26.2	27.3	27.7	28.3	*27.0*	*27.0*

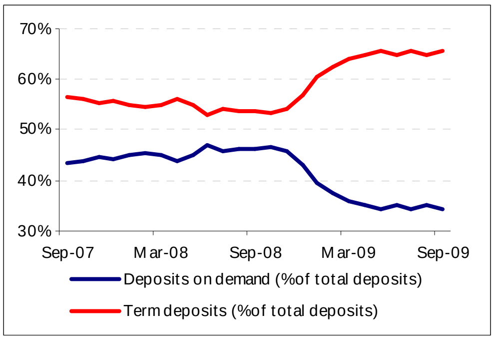
** national methodology*
Source: National Bank of Romania, National Institute of Statistics, Raiffeisen RESEARCH

Raiffeisen RESEARCH
RZB Group

Key events

Term deposits vs. demand deposits

The structure of deposits from companies and households changed substantially starting the beginning of the year. Share of term deposits in total deposits increased from 54% in September 2008 to 66% in September 2009. We think that the change in legislation (interest on term-deposits was also tax exempted starting 1 January 2009) was the main driver behind the changes in the structure of deposits. Also, starting September the banks have less incentive to stimulate sight deposits given that this reduces their liquidity indicator. So, it is not excluded to see further increases in the share of term deposits.



Source: National Bank of Romania, Raiffeisen RESEARCH

Recent important events

NBR released a new inflation forecast

On 4 November, the NBR released the inflation report for the third quarter. Also, it published its new inflation forecast.

The NBR expects now the annual inflation rate to be at 4.5% at the end of this year. It said previously (in August) that inflation rate would reach 4.3% by the end of this year.

The NBR hold unchanged the forecast for the end of 2010, at 2.6% yoy. The central bank is optimistic about dynamics of inflation in 2010 when compared with market expectations. Most likely, the large negative output gap (the GDP is at around 7.2% below the potential level in 2010 in their estimations) is the main driver of the fast disinflation process expected by NBR in 2010.

The NBR said that the inflation target for 2011 has been set at 3% with an interval of variation of +/-1%. The target should be also discussed with the government.

Last NBR's inflation forecast

	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10
CPI (% yoy, old forecast)	5.1	4.3	2.9	2.3	2.5	2.6
CPI (% yoy, new forecast)	4.9	4.5	3.2	2.6	2.7	2.6
Diference		0.2	0.3	0.2	0.2	0.0
CORE2 (% yoy, old forecast)	6.0	4.3	2.5	2.1	1.8	1.8
CORE2 (% yoy, new forecast)	5.8	4.9	3.4	2.9	2.7	1.7
Difference		0.6	0.9	0.8	0.8	-0.1

Key upcoming events and data releases

Date	Indicator/ Event	Next release		Recent developments			
		Reference date	Expected/ Efective	Sep-09	Aug-09	Jul-09	Jun-09
02-Nov-09	FX official reserves, EUR bn	Oct-09	28.4	28.3	27.7	27.3	26.5
03-Nov-09	PPI, %yoy	Sep-09		-1.2	-1.1	-1.6	-0.1
03-Nov-09	Monetary policy meeting, %	Nov-09	8.00	8.00	8.50	9.00	9.50
04-Nov-09	Gross wages in economy, %yoy	Sep-09		6.2	6.8	7.5	8.6
04-Nov-09	Gross wages in industry, %yoy	Sep-09		8.2	9.9	9.7	9.5
06-Nov-09	Output in construction, %yoy	Sep-09		-20.7	-21.5	-15.6	-6.4
09-Nov-09	Retail sales, %yoy	Sep-09		-13.9	-12.3	-13.5	-17.0
09-Nov-09	Industrial output, %yoy	Sep-09		-4.0	-5.0	-6.7	-7.6
09-Nov-09	FOB/FOB foreign trade deficit, EUR bn, last 12 months	Sep-09		-9.3	-10.6	-11.6	-13.0
11-Nov-09	CPI, %yoy	Oct-09	4.3	4.9	5.0	5.1	5.9
11-Nov-09	Current account deficit, EUR bn, last 12 months	Sep-09		-6.4	-7.8	-8.4	-9.4
11-Nov-09	FDI inflows, EUR bn, last 12 months	Sep-09		6.0	5.6	6.6	7.5
11-Nov-09	Total external debt, EUR bn	Sep-09		78.1	76.9	76.8	75.5
13-Nov-09	GDP, %yoy	Q3 2009	-9.0				
22-Nov-09	Presidential elections						
24-Nov-09	Non-government credit, %yoy	Oct-09		2.4	8.2	10.8	11.2
27-Nov-09	Economic Sentiment Indicator, s.a.	Nov-09	62.6	62.6	62.4	65.0	66.8

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

IMF mission came in Bucharest for the second review

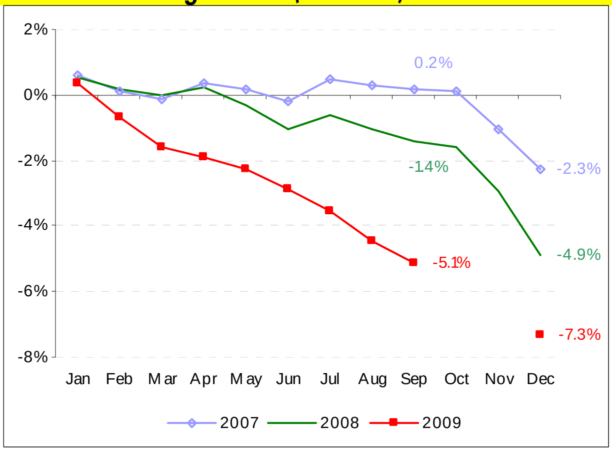
Third instalment could be disbursed only after 2010 budget is approved

IMF mission visited Bucharest for the second review of the Stand-By Agreement

On 28 October, the IMF mission came in Bucharest for the second review of the Stand-by Agreement. Teams from the European Commission and from the World Bank joined also to the IMF mission. Initially, both the IMF and the European Commission said that they will postpone the review until a new government would be in place. Eventually, the two international institutions accepted the invitation of the President to perform the review even the country was ruled by an interim government. At the beginning of the visit, the IMF representative said that that a follow-up mission may be necessary to continue discussions after a new government will be formed and that a successful completion of the review will require a broad-based political commitment to approve a 2010 budget with a budget deficit no higher than 5.9 percent of GDP.

The IMF mission (together with the teams from the European Commission and from the World Bank ended their visit in Romania and presented preliminary findings of the review on 6 November. During their stay in Bucharest, the representatives of international institutions have talks with interim government, central bank, president and political parties as well as with the trade unions and private companies.

Consolidated budget deficit (% of GDP)

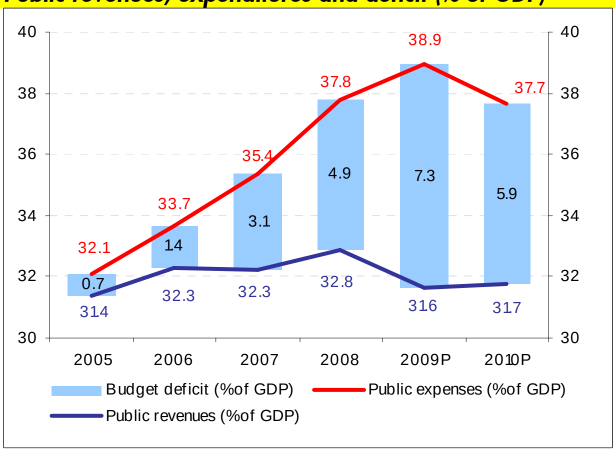


Source: Finance Ministry , Raiffeisen RESEARCH

Performance under the program has been good until end-September

At the end of the mission, the IMF representative said that performance under the program through end-September has been good and nearly all program targets have been met. The most important target for the second review was the one referring to the budget deficit, which was fulfilled. Consolidated budget deficit stood at 5.1% of GDP in September, below the agreed target of 5.5% of GDP. Also, the NBR's reserves were above the target. It seems that only the target for government's arrears has been missed (for the second time in a row). In June, Romania asked and received a waiver from the IMF Board for this target.

Public revenues, expenditures and deficit (% of GDP)



Note: Data for 2009 and 2010 have been agreed and projected under the Stand-by program with the IMF
Source: IMF, Raiffeisen RESEARCH

"Crucial components" of the program cannot be implemented in the context of current political instability

The staff from the IMF assessed both the performance of the program until the end of September but also the perspectives.

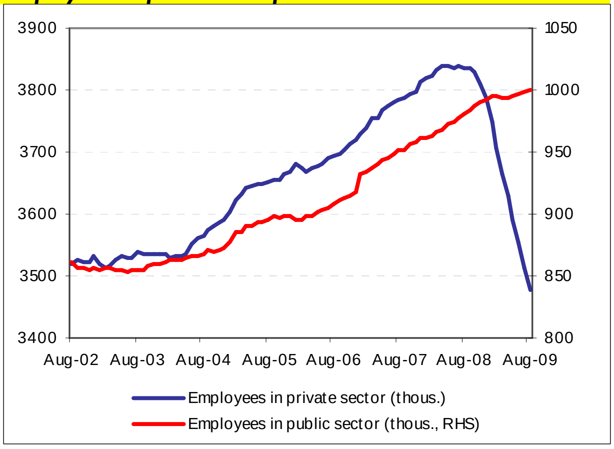
Romania fulfilled nearly all targets set for September, but this is not enough for the review to be successfully completed. In order to receive the third instalment, there is also necessary that the program will go forward in the next period. However, the perspectives are not very good.

Important measures should have been taken by the end of this year by Government and Parliament in order to meet the end-year targets and to receive the fourth instalment.

In the last quarter of 2009, the Parliament should have been approved the legislation for public wages, the pensions legislation and the fiscal responsibility law. The government should have taken measures to reduce the expenses with wages in public sector. Also, the budget plan for 2010 should have been approved by the end of this year.

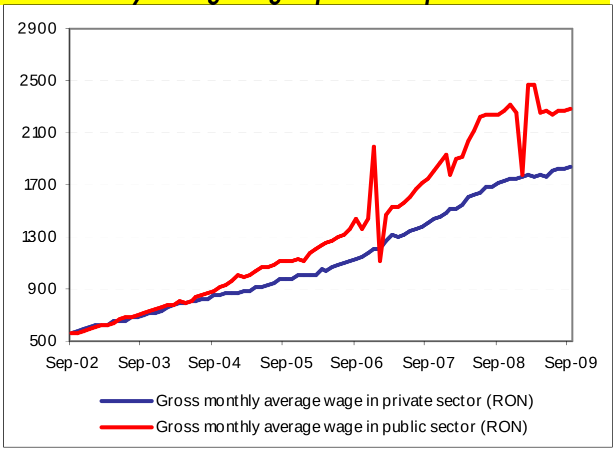
Conditionalities/measures	Timing	Our coments
Passage of public compensation legislation	30-Oct-09	Fulfilled
Presentation of fiscal responsibility legislation and implementation plan to parliament	30-Nov-09	Still chances to be fulfilled
Passage of revised pension legislation	31-Dec-09	Still chances to be fulfilled
Approval of agreed 2010 budget	31-Dec-09	Still chances to be fulfilled
Consolidated budget deficit at 7.3% of GDP in Q4 2009	31-Dec-09	Low chances to be fulfilled

Employees in private and public sector



Note: Based on INS monthly survey on enterprises with 4 or more employees
Source: National Institute of Statistics, Raiffeisen RESEARCH

Gross monthly average wages: public and private sector



Source: National Institute of Statistics, Raiffeisen RESEARCH

Change in public revenues and expenses: 2005-2009

	Change between 2005 and 2009 (% of GDP)
Revenue	**0.2**
Expenditure	**6.9**
Current expenditure, of which	6.8
Compensation of employees	1.6
Maintenance and operations	-1.3
Interest	0.4
Subsidies	-0.9
Transfers	6.1
Pensions	2.2
Other social transfers	1.1
Other transfers	2.5
Capital expenditure	0.3
Budget balance	**-6.7**

Note: Based on budget plan approved for 2009
Source: IMF, Raiffeisen RESEARCH

However, the ruling coalition collapsed on 1 October (when the ministers appointed by PSD left the government), and the Parliament voted against the government on 13 October. In fact, almost no measure was taken starting the beginning of October in order to fulfil the end-year targets agreed with the IMF. All political parties focused only on the presidential elections due on 22 November and 6 December. It seems that establishing rapidly a new government has not been an top objective for the parties during recent weeks.

As time has passed, it has become more difficult to take the appropriate measures in order to meet end-2009 targets agreed with the IMF. Taking into account recent developments, it seems that a new government would be established at earliest at the beginning of December. The interim government cannot legally submit the budget plan for 2010 to the Parliament. However, the parties said that they would bring some changes to legislation in order to allow the current interim government to send the Parliament the budget plan for 2010. Also, the deficit target for 2009 (7.3% of GDP) has only low chances to be achieved given that the government failed to take the measures needed to reduce expenses with wages in last quarter of this year.

The IMF representative said that another mission will return to Bucharest as soon as a new Government is in place. Given that we expect political instability to persist until the beginning of December and we expect to see a new government approved only in December, we think that the IMF mission could return to Bucharest in January. In this case, the IMF Board can approve the third instalment probably only at the beginning of 2010.

High efforts are necessary to meet the deficit target set for 2010

Under the Stand-By Arrangement with the IMF, Romania needs to reduce the budget deficit target to 5.9% of GDP. We think that important efforts are necessary to meet this target.

According to the Stand-by Agreement, the adjustment of the budget deficit in 2010 is projected to be achieved mainly on the expenditure side. Budget expenditures were projected to increase only marginally in nominal terms (+2.1% in 2010), which means a decrease of 1.3% of GDP. However, given that expenditure target for this year would most likely be outpaced, the budget plan for 2010 should assume flat expenditures or even lower expenditures than in 2009.

Limiting the increase in public expenditure in 2010 is necessary. Increase in the budget deficit between 2005 and 2009 (with 6.7 pp of GDP based on projected data for 2009) has been only driven by the increase in current expenditure (wages in public sector, pensions and other social transfers). The increase in current expenses was very fast. As public revenues decreased in 2009 and they are expected to increase only marginally in 2010 (no hike in taxation assumed in baseline scenario), any increase in public expenses would be translated into a higher deficit. Financing a high budget deficit is problematic when risk aversion of foreign investors remains high. Pursuing a high budget deficit would limit the access of private sector to financial resources on the domestic market and would keep the interest rates at a high level ("crowding out effect").

Available data shows sharp adjustment in case of private sector in 2009. Number of employees decreased sharply in recent year (by 9% between Sep 2008 and Aug 2009). Number of employees in public sector still increased since September 2009. Clearly, the government has limited the increase in earnings in public sectors (by cutting bonuses), but adjustment of compensations of employees was far behind the adjustment in the private sector.

If government fails to cut the expenses, then an increase in taxation could be the only way to limit the increase of budget deficit. In fact, we don't exclude to see such an increase in 2010, despite the fact that we think that this solution is not appropriate at all at this moment. An increase in taxation now could deepen the recession and would postpone the economic recovery. We strongly believe that the adjustment in the budget should be made on the expenditure side through a cut in the social bill (wages, pensions and other social transfers), which is tottaly unsustainable. Nevertheless, an increase in taxation could be even a requirement to keep the IMF Stand-by Agreement on track in 2010.

Foreign trade deficit increased in August and September

C/A posted a surplus in August

■ *Foreign trade deficit on the increase*

Foreign trade deficit increased both in August and in September. According to our calculus, seasonally adjusted foreign trade deficit stood at EUR 510 mn in August and EUR 803 mn in September. The level in September was the second highest since the beginning of this year. Increase in the deficit in August was driven by a fall in exports, while the increase in deficit in September was driven by the increase in imports. Available data don't allow us to see if the increase in the value of imports in September was driven by volumes or prices. However, we think that both components had a positive contribution to imports.

Value of exports has increased by 15.7% between February (when their reached the minimum) and September. However, in September they were still by 13.1% below their level from September 2008.

Imports increased by 13.6% in September from August. We think that imports cannot remain further at the low levels seen in the first half of this year. Both the increase in the exports and the expected slight recovery of the economic activity starting Q4 2009 point also to higher levels of imports.

■ *Current account balance posted a surplus in August based on higher net inflows from the European Commission*

Even though foreign trade balance remained in the negative territory, current account balance posted a slight surplus in August (EUR 24 mn based on our in-house seasonally adjusted data). This was the first surplus since July 2004. However, this was only a temporary development as the C/A balance posted again a deficit in September (in line with foreign trade deficit).

In fact, current account balance is more volatile than foreign trade balance, as it depends also on balance of current transfers and on balance of income. In recent months, the foreign trade deficit has decreased to very low levels (at around EUR 500 mn per month) and there were months when the inflows from the European Commission were important and they offset a large part of the foreign trade balance. This was the case in August when net public transfers (reflecting net transfers from the European Commission to Romania) amounted to EUR 459 mn.

The second factors which explains why current account deficit was lower that foreign trade balance deficit is the decrease in the deficit of balance of income. Reinvested earnings or dividends sent abroad by non-resident companies fell sharply in last quarters as these companies started to report losses. For instance, balance of income posted a deficit of only EUR 117 mn in August, down by 73.2% from August 2008 (EUR 436 mn).

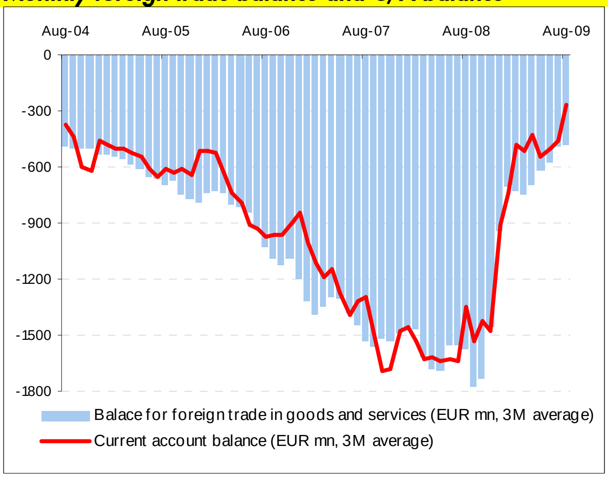
Summing up, this year's foreign trade deficit would be much higher than current account deficit. The difference would be explained by net inflows from the European Commission and by the decrease in reinvested earnings and repatriated profits.

■ *Net FDI inflows fell in last months*

Net FDI inflows were lower and lower in recent months. Net FDI inflows amounted to only EUR 51 mn in August, while the 3-month average stood at EUR 230 mn. In September, they were however high (EUR 637 mn according to preliminary data), increasing the 3 months average to EUR 310 mn. Decrease in the FDI inflows was similar than one recorded in the case of other countries in the region.

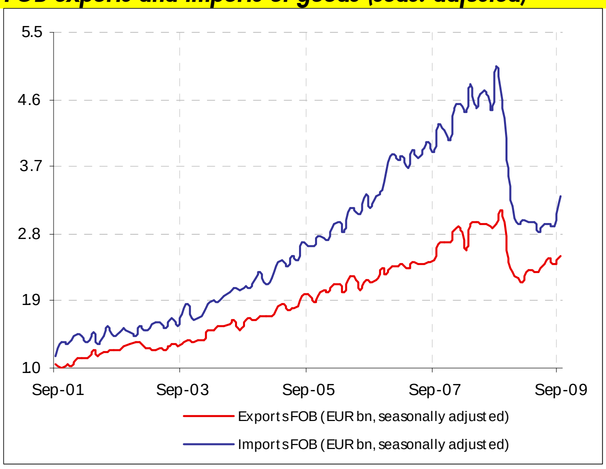
The good news is that FDI inflows were higher than the current account deficit. In January-September, current account deficit was 106% covered by FDI inflows. We expect the coverage ratio to decrease to around 80% by the end of the year.

Monthly foreign trade balance and C/A balance



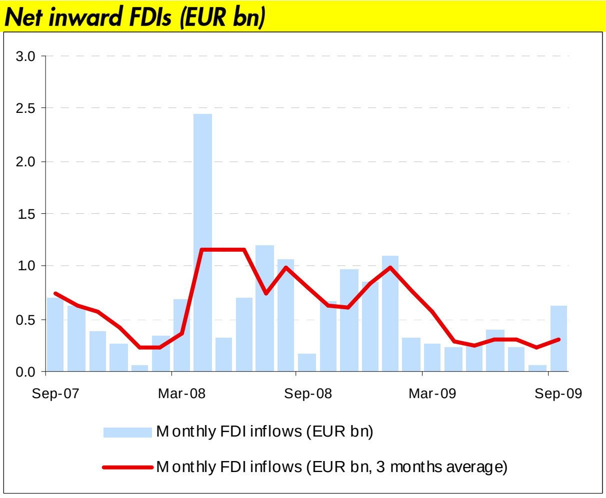
Source: NBR, National Institute of Statistics, Raiffeisen RESEARCH

FOB exports and imports of goods (seas. adjusted)



Source: Eurostat, National Institute of Statistics, Raiffeisen RESEARCH

Net inward FDIs (EUR bn)



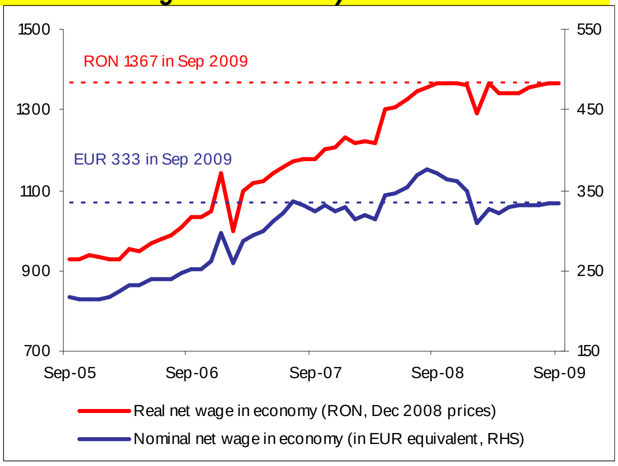
Source: National Institute of Statistics, Raiffeisen RESEARCH

Real sector

Very likely, real GDP fell again in Q3 2009

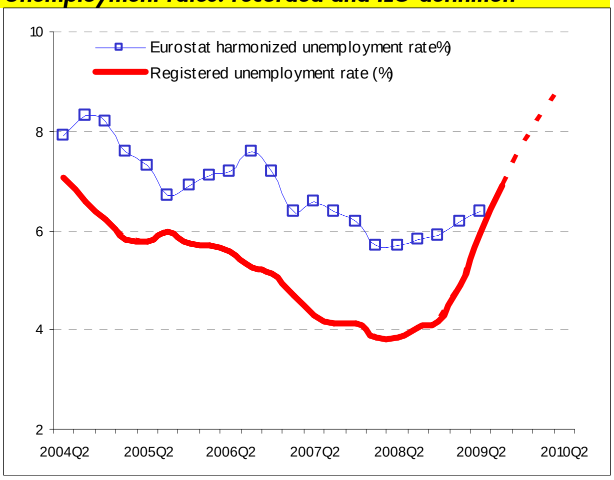
Even though industry and retail sales improved

Real net earnings in the economy



Note: Includes wages and bonuses
Source: National Institute of Statistics, Raiffeisen RESEARCH

Unemployment rates: recorded and ILO definition



Source: Eurostat, National Institute of Statistics, Raiffeisen RESEARCH

Industry expanded further in Q3, while retail sales stabilized

Industry and retail sales are the sectors where signs of stabilisation have arose first. Industrial output expanded for the second quarter in a row, increasing by 1.8% qoq in Q3. Although the automotive industry was the initial driver of the recovery, improvements were seen also in other sectors in last months. Industry should have again a positive contribution to the quarterly GDP growth rate in Q3. Deflated turnover in retail sales was flat in the third quarter (+0.1% qoq), improvement being seen especially in the case of the food segment. However, household consumption most likely fell again in Q3 given that turnover for market services rendered to population decreased again in Q3 (-4.1% qoq in real terms) and purchases of passenger cars shrink also by 24.2% qoq in Q3.

At the moment, construction sector shows the weakest performance. Output in construction fell by 7.5% qoq in the third quarter, after it contracted sharply in the previous two quarters as well. Given the sharp drop in building permits and the low level of business sentiment in the sector, we expect the production in construction sector to contract further in the quarters ahead.

Looking forward, we expect only moderate gains in the economic activity in the quarters ahead. Weak confidence among consumers, increasing unemployment rate, flat real net wages and difficult access to loans are the main factors which suggest only very poor gains in household consumption over the next quarters. Also, investments would suffer from low business confidence level and still difficult and expensive access to financing. Improvements in the industrial output would be also moderated, relying in a large extent on the developments on the external markets. So, most likely the recovery would come mainly driven by external demand (exports) in line with the improvements in the eurozone economy.

We look for another negative GDP growth rate in Q3 2009

Available indicators suggest that real GDP has most likely contracted again in Q3 2009. We think that pace of contraction stood close to -0.9% qoq in Q3 (only marginally below the figure from Q2 2009). We still believe that economic activity would reach the bottom in Q4 2009. So, we expect the quarterly GDP growth rate to be close to 0% qoq in Q4 2009 and to be only a bit above 0% in the next quarters.

However, the risks to this scenario are on the downside (deeper recession). The risks to see an increase in taxation (as a mean to see the Stand-by agreement with the IMF going forward) have increased. An increase in taxation (a hike in value added tax or in tax on personal income) would have a negative impact on consumption. In this case, we might see the GDP decreasing in 2010 as well.

On the other hand, if the Stand-by agreement with the IMF fails, which has a low probability in our view, then the recession might be deeper as additional depreciation of leu in this scenario would have also a negative impact on financial position of companies and of households. Confidence of foreign investors in Romanian economy would be also negatively affected. In such a scenario we don't exclude seeing the GDP decreasing in 2010 as well.

Short-term indicators, % yoy

	Q1-08	Q2-08	Q3-08	Q4-08	Q1-09	Q2-09	Q3-09
Industrial output	8.2	5.8	2.3	-6.1	-11.4	-8.8	-5.3
Manufacturing	7.0	7.1	3.7	-6.6	-15.2	-10.3	-6.8
Construction	36.3	39.9	27.4	14.5	3.5	-13.0	-19.3
Services: population	7.8	12.9	3.3	-12.4	-3.8	-17.4	-18.6
Retail sales	29.1	29.6	23.2	6.4	-6.3	-13.3	-13.2
Unemployment*	3.8	3.9	4.1	4.2	4.9	6.0	6.9
Sales of new passenger cars	12.4	-10.1	-5.5	-44.7	-56.0	-47.2	-60.1

** In case of employment the tables show the absolute level*
Source: National Institute of Statistics, Raiffeisen RESEARCH

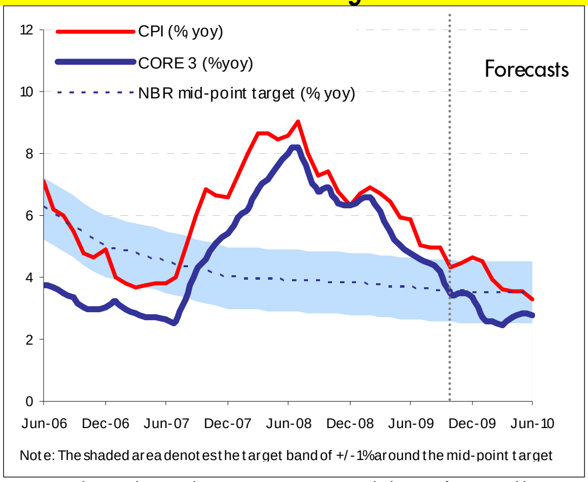
Short-term indicators, % qoq

	Q1-08	Q2-08	Q3-08	Q4-08	Q1-09	Q2-09	Q3-09
Industrial output	2.9	-1.3	-2.0	-5.6	-2.9	1.6	1.8
Manufacturing	1.5	-0.1	-0.9	-7.1	-7.8	5.7	3.0
Construction	5.3	7.8	-0.3	1.1	-4.7	-9.4	-7.5
Services: population	-4.0	3.7	-2.7	-9.6	5.4	-11.0	-4.1
Retail sales	13.3	3.9	0.1	-9.7	-0.3	-3.8	0.1
Sales of new passenger cars	-2.4	-18.7	0.2	-29.7	-21.4	-5.5	-24.2

Higher monthly inflation rates in the next months

Fuelled by increase in excises and leu depreciation

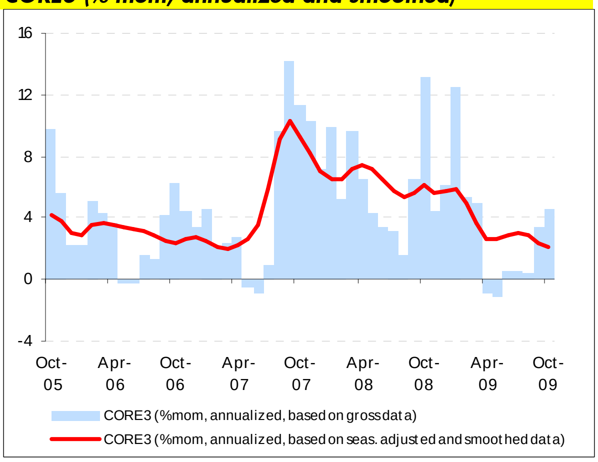
Inflation rate and the inflation target band



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

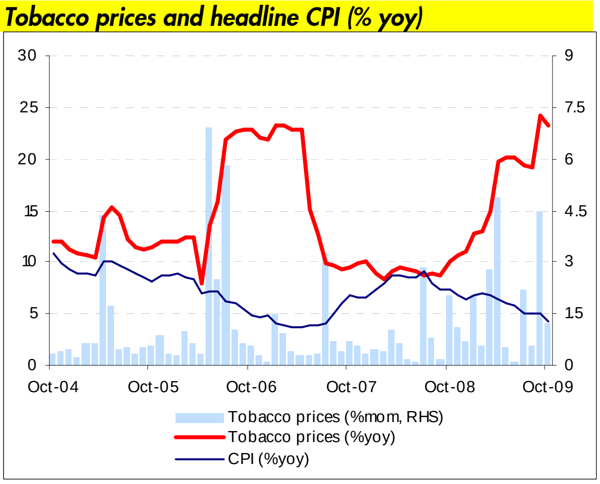
Source: National Institute of Statistics, NBR, Raiffeisen RESEARCH

CORE3 (% mom, annualized and smoothed)



Source: National Institute of Statistics, Raiffeisen RESEARCH

Tobacco prices and headline CPI (% yoy)



Source: National Institute of Statistics, Raiffeisen RESEARCH

Increase in tobacco prices pushed inflation rate up in September

Monthly inflation stood at 0.4% mom in September and at 0.44% in October. Even though monthly inflation rates were high, the annual rate of inflation fell to 4.3% yoy in October from 5% yoy in August.

The main drivers of inflation rate in September and October were increases in tobacco prices following the hike in excises (+5.8% mom in September and +1.2% mom in October) and leu depreciation which pushed phone tariffs up by 0.47% mom in September and by 0.94% mom in October.

Our calculus shows that CORE 3 measure of inflation (total CPI excluding administered and volatile prices, and tobacco and alcohol prices) decreased both in September and October based on seasonally adjusted data. It was at 0.15% mom in September and at 0.1% mom in October. This shows that underlying inflationary pressures remained contained and headline inflation rate is due in a large extent to temporary factors.

Increase in excises will put upward pressures on the inflation rate in the next quarters

Usually, the excises for different goods are set in euro and are paid in RON at the EUR/RON exchange rate announced by the European Central Bank (ECB) on 1 October in the previous year. During this year, the excises were paid at EUR/RON 3.7364 (the exchange rate announced by ECB on 1 October 2008). In 2010 the excises will be paid at the exchange rate of EUR/RON 4.2688 (the exchange rate announced by ECB on 1 October 2009). So, the RON equivalent of excises set in EUR would increase starting 1 January 2010 by 14.2% due to the change in the leu reference exchange rate.

At the same time, in 2010 there should be also increases in the EUR level of excises according to the fiscal law. For instance, the excise for cigarettes should increase form EUR 64 per 1000 cigarettes currently to EUR 74 per 1000 cigarettes in 2010 (15.6% increase in euro equivalent). An increase of around 3.5% is scheduled also for excise for gasoline. At the moment, we don't know the exact timing for increases in the level of excises. However, we think that the level of excises would be hiked in a first step on 1 January 2010 (with other steps expected to take place during 2010).

So, on 1 January we expect to see important increases in prices of goods which include excises (especially tobacco and gasoline) due to the change in the leu reference exchange rate and due to the increase in the level of excises. For instance, if the level of the excises is held constant on 1 January and only the reference exchange rate is changed then the tobacco prices should increase by around 8.5% and the gasoline price should increase by around 6%. If the level of excises is also increased, the advance in prices should be higher. In our baseline scenario, we take into account an increase of 13% for the price of cigarettes and of 8% for the price of gasoline as of 1 January 2010. However, in case of tobacco products it is very likely to see the increase in prices being split over several months starting November this year, putting at risk even the inflation target for 2009.

As the picture on the left shows, the increases in prices for cigarettes have been a main driver of inflation rate in last years. Tobacco prices advanced by 24.2% yoy in September. We expect the growth rate to remain close to this level at the end of 2010. Due to the large share of tobacco products in the CPI basket (4.6%), increase in prices of tobacco products has an important contribution to the inflation rate.

Recent depreciation of the leu raises risks for the disinflation

We still expect the annual inflation rate to decrease in the next two quarters. So, even though monthly inflation rates would be high in the next months (at around 0.5% mom October-December and higher in January), the annual rate of inflation might fall slightly below 4% in March. The main risks to our scenario came from the exchange rate and a hike in value added tax (VAT). The inflation rate would stop also to decrease in the case of leu depreciation and of a hike in VAT.

Interbank rates have increased in last two months

The NBR remained on hold in November

Interbank rates increased further in last weeks

Interbank interest rates fell rapidly during the second quarter due to the decrease in risk aversion for Romania, due to lower pressure on exchange rate and due to more liquidity injected in the banking system by the central bank. Accordingly, interbank rates were at 8.5%-9.0% in August, down from 14% in March. At that moment, interbank rates repositioned in the vicinity of the monetary policy rate (8.5%).

However, upward pressures emerged again on the interbank rates starting the second half of September. Central bank cut further the key interest rate from 8.5% to 8% on 29 September but the decision had no impact on the interbank rates which have climbed higher. In last weeks, effective money market interest rate (the average interest rate for all transactions in the money market) climbed to more than 10.5%. We see several factors behind the increase in the spread between the interbank rates and the monetary policy rate.

Firstly, we think that interbank interest rates climbed higher due to an increase in the risk premium required by investors. Risk aversion for Romania increased in last month following prolonged political turmoil and its expected negative impact on the public finances (budget deficit) and on Romania's agreements with international institutions (IMF and European Commission). Accordingly, the expectations for leu depreciation have increased. The central has tightened the control over the liquidity. On the one hand, the NBR reduced the tenor of repo operations from 1 month (until September) to even only 2 days (in October). On the other hand, we think that net injections of liquidity in the banking system from central bank and Finance Ministry decreased slightly over the last two months even though available data suggest that the decrease in outstanding level of repo operations (from RON 15.3 bn in July to RON 2.5 bn in September) matched the liquidity injected by the cut of minimum reserve requirements in RON and FCY and by Treasury's expenses.

Secondly, "the spread between interbank money market rates and the monetary policy rate widened in the context of a heightened impact on the money market of the substantial budget deficit financing needs for the last quarter of this year" as central bank said by itself in the statement following the monetary policy meeting on 3 November.

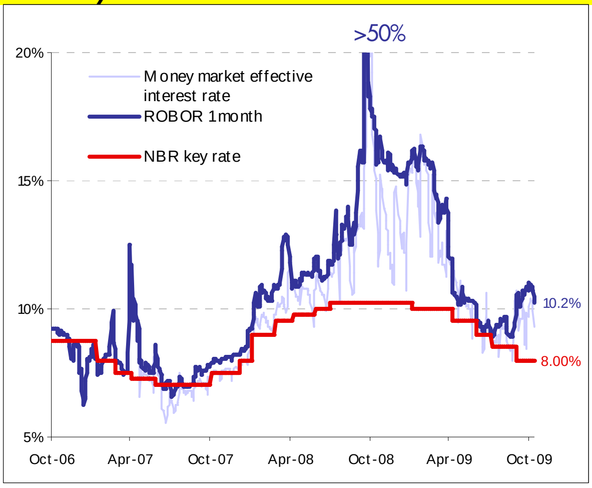
NBR remained on hold at last monetary policy meeting

On 3 November, the NBR decided to keep the monetary policy rate unchanged at 8%, although we and the market still expected to see a marginal cut of 25 bp. Also, minimum reserve requirements were kept unchanged at 15% for RON and at 30% for FCY. We think the NBR wanted to be cautious. Although the NBR was aware of the "persistent economic contraction", it was more concerned about the increase in investors' risk aversion for Romania amid heightened tensions in the political field (with negative impact on the public budget execution and on Romania's agreements with IMF and European Commission), about the increase in expectations regarding leu depreciation and about the increase in inflationary pressures (stemming from a potential leu depreciation and for expected hike in excises). Uncertainty regarding next developments on the political scene, especially about the moment when a new government would be established, has increased the uncertainty about the economy and exchange rate dynamics.

Market interest rates to remain high in the next months

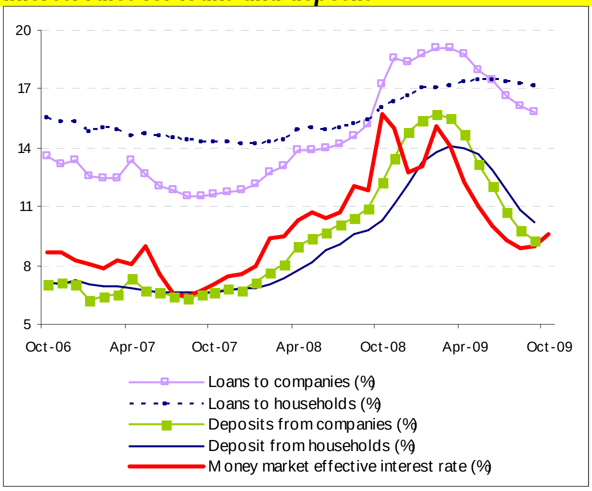
The risks to our baseline scenario (decrease in the interest rates) have materialized following recent developments in political scene. As a result, we have to adjust the interest rate and exchange rate scenario in line with recent developments. We expect now the market interest rates to be close to the current level in Q1 2010 as well and even to increase slightly by end of this year. Even the NBR suggested that the positive spread between the interbank rates and the monetary policy rate should be expected to persist in the "short-run" (which we think it should be read as next few months). As we explained above, increase in risk aversion and high funding needs of the government are the main factors which point to high interest rates in the months to come. We expect the interest rate to re-enter on a downward trend once the political turmoil would calm down, a new government would be established and a new agreement with the IMF would be concluded. At the moment, it seems that this could happen at the end of January – beginning of February next year.

NBR's key interest rate and market interest rates



Source: NBR, Raiffeisen RESEARCH

Interest rates for loans and deposits



Note: Interest rates for outstanding loans and deposits
Source: National Bank of Romania, Raiffeisen RESEARCH

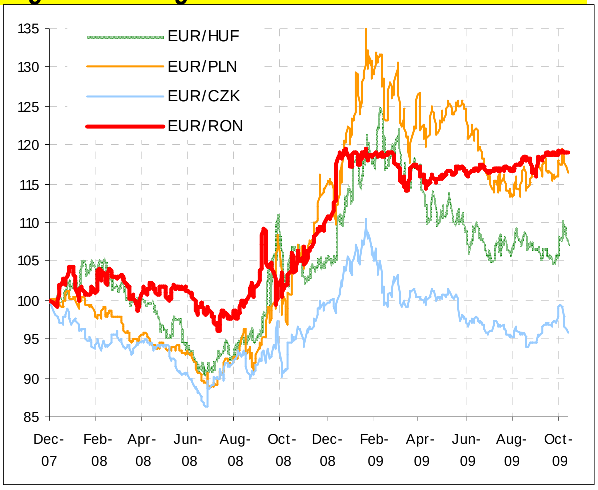
Interest rate outlook (%)

	Current	Dec-09	Mar-10	Jun-10
Domestic markets				
NBR key rate	8.00	8.00	8.00	7.50
ROBOR 1 month	10.2	11.8	10.3	8.5
ROBOR 3 months	10.4	11.3	10.4	8.7
T-bonds 3 years	9.8	9.8	9.5	9.1
T-bonds 5 years	9.4	9.5	9.4	9.1
T-bonds 10 years	8.5	8.3	8.3	8.1
External markets				
FED key rate	0 - 0.25	0 - 0.25	0 - 0.25	0 - 0.25
ECB key rate	1.00	1.00	1.00	1.00
EURIBOR 1 month	0.43	1.00	1.10	1.10
LIBOR USD 1 month	0.24	0.25	0.25	0.30

Source: Raiffeisen RESEARCH

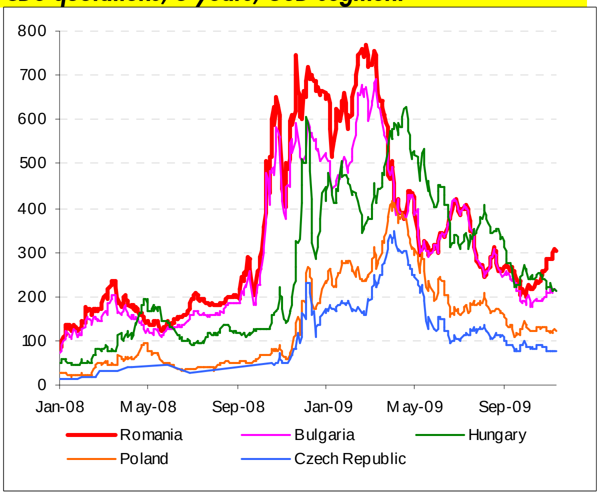
Prolonged political instability
Raises risks for leu depreciation

Regional exchange rates



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

CDS quotations, 5 years, USD segment



Source: Bloomberg, Raiffeisen RESEARCH

Exchange rates outlook

	Current	Dec-09	Mar-10	Jun-10	Sep-10
EUR/RON	4.2952	4.35	4.30	4.25	4.20
USD/RON	2.8566	2.90	2.77	2.74	2.90
CHF/RON	2.8445	2.84	2.77	2.69	2.71
EUR/USD	1.5036	1.50	1.55	1.55	1.45
EUR/CHF	1.5100	1.53	1.55	1.58	1.55

Source: Raiffeisen RESEARCH

■ Increase in investors' risk aversion

Last month's developments in the political field triggered an increase in investors' risk aversion for Romania.

Starting the beginning of October, the country is ruled by an interim government and expectations are now that a new government could be establishes the earliest in the first half of December. The European Commission and the IMF said that instalments from the external financing package agreed in March due by the end of this year would be disbursed only after a new government would be established and only after the budget plan for 2010 would be approved by Parliament in line with the parameters Romania agreed on last summer (deficit target for 2010 should be reduced to 5.9% of GDP). Much more, uncertainty regarding the disbursements scheduled for 2010 has increased given that political turmoil has made more difficult to fulfil the targets set for end of this year and the next quarters. Although external financing needs of the country have decreased substantially following the sharp fall in current account deficit (from 12.9% of GDP in 20008 to around 4.5-5.0% of GDP in 2009) and the decrease in short-external debt, it is still necessary to go forward in a timely manner with the agreements reached with the IMF and European Commission in order to improve investors' confidence in the sustainability of economic policies and of economic recovery. We see risks that the leu might depreciate and the economic recession might deepen if these agreements would fail.

Increase in risk aversion has been seen in the higher CDS quotations for Romania, in higher interest rates in the money market, and in an increase in expectations regarding leu depreciation in the next period. Until now, the increase in risk aversion for Romania has been materialized only in a marginal depreciation of the exchange rate. The leu depreciated only by 2.2% between 25 September and 10 November.

Most of the risks to our exchange rate scenario which we have talked about in the previous months have unfortunately materialized. The ruling coalition collapsed, the budget deficit is expected to outpace the targets agreed with the IMF, and the instalments from the IMF and the European Commission have been delayed. Much more, the risks to see the agreements with the IMF and European Commission failing during 2010 have increased. Political turmoil is at the root of these developments. With these risks materializing and due to high uncertainty about future developments in the economy, we had to adjust upward the exchange rate scenario.

We expect now the EUR/RON exchange rate to trade close to the current level (4.30) in March next year as well and to start then to slightly appreciate by the end of 2010. In short-term (December-January), we see risks even for a slightly weaker currency. As we said, the highly volatile political climate and its negative impact on the agreements Romania reached with the international institutions (IMF and European Commission) and on government's policies is the main reason for the adjustments in the exchange rate scenario.

In our opinion, economy's fundamentals (mainly the current account deficit) don't argue for additional depreciation of the leu. Nevertheless, the perception is driving the developments of the leu currently and as long as the perception doesn't improve, the pressure on the currency would remain in place.

Our scenario assumes that a new government would be established by the end of this year, the budget plan for 2010 would be approved by middle of January and IMF and European Commission would have a positive review for Romania's policies by end of January. We think that if political instability would persist more, then pressures for leu depreciation might be higher.

Upward pressures on bond yields

Government issued a new bond in euro

Slight upward pressures on bond yields

Money market interest rates increased in last weeks as market liquidity conditions tightened. Some upward pressures arose in case of government yields which moved also marginally up.

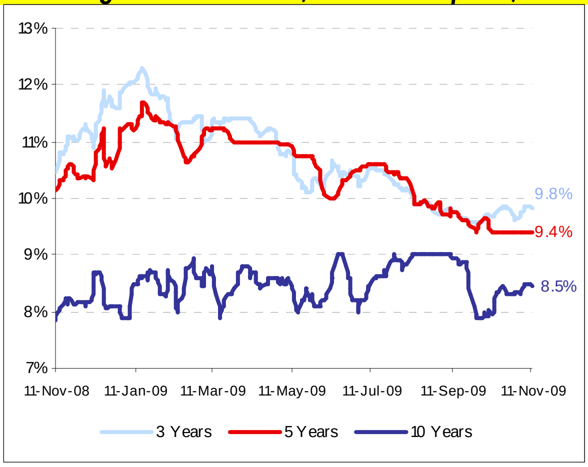
Up to now, the government used a 10% ceiling in the auctions in the primary market (both in case of T-bills and T-bonds). However, in October it had to accept only partially or even to completely reject the investors' bids. More and more investors started to require yields higher than 10%. In October, the government ended by issuing government securities amounting only to RON 2.4 bn although it intended to borrow RON 6 bn. The same story repeated at the beginning of November. The government decided to issue a new bond in euro on the local market. It borrowed EUR 794 mn for 3 years at a yield of 5.25%. The bonds were mainly purchases by banks which had liquidity in FCY following the cuts in minimum reserve requirements.

Funding needs of the government remain high, while the required yields by investors has increased. So, we expect the investors to ask for higher yields at the next auctions. If yields would increase or not depends in a large extent on the behaviour of the local commercial banks. Currently, they are financing more than 80% of the stock of government securities. Up to now, the banks were happy to invest in government securities and central bank favoured this behaviour. For instance, if central bank extends again the size of repo operations, then banks could increase further their holding of government securities. In this case, the upward pressures on yields should remain contained. Moves of non-residents should have no impact on the yields as they hold only small amounts of debt.

Given recent and expected developments, we have adjusted upward our scenario regarding dynamics of government bond yields in the next period. We expect now the yields to remain close to the current levels in the next few months. They might start to fell again in the second half of next year.

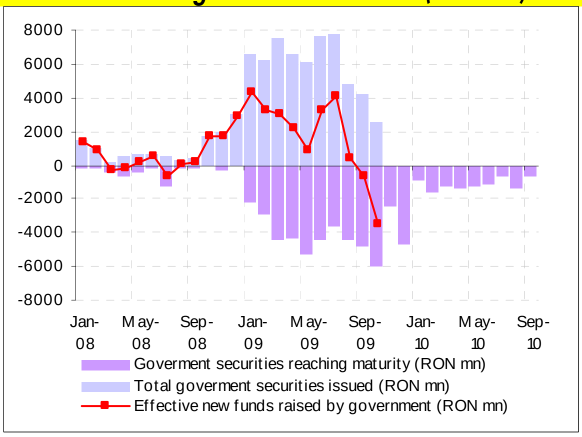
The risks to the baseline scenario are on the upside. This means that yields might even increase in short-term. However, we think that even in this case the advance would be only marginally.

Yields of government bonds (based on ask prices)



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

Net new issues of government securities (RON mn)



Source: Ministry of Public Finance, Raiffeisen RESEARCH

Auctions in Government securities

Discount T-Bills

Auction date	Tenor (Months)	Amount (RON mn) Intended	Effective	Average Yield	Maximum yield
03-Aug-09	12	1200	97	10.75%	10.75%
10-Aug-09	12	1200	1200	10.42%	10.50%
17-Aug-09	6	1200	1342	10.45%	10.50%
24-Aug-09	12	1200	0	-	-
07-Sep-09	12	1100	0	-	-
14-Sep-09	6	1100	1266	9.92%	10.00%
21-Sep-09	12	1000	650	9.99%	10.00%
28-Sep-09	6	900	1049	9.97%	10.00%
05-Oct-09	6	1100	0	-	-
12-Oct-09	6	1000	850	9.97%	10.00%
19-Oct-09	12	1000	222	10.00%	10.00%
26-Oct-09	12	1000	0	-	-
02-Nov-09	6	1200	0	-	-
09-Nov-09	12	1200	104	10.00%	10.00%
16-Nov-09	6	800			
23-Nov-09	12	1000			

Benchmark T-Bonds

Auction date	Tenor (years)	Cupon (%)	Amount (RON mn) Intended	Effective	Average Yield	Maximum yield
06-Aug-09	5	11.00%	850	0	-	-
20-Aug-09	3	11.25%	850	302	10.24%	10.25%
03-Sep-09	5	11.00%	950	247	9.90%	10.00%
17-Sep-09	3	11.25%	950	983	9.99%	10.00%
08-Oct-09	5	11.00%	950	862	9.98%	10.00%
22-Oct-09	3	11.25%	950	594	10.00%	10.00%
05-Nov-09	5	11.00%	950	0	-	-
19-Nov-09	3	11.25%	850			

Note: the amounts for the next period are only indicative

Source: Ministry of Public Finance

Main indicators

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009F	2010F
Economic activity											
Nominal GDP (EUR bn)	40.6	45.3	48.6	52.6	61.0	79.7	97.8	124.7	136.8	117.5	124.5
GDP per capita (in EUR)	1809	2022	2232	2419	2816	3688	4530	5788	6364	5471	5808
Real GDP (%, yoy)	2.4	5.7	5.1	5.2	8.5	4.2	7.9	6.3	6.2	-7.5	1.0
Household expenditures (% yoy)	1.2	9.3	6.3	8.4	15.8	10.1	12.9	12.0	9.1	-10.0	1.0
Fixed investments (% yoy)	6.3	9.9	8.9	8.8	11.0	15.3	19.9	30.3	19.3	-14.5	1.0
Industrial production (%, yoy)	7.1	8.3	4.4	3.1	5.3	2.0	7.1	5.4	2.5	-7.0	3.0
Unemployment rate (%, avg.)	11.1	8.8	10.0	7.5	6.7	5.8	5.4	4.3	4.0	6.5	8.8
Unemployment rate (%, eop)	10.5	8.8	8.4	7.4	6.3	5.9	5.2	4.1	4.4	8.0	9.5
ILO unemployment rate (%, avg.)	7.2	6.6	8.5	7.0	8.1	7.2	7.3	6.4	5.8	8.0	8.5
Wages											
Monthly average gross wage (EUR)	144	165	174	179	204	267	326	422	473	444	461
Gross nominal wages - economy (% yoy)	46.9	48.9	27.3	23.6	22.6	17.0	18.9	22.6	23.5	8.2	4.0
Gross nominal wages - industry (% yoy)	41.7	51.1	23.6	19.5	23.0	16.8	15.7	21.6	21.3	9.2	4.5
Prices											
CPI (%, yoy, eop)	40.7	30.3	17.8	14.1	9.3	8.6	4.9	6.6	6.3	4.5	4.0
CPI (% yoy, avg)	45.7	34.5	22.5	15.3	11.9	9.0	6.6	4.8	7.9	5.7	4.2
PPI (%, yoy, avg)	53.4	38.1	23.0	19.6	19.1	10.6	11.6	8.1	15.3	2.2	5.0
GDP deflator (%, yoy)	43.3	37.8	22.7	23.4	15.5	12.2	10.6	13.5	14.0	7.0	5.0
Non-government credit											
Non-government credit (%, yoy)	30.0	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)	9.3	10.0	11.8	15.3	16.6	20.7	26.8	35.6	39.3	n.a	n.a
Credit in foreign currencies (% of total)	59.5	59.8	62.7	55.4	61.8	54.7	47.3	54.3	57.8	n.a	n.a
Public sector											
Public budget balance (% of GDP)	-4.0	-3.2	-2.6	-2.2	-1.5	-0.8	-1.5	-3.1	-4.9	-7.8	-6.0
Public budget balance (ESA95, % of GDP)	-4.7	-3.5	-2.0	-1.5	-1.2	-1.2	-2.2	-2.5	-5.5	-8.1	-6.5
Public revenues (ESA95, % of GDP)	33.8	32.5	33.0	32.0	32.3	32.3	33.1	33.5	32.8	31.5	31.5
Public spending (ESA95, % of GDP)	38.5	36.0	35.0	33.5	33.5	33.5	35.3	36.0	38.4	39.6	38.0
Public debt (ESA 95, % of GDP)	24.6	25.7	24.9	21.5	18.7	15.8	12.4	12.6	13.6	20.5	23.5
Public debt (national definition, % of GDP)	31.2	28.4	28.8	26.0	22.5	20.4	18.4	19.8	21.8	28.2	31.3
External sector											
External debt (EUR bn)	12.1	14.8	16.2	17.8	21.5	30.9	41.2	58.5	73.0	78.0	85.0
External debt (% of GDP)	29.8	32.6	33.3	33.9	35.2	38.8	42.1	47.0	53.3	66.4	68.3
Short-term external debt (% of total debt)	6.7	7.5	7.6	11.1	14.9	20.3	30.5	33.9	30.4	19.2	21.2
External debt service (% of GDP)	6.8	8.1	8.7	7.2	8.1	17.0	20.2	24.0	29.8	36.6	24.7
External debt service (% of C/A receipts)	18.9	21.3	21.8	18.2	19.5	42.9	51.2	64.9	76.5	95.9	63.0
Current account balance (EUR bn)	-1.5	-2.5	-1.6	-3.1	-5.1	-6.9	-10.2	-16.7	-16.9	-5.6	-6.2
Current account balance (% of GDP)	-3.7	-5.5	-3.3	-5.8	-8.4	-8.6	-10.4	-13.4	-12.3	-4.8	-5.0
Current account + FDIs (% of GDP)	-0.8	-2.6	-0.9	-2.2	0.0	-2.1	-1.5	-7.7	-5.6	-1.0	-0.2
Trade balance (FOB/FOB, EUR bn)	-1.9	-3.3	-2.8	-4.0	-5.3	-7.8	-11.8	-17.8	-18.2	-6.8	-7.2
Trade balance (FOB/FOB, % of GDP)	-4.6	-7.3	-5.7	-7.5	-8.7	-9.8	-12.0	-14.3	-13.3	-5.8	-5.8
FOB exports (%, yoy)	41.3	12.9	15.4	6.4	21.3	17.5	16.2	14.3	13.8	-18.5	11.0
FOB imports (%, yoy)	43.4	22.1	8.6	12.3	24.0	23.9	25.1	26.0	9.4	-34.0	10.0
Net FDI inflows (EUR bn)	1.2	1.3	1.2	1.9	5.1	5.2	8.7	7.0	9.2	4.5	6.0
FX official reserves (EUR bn)	2.7	4.4	5.9	6.4	10.8	16.8	21.3	25.3	26.2	27.0	27.0
FX oficial reserves (months of imports)	2.9	3.6	4.2	4.1	5.2	6.3	6.4	6.1	5.7	8.9	8.1
Interest rates											
NBR key rate (%, avg)	n.a.	n.a.	22.5	19.3	20.0	11.5	8.5	7.5	9.7	9.1	7.6
NBR key rate (%, eop)	n.a.	n.a.	19.75	21.25	17.00	7.50	8.75	7.50	10.25	8.00	7.00
ROBOR 1month (%, avg.)	52.9	43.2	29.5	20.1	20.5	9.4	8.7	7.8	13.0	11.8	9.1
10-year T-Bonds (%, avg., ask prices)	n.a.	n.a.	n.a.	n.a.	n.a	7.4	6.5	7.0	7.9	8.5	8.0
Exchange rates											
EUR/RON (eop)	2.41	2.79	3.49	4.11	3.97	3.68	3.38	3.61	3.99	4.35	4.15
EUR/RON (avg)	2.00	2.60	3.13	3.76	4.05	3.62	3.52	3.34	3.68	4.25	4.25
USD/RON (eop)	2.59	3.16	3.35	3.26	2.91	3.11	2.57	2.46	2.83	2.90	2.96
USD/RON (avg)	2.17	2.91	3.31	3.32	3.26	2.91	2.81	2.44	2.52	2.99	2.83

Source: NBR, NIS, EUROSTAT, Raiffeisen RESEARCH

Disclosure appendix

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