

**August 2013**

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- GDP expanded by 1.3% yoy in H1 2013.
- GDP is expected to grow by 1.9% in 2013.
- Industrial production grew by 6.1% yoy in January-May 2013.
- The consolidated budget deficit amounted to 1.1% of GDP at the end of June 2013.
- Consumer inflation declined to 4.4% in July 2013.
- The foreign trade deficit decreased by 82% yoy in January-May 2013.
- The current account balance was in surplus of EUR 314 million at the end of April 2013.

### Executive Summary

Initial estimates of the National Statistical Office put the H1 2013 GDP growth at 1.3% yoy. The Q2 2013 GDP growth was 0.3% qoq (seasonally adjusted) and 1.3% yoy.

The Romanian Government upgraded its forecast for GDP growth for 2013 from 1.6% to 1.9%, due to recent improvements in exports, good agricultural output and monetary easing implemented by the NBU.

Increased external demand stimulated growth of industrial production in Romania. Solid performance of manufacturing and mining and quarrying led to a 6.1% yoy increase in the sector's output in January-May. A decrease in sector output observed in May was caused by closures during Orthodox Easter and May 1st.

The consolidated general budget deficit inched down from 1.2% in January-April to 1.05% in January-May. The January-May fiscal budget deficit is 0.2% yoy lower than the corresponding deficit last year.

In July 2013, consumer inflation declined to 4.4%, compared to 5.4% in June. It is projected to decline to 3.2% by the end of the year. This year's good harvest is pushing food prices down. This has led to deceleration of consumer inflation because of the high share of food products in the consumer basket.

The National Bank of Romania continued to pursue prudent monetary policy. The main goals of the NBR are to control inflation, stimulate national currency lending, and cushion adverse internal and external effects on economic recovery. In January-May 2013, the total volume of non-government loans decreased by 1.3% yoy.

In January-May 2013, the foreign trade deficit was to EUR 500 million. This is 82% lower compared to the same period in 2012. The mentioned progress in foreign trade accompanied by a significant decline in the income account deficit helped to keep the current account balance positive over the reporting period.

	2008	2009	2010	2011	2012	2013
DGDP growth, % yoy	7.1	-6.6	-1.6	2.5	0.2	1.9
GDP per capita, USD	9,497	7,649	7,667	8,863	8,030	8,080
Industrial production, % yoy	0.9	-5.5	5.5	5.6	0.0	7.0
Retail sales, % yoy	13.0	-10.3	-5.3	-2.5	2.9	3.5
Budget balance, % GDP	-4.9	-7.3	-6.4	-4.3	-2.5	-2.2
Government debt, % GDP	13.4	23.6	30.5	34.7	37.8	38.0
Inflation, eop	6.3	4.7	8.0	3.1	5.0	3.2
Gross international reserves, EUR billion	28.3	30.9	36.0	37.3	36.4	37.0
Current account balance, % GDP	-11.6	-4.2	-4.4	-4.5	-4.0	-3.6
Gross external debt, % GDP	51.8	68.7	74.4	75.2	75.1	75.0
Unemployment (ILO methodology), % eop	5.8	6.9	7.3	7.4	7.2	7.0
Exchange rate RON/EUR, annual average	3.68	4.24	4.21	4.24	4.45	4.5

| August 2013

### Economic Growth

Initial estimates by National Statistical Office put the H1 2013 GDP growth at 1.3% yoy. The Q2 2013 GDP growth was 0.3% qoq (seasonally adjusted) and 1.3% yoy.

The Ministry of Public Finance recently raised its GDP growth forecast for this year, citing an increase in export demand, monetary easing implemented by the National Bank of Romania and expected good agricultural output. It expects GDP to rise by 1.9% in 2013, compared to a previous forecast of 1.6%. The most recent (July 31, 2013) forecast of the IMF is for Romanian GDP to grow by 2.0% in 2013. That would be one of the highest rates of growth in the EU in 2013.

In January-May 2013, industrial production became the major driver for economic growth in Romania. It grew by 6.1% yoy over the period thanks to increases in manufacturing (7.8% yoy) and mining and quarrying (6.8% yoy). Industrial production growth itself was driven by improvements in external demand, following economic recovery in a number of European Union countries. Indeed, in January-May 2013, Romanian export-oriented industries such as manufacturing of motor vehicles, manufacturing of other transport equipment and manufacturing of electrical equipment posted the highest growth across all manufacturing subsectors (13.1%-19.1% yoy). Only repair and installation of machinery and equipment managed to surpass the growth rate of the above-mentioned industries with an impressive 21.6% yoy increase over the reporting period. Another positive sign was the fact that the oil refining industry regained growth after overhauls carried out in previous months. In particular, in May oil refining saw a 30.7% mom increase. In May 2013, industrial production showed a 10.7% mom decline, which was caused by factory closures during Orthodox Easter and May 1st and not by any internal or external shocks. Therefore, we expect industrial production to regain growth in subsequent months.

Romania's agricultural sector also performed well in 2013. According to the Minister of Agriculture, by early August 2013 Romania had registered the best wheat crop of the last eight years and the second best in 40 years. It also registered record productions in barley and rapeseed. Nevertheless, the country continues to have a large negative foreign trade balance in agricultural products.

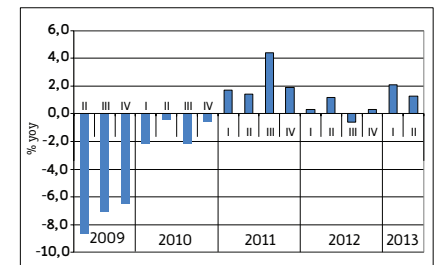
In January-May 2013, the performance of the trade and services sector was uneven. The trade component had a slight decline of 1% yoy during the period. This relatively flat performance conceals the fact that some trade subsectors registered larger declines (motor car trade and electronic appliances declined by 7.5% yoy and 5.0% yoy, respectively), while other trade subsectors (such as trade in car spare parts and motorcycles) showed good performance that balanced the growth of the overall trade component. As for the services component, it declined by 6.3% yoy over the reporting period. All its constituents underperformed, except for washing and cleaning of textile and fur products. As expected during a recession, leisure and travel activities and embellishment services decreased the most in January-May 2013 (by 29.3% yoy and 21.9% yoy respectively).

### Fiscal Policy

During the first half of the year, the government succeeded in maintaining the consolidated budget deficit (cash methodology) at 1.1% of the GDP, slightly below the 1.2% deficit in H1-2012 and in line with the 1.1% planned deficit. The budget planned and achieved a EUR 0.8 billion or 18% yoy increase in the state employees' wages in H1 2013 compared to the previous year. Faced with lower than expected revenues, the government balanced the budget with a combined cut of EUR 1.0 billion in planned expenditures on goods and services and investments.

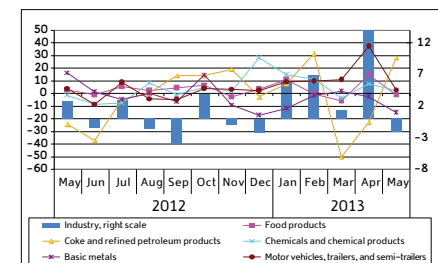
In January-June 2013, the consolidated budget revenues grew by 4.8% yoy but remained 6.5% below the planned value. There are two main reasons for this: lower than expected revenues from income tax, VAT, and excises; and lower than planned amounts from the EU budget. In particular, profit tax revenues were 13.3% lower than the plan due to repayments to banks (the profit tax is paid annually, but with

Graph of GDP growth



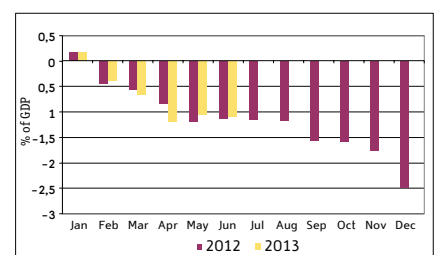
Source: INSSE

Graph of Industrial production by selected branches



Source: INSSE

Graph of Consolidated budget balance



Source: Ministry of Public Finance of Romania

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quarterly prepayments, netted after year-end) and weak performance of non-financial companies. The GDP increase was supported by exports, while consumption remains depressed, leading to VAT revenues 3.2% below the plan and excises revenues of 6.7% below plan. Amounts received from EU were equal to EUR 762 million or 52.4% below the plan over the reporting period. Romania remained the worst performing country in the EU in terms of funds attracted, with a 26.2% absorption rate. It will be hard for Romania to catch even the second worst Bulgaria with its 40% absorption rate.

Over the first half of the year, the consolidated budget expenditures were 4.3% higher yoy mainly due to the 18% yoy increase in wage costs, following the return of the state employees' wages to the pre-crisis levels. In terms of actual expenses versus the planned ones, there was a full achievement in the wages expenses, with cuts in investments and expenses on goods and services in order to meet the deficit target. The goods and services expenses were 6% or RON EUR 241 million lower than planned over the reporting period. At the same time, expenditures for projects financed with non-refundable funds were 26.5% or EUR 428 million lower than planned, while expenditures for projects financed with reimbursable funds were 22.6% or EUR 30 million lower than planned. Finally, capital goods expenditures were 17.1% or EUR 335 million lower than planned.

The government approved the revised budget for 2013, increasing the deficit to 2.4% (cash methodology) of the GDP, up from 2.1% of the GDP previously. The revised budget is based on the forecast of 1.9% GDP increase (previous forecast was predicted 1.6% increase in GDP in 2013). The Fiscal Council, an independent authority, created in 2010, with the purpose of reviewing the fiscal policy, issued a cautious opinion, noting that the budget remains vulnerable on the revenues side.

### Monetary Policy

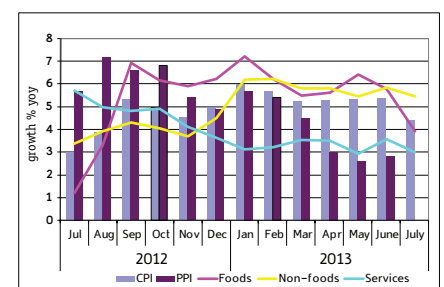
In the first half of the year, inflation was under control in Romania. The CORE2 inflation rate remained on a downward trend from the beginning of 2013. In May 2013, the inflation rate was 2.66% compared to 3.25% observed in December 2012. At the same time, consumer inflation is higher but also declining, reaching 4.4% in July, down from 5.37% in June. The reason for the higher CPI was high growth in food prices, a larger component in the CPI index. Food prices, in turn, grew at a high rate because of a bad harvest last year and high prices of fresh fruits and vegetables in the new harvest. However, this effect is temporary, since this year the harvest should be one of the best ones in recent years. In particular, short-term projections suggest a deceleration in consumer inflation starting in July. Therefore, consumer inflation is expected to slow down by the end of September to a level within the target interval of 2.5±1%.

The above-mentioned inflation projections prompted the NBR to take further actions to stimulate lending while retaining medium-term price stability. In particular, the NBR decided to lower the monetary policy rate to 5.0% starting on July 2nd. This will help ease the monetary policy stance. At the same time, adequate liquidity management in the banking system supported by unchanged levels of the minimum reserve requirement ratios will gradually decrease the costs of national currency lending and will stimulate economic activity. Furthermore, introduced measures will cushion the negative impact of domestic and external factors on the recovery of the country's economy.

In May-June 2013, the NBR had achieved some progress in attenuating the decline in non-government lending. On a month-to-month basis, in June the total volume of loans granted to the private sector by credit institutions grew for the second month in a row. This helped decelerate the decline in the amount of non-government loans from 2.4% yoy to 1.3% yoy. Statistical data shows a gradual reorientation of corporate sector borrowings from foreign currency loans to national currency loans in 2013. The total volume of RON-denominated non-government loans grew by 2.2% yoy in June thanks to a 4.8% yoy increase in corporate loans. At the same time, the total volume of Forex-denominated non-government loans declined by 3.3% yoy because of 5.3% yoy decline in corporate loans. Households, in contrast, continued to curtail their borrowing activities in both national and foreign currency (declines of 1.4% yoy and 1.2% yoy correspondently).

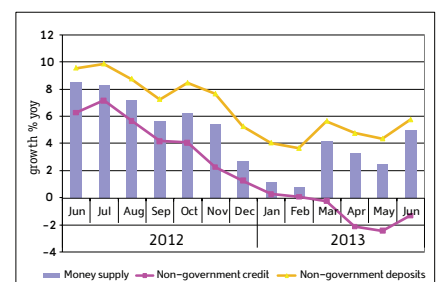
At the end of June, broad money (M3) increased by 5.0% yoy, reaching EUR

Graph of Inflation indexes



Source: INSSE

Graph of Selected monetary indicators



Source: NBR

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51.09 billion. This increase in M3 was attributed to a 95.0% increase in the net foreign assets of the NBR, which overwhelmed a 7.0% yoy decline in the net domestic assets. Over the first half of the year, the exchange rate of the RON posted wide swings caused by higher volatility of investors' risk appetite and persistence of uncertainty surrounding economic activity in Europe and elsewhere. As of the end of May 2013, the RON/EUR exchange rate of the NBR was equal to 4.3794.

### International trade and Capital

In January-May 2013, Romania's foreign trade continued to improve thanks to an expansion of extra-EU trade and despite the slow recovery of the Eurozone. During this period, exports of goods and services grew by 8.22% yoy and imports decreased by 2.05% yoy. As a result, Romania's foreign trade deficit declined by 82% yoy over the period (to EUR 500 million). Significant progress in the foreign trade balance was achieved for both goods and services. In particular, the foreign trade deficit for goods decreased by more than 53% yoy over the reporting period. At the same time, the balance of foreign trade in services turned into a EUR 783 million surplus from the EUR 18 million deficit observed a year ago. The current strong signs of economic revival within the Eurozone point to faster improvements of Romanian foreign trade balance in subsequent months of the year.

The current account balance remained positive at EUR 314 million over the first five months of the year. This was achieved thanks to the above-mentioned progress in foreign trade and a decline of the income account deficit. The income account deficit decreased by 39.2% yoy to EUR 779 million. Even though the surplus in the current transfers balance decreased by 10% yoy over the period, it was large enough to exceed the deficits in foreign trade and the income account. By the end of the year, the current account deficit is not expected to exceed 2.5% of GDP, according to IMF estimates.

However, the strong performance of the Romanian external sector and the stable situation in the country in general were not enough to attract larger amounts of foreign direct investments. In January-May 2013, FDI in Romania grew at a slower pace than over the same period of 2012. Net inflow of FDI totalled EUR 414 million over the reporting period, a 36.9% decrease compared to the same period last year. The vast majority of FDI inflows were attributed to inter-company lending, while just 20% of FDI inflows came from equity stakes and reinvested earnings.

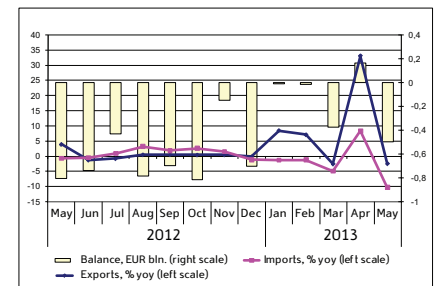
In January-May 2013, Romania had little incentive to borrow on the external financial markets because of solid performance in the real sector and balanced fiscal policy. As a result, medium- and long-term external debt inched up only by 1.0% over the period. At the end of May 2013, it amounted to EUR 79.5 billion or 79.5% of the total external debt of the country. Short-term external debt grew by 1.1% to EUR 20.467 billion over the reporting period.

During June, the foreign exchange reserves of the National Bank of Romania remained almost unchanged. As of June 30th 2013, they stood at EUR 32.3 billion, which is just 1.17% lower than a month ago. The NBR managed to generate EUR 662 million of forex reserve inflows. At the same time, the outflows amounted to EUR 1.046 billion, including EUR 246 million paid to the IMF as the eighth principal installment on the SBA loan. The gold stock of the country remained unchanged in terms of weight. However, its value declined by 15.1% mom because of changes in the international price of gold. Therefore, the total international reserves of Romania inched down by 2.56% mom to EUR 35.381 billion in June.

The government has completed negotiations on a new loan agreement with the International Monetary Fund and the EU. The agreement will involve a "precautionary" loan of EUR 4 billion, with loan conditions related to (i) safeguard of sound public finances, (ii) continue monetary and financial sector policies that preserve buffers and increase the resilience against external shocks, and (iii) reduce bottlenecks to potential growth through structural reforms. It is expected that the agreement will help the country reduce foreign financing costs and support the currency.

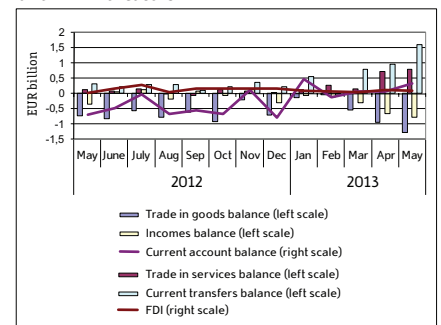
### Other developments affecting the investment climate

Graph of Monthly foreign trade balance indicators



Source: NBR

Graph of Current account components and FDI indicators



Source: NBR, INSSE

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