

August 2014

Valentyn Povrozhnyuk, Radu Mihai Balan, Edilberto L. Segura

- **Industrial output grew by 12.5% yoy in May 2014.**
- **The consolidated budget deficit reached 0.5% of GDP in January-June 2014.**
- **Consumer inflation hit a record low of 0.66% yoy in June 2014.**
- **The foreign trade balance was positive at EUR 10 million in May 2014.**
- **The current account deficit totalled EUR 351 million at the end of May 2014.**

Executive Summary

As the calendar effect observed in April diminished, industrial output returned to high growth. Manufacturing remained the major driver of growth, but increases were also registered in the other subsectors. The trade and services sector also performed better in general in May compared to April. Retail trade observed the second highest growth this year on the back of accelerated growth in the non-food goods segment. Automotive sales posted the highest growth this year thanks to a government program of car fleet renewal. Services to the population posted decent performance, even though the growth rate of the sector was a bit lower in May compared to April.

The general consolidated budget deficit significantly increased in June. It reached 0.5% of GDP over January-June compared to 0.24% in January-May. However, this is still a significant improvement over the same period of 2013, when the deficit was above 1% of GDP. Thanks to increases in receipts from all major taxes, the government managed to ensure a decent 2.9% yoy growth of the general consolidated budget revenues, while expenditures continued to decline in year-over-year terms, although at decelerated rate.

Consumer inflation was still below the forecasted level in June. Moreover, it reached another record low of 0.66% yoy on the back of deflation in the food goods sector and significant deceleration of growth in prices of services. Prices of non-food goods grew at a rate slightly below that observed in May.

Having low inflation and continued deleveraging of the banking sector, the NBR decided to lower its policy rate to 3.25% from August 5th. This is to further stimulate national currency lending in order to offset the decline in non-government forex-denominated loans. The stimulation policy helped to increase the volume of non-government national currency loans by 7.3% yoy, but this was still not enough to overcome the decline in non-government forex-denominated loans.

Foreign trade posted better performance in May compared to that in April. Growth of exports exceeded 10% yoy and was higher than that of imports. Foreign trade in services posted much better performance than trade in goods and ensured a positive foreign trade balance for the month. At the same time, growth of exports of goods accelerated to 7.95% yoy, but was still slightly lower than growth in imports of goods. The overall foreign trade developments did not help much to improve the situation with the current account deficit. Developments of the income account balance and current transfers balance had a high magnitude and were both negative for the current account. In particular, the income account deficit significantly increased in year-over-year terms in May, while the current transfers surplus decreased. As a result, the current account balance was negative both in May and over the first five months of the year.

Main Macroeconomic Indicators	2009	2010	2011	2012	2013	2014
GDP growth, % yoy	-6.6	-1.6	2.5	0.2	3.5	2.4
GDP per capita, USD	7,649	7,667	8,863	8,030	8,080	8,100
Industrial production, % yoy	-5.5	5.5	5.6	0.0	7.0	5.0
Retail sales, % yoy	-10.3	-5.3	-2.5	2.9	0.5	2.0
Budget balance in cash methodology, % GDP	-7.3	-6.4	-4.3	-2.5	-2.5	-2.4
Government external debt, % GDP	23.6	30.5	34.7	37.8	38.0	38.5
Inflation, eop	4.7	8.0	3.1	5.0	3.1	3.2
Gross international reserves, EUR billion	30.9	36.0	37.3	36.4	37.0	37.0
Current account balance, % GDP	-4.2	-4.4	-4.5	-4.0	-1.0	-1.5
Gross external debt, % GDP	68.7	74.4	75.2	75.1	75.0	75.0
Unemployment (ILO methodology), % eop	6.9	7.3	7.4	7.2	7.3	7.0
Exchange rate RON/EUR, annual average	4.24	4.21	4.24	4.45	4.5	4.5

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Economic Growth

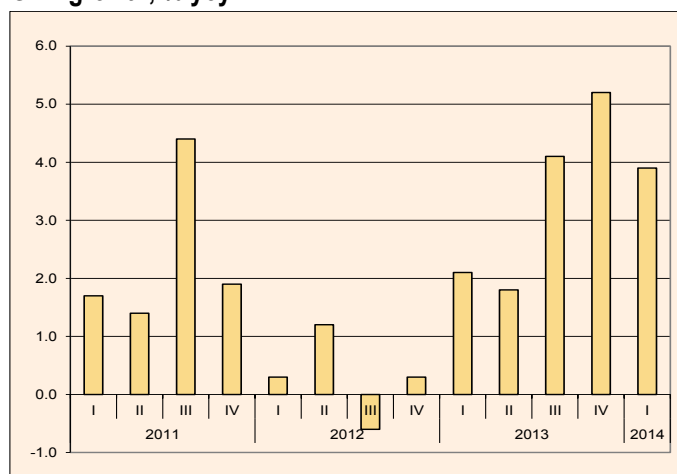
The improved performance of industry confirmed the large impact of the calendar effect on the sector observed in April. Growth of total industrial output jumped to 12.5% yoy in May. The growth was significantly higher than the 2.6% yoy observed in April and even slightly higher than growth recorded in the first three months of 2014. All the industrial subsectors registered increases and the highest one was observed in manufacturing (14.1% yoy). Most of the manufacturing subsectors significantly improved their performance in year-over-year terms compared to the previous month. However, both chemicals and metallurgy reported even sharper annual declines because of contraction in the activities of important operators. In terms of growth, the best manufacturing performers of the month were producers of computer, electronic and optical products (100.5% yoy increase), paper and paper products (37.9% yoy increase) and other transport equipment (23.2% yoy increase). The most significant decline was registered by producers of basic metals (19.3% yoy) and by producers of beverages (17.0% yoy). Improved performance of industry in May helped accelerate growth of industrial output from the beginning of the year to 8.7% yoy.

The trade and services sector generally performed better in May compared to April. In particular, retail trade grew at 9.2% yoy, the second highest growth this year. This increase was achieved thanks to growth in all of the retail trade components. Non-food goods sales ensured the highest growth of 15.9% yoy, which is almost 2.5 times more than growth of food goods sales and ten times more than growth of fuel sales. On the other hand, sales of fuel were influenced by a hike in the excise tax; therefore, there was no expectation of their fast growth. As for automotive sales, they posted the highest growth this year at 6.2% yoy thanks to resumption of the car fleet renewal program in April. Provision of services to the population was the only subsector growing slower in May compared to April. However, May's growth still remained quite high at 5.5% yoy. On the positive side, growth in the hotels and restaurants component accelerated further to 12.6% yoy; however, this was offset to some extent by a decline in gambling and other recreational activities by 5.4% yoy and the discontinued uptrend in the receipts of tourism operators.

Fiscal Policy

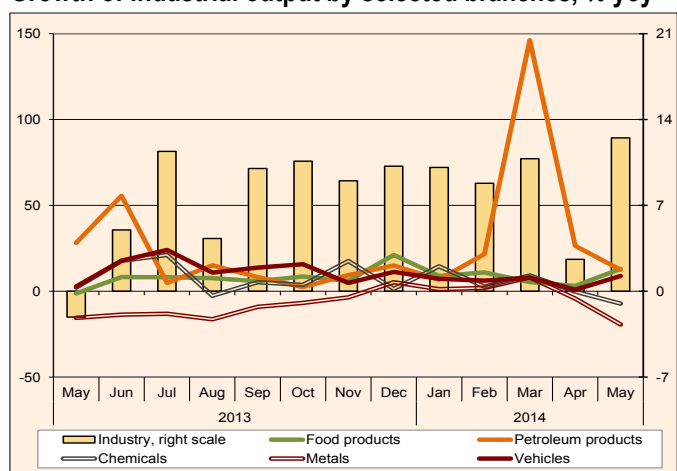
Despite some increase in the consolidated general budget in June 2014, fiscal consolidation helped significantly lower the deficit over the first half of the year. The deficit reached RON 3.5 billion (EUR 791.16 million) or 0.5% of GDP, compared to 1.05% of GDP in January-June 2013. This proves the government is still keen to meet the fiscal consolidation and integration parameters established by Romania's international financial partners (EC, IMF, and the World Bank). At the same time, the primary balance slightly decreased to 0.4% by the end of June. However, it still remained significantly higher than that observed over the same period of time last year (0.05%).

GDP growth, % yoy



Source: INSSE, The Bleyzer Foundation

Growth of industrial output by selected branches, % yoy



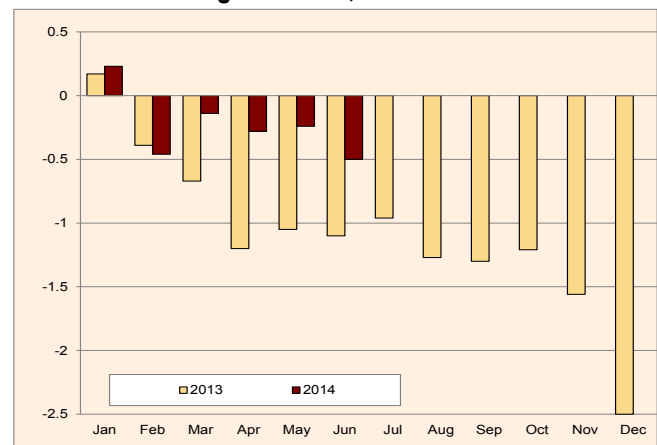
Source: INSSE, The Bleyzer Foundation

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Growth of general consolidated budget revenues continued to decelerate in June. The total first half of 2014 general consolidated budget revenues amounted to RON 100.4 billion (EUR 22.69 billion) or 15.2% of GDP. This is a 2.9% yoy increase, while the January-May growth was equal to 3.7% yoy. In June 2014, the highest growth was observed for social security contributions, which grew by RON 456.9 million over the amount collected in June 2013. Proceeds from the excise tax and the VAT also registered high growth in June 2014, by RON 272 million (EUR 61.48 million) and RON 182.3 million (EUR 42.21 million) over the amounts collected in June 2013 respectively. At the local level, local authorities managed to hold growth rates of proceeds from property taxes and non-tax revenues in June at almost the same level as that observed in January-May. However, proceeds from the use tax on goods significantly declined in June. As a result, in January-June 2014, growth of local government use tax on goods revenues amounted to 3.6% yoy, which is 1.0% lower than in January-May. Overall growth of property tax and non-tax revenues remained almost unchanged at 5.2% yoy and 2.2% yoy respectively. Amounts reimbursed by the EU decreased by 10.8% yoy over January-June compared to the 16% yoy decline in January-May.

Consolidated budget balance, % of GDP



Source: Ministry of Public Finance of Romania

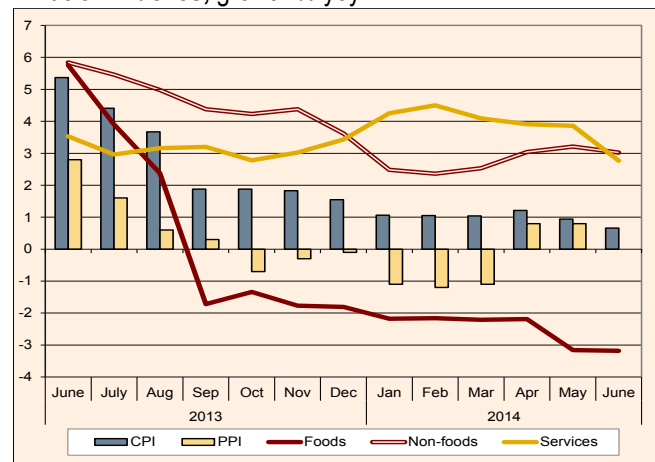
Accelerated growth in some major general government expenditure items in June led to the deceleration of the decline in overall general government expenditures over the first half of the year. Total general consolidated budget expenditures decreased by 0.3% yoy to RON 103.9 billion (EUR 23.49 billion), while the decline was 2.3% yoy in January-May 2014. In terms of GDP share, total expenditures declined by 0.9% to 15.72%. Growth of the wage bill accelerated to 3.4% yoy in January-June compared to 2.3% yoy in January-May. Expenditure on goods and services grew at an accelerated rate in June, leading to an increase in total 6-month growth to 5.7% yoy from 4.6% observed in January-May 2014. The major driver of the increase was an 11.3% yoy increase in expenditures on goods and services of the National Health Insurance Fund due to payment of arrears to providers of medications. At the same time, a decline in the interest payment expenditures decelerated to just 1% yoy from 6.4% yoy observed over the first five months of the year. The Ministry of Public Finance also reported a decline in provided subsidies by 4.7% yoy in the first half of 2014. Investment expenditures of the general government declined by 21.21% yoy to USD 9.6 billion (1.5% of GDP).

Monetary Policy

Consumer inflation remained on the downward trend in June. It declined by 0.28% compared to May to 0.66% yoy. As deflation of the food goods sector remained almost unchanged at 3.18% yoy, the slowdown in the inflation rate of the services sector became the major driver of total inflation deceleration. Prices of services grew by 2.77% yoy in June, which is 1.09% lower compared to May. The inflation rate of the non-food goods sector also decelerated a bit but deceleration was not that significant (from 3.21% yoy in May to 3.02% yoy in June). In 2014, the total half-year consumer inflation rate of 1.17% was almost two times lower compared to that in 2013 (2.07%).

The continued slowdown of inflation below forecasted levels induced the NBR to adjust its monetary policy. As inflation is running below the lower bound of the

Inflation indexes, growth % yoy



Source: INSSE, The Bleyzer Foundation

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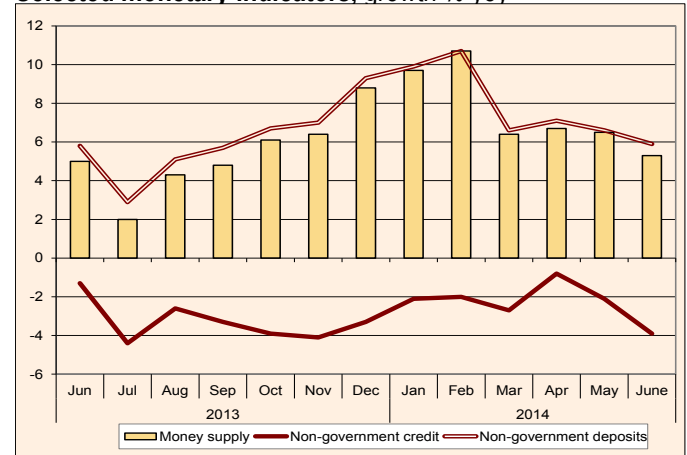
variation band of the flat target and economic activity continues to improve (fueled mainly by external demand growth and gradually rebounding domestic demand) amid a further narrow current account deficit, the NBR decided to lower its policy rate to 3.25% on August 5th. One of the reasons for this was the desire to further stimulate recovery of national currency lending, which posted some significant progress over the last couple of months. National currency-denominated non-government loans posted their highest growth over the last five years at a 7.3% yoy increase in June. Both household and corporate loans grew at a decent rate. However, the mentioned growth rate was not enough to compensate for a 10.7% yoy drop in forex-denominated non-government loans. Since the total volume of RON-denominated non-government loans is still significantly lower than that of forex-denominated non-government loans (by around one third), dynamics of the latter has had a more significant impact on the dynamics of total non-government loans. Therefore, total non-government loans decreased by 3.9% yoy in June. This continued deleveraging of the banking system forced the NBR to prolong its policy of national currency lending stimulation.

Despite negative monthly dynamics, broad money (M3) grew at a decent rate in year-over-year terms in June 2014. 2.3% mom growth in net foreign assets was not enough to overcome the 1.8% mom decline in net domestic assets. Therefore, broad money inched down by 0.4% mom. However, monthly growth of net foreign assets accelerated its year-over-year growth to 64.7% from 48.3% observed in May. As a result, growth in net foreign assets compensated for a 11.3% yoy decline in net domestic assets (also accelerated) and ensured 5.3% yoy overall growth in broad money to RON 239.792 billion.

International Trade and Capital

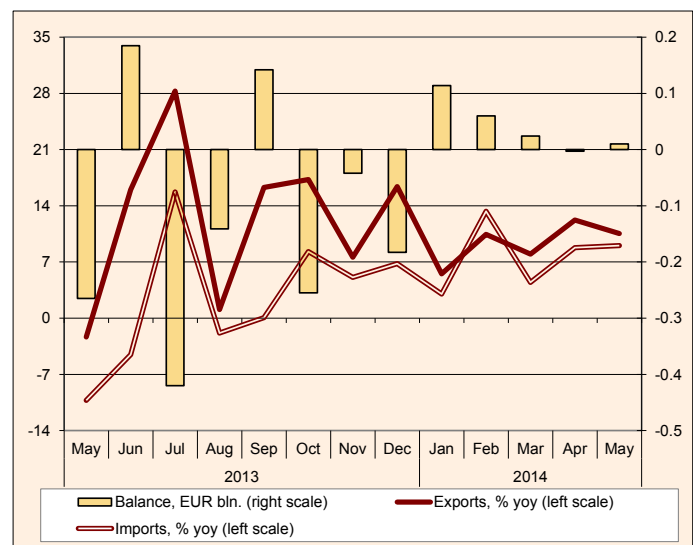
The overall performance of foreign trade improved in May on the back of trade in services. Both exports and imports of goods grew at accelerated rates. Moreover, just as in April, growth of imports of goods exceeded that of exports of goods (8.12% yoy versus 7.95% yoy). Exports of goods grew solely to intra-EU sales. The major drivers of growth were the same, namely, the machinery and transport equipment category and the miscellaneous manufactured articles category. Higher imports compared to exports of goods led to a 10.23% yoy increase in the balance of foreign trade in goods in FOB-FOB terms in May. The deficit totalled EUR 334 million. Unlike the foreign trade in goods, trade in services experienced deceleration of growth for both exports and imports. However, imports of services decelerated more, leading to an increase in surplus of foreign trade in services. In particular, exports of services grew by 22.81% yoy compared to 15.64% yoy of growth in imports. As a result, surplus of foreign trade in services expanded by

Selected monetary indicators, growth % yoy



Source: NBR

Monthly foreign trade balance



Source: NBR

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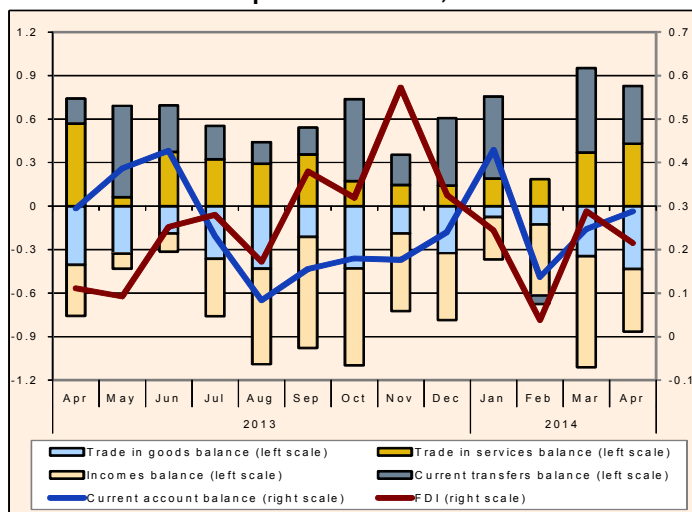
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40.41% yoy to EUR 344 million in May. Thanks to trade in services, total exports grew by 10.54% yoy, while total imports increased by 9.03% yoy. The total balance of foreign trade happened to be positive at EUR 10 million that month, compared to a negative balance of EUR 58 million a year ago.

After a couple of months of improvement, the current account balance turned for the worse in May. The good performance of foreign trade did not alleviate the negative impacts of the current transfers and income accounts. As outflows from income account continued to grow faster than inflows, the deficit of the income account continued to increase. In May, the income account deficit totalled EUR 305 million, which is a 68.5% yoy increase. Inflows of current transfers dropped 47.3% yoy in May, while outflows grew by 2.7% yoy. Therefore, the current transfers surplus declined by 63.9% yoy to EUR 242 million. Overall, the current account balance was negative at EUR 53 million in May, expanding the total deficit from the beginning of the year to EUR 351 million, compared to a EUR 191 million surplus in January-May 2013.

Current account components and FDI, EUR billion



Source: NBR, INSSE

Net FDI inflows into Romania accelerated in May, which also led to higher annual growth of FDI. The country received EUR 306 million in net FDI during the month, increasing the total net FDI inflow from the beginning of the year to EUR 1,091 million. This is a 13.9% increase over the amount of FDI received in January-May 2013. The share of the equity stakes decreased to 83.4% compared to 89.8% in April.

Thanks to declines in both its components, external debt decreased slightly in May. Short-term external debt with its 1.98% mom decline was the major driver of the decrease, as medium and long-term external debt inched down insignificantly. In particular, a decrease in IMF borrowings was almost fully offset by increases in direct public debt, medium and long-term deposits of non-residents, and non-publicly guaranteed debt. Therefore, total external debt inched down by a mere 0.45% mom in May to EUR 94.064 billion. Due to the above mentioned developments, the share of short-term external debt declined to 19.1% from 19.4% observed at the end of April.

International reserves of the National Bank of Romania grew despite substantial state and guaranteed debt payment in June. Foreign exchange reserves grew by 1.8% mom to EUR 31.236 billion. Reserve inflows totaled EUR 1,372 million, representing mainly changes in the foreign exchange reserve requirements of the credit institutions, inflows into the European Commission's account, and inflows into accounts of the Ministry of Public Finances of Romania. At the same time, reserve outflows amounted to EUR 817 million, representing mostly interest and principal payments on foreign currency public debt and changes in the foreign exchange reserve requirements of the credit institutions. Total interest and principal payments on foreign currency public debt were equal to around EUR 667 million, EUR 352 million of which were payments to the IMF (EUR 230 million on the side of the NBR and the rest on the side of the Ministry of Public Finance of Romania). Growth of the international prices of gold helped build up Romanian gold stock in terms of its value (as its weight remained unchanged at 103.7 tonnes). In particular, the total value of Romanian gold stock grew by 4.4% mom to EUR 3.206 billion. Therefore, total international reserves of Romania reached EUR 34.442 billion as of June 30th, 2014, which is a 2.0% mom increase.

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