September 2014 Valentyn Povroznyuk, Radu Mihai Balan, Edilberto L. Segura

- **GDP grew by 1.2% yoy in Q2 2014.**
- **Industrial output growth was equal to 10.4% yoy in June 2014.**
- **The consolidated budget deficit narrowed to 0.2% of GDP in January-July 2014.**
- **Consumer inflation slightly accelerated to 0.95% yoy in July 2014.**
- **The foreign trade balance decreased to just EUR 12 million in June 2014.**
- **The current account deficit expanded to EUR 878 million by the end of June 2014.**

Executive Summary

Central statistics authority of Romania reported a significant deceleration in GDP growth in Q2 2014. Preliminary data showed that GDP increased by 1.2% yoy in Q2 compared to a 3.9% yoy increase registered in Q1. Romania has entered a technical recession with a 1.0% qoq decline in Q2 2014 which followed the 0.2% qoq decline in Q1 2014. A main cause of the recession was cut in investments in H1-2014 on the side of the government at the background of lower than planned budget revenues.

Negative developments in mining and energy slowed growth in industrial production in June. Growth of manufacturing slightly decelerated due to problems in some sectors, but still ensured that total industrial output was in double digits. Good performance in a majority of manufacturing industries compensated for the major setback in the performance of coke and refined petroleum production. At the same time, the trade and services sector accelerated its growth to 9% yoy on the back of the trade component. All the trade sub-components posted high pace growth except for fuel sales. Growth of services to households decreased six times due to declines in all the sub-components, except hotels and restaurants.

The general consolidated budget deficit decreased to just 0.2% in July. Thanks to minor improvements in collection of receipts, the government accelerated growth of general consolidated budget revenues by more than 1 percentage point, while growth dynamics of general government expenditures remained negative and almost intact because of deep cuts in investment expenditures. This helped decrease the budget deficit to one of the lowest half-year values in years. The registered H1 general consolidated budget deficit is five times lower than that over the same period of 2013.

Consumer prices grew at a slightly higher rate in July compared to June. At the same time, the CPI still remained below 1%. Slightly slower deflation of food goods prices was supported by deceleration of growth in non-food goods prices, while the rate of growth in prices of services was insignificantly higher than that observed in June.

Progress in national currency lending continued to gain momentum in July. Growth in volume of national currency non-government loans accelerated for the second month in a row on the back of improvements in both household and corporate loans. However, the progress was still not enough to overcome the decline in forex-denominated non-government loans, which remained at high rates. Therefore, deleveraging of the banking sector continued in July, though at a decelerated pace.

Good performance of foreign trade in services helped improve dynamics of total foreign trade in June. Double-digit growth in exports of services combined with an almost double-digit decline in imports ensured a high surplus of foreign trade in services, which almost fully compensated for the deficit of foreign trade in goods. The latter increased compared to June 2013 because growth of imports was almost twice as high as that of exports. Good performance of foreign trade was overshadowed by negative developments in the income account balance and current transfers, which led to a significant increase in the current account balance. Income account inflows significantly declined, while outflows significantly increased in year-over-year terms in June 2014. Current transfers also registered a significant decline in inflows, but outflows remained almost unchanged. Due to the mentioned developments, the current account deficit grew almost seven times year-over-year in June.

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

Chief Economist Edilberto L. Segura
Editor Rina Bleyzer O'Malley

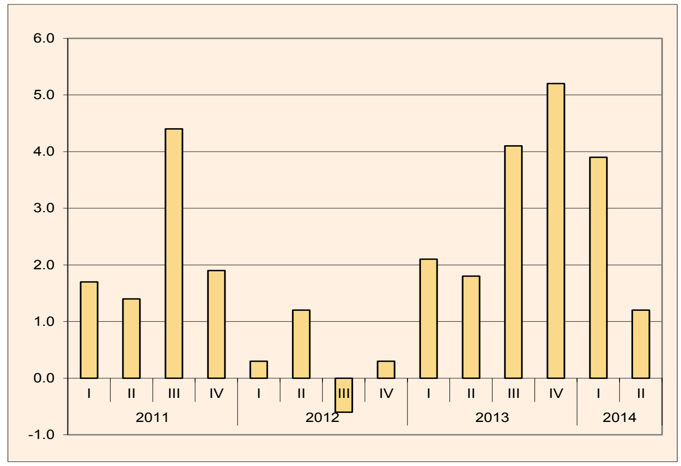
September 2014 Valentyn Povroznyuk, Radu Mihai Balan, Edilberto L. Segura

Economic Growth

Growth of GDP significantly decelerated in Q2 2014. According to preliminary data, Romania's GDP amounted to RON 152.969 billion (EUR 34.5 billion) in Q2 2014, which is a 1.2% yoy increase in real terms, a 2.7 percentage point decline compared to growth in Q1. As a result, the H1 2014 GDP growth was equal to 2.4% yoy. With respect to seasonally adjusted quarterly data, GDP growth declined for the second quarter in a row in Q2 (1.0% qoq decline after a 0.2% qoq decline in Q1). This indicates that economy of the country is in technical recession.

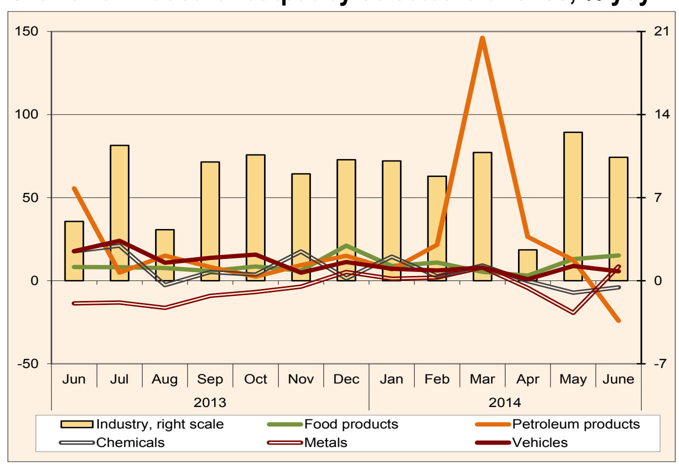
Industry made the largest contribution to GDP yoy growth of 0.7%. At the same time, trade made the largest negative contribution to GDP yoy growth (-0.5%), followed by agriculture and construction (-0.3% each). These results were closely tied to development dynamics of the sectors with adjustment to their shares in GDP. In particular, industry grew by 2.1% yoy in Q2 2014, while trade contracted by 4.3% yoy, agriculture declined by 7.6% yoy, and construction dropped 5.2% yoy. The contribution of net taxes on products was equal to 0.9% yoy in Q2 2014. On the side of GDP use, the highest contribution was made by total final consumption (3.0% yoy), which was fully offset by the negative contribution of gross fixed capital formation (-3.0% yoy). The contribution of net exports amounted to 0.9% yoy. Considering gross fixed capital formation, its 12.8% yoy decline in Q2 is a direct result of cuts in investment expenditures made by the government for the sake of budget consolidation.

GDP growth, % yoy



Source: INSSE, The Bleyzer Foundation

Growth of industrial output by selected branches, % yoy



Source: INSSE, The Bleyzer Foundation

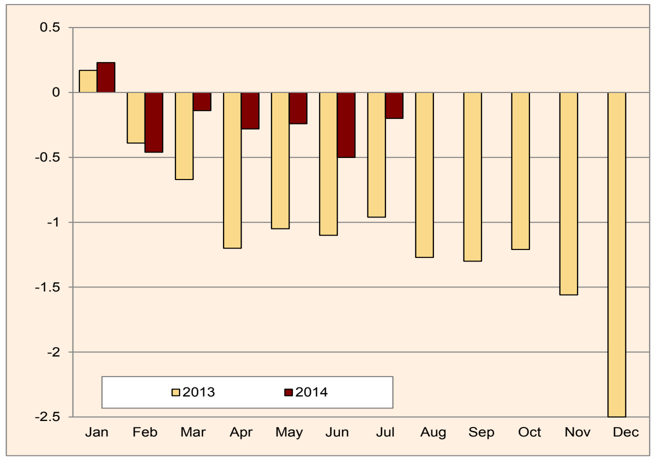
Industrial output growth remained high despite some deceleration in June. Because of slower growth in manufacturing and declines in two other main industrial sectors, growth of industrial production decelerated from 12.5% yoy observed in May to 10.4% yoy. A 1.2 pp deceleration in growth of manufacturing to 12.9% yoy was largely the result of a 24.1% yoy decline in manufacturing of coke and refined petroleum products. Performance of the sub-sector suffered from closing of the Petrobrazi refinery due to overhaul. In addition, production of transport means saw less favourable developments as Ford decided to temporarily halt production. However, the majority of manufacturing sub-sectors posted good performance with positive growth rates. In particular, metallurgy recorded much faster dynamics in June compared to May. The growth rate increased by 27.9 percentage points to 8.6% yoy as several productive capacities resumed operation after the overhaul. As for mining and quarrying, it declined by 10.8% yoy due to declines in all its sub-sectors except for coal mining. A 61.2% yoy increase in coal mining was not enough to compensate for declines in other sub-sectors, which varied from 1.3% yoy in extraction of crude petroleum and natural gas to 33.5% yoy in mining support service activities. The energy sector saw a decline of 6.0% yoy thanks mainly to good weather conditions.

Dynamics of trade and services volume picked up again to about 9% yoy in June. The increase is a result of swifter growth of the trade component thanks to better performance of food goods sales and automotive sales. Sales of food goods grew by 11.7% yoy, which is a new post-crisis peak. Automotive sales increased by 9.1% yoy on the back of a 16.4% yoy growth in sales of motor vehicles (mostly thanks to sales of new units). Sales of non-food goods also posted good performance, increasing by 14.0% yoy on the back of an increase in sales of household appliances and furniture, pharmaceuticals and cosmetics, apparel and footwear in both traditional commercial networks and online shops. Despite the high pace of increase in sales of motor vehicles, sales of fuel in specialized shops grew by just 2.1% yoy. One of the reasons may be the recent hike in excise tax on fuel. As for market services to households, their volume increased in June but at a significantly decelerated rate compared to May. Total growth of the component was equal to just 0.9% yoy (5.5% yoy in May) as hotels and restaurants was the only sub-component posting an increase. Furthermore, growth in hotels and restaurants decelerated by almost 5 percentage points to 7.7% yoy.

Fiscal Policy

The government saw some minor improvements in collection of the general consolidated budget revenues. Even though revenue collection was still below the plan (4.3% yoy lower in H1 2014 due to underperformance in the VAT, excises, social security contributions, and profit and income taxes which together account for 75% of the consolidated budget revenues), the mentioned improvements helped significantly decrease the budget deficit in January-July 2014. As of July 31st, the general consolidated budget deficit amounted to RON 1.01 billion (EUR 227 million) or just 0.2% of GDP. In terms of the GDP share, the deficit decreased five times from 1.0% of GDP observed over the same period last year. At the same time, the primary surplus was equal to 0.96% of GDP at the end of July 2014 compared to 0.25% of GDP a year ago.

Consolidated budget balance, % of GDP



Source: Ministry of Public Finance of Romania

Higher receipts of general government revenues in July helped accelerate growth of revenues over the first seven months of the year. The general consolidated budget revenues grew by 4.1% yoy to RON 120.9 billion (EUR 27.4 billion) in January-July 2014. As a share of GDP, the revenues reached 18.3%. Growth was observed for all the tax and non-tax revenues except for use tax on goods and amounts reimbursed by the EU in January-July. The former dropped 80% yoy due to base effect, as RON 2 billion (EUR 452.8 million) was collected as license fees for use of radio frequencies in 2013. The latter also decreased, but at a much lower rate of 10.4% yoy. As for other receipts at the central level, the government collected RON 1.77 billion (EUR 397.3 million) more of social security contributions, RON 1.273 billion (EUR 285.8 million) more of excise taxes, RON 990.5 million (EUR 224.3 million) more of property taxes, RON 864.5 million (EUR 194.0 million) more of profit taxes, and RON 643.5 million (EUR 144.4 million) more of VAT. Local authorities managed to collect 5.3% yoy more of use taxes on goods, 3.5% yoy more of property taxes, and 2.0% yoy more of non-tax revenues in January-July.

Growth of general government expenditures remained negative at 0.2% yoy in January-July. Total expenditures were equal to RON 121.9 billion (EUR 27.6 billion) or 18.5% of GDP, which is 1.0% lower than the share of GDP over the same period of the previous year. The wage bill grew by 3.3% yoy in January-July, which is almost the same as observed over H1 2014. This number was slightly above of the planned levels because of upcoming presidential elections. At the same time, dynamics of expenditures on goods and services changed again in July 2014. As a result, after one month of acceleration, growth of these expenditures decelerated to 4.0% yoy over the first seven months of the year. As before, payment of arrears to suppliers of drugs remained the major driver of the growth. Decline in interest payment expenditures accelerated to 3.1% yoy in January-July, which is still below the 6.4% yoy observed in January-May. At the same time, the decline of subsidies provided by the government remained unchanged at 4.7% over the reporting period. Capital expenditures declined by 29% yoy over the January-July 2014 period to RON 2.4 billion (EUR 544.9 million), while expenses on projects financed from non-refundable external funds declined by 14% yoy to the equivalent of RON 907 million (EUR 203.7 million).

Headquarters
**123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com**

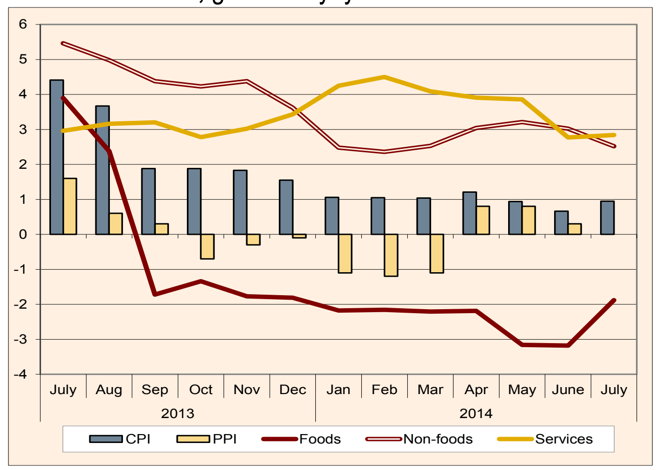
**Bucharest Office, Romania
12Bis, Dr.Draghiescu St., Sect. 5,
Bucharest, 050579
Tel: +40 (21) 4101000
Fax: +40(21)4102222
Email: Bucharest.office@sigmableyzer.com**

September 2014 Valentyn Povroznyuk, Radu Mihai Balan, Edilberto L. Segura

Monetary Policy

Consumer inflation accelerated slightly in July but remained close to record lows. Consumer prices grew by 0.95% yoy compared to 0.66% yoy in June. The major reason for this was deceleration in food goods deflation from over 3% yoy to 1.88% yoy due to lower seasonal decreases in prices of vegetables and fruit compared to 2013. The reason was lower domestic production due to higher precipitation. Prices of services grew by 2.84% yoy in July, which is a bit faster than a month ago. On the other hand, inflation in non-food goods inched down by 0.5 percentage points to 2.52% yoy.

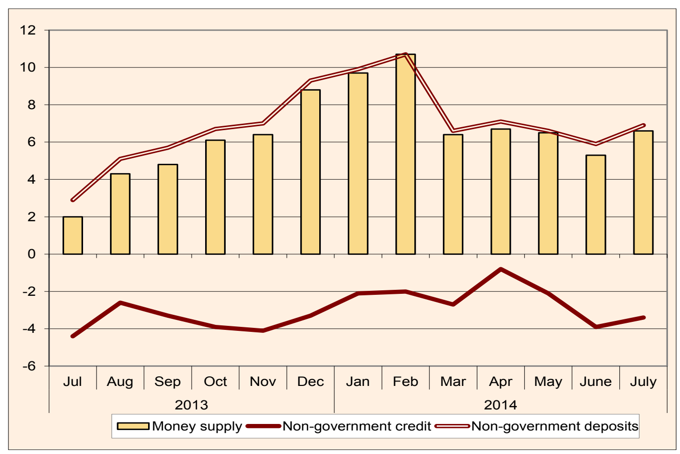
Inflation indexes, growth % yoy



Source: INSSE, The Bleyzer Foundation

The NBR was quite successful in slowing down banking sector deleveraging in July. In particular, national currency lending continued to gain momentum, being stimulated by the NBR through a number of instruments. Total national currency non-government lending growth accelerated to 8.6% yoy from 7.3% yoy observed in June. Household loans still grew faster than corporate loans (10.5% yoy versus 7.3% yoy). At the same time, the decline in forex-denominated non-government loans remained almost unchanged at 10.8% yoy in July, as a faster decline in the household sector compensated for a deceleration in the decline in the corporate sector. Because of these developments, the total volume of non-government loans continued to decline over the reporting period. However, the pace of decline decelerated to 3.4% yoy from 3.9% yoy registered in June.

Selected monetary indicators, growth % yoy



Source: NBR

In July, broad money (M3) growth accelerated on the back of both the continued high pace of growth in net foreign assets and deceleration in the decline of net domestic assets. In particular, net foreign assets increased by 49.5% yoy, which is lower than that observed in June (64.7% yoy). On the other hand, the decline in net domestic assets decelerated by 3.4 percentage points to 7.9% yoy. Overall, these developments caused acceleration of growth in total broad money from 5.3% yoy observed in June to 6.6% yoy.

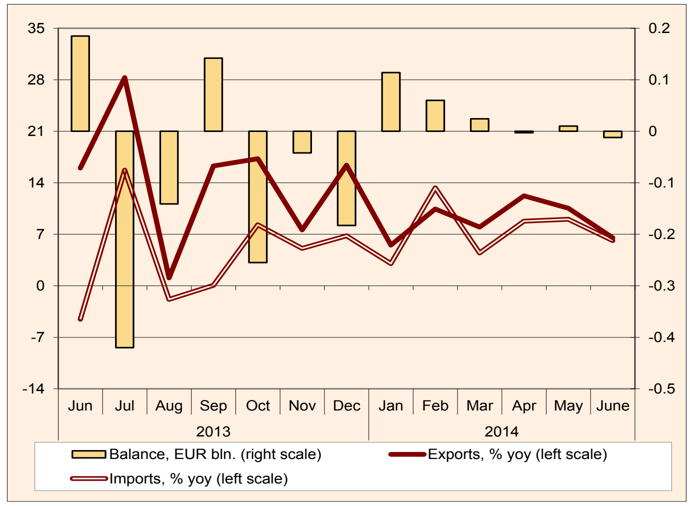
International Trade and Capital

In June 2014, foreign trade performance improved over the same period of time last year. However, looking by sector, the situation is not so simple. Performance of foreign trade in goods significantly worsened. FOB Exports of goods grew by 5.54% yoy on the back of solely intra-EU sales, similar to the previous month. Negative developments in a number of manufacturing industries, such as hydrocarbon processing, light industry, woodworking and a number of others, led to deceleration of manufacturing exports growth to single digits for the first time in the past 13 months. At the same time, the negative trends in chemicals and pharmaceuticals have alleviated, while metallurgy saw an increase in export turnover. The fact that growth of June exports fell below the average of 8.1% yoy observed through January-May, while growth of imports (FOB) accelerated to 9.22% yoy, led to an increase in the deficit of foreign trade in goods by 88.71% yoy to EUR 351 million. The foreign trade in services picture significantly differs from that in trade with goods. Exports of services (FOR) grew by 10.59% yoy, while imports (FOB) dropped 9.68% yoy. The balance of foreign trade in services was more than twice as high as that in the same period last year at EUR 339 million and covered almost all the deficit of the foreign trade in goods. As a result, the total foreign trade deficit was equal to just EUR 12 million. On the positive side, the January-June balance of foreign trade is positive at EUR 193 million compared to a deficit of EUR 215 million in January-June 2013.

The current account balance sustained further negative developments in June, due to continued worsening of the income account balance amplified by negative developments with current transfers. Inflows to the income account declined by almost 45% yoy in contrast to a 37.5% yoy increase in income account outflows. This caused a 67.4% yoy growth in the income account deficit to EUR 688 million. As for current transfers, inflows dropped 34.26% compared to the same month last year, while outflows remained almost unchanged. As a result of these developments, the surplus of current transfers decreased by 53.5% yoy to EUR 173 million and covered just a small portion of the income account deficit. Taking into account the foreign trade deficit, the total current account deficit reached EUR 527 million in June, which is almost seven times higher than in June 2013. From the beginning of the year, the current account deficit amounted to EUR 878 million compared to a surplus of EUR 123 million over the same period of time last year.

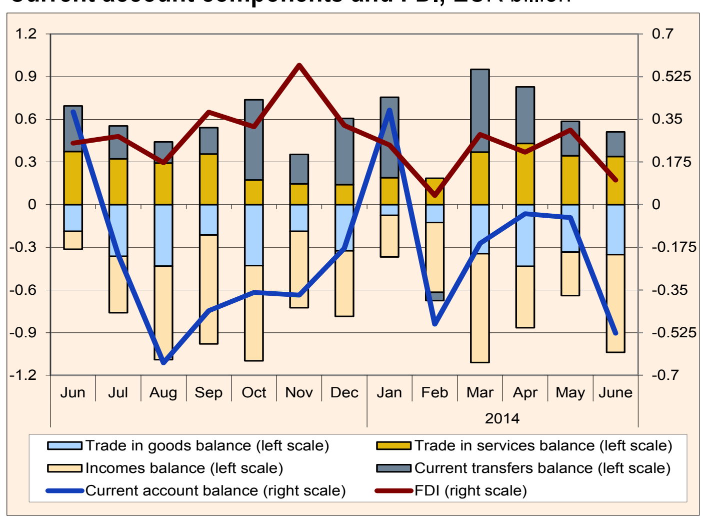
Net FDI inflows into Romania significantly decelerated in June. The country received just EUR 101 million in net FDI over the period, which is below one third of the amount received in May. This led to deceleration of annual net FDI growth. The total amount of net FDI reached EUR 1.192 billion from the beginning of the year, which is a 10.3% yoy drop. At the same time, the share of equity within the FDI increased to 94.5% and surpassed the value observed in April (89.8%).

Monthly foreign trade balance



Source: NBR

Current account components and FDI, EUR billion



Source: NBR, INSSE

Romania's external debt saw a decline in all of its components in June. In particular, a 1.07% mom decline in medium- and long term external debt, accompanied by a 1.63% mom decline in short-term external debt, led to a 1.18% mom decline in the total external debt of the country. The decline in medium- and long-term external debt was also driven by declines in all components. The most significant decline was registered in IMF borrowings (by 17.3% mom for the direct public debt subcomponent and by 8.6% mom for the separate medium- and long-term external debt component). Despite the fact that short-term external debt decreased at a faster pace, its share remained virtually unchanged at 19.0%. As of June 31st, the total external debt of Romania stood at EUR 92.958 billion, which is a 3.22% decline from the beginning of the year.

International reserves of the National Bank of Romania declined in July 2014. They dropped 1.05% mom to EUR 30.908 billion. The NBR reported EUR 746 million of reserve inflows during the reporting period. Those inflows mainly represented changes in the foreign exchange reserve requirements of the credit institutions and inflows into accounts of the Ministry of Public Finance. The reserve outflows totaled EUR 1.074 billion over the period and represented a cut in the minimum reserve requirement ratio on forex-denominated liabilities of credit institutions from

18% to 16% starting with the July 24-August 23 maintenance period, which was introduced by the NBR decision. The outflows also represented changes in the foreign exchange reserve requirements of the credit institutions, interest and principal payments on foreign currency public debt, and payments from the account of the European Commission. The gold stock of the country further inched up in terms of value (its weight remained unchanged) by 0.56% mom thanks to increasing international prices of gold to EUR 3.224 billion. As a result, Romania's international reserves stood at EUR 34.132 billion as of July 31st, which is a 0.9% mom decline.

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Bucharest Office, Romania
12Bis, Dr.Draghiescu St., Sect. 5,
Bucharest, 050579
Tel: +40 (21) 4101000
Fax: +40(21)4102222
Email: Bucharest.office@sigmableyzer.com

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Bucharest Office, Romania
12Bis, Dr.Draghiescu St., Sect. 5,
Bucharest, 050579
Tel: +40 (21) 4101000
Fax: +40(21)4102222
Email: Bucharest.office@sigmableyzer.com