Executive Summary

Fueled by external demand, industrial production in Romania almost doubled its year-over-year growth in July. The increase was attributed to growth in manufacturing of 13.3% yoy (twice as high as in June). At the same time, recovery of domestic demand helped the trade and services sector enter positive territory for the first time in several months. Growth was registered in all the sector’s major components.

The consolidated general budget deficit significantly expanded in August. Its share of GDP grew from 0.96% observed in January-July to 1.27% at the end of August. At the same time, the deficit still remained within the limits agreed with international financial institutions and the EU.

Consumer inflation continued to slow on the back of deceleration in growth of prices of food goods. The National Bank of Romania expects consumer inflation to fall below the target level for the year of 2.5%, taking into account recent developments in consumer prices and projections for the rest of the year.

Recovery of national currency lending remained slow in Romania in July. The total volume of RON-denominated loans remained almost flat despite recent decreases in the policy rate introduced by the National Bank of Romania. This forced the NBR to reduce the policy rate once again. From September 30th, the policy rate is equal to the historical low of 4.25%. Moreover, experts expect it to decline further to 4%.

Driven by high external demand for Romanian goods, foreign trade in both goods and services posted good performance in January-July 2013. 73.25% yoy growth in exports of transport services and their flat imports tripled the surplus of foreign trade in transport services. On the other hand, the deficit of foreign trade in goods declined by almost 55% yoy in January-July. As a result, the total foreign trade deficit declined by more than 11 times. The current account surplus declined in monthly terms in July because of high growth in the income account deficit. However, it remained quite high at EUR 489 million, which is a significant improvement over the EUR 3.041 billion deficit at the end of July 2012.

Economic Growth

Romania’s real sector continued to grow in July, stimulated by increased external demand for Romanian goods and services. In monthly terms, industrial production remained almost flat because of a 5.1% mom decline in mining and quarrying. However, in year-over-year terms its growth did not slow down during the month but almost doubled compared to growth observed in June, despite remaining flat in monthly terms. External demand for Romanian goods favored manufacturing, which added 6.7% to a 6.6% yoy increase observed in June. All the export-oriented industries grew faster than domestic market oriented industries. This includes chemical production, even though its growth was attributed not to good performance but to a favorable base effect. The small decline in electricity, gas, steam, and air conditioning supply and flat mining and quarrying slightly affected the total growth in the industrial production sector, decelerating it to 11.4% yoy.
After a couple of months of decline, the trade and services sector in total was back to growth in July (grew by 2% yoy). Retail trade imposed significant progress in July 2013. Its monthly growth of 2.1% helped turn negative year-over-year dynamics positive. The 1.0% yoy increase was generated thanks to an increase in sales of non-food products, which overcame declines in other retail trade subsectors. Turnover of trade in motor vehicles and motorcycles managed to generate a 4.4% yoy increase in July. This growth was driven by 12.9% yoy growth in trade of spare parts and accessories for motor vehicles and a 1.3% yoy increase in trade of motor vehicles stimulated by the car fleet renewal program. Growth could have been much higher, if not for significant declines in trade of motorcycles and in maintenance and repair of both motor vehicles and motorcycles. At any rate, the total sector year-over-year growth in July was not enough to break the downward sector development trend observed over the first seven months of the year. However, the decline decelerated to 0.8% yoy. As for market services rendered to households, they grew by 1.1% yoy on the back of increase in activities of travel agencies (24% yoy) and services of cleaning textiles and furs (15.3% yoy). However, the mentioned increase was not enough to generate growth in the sector in the first seven months of the year. Total volume of market services provided to households decreased by 3.9% yoy over the mentioned period.

**Fiscal Policy**

The Romanian government continued to optimize fiscal policy and cut expenditures in order to meet the deficit target at the background of deceleration in growth of revenues. The consolidated general budget deficit amounted to RON 7.9 billion (EUR 1.79 billion) or 1.27% of GDP in January-August 2013. This share is considerably higher than 0.96% of GDP a month ago and is 0.1% yoy higher but is still within the limits agreed with the EC, the IMF, and the WB. On the positive side, Ministry of Finance reported a 0.05% of GDP budget primary surplus.

In January-August 2013, growth of consolidated general budget revenues decelerated to 4.4% yoy from 5.2% yoy observed in January-July 2013. Their total amount of RON 131.2 billion (EUR 29.67 billion) was equivalent to 20.9% of GDP. Deceleration in growth of revenues is a result of a 0.8% decline in receipts from the corporate profit tax caused by lower revenues of commercial banks. At the same time, growth of revenues from other taxes slightly decelerated in January-August compared to January-July.

In particular, growth of the personal income tax revenues inched down by 0.5% to 8.2% yoy, the increase in VAT revenues decelerated by 1.2% to 3.7% yoy, and growth of excise tax revenues lost almost 1% and was equal to 1.5% yoy. Growth of revenues from the use tax on goods and of social security contributions remained at the level observed in January-July 2013. The situation with budget revenues at the local level was similar to that at the state level over the reporting period. Growth of tax revenues of the local governments inched down by 0.6% to 8.9% yoy. This was a bit compensated thanks to faster growth of non-tax revenues. Non-tax revenues grew by 8.4% yoy in January-August, which is 0.2% higher than growth observed in January-July. Over the first eight months of the year, amounts repaid by the European Union finally reached the level of the same period of time in 2012 thanks to a 18% mom increase in August.

General government expenditures grew faster than revenues in January-August 2013. Total general government expenditures amounted to RON 139.1 billion (EUR 31.46 billion), which is 22.2% of GDP. This is a 4.8% yoy increase, 0.7% higher than a month ago. The increment in growth of expenditures was caused by accelerated growth in expenditures on goods and services. This growth amounted to 10.8% yoy in January-August, while it was observed at a level of 7.4% yoy a month ago. The wage bill expenditures also grew at a high rate, but one that was lower than in January-July (15.2% yoy compared to 16.4% yoy). Volume of investment expenditures declined 10.5% yoy to RON 17.3 billion (EUR 3.91 billion) during January-August as the government reduces the investments in order to balance the budget.

**Monetary Policy**

In August, consumer inflation continued to decelerate on the back of decreased growth of goods prices, while prices of services slightly accelerated. A 0.93% deflation was observed in the food sector in January-August 2013 because growth of...
prices there decelerated for a couple of months in a row. Particularly, in August growth of prices of food goods decelerated by 1.52% from 3.9% observed in July. Prices of non-food goods grew by 4.98% yoy in August, which is 0.58% yoy less than in July. At the same time, prices of services increased at a higher rate in August compared to that in July (3.16% yoy and 2.96% yoy respectively). Total consumer inflation was equal to 3.67% yoy in August compared to 4.4% yoy in July.

The National Bank of Romania decided to continue stimulating the economy and further lowered its policy rate. On September 30th, the NBR announced it was lowering its policy rate by 25 basis points to 4.25%, which is the lowest level in Romania's history. The decision was based on inflation projections and the need to further stimulate economic recovery. According to the Bank, inflation will remain on a downward path through the end of the year. It is expected to fall below the target level of 2.5%.

CORE2 inflation dropped to 2.24% already in August. Taking into account the attitude of the NBR and inflation dynamics, experts expect a further decrease in the policy rate to 4.00% this year.

The policy rate cuts finally started to affect processes related to national currency non-government loans. RON-denominated loans posted insignificant increases for two months in a row (0.7% yoy increase in July and 0.6% yoy increase in August). The decline in volume of total non-government loans decelerated to 2.6% yoy in August compared to 4.4% yoy in July. This improvement is mainly attributed to positive shifts in forex-denominated non-government loans, the decline of which decelerated from 7.2% yoy in July to 4.6% yoy in August. Households continued curtailing their borrowing activities in both domestic and foreign currency.

After one month of deceleration in July, the growth of broad money (M3) more than doubled in August to 4.3% yoy. This growth was still driven by the increase in net foreign assets, which accelerated to 98.4% yoy from 74.9% yoy observed a month ago. At the same time, the decline in net domestic assets remained above 10% yoy even though it slightly decelerated (from 10.6% yoy in July to 10.2% yoy in August).

Favourable investor sentiment towards the Romanian economy is causing some depreciation pressure on the Romanian currency. Accompanied by the actions of the NBR related to lowering of the policy rate, this led to moderate depreciation of the RON in August and September 2013. As a result, Romania was the leader in currency depreciation in the region as the RON depreciated by 1.26% to EUR in two months. As of September 30th, the RON/EUR exchange rate was 4.4604.

**International Trade and Capital**

In July 2013, Romanian foreign trade fared much better compared to the same month of the previous year. There were improvements in trade with both goods and services. Faster growth of exports compared to that of imports led to the decline in foreign trade in goods deficit (by 34.77%) and to the astonishing increase in the foreign trade in services surplus (by more than 7 times) in year-over-year terms. Stable high growth of the foreign trade in services surplus helped to restrain growth of the total foreign trade deficit during the year. As a result, the total foreign trade deficit of Romania reached just EUR 357 million in January-July 2013 compared to EUR 4.056 billion in January-July 2012. Transport services were the major driver of the increase in the foreign trade in services surplus. Exports of transport services almost doubled to EUR 2.105 billion in January-July 2013, while imports inched down by 0.79% yoy over the period to EUR 755 million. This led to growth of the foreign trade in services surplus to EUR 1.478 million over the reporting period, compared to just EUR 18 million a year ago. As for trade in goods, it also posted good performance over the reporting period. In particular, exports of Romanian goods grew by 7.68% yoy over the first seven months of the year, while imports remained almost unchanged (inched down by a mere 0.69% yoy). As a result, the deficit of foreign trade of goods amounted to EUR 1.835 billion over the period, which is a 54.76% yoy decline.

The deficit of both foreign trade in goods and income account grew faster than the surplus of foreign trade in services and current transfers account in July. Therefore, the current account surplus decreased to EUR 489 million in January-July 2013 compared to EUR 695 million in January-June. The deficit of income account grew by 43.8% mom in July reaching EUR 1.3 billion from the beginning of the year. This is 8.7% higher than the deficit over the same period of time last year. Current transfers account surplus almost reached the amount observed over the same period of time last year.
Foreign direct investments decreased by 28.9% yoy in January-July 2013 despite significant investments into Romania in June and July. In particular, the highest EUR 252 million investments of June were followed by even higher EUR 280 million investments in July. The total amount of FDI from the beginning of the year totaled EUR 946 million. Around 60% of this amount was generated through intragroup loans (EUR 570 million). Equity stakes consolidated with the estimated net loss amounting to EUR 96 million.

The total external debt of Romania decreased by slightly more than 0.5% or by EUR 509 million in July. The decline was attributed to the fact that the medium- and long-term external debt decreased by 0.73% mom to EUR 78,336 billion. The highest decline of 1.89% mom (or EUR 696 million) was registered in the non-publicly guaranteed medium- and long-term external debt, while direct public debt even increased despite repayment of the ninth and tenth installments of the IMF credit and repayment of Eurobonds. The short-term external debt of the country increased by EUR 73 million or 0.37% mom in July. The share of medium- and long-term external debt within the total external debt decreased by 0.15% to 79.7%, which means that the share of short-term external debt expanded to 20.3%.

Significant repayments of external debts led to a decrease in the foreign exchange reserves of the National Bank of Romania in August. In particular, Romania repaid ninth and tenth principal installments to the IMF, in which the share of the National Bank of Romania was equivalent to EUR 835 billion and the share of the Ministry of Public Finance of Romania was equivalent to EUR 168 million. In addition, the country repaid EUR 470 million of principal and interest payments on Eurobonds issued by the Ministry of Public Finance. Taking into account the foreign exchange reserve outflows related to changes in the foreign reserve requirements of the credit institutions and other outflows, the total amount of the foreign reserve outflows amounted to EUR 2,068 billion in August. This is more than two times higher than foreign exchange reserve inflows of the month (EUR 888 million). The decline in the foreign exchange reserves equalled 3.54% mom, while their total amount was equal to EUR 32,173 billion. Romania did not trade gold from its reserves in August. Therefore, the value of its gold stock was influenced solely by changes in prices of gold on the international markets. The price of gold increased on the international markets, as did the value of Romanian gold stock (by 4.87% mom). This increase slightly compensated for the decline in the foreign exchange reserves of the country. Therefore, the decrease in the total international reserves of the country was below 3% mom (2.77% mom to be more precise). The total international reserves of Romania equalled EUR 35,680 billion as of August 31st, 2013.

**Other Developments Affecting the Investment Climate**

The Executive Board of the IMF approved a new, 24 months EUR 1.98 bn Stand By Arrangement with Romania, a successor of the 27 months, EUR 3.4 bn SBA completed in June 2013. The Romanian authorities have informed the IMF they intend to treat the program as precautionary. The Romanian authorities have also requested precautionary support from the European Union of EUR 2.0 bn.

CFR Marfa (national freight railway transport company) privatization has failed, procedures closing in October 2013, Romanian authorities and Grup Feroviar Roman (GFR), blaming each other for the failure. Back in June 2013, GFR bid was declared the winner, after the two other bidders, Transferoviar Grup & Donau Finanz GmbH & CoKG and the US company Omnitrax have withdrawn from the process, accusing the flaws in the privatization process. GFR offered EUR 202 mn for 51% of CFR Marfa shares and pledged another RON 900 mn (EUR 202 mn) for investments. The privatization contract was signed on September 2nd, with GFR paying EUR 30 mn, while the difference up to EUR 202 mn was due on October 14th. GFR failed to make the second, main payment, citing the lack of Competition Council approval of the deal and the lack of some of the banks approval of the deal. This is the third major privatization failure since the leftist USL coalition reached power, after the failures of Olchim (chemical industry) and Cupru Min (mining, copper) privatizations.

Romgaz IPO started in October, with the purpose of listing a 15% Romgaz stake on the Bucharest Stock Exchange and Global Depositary Rights (GDRs) on the London Stock Exchange. Romgaz is the largest producer and supplier of natural gases in Romania, with 5.7 bn cubic meters produced in 2012, and a market share of 50.1% of the internal gas production. Romgaz revenues stood at RON 3.8 bn (EUR 861 mn) in 2012, while net earnings reached RON 944 mn (EUR 251 mn). At end-June 2013, Romgaz had cash of RON 2.5 bn (EUR 551 mn). The price range for the IPO puts the company market capitalization between EUR 2.08-2.77 bn. The privatization consortium includes Goldman Sachs International, Erste Group Bank AG, Banca Comerciala Romana and SSIF Raiffeisen Capital & Investment.