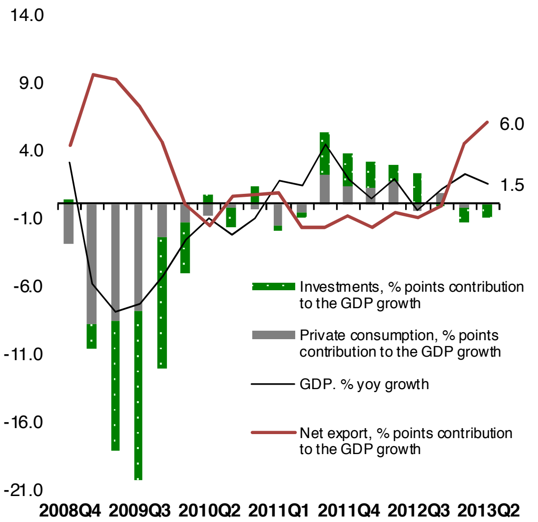
Investments needed!

KEY EVENTS

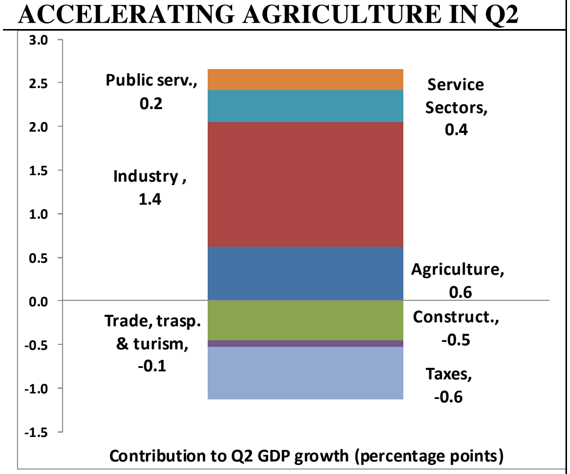
30th of September, 2013: NBR Key rate decision
05th of November, 2013: NBR Key rate decision

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

GDP GROWTH ENTIRELY DRIVEN BY EXTERNAL DEMAND in Q1 and Q2



STRONG MANUFACTURING AND ACCELERATING AGRICULTURE IN Q2



Source: NIS, Garanti Bank Research

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Outlook – Investments dropped in the first half of 2013. While the much needed infrastructural projects have been blocked by the EU funds investigations during the first half of the year, foreign direct investments stayed at the lowest level of the last ten years. The only drivers of the GDP growth so far have been the exports and the lower consumption from imports. Moreover, around 70% of the exports' growth, the main GDP driver, can be attributed to the car industry. Consumption is still weak, depressed by real wages below the last year's level. Nevertheless, some positive drivers are expected for the second part of the year. First, the lower inflation should improve the purchasing power of the population. Second, the cheaper RON financing through the policy rate cuts might positively affect consumption, but this will rather be visible towards the year-end. Third, and with the strongest impact, agricultural production is expected to give a significant boost to 2013 GDP.
Inflation outlook improved significantly. Beside the drop in volatile food prices, the VAT cut from 24% to 9% for bread and the electrical energy price drop are among the drivers of a stronger than initially expected disinflation process. Inflation will likely enter the NBR target band already in September. This allows NBR to continue its cutting cycle with two additional cuts till early 2014 at 4.0%.
The Ministry of Finance is still benefiting from good demand with yields below the key rate. Moreover, it managed to sell EUR 1.5 bn in September and this way further increasing its FX buffer to a comfortable level.

Main Topics:

• GDP –Q2 growth still driven by external demand
• Country risk profile – Stabilized country risk profile supported by the new IMF precautionary arrangement
• Inflation– Disinflation process started
• Monetary policy – Rate cut cycle to continue
• Fiscal Policy – Back on the track
• Public financing – External financing target mainly reached for 2013
• External Accounts and Financing – Current Account on the surplus; Portfolio investments affected by the US Quantitative Easing program and Global tensions
• FX outlook – Volatility is back driven by global uncertainties
• Bank flows – The lower key rate's pass through on loans' dynamic not visible yet

Economic Growth

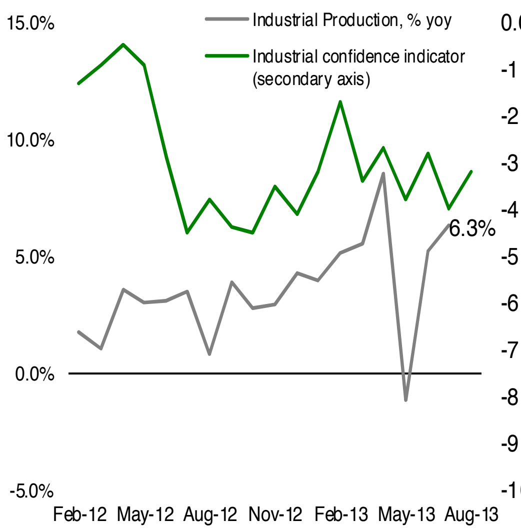
Q2 GDP growth still driven by external demand

Real GDP in Q2 softened its expansion to 0.5% qoq from 0.7% qoq registered in Q1. The annual growth was 1.5%, confirming market expectations. Details on the GDP reveal a similar picture to the first quarter with weak private consumption and still strong net export.

On the one hand, the industry kept its strong performance with 1.4 percentage points contribution to the total GDP growth, while the agricultural sector turned to double digit growth rate that brought 0.6 percentage points growth out of the total 1.5% GDP growth. The services sector, although softened its growth, still has contributed by 0.4 percentage points. On the other hand, the trade and construction sectors turned negative (-0.1 pp and -0.5 pp contribution, respectively). Taxes started also to drop with significant negative contribution to GDP (-0.6 pp).

The question is how sustainable is the export driven growth of Romania, given the structural weaknesses of some strategic industries, like metallurgy, and the still fragile performance of European economies. Although the European business climate figures show improvement, industrial production in the Euro Area fell unexpectedly by1.5% mom in July. In Germany, Romania's major export partner, industrial production fell 2.3% mom while France, Italy also performed poorly.

GOOD PERFORMANCE OF INDUSTRY



Source: NIS, Eurostat, Garanti Bank Research

DRIVEN BY EXPORTS

	Production, yoy %, Jan-Jul 2013	**Export,** yoy% (Jan-May)	**Export**, % share from total
Agriculture H1	6.1	8.2	4.3
Food, beverages % tobacco	3.2	2.1	3.7
Textile, Wearing apparel and	5.9	0.5	9.5
Wood	12.5	12.7	3.4
Coke & petroleum	0.3	-19.6	3.9
Chemicals	11.6	-2.2	4.5
Pharmaceuticals	10.4	11.1	1.9
Rubber& Plastic	4.0	9.5	4.9
Metallurgy	-8.6	-7.6	5.8
Metal products	4.9	2.8	2.9
Comp electronic	3.4	-16.7	5.0
Electrical equipment	18.2	6.1	7.8
Machinery and equip.	7.4	4.4	7.9
Motor vehicles	16.0	28.3	19.8
TOTAL	**6.1**	**5.7**	**100**

Source: NIS, Eurostat, Garanti Bank Research

Economic Growth

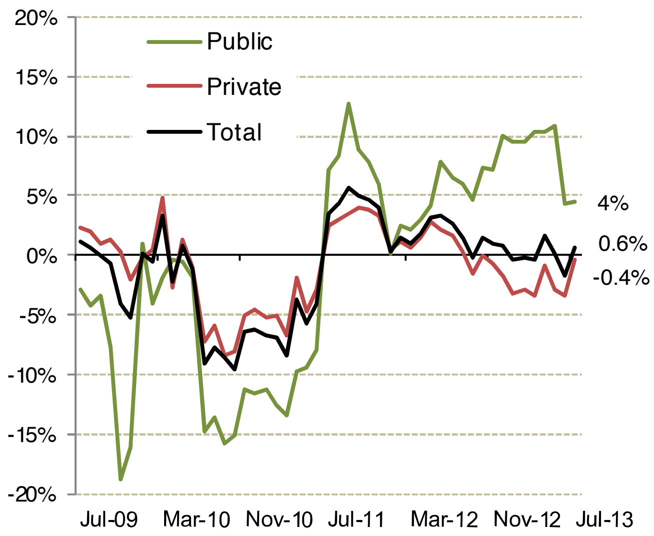
Industrial Production in July reveals some softening with -0.1% mom (seasonally and working day adjusted), but is still performing well in comparison with July last year by 6.3% yoy. Export oriented industrial sectors like the car industry, machinery and equipments, electrical equipment, pharmaceuticals and wood industry proved to be the drivers of this growth in the first seven months of the year. It's worth mentioning that if we analyse the share contribution of each sector to the export growth, actually 77% of the export growth is generated by the car industry. This reveals the strategic weaknesses of the Romanian export growth, relying significantly on a single industry.

Looking at the remainder of the year, the agricultural contribution to this year's GDP growth has been upward revised by the EC's latest report. The wheat crop production is expected to be around 27% higher than last year's figure while for maize production an even stronger growth is expected (92% above last year and 18% above the five years average).

Regarding domestic demand, consumption was depressed by the continuously dropping real private wages since the second half of 2012. The weak retail sales suggest that domestic consumption is still struggling underlying the importance of monetary policy softening with two rate cuts already implemented in July and August. The consumer sentiment readings for August came also worse than the previous three months (-36.1 versus -34.3 in July).

Still, consumer morale might receive some boost from improved purchasing power through lower inflation and cheaper financing in local currency but this will rather be visible in the last quarter of the year. Nevertheless, the third quarter consumption might accelerate on the back of higher consumption of self-produced agricultural production.

REAL PRIVATE WAGES STILL DROPPING



Source: NIS, Garanti Bank Research

NEGATIVE SALES PERSISTING

Source: NIS, Eurostat, Garanti Bank Research

Economic Growth

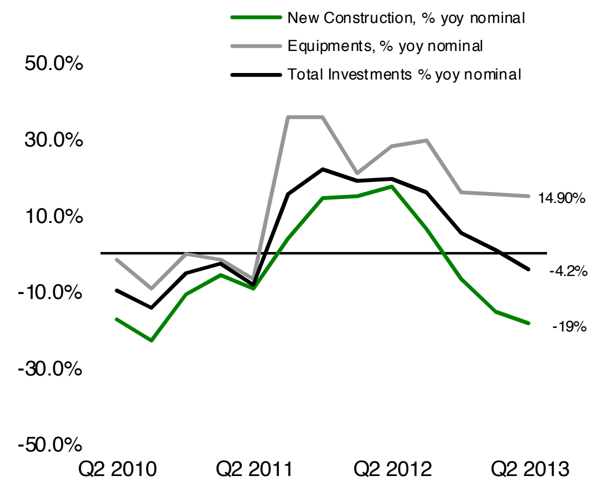
The most worrisome figures however are related to the investments' contraction (-4.4% yoy in H1), since they should have been the driver of growth, relying on the much needed structural changes and EU funds.

The EU structural funds are still lagging behind. Based on our estimations, EU structural funds in 2013 should amount to around EUR 2.5 bn (reaching a 37% absorption rate at the year-end from the current 31% as of June 2013, based on final payments to beneficiaries) and around EUR 2 bn rural and agriculture development funds (absorption rate to increase from the current 64% at end of August to 80% at the end of December). Out of this expectation only EUR 1.8 bn (in both structural and agricultural funds) were paid to beneficiaries in the first half of the year affected by the still blocked operational programs. The four Operational Programmes under investigation have been unblocked towards the end of the first semester, including the Transportation and Competitiveness Programs at the end-June, so a much better performance should come in the second half of the year.

The result of EU Funds' blockage is reflected by the data on infrastructural works that were the driver of growth in the first half of last year but contracted significantly during this year. Romanian net investments deepened their contraction at -4.2% yoy to RON 15.6 bn (EUR 3.5 bn) in the second quarter of 2013, compared to the 15% yoy growth during 2012.. Investment in equipment (including transport equipment) stayed relatively high at 14.9% yoy in Q2, but unable to counterbalance the drop of investment in new construction (-18.6%). Construction works overall (including new construction and maintenance and repair works) dropped by 4% yoy in the first seven months due to the civil engineering constructions' and residential constructions' drop of 7.6% yoy and 6.7% yoy, respectively.

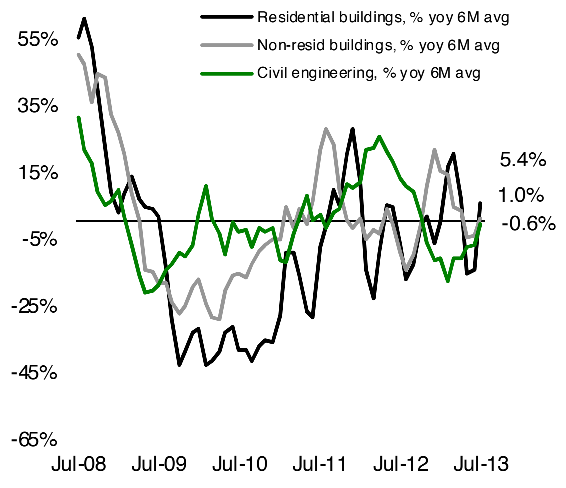
Any improvement of domestic demand is expected to be minor for this year, while the investment projects might be further delayed towards next year. Moreover, we expect the current external demand expansion to soften, given its strong dependence on just a couple of industries. Consequently, we keep our full year GDP expectations at 1.7%, but we see an upward bias from a stronger than expected autumn harvest and the robust external demand persisting in the second half of the year.

STILL CONTRACTING INVESTMENTS



Source: NIS, Garanti Bank Research

FIRST SIGNS OF RECOVERY IN CONSTRUCTION



Source: NIS, Garanti Bank Research

Country risk

Stabilized country risk profile supported by the new IMF precautionary arrangement

Fitch Ratings has affirmed in September Romania's Long-term foreign and local currency Issuer Default Ratings (IDR) at 'BBB-' and 'BBB', respectively. The Outlook on both ratings is Stable. We believe that recent improvements in macroeconomic imbalances (public budget deficit on track and current account surplus) are acting as major stabilisers of the country risk, although the expected upgrades in sovereign ratings (from S&P sub-investment grade) and/or outlook might be postponed for the moment, mainly due to the still fragile growth and on the short-term due to stronger than initially effect of international uncertainties/US monetary decision on emerging markets, including Romania. Looking at domestic drivers, the rating agencies highlighted that the results of structural reforms are expected to put the country on a sustainable growth.

There is good news regarding the reinforced IMF assistance in this process, that should enforce the country’s credibility. As widely expected, the Romanian government has reached an agreement at staff level with the IMF and the EC for a new programme, reported to be for two years and worth EUR 4bn. The arrangement has to be approved by the Executive Board of the IMF in autumn – a process that we expect will go very smoothly. The agreement is very much in line with expectations. Similar to the previous arrangement, the new funds are being made available as a ‘precaution’ and the government does not intend to draw on them.

Unlike the previous arrangement, which was primarily focused on addressing macroeconomic imbalances, however, the new one will be more focused on structural reforms, particularly on the privatisation of state-owned enterprises, health-care, energy, transportation, education, and fiscal administration. Still, the new program will also seek to maintain the macroeconomic balances that were achieved under the previous programme.

The new IMF partnership will definitely increase the country’s credibility to improve its measures that foster medium-term planning, strengthen administrative capacity, accelerate the absorption of EU funds, strengthen tax administration and fiscal governance, and better control state arrears.

Another focus of the IMF deal, the process of reforming inefficient state-owned enterprises, already started at the beginning of 2013 with more or less success. Hopes are that investment and efficiency will be fostered in these strategic industries, like energy and transportation sectors, which are regarded as key to enhancing Romania’s competitiveness and boosting long-term growth.

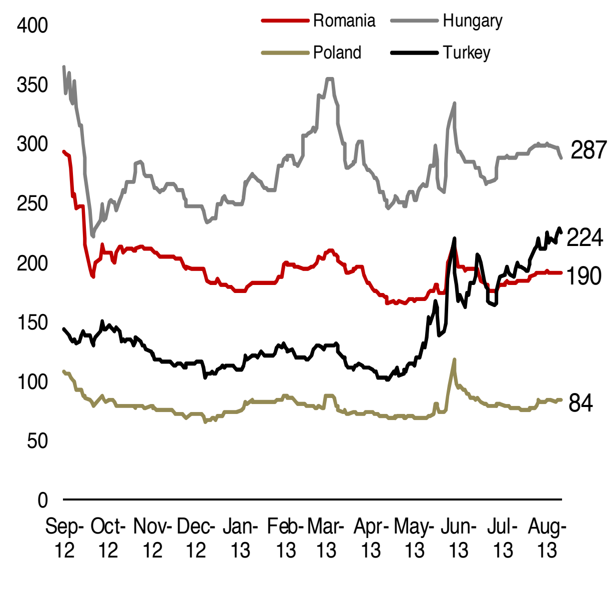
Grup Feroviar Roman (GFR) was selected as winning bidder in the privatisation auction of the cargo railway company CFR Marfa (51%) on the 20th of June, just before the IMF assessment. The privatisation contract was delayed by some political disputes between the prime minister and the president, but it was finally signed on September 2. Although closer to the goal, the procedure is still not finalized since according to the local media, the GFR is still searching for financing of this investment, that is EUR 202 million to be paid to the state for the 51% of the company (EUR20 million to be paid in an escrow account within 32 days from signing the contract).

Less clear steps have been visible for chemical plant Oltchim and postal company Posta Romana, the other two companies for which the privatisation was complicated due to the huge accumulated debts. Oltchim, for which the privatisation failed one year ago, is trying to restructure under insolvency, while a plan drafted by the court-appointed manager has been endorsed, under which the viable assets of the company would be sold to an investor later this year. Posta Romana, another failed privatisation attempt at the end of May 2013 due to lack of interest, announced also that it will be restructured in 180 days and potential investors are invited to file binding bids until June 30, 2014.

Nevertheless, there are also some success stories, like the Hidroelectrica, Romania's biggest energy company (provider of 21% of total energy of the country[1]), that after restructuring for one year got out of insolvency on June 26, 2013 and reported a record first-half profit of RON 481 million (EUR109.5 million) in comparison to losses in the year-earlier period, boosted by higher revenue from electricity trading and improved efficiency. Hidroelectrica is announced to be prepared for stock exchange listing in May next year.

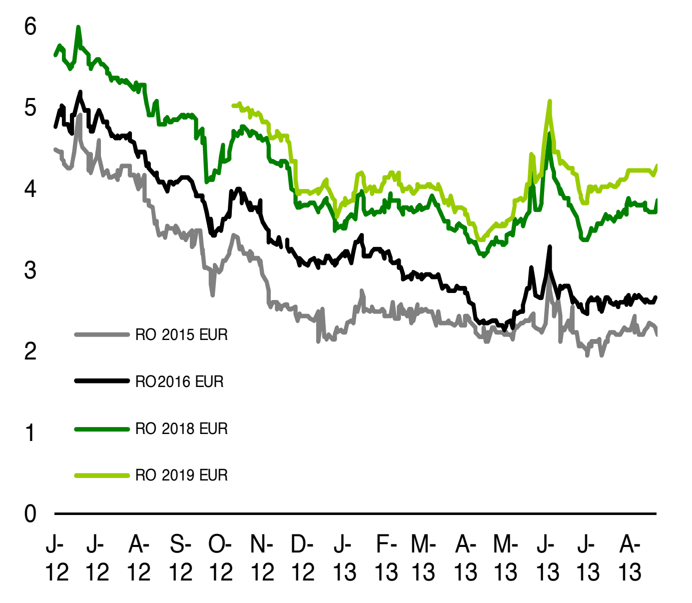
Moreover, the 10% Initial Public offering (IPO) privatisation of Nuclearelectrica (provider of 20% of total energy of the country) is just taking place in the period of 9-20th of September. The list of privatisations is still long, among which the most important are the 10% in Romgaz planned for November 2013, Electrica with majority package till April 2014, 15% listing of the largest electricity producer and coal mining complex in the country, CE Oltenia (provider of 31% of total energy of the country), in the first half of 2014.

COUNTRY RISK STABILISAED, 5Y EUR CDS



Source: Reuters, Garanti Bank Research

YIELDS FOR EUROBONDS AFFECTED BY GLOBAL RISK ASSESMENT IN JUNE BUT THEN STABALISED



Source: Reuters, Garanti Bank Research

[1] Data as of 2012. Source: National Institute of Statistics.

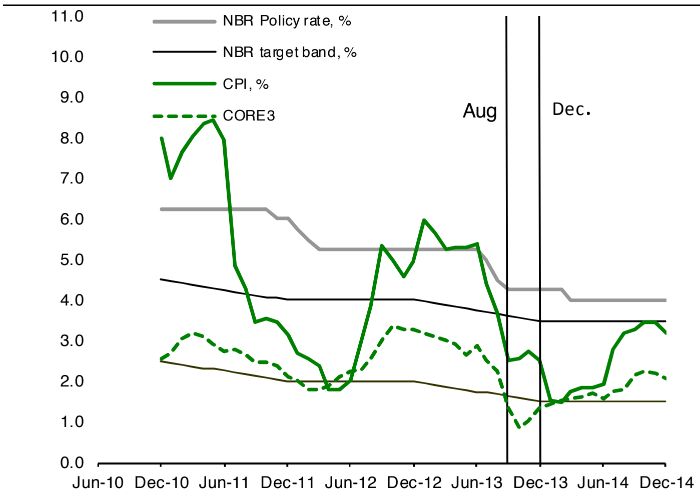
Inflation

Disinflation process started

The August headline inflation decreased for the second month at 3.7% yoy from 4.4% yoy in the previous month. The strongest positive effect is coming from the drop of vegetables' (-5.3% mom after -13.3% mom in July) and fruits' prices (-6.3% mom after -4.5% mom in July). The inflation adjusted by administrative prices, volatile prices and tobacco and alcohol products (CORE 3) dropped further to 2.2% yoy from 2.5% yoy in previous month and 3.5% yoy at the end-2012. The outlook remains favorable with further food price drop in the next couple of months thanks to the good harvest. Moreover, the VAT drop for bread and bakery goods from 24% to 9% will be implemented in September which translates into a 7-8% drop in prices even with a 60% pass-through to the final prices. Moreover, the price pressure coming from energy prices has softened due to the new ordinance that the issuance of tradable green certificates to green power generators will be delayed till 2017 and the licensing of new production capacities will be restricted[2]. Consequently, electricity prices dropped by 2.5% in July, and an additional 3% cut is still possible based on the announcements. As a result, energy prices in 2013 are expected to rise by 8% instead of 14% yoy initially expected[3].

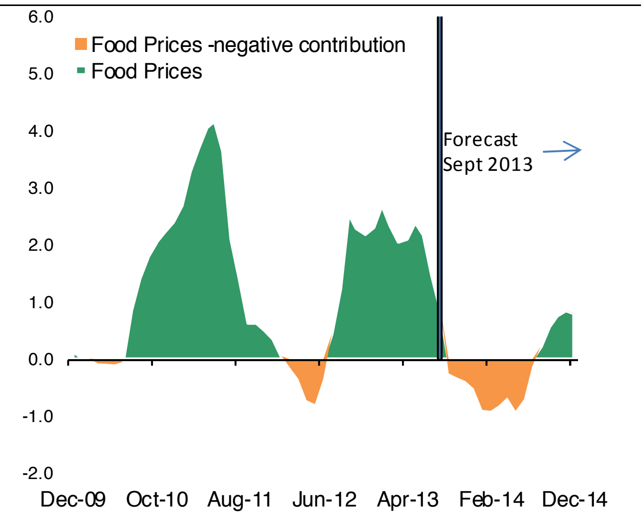
Given all these positive price impacts, we will see further deceleration of inflation at below 3% already in September and we adjust downward our end-year forecast to 3% from 3.5% expected 3 months ago.

IMPROVED INFLATION EXPECTATIONS FOR 2013



Source: NIS, NBR, Garanti Bank Research

FOOD PRICE CONTRIBUTION TO THE ANNUAL INFLATION TURNS FAVORABLE



Source: NIS, Garanti Bank Research

[2] Nonetheless, the wind power association already challenged the amendments, saying they need to be endorsed by the European Commission, so there is a risk of further price increase generated by green energy support if the amendment is not accepted by EC.

[3] The electrical energy price liberalization[3] agreed with the IMF will start this year with 10% in July and reaching 100% liberalized prices at the end of 2017. In January a 10% hike of electric energy prices has been already implemented (6% coming from regulated prices and 4% from green energy support). The gas prices have been announced to increase by 10% in two steps in July and October.

Monetary Policy

Rate cut cycle to continue

NBR started the key rate cutting cycle already in July with 0.25 percentage points and surprised the market with 0.50 percentage points in August (above the expectations of 0.25 percentage points cut). The stronger than expected cut reflects the improved inflation outlook with high probability to reach its target band of 2.5+/-1%, and intends to boost the RON lending to support the domestic consumption.

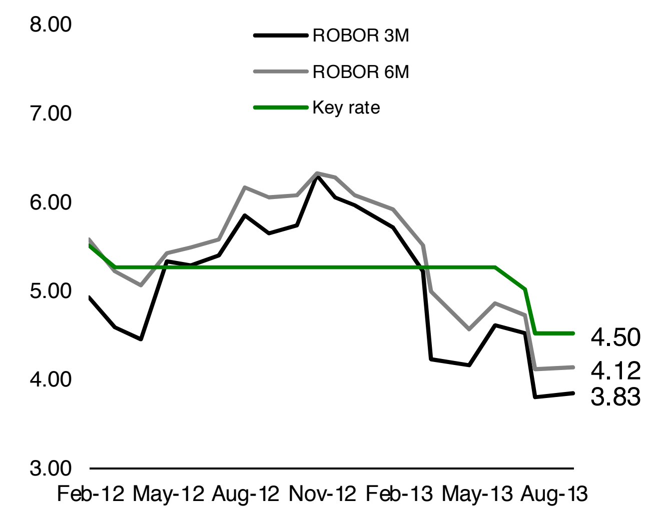
Policy rate already reached 4.5% in August 2013 with additional 0.25 pp rate cut expected for this year and 0.25 pp at the beginning of 2014 (4.0% at the end-2014).

Overall, we expect a total 1.00 percentage points rate cut in 2013 and additional 0.25 percentage points at the beginning of 2014. This means one more cut out of the two monetary policy meetings to be held till the year end. While the strong disinflation process might allow even more cuts this year, a counterbalancing effect might come from depreciation pressures on RON, on the back of international events that might determine the NBR to hold temporary the yields in an attempt to defend the currency, and to continue at the beginning of 2014.

During August-September we see continuous improvement of liquidity with REPO operations close to zero (with only injection of RON 7 mn in the last week of August) with August entering on surplus of RON 1.3 bn average daily value while during July the banking system was still on a deficit with average daily value of REPO at RON 1.3 bn. The good liquidity is reflected on the inter-bank market with interest rates consistently below the key rate.

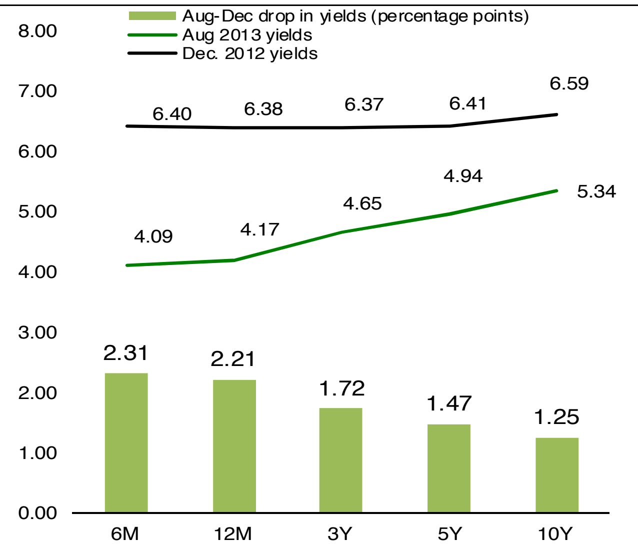
Cuts in the rates of reserve requirements remain a possibility, but rather shifted towards next year. If there is good liquidity on money market there is no reason to cut the minimum reserve requirement for local currency; moreover they will probably use the REPO instrument for any need of further liquidity.

LIQUIDITY IMPROVEMENT PUSHED MONEY MARKET RATES BELOW THE KEY RATE



Source: NBR, Garanti Bank Research

MINISTRY OF FINANCE REFINANCING AT LOWER COSTS



Source: NBR, Garanti Bank Research

Fiscal Policy

Back on the track

Romania's budget deficit corrected in July from 1.1% to 1.0% of GDP with total deficit of RON 6.0 bn for the first seven months of the year, improving from the end-April level of RON 7.5bn. On the positive note, it registered a 13.7% improvement compared to the deficit for the same period of last year and stood comfortably on the track of the Ministry of Finance's deficit target for end 2013 (readjusted at 2.3% from 2.1% of GDP, in accordance with the IMF delegation in June).

The major improvement is coming from the decelerated spending at 4.1% yoy from 7.6% yoy registered in April. Personnel spending decelerated at 16.4% from 28.2% yoy in April. On the negative side expenditures on EU funded projects is still lagging behind the last year's figures by 14.4% while capital expenditures contracted by 10.4%.

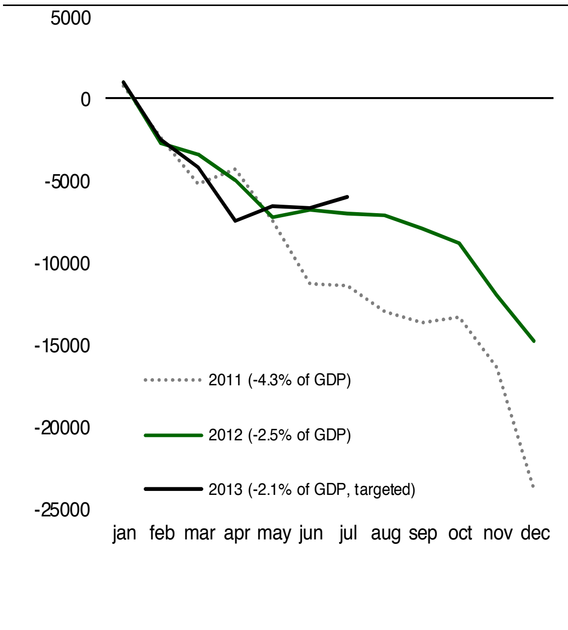
Also on the positive side, revenues from profit tax expanded for the first time this year by 2.1% yoy compared to -5.5% registered at the end of June while revenues from VAT accelerated to 4.9% yoy from 2.3% yoy one month ago.

Given that the European program for financing transport infrastructure has been unlocked we expect continuous acceleration of public investment projects on the one hand, and increase of EU transfers on revenue side (currently at -0.6% yoy), on the other hand.

Romania's government has cut the VAT rate for bread and other bakery goods from the standard 24% to 9% based on a new ordinance in July and effective as of September 1.

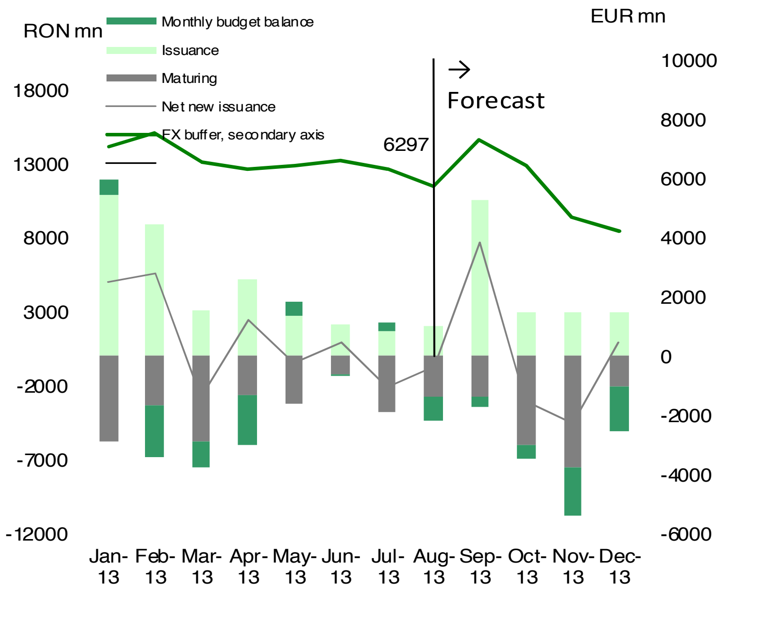
The impact on the budget revenues under the worst-case scenario, RON 100 mn for Sep-Dec, is expected to be offset by higher excises enforced also as of September for alcoholic beverages and luxury goods such as large-capacity automobiles and jewelry. Actually, the supplementary collection from higher excise taxes is estimated by the Government at RON 300mn. Cutting the VAT rate for bakery is aimed also to fight tax evasion.

BUDGET DEFICIT ON THE TRACK AGAIN



Source: MF, Garanti Bank Research

CONFORTABLE FX BUFFER OF MF



Source: MF, Garanti Bank Research

The profit tax revenue is still lagging behind. The new tax code enforced as of February aimed at finding new sources of profit tax might help in the second part of the year. The new income tax on companies in agricultural sector cannot be visible yet since activities are calculated by applying the 16% rate on the annual income payable to the State Budget two times per year (25 October, 15 December). Nevertheless, the profit tax of micro-firms calculated mandatory on turnover and not profit, was designed to bring additional revenue for the budget, although not visible yet.

While our major concerns are related to the profitability of Romanian companies, still struggling with financial difficulties[4], the Government hopes to get additional tax revenue through additional measures to fight tax evasion. There are plans to introduce a new minimum taxation system[5] on SMEs, from sectors considered to be more affected by tax evasion, mainly from service sectors like IT, hotels and restaurants or car services. For these SMEs taxes are planned to be calculated by more technical criteria (like space of the unit, number of working units, etc.) rather than the 3% of sales and 16% of profit, among which the company can choose under the current legislation. According to the latest report of the Fiscal council, tax evasion in Romania reached 14% of GDP (around EUR 18 bn) in 2012, out of which 60% is on the VAT collection.

Public Financing

External financing target mainly reached for 2013

The Ministry of Finance has tapped about EUR4.1bn in hard currency, out of which EUR1.4bn from the domestic market, and this way increased successfully its foreign currency buffer at around EUR 7 bn as of September. Its latest Eurobond auction was organised on the 12th of September tapering EUR1.5bn in a seven-year Eurobonds. The issuance has been initially announced for June but then postponed due to risk reassessment on the international markets.

External financing costs for Romania decreased by around 200 bps during the last year amid improved country risk profile and increasing global liquidity. Nevertheless, most of the developing countries have been negatively affected since end-May 2013 by the increased expectations of market participants regarding the exit of the USA Federal Reserve's quantitative easing program. Still, yields on this latest issuance came some 50 bp above the yield on the six-year Eurobond on the secondary market (4.3% on the 12th of September 2013), at 4.77%. The higher yields resulted in a strong demand with bid to cover ratio at 4.

The refinancing of the IMF loan this year went smoothly. There are only EUR 1.8bn left as of end of August to be paid out of the total of 5.1 bn scheduled for 2013, that probably will face no additional pressure, given also the relatively comfortable international reserve of EUR 35.7 bn (as of end-August 2013).

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[4] Based on a latest study on insolvency by Coface Romania, the number of insolvencies had the strongest growth of the last five years in 2012 (+20% yoy) driven by accumulated losses and less financing sources available since the beginning of crysis.

[5] A temporary minimum tax on SMEs have been in place between May 2009 and September 2010 with minimum tax on the range of RON 2.200 approximately EUR 500, for firms with total income of RON 52.000, and RON (around EUR 10.000) for income above RON 129 mn.

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IMF reimbursement calendar (EUR mn):

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

External Accounts and Financing

Current Account on the surplus; Portfolio investments affected by the US Quantitative Easing program and Global tensions

Current Account

The Current Account for the first seven months of 2013 remained on surplus of EUR 0.5 bn, significantly improving compared to the EUR 3 bn deficit recorded in the first seven months of last year. Its major component, the goods trade deficit (FOB-FOB) narrowed by 55% to EUR 1.8 bn, with export growth (7.7%) strongly outperforming the imports' dynamic that dropped by -0.7% yoy.

Export figures are above expectations; however we doubt their sustainability at this current performance. The drop in imports shows some reorientation of consumption towards domestic versus imported products but it shows also the weak domestic consumption and investments. The CA adjustment has been also helped by the service balance, especially the positive transportation services balance (1.3 bn versus 0.5 bn of similar period of last year). The net current transfers stabilized at around EUR 2.1 bn net for the first seven months, just 2% yoy lower compared to the similar period of 2013. Some acceleration might come on this component since the entire drop is due to lower EU money transfers on temporary blockage of EU funds.

We expect some slowdown in the export growth for the rest of the year given the strong dependence of the good performance on the car industry and some slowdown also EU industrial production, while some acceleration in imports should come as long as domestic consumption and investments start its recovery. We expect a CA deficit at around 1.7% of GDP in 2013 amid exports' growth outperforming the imports' dynamic (4.7% yoy and -1.0% yoy, respectively).

External Debt

Romania's total medium and long-term external debt dropped slightly in the first seven months by 0.5% yoy to EUR 78.3 bn. Out of this, EUR 8.5 bn represents the debt to the IMF, which decreased by 21% yoy (by EUR 2.2 bn) as of July 2013. The private sector's external debt stayed relatively stable at EUR 36.1 bn (3% less than one year ago). The short-term debt stabilized at EUR 20.0 bn, close to the value of last year (-1% yoy). Romania's total external debt thus edged down slightly by 1% yoy at the end of July 2013 to EUR 98.3 bn (70% of GDP).

FX reserves

The Romanian foreign exchange reserves dropped in August by EUR 1.1 bn at EUR 32.2 bn, but stayed still above the EUR 31.21 bn at the end of 2012. Outflows also include the amount of approximately EUR 1 bn, the ninth and tenth principal installment on Romania's loan from the International Monetary Fund and the EUR 0.5 bn repayment of the euro denominated bond issued by the Ministry of Finance that matured on August 2013. FX reserves stay still at a comfortable level by covering 7 months of imports.

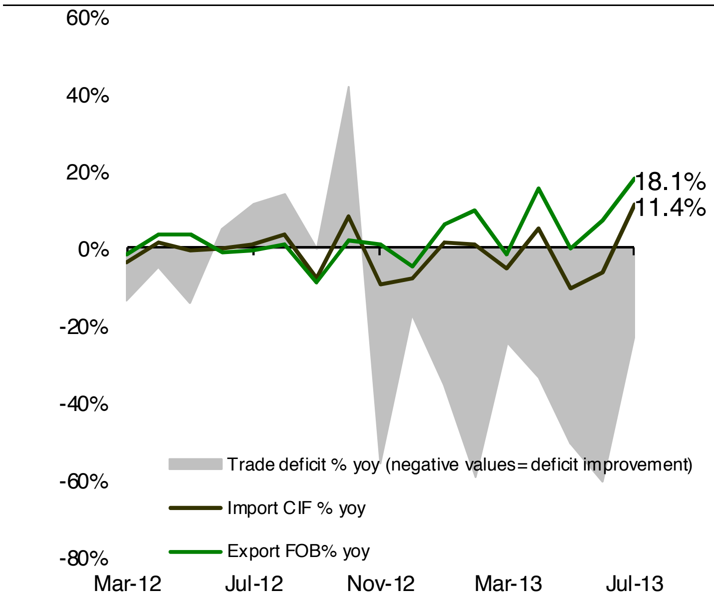
FDI and other financing sources

The FDI in the first seven months of the year inched down at EUR 0.95 bn, some 29% below the last year's level of similar period and given the very weak domestic investment figures, lower than expected EU fund project and generally low dynamic of the economy, there is not too much hope for any acceleration this year. Consequently, we readjust our forecasts at EUR 1.7 bn (1.2% of GDP), close to the last year's EUR 1.6 bn, the lowest level for the last ten years.

Moreover, Romania attracted less portfolio investments in the second quarter, however affected also by the international events that negatively affected most of the emerging countries. After the net outflow of around EUR 0.5 bn just after the announcement of a possible tapering of US Quantitative Easing, the balance turned positive in July. More importantly, during the international volatility, out of the short-term funds attracted at the beginning of the year only a small part left the country. Romanian governmental debt market can still offer an interesting opportunity for foreign investors with relatively higher yield amid improved macro environment, helped also by the IMF presence for the next two years, according to the new deal. Moreover, the major part of the proposed privatization will imply IPO or SPO deals that should bring fresh capital on the stock exchange. Still, any changes on the US monetary policy (with start of tapering expected in September) might have stronger negative effect on short-term capital than any local factor.

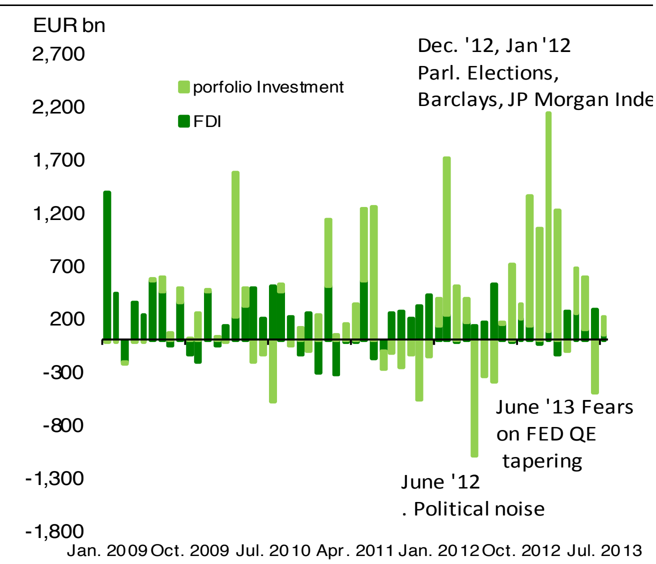
Nevertheless, the current account surplus and Ministry of Finance managing well so far its external financing need put less pressure on private external financing, at least for the moment.

TRADE DEFICIT IMPROVING ON THE BACK OF STRONG EXPORT



Source: Eurostat, Garanti Bank Research

PORTFOLIO INVESTMENTS NEGATIVELY AFFECTED BY INTERNATIONAL EVENTS



Source: NBR, Garanti Bank Research

FX Outlook

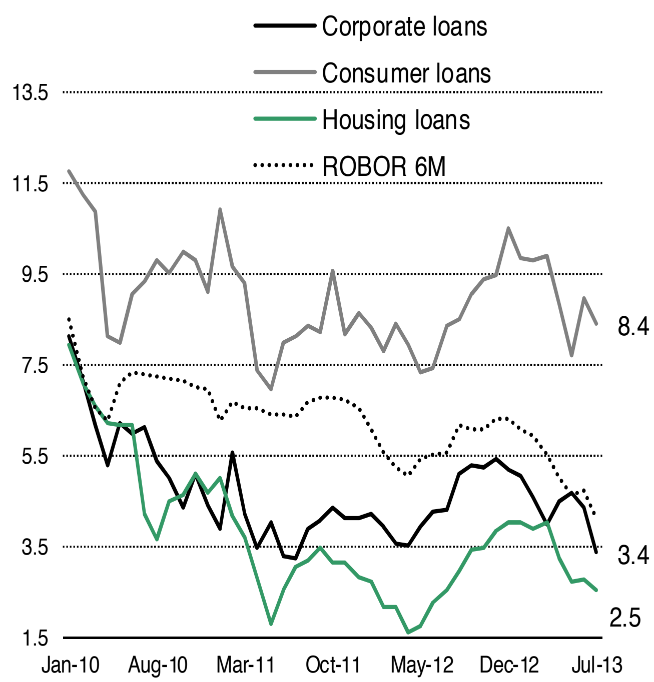
Volatility is back driven by global uncertainties

Volatility is back driven by international events. Moreover, as the US Federal Reserve decide to taper QE and to rise interest rates investors might pull their cash out of emerging markets to take advantage of better returns back home.

Consequently, the Romanian currency might be also affected by the global risk reassessment and move of liquidity towards lower-risk areas. The volatility has intensified through increased reliance on short-term financing and the expected country performance depending on political commitments. Some political risk surfaced at the current dispute on the gold mine investment project which was strongly mediatised, since the two leaders of coalition partners (Prime Minister Ponta from socialist party PSD and Crin Antonescu, the president of liberal party PNL and currently president of the Upper House) expressed contradicting views related the project. Nevertheless, we think the incentive to stay in coalition is still stronger, given their common project of constitutional changes to be implemented towards the end of 2014.

We expect RON to stabilise at around 4.45 towards the year-end driven by macro stability and the new investment alternatives. Still, risks are on the upside mainly coming from international happening but also, on a lower intense, from local political risk related to the success of major governmental projects of structural reform and possible coalition conflicts.

LOANS INTEREST RATES



Source: NBR, Garanti Bank Research

BANKING VOLUMES AS OF JULY 2013

	Private Domestic Loans		Private Domestic Deposits	
	EUR bn	% yoy	EUR bn	% yoy
Total Non-Gov. Domestic	50.3	-2.2	45.5	4.3
RON	19.0	0.7	29.0	0.8
FX	31.2	-3.8	16.5	10.8
Total Household	23.5	-1.3	28.5	5.3
RON	7.7	-1.1	17.4	1.6
FX	15.7	-1.4	11.0	11.6
Consumer	14.6	-7.2		
RON	7.2	-2.8		
FX	7.4	-11.0		
Housing loans	8.8	10.2		
RON	0.5	34.3		
FX	8.3	9.1		
Non-fin. Companies	26.2	-3.0	13.8	2.9
RON	11.0	2.0	9.3	0.7
FX	15.2	-6.2	4.5	7.5
General government	2.2	-2.2	8.9	51.8
Non-residents	9.6	12.1	27.4	-19.4

Source: NBR, Garanti Bank Research

Bank flows

The lower key rate's pass through not visible yet on loans' dynamic

On the annual basis, private loans contracted by 2.2%, as of July 2013. The housing loans expanded by 10.2% compared to the last year, but this expansion was weaker than the consumer loans' contraction (-7.2% yoy, but with a stronger basis). The portfolio of loans to companies also contracted by 3% during the last 12 months. Demand for loans remained very weak overall in H1 2013 while credit standards were tightened during the second quarter. Total private deposits contracted also slightly during the last couple of months, but still holding relatively well compared to last year, especially in hard currency that is by around 11% above the last year's level.

The RON financing is taking more and more attention, helped by lowering interest rates but also by the reinforced regulation. For example, the New First House Lending program, that proved to be very successful since it has been launched four years ago, for the first time will be available just in local currency (so far 94% of the housing loans has been contracted in hard currency). This is a constraint for the client, limiting his possibility to choose the preferred type of financing, but any interest rate differentiation among the RON and FX financing (just 2.5 percentage points as of July 2013), can be considered also as a necessary insurance against the RON depreciation, that might turn beneficial in case of stronger volatility. Nevertheless, the local currency denominated housing loans started to be preferred during the last year through lower RON interest rates and became the most dynamic component with 23.5% yoy growth as of July 2013[6].

On the contrary, consumer loans' recovery has some serious barriers from both demand and supply side. On the demand side, this can be the result of lower real income, more pessimistic outlook of the future income, working conditions uncertainty, increased precaution and risk aversion on any indebtedness, which on a certain level is helpful and shows responsible consumption but it blocks also the economic recovery.

On the supply side, restrictions stipulated by the NBR regulation[7] on FX denominated household loans push the offer on the RON financing; however these are significantly more expensive that the FX alternative (RON interest rates above the FX interest rates by 8.4 percentage points on average as of July 2013) and not by chance it is refused by the more cautious clients.

Companies also reoriented towards loans denominated in domestic currency (with additional costs of just 3.4 percentage points above the FX interest rates as of July 2013), which resulted in 2% annual growth of RON financing versus the 6.2% contraction of FX denominated loans, as of July 2013. More restriction on FX lending has been enforced as of March 2013, addressing this time companies, whose revenue is not in hard currency[8].

Given its increased weight of RON financing, the current softening of monetary policy might play an important role in re-launching both domestic consumption and investments, but to become visible rather in the last quarter of the year.

[6] The growth rate is higher also due to lower base.
[7] NBR Regulation no. 24/2011 enforced as of February 2012.
[8] NBR Regulation no. 17/2012 enforced as of March 2013.

Main macroeconomic data and forecasts

	2010	2011	2012	2013F	2014F
Economy					
Nominal GDP, (EUR bn)	124.1	131.4	131.8	140.4	144.9
GDP per Capita (EUR)	5,773	6,529	6,556	6,983	7,214
Real GDP, (% yoy)	-1.6	2.2	0.7	1.7	1.8
Agriculture, % yoy	-5.5	12.4	-21.6	13.2	-1.8
Industry (except construction), % yoy	4.0	0.1	-1.0	2.3	2.0
Construction, % yoy	-4.5	-6.4	-0.3	-0.9	3.1
Wholesale and retail trade; turism and transport, % yoy	-2.4	-2.1	1.5	0.2	2.0
Other services, % yoy	-3.1	8.8	9.1	2.4	3.5
Public administration, % yoy	-6.3	0.6	2.4	0.9	0.5
Population, (mn)	21.5	20.1	20.1	20.1	20.1
Avg net monthly wages (EUR, nominal)	334	348	347	371	383
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	7.4	7.0
External Accounts					
Current Account (EUR bn)	-5.5	-5.9	-5.2	-2.5	-1.7
Current Account (% of GDP)	-4.4	-4.5	-3.9	-1.8	-1.2
Export (EUR bn)	37.4	45.3	45.1	47.2	49.5
Import (EUR bn)	45.0	52.7	52.4	51.9	53.5
Export (% yoy)	28.5	21.2	-0.5	4.7	5.0
Import (% yoy)	25.1	17.2	-0.5	-1.0	3.0
Trade balance FOB-FOB (EUR bn)	-7.6	-7.4	-7.4	-4.7	-3.9
Trade balance FOB-FOB (% of GDP)	-6.1	-5.6	-5.6	-3.4	-2.7
Net FDI (EUR bn)	2.2	1.8	1.6	1.7	2.0
Internat. reserves incl. Gold (EUR bn)	36.0	37.3	35.4	34.9	33.7
Gross Foreign Debt (% ogf GDP)	74.5	75.1	75.2	71.9	71.1
Fiscal Accounts					
Budget Balance (% of GDP)	-6.4	-4.3	-2.5	-2.5	-2.2
Public Governmental Debt (% of GDP)	34.9	37.8	38.6	38.5	38.3
Inflation/Monetary/FX					
Inflation (CPI) yoy, eop	8.0	3.1	5.0	3.0	3.2
Inflation (CPI) yoy, yearly average	6.1	5.9	3.3	4.4	2.6
Central bank reference rate, eop	6.25	6.00	5.25	4.25	4.00
Central bank inflation target	3.50	3.00	3.00	2.50	2.50
1M Robor, eop	4.05	5.72	6.04	4.20	3.90
1M Robor, avg	5.90	5.27	5.22	5.12	4.05
EUR/RON, eop	4.28	4.32	4.43	4.45	4.55
EUR/RON, avg	4.21	4.24	4.46	4.41	4.53

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