

May 2012

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- GDP increased by 0.8% year-over-year (yoy) in Q1 2012
- The industrial production index was up 0.5% yoy up in March
- The consolidated general budget deficit amounted to 0.56% of GDP Q1 2012
- Consumer prices increased by 1.8% yoy in April
- The National Bank of Romania (NBR) decided to keep the policy rate unchanged at the 5.25% per annum (pa)
- The FOB-CIF commercial deficit increased by 12.1% yoy in Q1 2012
- In Q1 2012, the current account deficit narrowed by 43.7% yoy

### Executive Summary

GDP decreased by 0.8% yoy in the first quarter of 2012. This demonstrates a significant slowdown from the 2.1% yoy increase in the fourth quarter of 2011. Among the reasons are bad weather conditions and a continuing crisis in the Euro-zone. All of this influenced both production sectors and consumer expectations. Industrial production remained almost unchanged with a 0.5% yoy increase, according to the adjusted data, while construction volumes decreased by 4.5% yoy in March. Retail trade demonstrated a moderate growth of 3.1% yoy, which is not enough to boost high economic growth.

The austerity measures introduced for the sake of faster recovery helped reach a consolidated general budget deficit of 0.56% of GDP in Q1 2012. This means that the deficit remains within the target level proposed by the international financial institutions. Revenues demonstrated a 9.9% yoy increase during the period thanks to increased proceeds from tax revenues. The expenditures of the general government budget were up 4.9% yoy in the quarter thanks to a 54.7% yoy increase in expenditures for EU-funded projects and investment expenditures.

Due to a significant decline in consumer confidence, consumer price growth moderated to 1.8% yoy in Q1 2012. At the same time, the adjusted CORE2 inflation rate slowed down to 2%. Taking into account many developments on both domestic and international markets the National Bank of Romania decided to keep the monetary policy rate unchanged at 5.25% pa. Even though the volume of loans to the private sector provided by credit institutions demonstrated some growth of 0.9% mom, this is far from being optimal.

The foreign trade commercial deficit declined by 16% yoy in

March but increased by 12.1% yoy in Q1 2012. This, accompanied by a 52.2% increase in the current transfers' surplus, helped shrink the current account deficit by 43.7% in the first quarter of the year. On the negative side, direct investments inflow declined by 4.3% yoy.

On April 27th, the country experienced a major political shock for the second time in two months. The Cabinet was automatically dismissed after the loss of a no-confidence vote. The event was reflected by immediate and significant depreciation of the national currency. In addition, the missions of teams from the World Bank, European Commission, and the International Monetary Fund were forced to suspend their work until the establishment of the new government. Fortunately for Romania, no major flaws were identified in its economic programme, but it was recommended to intensify structural reforms.

	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	9,496.89	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	2.9
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

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### Economic Growth

The Romanian economy continues its recovery, but the growth rate is significantly lower than previously observed. GDP grew by 0.8% yoy in the first quarter of 2012, while the previous quarter recorded a 2.1% yoy increase in GDP. In quarterly terms, the situation is even worse because GDP was 0.1% quarter-over-quarter lower in Q1 2012. There are several objective reasons for this – a worsening economic situation in Europe, extreme frosts at the beginning of the year, and political uncertainty affecting the domestic consumption. The political uncertainty will continue to affect the country through 2012, as Romania faces local and parliamentary elections in June and November respectively.

Due to these reasons, some sectors of the economy performed worse than expected. Industrial production increased by a mere 0.5% yoy in March on the shoulders of a 5.6% yoy increase in electricity, gas, steam, and air conditioning supply and a 1.7% yoy increase in mining and quarrying. At the same time, manufacturing was down by 0.5% yoy.

The volume of construction works decreased by 4.5% yoy in March because of uncommonly cold weather, which prevented construction works and slowed down the economy in general.

The highest decrease within the structure of construction works was observed in capital repair works – 10.2% yoy, while maintenance and current repair was not that far behind, with a 8.5% yoy decline. New construction works decrease the least – by 1.0% yoy.

Bad news concerning the economic development of the EU and domestic political uncertainty caused a decline in consumer expectations. As a result, retail turnover volume (excluding trade with motor vehicles and motorcycles) was up in March 2012 by just 3.1% yoy (only 0.1% higher than in February) thanks to fuel retail for motor vehicles in specialized shops (a 8.0% yoy increase) and the sale of food, beverages and tobacco (a 4.4% yoy increase). Sales of non-food products decreased by 0.5% yoy in March, the same as turnover of market services provided to the population.

Taking into account some negative developments in the country and the EU as a whole, we expect GDP to grow by 1.5% yoy at most in 2012.

### Fiscal Policy

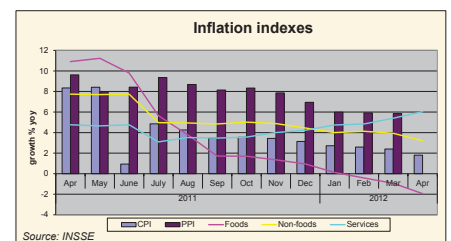
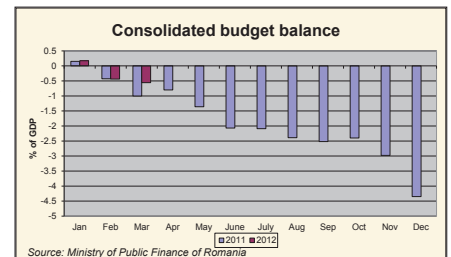
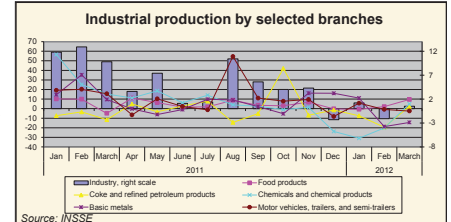
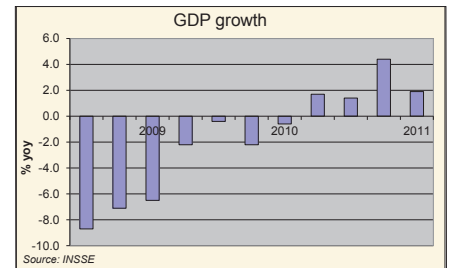
According to the data, the austerity measures introduced to speed up the recovery from the financial and economic crisis are doing well. The consolidated general budget was executed with a deficit of RON 3.4 bln (EUR 0.8 bln) in Q1 2012 which is 0.56% of GDP. Even though the deficit is still within the deficit target set by international financial bodies, it expanded by 0.12% mom.

Revenues demonstrated a 9.9% yoy increase during the period and amounted to RON 45.7 bln (EUR 10.5 bln). This increase took place on the shoulders of a 16.5% yoy increase in tax revenues. In particular, the value added tax revenues increased by 7.6% yoy, revenues from excises increased by 7.3%, and income tax revenues increased by 21.2% yoy. In addition, social security contributions grew by 8.2% yoy during the period to RON 12.8 bln (EUR 2.9 bln). Revenues of the local administrations increased thanks to growth of proceeds from property taxes (3.8% yoy) and non-tax revenues (21.7% yoy). Transfers from the EU budget increased by 35.0% yoy.

As for general government expenditures, they increased by 4.9% yoy to RON 49.1 bln (EUR 11.3 bln). The increase was ensured mainly by EU-funded projects (increase in expenditures 54.7% yoy) and servicing of state and state-guaranteed external debt (17.9% yoy increase). Spending on goods and services expanded by 4.6% due to payments made to fund health care and medicines. The state wage bill expanded by 0.9% yoy, while investment costs (which include capital expenditures and related development programs) increased by 43.2%

### Monetary Policy

Consumer prices were essentially stable in April. They saw just a 0.07% mom increase which amounted to a 1.49% increase for the first quarter of 2012 and to a 1.8% increase in annual terms. The annual inflation rate has shown a continuous decline, since it was equal to 2.4% yoy in March and to 2.6% yoy in February. Prices of foods decreased by 0.11% in April or by 1.94% yoy, while prices of both non-foods and services increased by 0.17% in April or by 3.21% yoy and 6.03% yoy, respectively. Almost all groups of consumer prices, except for tobacco prices, contributed to the decrease in annual inflation in Q1. The slower annual dynamics of both volatile food prices and fuel prices were entirely attributable to a base effect. Nevertheless, compared to the end of



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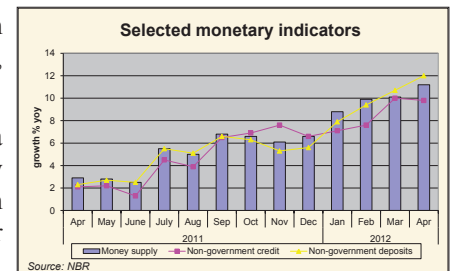
2011, prices have significantly increased due to higher costs triggered by the unfavourable weather conditions and the hikes in global food and energy commodity prices.

The annual adjusted CORE2 inflation rate decelerated to 2% at the end of Q1 2012, which is 0.4 percentage points lower than at the end of 2011. The stronger pressures generated by the persistent negative output gap were the main drivers of this development, even though these pressures were slightly mitigated by the impact of weaker RON on import prices.

The aggregate real broad monetary conditions have been permanently calibrated so that the inflation rate would continuously remain within the variation band around the target. The new inflation forecast of the NBR reiterates the prospects of the annual inflation rate to remain within the variation band around the target throughout the entire forecast horizon despite a temporary unfavorable statistical base effect, which is to be expected in the second part of 2012.

Broad money (M3) amounted to RON 216.1 bln (EUR 49.3 bln), declining by 0.7% month on month at the end of March 2012, while it increased by 0.5% in February. In annual terms, broad money increased by 10.1% in March after a 9.9% increase in February.

The Board of the NBR decided to keep the monetary policy rate unchanged at 5.25% pa during its May meeting, because recent developments in macroeconomic indicators show continuing disinflation and because there is a moderate recovery of lending activities. In addition, the Bank took into consideration the persistent aggregate demand deficit and lower than expected growth in exports caused by problems in the Euro-zone.

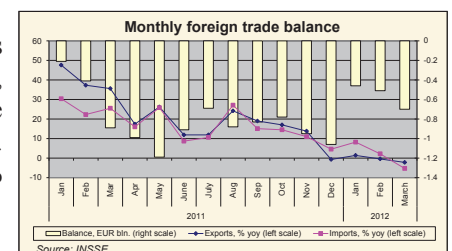


Changes of expectations regarding economic growth at the global level and impact of the process of deleveraging economies in Central and Eastern Europe, initiated by some European Union credit institutions, influences the risk appetite of investors. Significant fluctuations in risk appetite combined with domestic developments in electoral context may increase the capital flow volatility. In order to achieve price stability in the medium term the country has to maintain a prudent monetary policy stance for the aggregate broad monetary conditions. In this context, the NBR expects that the monetary policy rate at 5.25% per annum will ensure the adequate management of liquidity in the banking system and maintenance of the existing levels of minimum reserve requirement ratios on both RON-denominated and foreign currency-denominated liabilities of credit institutions.

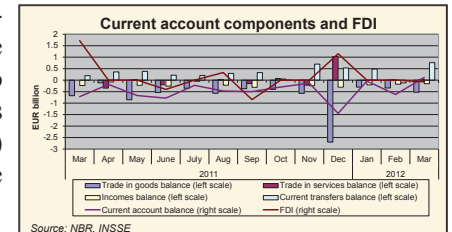
Loans to the private sector provided by credit institutions increased by 0.9% in March comparing to February to RON 224.3 bln (EUR 51.2 bln). This is a good sign after the 0.1% decrease in February, but the growth rate is too low. In annual terms, loans to the private sector increased by 10.0% compared to a 7.6% increase in February. RON-denominated loans increased by 5.7% yoy and foreign currency-denominated loans expressed in RON increased by 12.6% yoy (5.8% yoy when expressed in EUR), while growth rates in February were more modest – 4.3% yoy and 9.5% yoy (6.1%) respectively.

### International Trade and Capital

Preliminary estimations of the National Institute of Statistics show that FOB exports amounted to EUR 4.0 billion and CIF imports amounted to EUR 4.7 billion in March 2012, which is a 2.2% yoy decrease and a 5.3% yoy decrease correspondently. Compared to the previous month, the increase in exports amounted by 14.4% and imports increased by 17.5%. In March 2012, the decrease in the FOB-CIF commercial deficit was registered at about 19% yoy to EUR 0.7 billion.



For Q1 2012 FOB exports amounted to EUR 11 billion and CIF imports amounted to EUR 12.7 billion, which is a 0.4% yoy decrease and a 1.1% yoy increase respectively. The FOB-CIF commercial deficit increased by 12.1% yoy in the quarter to EUR 1.7 billion. The trade of goods between the Member States amounted to almost EUR 8 billion for dispatches and to EUR 9.3 billion for arrivals, representing 72.4% of total exports and 73.8% of total imports respectively. Transport equipment and vehicles (41.8% for exports and 33.5% for imports) and other manufactured goods (34.7% for exports and 29.4% for imports) represented the highest weights within the structure of exports and imports in Q1 2012.



In Q1 2012, the current account deficit narrowed by 43.7% yoy to EUR 544 million. This happened mainly due to the 52.2% increase in the current transfers' surplus supported by an almost one-fourth increase in the income balance deficit.

Direct investments in Romania from non-residents are estimated at a EUR 425 million level and demonstrated a 4.3% yoy decline. They covered 78.1% of the current account deficit in Q1 2012.

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Medium- and long-term external debt amounted to EUR 76.4 billion (77.4% of total external debt) at the end of Q1 2012, or 1.1% growth from the end of 2011. Short-term external debt, in contrast, decreased by 2.4% during the first quarter of 2012 and reached EUR 22.3 billion.

The foreign exchange reserves of the NBR decreased in April 2012 by 0.8 mom to EUR 34.3 billion. The inflow amounted to EUR 698 million, representing inflows to the accounts of the European Commission and Ministry of Public Finance, changes in the foreign exchange reserve requirements to credit institutions, income from the management of foreign exchange reserves, etc. At the same time, the outflow amounted to EUR 966 million in changes of foreign exchange reserve requirements to credit institutions, interest and principal payments on foreign currency public debt, etc. The gold stock has held steady at 103.7 tonnes, but its value increased by EUR 37 million or by 0.9% due to changes in the international price of gold. The international reserves of Romania stood at EUR 38.5 billion at the end of April 2012 increasing by 0.6% mom.

### Other Developments Affecting the Investment Climate

On April 27th, the Cabinet unexpectedly lost a no-confidence vote and was automatically dismissed. The new government, led by Mr. Ponta, and supported by Social Democratic Party (PSD), National Liberal Party (PNL) and Conservative Party (PC). Since the last elections back in 2008, these parties have been in the opposition, but they were able to gain majority in the Parliament and, consequently, to form the government following the dismissal through the non-confidence vote of the previous government. Since this was the second Cabinet change in two months, the RON/EUR exchange rate depreciated by 0.4% to 4.401 immediately after the vote in the parliament and reached a new record low of 4.4168 on May 2, 2012. The political situation in the country will remain unstable through 2012 for two main reasons. The first is that Romania faces two rounds of elections in 2012, locals in June and parliamentary in November. Second is that the President, Mr. Basescu, and the Prime Minister, Mr. Ponta represent opposing political currents and they may not collaborate with ease. Major fiscal problems are unlikely, because all parliamentary parties formally support the agreement with the IMF, but there is a risk that Romania will face significant pressures from international markets with growing costs of borrowing.

Romania is continuing cooperation with international financial institutions. A recent mission of teams from the World Bank, European Commission, and the International Monetary Fund visited the country during April 24-May 9 to review Romania's economic programme, but was interrupted due to the Cabinet resignation. Prompt formation of the government, however, allowed the mission to be completed. The major conclusion of the mission is that the programme fulfills all the requirements, since just one of the quantitative performance criteria in the Stand-By Agreement with the IMF was not observed but missed by a small margin. However, the mission advised the government to intensify structural reforms needed to boost economic growth. Special attention should be paid to the energy and transport sectors. The new government announced its intentions to amend the agreements with the IMF, in order to be able to increase wages of the public employees. The public employees' wages were cut by 25% in 2009, at the crisis onset in order to reduce the budget deficit. The increase might have a positive influence with respect to the household consumption and might help the economic activity.

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