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

- **GDP grew by 2.9% yoy in 2014.**
- **Industrial output grew by 3.1% yoy in December 2014.**
- **The consolidated budget surplus was at 0.56% of GDP in January 2015.**
- **Consumer inflation decelerated to 0.41% yoy in January 2015.**
- **The balance of foreign trade in goods was at EUR 6.046 billion in 2014.**
- **The current account deficit decreased by 40.4% yoy in 2014.**

Executive Summary

According to the first estimates of the National Institute of Statistics, GDP grew by 2.9% yoy in 2014. This is slightly above of our expectations of 2.5-2.6% yoy.

Industrial output saw acceleration in growth for the first time over the last couple of months on the back of positive developments in manufacturing. Manufacturing industries benefited from swifter increases in demand for their goods in both domestic and external markets. Growth in manufacturing was supported by positive developments in mining and quarrying, which returned to growth. The energy sector further declined in December. Unlike industrial output, the trade and services sector saw deceleration in growth due to market services to households returning to a downward trend and a further decline in car sales. Retail trade posted good growth even though it decelerated a bit compared to that observed in November.

The IMF mission admitted the success of the Romanian government in fiscal consolidation in 2014. However, it also provided recommendations concerning further reforms in public revenues and expenditures needed to reduce fiscal vulnerabilities and to reach the new consolidated budget deficit target of 1.8% of GDP. The data on budget execution in January 2015 showed that the consolidated budget was executed with a surplus more than twice as high as the surplus observed in January 2014. The result was obtained thanks to both good growth in revenues and a decline in expenditures, which indicates that the government is taking the recommendations of the IMF seriously and is trying to continue fiscal consolidation.

Deflation in the food goods sector led to further deceleration in consumer inflation in January 2015. At the same time, the trend of deceleration in growth of non-food goods prices also continued. Growth of services prices remained virtually unchanged for the third consecutive month.

The National Bank of Romania lowered the policy rate in February basing on the economic data analysis and sluggish performance of non-government lending. Inflation forecasts were revised downwards for 2015 and 2016. The Bank also expects the risks to the projections to be related solely to external shocks. These conclusions led to the decision on further lowering of the policy rate, as national currency lending needs further stimulation. Data on January developments showed that the desired effect of national lending stimulation was not obtained, especially in the corporate sector.

The situation with foreign trade further deteriorated in December 2014. Exports of goods posted the first decline in 2014 during the month, while imports increased at an accelerated rate. These negative developments were the result of weaker demand for Romanian goods in the non-EU markets and swifter growth of imports from the EU. As a result, the commercial FOB-CIF deficit from foreign trade in goods further increased in December. Even though the current account deficit expanded in December, it declined for the year 2014 by more than two-fifths.

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

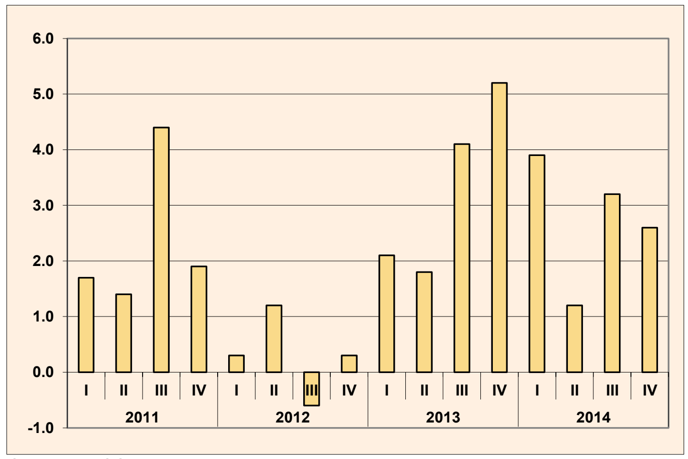
Chief Economist Edilberto L. Segura
Editor Rina Bleyzer O'Malley

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

Economic Growth

The National Institute of Statistics published its first estimates of GDP growth in Q4. According to the data, GDP growth decelerated to 0.5% qoq over the period as compared to 2.2% qoq observed in Q3. In year-over-year terms, growth was more significant at 2.6% but still behind that in Q3 equal to 3.3%. The first estimates of annual GDP for 2014 showed its increase by 2.9% to 2013, which is slightly above expectation of 2.5-2.6%.

GDP growth, % yoy

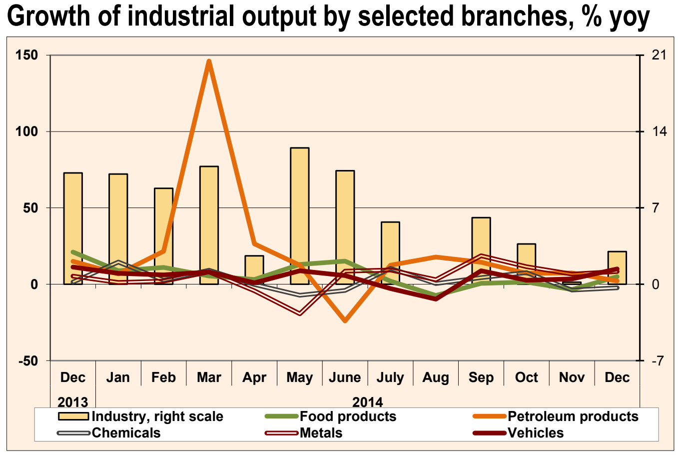


Source: INSSE, The Bleyzer Foundation

After a couple of month of slowdown in growth, industrial production saw improvements in development in December 2014. Total industrial output grew at 3.1% yoy, or 2.9 percentage points higher than in November. The major driver of growth was expansion of manufacturing, which saw a four-fold increase in growth rate to 4.5% yoy. Both external and domestic demand made their contributions to manufacturing growth. In particular, road transport means, electrical equipment, electronics, and IT products industries benefited from demand on external markets. At the same time, food industry, metallurgy, and manufacture of non-metallic mineral products observed higher demand on the domestic market. Output of the energy sector continued to decline. Furthermore, the rate of decline accelerated to 7.1% yoy from 6.7% yoy observed in November. In contrast, mining and quarrying returned to growth and expanded by 4.0% yoy thanks to acceleration of growth in other mining and quarrying and mining support service activities, which offset the decline in metal ores mining. The annual growth of industrial output totalled 6.1% in 2014. It was mainly attributed to a 7.5% yoy increase in manufacturing as mining and quarrying expanded by just 1.0% yoy and the energy sector posted a 4.7% yoy decline. Just four manufacturing industries posted declines, with the sharpest one observed in manufacture of beverages at 3.3% yoy. All the other manufacturing industries posted increases ranging from 0.4% yoy for manufacture of wearing apparel to 53.9% yoy for manufacture of computer, electronic, and optical products.

The return of market services to households to a downward trend together with a sharper decline of car sales decelerated growth in the trade and services sector by about one percentage point to around 3.0% yoy in December. Retail trade saw a marginal deceleration of 0.6 percentage points to 6.5% yoy because of a rebound in fuel sales. Retail of fuel for motor vehicles in specialized shops grew by 9.0% yoy compared to a 3.3% yoy decline in November. The mentioned increase almost fully compensated for the deceleration of growth in retail of both food and non-food products. The annual increase in retail trade was 7.0% yoy. The decline in the trade with motor vehicles accelerated by five percentage points to 5.6% yoy as all of its components, except for maintenance and repair of motor vehicles, posted declines. This may be related to both the base effect and consumer decisions. In particular, it seems that many consumers decided to postpone the purchase of a new car until the "First Car" national program is launched. The negative developments observed at the end of 2014 led to lower annual growth of motor vehicle sales at just 1.7%. Sharper reduction in receipts of hotels and restaurants (by 11.0% yoy compared to 6.6% yoy in November) led to a contraction in market services to households as a whole by 5.2% yoy. Other

Growth of industrial output by selected branches, % yoy



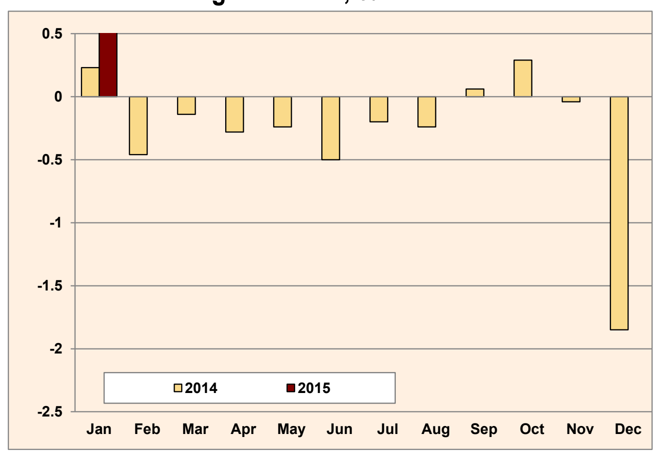
Source: INSSE, The Bleyzer Foundation

components of the sector also observed negative developments. This was reflected either by acceleration of the decline, as in the case of washing and cleaning services, or by deceleration of growth, as in the case of other sub-sectors. Mixed developments of the sector over the year and a decline over the last couple of months of 2014 were the reasons why the sector remained almost flat (increased by 0.9% yoy) from a year-over-year perspective.

Fiscal Policy

The IMF mission gave a high appraisal of Romanian measures on fiscal consolidation. In its concluding statement of the 2015 Article IV Mission, the IMF staff noted Romania's efforts to reduce fiscal vulnerabilities. On the other hand, the Fund also pointed out that spending pressures are building. In particular, more effective public investment is needed to address a rising infrastructure gap. Taking this into account, together with government plans to raise defense spending and face age-related social spending, the country needs fiscal structural reforms in order to further consolidated fiscal adjustment. On the revenue side, the government needs further efforts to improve revenue mobilization. On the expenditure side, among other issued, Romania needs to improve efficiency of realization of projects financed from public sources and conduct further health sector reforms to address the expansion of health-related spending. The new fiscal deficit target for 2015 was set at 1.8% of GDP. This level is supposed to help put public debt on a gradual downward path.

Consolidated budget balance, % of GDP



Source: Ministry of Public Finance of Romania

As data from the Ministry of Public Finance shows, the government is trying to fulfill the new fiscal deficit target for 2015. The consolidated budget was executed with a surplus of RON 3.95 billion in January, which is equivalent to 0.56% of GDP. This is an improvement over the same period of the previous year, when the consolidated budget surplus was at 0.22% of GDP.

Consolidated budget revenues started the year with solid growth. They grew by 4.1% yoy amounting to RON 18.4 billion, which is equivalent to 2.6% of GDP. The mentioned growth was ensured thanks to expansion of receipts from corporate profit tax (by 23.8% yoy), VAT (18.5% yoy), personal income tax (16.9% yoy). At the same time, receipts from excise duties and social security contributions declined by 11.6% yoy and 3.4% yoy respectively. Non-tax revenues posted the fastest growth among the national level budget revenues expanding by more than 25% yoy. Local governments were also effective in revenue collection as they managed to expand receipts from property taxes by 11.9% yoy, while non-tax revenues grew by 7.4% yoy.

In contrast to revenues, consolidated budget expenditures posted a decline in January. They amounted to RON 14.4 billion, which is a 10.7% yoy decrease. The major reason for such a significant contraction was a 25.1% yoy decline in expenditures on goods and services due to the unfavorable base effect. In January 2014, the government paid arrears to suppliers of drugs from the Single National Social Insurance Fund following the implementation of legislation on combating delays in making commercial payments. Public investment expenditures, including capital expenditures and related development programs financed from both internal and external sources, amounted to RON 682.6 million, which is comparable to expenditures over the same period of time last year.

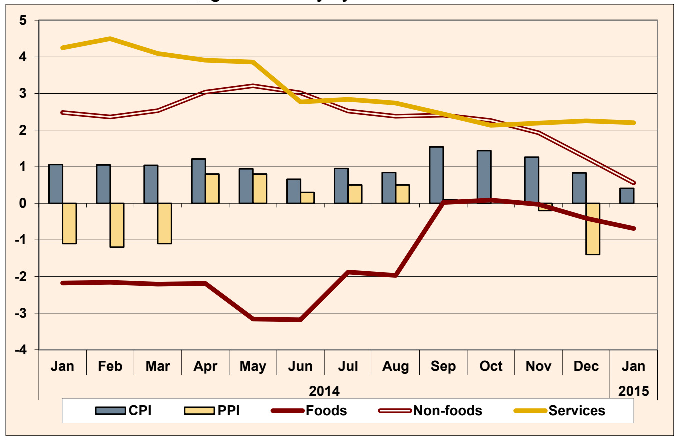
Monetary Policy

The trend of consumer inflation deceleration continued in January 2015. Consumer prices of all items inched up by 0.41% yoy over the period. The main reason of deceleration was deflation of food prices at 0.69% yoy and further deceleration in growth of non-food goods prices. Prices of non-foods increased by 0.56% yoy in January, or 0.69 percentage points lower than in December 2014. At the same time, prices of services posted a 2.2% yoy increase, which is virtually the same as a month ago.

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

The National Bank of Romania (NBR) adjusted its monetary policy in February based on the statistical data on inflation and on non-government loans. In particular, the continued trend of consumer inflation being below the lower bound of the variation bank of the flat target, while the economy remained on the upward trend, induced the National Bank to revise its inflation projections. As a result, consumer inflation is forecasted to be at 2.1% at the end of 2015 and at 2.4% at the end of 2016. Furthermore, NBR forecasted that the risks associated with new projections relate to external uncertainties but to domestic ones. Taking this into account and the fact that national currency lending needs further stimulation, as its growth was still not enough to compensate for decline in the forex-denominated loans, the NBR decided to lower the policy rate again to 2.25% starting on February 5. Obviously, the symmetrical corridor of interest rates on the NBR's standing facilities was also adjusted accordingly to ±2.00 percentage points from ±2.25 percentage points. As for non-government loans, their decline accelerated again to 3.8% yoy in January. Same as in December 2014, corporate sector was to blame for the decline. Monthly decline of the national currency loans to corporate sector made the year-over-year growth of the indicator almost flat (0.2% increase). Household national currency loans, in contrast posted a high growth of 16.3% yoy. As a result, total national currency loans saw a 6.7% yoy increase in January. At the same time, forex-denominated loans to the corporate sector declined in monthly terms again, which further accelerated the year-over-year decline to 12.4%. Since forex-denominated non-government loans to households also declined at a high rate of 8.9% yoy, total forex-denominated loans dropped 10.6% yoy just as in December 2014. Since the total amount of forex-denominated non-government loans remains significantly higher than that of national currency loans, their dynamics have a more significant impact on total private sector loans.

Inflation indexes, growth % yoy



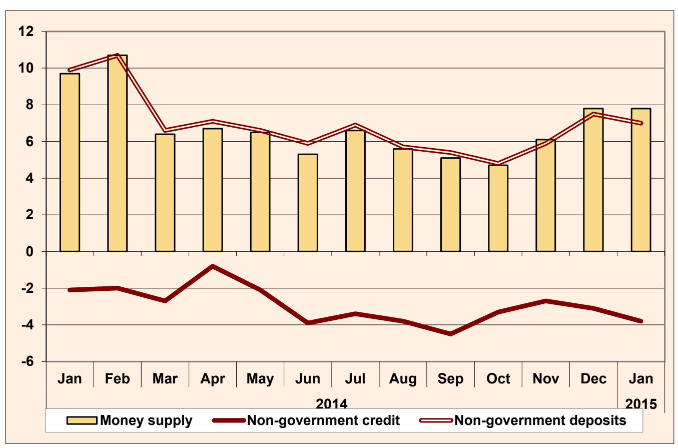
Source: INSSE, The Bleyzer Foundation

Broad money continued to increase at a high rate in January 2015. In total, broad money grew by 7.8% yoy on the back of net foreign assets expansion. Net domestic assets also expanded but at a much lower rate. In particular, net foreign assets grew by 22.1% yoy, while net domestic assets posted just a 1.1% yoy increase. Even though net foreign assets have been growing at a double-digit rate for more than 12 months, they were still almost two times lower than net domestic assets (RON 92.6 billion and RON 166.649 billion respectively). That is why the dynamics of the latter has a larger impact on the growth of broad money as a whole.

International Trade and Capital

December marked further deterioration in the foreign trade of Romania. According to preliminary data, exports of goods posted negative growth for the first time in 2014, decreasing by 1.4% yoy. Exports of goods to EU actually increased at an accelerated rate of 7.4% yoy, which is a 2.2 percentage point increase. At the same time, exports of goods outside the EU dropped 17% yoy due to a significant contraction in fuel sales and the base effect associated with naval industry exports. The latter posted the highest increase over the previous two years in December 2013. As mentioned earlier, transport means, electrical equipment, electronics and IT products benefited the most from higher

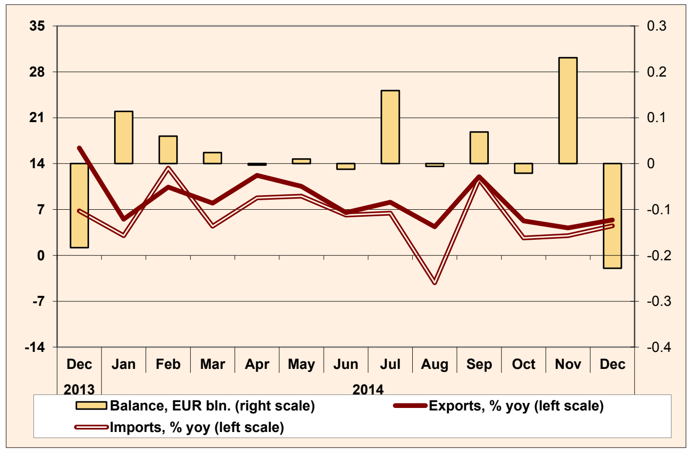
Selected monetary indicators, growth % yoy



Source: NBR

external demand in December. However, this is not the full list as pharmaceuticals, rubber and plastic products, furniture, and wood products were also of high demand abroad. Despite the mentioned negative developments in December, total annual exports of goods grew by 5.8% yoy to EUR 52.459 billion in 2014. As for imports of goods, they increased by 4.5% yoy in December, which is a 0.6 percentage points higher than in November. Same as in case of exports, imports of goods from EU increased, while imports from non-EU markets declined (to a great extent due to oil purchases). Monthly growth in imports of goods helped accelerate the annual growth to 5.9%. As a result, total merchandise imports amounted to EUR 58.505 billion in 2014. The increase in imports and decline in exports of goods the commercial FOB-CIF deficit of foreign trade in goods significantly widened in December. It totalled EUR 744.9 million, which is a 50.6% yoy increase. In 2014 as a whole, the deficit of merchandise foreign trade reached EUR 6.046 billion, which is a 5.9% yoy increase.

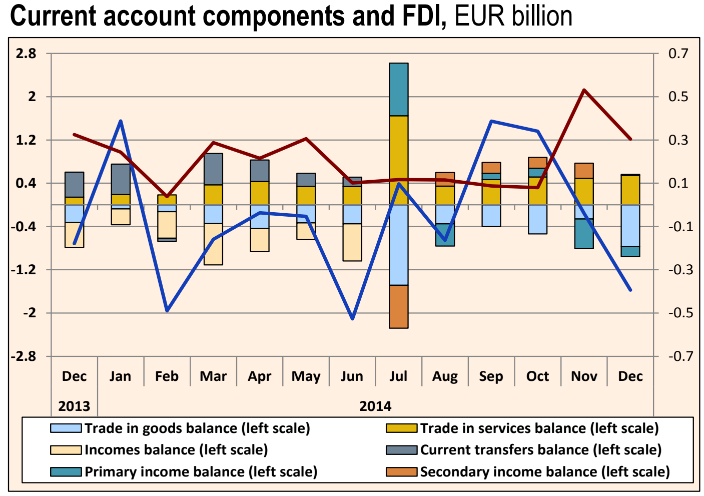
Monthly foreign trade balance



Source: NBR

Despite some deterioration in December, the current account balance improved in 2014. The current account deficit increased in December due to a sharp decline in secondary income surplus, which offset declines in the deficit observed for primary income and foreign trade. As for foreign trade itself, the deficit in merchandise trade calculated following the "change of economic ownership" principle increased by 39.2% to EUR 771 million as exports inched down by 0.7%, while imports posted good growth at 5.0% yoy. However, exports of services expanded by more than one-fifth in December 2014 compared to the same month of the previous year, while imports of services posted just a modest increase of 2.5% yoy. Growth in surplus of foreign trade in services to EUR 543 million fully offset growth in deficit observed for merchandise foreign trade and led to further decline of total foreign trade deficit by 12.3% yoy to EUR 228 million. The deficit of foreign trade in goods for the full 2014 saw just minor changes compared to the deficit in 2013, while the surplus of foreign trade in service increased by one-forth. This turned the total foreign trade deficit of EUR 743 million in 2013 to a surplus of EUR 352 million in 2014. Positive developments in foreign trade were supported by changes in the primary income account in December as outflows from the account decreased sharper than inflows (58.8% yoy against 39.1% yoy respectively). This led to a 65.0% yoy decline in the deficit of the account to EUR 188 million. For the whole 2014, the decline in the deficit was less significant, but still at a good rate of 7.8% yoy to EUR 2.870 billion. As for the secondary income account, it saw a decline in inflows of more than one-third in year-over-year terms in December. At the same time, outflows from the account increased by 134.4% yoy. This, obviously, resulted in significant decline of the account's positive balance (by 94.9% yoy) from EUR 430 million in December 2013 to EUR 22 million in December 2014. Fortunately, the year-over-year decline of the account's surplus was much lower at 32.2% to EUR 1.822 billion. As a result of the

Current account components and FDI, EUR billion



Source: NBR, INSSE

mentioned above developments, the current account deficit increased by 7.4% yoy to EUR 394 million in December 2014. At the same time, the year-over-year dynamics of the current account deficit for the whole 2014 remained positive, as the deficit declined by 40.4% yoy to EUR 696 million.

Net foreign direct investments decreased in December compared to November, but were still significantly higher than the average monthly amount in 2014. Non-residents made EUR 304 million of direct investment into Romania over the reporting period. Compared to EUR 531 million received in November, this was quite a decline. At the same time, average net FDI stood at EUR 192.9 million per month over the January-November 2014 period. This makes December net FDI look not that bad.

The decline in external debt of Romania accelerated a bit in December 2014. However, developments in external debt components leading to this result were exactly the opposite of those observed in November. The total external debt decreased by 1.3% mom to EUR 94.259 billion. Unlike in November, the long-term external debt saw a decline of 1.8% mom thanks to declines in all its components. The sharpest decline was observed in non-publicly guaranteed debt at 2.6% mom to EUR 40.737 billion. The short-term external debt, in turn, posted a minor increase of 0.6% mom to EUR 18.143 billion compared to a 3.0% mom decline in November. As a result, the share of the short-term external debt within the total external debt increased back to 19.3%.

The international reserves of Romania sustained minor negative developments in January, as positive changes in value of gold stock were not enough to overcome the negative developments in foreign exchange reserves. The later saw a 5% decline over the month, as outflows were two times higher than inflows in January. Inflows amounted to EUR 1.593 billion and represented mostly changes in the foreign exchange reserve requirements of the credit institutions, inflows into the European Commission's account, and into accounts of the Ministry of Public Finance representing European funds. Outflows amounted to EUR 3.214 billion, more than half of which represented interest and principal payments on the foreign currency public debt. In particular, EUR 1.547 billion was paid to the European Commission as the interest and principal installments on the loan. The government also paid EUR 240 million equivalent as the principal installment on the loan from the IMF. The gold stock stayed unchanged in terms of weight at 103.7 tons but continued to increase in terms of value thanks to positive developments in world gold prices. As of January 31st, the value of Romanian gold stock was equal to EUR 3.718 billion, which is a 13% mom increase. Thanks to the mentioned above developments, the international reserves of Romania declined by 3.4% mom to EUR 34.313 billion in January.

Other developments affecting the investment climate