Romania

Macroeconomic Situation

July 2012

Valentyn Povroznyuk, Radu Mihai Balan, Edilberto L. Segura

- **Industrial production grew by 2.7% yoy in May.**
- **The consolidated budget deficit grew to 1.19% of GDP at the end of April.**
- **Consumer price growth was 2.04% yoy in June.**
- **The FOB-CIF commercial deficit for goods decreased by 20.7% in May.**
- **The current account deficit was down by 22.2% as of the end of May.**
- **A deepening political crisis caused depreciation of the RON.**

Executive Summary

Despite recession in the Euro-zone, industrial production grew by 11.5% mom in May, which contributed to 2.7% yoy growth. Robust growth was observed in all categories of goods except for the energy sector.

Consolidated budget revenues grew faster than expenditures, but the deficit still increased to 1.19% of GDP in May from 0.83% in April (but remained within the target level). The revenues grew by 9.6% yoy on the shoulders of an 11.5% yoy increase in tax revenues and 55% increase in EU budget transfers. At the same time, the total government expenditures were 8.5% yoy up. The largest contribution to growth was EU-funded projects' expenditures (55.6% yoy).

Consumer inflation remains around twenty year lows after small deflation in June. Deflation was fuelled by a 0.93% yoy decrease in food goods prices thanks to increased supply of fruits and vegetables. Non-food goods prices, in contrast grew by 2.96% yoy. Overall, consumer prices grew by 2.04% yoy in June.

FOB exports of goods grew faster than CIF imports (3.9% yoy versus 1.9% yoy) in May. As a result, the FOB/CIF commercial deficit of trade in goods decreased by 20.7% yoy and reached EUR 0.946 bln. The current account balance deficit narrowed by 22.2% yoy in January-May 2012 on the shoulders of decrease in trade deficit and surpluses of the current transfers and services accounts. On the negative side, FDI continued to decline in annual terms. By the end of May, the decline rate was equal to more than 45% yoy.

A conflict between the President and Prime Minister escalated in July. It resulted in suspension of the President until the national referendum on his impeachment on July 29th. The forex market reacted immediately and RON depreciated by 2.6%. Apart from this and an insignificant growth in the price of borrowings, no other major immediate economic impacts were observed. Leading rating agencies did not consider escalation of the conflict as a threat to the country's sovereign ratings.

	2007	2008	2009	2010	2011	2012
GDP growth, % yoy	6.2	7.1	-6.6	-1.6	2.5	1.5
GDP per capita, USD	7,916.744	9,496.899	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 balance, % 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	3.3
Gross international reserves, EUR 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

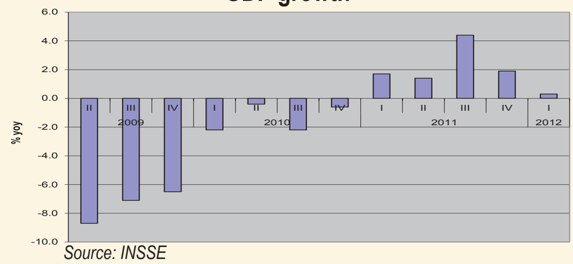
Chief Economist Edilberto L. Segura
Editor Rina Bleyzer O'Malley

Economic Growth

Industrial production grew by 11.5% mom in May thanks mainly to 14.1% growth in manufacturing and 6.1% growth in mining and quarrying. Such high monthly growth, considering the recession in the Euro-zone and political turmoil in the country, allowed the country to reach just 2.7% growth in annual terms, while from the beginning of the year industrial production grew by only 0.4%. All the categories of goods, except for the energy sector, showed significant growth rates. In particular, intermediate goods grew by 17.6% yoy and capital goods by 15.5% yoy. Consumer non-durables and consumer durables grew almost identically by 10.6% and 10.5%, respectively. In contrast, the energy sector dropped by 4.7%. Growth in industrial production was stimulated by increase in demand at both international and domestic markets.

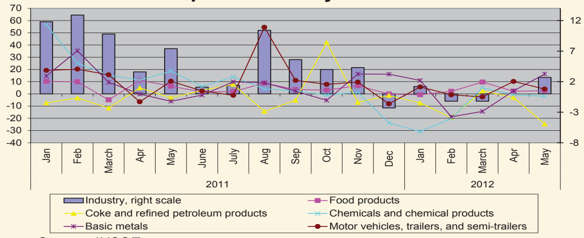
Retail trade performed better in May compared to April. Turnover volume growth almost doubled in May to 5.9% yoy compared to 3.4% yoy in April. At the same time, drivers of such growth remained the same: fuel retail for motor vehicles in specialized shops with a 11.2% yoy increase and sale of non-food products with a 4.6% yoy increase. Sales of food, beverages, and tobacco also grew in annual terms by 3.7%, even though in monthly terms they inched down by 0.1%.

GDP growth



Source: INSSE

Industrial production by selected branches



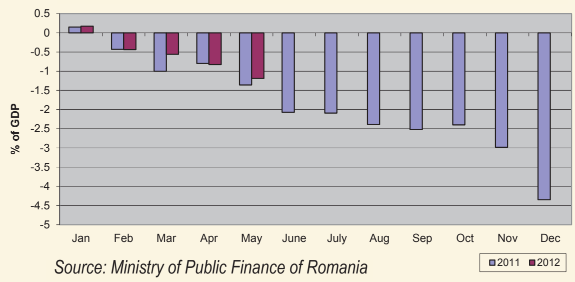
Source: INSSE

Fiscal Policy

According to the Ministry of Finance of Romania, the consolidated general budget cash deficit grew to 1.19% of GDP by the end of May or RON 7.2 bln (EUR 1.6 bln) from 0.83% GDP in April. However, this is still an improvement compared to the previous year – 1.28% of GDP or RON 7.4 bln (EUR 1.8 bln).

Consolidated budget revenues grew by 9.6% yoy to RON 77.5 bln (EUR 17.5 bln) and reached 12.8% of GDP, an improvement from 7.4% yoy growth last month. The highest growth was observed for tax revenues – 11.7% yoy. Income tax revenues demonstrated the highest growth rate of 18.9% yoy, while corporate tax and excise revenues grew slower (by 9.7% yoy and 8.2% yoy respectively). The lowest growth rate was registered for value added tax revenues – 6.9% yoy. Growth in social security contributions accelerated a bit compared to the previous month to 7.7% yoy from 7.3%. The total amount of contributions reached RON 21.5 bln (EUR 4.8 bln). The highest growth in revenues at the local level was registered for income and property taxes (5% yoy). Non-tax revenues of the consolidated budget were up by 6.3% yoy to RON 7 bln (EUR 1.6 bln). Growth of EU budget transfers almost doubled in May and reached 55.0% yoy.

Consolidated budget balance



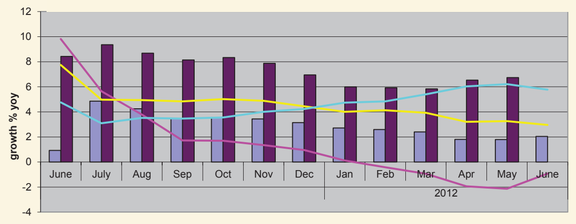
Source: Ministry of Public Finance of Romania

Despite lower growth, general government expenditures still significantly exceed budget revenues. In particular, general government expenditures grew by 8.5% yoy in May, reaching RON 84.8 bln (EUR 19.1 bln) or 14.0% of GDP. The major factor of growth in expenditures remained the same as in previous months of the year. This is an increase in expenditures of the EU-funded projects equal to 55.6% yoy. Growth in public debt interest payments decelerated to 29.3% yoy from 44% yoy last month, while capital expenditures grew faster instead (33.1% yoy growth against 31.4% yoy growth last month). Payments for medical services and medicines, together with current repairs, were responsible for 11.7% growth in expenditures on goods and services. Staff costs remained almost flat with a tiny 0.5% yoy increase in May. At the same time, investment expenditures grew by 36.2%, which is almost the same as in the previous month (36.7% yoy). They reached 2.1% of GDP or RON 12.6 bln (EUR 2.8 bln) at the end of the month.

Monetary Policy

June was characterized by small deflation in consumer prices, as the CPI amounted to 99.96% mom. In annual terms however, consumer prices grew by 2.04%. Food and non-food goods' prices remained almost stable in monthly terms, as the CPI was equal to 99.87% and 99.9% in June compared to May, respectively. At the same time, if prices of food goods inched down by 0.93% in annual terms, prices of non-food goods did the opposite – they grew by 2.96% yoy. Prices of services continue to grow in both monthly and annual terms but at a different pace. For instance, an

Inflation indexes

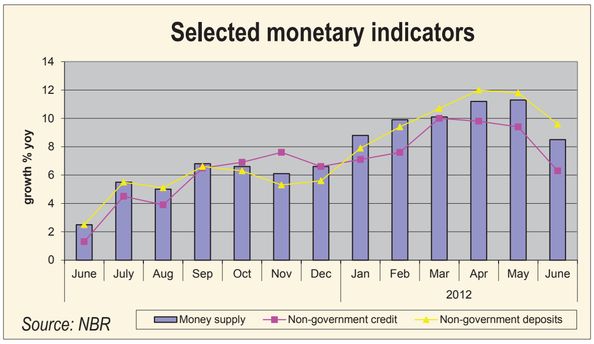


Source: INSSE

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 6213111 Fax: +1 (713) 6214666
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

insignificant 0.27% growth in prices was observed as compared to May, while growth as compared to June 2011 was at 5.77%. Apart from statistical base effects generating a decrease in volatile food prices, low consumer inflation levels were caused by some domestic and external factors on the supply side. These are drops in external prices for some commodities and consumer goods, increase in supply of fruits and vegetables to normal levels, and some adjustments of administered prices. At the same time, consumer expectations remained low as reflected by a deficit of consumer demand. We expect inflation to accelerate in the coming quarters due to base effects of the exceptional harvest last year and possible foreign exchange depreciation, but yet to remain within the target band of 3±1%.



The demand deficit contributed to preserving CORE2 inflation at 2%, which helped offset the effects from RON depreciation and increase in unit labour cost.

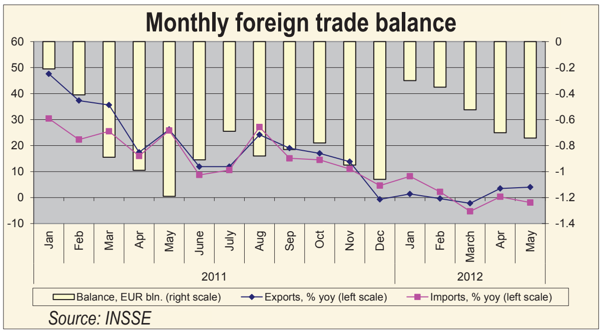
Broad money (M3) grew by 1% mom for the second month in a row reaching RON 220.7 bln in May. In annual terms, the growth of broad money was almost identical to last month's 11.3% (11.2% in April).

Private sector loans granted by credit institutions continue to grow at high rates. In May, they grew by 9.4% yoy, which is slightly lower than in April and March (9.8% and 10.0% respectively). Such a growth became possible because of a 3.1% increase in RON-denominated loans and a 13.2% growth in foreign currency-denominated loans expressed in RON (4.4% if expressed in EUR). Overall, the volume of loans reached RON 227.1 bln (EUR 51.2 bln).

International trade and Capital

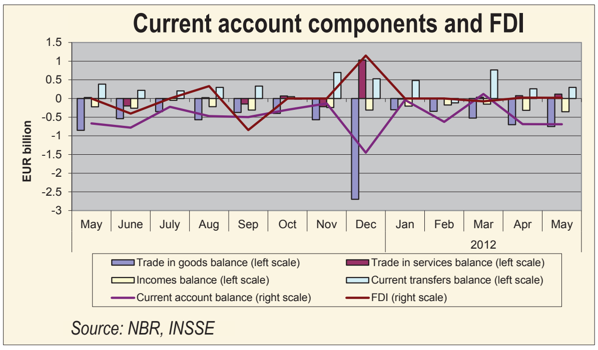
Preliminary estimations show that FOB exports of goods grew by 3.9% yoy at values expressed in euro and were equal to EUR 4.0 bln. At the same time, CIF imports of goods grew by just 1.9% and were equal to EUR 4.95 bln. As a result, the commercial deficit of trade in goods amounted to EUR 0.946 bln in May, which is a 20.7% yoy decrease.

In the first five months of the year, FOB exports of goods grew moderately by 1.5% yoy amounting to EUR 18.6 bln, while CIF imports of goods inched up 0.5% amounting to EUR 22.1 bln. This led to a decrease in the FOB-CIF commercial deficit by 4.4% to EUR 3.5 bln. The share of trade in goods between the Member states inched down for exports from 71.3% to 71.1% and grew to 73.4% from 72.9% for imports. In monetary terms, exports to the Member states amounted to EUR 13.2 bln and imports to EUR 16.1 bln. As observed before, transport equipment and vehicles along with other manufactured goods were goods categories with the largest shares in foreign trade in May. The shares of these categories in exports amounted to 41.3% and 34.0% respectively, while their shares in imports amounted to 33.1% and 29.5% respectively.



The current account deficit narrowed by 22.2% yoy in May to EUR 1.92 bln. The main reasons are increases in the current transfer surplus of EUR 192 mln and in the services surplus by EUR 161 bln. Another reason is, naturally, a decrease in the trade deficit.

Foreign direct investments slumped by more than 45% yoy in January-May 2012. As of the end of May, they amounted to just EUR 465 mln (EUR 849 in January-May 2011). As a result, their coverage of the current account deficit decreased from 36.3% in April to 24.2%.



At the same time, the medium- and long term external debt grew by 4.1% yoy and stood at EUR 77.6 bln as of the end of May. Its share in total debt continued to grow and amounted to 78.8% (compared to 78.1% in April and 77.4% in March). Short-term external debt, in contrast, decreased in both size and share of total debt; it decreased by 2.1% to EUR 20.8 bln, and its share in the total debt decreased to 21.2%.

Foreign exchange reserves of the National Bank of Romania (NBR) declined by 1.7% mom to EUR 32.96 bln in June (EUR 33.52 as of the end of May). The NBR received EUR 2.24 bln of foreign exchange reserves, while outflows of the foreign exchange reserves amounted to EUR 2.80 bln. The gold stock once again remained unchanged in June. At the same time, its value decreased to EUR 4.161 bln due to changes in the international price of gold. The decrease in value was equal to 1.14%. Overall, the international reserves of Romania were equal to EUR 37.121 bln as of the end of June, which is a 1.6% mom decrease.

Other Developments Affecting the Investment Climate

Political turmoil escalated in Romania in July. On the initiative of the Prime Minister, the Romanian Parliament voted to suspend the President on July 6th. As a result, the President was suspended for until the national referendum on July 29th. This event was immediately reflected in the forex market. The RON depreciated by 2.6% during the month and renewed its historical low to the Euro on July 24.

At the same time, the deepening political crisis in the country did not affect the international rankings of Romania. In particular, Fitch Ratings issued a statement that intensification of political instability is not a near-term threat to the country's sovereign rating, which stands at "BBB-". The reason is that the country is protected by substantial external buffers and is strictly following recommendations of international institutions concerning fiscal consolidation. The only significant concern of Fitch was possible problems with implementation of structural reforms required under agreements with the IMF and EU. However, the company not only reaffirmed the rating for Romania but also left the "stable" rating outlook intact.

SigmaBleyzer

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 6213111   Fax: +1 (713) 6214666
Email: sbleyzer@sigmableyzer.com

Where Opportunities Emerge.

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