

**August 2012**
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- GDP grew by 1.2% in Q2 2012.
- Industrial production decreased by 5.7% mom and 1.4% yoy in June.
- The consolidated budget deficit reached 1.12% of GDP at the end of June.
- Consumer price growth was 3.0% in July.
- The FOB-CIF commercial deficit for goods grew by 2.8% in June, but decreased by 0.7% yoy in H1 2012.
- The current account deficit fell by 29.4% yoy in June to EUR 2.4 bln.
- The sixth review of the economic program was conducted by staff teams of the IMF, EU and WB and brought generally positive conclusions.

### Executive Summary

Romania recorded 1.2% yoy growth of GDP in Q2 2012, according to preliminary estimates of the National Institute of Statistics, despite adverse external conditions and political uncertainty inside the country. As a result, growth for the first half of the year stood at 0.8% yoy.

Industrial production fell by 5.7% mom in June due to poor performance in manufacturing, which also led to a decline in annual terms. Retail turnover also decreased in monthly terms but, fortunately, the annual growth rate remained positive.

The trend of higher growth of consolidated budget revenues than expenditures continued in June. Revenues grew by 8.9% yoy in January-June, while expenditures were up by 3.3%. However, the consolidated budget deficit still rose, as expenditures of the general government still exceeded revenues. At the end of June, the consolidated budget deficit reached 1.12% of GDP.

As of the end of July, consumer inflation in Romania reached the target level for the year of 3.00%, due to price growth for all segments of goods in annual terms. Prices of non-food goods and of services grew much faster than prices of food in both monthly and monetary terms. Despite prudent policy of the NBR aimed at supporting liquidity of banks, the growth of credit to the private sector decelerated to 6.3% yoy.

Unlike in the previous couple of months, the commercial deficit of trade in goods increased in June. The growth rate of the deficit reached 2.8% yoy. However, this increase was not enough to break the decreasing trend of the trade deficit in goods, which decreased by 0.7% yoy in the first half of the year since growth of exports exceeded that of imports.

Staff teams from the IMF, EU and WB were on mission in Romania from July 31st – August 14th. They conducted the sixth review of the economic program in Romania. The general conclusion is that policy implementation is still on track, despite many challenges. However, the government has to pursue implementation of reforms in order to gain further improvement.

	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	9,496.899	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 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	3
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

According to estimates of the National Institute of Statistics of Romania, the Gross Domestic Product of Romania amounted to RON 139.1 bln (EUR 31.4 bln) in current prices in Q2 2012, a 1.2% yoy increase. This growth was ensured thanks to a 6.1% yoy increase in services, a 5.2% yoy increase in construction, and a 3.8% increase in entertainment and recreation activities and repair of household goods and other similar services. Information and communication, real estate activities, and industry also demonstrated growth, even though this growth was not that significant (1.9% yoy, 1.3% yoy, and 0.5% yoy respectively). On the other hand, GDP growth could be higher if not for the decrease in the public sector (-1.9% yoy), agriculture (-1.6% yoy), financial intermediation and insurance (-0.9% yoy), and wholesale and retail, repair of motor vehicles, transport and storage, and hotels and restaurants (-0.2% yoy).

Domestic demand increased moderately by 0.9% yoy in Q2 2012, thanks to a significant increase in gross fixed capital formation (15.2% yoy). Total final consumption also grew but not as sharply (1.1% yoy). Final general government consumption expenditures declined by 1.0% yoy. Since exports grew by 0.7% yoy, while imports grew by just 0.2% yoy, net exports had a positive impact on GDP.

Estimates for the first half of 2012 showed a 0.8% yoy increase in GDP to RON 248.6 bln (EUR 56.6 bln) in current prices, thanks to an increase in volume of activities and gross value added in several sectors, including services (3.2% yoy), construction (3.1% yoy), entertainment and recreation activities, repair of household goods and other similar services (2.7%), and information and communication (1.7%). Total final consumption grew by 0.7% yoy in H1 2012 on the shoulders of a 1.1% increase in final household consumption expenditures. Gross fixed capital formation grew by 14.1% yoy.

Industrial production decreased by 5.7% mom in June. As a result, the sector recorded a 1.4% decrease in annual terms that month compared to a 2.7% growth in May. The main reason was a decrease in manufacturing (-6.0% mom and -2.7% yoy). Electricity, gas, steam, and air conditioning supply grew in annual terms by 7.2% despite a 7.1% mom decrease in June. The mining and quarrying sector recorded growth in both monthly (3.6%) and annual (5.2%) terms.

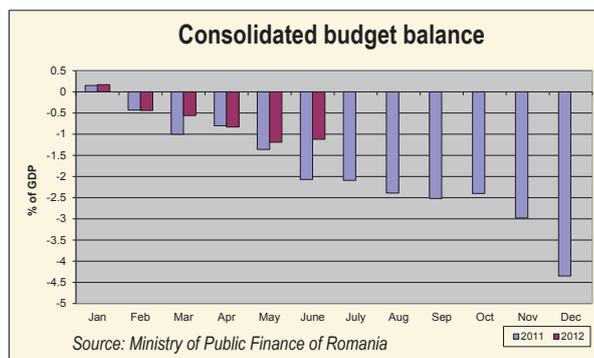
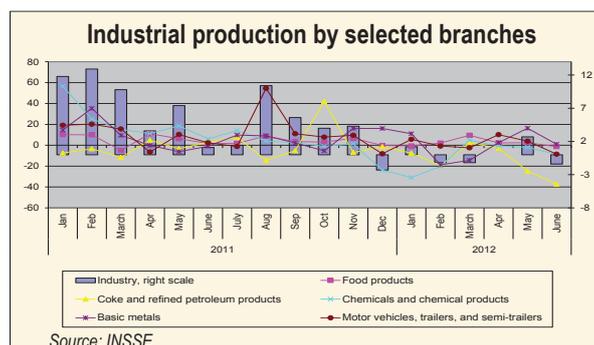
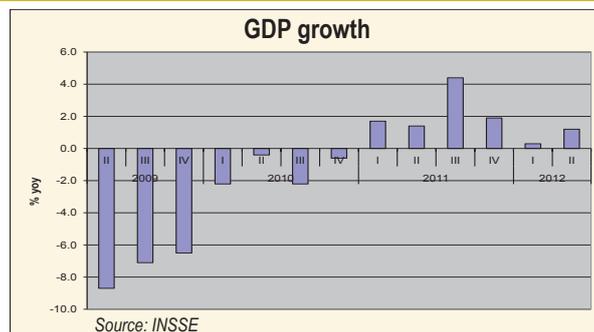
As for the main industrial groups, all the goods categories, except for consumer durables, declined. The highest decrease was registered for capital goods (-2.6% yoy). The decreases of consumer non-durables and the energy industry were twice as low, amounting to 1.4% yoy and 1.3% yoy, respectively. Intermediate goods decreased by 0.7% yoy. Consumer durables, in contrast, recorded 3.5% yoy growth.

Despite a 0.7% mom decrease in June, retail turnover volume grew by 3.9% in June compared to the same month of 2011. The main drivers of the growth were fuel retail for motor vehicles in specialized shops (a 10.2% yoy increase) and sale of food, beverages, and tobacco (a 4.4% yoy increase). Retail turnover volume of non-food products decreased by 0.1% yoy. At the same time, all major retail trade categories recorded growth in H1 2012 in annual terms. In particular, fuel retail for motor vehicles in specialized shops grew by 10.3% yoy, food, beverages, and tobacco sales grew by 3.6% yoy, and non-food product sales increased by 1.3% yoy.

#### Fiscal Policy

Data from the Ministry of Finance of Romania shows that the consolidated general budget of the country was executed with a cash deficit of RON 6.8 bln (EUR 1.55 bln) or 1.12% of GDP in January-June 2012. This is much better than during the same time period last year, when the deficit was equal to RON 11.2 bln, or 1.94% of GDP.

Revenues of the consolidated general budget grew by 8.9% yoy in six months of 2012 to RON 93.0 bln (EUR 21.2 bln), which is equal to 15.3% of GDP. In particular, tax revenues increased by 11.5% compared to the same period last year. The highest growth rate was observed for income taxes (15.5% yoy), while the lowest – for



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excises (6.6% yoy) and corporate tax (7.7% yoy). Value added tax revenues grew by a significant 9.5% yoy. Other taxes on goods and services increased due to a governmental decree setting collection of contributions to finance healthcare expenditures. At the local administration level, the highest growth of 14.6% yoy was registered for non-tax revenues. At the same time, income and property taxes grew by 4.3% yoy. Social insurance contributions grew by 5.4% yoy to RON 25.5 bln (EUR 5.8 bln). Transfers from the EU continue to grow at high rates. As of the end of June, they had increased by 31.6% yoy in 2012.

Austerity measures are still helping to restrain the growth of public expenditures, as general government expenditures grew by 3.3% yoy, which is moderate compared to growth of budget incomes. As of the end of June 2012, general government expenditures amounted to RON 99.8 bln (EUR 22.7 bln), which is 16.4% of GDP. Once again, expenditures for EU-funded projects recorded the highest growth, at 45.1% yoy. Public debt interest payment growth continues to decelerate, even though it is still one of the highest expenditures at 34.4% yoy. Expenditures on goods and services grew by 7.1% yoy due to payments for medical services and medicines at the local level and the national health fund. The consolidated budget wage bill increased by 1.2% yoy. Finally, investment expenditures grew by 4.7% yoy in January-June 2012 to RON 13.8 bln (EUR 3.1 bln).

### Monetary Policy

The National Bank of Romania continues to follow prudent monetary policy in order to maintain the inflation rate inside the variation band and to create an environment for lasting economic recovery.

Inflation in Romania accelerated from 2.04% yoy in June to 3.00% yoy in July, even though in monthly terms prices remained almost stable. Food prices increased by 1.19% yoy – the first increase in four months. At the same time, in monthly terms food prices inched up by a mere 0.14%. Both non-food goods prices and service prices grew in July by 0.84% mom and demonstrated much faster growth in annual terms compared to food prices. Non-food goods prices grew by 3.37% yoy, while service prices grew by 5.69% yoy. These increases are almost the same as increases recorded in June and in May.

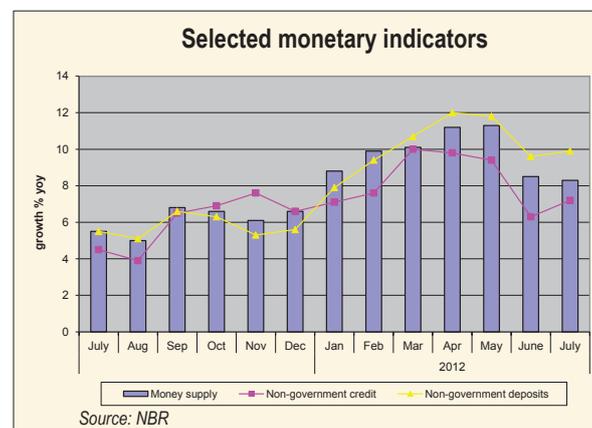
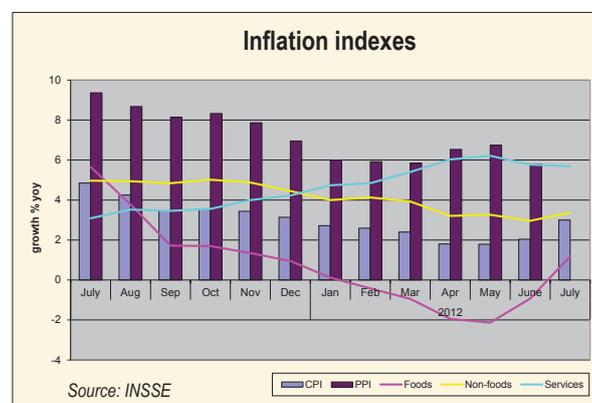
The annual adjusted CORE 2 inflation rate stood around 2.0% in June thanks to diminishing impact from unfavourable RON depreciation (caused by persistence of the negative output gap.)

The NBR Board has decided to leave the monetary policy rate at 5.25 percent per annum at its August meeting. The main reason is the desire to ensure adequate liquidity management in the banking system. At the same time, the NBR also wants to preserve the existing minimum reserve requirement ratios on both RON- and foreign currency-denominated liabilities of credit institutions.

During August, the RON slightly appreciated against the EUR, gaining 2.5%, helped by the NBR actions to limit the RON liquidity in the market, by reducing the liquidity provided in the market through the repo operations. During August the NBR repeatedly limited the RON amounts available to the banks, to as low as RON 4.0 bn (EUR 0.9 bn) in each of the last two weeks of August. This amount represented only approximately ¼ of the financing requested by banks, while for the rest of 2012, NBR financing matched banks requests.

Broad money (M3) broke the two-month upward trend in monthly terms and decreased by 1.7% mom as of the end of June 2012. This led to a decrease in the annual growth rate from 11.3% in May to 8.5%.

The total volume of loans to the private sector granted by credit institutions reached RON 227.1 bln (EUR 51.7 bln). In terms of growth dynamics, the growth rate of these loans decelerated to 6.3% yoy as of the end of June, after close to 10% yoy growth over the last three months. RON-denominated loans grew by 4.2% yoy, while foreign currency-denominated loans expressed in RON grew faster – by 7.5% yoy (if expressed in EUR, the growth is just 2.3% yoy).



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#### International trade and Capital

Preliminary estimates of the National Institute of Statistics show that in June, FOB exports of goods amounted to EUR 3.7 bln and CIF imports of goods reached EUR 4.7 bln. This marked a decrease in both exports and imports by 1.2% yoy and 0.4% yoy, respectively. Compared to the last couple of months, when the deficit of trade in goods had been decreasing, the deficit increased in June. In particular, the deficit increased by 2.8% yoy to EUR 933.4 mln in June 2012 after a double-digit decrease over the last two months. The growth in the deficit is not high yet, but the change in the deficit trend is still quite alarming.

Data on foreign trade in goods for H1 2012 shows that exports grew a bit faster than imports over the first six months of the year (1% yoy against 0.7% yoy, respectively). As a result, the commercial deficit of trade in goods decreased by 0.7% yoy. Compared to data for January-May, the decrease in the commercial deficit decelerated.

In absolute terms, FOB exports were equal to EUR 22.3 bln and CIF imports were equal to EUR 26.9 bln, while the commercial deficit amounted to EUR 4.6 bln. Data for H1 2012 proves that Member States remain the main market for Romanian goods. It also showed that the share of Romanian exports to the Member States over the first six months of the year was equal to 71.2% of EUR 15.9 bln. The share of imports was equal 73.1% or EUR 19.6 bln for the same time period. Transport equipment and vehicles and other manufactured goods remain the group of goods with the highest shares in Romanian international trade. The share of transport equipment and vehicles in Romanian exports was equal to 40.9%, but the share in imports is much lower at 33.0%. As for shares of other manufactured goods, the one in exports is equal to 34.5% and the one in imports is 29.6%.

Thanks to an increase in the current transfers surplus and in the service surplus accompanied by a decrease in the income deficit and in the trade deficit, the current account deficit declined by 29.4% yoy to EUR 2.4 bln. This is a significant improvement compared to the January-May period, which posted a 22.2% decrease in the current account deficit.

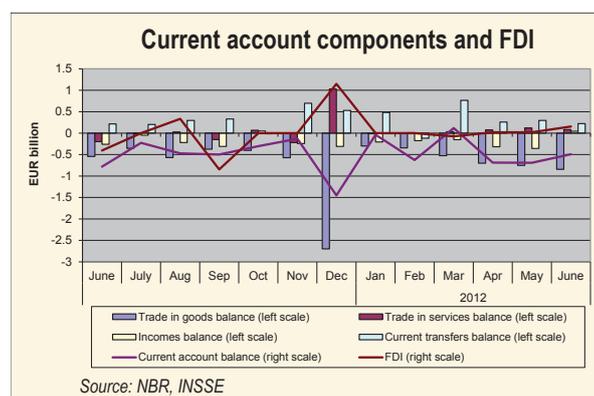
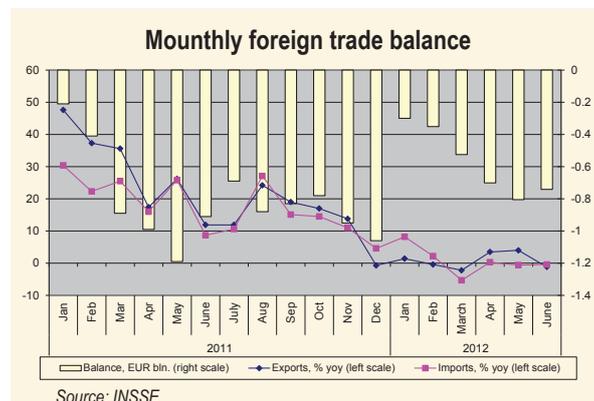
Foreign direct investments continued to decline, down 28.9% yoy during Jan-June, yet the decline rate decelerated from 45% yoy during the first five months of the year. By the end of June, foreign direct investment amounted to EUR 621 mln in 2012. This is enough to cover just 25.8% of the country's current account deficit, but still better than 24.2% coverage observed at the end of last month.

Medium- and long-term external debt continues to grow, amounting to EUR 77.8 bln at the end of June, a 2.9% growth from the beginning of the year. At the same time, short-term external debt continues to decrease declining by 6.8% from the beginning of the year to EUR 21.3 bln. Despite such a decrease, the share of short-term external debt slightly increased by 0.3% to 21.5% of total debt.

According to data from the National Bank of Romania, foreign exchange reserves declined by 2.5% to EUR 32.96 bln as of July 31st. The inflows to reserves amounted to EUR 1.3 bln, while outputs to EUR 2.1 bln. Thanks to changes in international gold prices, the value of the gold stock of Romania grew by more than 6% mom to EUR 4.4 bln, even though the stock of gold itself remained unchanged. This increase in the value of gold compensated a bit for the decrease in foreign currency reserves. As a result, the total international reserves of Romania decreased to EUR 36.6 bln at the end of July compared to EUR 37.1 bln at the end of June.

#### Other Developments Affecting the Investment Climate

Staff teams of the IMF, EU and WB visited Romania from July 31st to August 14th for the sixth review of the country's economic program. They came to the general conclusion that policy implementation is doing well, despite a challenging environment. In particular, inflation is expected to remain within the target band. Banks are believed to still be vulnerable to negative shocks but are maintaining sufficient capital buffers and adequate loan-loss provisions. The target for the fiscal deficit of not higher than 3% is considered achievable (assuming spending restraint), especially in the public sector, since arrears targets for the general government are missed by a small margin.



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Unfortunately, the mission decreased its forecast of real growth for 2012 to 1% from 1.5%. The reason is political uncertainty due to future parliament elections and a slowdown in the Euro area. The mission also recommended that the government speed up needed structural reforms and privatization. It was also advised to terminate unsuccessful investment projects financed by the state to reduce losses.

The political turmoil continued for almost the entire month of August, following the referendum to suspend the president at end-July. The final decision was taken by the Constitutional Court which argued that the referendum was not valid due to lower than required quorum. We expect to politics to remain a strong instability factor until the end of 2012, Parliamentary elections are scheduled for December 2nd.

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