Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

31 March 2014

neweuropecapital

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Statistics

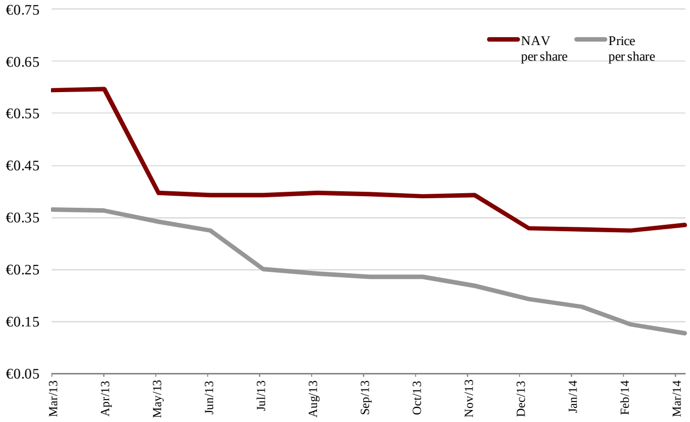
NAV per share (€)	0.3345
Share price (€)	0.1275
Total NAV (€m)	33.4
Mk Cap (€m)	12.8
# of shares (m)	100.0
NAV return since inception	-65.03%
12-month NAV CAGR	-43.71%
NAV annualized Return*	-11.96%
NAV annualized Volatility*	20.69%
Best month (NAV)	15.60%
Worst month (NAV)	-33.53%
# of months up (NAV)	49
# of months down (NAV)	50

*since inception

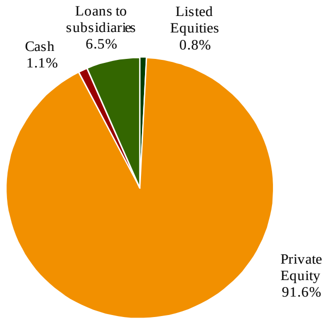
RC2 NAV returns

	2010	2011	2012	2013	2014
Jan	1.36%	-0.54%	0.12%	-31.58%	-0.65%
Feb	0.03%	0.24%	-9.69%	-0.51%	-0.34%
Mar	2.07%	2.48%	-0.50%	-0.62%	2.94%
Apr	15.60%	0.70%	-0.66%	0.29%	
May	-5.42%	0.55%	-4.98%	-33.53%	
Jun	-1.57%	0.25%	-1.47%	-0.85%	
Jul	0.53%	0.13%	-0.73%	-0.28%	
Aug	0.07%	-1.10%	0.61%	1.27%	
Sep	-0.62%	-1.25%	0.01%	-0.69%	
Oct	0.96%	2.63%	-0.82%	-0.72%	
Nov	-1.15%	-0.25%	-0.36%	0.43%	
Dec	-0.06%	-0.49%	0.29%	-16.44%	
YTD	11.07%	3.32%	-17.17%	-62.64%	1.92%

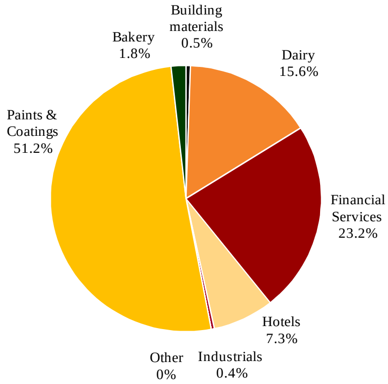
Share price / NAV per share (€)



Portfolio Structure by Asset Class

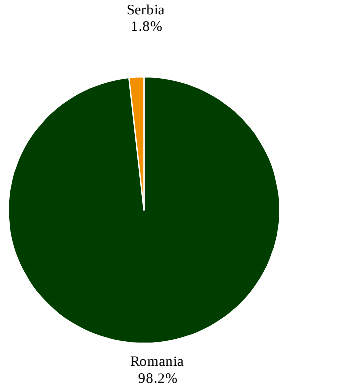


Equity Portfolio Structure by Sector



Note: EPH investment included under Other

Portfolio Structure by Geography



Note: EPH investment included under Serbia

Message from the Investment Manager and Advisers

Dear Shareholders

RC2's NAV per share increased by 1.9% over the quarter from €0.3282 at the end of December to €0.3345, mainly as a result of a 4% increase in the Alabalact share price over the quarter, as well as the receipt of €0.9m of dividends from the Top Factoring group.

All the Romanian investee companies managed to post improved EBITDA compared to the first quarter of 2013, with the exception of the Mamaia hotel which was closed due to renovations. Albalact and Top Factoring achieved exceptional results, with Albalact's recurring EBITDA increasing from €1.5m to €2.0m, and Top Factoring's EBITDA growing from €0.5m to €1.8m, although the latter reflects the €1.3m write up of its proprietary debt portfolios, following better than budgeted collections. The first quarter represents the low season for paints and coatings, so the results for the period are not so significant. Nevertheless, Policolor's paints and coatings sales were up by 12%, with the overall result being affected by the re-opening of the group's re-built resins plant being delayed to April, as well as poor market conditions for its chemicals (anhydrides) business. Klas, the Serbian bakery business in which RC2 holds a direct 11.1% stake performed poorly, as the management has struggled to turn the business around. This has led to a change of CEO in March, when the manager of EPH's milling business was appointed to also run EPH's bakery operations.

The Manager is continuing to pursue a number of exits, both from the Fund's investee companies as well as from certain assets held by them. However, whilst discussions are ongoing with a number of potential buyers, in particular relating to Top Factoring and Policolor's surplus real estate and chemicals business, there are no breakthroughs to report.

At the end of the quarter, the Fund had cash and cash equivalents of approximately €0.5m, compared to €0.3m at the end of December. At the end of the quarter, the Fund's borrowings (excluding borrowings of investee companies) amounted to €4.5m, whilst overdue liabilities amounted to €3.8m. During the quarter, the Fund received €0.9m in dividends from Top Factoring Group, as well as €0.6m from Mamaia Resort Hotels, pursuant to a loan made by RC2 which is now being refinanced by a bank.

Yours truly,

New Europe Capital

Policolor Group

Background

RC2 has a 40.0% shareholding in Policolor, the parent company of the Policolor Group ("Policolor" or the "Group"), which operates along the following business lines: coatings (architectural, automotive and industrial), resins and specialty chemicals. The Romanian company Policolor SA and its 100% owned Bulgarian subsidiary Orgachim AD form the largest producer of coatings in Romania and Bulgaria. The Group also owns 91% of Orgachim Resins, the leading supplier of resins in SE Europe, and 91% of Ruse Chemicals, a producer and trader of anhydrides. All the companies of the Group are unlisted.

Group Financial results

(EUR '000)	2012 *	2013**	2014 B	1Q13**	1Q14**	1Q14B
Income statement (according to IFRS)						
Total operating revenues	**58,663**	**56,077**	**71,095**	**10,542**	**8,727**	**11,442**
Total operating expenses	**(58,246)**	**(56,306)**	**(68,907)**	**(11,989)**	**(9,895)**	**(13,253)**
Operating profit	**417**	**(229)**	**2,188**	**(1,446)**	**(1,168)**	**(1,811)**
Operating margin	*0.7%*	*neg.*	*3.0%*	*neg.*	*neg.*	*neg.*
EBITDA	**3,645**	**3,110**	**5,891**	**(570)**	**(300)**	**(901)**
EBITDA margin	*6.2%*	*5.5%*	*8.0%*	*neg.*	*neg.*	*neg.*
Financial Profit/(Loss)	(1,126)	(786)	(788)	(128)	(261)	(180)
Profit before tax	**(709)**	**(1,015)**	**1,400**	**(1,575)**	**(1,429)**	**(1,991)**
Income tax	(219)	(211)		-	-	-
Profit after tax	**(928)**	**(1,226)**		**(1,575)**	**(1,429)**	**(1,991)**
Minority interest	260	110		126	14	-
Profit for the year	**(668)**	**(1,115)**		**(1,449)**	**(1,415)**	**(1,991)**
avg exchange rate (RON/EUR)	*4.450*	*4.450*	*4.420*	*4.385*	*4.502*	*4.420*

*Note: * audited, ** unaudited*

The 2014 budget is slightly different to the one presented in the previous quarterly report as it has been revised to exclude the intra-group sales of the resins division.

The Group generated consolidated revenues of €8.7m in the first quarter of 2014, 24% below budget and 17% lower than the first quarter of 2013. This was mainly due to the resins plant only re-starting production in April, and lower sales of anhydrides at the chemicals division, as net sales at the paints and coatings divisions actually increased from €5.7m in the first quarter of 2013 to €6.4m in the same period of 2014, up 12% year-on-year and only 3% below budget. The coatings performance was slightly stronger in Bulgaria, where sales were up 13% year–on-year and 4% above the budget. In Romania, a number of changes in the route-to-market strategy generated a disruptions, resulting in lower than expected year-on-year sales growth of 12%.

Although the first quarter performance does not have a high impact on the overall annual results as it represents the low season for coatings sales, it is worth mentioning that the Group generated a lower EBITDA loss than last year and compared to the budget.

In March, Policolor finalized the acquisition of a 9% shareholding in Orgachim and now owns 100% of this company. It now still needs to complete the acquisition of 9% of the demerged Bulgarian resins and chemicals companies.

Operations

The coatings division has made significant changes in the divisions' sales strategy in Romania. Distributors' contracts were re-negotiated (some of them having been terminated) and sales to the respective areas handled by direct distribution. The full effect of these changes will begin to be visible in the second quarter of 2014. The new management team recruited in 2013 is focussing on improving the market execution by increasing the shelve space in the existing shops, as well as increasing the numerical distribution. This is supported by a marketing effort including trade promotions, a media campaign and product rebranding. The R&D department continues to focus on improving the product formulations in order to allow a competitive price positioning of the products, as well as improving the gross margin.

The re-starting of production at Orgachim Resins' re-built factory was affected by delays in obtaining production authorisations, resulting in resins sales 38% below budget (-€700,000). The company's own resins production was eventually restarted in April, and management expects to recover the loss in sales by the end of the year.

Due to the process of re-licensing the demerged chemicals business, the production of anhydrides plant was also stopped over the first quarter of 2013, whilst the company sold down its remaining anhydrides stocks. Accordingly, anhydrides sales amounted to approximately one third of the sales achieved over the first quarter of 2013.

Top Factoring

Background

Top Factoring ("Top Factoring") is a Romanian receivables collection company in which RC2 owns a 93% shareholding. The remaining 7% is owned by the Company's CEO. The debt purchase part of the business is undertaken by an SPV also 93%-owned by RC2 (Glasro Holdings Ltd) which sub-contracts the debt collection process to Top Factoring. Top Factoring and Glasro Holdings Ltd are together referred to as the "Group".

Group Financial Results

(EUR '000)	2012*	2013**	2014B	1Q13**	1Q14**	1Q14B
Combined Group Income Statement						
Total Gross Operating Revenues	**8,787**	**9,762**	**12,615**	**2,226**	**2,863**	**2,853**
Debt portfolios (collections)	7,531	8,735	11,590	1,996	2,632	2,590
Agency contracts	1,256	1,027	1,026	230	231	263
Amortization and fair value adjustments of debt portfolios	(3,441)	(3,198)	(5,870)	(897)	(72)	(1,214)
Total Net Operating Revenues	**5,346**	**6,564**	**6,745**	**1,329**	**2,791**	**1,639**
Total Operating Expenses	**(3,689)**	**(4,099)**	**(4,564)**	**(822)**	**(1,032)**	**(1,072)**
Operating Profit	**1,658**	**2,465**	**2,181**	**506**	**1,760**	**568**
EBITDA	**1,745**	**2,573**	**2,323**	**534**	**1,790**	**602**
EBITDA margin	*32.6%*	*39.2%*	*34.4%*	*40.2%*	*64.1%*	*36.7%*
Financial Profit/(Loss)	(234)	(331)	(322)	(50)	(34)	(68)
Profit before Tax	**1,423**	**2,134**	**1,859**	**457**	**1,726**	**500**
Income Tax	(161)	(269)	(232)	(46)	(216)	(62)
Profit after Tax	**1,262**	**1,865**	**1,627**	**411**	**1,510**	**437**
Net margin	*23.6%*	*28.4%*	*24.1%*	*30.9%*	*54.1%*	*26.7%*
Avg exchange rate (RON/EUR)	*4.456*	*4.419*	*4.420*	*4.385*	*4.502*	*4.420*

Note: IFRS(audited, combined accounts), IFRS**(unaudited, combined accounts)*

The Group's first quarter gross revenues increased by 28.6% year-on-year and were slightly above the budget (+0.4%). The quarterly impairment test resulted in a net write-up of €1.3m as at 31st March, mainly generated by the improved performance and better prospects of most of the Group's proprietary banking portfolios, while most of the telecom portfolios were re-valued downwards. The write-up gets booked together with the amortization expense and consequently influences the net revenues. In the first quarter of 2014, the debt purchase line accounted for 92% of net operating revenues, of which banking portfolios contributed 80%. The agency business generated revenues of €0.2m, virtually unchanged over the year. The first quarter EBITDA, which takes into account the portfolio write-up, amounted to €1.8m, significantly up on both the budgeted figure of €0.6m and last year's figure of €0.5m.

In the first quarter of 2014, the Group distributed €1m of its retained earnings as dividends, of which €0.9m was paid to RC2.

Operations

The Group invested €0.9m in debt portfolio acquisitions in the first quarter, which was financed by a combination of bank loans and equity. The Group now owns 47 debt packages (thirteen telecoms and thirty four banking) made up of 872,000 cases with a total face value of €253m.

Gross collections from proprietary portfolios increased from €2.0m in the first quarter of 2013 to €2.6m in the first quarter of 2014. The call centre department generated 73.0% of gross collections in the first quarter, followed by the legal and field departments, which generated 17.4% and 9.6% of total collections, respectively. The legal and field departments have increased their share of total collections, having generated a combined 16% in the same period of 2013.

Albalact

Background

Albalact SA ("Albalact" or the "Company") is a Romanian dairy company quoted on the RASDAQ section of the Bucharest Stock Exchange in which RC2 owns a 25.4% stake under its Private Equity Programme. A local entrepreneur and his family own 43%, with the 28.3% representing the free float and 3.3% representing treasury shares acquired within a buy-back program. On cancellation of these treasury shares, RC2's shareholding would increase to 26.3%. With Albalact's market capitalization increasing by 4.0% over the quarter, the value of RC2's shareholding increased from €5.8m as at 31 December 2013 to €6.0m as at 31 March 2014.

Financial results

(EUR '000)	2012*	2013*	2014B	1Q13**	1Q14**
Standalone Income Statement					
Sales Revenues	**77,164**	**90,829**		**23,361**	**25,037**
Other operating revenues	192	5,264		(159)	5,820
Total Operating Revenues	**77,356**	**96,093**	**114,280**	**23,202**	**30,857**
Total Operating Expenses	(74,946)	(93,275)	(110,768)	(22,427)	(28,138)
Operating Profit	**2,410**	**2,818**	**3,512**	**775**	**2,719**
Operating margin	*3.1%*	*2.9%*	*3.1%*	*3.3%*	*8.8%*
Recurring EBITDA	**5,655**	**5,894**		**1,496**	**1,985**
EBITDA from non-recurring sale of non-core assets	(429)	-		-	1,594
Total EBITDA	**5,225**	**5,894**	**6,966**	**1,496**	**3,580**
EBITDA margin	*6.8%*	*6.1%*	*6.1%*	*6.4%*	*11.6%*
Financial Profit/(Loss)	(450)	(591)	(584)	(57)	49
Profit before Tax	**1,960**	**2,227**	**2,927**	**718**	**2,768**
Income Tax	(317)	(326)	(468)	(105)	(218)
Profit after Tax	**1,643**	**1,901**	**2,459**	**613**	**2,551**
Net margin	*2.1%*	*2.0%*	*2.2%*	*2.6%*	*8.3%*
Avg exchange rate (RON/EUR)	*4.456*	*4.419*	*4.450*	*4.385*	*4.502*

*Note: * RAS (audited), ** RAS (unaudited)*

Albalact's euro-denominated sales revenues increased by 18% year-on-year in 2013, mainly driven by an over-50% increase in its yogurt and cheese sales, and a 30% increase in its fresh milk sales. The operating profit reached €2.8m, 17% above the 2012 level, while EBITDA amounted to €5.9m, a growth of 12% over the previous year. As of December 2013, the Company was the market leader in milk (20.7% market share), sour cream (12.6% sour cream) and butter (21.8% market share).

The Company continued to grow, although at a slower pace, in the first quarter of 2014, with sales increasing by 7% year-on-year in euro terms. Yogurt, cheese and milk continued to be the main growth drivers. The profitability also improved, with recurring EBITDA increasing by 32.7% over the first quarter of 2013. The €1.6m gain from the sale of non-core assets relates to the transfer of Albalact's logistics activity to a newly set-up subsidiary in March 2014, and therefore would not be included if Albalact published consolidated accounts.

Operations

As a result of the buy-back programme approved by the shareholders in September 2013, Albalact acquired 3.3% of its share capital at a total cost of approximately €750,000 over the quarter.

The transfer of Albalact's distribution and logistics activities to a newly-set up wholly-owned subsidiary, as approved by the EGM in September 2013, was implemented in March 2014 and the Company is now in the process of identifying a strategic equity partner for this business.

A shareholder meeting held on 28 April 2014 passed the resolution to approve the merger of Albalact with its 99%

owned subsidiary, Raraul. This should have little impact on Albalact's shareholder structure, whilst simplifying the management, administration and IT functions of the two businesses.

2014 Budget

The 2014 budget as approved at the April 2014 AGM provides for an increase of the Company's sales above the €100m threshold and unchanged profit margins. The sales growth is due to be backed by a major investment program which started in the last quarter of 2013 to support the expansion of the Company's product portfolio and improve the operational efficiency of the plant, as well as by a higher marketing budget.

Mamaia Resort Hotels

Background

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the Golden Tulip Mamaia Hotel (the "Hotel"), which is located at Mamaia, Romania's premium seaside resort next to Constanta. In March 2008, RC2 acquired 63% of the Company, with the remaining 37% being owned by a Romanian private individual.

Financial results and operations

(EUR '000)	2012*	2013**	2014B	1Q13**	1Q14**	1Q14B
Income Statement						
Sales Revenues	**1,775**	**1,890**	**2,216**	**24**	**11**	**83**
Other operating revenues	42	41	17	6	3	7
Total Operating Revenues	**1,817**	**1,931**	**2,234**	**30**	**14**	**90**
Total Operating Expenses	(1,606)	(1,714)	(2,033)	(163)	(187)	(253)
Operating Profit	**210**	**217**	**201**	**(133)**	**(172)**	**(163)**
Operating margin	*11.6%*	*11.2%*	*9.0%*	*neg.*	*neg.*	*neg.*
EBITDA	**455**	**420**	**474**	**(80)**	**(124)**	**(112)**
EBITDA margin	*25.0%*	*21.7%*	*21.2%*	*neg.*	*neg.*	*neg.*
Financial Profit/(Loss)	(182)	(114)	(132)	(88)	(71)	(61)
Profit before Tax	**28**	**103**	**68**	**(169)**	**(196)**	**(173)**
Income Tax	-	-	-	-	-	-
Profit after Tax	**28**	**103**	**68**	**(169)**	**(196)**	**(173)**
Net margin	*1.5%*	*5.4%*	*3.0%*	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*4.456*	*4.419*	*4.420*	*4.385*	*4.502*	*4.420*

*Note: * RAS (audited), ** RAS (unaudited)*

In mid-March, the Company signed an agreement with its banks to refinance all of its debts (including the shareholder loan from RC2) and to provide an additional loan for financing €0.7m of investments to be made over 2014. The total loan package provided to the Company amounts to €2.1m and has a maturity of 5 years.

Management has prioritized refurbishing the Hotel ahead of the high season, and therefore decided to open the Hotel only for major events over the first quarter, resulting in only €14,000 of revenues, significantly below the budget. However, based on the bookings for the summer season confirmed to date, management is confident it will meet the 2014 budget.

The refurbishment works, which started in the last quarter of 2013, are reshaping the reception area, the lobby, the bar, and the restaurant and its terrace. The renovation work will be interrupted at the end of May and resumed in October with the extension of the pool and the building of a spa next to the pool which will be connected to the Hotel by means of a bridge.

The occupancy rate over the first week of May (which is the beginning of the holiday season on the Romanian seaside) reached 73%. Corporate events contracted for May and June are expected to generate revenues of approximately €200,000.

Klas

Background

Klas DOO ("Klas" or the "Company") is the bakery division of East Point Holdings Ltd ("EPH" or the "Group") a Cyprus-based holding company in which RC2 holds a 63% stake but has written the investment in the holding company down to zero at the end of 2013. In March 2010, RC2 acquired a direct 11.1% shareholding in Klas for €2.7m.

Financial results and operations

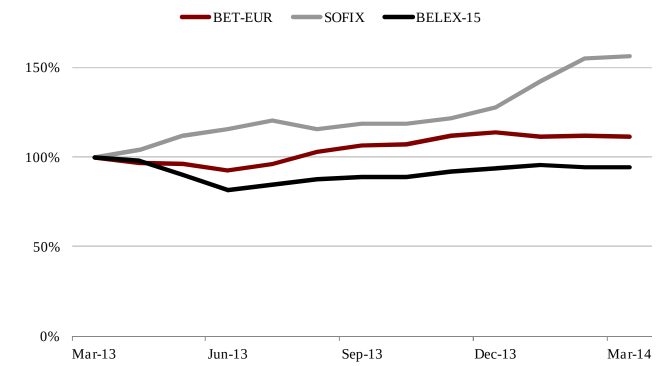
(EUR '000)	2012A*	2013**	1Q13**	1Q14**	1Q14B
Income Statement					
Net Sales	**16,826**	**14,593**	**3,955**	**3,345**	**2,724**
EBITDA	**(1,308)**	**(2,078)**	**(648)**	**(529)**	**(501)**
EBITDA margin	*-7.8%*	*-14.2%*	*-16.4%*	*-15.8%*	*-18.4%*
Profit after Tax	**(6,852)**	**(4,812)**	**(1,311)**	**(988)**	**(983)**
Net margin	*-40.7%*	*-33.0%*	*-33.1%*	*-29.5%*	*-36.3%*

*Note: *audited; **unaudited management accounts*

Klas continued to operate in difficult conditions in the first quarter of 2014. Sales volumes fell by 15.4% year-on-year, and the low margins resulted in significant monthly EBITDA losses in January and February of around €0.2m, and around €0.15m in March. The General Manager who has successfully run EPH's milling business for many years was given the responsibility to turn around Klas's business in March. The new management team managed to decrease the losses in March and April, mainly by introducing a statutory minimum wage policy, cost-cutting and tight control of the production process. The new manager expects conditions on the market to remain unfavourable due to the expected increase in wheat and flour prices, as a result of the Ukrainian crisis and recent floods in Serbia. Klas is in the process of selling some stakes in regional bakeries in order to re-invest the proceeds to support its own operations.

Capital Market Developments

BET-EUR, SOFIX and BELEX-15: 1 year performance



Commentary

Over the first quarter, Romania's BET index fell by 2.1%, whilst the Bulgarian SOFIX indices and the Serbian BELEX-15 gained 22.1% and 0.4%, respectively, all in euro terms. Over the year, the BET-EUR index and the SOFIX increased by 11.1% and 56.3% respectively, while the BELEX-15 lost 5.6%, all in euro terms.

By comparison, over the first quarter, the MSCI Emerging Market Eastern Europe index lost 9.9%, the MSCI Emerging Market index was 0.7% down, the FTSE100 lost 1.4% and the S&P index increased by 1.4%, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	3.8%	3M14	1.1%	3M14	2.6%	FY13
Inflation (y-o-y)	1.0%	Mar-14	-2.3%	Mar-14	2.3%	Mar-14
Ind. prod. growth (y-o-y)	11.6%	Mar-14	4.2%	Mar-14	3.8%	Mar-14
Trade balance (EUR bn)	-1.1	3M14	-0.8	3M14	-0.9	3M14
y-o-y	*3.8%*		*83.9%*		*-30.0%*	
FDI (EUR bn)	0.6	3M14	0.1	3M14	0.0	1M14
y-o-y change	*30.1%*		*-76.2%*		*-68.2%*	
Total external debt/GDP	63.0%	Mar-14	91.7%	Feb-14	73.4%	Feb-14
Reserves to short-term debt	174.4%	Mar-14	141.0%	Feb-14	3523.1%	Feb-14
Loans-to-deposits	101.8%	Mar-14	93.6%	Mar-14	116.8%	Feb-14
Public sector debt-to-GDP	39.5%	Mar-14	18.4%	Feb-14	57.9%	Feb-14

Commentary

Romania

Romania's first quarter GDP increased by 0.1% quarter-on-quarter and by 3.8% year-on-year. In its spring 2014 report, the European Commission forecasts Romania's 2014 GDP to grow by 2.5% year-on-year triggered by improved confidence as well as stronger domestic demand.

Between January and March 2014, the trade deficit grew by 3.8% year-on-year. This small increase of the trade deficit together with an 86% increase in the income deficit resulted in a current account deficit of €261m (compared to a €6m positive balance the year before). FDI flows amounted to €0.6bn, up 30.1% year-on-year.

The Romanian leu depreciated by 1.6% against the euro over the quarter.

Romania's CPI fell from 1.6% at the end of 2013 to 1.0% at the end of March due to food prices falling by 2.2% year-on-year.

Over the first quarter, the budget deficit came in at €0.2bn, down 77.8% year-on-year and equivalent to 0.1% of GDP, as revenues increased by 3.8% year-on-year whilst expenses fell 2.9%. On the negative side, capital expenses halved from €0.8bn to €0.4bn. The Government is targeting a budget deficit of 2.2% of GDP for 2014.

Romania's total external debt was €93.2bn at the end of March, down 2.9% year-to-date and equivalent to 63% of GDP. The fall was mainly the result of Romania repaying €1.4bn of a €12.4bn loan it was granted by the IMF in March 2009. Romania still has to repay €6.8bn over 2014-2016, of which €3.3bn has to be repaid by the end of 2014. The public sector's debt stood at 39.5% of GDP at the end of March, up from 38.6% at the end of 2013. Romania's public debt is amongst the lowest in the EU (the euro area's average public debt was 92.6% of GDP at the end of 2013).

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €47.8bn at the end of March, down 0.3% year-to-date in RON terms. Both corporate loans and household lending have fallen by 0.1% and 0.8%, respectively, since the beginning of the year. On a similar note, the deposit base fell by 0.7% year-on-year in RON terms, and amounted to €47bn at the end of March. By contrast, household deposits increased by 0.5% year-to-date and accounted for 61% of the total deposit base at the end of March.

In April, Moody's increased Romania's credit rating outlook from negative to stable on the grounds of improved fiscal and current account balances

Bulgaria

Bulgaria's first quarter GDP grew by 1.1% year-on-year and by 0.2% quarter-on-quarter. In its spring 2014 report, the European Commission forecasts Bulgaria's 2014 annual GDP growth to come in at 1.7% on the grounds of improved domestic demand.

Bulgaria's first quarter current account deficit was €83m, or 0.2% of GDP, compared to a deficit of 1% in the same period of 2013. The improved current account balance was the result of a surplus of current transfers which increased from €0.3bn to €0.7bn whilst the trade deficit deepened compared to last year (from -€0.4bn to -€0.8bn), as exports fell by 6.9% while imports increased slightly (by 0.3%). FDI inflows were only €89m over the period, down from €373m over the same period in 2013.

Bulgaria's inflation rate continued its downward pace started in August 2013, as the country recorded a 2.3% fall in prices in

March, down from a 1.6% decrease at the end of 2013. A 1.3% cut in electricity prices undertaken in January as part of the measures taken after last year's street protests was one of the triggers of the fall in the CPI.

Bulgaria's first quarter budget deficit was €0.4m, or 1.1% of GDP, representing a 9.9% year-on-year increase. The growth of the deficit was mainly triggered by higher wages and social and healthcare benefits which rose by 8.6% year-on-year. The government is targeting a deficit of 1.8% of GDP in 2014. Bulgaria's public sector debt was 18.4% at the end of February, up from 18.1% at the end of 2013, but still tiny by EU standards.

The Bulgarian banking system's total loans-to-deposits ratio was 94% at the end of March, down from 95% at the end of 2013. Whilst loans to non-financial institutions stood at €27.6bn at the end of March, increasing by 0.5% year-to-date, the deposit base increased by 1.7% from €29.0 to €29.5bn.

Serbia

In 2013, Serbia's GDP grew by 2.6%, mainly as a result of the start of serial car production at the new FIAT factory and a good agricultural season. The National Bank of Serbia (NBS) is projecting lower 1% GDP growth in 2014, mainly as a result of the expected decline in consumption due to fiscal consolidation measures announced by the Government. Industrial output grew by 3.8% year-on-year in March, mainly due to increased production at the FIAT factory in Kragujevac, and growth in food production.

As a result of disinflationary pressures, driven by low demand and a stable local currency, the CPI came in at 2.3% year-on-year in March, just under the NBS' targeted range of 4% ± 1.5%. The NBS expects inflationary pressures from regulated price hikes and possible wheat price increases due to the Ukraine crisis. As a result, the NBS has kept its key interest rate unchanged at 9.5% during the first quarter of 2014.

Despite increased expenditures during the parliamentary election campaigns, the budget deficit fell by 5.3% year-on-year over January and February. The government plans to cut public spending and channel those savings to incentivize the private sector, while simultaneously fighting the grey economy and implementing public sector reforms. In February, the government agreed a EUR 3bn loan with the United Arab Emirates, having a 2% interest rate and a 10-year repayment schedule. The first tranche of USD 1bn is expected in the first half of 2014.

During the first quarter, exports reached €2.6bn (+17% year-on-year), while imports rose by only 0.6% to €3.5bn. As a result, the trade deficit was €0.9bn, a 30% year-on-year fall.

Following the government reshuffle in August 2013, the ruling Serbian Progressive Party (SNS) decided to go for early parliamentary elections in March and won 48.4% of the votes. Despite an undisputed victory, the SNS has again opted for a coalition government, with three ministers coming from the Socialist Party, and several cabinet members being non-partisan experts.

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