Romania
Macroeconomic Situation

June 2012

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- **Industrial production grew by 2.6% yoy in April.**
- **The consolidated budget deficit grew to 0.83% of GDP by the end of April.**
- **Consumer price growth in May was almost the same as in April at 1.79% yoy.**
- **The FOB-CIF commercial deficit declined by 12.5% yoy in April.**
- **Growth in current transfers surplus and a decrease in the income account deficit lowered the current account deficit by 23.7% yoy in January-April 2012.**
- **International financial institutions provided additional loans to Romania in June.**

Executive Summary

The continuing recession in the Euro-zone is obviously having an effect on economic performance of Romania. Industrial production remained flat in April in yoy terms; and retail increased by 3.4% yoy in April.

Some easing of austerity measures led to an increase in the consolidated state budget deficit from 0.56% of GDP at the end of Q1 2012 to 0.83% of GDP by the end of April. The deficit is still within the target level proposed by international institutions. Moreover, it was expanded for the year in coordination with the IMF to 2.2% of GDP in cash terms, while maintaining the 3.0% budget deficit target under the ESA95 standard. The consolidated state budget (cash) revenues grew by 7.4% yoy on the shoulders of an increase in tax revenues, while general government expenditures grew by 7.9% thanks to a significant increase in expenditures of the EU-funded projects.

Low consumer expectations were reflected in an insignificant growth in prices – 0.2% mom and 1.79% yoy in May, which is a two-decade low. Acting prudent, on the background of internal political instability due to 2012 parliamentary elections, which increases the risk of currency devaluation, NBR left the policy rate unchanged at 5.25%. This, together with other conditions, helped to increase the flow of credit to the private sector by 9.8% yoy.

April FOB/CIF commercial deficit declined 12.5% yoy as exports increased 3.4% yoy, while imports inched down 0.2% yoy. The current account deficit decreased by 23.7% yoy in January-April 2012 thanks to growth in current transfers surplus, services surplus, and decrease in income balance deficit. Direct investments of non-residents into Romania continued to decline.

Standard & Poor's reaffirmed the BB+ rating of Romania for long-term bonds while Moody's, which rates Romania investment grade at Baa3, worsened the outlook to negative, from previously stable, citing risks from the ties with Euro-zone.

The World Bank, through decision of the Board of Executive Directors, approved a EUR 1 bln development policy loan with a deferred drawdown option to Romania to protect public finances against unforeseen external shocks. Ten days later, the IMF approved a new stand-by payment to Romania of USD 651.3 mln, as the country met all the targets set under a precautionary agreement.

	2007	2008	2009	2010	2011	2012
GDP growth, % yoy	6.2	7.1	-6.6	-1.6	2.5	1.5
GDP per capita, $	7,916.744	9,496.899	7,649.485	7,667.224	8,862.874	8,720.926
Industrial production, % yoy	5.4	0.9	-5.5	5.5	5.6	5.6
Retail sales, % yoy	17.8	13	-10.3	-5.3	-2.5	2
Budget deficit, % GDP*	-2.3	-4.9	-7.3	-6.4	-4.1	-4.2
Government external debt, % GDP	7.8	7.6	16.4	22.3	23.8	24.5
Inflation, eop	4.84	7.85	4.7	8	3.1	3
Gross international reserves, $ billion	27.2	28.3	30.9	36	37.3	36.5
Current account balance, % GDP	-13.9	-12.3	-4.1	-4.4	-4.2	-4.2
Gross external debt, % GDP	47	51.8	69.1	75.8	71.9	71
Unemployment (ILO methodology), % eop	6.4	5.8	6.9	7.3	7.4	7.2
Exchange rate RON/EUR, annual average	3.34	3.68	4.24	4.21	4.24	4.5

Source: National Institute of Statistics, National Bank of Romania, Ministry of Public Finance, The Bleyzer Foundation

Where Opportunities Emerge.

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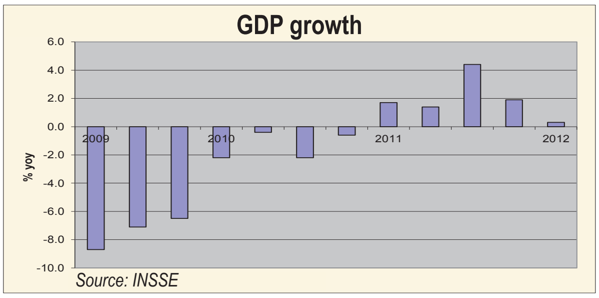
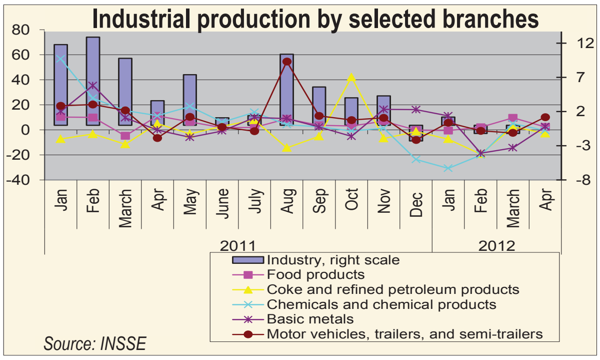
Economic Growth

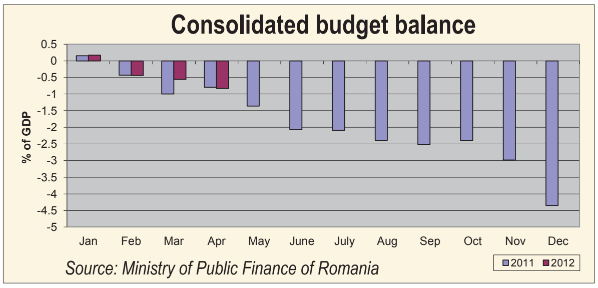


The economic crisis in Europe accompanied by political turmoil inside the country continues to affect the economic performance of Romania. Industrial production remained flat in April in yoy terms. Electricity, gas, steam, and air conditioning supply increased 5.8% yoy, while manufacturing lost 0.3% yoy and mining and quarrying have dropped by 7.7% yoy. Among the main industrial sectors, the highest growth rate was registered for capital goods (10.9% yoy), with consumer durables demonstrating the second fastest growth at 5.2% yoy and energy demonstrating the lowest growth at 2.6% yoy. Intermediate goods demonstrated a 8.3% yoy decrease, while consumer non-durables declined by 4.2% yoy.



Consumption improved slowly on the background of the continuing economic turmoil in the Euro-zone and uncertainty in the country. Retail turnover volume demonstrated only moderate growth rate of 3.4% yoy in April (which is still an improvement comparing to 1.6% yoy increase of the previous month). The main driver of the increase was fuel for motor vehicles in specialized shops with a 11.0% yoy, along with 1.9% yoy increase in sales of non-food products, while sales of food products, beverages, and tobacco inched up 0.3% yoy.

Fiscal Policy

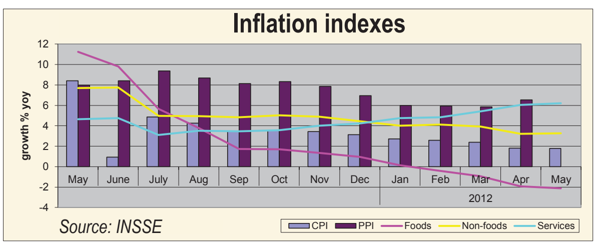


Data from the Ministry of Finance of Romania shows that the consolidated state budget was executed with a cash deficit of RON 5.0 bln (EUR 1.2 bln) over the January-April 2012, or 0.83% of GDP. The deficit amounted to RON 4.4 bln (EUR 1.0 bln) or 0.75% of GDP for the corresponding period last year.

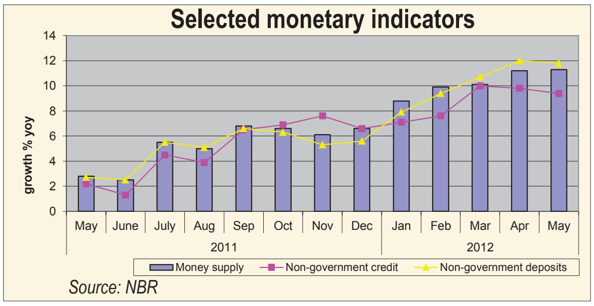
Consolidated budget revenues demonstrated a 7.4% yoy increase to RON 62.0 bln (EUR 14.3 bln) during the period. This increase became possible thanks to a 10.1% yoy growth of tax revenues. The highest growth was registered for income tax revenues – 17.5% yoy, while value added tax and excises added 5.8% yoy and 5.0% yoy increases, respectively. Social security contributions amounted to RON 17.0 bln (EUR 3.9 bln) over the period, which is a 7.3% yoy increase. Local administrations generated a 5.3% yoy increase in tax revenues and a 19.1% yoy increase in non-fiscal revenues. Finally, transfers from the EU budget grew by 30.2% yoy.

General consolidated budget expenditures, in turn, grew by 7.9% yoy to RON 67.3 bln (EUR 15.4 bln). The highest contribution to this growth was made by the EU-funded projects, the expenditures of which increased by 65.8% yoy. Public debt interest payments on state and guaranteed by the state debt grew by 44% yoy, while capital expenditures grew by 31.4% yoy. Expenditures of the National Health Fund on goods and services grew by 6.6% yoy because of payments for medical services and medicines. At the same time, the expenditures of local governments on goods and services grew by 17.3% yoy due to payment for transformation of hospitals into nursing homes in accordance with the Decree of the Government. The consolidated budget wage bill expanded by a mere 0.9% yoy because it does not include a 15% increase of wages in the public sector for January 2011, since increased salaries and contributions were paid starting in February 2011. Investment costs, including capital expenditures and related development programs, increased by 36.7% yoy.

Monetary Policy



Consumer prices were almost stable in May, since the Consumer Price Index was equal to 100.2% mom. In annual terms, consumer prices demonstrated more significant growth of 1.79% yoy, almost the same as the previous month. However, this is still a two-decade low. Food prices were almost stable in May with just a 0.02% increase mom. In annual terms, however, they continue to decrease, declining by 2.13% yoy. This decrease significantly compensated for the 3.26% yoy increase in prices of non-foods and the 6.21% yoy increase in prices of services (caused by both a fall in RON/EUR exchange rate and the resulting increase in telephone bills, postal service prices, and other tariffs denominated in EUR). Inflation may increase towards the end of the year due to the risk of foreign exchange depreciation on the back of the political instability. However, it is not expected to exceed 3.0% at the end of the year. Due to both external risks and due to internal political instability, caused by the parliamentary elections, the NBR has decided to act prudent and left the policy rate unchanged at 5.25%. This rate allows recovering of lending activity under low inflation.



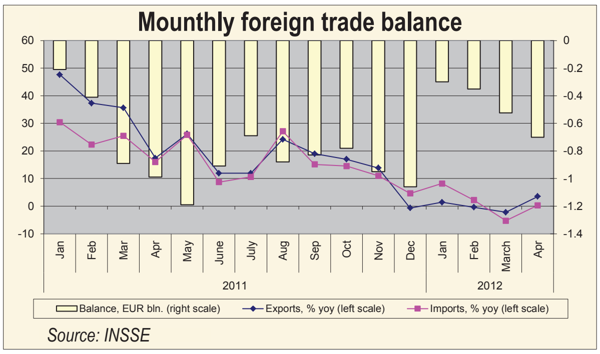
Broad money (M3) grew by 1.0% mom to RON 218.5 bln (EUR 50.1 bln) in April, compared to a 0.7% decrease in March. In annual terms, the increase was 11.2% (compared to 10.1% in March).

Loans to the private sector granted by credit institutions demonstrated a significant 9.8% yoy increase to RON 224.7 bln (EUR 51.6 bln), on the shoulders of a 3.3% growth in RON-denominated loans and a 13.9% yoy increase in foreign currency-denominated loans expressed in RON (a 5.5% yoy increase, if expressed in EUR). In March, the corresponding growth rates were 10.0%, 5.7%, and 12.6% (5.8%) yoy, respectively.

International trade and Capital

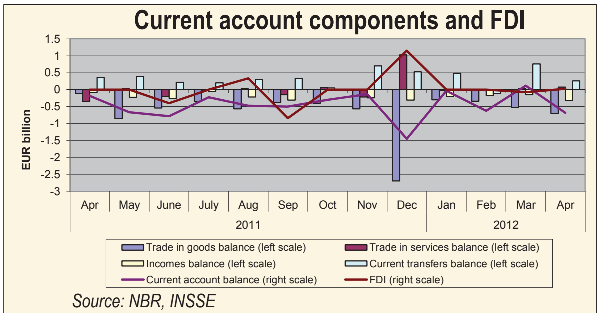
Calculations based on the preliminary data of the National Institute of Statistics show that FOB exports amounted to EUR 3.5 bln in April, which is a 3.4% yoy increase. CIF imports amounted to EUR 4.4 bln, decreasing by a mere 0.2% in annual terms. The FOB-CIF commercial deficit amounted to EUR 866.6 mln in 2012, demonstrating a 12.5% yoy decrease.

From the beginning of the year, FOB exports amounted to EUR 14.5 bln, which is a 0.7% yoy increase. At the same time, CIF imports grew by 1.1% yoy to EUR 17.1 bln. As a result, the FOB-CIF commercial deficit amounted to EUR 2.6 bln, or up by 3.1% yoy. Trade in goods between the Member States represented 71.3% of the total exports and 73.4% of the total imports (EUR 10.4 bln and EUR 12.6 bln, respectively). Transport equipment and vehicles along with other manufactured goods had the largest shares in foreign trade during the period as usual (41.1% and 34.3% in exports and 33.1% and 29.4% in imports).



A 24.1% yoy increase in the current transfers surplus accompanied by turning services deficit into surplus and a 4.6% yoy decrease in the income balance deficit helped narrow the current account deficit by 23.7% yoy to EUR 1.2 bln over the first four months of the year.

Direct investments of non-residents into Romania continued to decline. In January-April 2012 they amounted to EUR 446 mln decreasing to the correspondent period of the last year by 9.0%. Furthermore, they covered just 36.3% of the current account deficit over the first four months of the year.



Medium- and long-term external debt increased in both size and share of total debt over January-April. It amounted to EUR 77.4 , bln which is 2.3% higher than last year over the same period. Its share of total debt grew to 78.1% from 77.4% at the end of Q1 2012. Short-term external debt decreased by 5.2% yoy in January-April 2012 to 21.6 mln.

At the end of May 2012, National Bank's reserves stood at EUR 33.5 bln, down from EUR 34.3 bln in the previous month. Overall, the foreign exchange reserves of the National Bank of Romania decreased by 2.3% mom to EUR 33.5 bln. Inflows to the foreign exchange reserves of the National Bank of Romania, representing changes in the foreign exchange reserve requirements of the credit institutions, inflows into an account of the European Commission, inflows into the Ministry of Finance accounts, etc., amounted to EUR 1.9 bln in May 2012. At the same time, outflows from reserves, representing changes in the foreign exchange reserve requirements of the credit institutions, interest and principal payments on foreign currency public debt, etc., amounted to EUR 2.7 bln. The outflow included EUR 759.5 bln in repayment of Eurobonds on May 8th, 2012. The gold stock of the country remained unchanged in May, but its value increased by 0.5% mom to EUR 4.209 bln. As a result, the total international reserves of Romania decreased by 2.1% mom to EUR 37.7 bln in May.

Other Developments Affecting the Investment Climate

Rating agency Standard & Poor's reaffirmed the BB+ rating of Romania for long-term bonds issued in foreign and national currency on May 25, 2012. It also reaffirmed the B rating for short-term bonds issued in foreign and national currency. The outlook for both ratings is stable. The transfer and convertibility rating (T&C) is reaffirmed at BBB+. Standard & Poor's stated that ratings were reaffirmed basing on economic recovery in the country thanks to measures introduced in compliance with the Stand-By Agreement with the IMF and with recommendations of other foreign donors.

Moody's rating agency, which rates Romania investment grade at Baa3 for long-term foreign currency and RON debt, worsened the outlook to negative, down from previously stable, citing risk from ties with Euro-zone.

The World Bank Board of Executive Directors approved a development policy loan with a deferred drawdown option (DPL-DDO) in the amount of EUR 1 bln on the payment terms and conditions set out in the President's Memorandum on June 12th. The purpose is to support reforms in the areas of public spending efficiency and Government revenue-raising, improve state owned enterprises governance in the areas of energy and transport, and enhance the quality of public health. The loan will also create a fiscal buffer to protect Government finances against continuing turbulences in export and financial markets.

The IMF approved a new stand-by payment to Romania on June 22nd, 2012 after the country met targets set under a precautionary accord. The additional amount provided to Romania is EUR 519.4 mln. The overall amount granted to Romania under the stand-by arrangement is about EUR 2.67 bln. During negotiations, the IMF agreed to let Romania increase the cash target for the budget deficit to 2.2% of the GDP, while maintaining the budget deficit target at 3% of the GDP under ESA 95.

Starting June 2012, the leftist Government led by USL (Socialist Liberal Union), sought to capitalize on its political assets, Parliamentary majority and the Government, gaining control of different institutions and moving to oust the President Traian Basescu. Possible impeachment of the President may lead to another depreciation of Romanian currency, as it was earlier this year after resignation of Romanian governments. It also may cause a decrease in ratings of Romania granted by the leading international rating agencies, meaning that the country will face difficulties with raising capital.

During June, the Board of SC Hidroelectrica SA, the hydro-electricity producer, asked for the insolvency of the company in order to re-organize the company, citing declining turnover and rising debt. Hidroelectrica, which in a normal year provides approximately 24.5% of the electricity consumption, had a turnover of RON 3,021 mln (EUR 713 mln) in 2011. The company shareholders are the Ministry of Economy (80.06% of shares) and Fondul Proprietatea (19.94%). Fondul Proprietatea is an entity created to reimburse the owners whose property were nationalized during the communist regime, and it is managed by the international fund manager Franklin Templeton.

The main consequence of the insolvency is cancelling or re-negotiation of the direct supply contracts for electricity at a fixed price with several large electricity re-sellers and users below the price on the electricity exchange. According to the Minister of Economy, Mr Daniel Chitoiu, Hidroelectrica has incurred losses of EUR 1.2-1.3 bln on these by-lateral contracts since 2006. While the contract terms were unfavourable to Hidroelectrica, its insolvency increases business risk in Romania, on the background of continuing Euro-zone crisis and of political instability, due to 2012 presidential elections and recent steps to oust President Basescu.

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