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

- **GDP grew by 3.9% yoy in Q1 2014.**
- **Growth of industrial production decelerated to 2.6% yoy in April 2014.**
- **The consolidated budget deficit amounted to 0.24% of GDP in January-May 2014.**
- **Consumer inflation decelerated to 0.94% yoy in May 2014.**
- **The foreign trade balance turned negative (EUR 3 million) in April 2014.**
- **The current account declined by 85% yoy in April 2014.**

Executive Summary

Preliminary data shows that GDP grew by 3.9% yoy in the first quarter of 2014 on the back of a high contribution from industry, public sector, and trade.

Easter at the end of April negatively influenced the industrial output for the month. Growth of the sector decelerated by four times compared to that in March. Manufacturing was the only subsector generating growth in April, although still was much lower than in previous months. Trade and services sectors posted mixed performance in April. Growth in trade significantly decelerated mainly due to contraction in sales of fuel. On the other hand, services to households posted much better performance in April as hotels and restaurants registered high growth, while gambling and other recreational activities were back on the growth path again.

The government was successful in restraining increases of general consolidated budget expenditures in May. Growth in all the major budget revenues except for the amount reimbursed by the EU ensured 3.7% yoy growth in total revenues in January-May. At the same time, the decline in general government expenditures continued, although slightly decelerated. As a result, the general consolidated budget deficit remained significantly lower than during the same period last year in January-May.

Continued decline of food prices decreased consumer inflation in May. As growth of prices of non-food goods and services did not change significantly, some acceleration of deflation in the food goods sector to 3.16% yoy led to a slow down in total consumer inflation to a new historical low of 0.94% yoy.

The National Bank of Romania decided to continue its prudent monetary policy, which proved to be adequate under current economic conditions in the country. At the same, the Bank decided to continue its measures aimed at stimulation of national currency lending, which started to see a positive response. However, the positive developments in national currency lending were still overwhelmed by the negative impact of contraction in forex-denominated loans.

Just as in the case of industrial output, Easter celebration in April had some adverse effect on Romania's foreign trade. In particular, growth in exports of goods decelerated to just 2.2% yoy, which is below the growth rate of imports of good for the period. Fortunately, foreign trade in services performed much better than trade in goods. Thanks to the increased surplus of foreign trade in services, the total foreign trade deficit decreased by 98.1% yoy. The income account deficit remained the major factor negatively influencing the current account balance. Income account outflows were almost nine times higher than inflows, which led to significant expansion of the deficit. At the same, time current transfers generated a surplus, which almost fully covered the deficit of the income account in May. Therefore, the current account deficit for the month was significantly lower in year-over-year terms.

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

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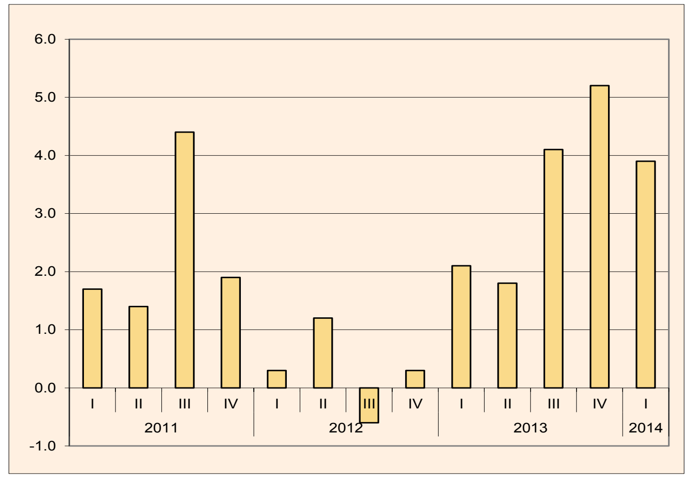
Economic Growth

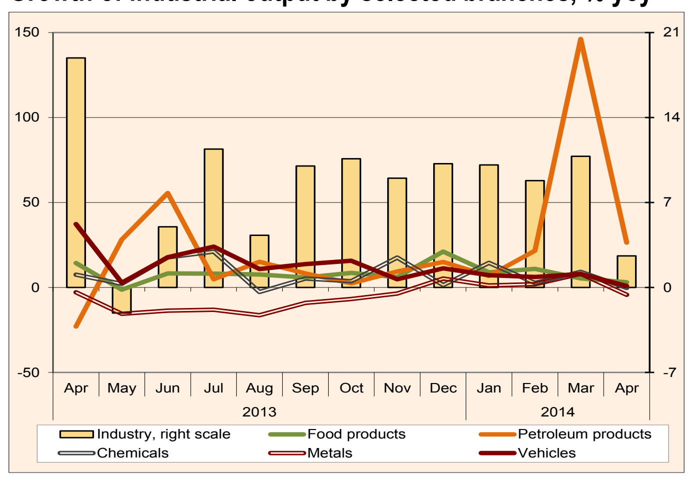
preliminary data, improved performance of the Romanian economy led to 3.9% yoy growth of GDP in Q1 2014. The unadjusted GDP amounted to RON 127.62 billion in the quarter. In terms of value added, industry had the highest share of nominal GDP value at 29.7%, followed by public sector (13.4%) and trade (12.5%). The share of net taxes on products in GDP was equal to 13.9%. As for contribution to the growth rate of GDP, negative values were observed only for professional, scientific and technical activities, with activities of administrative and support services (-0.2%), construction (-0.1%), and financial intermediation and insurance (-0.1%). Quite expectedly, industry made the highest contribution to GDP growth of 2.3% of the total 3.9% yoy growth. Contribution of trade was the second largest (0.6%) but significantly behind industry. Finally, information and communication made the third largest contribution to growth with 0.3%. Net taxes on products contributed 0.8% of GDP growth.

GDP growth, % yoy



Source: INSSE. The Blevzer Foundation

Growth of industrial output by selected branches, % yoy



Source: INSSE, The Bleyzer Foundation

Industry significantly worsened its performance in April, mainly due to a calendar effect. In particular, Easter was celebrated in the second half of April this year in contrast to early May in 2013. As a result, industrial output grew by just 2.6% yoy in April 2014, which is four times lower compared to March. Only manufacturing was able to ensure growth in April, while two other major sectors of industry posted declines. Growth of manufacturing, at the same time, significantly decelerated. It reached 3.9% yoy after seven consecutive months of double-digit rates. In addition to calendar issues, decline in external demand for some manufacturing goods is to blame for the deceleration. The decline was observed, among others, in transport means, food and light industries. As for other industry sectors, energy posted a 8.9% yoy decrease, while mining declined by 4.1% yoy in April. Despite significant deceleration in growth in April, total industrial output posted very good performance from the beginning of the year. 9.6% yoy growth in manufacturing in January-April ensured total industrial growth of 8.1% yoy for the period.

In April 2014, growth patterns reversed in trade and services compared to those in March. Growth of trade decelerated from 11% yoy to just around 4% yoy. At the same time, services to households grew by 7.4% yoy in April, which is more than 4 times higher than in March. As for trade, there were two major reasons for growth deceleration: significant decline in sales of fuel and negative dynamics of durables sales. The decline in sales of fuel amounted to 6.1% yoy and was caused by introduction of increased fuel excise from April 1st, 2014 (as this was announced a couple of months ago, people were buying fuel for future use in anticipation of the price increase, causing higher growth of fuel sales previous months). Sales of durables entered negative territory on the back of a significant decline in sales of electronics and IT products. Sales of transport means inched up just by 0.6% yoy, which was not enough to compensate for declines in sales of other durables. Sales of non-durables, except for fuel, pharmaceuticals and textiles, performed quite well. Sales of foodstuffs grew by 10.6% yoy, while sales of non-food goods in general increased by almost 6% yoy. Performance of services to households significantly improved on the back of hotels and restaurants and return of dynamics of gambling and other recreational activities to positive territory. As a result, total services to households expanded by 7.4% yoy in April.

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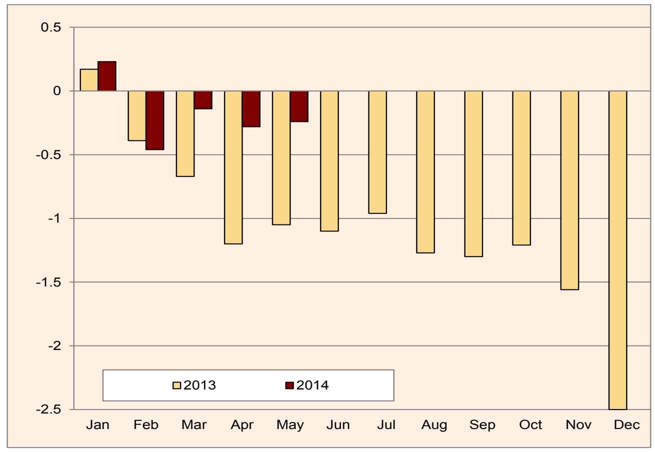
Fiscal Policy

The government continued its fiscal consolidation policy in May 2014. The general consolidated budget was executed with a deficit of 0.24% of GDP in January-May. This is 0.8% of GDP less compared to the same period last year. In monetary terms, the decline in the deficit amounted to RON 5.0 billion. Furthermore, the primary balance was positive at 0.45% of GDP at the end of May, compared to a primary deficit of 0.27% of GDP a year ago.

Consolidated budget balance, % of GDP



Source: Ministry of Public Finance of Romania

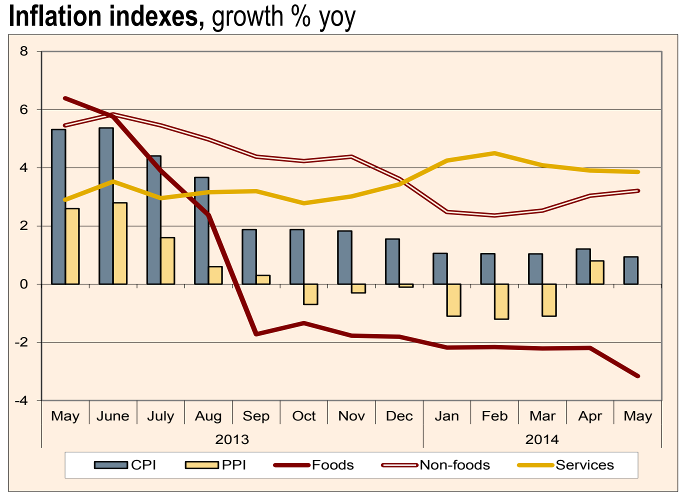
The general consolidated budget revenues continued to grow in May. However, their growth was lower than in previous months. Therefore, the total five-month growth of revenues decelerated to 3.7% yoy. Their total amount was equal to RON 84.1 billion (EUR 18.9 billion), which is equivalent to 12.7% of GDP. Increases were registered in almost all the major revenues except for amounts reimbursed by the EU, which decreased by 16% yoy and non-fiscal revenues, down 20% yoy. In particular, the government collected RON 1020.6 million (EUR 229.2 million) more of social security contributions, RON 901.2 million (EUR 202.4 million) more of property taxes, RON 814.9 million (EUR 183 million) more of excises, RON 604.2 million (EUR 135.7 million) more of income taxes, and RON 277.0 million (EUR 62.2 million) more of VAT. Local governments collected 5.3% yoy more of property taxes, 4.6% yoy more of use tax on goods, and 2.1% yoy more of non-tax revenues.

The decline in general consolidated budget expenditures decelerated because of developments in May. The expenditures totaled RON 85.7 billion (EUR 19.2 billion) in January-May, which is 2.3% lower than the same period last year. As a share of GDP, the total government expenditures were equal to 12.93%, which is 1% lower than a year ago. Moderate growth was registered in all the major expenditure lines of the budget except for interest payment and investment expenditures. The wage bill grew by 2.3% yoy thanks mainly to an increase in the minimum wage on January 1st, 2014. Spending on goods and services expanded by 4.6% yoy on the back of continued repayment of arrears to providers of medications on the side of the National Health Insurance Fund. Interest payment expenditures decreased by 6.4% yoy thanks to lower benchmark yields at sovereign bond auctions. Investment expenditures of January-May 2014 stood at RON 7.5 billion (1.14% of GDP), down from RON 10.1 billion during the same period of 2013.

Monetary Policy

Good news on the harvest projections positively influenced price dynamics in May. In particular, the decline in prices of food goods accelerated by almost one percent to 3.16% yoy. This led to deceleration of overall inflation, as changes in prices of non-food goods and services were not that significant. Actually, growth in prices of services remained almost unchanged compared to that in April (3.86% yoy against 3.91% yoy), while growth in prices of non-food goods accelerated insignificantly (from 3.04% yoy to 3.21% yoy). As a result, total consumer inflation fell to a historical low of 0.94% yoy in May. From the beginning of the year, consumer prices grew by 1.44%.

Inflation indexes, growth % yoy



Source: INSSE, The Bleyzer Foundation

Low consumer inflation and gradual recovery of savings assured the National Bank of Romania (NBR) that its prudent monetary policy is adequate under current

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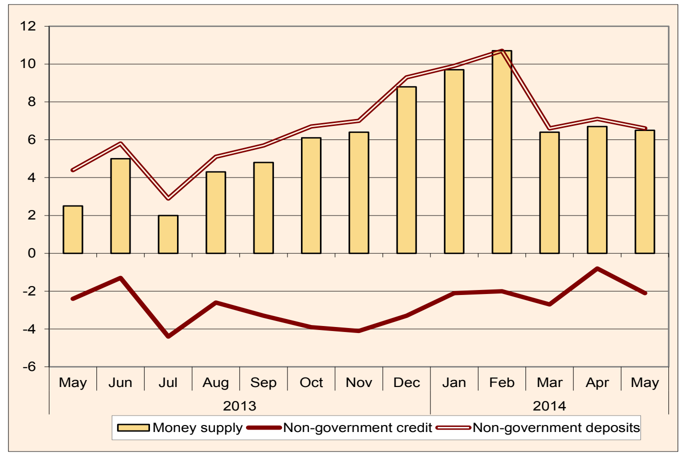
economic conditions in the country. In order to further stimulate national currency lending and somewhat restrain the decline in forex-denominated loans, the NBR in its July 1st meeting decided to keep the policy rate and the minimum reserve requirement ratio on RON-denominated loans unchanged (at 3.5% and 12% respectively) but to lower the minimum reserve requirement on forex-denominated loans from 18% to 16%. National currency loans continued to increase at a decent rate at both the corporate and household level. As a result, total RON-denominated non-government loans grew by 7.0% yoy in May 2014. However, the decline in total forex-denominated loans was even higher at 7.7% yoy. As observed in previous months, forex-denominated non-government loans decreased faster at the corporate level (9.9% yoy) but the decline rate at the household level is also high (5.4% yoy). Since the total amount of forex-denominated non-government loans is still significantly higher than that of national currency loans, it is not a surprise that total non-government loans declined in May. Moreover, the decline accelerated from 0.8% yoy observed in April to 2.1% yoy.

Selected monetary indicators, growth % yoy



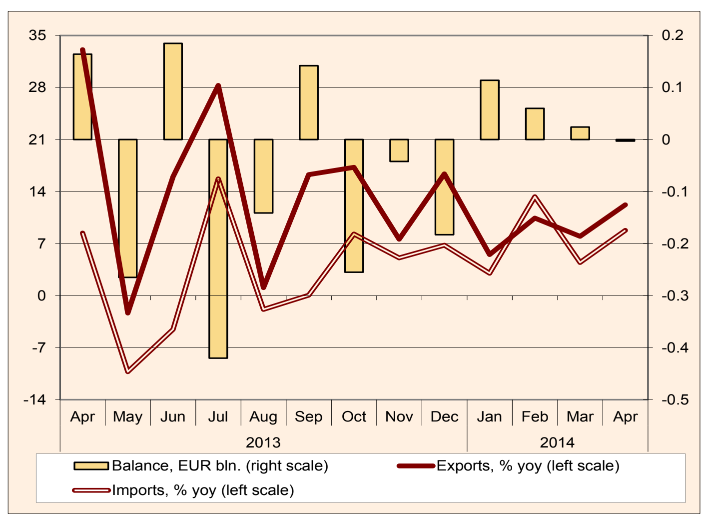
Source: NBR

Broad money (M3) grew at a slightly decelerated rate in year-over-year terms in May because of monthly dynamics of the indicator. In monthly terms, broad money remained unchanged as a 2.8% mom increase in net domestic assets fully compensated for a 5.3% mom decline in net foreign assets. On the other hand, both net domestic and net foreign assets continued to follow annual dynamics patterns observed from the beginning of the year. These patterns are exactly the opposite of the monthly dynamics observed in May. Net domestic assets declined by 6.6% yoy, while net foreign assets increased by 48.3% yoy. Total broad money amounted to RON 240.837 billion (EUR 54.1 billion), which is a 6.5% yoy increase.

International Trade and Capital

Romania's foreign trade experienced mixed developments in April as lackluster performance in trade in goods was accompanied by fast growth in trade in services. After months of good performance, foreign trade in goods experienced a major deceleration in April. Growth of FOB exports of goods declined from around 8% yoy in March to just 2.2% yoy. The reason behind this is believed to be the calendar effect associated with the Easter holidays. The main driver of growth in exports was machinery and transport equipment. As for imports, their growth also decelerated but much less than exports. FOB imports grew by 2.6% yoy, which is lower than 4.46% yoy in March but still higher than growth in exports in April. Therefore, the deficit of foreign trade in goods reached EUR 434 million in FOB-FOB terms, expanding by 6.11% yoy in April. On the other hand, the mentioned deficit was almost fully covered by the surplus of foreign trade in services. Growth of both exports and imports of services was above 50% in year-over-year terms in April. However, since exports of services were almost 1.5 times higher in absolute terms and their growth rate was also higher than that of imports, surplus of foreign trade in services grew by 73.1% yoy to EUR 431 million in April. Overall, good performance of foreign trade in services

Monthly foreign trade balance



Source: NBR

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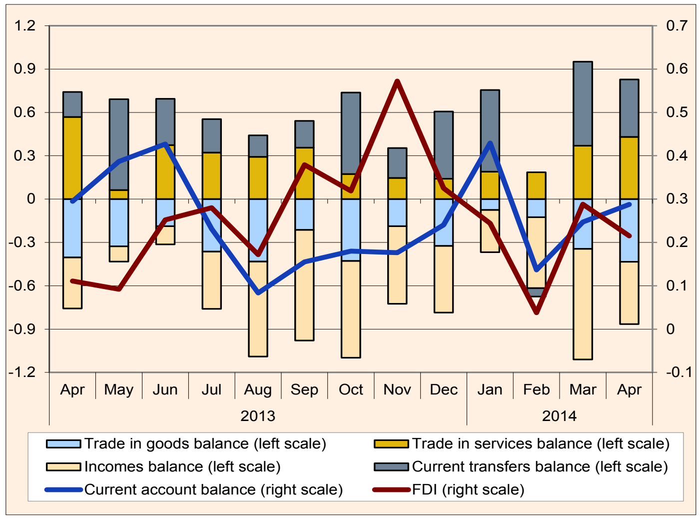
ensured high growth of foreign trade in general. Total exports grew by 12.2% yoy, which is significantly higher than 8.8% yoy growth in total imports. Total FOB-FOB foreign trade deficit was equal to just EUR 3 million in April compared to EUR 160 million a year ago. After four months of 2014, the total foreign trade balance remains positive at EUR 195 million compared to a deficit of EUR 128 million in January-April 2013.

Current account components and FDI, EUR billion



Source: NBR, INSSE

The situation with the current account balance continued to improve in April 2014 on the back of improvements with the foreign trade balance. The trend over the last couple of months of fast growth of the income account deficit fully compensated for by growth in the surplus of current transfers continued in April. The income account deficit totalled EUR 431 million in the reporting months, while the surplus of current transfers amounted to EUR 397 million. Taking into account the above mentioned deficit of foreign trade, the current account deficit reached EUR 37 million in April, which is an 85% decline. At the same time, despite a positive foreign trade balance and high surplus of current transfers over the first four months of the year, the current account balance is negative for the period because of the high income account deficit (79.8% yoy higher).

Foreign direct investments continued to grow in April, though at a slightly decelerated pace compared to March. Total FDI inflow was equal to EUR 215 million in April. As a result, from the beginning of the year, Romania received EUR 785 of direct investments from non-residents, which is an 8.7% yoy increase. Equity stakes accounted for the majority of FDIs (EUR 705 million or 89.8%). Intragroup loans amounted to EUR 80 million.

The external debt of Romania expanded due to increases in both its components in April. Medium- and long-term external debt grew by 1.16% mom to EUR 76.182 billion. Most of the increase was caused by direct public debt expansion from EUR 28.222 billion at end-March to EUR 29.371 billion (4.1% mom) at end-April. Developments in other medium- and long-term external debt components were insignificant. As for short-term external debt, it grew at a higher rate (2.14% mom). As a result, the total external debt of Romania grew by 1.34% mom in April. As the growth rate of the short-term external debt was higher, its share in the total external debt further increased to 19.38%.

Due to high payments on loans, the National Bank of Romania's foreign exchange reserves shrank by 5.4% to EUR 30.681 billion in May 2014. Inflows of reserves amounted to EUR 1.248 billion and mainly represented changes in the foreign exchange reserve requirements of the credit institutions and inflows into accounts of the Ministry of Public Finances of Romania. As for outflows of reserves, they amounted to EUR 3.007 billion and represented mainly interest and principal payments on the foreign currency public debt but also changes in the foreign exchange reserve requirements of the credit institutions and payments from the account of the European Commission. In particular, interest and principal payments on external debt include EUR 941 million equivalent paid on a loan from the IMF (EUR 784 million from the National Bank of Romania and EUR 157 million from the Ministry of Public Finance) and EUR 1.339 billion paid in repayment of the principal and interest on euro denominated bond issued by the Ministry of Public Finance, which matured on May 6th, 2014. As the international price of gold continued to decline in May, the value of the Romanian gold stock declined by 1.48% mom to EUR 3.071 billion, even though it remained unchanged in terms of weight. All the mentioned developments led to a 5.07% mom decline in total international reserves of Romania, which stood at EUR 33.752 billion as of May 31st, 2014.

Other developments affecting the investment climate

In June 2014, the IMF representatives visited Bucharest to conduct discussions with the Romanian government, regarding the third review of under the Stand-By Arrangement. Yet the IMF representatives left without any official review of the agreement, which was postponed for a later date. According to media statements, the major disagreement issue was the budgetary effect of the government plan to cut 5% of the social security tax rate. The IMF postponed its review until November to give the government time to decide on the fiscal measures.

Electrica (power utility) shares and Global Depository Rights (GDR) started trading on July 4th following the Initial Public Offering. Shares are traded on the Bucharest Stock Exchange while GDRs are traded on the London Stock Exchange. After the first day of trading, the market capitalization stood at RON 3.9 bn (EUR 0.9 bn). Following the IPO, the government is the largest shareholder, controlling 48.8% of the shares. EBRD announced it acquired 8.65% of the Electrica shares. Electrica is a holding company for the Romanian state-owned electricity distribution and supply companies, holding 78% stakes in three of the total seven regional distribution companies, 78% of Electrica Furnizare (power supply) and 100% of Electrica Serv (services). The joint global coordinators and joint bookrunners were Citigroup, Raiffeisen Bank and Societe Generale.