

December 2013

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- **Industrial production grew by 10.0% yoy in September 2013.**
- **The consolidated budget deficit declined to 1.21% of GDP at the end of October 2013.**
- **Consumer inflation remained at 1.88% yoy in October 2013.**
- **The foreign trade deficit reached EUR 356 million in January-September 2013.**
- **The current account deficit grew to EUR 595 million at the end of September.**

Executive Summary

Thanks to recovered external demand, industrial production accelerated its growth to 10.0% yoy in September. This became possible thanks to improved performance of manufacturing, which grew by 11.3% yoy. Domestic demand also recovered, which positively influenced trade and services sector. The sector's dynamics turned positive again on the back of improvement in both subsectors.

Improved collection of corporate profit tax proceeds helped to improve the situation with the consolidated general budget deficit in October. Change in growth dynamics of the mentioned proceeds from the 1.3% yoy decline observed in January-September to 1.5% yoy growth in January-October accelerated growth of the consolidated general budget revenues and decreased the consolidated general budget deficit to 1.21% of GDP.

Following the optimistic scenario, consumer inflation remained at the same level of 1.88% yoy for the second month in a row in October. Prices of foods continued to decline, but at a slightly decelerated level. At the same time, inflation in both non-food goods and services sectors also decelerated. Thanks to this, the total consumer inflation level remained intact.

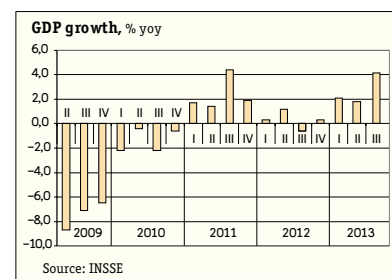
The National Bank of Romania's attempts at stimulation of national currency lending had little effect in October. There are some improvements, but they are still too far from expectations. The volume of national currency loans increased for both households and corporations. However, increases were not that significant, especially for households. At the same time, the volume of forex-denominated loans declined in total and for both households and corporations separately. This decline exceeded growth in the volume of national currency loans, meaning that total non-government loans also declined.

Thanks to recovery in external demand, Romania's foreign trade posted good performance in September. Continued growth of exports of goods at high rates and decline of imports of goods led to further decline in the commercial deficit of trade in goods in year-over-year terms in January-September. Foreign trade in services was in surplus over the mentioned period. Furthermore, the surplus was more than three times higher than that observed over the same period last year. The total foreign trade deficit reached EUR 356 from the beginning of the year. The current account deficit, in turn, expanded to EUR 595 million due to a sharp increase in the income account deficit.

	2008	2009	2010	2011	2012	2013
GDP growth, % yoy	7.1	-6.6	-1.6	2.5	0.2	1.9
GDP per capita, USD	9,497	7,649	7,667	8,863	8,030	8,080
Industrial production, % yoy	0.9	-5.5	5.5	5.6	0.0	7.0
Retail sales, % yoy	13.0	-10.3	-5.3	-2.5	2.9	3.5
Budget balance, % GDP	-4.9	-7.3	-6.4	-4.3	-2.5	-2.2
Government external debt, % GDP	13.4	23.6	30.5	34.7	37.8	38.0
Inflation, eop	6.3	4.7	8.0	3.1	5.0	3.1
Gross international reserves, EUR billion	28.3	30.9	36.0	37.3	36.4	37.0
Current account balance, % GDP	-11.6	-4.2	-4.4	-4.5	-4.0	-3.6
Gross external debt, % GDP	51.8	68.7	74.4	75.2	75.1	75.0
Unemployment (ILO methodology), % eop	5.8	6.9	7.3	7.4	7.2	7.0
Exchange rate RON/EUR, annual average	3.68	4.24	4.21	4.24	4.45	4.5

Economic Growth

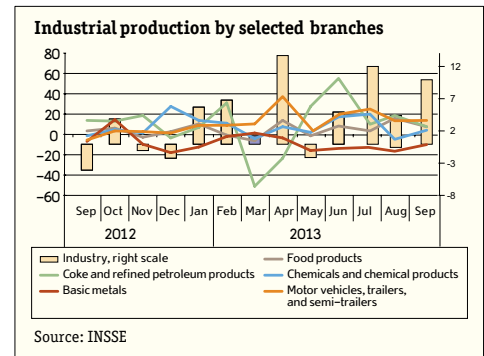
In September 2013, a significant increase in manufacturing spurred growth of industrial production in general. In particular, a 22.8% mom increase in manufacturing supported by a 6.1% mom increase in mining and quarrying ensured a 19.5% mom growth of the total industrial production. As a result, the year-over-year dynamics of the sector also improved compared to August (growth accelerated from 4.3% yoy to 10.0% yoy). Growth of manufacturing accelerated from 5.1% yoy to 11.3% yoy in September. The improvement of manufacturing performance was to light industry, wood, electrical equipment and machinery and equipment, which benefited from stronger external de-



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mand. Producers of transport means exported a wider range of products (i.e. parts), which also helped achieve higher growth rates. Growth dynamics of metallurgy remained in negative territory in year-over-year terms. However, the industry managed to decelerate its decline to 9.0% yoy from 16.3% yoy observed in August, which became possible thanks to investment made by one of the producers in the field. Overall, industrial production grew by 7.0% yoy in January-September 2013. As before, manufacturing was the major driver of growth with its 8.5% yoy increase over the period. Mining and quarrying managed to grow by 3.2% yoy, while electricity, gas, steam, and air conditioning supply declined by 3.9% yoy over the first nine months of the year.

In September, the annual dynamics of trade and services turnover returned to positive territory (grew by about 2% yoy). Moreover, both components recorded reversals. The positive trade developments were attributable to both durables and nondurables. In the case of durables, favorable developments were ensured by automotive trade (grew by 7.5% yoy), largely on the back of sales of motor cars (grew by 4.1% yoy), as well as from the faster increase in sales of accessories and spare parts (17.5% yoy). The swifter rate of change of non-durables sales was supported by a slight rebound in retail of fuel for motor vehicles in specialized shops (inched up by 0.6% yoy), whereas food sales saw a sharper contraction (3.4% yoy) in real terms for the second month in a row. The annual dynamics of market services to households accelerated to 1.5% in the context of the recovery seen by the hotel sub-sector (grew by 3.6% yoy) supported by growth of travel related services (by 5.6% yoy) and textile and fur products cleaning services (by 12.8% yoy).

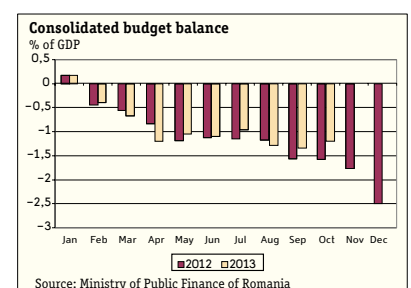


Fiscal Policy

Significant increase in proceeds from the corporate profit tax in October led to improvement of the situation with the consolidated general budget in January-October 2013. The deficit decreased from RON 8.1 billion (EUR 1.8 billion) to RON 7.6 billion (EUR 1.7 billion), which is 1.21% of GDP. The consolidated general budget for October was executed with a surplus of RON 577.8 million (EUR 130.0 million). The budget primary balance remained positive at 0.32% of GDP in January-October.

Thanks to the mentioned improvement with proceeds from corporate profit tax, growth of the consolidated general budget revenues inched up to 4.6% yoy in January-October. The total amount of revenues was equal to RON 166.7 billion (EUR 37.5 billion), representing 26.7% of GDP. Corporate profit tax revenues grew by 1.5% yoy in January-October, while they declined by 1.3% yoy in January-September. This was the most significant change in development dynamics among sources of budget revenues. Personal income tax revenues and revenues from VAT posted growth almost identical to that observed in January-September (7.8% yoy and 4.2% yoy compared to 7.9% yoy and 4.1% yoy respectively). Growth of receipts from excise taxes, in contrast, sped up to 3.4% yoy in January-October, compared to 2.8% yoy in January-September. Revenues from dividends, use tax on goods, and selling certificates emissions remained almost unchanged compared to those observed a month ago. Moreover, revenues from dividends even declined. Growth of the budget revenues significantly decelerated at the local government level. In particular, income and property tax revenues grew by 6.2% yoy in January-October compared to 8.9% yoy in January-September. At the same time, growth of non-tax revenues decelerated even more significantly from 7.7% yoy to 4.6% yoy. On the other hand, growth of amounts repaid by the European Union recovered to 18.9% in monthly terms, while the total amount of reimbursements from the beginning of the year was almost the same as during the same period of the previous year.

Growth of consolidated general budget expenditures slightly decelerated and became equal to that of revenues in January-October. The total amount of expenditures reached RON 174.3 billion (EUR 39.2 billion) or 27.9% of GDP. Increases of both spending on goods and services and wage bill expenditures remained almost unchanged in January-October compared to those observed in January-September (both inched down by 0.2% yoy). Therefore, they remained as the main drivers of growth in total consolidated general budget expenditures. Investment expenditures grew by 16.5% mom or by RON 3.2 billion (EUR 720 million) in October, which is higher than the average monthly investment expenditures over 9 previous months of the year. In



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total, investment expenditures reached RON 22.6 billion or 3.6% of GDP. Investment expenditures, including capital expenditure and the related development programs financed from internal and external sources, were 22.6 billion (EUR 5.1 billion), or 3.6% of GDP in January-October 2013.

Monetary Policy

Consumer inflation met the most optimistic expectations, staying below 2% for the second month in a row in October. Consumer prices in general grew by 1.88% yoy, which is below the lower bound of the target band of 3%±1% for the year. The major reason is continuing deflation of the food goods sector (1.34% yoy compared to 1.72% yoy a month ago). At the same time, some deceleration in deflation of the food goods sector was compensated for by deceleration of inflation in the services sector (from 3.2% yoy in September to 2.78% yoy in October). Growth of prices in the non-food goods sector remained almost unchanged at 4.23% yoy.

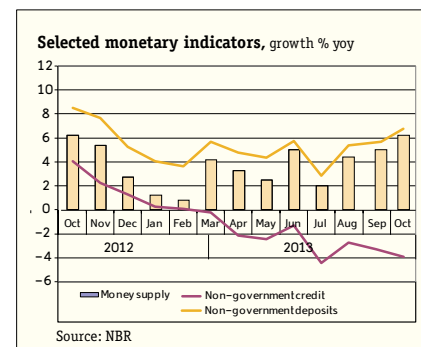
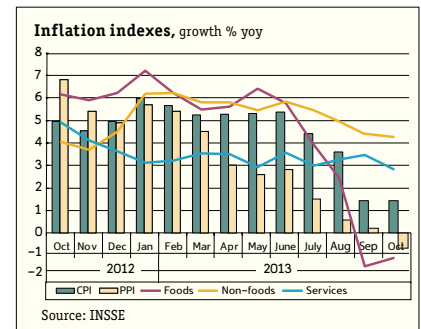
The National Bank of Romania's attempts to stimulate national currency lending saw some positive achievements, as policy rate cuts led to gradual declines in the lending rates to the real sector. However, the achieved results still were too far from what was expected in October. On the one hand, both households and the corporate sector expanded their portfolio of RON-denominated non-government loans. At the same time, the growth of household RON-denominated loans was insignificant (0.2% yoy) and growth of corporate loans was not very high (3.1% yoy). Moreover, forex-denominated non-government loans also decreased for both households and companies, and the decrease (4.6% yoy for households and 10.1% yoy for corporate sector) was much higher than growth of the RON-denominated loans. Taking into account that amount of forex-denominated non-government loans was 1.5 times higher than that of RON-denominated loans, the total amount of non-government loans declined by 3.9% yoy in October.

Broad money (M3) continued to grow in October at an accelerated rate. Its growth rate was equal to 6.1% yoy at the end of the month. This is 1.3% yoy higher than the growth rate observed in September. Same as in the previous months of the year, net foreign assets were the driver of growth, while net domestic assets decline at quite a high rate. In particular, net foreign assets grew by 124.8% yoy in October. At the same time, net domestic assets decreased by 13.9% yoy. However, since the share of net foreign assets remained much lower than that of net domestic assets (30.5% compared to 69.5%), their contribution to growth of broad money in general is also much lower.

Two major factors influencing the RON/EUR exchange rate remained the same. On the one hand, strong economic performance strengthened domestic currency. On the other hand, actions of the NBR related to stimulation of domestic currency lending through lowering of the policy rate still caused some depreciation pressure on the RON. The effect from the latter was a bit stronger in November and the RON/EUR exchange rate depreciated insignificantly to 4.4412 by November 30th, 2013.

International Trade and Capital

Thanks to improvements in trade with both goods and services, foreign trade posted good performance in September 2013. In particular, exports of goods grew by 16.1% yoy to EUR 4.456 billion, while imports increased at a much slower rate of 4.3% yoy to EUR 4.670 billion. As a result, the FOB-FOB commercial foreign trade in goods balance remained in deficit of EUR 214 million, which, however, was 66.8% yoy lower. Machinery and transport equipment and food and livestock groups made the largest additional contributions to the positive export performance, against the background of sustained demand for automobiles and spare parts and plentiful crops, respectively. Considerable annual dynamics in export turnover values were also reported by textiles, oil processing and the machinery and equipment industries. As for services, their exports grew by 16.9% yoy to EUR 762 million, while imports declined by 31.5% yoy to EUR 406 million, leading to a foreign trade in services surplus of EUR 356 million. This surplus is not only 5 times higher than that observed a year ago, but also exceeds the deficit of foreign trade in goods, meaning that the total foreign trade balance was in surplus at EUR 142 million in September. Transport services and other services group still ensured a surplus of foreign trade in services. From the beginning of the year, the total foreign trade deficit reached EUR 356



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billion, which is less than one tenth of the deficit observed over the same period last year. Such progress was possible thanks to improvements in trade in both goods and services. The deficit of foreign trade in goods totalled EUR 2.482 billion in January-September, which is a 55.2% yoy decline. At the same time, foreign trade in services was in surplus in January-September, but the surplus itself was more than three times higher than that observed over the same period last year.

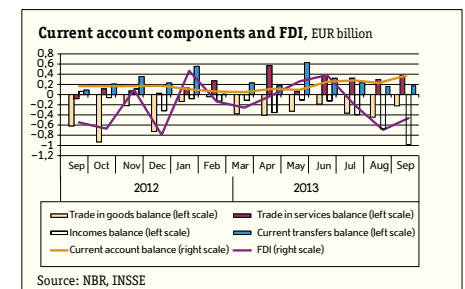
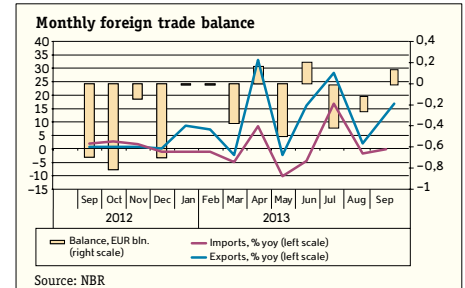
The foreign trade deficit was not the major factor of the current account deficit expansion. The EUR 765 million income account deficit in September led to a 39.1% increase in the income account compared to that observed at the end of August. As surplus of the current transfers account grew by just EUR 356 million in September, the total current account deficit increased to EUR 595 million as of September 30th, 2013. At the same time, the current account deficit remained much smaller in year-over-year terms in January-September 2013 (declined by 87.6% yoy).

Dynamics of foreign direct investments (FDI) significantly improved thanks to significant inflows of foreign direct investments in September. In particular, net FDI inflows amounted to EUR 379 million over the month, which is more than one third of net FDI inflows in January-August 2013. As a result, total FDI reached EUR 1.497 billion in January-September 2013, which is a 9.9% decline. It is a significant improvement, as the decline observed in January-August 2013 was equal to 35.9% yoy. The share of intra-group loans was equal to 32.9% (2.6% higher than a month ago) at EUR 492 million. The share of equity stakes consolidated with the estimated net loss reached 67.1% at EUR 1.005 billion.

The total external debt of Romania expanded by 1.3% to EUR 98.523 billion as of September 30th, compared to the amount observed a month ago. This increase was caused by expansion of direct public medium- and long-term external debt by 6% to EUR 28.558 billion, which was slightly compensated for by a 1.5% decline in short-term external debt to EUR 19.380 billion. Other components of medium- and long-term external debt, such as publicly guaranteed debt, non-publicly guaranteed debt, medium- and long-term deposits of non-residents, and IMF borrowings changed insignificantly. The share of medium- and long-term external debt inched up from 79.7% to 80.3%.

Foreign exchange reserves of Romania expanded for the second month in a row in October 2013. This time the increase was attributed not only to issuance of Eurobonds. In particular, EUR 700 million was received as the first tranche from the World Bank under the 2012 agreement. The amount received from selling Eurobonds was equal to EUR 650 million, EUR 500 million from which was received from placement of bonds denominated in Euros and maturing in 2020 on the international market, and the rest EUR 150 million was obtained from placement of bonds denominated in Euros on the local market. Overall, foreign exchange reserve inflows totalled EUR 2.198 billion. At the same time, as there were no large interest and principal payments on foreign currency public debt and the main source of foreign exchange reserve outflows was changes in the foreign exchange reserve requirements of credit institutions, the total amount of foreign exchange reserve outflows was more than three times less than that of inflows at EUR 722 million. As a result, total foreign exchange reserves grew by almost 4.5% to EUR 34.562 billion in October. The gold stock remained unchanged in terms of weight at 103.7 tonnes, but inched down by 1.4% to EUR 3.254 billion. Total international reserves of Romania expanded by almost 4% in October and were equal to EUR 37.816 billion as of October 31st, 2013.

Other Developments Affecting the Investment Climate



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