January 2015 Valentyn Povroznyuk, Radu Mihai Balan, Edilberto L. Segura

- **Industrial output decelerated to 3.7% yoy in October 2014.**
- **The consolidated budget was almost balanced in January-November 2014.**
- **Consumer inflation decelerated to 1.26% yoy in November 2014.**
- **The balance of foreign trade in goods totalled EUR 568 million in October 2014.**
- **The current account deficit decreased by 61% yoy in January-October 2014.**

Executive Summary

Return to growth of mining and quarrying was not enough to compensate for decelerated growth in manufacturing and a faster decline in the energy sector in October 2014. Therefore, total industrial output slowed in its expansion after one month of fast growth in September. Major manufacturing sub-sectors observed slowdowns in their expansion, which conditioned development of the sector as a whole. The trade and services sector also posted growth at a decelerated rate in October. However, slowdown of the sector was not that significant and the resulting growth was close to that of industrial output. Observed deceleration in growth was caused by slower expansion of the trade component, while services to households showed some improvements in their dynamics even though their growth remained in negative territory.

The government was successful in controlling its expenditures in January-November 2014 despite the presidential campaign. The consolidated general national budget was almost balanced. General government revenues continued to expand at a rate higher than that of expenditures thanks to growth of all the major tax receipts. Growth of expenditures was ensured by growth of the wage bill and by November's faster growth of investment expenditures and expenditures on projects financed from external funds.

Consumer inflation decelerated again in November due to stable food goods prices and deceleration in non-food goods prices. Prices of food goods have been more or less stable for three months in a row. Services prices did not change much over the reporting months.

Improvement of national currency non-government lending continued in November. This helped decelerate the decline in non-government lending in general. Positive developments were also observed for forex-denominated private sector loans, which slightly decelerated in decline. However, deceleration in decline of forex-denominated loans and accelerated growth of RON-denominated loans were not significant enough to ensure growth of total non-government loans.

Foreign trade data showed deceleration in development in October 2014. Both exports and imports of goods sustained major drops in growth, but deceleration in growth of imports was significantly faster. This had a positive impact on the balance of foreign trade in goods, which still remained negative. Positive developments of foreign trade in goods were supported by growth in surplus of foreign trade in services and by surpluses in both primary and secondary income. As a result, the current account balance was positive in October. This helped reduce the current account deficit for the first ten months of the year by more than two times.

Main Macroeconomic Indicators	2009	2010	2011	2012	2013	2014
GDP growth, % yoy	-6.6	-1.6	2.5	0.2	3.5	2.5
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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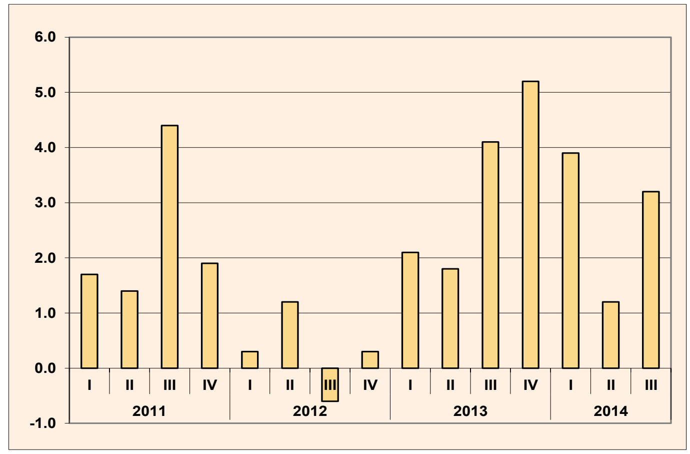
Economic Growth

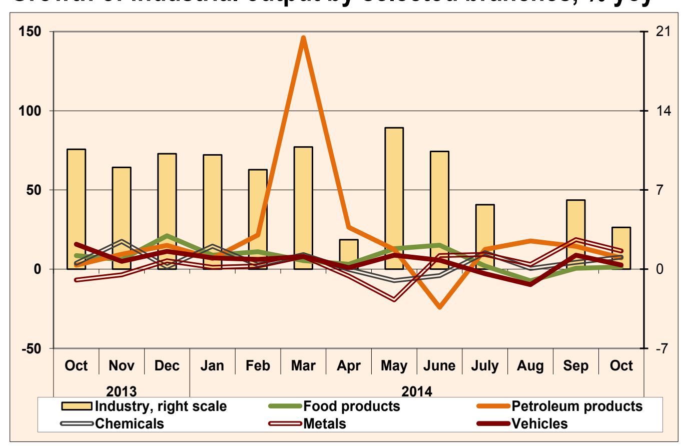
Industrial output experienced deceleration in growth (to 3.7% yoy) in October because of slower growth in manufacturing and faster decline in the energy sector. Manufacturing posted a 5.0% yoy increase in October, which is lower than in September by one third. This happened because of significant slowdown in growth of several manufacturing sub-sectors, such as oil processing (from 14.4% yoy in September to 7.1% yoy in October), metallurgy (from 18.7% yoy to 11.5% yoy), and computer and electronics industry (from 61.9% yoy to 29.6% yoy). In contrast, annual dynamics of food and chemical industries positively influenced by lower commodity prices and of motor vehicle production and related industries improved. The energy sector saw significant acceleration in decline from 6.7% yoy in September to 9.6% yoy in October. Therefore, the only sector posting positive changes in dynamics was mining and quarrying, which saw a robust 4.9% yoy growth in October compared to a 1.5% yoy decline in the previous month. Better growth dynamics was ensured solely by faster growth in mining support service activities (from 8.8% yoy in September to 27.9% yoy in October) as other sub-sectors posted declines, including mining of metal ores, which observed an 11.2% yoy decline after 9.7% yoy growth in the previous month.

GDP growth, % yoy



Source: INSSE, The Bleyzer Foundation

Growth of industrial output by selected branches, % yoy



Source: INSSE, The Bleyzer Foundation

In October, trade and services saw a 1.0 percentage point drop in year-over-year growth on the back of slower pace of growth of goods sales. On the positive side, growth of the sector in general remained robust at 4.0% yoy. As for sales of goods, the major reason for their slower growth was the significant slowdown in growth of automotive sales (from 5.5% yoy in September to just 0.4% yoy in October). Other groups of goods, in contrast, improved their dynamics. In particular, sales of furniture and household appliances benefitted from improved conditions on the real estate market, while sales of fuels increased on decreasing oil prices. Market services to households posted another significant contraction in October. The sub-sector dropped 6.0% yoy, which is still an improvement over the 7.3% yoy decline in the previous month. The improvement was achieved mainly thanks to slower decline in travel and recreational activities.

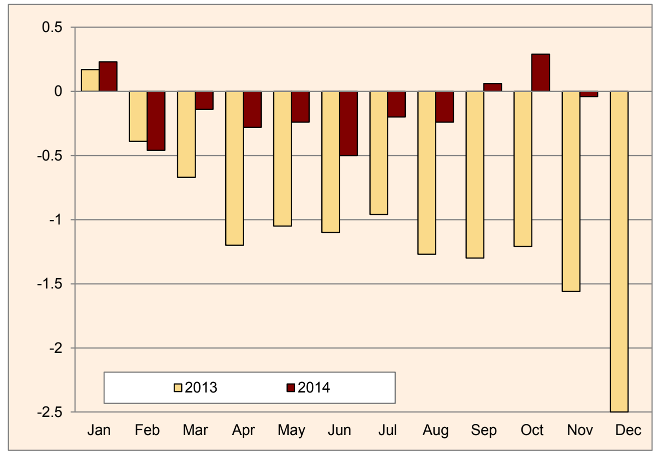
Fiscal Policy

The presidential campaign did not lead to significant expansion of government expenditures in November. The consolidated budget deficit equaled RON 270 million (EUR 61 million), which is just 0.04% of GDP. In January-November 2013, the deficit was equivalent to 1.53% of GDP.

Growth of consolidated budget revenues further accelerated in November, totaling 6.8% yoy over the whole 11 month period of 2014. Total revenues reached RON 195.0 billion (EUR 44.1 billion), which is equal to 28.9% of GDP. Almost all the major tax revenues posted increases in receipts in November. In particular, the government collected RON 393 million (EUR 88.9 million) more of excises compared to November 2013, which extended the total increase in excise receipts to RON 2.684 billion (EUR 606.9 million) in January-November 2014. Increases in receipts of other taxes were not as high. In particular, the increase in the VAT tax receipts, which amounts to 7.1% of the GDP, was a mere 0.6%

yoy in January-November, even though the retail trade increased 7.2% yoy during the same period The only receipts posting a decline in November were receipts of social security contributions, while receipts of property taxes were almost equal to those observed in November 2013. Decline in revenues from use tax on goods further decelerated and reached 39.5% yoy at the end of November. Growth of the local level consolidated general state budget revenues decelerated again for two out of three major components. Growth of receipts from property taxes decelerated to 3.8% yoy from 4.2% yoy observed in January-October and growth of receipts from use tax on goods decelerated to 2.1% yoy from 2.5% yoy. At the same time, non-tax revenues grew by 2.5% yoy in January-November, which is more than twice as high as in January-October. The government managed to increase absorption of EU funds, as the total amounts received from the EU reached RON 8.5 billion (EUR 1.9 billion), which is almost one quarter higher than the amount received over the same period of time last year.

Consolidated budget balance, % of GDP



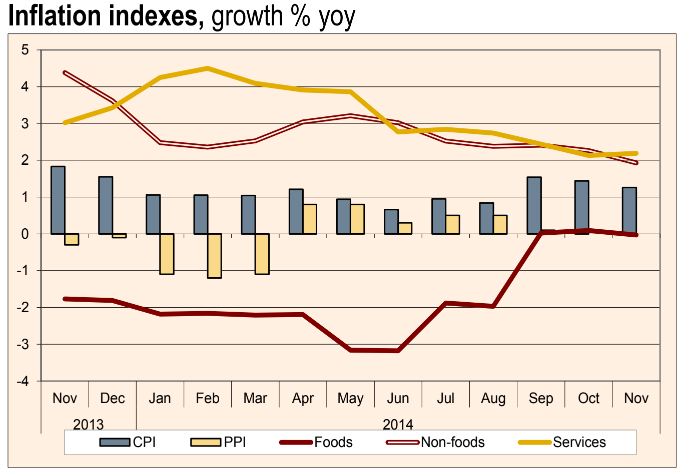
Source: Ministry of Public Finance of Romania

Consolidated general state budget expenditures accelerated their growth in November. The consolidated budget expenditures amounted to RON 195.3 billion (EUR 44.2 billion) in January-November 2014. This is a 1.5% yoy increase compared to the 0.7% yoy growth observed in January-October. The wage bill grew by 3.8% yoy as of the end of November, which is a 0.2 percentage point deceleration over the end of the previous month. At the same time, interest payment expenditures dropped 3.7% yoy on the dynamics of yields and bond auction benchmarks. Expenditures on projects financed from external funds sustained the most dramatic change in dynamics as after a 8.1% yoy decline in January-October, they posted a 4.9% yoy increase to around RON 11.7 billion (EUR 2.7 billion) over the reporting period. As of the end of November, investment expenditures significantly decreased the lag from their level observed over the same period of time last year despite the cuts earlier this year. In particular, total investment expenditures equaled RON 24.2 billion (EUR 5.5 billion) or 3.6% of GDP in January-November 2014. This is a 4.34% yoy decline compared to a 10.2% yoy decline observed a month earlier.

Monetary Policy

Growth of consumer prices decelerated again in November on the back of slower growth of non-food goods prices. Food goods prices remained almost stable for the third consecutive month in year-over-year terms. Dynamics of services prices also sustained no significant changes in November. In contrast, non-food goods prices observed a 0.33 percentage point deceleration in growth to 1.93% yoy. As a result of these developments, total consumer inflation slowed to 1.26% yoy from 1.44% yoy observed in October.

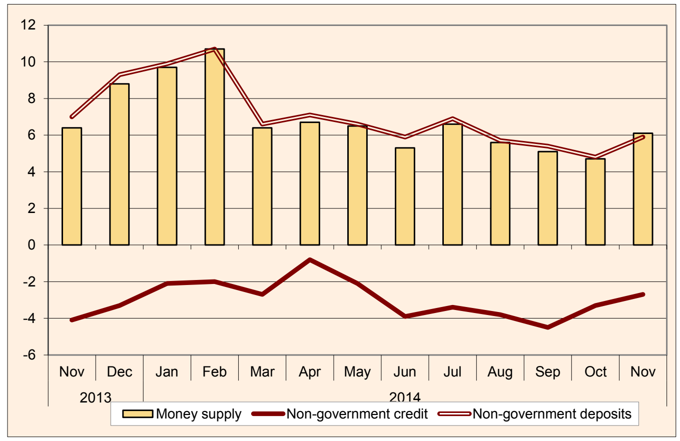
Inflation indexes, growth % yoy



Source: INSSE, The Bleyzer Foundation

Non-government loans observed further improvements in November reflected by accelerated growth of national currency private sector loans and deceleration in decline of forex-denominated non-government loans. Acceleration of growth in RON-denominated corporate loans to 5.1% yoy under almost unchanged but high growth of household loans at 14.8% yoy pushed the increase of total national currency non-government loans upwards by 1.0 percentage point to 9.1% yoy. At the same time, marginal deceleration of decline in both household and corporate forex-denominated loans led to a 0.3 percentage point slowdown in decline of the total forex-denominated loans to 10.3% yoy. Since the national currency loans grew slower than forex-denominated loans declined and the share of the national currency loans was still significantly lower than that of the forex-denominated loans, total non-government loans declined in November. At the same time, the rate of decline was 0.6 percentage points lower compared to October at 2.7% yoy.

Selected monetary indicators, growth % yoy



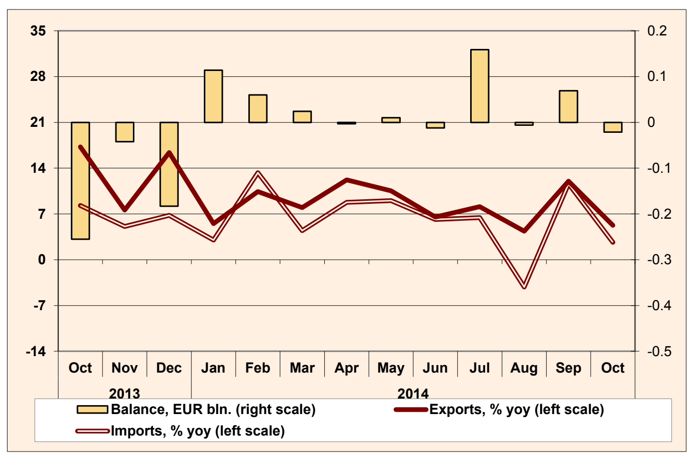
Source: NBR

Broad money followed the trend observed from the beginning of the year. Net foreign assets continued to increase at a very high rate, while net domestic assets continued to decline also at a quite high rate. The difference with the previous month was acceleration of both growth for net foreign assets and decline for net domestic assets. In particular, net foreign assets grew by 50% yoy compared to 32.9% yoy in October. Net domestic assets declined by 10.3% yoy, which is 2.6 percentage points higher than the decline a month ago. As a result, total broad money posted a 6.1% yoy increase in November 2014.

International Trade and Capital

After one month of a pick-up in growth, foreign trade saw deceleration in development in October. Exports of goods grew by 4.9% yoy to EUR 4.933 billion on the back of sales on the EU market, which is less than half of the growth observed in September 2014. Such sectors as machinery and equipment, computers and electronics, rubber and plastic products, metallurgic products, furniture, and food observed high growth rates ranging from 10% yoy to 15% yoy. However, the fastest growth was registered by electrical equipment at 26% yoy. Another positive note was the significant deceleration in imports of goods from 10.7% yoy in September to 2.9% in October. The slowdown in growth was attributed mainly to the negative contributions of mineral fuels, lubricants and related materials, which are highly dependent on world oil prices. Imports of goods amounted to EUR 5.502 billion in October 2014. The commercial result from foreign trade in goods was negative at EUR 568.6 million which is, however, an almost 12% yoy decline.

Monthly foreign trade balance

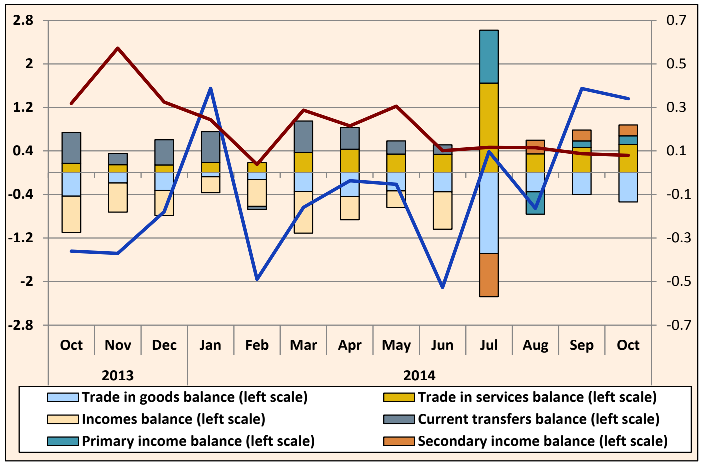


Source: NBR

Positive developments in foreign trade and in primary income helped improve the current account balance in October 2014. In particular, the foreign trade balance calculated following the "change of economic ownership" principle remained negative but the deficit was 86.6% lower than the deficit for the corresponding month of 2013. Both components of foreign trade (goods and services) posted improvements in October as they both observed faster growth of exports compared to that of imports. Preliminary data on primary income showed that its balance experienced significant improvements despite its inflows contracting by 73.7% yoy. The reason is that outflows from the primary income account were negative. As a result, the primary income balance was in surplus of EUR 159 million compared to a EUR 494 million deficit in October 2013. As for secondary income, its balance remained positive but the surplus almost halved. Secondary income inflows dropped almost one-third in year-over-year terms, while outflows posted a

9.2% yoy increase. Overall, positive dynamics of the current account balance were ensured by a 9.8% yoy decline in outflows, as inflows to the account remained almost unchanged in October 2014. The current account surplus amounted to EUR 340 million compared to a deficit of EUR 263 million a year ago. These dynamics helped improve the current account balance in 2014 as a whole. In January-October 2014, the deficit of the current account declined by 61% yoy to EUR 263 million.

Current account components and FDI, EUR billion



Source: NBR, INSSE

Monthly net FDIs continued to decline in October. The estimated volume of net FDI amounted to EUR 80 million in reporting month, which was the second lowest result in 2014 after EUR 38 million in February. Total net FDI volume from the beginning of the year reached EUR 1.591 billion. This amount was 12.4% lower than the amount observed over the same period of time in 2013. Equity stakes amounted to EUR 1.598 billion in October, while intercompany lending posted net repayments for the second time in 2014 at EUR 7 million.

The external debt of Romania remained almost unchanged in October 2014. Insignificant increases in both long-term and short-term components of external debt led to its 0.15% increase against the value as of the end of September. In particular, an increase in direct public debt overcame declines in non-publicly guaranteed debt and in debt of monetary authority by just EUR 51 million. The increase in short-term external debt was larger at EUR 94 million, which was, however, 0.5% of total short-term debt. Taking into account such small-scale developments, it is not a surprise that shares of the long-term and short-term components of external debt within total external debt remained virtually unchanged at 80.6% and 19.4%, respectively.

The international reserves of Romania declined in November. Among the major factors of the decline was the entering into force of the National Bank's decision to cut the minimum reserve requirement ratio on foreign currency-denominated liabilities of credit institutions by 2 percentage points to 14% starting with the November 24-December 23 maintenance period. The decision together with EUR 326 million equivalent interest and principal payments on foreign currency public debt (including payments to the IMF) and changes in the foreign exchange reserve requirements of credit institutions were responsible for most of the EUR 1.889 billion outflows from the NBR's foreign exchange reserves. On the other hand, reserve inflows were equal to EUR 1.142 billion, representing mainly changes in the foreign exchange reserve requirements of the credit institutions, other inflows into accounts of the Ministry of Public Finance, and inflows into the European Commission's account. Unlike in October, the international prices of gold increased, which led to an almost 2% increase in the value of Romania's gold stock to EUR 3.171 billion with its constant weight in one month. This, however, was not enough to compensate for the net outflow of foreign exchange reserves and, as a result, the international reserves of Romania fell by 1.95% by the end of November compared to reserves on October 31st.

Other developments affecting the investment climate

Klaus Iohannis won the Presidential election of Romania in November 2014 against the main favourite, the Prime Minister Victor Ponta. Mr. Iohannis won the second tour of the elections, even though he lost the first tour at a 10% difference. Mr. Iohannis' message during the electoral campaign was provision of support for anti-corruption and reforming the justice system.

Mr. Iohannis was the right wing candidate, supported by ACL alliance (National Liberal Party and Democrat Liberal Party). He is a Romanian citizen of German ethnicity, and has been the mayor of Sibiu since 2000. In Sibiu, Mr. Iohannis initially had run for the German Democratic Forum, for which he won the elections, despite the fact that the German population in Sibiu has declined to only 1.6%. He won the Sibiu elections in 2000 with 68.18%, in 2004 with 88.7% and in 2008 with 87.4%.