Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

31 December 2014

neweuropecapital

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Statistics

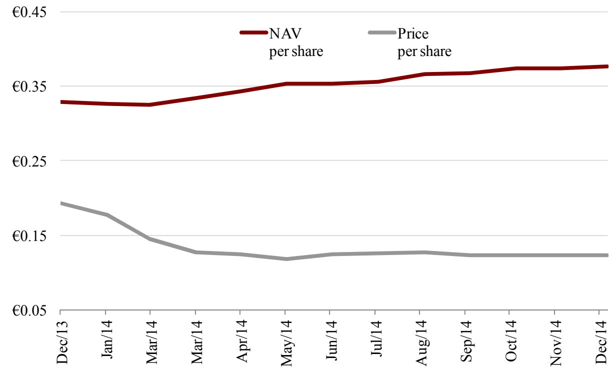
NAV per share (€) - undiluted	0.3771
NAV per share (€) - fully diluted	0.2810
Total NAV (€ m) - undiluted	37.7
Total NAV (€ m) - fully diluted	45.7
Share price (€)	0.1238
Mk Cap (€ m)	12.4
# of shares (m) - undiluted	100.0
# of shares (m) - fully diluted	162.6
NAV return since inception†	-60.58%
12-month NAV CAGR†	14.90%
NAV annualized Return*†	-9.83%
NAV annualized Volatility*†	19.95%
Best month (NAV)†	15.60%
Worst month (NAV)†	-33.53%
# of months up (NAV)†	58
# of months down (NAV)†	50

*† undiluted basis * since inception*

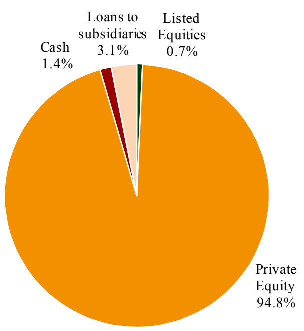
RC2 NAV returns (undiluted basis)

	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%	2.73%
May	-5.42%	0.55%	-4.98%	-33.53%	2.70%
Jun	-1.57%	0.25%	-1.47%	-0.85%	0.28%
Jul	0.53%	0.13%	-0.73%	-0.28%	0.44%
Aug	0.07%	-1.10%	0.61%	1.27%	3.23%
Sep	-0.62%	-1.25%	0.01%	-0.69%	0.01%
Oct	0.96%	2.63%	-0.82%	-0.72%	1.87%
Nov	-1.15%	-0.25%	-0.36%	0.43%	0.15%
Dec	-0.06%	-0.49%	0.29%	-16.44%	0.72%
YTD	11.07%	3.32%	-17.17%	-62.64%	14.90%

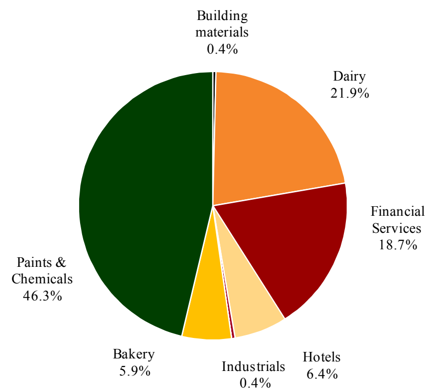
Share price / undiluted NAV per share (€)



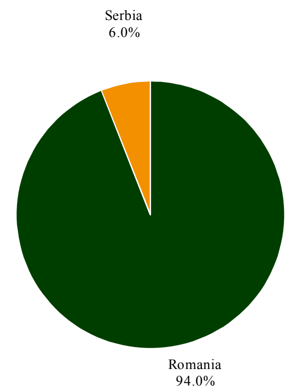
Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Portfolio Structure by Geography



Message from the Adviser

Dear Shareholders

RC2's NAV per share increased by 2.77% over the quarter from €0.3670 at the end of September to €0.3771, mainly as a result of the new independent valuations of the unlisted investments performed at the year end. Over the year, RC2's NAV appreciated by a total of 14.90%.

The Policolor group's 2014 consolidated sales of €52.8m were slightly lower than in 2013, mainly due to sales of anhydrides being interrupted over the first semester due to unfavourable market conditions. The other divisions experienced an increase in sales, with paints and coatings sales growing by a modest 4.4%, and resins sales growing by 32.6% due to the re-opening of Policolor's own resins plant in May. The group's 2014 EBITDA of €2.4m was 20.6% lower than in 2013, and significantly lower than the budget, which had anticipated higher sales of anhydrides, resins and automotive and industrial paints. In August, Policolor agreed the sale of its Bucharest site for €18.3m, to be received over three years. Policolor has to relocate its operations to a new facility, but has altered its plans, having opted to rent warehouses and office space for the foreseeable future, instead of building them. Consequently, the cost of the new facility, including land, is now projected at €6.4m, increasing Policolor's net proceeds from the land sale from €6.6m to €8.2m over the coming three years, after deducting the costs of the land purchase and the new factory, the demolition and environmental clean-up costs, and the estimated capital gains tax on the sale.

Top Factoring Group had an excellent 2014, achieving EBITDA of €3.7m, although €2m comprised the write-up of existing portfolios due to better than expected collections. Management expects the 2015 EBITDA to fall back to €1.7m, as the 2014 write-up in the value of the portfolios is unlikely to be repeated.

Albalact continued to grow strongly over 2014, with sales increasing by 13.7% in euro terms. However, this was slightly below budget due to delays in commissioning some of the equipment ordered under its 2013-14 investment programme, resulting in delays in launching part of the new products. The company's EBITDA was basically unchanged compared to the prior year, but this was due to a €0.5m fine from the Romanian Competition Authority in respect of the years 2005–2008 affecting the 2014 result. In February, Albalact's shareholders voted in favour of listing the company on the main market of the Bucharest Stock Exchange, which should increase the visibility, and hopefully the liquidity, of the stock.

At Mamaia Resort Hotels, revenues were virtually unchanged compared to the previous year, but the Hotel was affected by particularly bad weather in July, one of its two peak months when it earns the bulk of its revenues, and it was closed from January to May due to refurbishment works. Whilst EBITDA was 13.1% lower at €0.37m, in 2014 this included €0.1m of refurbishment works which were expensed through the income statement to the extent permitted under Romanian law. During the course of 2014, the Hotel refinanced its existing debt of €1.7m, and increased its borrowings to €2.1m in order to finalize its refurbishment works. It intends to draw a further €0.3m in 2015 in order to build a spa, which it sees as an important tool to extend its season.

There has been no improvement in the status of East Point Holdings ("EPH") since it was written down to zero by the Fund as at December 2013. Klas, EPH's former bakery division which is now 52%-owned by RC2, had a poor year, with sales continuing to fall and negative EBITDA of €2.3m. However, the new management team which joined in September managed to increase daily average sales from 35 to 40 tons, reduced the workforce by a further 46, bringing it to 400 employees, and sold a 46% stake in a regional bakery for €0.5m to shore up its cash position. For 2015, the new management team hopes to reduce the EBITDA loss to €0.4m.

At the end of October, the Fund launched an €8.45m three year convertible bond, which it used to repay overdue liabilities and all its short term debt and to provide working capital for its ongoing activities. At the end of the quarter, the Fund had cash and cash equivalents of approximately €0.7m, compared to €0.8m at the end of September.

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 includes Orgachim Resins, the leading supplier of resins in SE Europe, and Ruse Chemicals, a producer of anhydrides. All the Group companies are unlisted.

Group Financial results

(EUR '000)	2013*	2014B	2014	2015B
Consolidated Income statement (according to IFRS)				
Sales	54,150	71,095	52,839	65,552
Total operating revenues	**55,711**	**71,095**	**54,068**	**65,552**
Total operating expenses	**(55,935)**	**(68,907)**	**(55,191)**	**(63,993)**
Operating profit	**(224)**	**2,188**	**(1,123)**	**1,559**
Operating margin	*neg.*	*3.0%*	*neg.*	*2.4%*
Recurring EBITDA	3,055		2,650	4,271
Non-recurring EBITDA			(224)	1,000
Total EBITDA	**3,055**	**5,891**	**2,426**	**5,271**
EBITDA margin	*5.6%*	*8.0%*	*4.5%*	*8.0%*
Net extraordinary result (land sale)				**10,891**
Financial Profit/(Loss)	(983)	(788)	30	(2,009)
Profit before tax	**(1,207)**	**1,400**	**(1,094)**	**10,441**
Income tax	(178)		(118)	(2,654)
Profit after tax	**(1,385)**		**(1,211)**	**7,788**
Minority interest	106			
Profit for the year	**(1,279)**		**(1,211)**	**7,788**
avg exchange rate (RON/EUR)	*4.450*	*4.420*	*4.446*	*4.500*

*Note: * audited, ** preliminary management accounts*

The Group's 2014 consolidated sales came in at €52.8m, 25.7% below budget and 2.4% lower than in 2013. The year-on-year fall in sales was triggered by lower sales of anhydrides, as unfavourable market conditions in early 2014 meant that the plant only operated in the second half of the year. Paints and coatings sales increased by 4.4%, whilst sales of resins increased by 32.6% year-on-year due to the re-opening of Policolor's own resins plant in May. Because of the loss of sales, and a lower than expected margin at the resins division (as the Group had to make price concessions to re-gain clients), the Group generated recurring EBITDA of €2.7m, down 13.3% year-on-year and significantly below budget.

In July 2014, the Group received a €1.5m advance in relation to the sale of its main Bucharest site. It is due to receive a further advance of €0.5m in early 2015, to be followed by staged payments of a further €16.3m over 2015 - 2017. The Group's net debt amounted to €17.4m as of 31 December 2014.

Operations

The modest 4.4% growth of sales of paints and coatings was achieved in spite of the Group re-thinking its route-to market approach in Romania, with Policolor setting up direct distribution operations in a number of areas where it had felt its distributors had not been effective. Although driven by long term strategic considerations, the move generated significant disruption to its sales. The anhydrides plant only operated in the second semester, when market conditions improved and the Group managed to secure the supply of its main raw material at a sufficiently attractive price for it to generate a positive result.

Prospects

The Group's 2015 budget provides for a 24% year-on-year increase in sales, as a result of an expected improved performance at all divisions, especially automotive coatings (projected to grow by 29% year-on-year), resins (projected to grow by 27% year-on-year) and chemicals (projected to grow by 47% year-on-year), whilst sales of decorative paints are budgeted to grow by 15% year-on-year.

In January 2015, Policolor completed the acquisition of the new plot of land in Bucharest on which it intends to build a new factory. Policolor has altered its plans for its new facility, having opted to rent warehouses and office space for the foreseeable future, instead of building them. Consequently, the cost of the new facility, including land, is now projected at €6.4m, increasing Policolor's net proceeds from the land sale from €6.6m to €8.2m over the coming three years, after deducting the costs of the land purchase and of building the new factory, the demolition and environmental clean-up costs, and the estimated capital gains tax on the sale.

Top Factoring Group

Background

RC2 invests in Romanian non-performing loans through its 93%-owned subsidiary Glasro Holdings Ltd ("Glasro"), and also owns a 93% interest in Top Factoring, a Romanian receivables collection company. Top Factoring and Glasro are together referred to as the "Top Factoring Group" or the "Group".

Group Financial Results

EUR '000	2013*	2014B	2014**	2015B
Combined Group Income Statement				
Gross revenues	**9,753**	**11,332**	**12,445**	**12,559**
Amortization and fair value adjustments of debt portfolios	(3,303)	(3,919)	(4,199)	(5,533)
Total Net revenues	**6,451**	**7,413**	**8,245**	**7,027**
Debt Portfolios	5,409	6,633	7,268	6,269
Agency agreements	1,041	780	977	757
EBITDA	2,612	3,105	3,702	1,701
EBITDA margin	*40%*	*42%*	*45%*	*24%*
Profit after tax	1,898	2,411	2,930	1,048
Net Margin	*29%*	*33%*	*36%*	*15%*
Avg exchange rate (RON/EUR)	*4.42*	*4.42*	*4.44*	*4.42*

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

The Group's 2014 gross revenues of €12.4m were up 27.6% year-on-year, driven by the debt purchase line which accounted for 88% of net operating revenues. Gross collections from proprietary portfolios increased from €8.7m to €11.5m, with increased contributions from the field and legal departments. Collections on portfolios continue to exceed expectations, resulting in a net €2.0m write-up in the book value of portfolios over 2014, driving the 2014 EBITDA up to €3.7m, whilst operating cashflow reached €5.1m, up from €4m in 2013. Glasro invested €4.9m in debt portfolio acquisitions in 2014, similar to the 2013 level. The 2014 acquisitions were financed by a combination of bank loans and equity. As of 31 December 2014, the Group's net debt stood at €4.3m.

Operations

Glasro acquired a portfolio of 11,000 cases from a cable television operator in December, and renewed its frame agreement with a Romanian bank, also in December. At the end of 2014, the Group owned 938,000 cases with a total face value of €287m.

Prospects

The 2015 budget is based on the Group investing €5.6m in new portfolios in 2015, and targets gross revenues of €12.6m, a slight year-on-year increase, and EBITDA of €1.7m, compared to €3.7m in 2014. The fall in EBITDA is mainly due to the €2m write-up in 2014 which boosted that year's EBITDA but increases the amortisation expense in future years.

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 (Mr Raul Ciurtin) and his family own 42.5%, with the 28.8% 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 shrinking by 0.7% over the quarter, the value of RC2's shareholding fell from €9.8m as at 30 September 2014 to €9.7m as at 31 December 2014.

Financial results

(EUR '000)	2013*	2014B	2014**
Standalone Income Statement			
Sales Revenues	**90,829**		**106,851**
Other operating revenues	5,264		2,414
Total Operating Revenues	**96,093**	**114,280**	**109,265**
Total Operating Expenses	(93,275)	(110,768)	(105,488)
Operating Profit	**2,818**	**3,512**	**3,778**
Operating margin	*2.9%*	*3.1%*	*3.5%*
Recurring EBITDA	**5,894**		**5,873**
EBITDA from non-recurring sale of non-core assets			1,594
Total EBITDA	**5,894**	**6,966**	**7,467**
EBITDA margin	*6.1%*	*6.1%*	*6.8%*
Financial Profit/(Loss)	(591)	(584)	(563)
Profit before Tax	**2,227**	**2,927**	**3,214**
Income Tax	(326)	(468)	(447)
Profit after Tax	**1,901**	**2,459**	**2,767**
Net margin	*2.0%*	*2.2%*	*2.5%*
Avg exchange rate (RON/EUR)	*4.419*	*4.450*	*4.445*

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

Albalact's 2014 euro-denominated operating revenues grew by 13.7% year-on-year, primarily driven by an increase in yogurt and milk sales, but were 4.4% below budget, mainly due to delays in commissioning part of the new equipment ordered under its 2013-14 investment programme.

Operations

In December 2014, the Romanian Anti-Trust Authority imposed a €0.5m fine on Albalact, as a result of a wide investigation involving five international retailers and tens of their suppliers in respect of their shelf price policies over 2005–2008. The fine had a direct impact on Albalact's profitability, resulting in recurring EBITDA being almost unchanged over 2014.

Prospects

The Company's 2015 budget has not yet been disclosed to the market.

According to a law which came into force in October 2014, all companies listed on the RASDAQ section of the Bucharest Stock Exchange (BSE) are required to hold a shareholder vote by the end of February 2015 to decide whether to list on the main market of the BSE or on its Alternative Trading System (which is the Romanian equivalent of the London Stock Exchange's AIM market), or to delist altogether, as the RASDAQ market is due to be shut down. Accordingly, on 10 February 2015, Albalact shareholders voted in favour of a listing on the main market of the BSE, and the Company is expected to finalise the listing process by mid 2015.

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 the city of 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)	2013*	2014B	2014**	2015B
Income Statement				
Sales Revenues	1,922	2,216	1,986	2,129
Total Operating Revenues	1,931	2,234	2,075	2,129
Total Operating Expenses	(1,714)	(2,033)	(1,905)	(1,923)
Operating Profit	217	201	171	207
Operating margin	11.2%	9.0%	8.2%	9.7%
EBITDA	422	474	367	487
EBITDA margin	21.9%	21.2%	17.7%	22.9%
Profit after Tax	103	68	44	107
Net margin	5.4%	3.0%	2.2%	5.0%
Avg exchange rate (RON/EUR)	4.419	4.420	4.445	4.450

*Note: *RAS (audited), **RAS (management accounts)*

The 2014 sales revenues of €2.0m were up 3.3% year-on-year, but affected by unseasonally cold weather in July (when accommodation revenues were 20% below budget) and by the Hotel's closure for refurbishment works between January and May. EBITDA was €0.37m, down 13.1% year-on-year, but in line with the budget adjusted for €0.11m of refurbishment works which were expensed through the income statement to the extent permitted under Romanian accounting rules, resulting in normalized EBITDA of €0.48m.

Accommodation revenues increased by 5% year-on-year and accounted for 52% of the Hotel's turnover. 52% of the accommodation revenues were generated by agency bookings, 19% by "walk-ins", and 17% by corporate contracts, with the balance of 12% being generated by booking websites. The Company managed to improve the profitability of its rooms department, with the department's margin increasing from 75% to 78%, while the food and beverage department generated revenues of €0.9m, up 2% year-on-year and equal to 43% of total sales.

During the course of 2014, the Hotel refinanced its existing bank debt of €1.7m, and increased its credit line to €2.1m in order to finance its ongoing refurbishment works. It will draw a further €0.3m in 2015 to build a spa, which it sees as an important tool to attract customers outside its summer season. The Company had €0.2m in cash at the end of 2014, significantly up from €0.04m at the end of 2013, as a result of the new bank loan, which has improved the Hotel's cashflow by extending the loan's repayment term.

Prospects

The 2015 budget is based on accommodation revenues increasing by 8.5% year-on-year to €1.1m, as a result of higher average tariffs reflecting the investment in the Hotel's refurbishment. The 2015 budget also provides for EBITDA of €0.5m, which is 15% higher than last year, after adjusting for the net effect of renovation works in both years.

Klas

Background

Klas DOO ("Klas" or the "Company"), the former bakery division of East Point Holdings Ltd ("EPH" or the "Group"), is now 52% owned by RC2, with the balance being owned by Darby, part of the Franklin Templeton investment group, and DEG, the German overseas development finance institution. RC2 also had €1.4m (including accrued interest) of a shareholder loan to Klas outstanding as at 31St December 2014.

Financial results and operations

EUR'000	2013A*	2014B	2014A**	2015B
Income Statement				
Net sales	14,593	13,811	10,654	8,299
EBITDA	(2,078)	(756)	(2,266)	(388)
EBITDA margin	-14.2%	-5.5%	-21.3%	-4.7%
Profit after tax	(4,812)	(2,697)	(2,826)	(1,664)
Net margin	-33.0%	-19.5%	-26.5%	-20.1%

*Note: * audited ** management accounts*

Klas suffered a 26.9% net fall in sales in 2014, following a 13.2% fall in 2013. The main reason for this was the loss of several key accounts, as well as a number of customers in the traditional trade channel. However, the new management appointed over the summer of 2014 took a number of actions in the fourth quarter to arrest this decline, with daily average sales increasing from 35 tons to 40 tons over the quarter.

EBITDA came in at €-2.3m, which, though worse than 2013, included substantial redundancy costs of €0.3m. In addition to redundancies of 100 personnel, action was also taken to reduce energy consumption and maintenance costs, rationalize distribution routes and put staff on the minimum wage. Overall the annual fixed and variable cost base of Klas was reduced by €0.5m during the year.

During 2014 management also successfully disposed of minority holdings in two regional bakeries – Zitopek for €0.8m and Izvor for €0.5m. Proceeds from these sales have been used to finance redundancies and shore up working capital reserves.

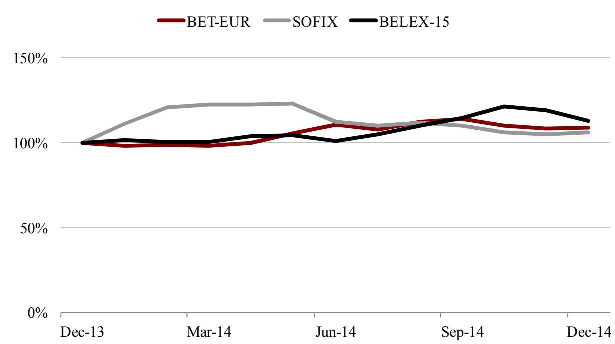
Prospects

The 2015 budget provides for EBITDA of €-0.39m, which would be a substantial improvement over last year's result.

For 2015, management aims to secure new, long-term credit line for the company, whilst continuing the disposal of surplus assets (including an unused production facility in south Belgrade) and increasing sales volumes through the traditional trade channel with improved logistics, allowing a wider customer base to be serviced.

Capital Market Developments

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



Commentary

Over the fourth quarter, the Romanian BET, the Bulgarian SOFIX and the Serbian BELEX-15 indices lost 4%, 3% and 1% respectively, all in euro terms.

Over the past year, the BET-EUR index has gained 9%, the SOFIX 6.2%, and the BELEX-15 12.9%, all in euro-terms.

By comparison, over the last year, the MSCI Emerging Market Eastern Europe index lost 31.6%, the MSCI Emerging Market index gained 8.7%, while the FTSE100 index was up 4.3% and the S&P index up 26.9%, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	2.9%	FY14	1.7%	FY14	-2.0%	FY14
Inflation (y-o-y)	0.8%	Dec-14	-0.9%	Dec-14	1.7%	Dec-14
Ind. prod. growth (y-o-y)	3.1%	Dec-14	0.9%	Dec-14	-6.5%	Dec-13
Trade balance (EUR bn)	-6.0	FY14	-2.9	FY14	-3.9	FY14
y-o-y	*5.9%*		*19.4%*		*-0.9%*	
FDI (EUR bn)	2.4	FY14	1.2	FY14	1.2	11M14
y-o-y change	*-10.6%*		*-7.3%*		*n/a*	
Total external debt/GDP	63.7%	Dec-14	94.3%	Dec-14	82.5%	Nov-14
Reserves to short-term debt	177.6%	Dec-14	163.2%	Dec-14	0.0%	Dec-14
Loans-to-deposits	91.3%	Dec-14	85.7%	Dec-14	0.0%	Oct-14
Public sector debt-to-GDP	40.0%	Dec-14	27.1%	Dec-14	71.3%	Dec-14

Commentary

Romania

Romania's fourth quarter GDP grew by 2.5% year-on-year, and by 0.5% compared to the previous quarter. Overall, GDP grew by 2.9% in 2014. Positively, industrial production grew by 6.1%. An IMF mission visited Romania at the end of January 2015 for a regular review of the economy. The IMF is forecasting 2.7% GDP growth in 2015, helped by growing domestic demand and the expected gradual recovery of the global economy.

Romania's CPI fell from 1.6% at the end of 2013 to 0.8% at the end of 2014, mainly as a result of a 1.9% fall in fuel prices and a 0.4% fall in food prices. The lower inflation rate led the National Bank of Romania ("NBR") to reduce its monetary policy rate from 2.75% as of November 2014 to 2.25% in February 2015, this being the historical minimum for this rate. The NBR is projecting the 2015 inflation rate at 2.1%.

The Romanian leu fell 1.6% against the euro over the fourth quarter of 2014, but was up 0.1% over the year. In the first two months of 2015, the leu appreciated by 1% against the euro.

In 2014, the budget deficit came in at €2.8bn, down 21% year-on-year and equivalent to 1.85% of GDP, which is lower than the Government's target budget deficit of 2.2% of GDP agreed with the IMF. Budgetary receipts increased by 6.7% year-on-year, whilst total expenses increased by 4.7%. Publicly-funded investments are still depressed, with capital expenses falling by 4.6% year-on-year in RON terms (from €4bn to €3.9bn). For 2015, the Government plans to further reduce the budget deficit to 1.83% of GDP.

The 2014 trade deficit worsened by 5.9% year-on-year (from €-5.7bn to €-6bn). The negative evolution of the trade balance was compensated by a 25% surplus from services (+€1.2bn) which resulted in a current account deficit of €0.7bn (compared to €1,2bn over 2013). 2014 FDI flows amounted to €2.4bn, down 10.6% year-on-year.

Romania's total external debt was €94.3bn at the end of 2014, down 3.9% over the year and equivalent to 63.7% of GDP. The fall is the result of Romania re-paying €4.2bn of the €12.4bn loan that it took from the IMF in March 2009. Romania still has to repay €2.1bn up to March 2016. The total public debt was 40% of GDP at the end of 2014, compared to 37.8% of GDP at the end of 2013.

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €47.2bn at the end of

December 2014, down 3.1% year-to-date in RON terms. Although the overall loan stock fell in 2014, lending in RON increased by 8.5% year-on-year. Whilst the loan stock fell, the deposit base increased by 7.5% in RON terms, amounting to €51.7bn at the end of 2014. The NPL ratio was 14% at the end of December, down from 15.3% at the end of September.

In February 2015, Fitch Ratings affirmed its Romania rating at BBB-, citing the country's positive outlook, on the grounds of a better fiscal position and economic growth close to potential. For 2015 and 2016, Fitch is forecasting Romania's GDP growth at 2.7% and 2.8%, respectively. Fitch also noted the accelerating pace of EU transfers: the absorption of €19.2bn of available EU funds for the period 2007-2013 (now extended to 2015) has increased from 15% at the end of 2012 to 51.8% at the end of 2014.

Bulgaria

Bulgaria's fourth quarter 2014 GDP grew by 1.2% year-on-year and by 0.3% quarter-on-quarter. Overall, GDP grew by 1.7% in 2014. In its latest forecast, the European Commission expects Bulgaria's GDP growth to slow down to 0.8% in 2015, due to depressed domestic demand, in particular investment and private consumption. In December, industrial production grew by only 0.9% year-on-year, providing little evidence of dynamic growth in the last part of 2014.

In line with the deflationary trend which begun in mid-2013, Bulgaria recorded a 0.9% year-on-year fall in prices in December 2014, compared to a 1.6% fall in December 2013.

In 2014, Bulgaria ran a budget deficit of €1.6bn, or 3.7% of GDP, in line with the government's revised target, but double the 1.8% deficit recorded in 2013. The deterioration in the budget deficit was trigged by an underperformance of VAT revenues (-1.4% year-on-year) and increased social expenditures (+7.5% year-on-year). For 2015, the government is targeting a budget deficit equal to 3% of GDP.

Bulgaria's public sector debt was 27% of GDP at the end of 2014, up from 18.1% at the end of 2013, following the issue of a €1.5bn eurobond with a 2024 maturity in June, and the issue of a six-month €1.5bn bridge loan in December 2014.

Bulgaria recorded a current account surplus of €19m, or 0.04% of GDP, in 2014 compared to a surplus of 2.1% in 2013. The fall in the current account surplus was mainly triggered by the worsening trade deficit. With exports falling by 0.7% year-on-year and imports growing by 1.2%, the trade deficit widened from €2.4 to €2.9m. FDI inflows were only €1.2bn in 2014, down 7.3% compared to the previous year. Equity investments accounted for 42% of total FDI flows, down from 85% in 2013.

The Bulgarian banking system's loans to non-financial institutions amounted to €25.3bn at the end of 2014, down from €27.5bn at the beginning of the year. However, the comparison is not so meaningful as the December 2014 figure excludes data from the troubled Corporate Commercial Bank. The deposit base actually increased by 1.5% from €29.0 to €29.5bn, while overdue loans accounted for 24% of the loan stock at the end of 2014.

In December 2014, Standard & Poor's lowered Bulgaria's sovereign credit ratings to below investment grade at BB+ with stable outlook, on the grounds of the deteriorating fiscal position over the year, which was in turn also due to the default of Corporate Commercial Bank and a liquidity injection into First Investment Bank, financed with new public debt.

Serbia

Serbia's GDP recorded a 2% fall in 2014, mainly as a result of severe floods which caused significant damage to the mining and energy sectors, agriculture and infrastructure. The National Bank of Serbia (NBS) has forecast the recession to continue in 2015, and projects GDP growth at -0.5% for the year. An economic recovery on the back of new investments and exports is expected by the NBS to get underway in 2016, with GDP growth of 1.5% projected for that year.

The CPI fell to 1.7% in 2014, the lowest level in Serbia's recent history, and well below the targeted range of the NBS (4% ± 1.5%). This was mainly the result of low aggregate demand and a fall in the prices of agricultural products and oil. The NBS expects inflation to increase in the first half of 2015 and return to the 4% ± 1.5% targeted range, mainly due to the effects of the depreciation of the Serbian Dinar (from RSD 114.64 to RSD 120.95 against the euro in 2014) and an anticipated increase in electricity prices.

During 2014, exports reached €10.2bn (up 0.9% year-on-year), while imports reached €14.1bn (up 0.4% year-on-year). The slowdown in exports in the second half of 2014 was primarily the result of lower demand on the European market for cars produced in FIAT's factory in Kragujevac. The country's trade deficit came in at €3.9bn, a 0.9% year-on-year fall.

In January, the government released its fiscal strategy for 2015–2017, which includes a series of measures aimed at preventing a further widening of the budget deficit. These focus on the implementation of a number of fiscal consolidation measures and structural reforms, including the restructuring of state-owned companies, reductions in subsidies and cuts in public sector wages.

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