Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

31 March 2016

neweuropecapital

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Statistics

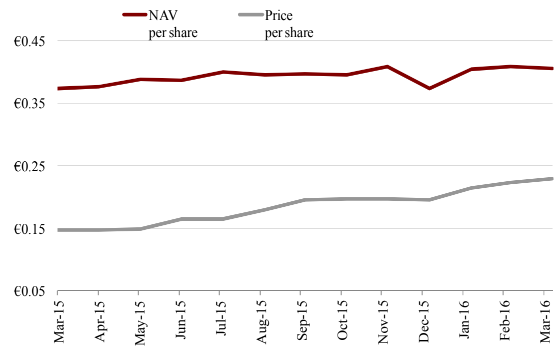
NAV per share (€) - undiluted	0.4058
NAV per share (€) - fully diluted	0.3061
Total NAV (€ m) - undiluted	40.6
Total NAV (€ m) - fully diluted	49.8
Share price (€)	0.2288
Mk Cap (€ m)	22.9
# of shares (m) - undiluted	100.0
# of shares (m) - fully diluted	162.6
NAV return since inception†	-57.58%
12-month NAV CAGR†	8.81%
NAV annualized Return*†	-8.02%
NAV annualized Volatility*†	19.16%
Best month (NAV)†	15.60%
Worst month (NAV)†	-33.53%
# of months up (NAV)†	65
# of months down (NAV)†	58

*† undiluted basis * since inception*

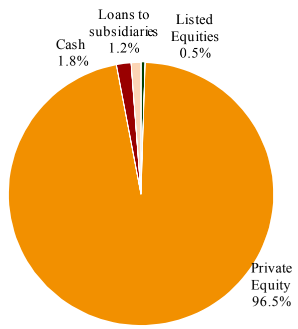
RC2 NAV returns (undiluted basis)

	2012	2013	2014	2015	2016
Jan	0.12%	-31.58%	-0.65%	-0.07%	8.03%
Feb	-9.69%	-0.51%	-0.34%	-0.34%	1.22%
Mar	-0.50%	-0.62%	2.94%	-0.70%	-0.66%
Apr	-0.66%	0.29%	2.73%	0.93%	
May	-4.98%	-33.53%	2.70%	3.11%	
Jun	-1.47%	-0.85%	0.28%	-0.38%	
Jul	-0.73%	-0.28%	0.44%	3.24%	
Aug	0.61%	1.27%	3.23%	-0.85%	
Sep	0.01%	-0.69%	0.01%	0.31%	
Oct	-0.82%	-0.72%	1.87%	-0.35%	
Nov	-0.36%	0.43%	0.15%	3.17%	
Dec	0.29%	-16.44%	0.73%	-8.47%	
YTD	-17.17%	-62.64%	14.91%	-0.94%	8.62%

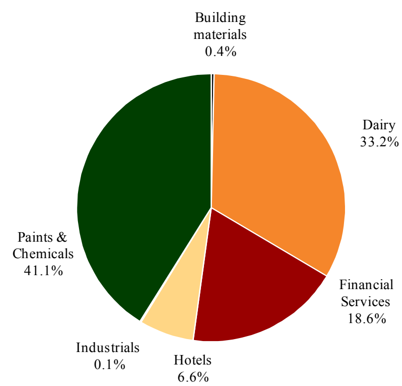
Share price / undiluted NAV per share (€)



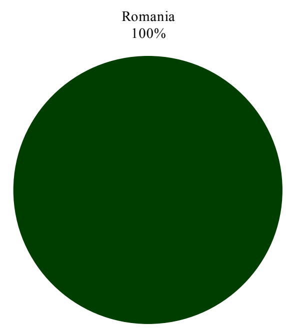
Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Portfolio Structure by Geography



Message from the Adviser

Dear Shareholders

Over the first quarter of 2016, RC2's NAV per share grew from €0.3736 to €0.4058, both on an undiluted basis, which represents an increase of 8.62%, mainly driven by a 31% rally in the Albalact share price, following the announcement on 28 January that RC2 and the Ciurtin family had agreed the sale of their shares in the business to a strategic investor, subject to the fulfilment of a number of conditions precedent, including Romanian Competition Council approval.

As indicated in that announcement, the final sale price will be based on the net debt of that business at the end of the month prior to the fulfilment of all the conditions precedent. Based on the net debt as at 30 September 2015 (the last quarterly results when the announcement was made) the implied price per share is RON0.4543, whilst the closing price of Albalact shares on 30 March 2016 was RON0.4330/share. Albalact is still waiting for all the conditions precedent to be fulfilled so that the sale can go ahead by means of a public tender offer to be initiated by the buyers.

The first quarter of the year is one of low turnover for Policolor, given the seasonality of paint sales in Romania and Bulgaria. The Group's EBITDA loss (net of revenues and expenses allocated to the real estate division) for the quarter was €0.6m, significantly better than the loss of €1.1m over same quarter of 2015 and the budgeted loss of €1.5m. The EBITDA improvement is both the result of an increase in sales at the paints and coatings divisions, but also the result of improved cost controls. Policolor was not able to find a solution with the buyers of its main Bucharest site, who have defaulted on the purchase. However, it is continuing to seek a solution and is in a relatively strong position, having taken a €3m advance over the course of 2014-15 in respect of the sale.

Top Factoring continued its excellent performance, with higher than expected collections on its portfolios resulting in a €2.5m write-up in the value of its portfolios at the end of March, and quarterly EBITDA of €2.7m, compared to €2m over the same quarter of the prior year.

Mamaia Resort Hotels' operations are negligible over the first quarter due to the seasonality of the Hotel, but it successfully completed its re-branding over the quarter, made big progress in the construction of its SPA facility, and has already contracted almost 60% of its total room occupancy capacity over the high summer season, which already looks very promising.

Klas continued to reduce its quarterly EBITDA loss, which was €-0.1m in the first quarter of 2016 compared to €-0.5m in the same quarter of 2015. It also managed to complete the sale of its former production facility, generating €2.4m which has allowed the Company to repay €1.9m of bank debt, bringing its total outstanding bank debt down to €1.4m.

At the end of the quarter, the Fund had cash and cash equivalents of approximately €0.9m and short-term liabilities of €0.2m.

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 South East Europe, and Ruse Chemicals, a producer of anhydrides. All the Group companies are unlisted.

Group Financial results

(EUR '000)	2014*	2015**	2016B	1Q15**	1Q16**	1Q16B
Consolidated Income statement (according to IFRS)						
Sales revenues	**53,655**	**57,045**	**64,937**	**10,883**	**11,592**	**11,643**
Other operating revenues	252	336		96	8	58
Total operating revenues	**53,907**	**57,381**	**64,937**	**10,979**	**11,600**	**11,701**
Total operating expenses	**(55,549)**	**(59,047)**	**(65,748)**	**(13,137)**	**(13,029)**	**(14,125)**
Operating profit	**(1,642)**	**(1,666)**	**(810)**	**(2,158)**	**(1,429)**	**(2,424)**
Operating margin	*neg.*	*neg.*	*neg*	*neg.*	*neg*	*neg*
Recurring EBITDA	2,438	1,957	1,806	(1,067)	(608)	(1,538)
Non-recurring EBITDA	(563)	(286)	(125)	(173)	(8)	(35)
Total EBITDA	**1,875**	**1,671**	**1,681**	**(1,241)**	**(616)**	**(1,573)**
EBITDA margin	*3.5%*	*2.9%*	*2.6%*	*neg.*	*neg.*	*neg.*
Net extraordinary result		441				
Financial Profit/(Loss)	(958)	(1,027)	(855)	(74)	(179)	(167)
Profit before tax	**(2,600)**	**(2,693)**	**(1,665)**	**(2,232)**	**(1,608)**	**(2,591)**
Income tax	114	(31)		(4)		
Profit after tax	**(2,486)**	**(2,724)**	**(1,665)**	**(2,236)**	**(1,608)**	**(2,591)**
Minority interest	48					
Profit for the year	**(2,438)**	**(2,724)**	**(1,665)**	**(2,236)**	**(1,608)**	**(2,591)**
avg exchange rate (RON/EUR)	*4.45*	*4.44*	*4.50*	*4.45*	*4.49*	*4.50*

*Note: * audited, ** unaudited*

The Group generated consolidated operating revenues of €11.6m in the first quarter of 2016, within the budget and 5.7% above the first quarter of 2015. With the exception of the anhydrides division whose sales were half the value of the sales in the first quarter of 2015, all divisions delivered strong performance. Overall, paints and coatings grew by 20.6% year-on-year, whilst sales of resins were up 10.6%. Given the volatility in oil prices, the anhydrides division's plant did not operate during the quarter and sales were limited in order to secure the stock needed for the Group's internal needs.

The Group generated a recurring EBITDA loss (net of revenues and expenses allocated to the real estate division) of €-0.6m, significantly better than the loss of €-1.1m over same quarter of 2015, and the budgeted loss of €-1.5m. The EBITDA improvement is both the result of the increase in sales at the paints and coatings divisions, and improved cost controls.

Real Estate

Policolor has been exploring various options with the buyers of the real estate, who were unable to fulfil their contractual commitments to pay €11m by the end of 2015, but has not reached a satisfactory solution. Policolor had already received a €3m deposit to secure the buyers' obligations.

Top Factoring Group

Background

RC2 invests in Romanian non-performing loans through its 100%-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	2014*	2015*	2016B	1Q15**	1Q16**	1Q16B
Combined Group Income Statement						
Net revenues	**8,147**	**10,007**	**8,828**	**3,215**	**3,805**	**3,748**
Debt purchase	7,252	9,028	8,037	3,030	3,633	3,546
gross collections	11,460	12,903	11,950	3,092	3,253	3,068
amortization and fair value adjustments of debt portfolios	(4,207)	(3,874)	(3,913)	(60)	380	478
Mandate agreements	894	978	791	186	173	202
Operating expenses	**(4,560)**	**(4,901)**	**(4,848)**	**(1,170)**	**(1,120)**	**(1,158)**
EBITDA	**3,587**	**5,106**	**3,979**	**2,045**	**2,685**	**2,590**
EBITDA margin (%)	*44.0%*	*51.0%*	*45.1%*	*63.6%*	*70.6%*	*69.1%*
Depreciation	(135)	(242)	(330)	(52)	(76)	(71)
Earnings before taxes	**2,894**	**4,314**	**3,157**	**2,004**	**2,553**	**2,390**
Income tax	(547)	(586)	(410)	-	-	-
Net profit	**2,347**	**3,728**	**2,747**	**2,004**	**2,553**	**2,390**
Net profit margin (%)	*28.8%*	*37.3%*	*31.1%*	*62.3%*	*67.1%*	*63.8%*
Avg exchange rate (RON/EUR)	*4.445*	*4.445*	*4.450*	*4.451*	*4.493*	*4.450*

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

Over the first quarter of 2016, the Group generated gross revenues (made up of gross collections on proprietary portfolios and agency revenues) of €3.4m, up 4.5% year-on-year and 4.8% above budget, driven by the debt purchase line which accounted for 95% of gross operating revenues.

The March quarterly impairment test resulted in a net write-up of €2.5m, due to higher than expected collections on proprietary portfolios over the quarter. Gross collections were 6% over budget in the first quarter, a combined result of more efficient collection operations and an overall improvement in the macroeconomic climate.

The first quarter EBITDA, which takes into account the portfolio write-ups, was €2.7m, up 31.3% on last year's €2.0m.

Operations

Glasro invested €1.4m in seven banking portfolios made up of 3,000 cases over the first quarter, financed by a combination of equity and bank loans. At the end of the first quarter, the Group owned 965,000 cases with a total face value of €303m.

Albalact

Background

Albalact SA ("Albalact" or the "Company") is a publicly quoted Romanian dairy company in which RC2 holds a 25.4% stake under its Private Equity Programme. A local entrepreneur (Mr Raul Ciurtin) and his family own 44.9%, with 26.4% representing the free float and 3.3% representing treasury shares acquired within a buy-back program. With Albalact's market capitalization increasing by 30.4% over the quarter, following the announcement that Lactalis has agreed to acquire the Albalact shares held by RC2 and the Ciurtin family representing in aggregate 70.29% of the fully-diluted issued share capital of Albalact, the value of RC2's shareholding increased from €12.3m as at 31 December 2015 to €16.1m as at 31 March 2016.

Financial results

EUR '000	2014*	2015*	2016B	1Q15**	1Q16**
Consolidated Income Statement					
Sales Revenues	**91,826**	**99,893**	**100,748**	**23,805**	**27,905**
Total Operating Revenues	**94,807**	**100,049**		**23,850**	**27,943**
Total Operating Expenses	(93,490)	(95,164)			
Operating Profit	**1,317**	**4,885**		**960**	**2,434**
Operating margin	*1.4%*	*4.9%*		*4.0%*	*8.7%*
EBITDA	**6,040**	**10,056**	**10,000**	**2,286**	**3,684**
EBITDA margin	*6.4%*	*10.1%*	*9.9%*	*9.6%*	*13.2%*
Profit before Tax	**360**	**4,326**		**1,116**	**2,550**
Income Tax	(177)	(1,486)		(313)	(656)
Profit after Tax	**183**	**2,840**		**803**	**1,894**
Minority Interest	11	6		4	1
Profit for the year	194	2,846		807	1,893
Net margin	*0.2%*	*2.8%*			
Avg exchange rate (RON/EUR)	*4.44*	*4.44*	*4.50*	*4.45*	*4.49*

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

Based on the audited consolidated financial statements approved by its shareholders in April, Albalact generated sales of €100m in 2015, up 8.8% year-on-year, and achieved a significant improvement in its operating profitability, with EBITDA of €10.1m up 66.5% year-on-year, the result of lower raw milk prices and an improved sales mix.

In May, the company also disclosed its first quarter 2016 results, with euro-denominated sales of €27.9m, 17.2% higher than over the same quarter of 2015. The strong growth in profitability, with EBITDA of €3.7m up 61.2% year-on-year, was mainly due to higher sales and an improved gross margin due to the lower market price of raw milk.

Prospects

Based on the budget approved by the shareholders at the Company's annual general meeting held in April, the Company expects its overall 2016 sales and EBITDA to be stable year-on-year.

Mamaia Resort Hotels

Background

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the now re-branded ZENITH – Conference & Spa 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)	2014*	2015*	2016B	1Q15**	1Q16**	1Q16B
Income Statement						
Sales Revenues	**1,972**	**2,331**	**2,527**	**32**	**29**	**33**
Total Operating Revenues	**2,045**	**2,349**	**2,527**	**35**	**32**	**39**
Total Operating Expenses	(2,106)	(2,044)	(2,163)	(244)	(269)	(296)
Operating Profit	**(61)**	**305**	**364**	**(209)**	**(237)**	**(258)**
Operating margin	*neg.*	*13.0%*	*14.4%*	*neg.*	*neg.*	*neg.*
EBITDA	**253**	**484**	**580**	**(163)**	**(194)**	**(210)**
EBITDA margin	*12.4%*	*20.6%*	*22.9%*	*neg.*	*neg.*	*neg.*
Profit after Tax	**(158)**	**176**	**204**	**(210)**	**(243)**	**(283)**
Net margin	*neg.*	*7.5%*	*8.1%*	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*4.445*	*4.445*	*4.450*	*4.451*	*4.493*	*4.450*

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

Revenues over the first quarter are negligible due to the seasonality of the Hotel's business, and the Company's financial performance was in line with the budget in the first quarter in terms of profitability.

The construction of the spa facility is currently underway and is expected to be completed at the beginning of June.

Almost 60% of the total occupancy capacity over the high summer season has already been contracted with agencies, with the rest being available for spot reservations, as the Hotel aims to improve its average room tariffs by increasing the number of "walk-in" clients.

Klas

Background

Klas DOO ("Klas" or the "Company"), the former bakery division of East Point Holdings Limited ("EPH") 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 a €0.6m (including accrued interest) shareholder loan to Klas outstanding as at 31 March 2016. In December 2015, €3m of outstanding payables due to Zitomlin, the milling company of the EPH group, was converted into 33.3% of the share capital of BPI, Klas's operating subsidiary, in an effort to stabilize the group's cashflow, and improve its working capital position.

Financial results and operations

EUR '000	2014*	2015A**	2016B	1Q15**	1Q16**	1Q16B
Net sales	**10,659**	**5,097**	**6,943**	**1,123**	**1,192**	**1,222**
EBITDA	**(2,266)**	**(1,095)**	**157**	**(464)**	**(130)**	**(107)**
EBITDA margin	*-21.3%*	*-21.5%*	*2.3%*	*-41.3%*	*-10.9%*	*-8.8%*
Profit after tax	**(2,826)**	**(2,056)**	**(1,488)**	**(374)**	**(467)**	**(296)**
Net margin	*-26.5%*	*-40.3%*	*-21.4%*	*-33.3%*	*-39.2%*	*-24.2%*

*Note: * audited, ** management accounts*

Klas's first quarter sales at €1.19m were just 2.5% less than budget demonstrating that sales have now stabilized at around 30 tons per day. The challenge for 2016 will be to grow sales both in terms of quantity and higher margins. Negotiations are already advanced with a major chain for sale of lower margin breads, and a new range of pastries has been launched with positive initial feedback. EBITDA in the first quarter was €-

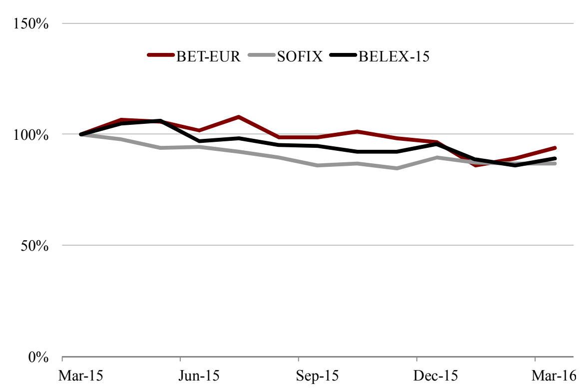
130,000, which, although approximately 20% higher than budgeted, is a marked improvement on prior years, and the month-on-month performance is improving, with management forecasting breakeven EBITDA for the second half of 2016.

Proceeds of €2.4m from the sale of the Company's former production facility at Juzni Bulevar site were received in February. This has allowed the Company to repay €1.9m of bank debt, settle outstanding tax liabilities of €0.2m, invest € 0.1m in a frozen products line, and allocate the balance of €0.2m to its working capital needs.

Klas has now reduced its external debt from €3.3m to €1.4m, on which it benefits from a principal and interest payment holiday until March 2017.

Capital Market Developments

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



Commentary

During the first quarter, the Romanian BET, the Bulgarian SOFIX and the Serbian BELEX indices fell by 2.5%, 3.2% and 6.8%, respectively, all in euro terms. By comparison, over the same quarter, the MSCI Emerging Market Eastern Europe and the MSCI Emerging Market indices increased by 9.7% and 0.6%, respectively, while the FTSE100 and the S&P indices were down by 7.7% and 3.8%, respectively, all in euro terms.

Over the past year, the BET-EUR index has lost 6%, the SOFIX 13.2% and the BELEX-15 11%, all in euro-terms. Over the same period, the MSCI Emerging Market Eastern Europe and the MSCI Emerging Market indices lost 10.3% and 19.1%, respectively, and the FTSE100 and S&P indices fell by 16.7% and 6.1%, respectively, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	4.2%	1Q16	2.9%	1Q16	0.8%	1Q16
Inflation (y-o-y)	-3.0%	Mar-16	-1.5%	Mar-16	1.5%	Mar-16
Ind. prod. growth (y-o-y)	-1.9%	Mar-16	3.0%	Mar-16	8.8%	Mar-16
Trade balance (EUR bn)	-2.0	3M16	-0.2	3M16	-4.3	FY15
y-o-y	*42.8%*		*-58.3%*		*7.8%*	
FDI (EUR bn)	0.8	3M16	0.4	3M16	1.8	FY15
y-o-y change	*-12.4%*		*-36.6%*		*45.6%*	
Total external debt/GDP	52.6%	Mar-16	73.1%	Feb-16	80.3%	Dec-15
Reserves to short-term debt	168.2%	Mar-16	254.6%	Feb-16	393.6%	Mar-16
Loans-to-deposits	87.1%	Mar-16	79.6%	Mar-16	109.5%	Mar-16
Public sector debt-to-GDP	38.1%	Mar-16	29.3%	Mar-16	73.4%	Dec-15

Commentary

Romania

Romania's first quarter GDP increased by 1.6% quarter-on-quarter and by 4.2% year-on-year, the second highest growth in the EU. Detailed data on the sources of growth is not yet available. However, Romania's industrial production continued to perform weakly, and March was the third consecutive month in which it has fallen (-1.9% year-on-year). With industrial production falling, it is clear that private consumption was the driver of GDP growth. Driven by higher wages, retail sales grew by 19% year-on-year in the first quarter. In its spring 2016 report, the European Commission forecasts Romania's overall 2016 GDP to grow by 4.2% year-on-year, driven by strong domestic demand.

Inflation hit a historical low in March as prices fell by 3% year-on-year. The decrease was led by a reduction in the standard VAT rate from 24% to 20%, and falling international commodity prices. Falling prices in Romania within the context of low inflation in Europe prompted the National Bank of Romania ("NBR") to revise its forecast for the 2016 inflation rate downwards from 1.4% to 0.6%.

The low inflationary environment has determined the NBR to maintain its monetary policy at 1.75%, which is unchanged for a year now. In the context of the higher volatility of regional currencies, the Romanian leu lost 1.1% against the euro over the first quarter.

Romania achieved a budget surplus of €0.7bn over the first quarter, equivalent to 0.4% of GDP, compared to a 0.7% deficit over the first quarter of 2015. Although budgetary receipts increased by 1.1% year-on-year in RON terms, they were approximately unchanged in euro terms at €12.4bn, VAT collections, which made up 25.7% of total budgetary receipts (being the largest revenue item), fell by 1.7% year-on-year. The fall in revenues is explained by the reduction in the standard VAT rate mentioned above. Receipts from corporate profit taxes, which represent 7.1% of total receipts, increased by 26.2% year-on-year, a sign of improved economic conditions.

Total budgetary expenses increased by 5.0% year-on-year from €11.2bn to €11.7bn, with personnel and social expenditures, which account for 64% of total expenses, increasing by 7.4%. The 2016 budget deficit target is 2.8% of GDP. Local elections, which are set to take place in early June, with parliamentary elections due to follow this autumn, are likely to put a stress on the state of the public finances.

With domestic demand increasing, imports continued to rise, having grown by 7.0% over the first quarter, whilst exports increased by only 3.5%. Accordingly, the first quarter trade deficit of €2bn was the worst of the last six years (the 2009 first quarter trade deficit was €2.2bn) and was up 42.8% year-on-year. The first quarter current account balance was negative by €-1.5bn (or the equivalent of 0.9% of GDP), compared to a positive balance of €0.5bn over the same quarter of 2015. FDI inflows amounted to only €0.8bn, down from €0.9bn in the same quarter of 2015.

Romania's total external debt was €89.0bn at the end of March, which amounts to a 2.1% year-to-date fall, and equates to approximately 52.6% of GDP. Total public debt was €60.8bn, or 38.1% of GDP, at the end of March, down from 38.6% at the end of 2015.

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €48.4bn at the end of March, and was down 0.6% year-to-date in RON terms. Nonetheless, the loan stock was up 0.5% month-on-month in March. The balance of loans in domestic currency continues to be higher than those in foreign currencies, with the former accounting for 52.6% of the total loan stock at the end of March, compared to 50.7% at the end of 2015, having increased by 3.2% year-to-date. Household loans amounted to €24.1bn at the end of March, unchanged in RON terms since the beginning of the year. As interest rates are falling and private consumption is growing, the overall deposit base has fallen by 2.1% in RON terms since the beginning of the year, and amounted to €55.5bn at the end of March. The monthly fall in the deposit base was of 1%. The NPL ratio was 13.68% at the end of February, slightly up on the 13.61% recorded at the end of 2015.

Bulgaria

Bulgaria's first quarter GDP grew by 2.9% year-on-year and by 0.7% quarter-on-quarter. With exports flat compared to the same quarter of last year, consumption, which increased by 2.4% year-on-year, has been the main driver of GDP growth. According to its latest forecast, the European Commission expects the Bulgarian economy to grow by 2.0% in 2016, driven by higher international demand resulting in higher net exports. Bulgaria's industrial production increased by 3% year-on-year in March.

Bulgaria continues to experience deflation, having recorded a 1.5% year-on-year fall in prices in March, compared to a 0.4% year-on-year fall in December 2015.

Over the first quarter, Bulgaria achieved a budget surplus of €0.1bn, or 2.1% of GDP, which is a marked improvement over the 0.3% surplus achieved over the same period last year. The surplus was triggered by an 11.1% increase in tax revenues (from €3.0bn to €3.4bn), whilst total budgetary expenses fell by 3.6% (from €3.7bn to €3.6bn). VAT receipts, which make up 25.2% of total budgetary receipts, increased by 16.5% year-on-year. For 2016, the government is targeting a budget deficit of 2.0% of GDP. Bulgaria's public sector debt amounted to 29.3% of GDP at the end of March, up from 26.4% at the end of 2015. The increase was due to Bulgaria placing €1.1b of seven-year bonds at a yield of 2.16%, and €0.9bn of 12-year bonds at a yield of 3.18%. Both issues took place in March and the funds will be used to re-finance debt and cover the budget deficit.

Bulgaria's trade balance improved from a deficit of €-0.5bn in the first quarter of 2015 to a deficit of €-0.2bn in the same quarter of 2016. While exports were flat at €5.2bn, imports fell by 5.2% year-on-year, from €5.7bn to €5.4bn. Helped by a €0.3bn surplus from primary and secondary income and a €0.1bn surplus from services, the current account balance was €0.2bn in surplus, or 0.4% of GDP, slightly up on the 0.3% surplus achieved a year ago. FDI inflows amounted to €0.4bn, 36.6% lower than in the first quarter of 2015. The decrease was due to lower equity investments, which fell from €0.31bn to €0.28bn, whilst intra-group loans shrank by €0.2bn.

The Bulgarian banking system's loans to non-financial institutions continued the negative trend recorded last year, and amounted to €24.5bn at the end of March, which is 1.7% lower than at the end of December. The deposit base also fell, from €31.1bn at the end of 2015 to €30.8bn at the end of March (-0.9%). NPLs accounted for 22.1% of total loans at the end of the quarter, virtually unchanged year-to-date.

Serbia

The main economic indicators for the Serbian economy continued to improve during the first quarter of 2016, with year-on-year data showing GDP growth at 0.8%, inflation at a steady 1.5% and industrial production increasing by 8.8%. Export growth at 7.8% year-on-year outstripped import growth of 5.8% over the quarter. This bodes well for the years ahead and has led the European Commission to forecast GDP growth of 1.6% and 2.5% in 2016 and 2017, respectively.

FDI for 2015 of EUR 1.8billion represents an increase of 45.6% over 2014. This is particularly important since it was directed primarily at the manufacturing sectors of the economy (vehicles, plastics and steel), whereas in prior years FDI had been concentrated on the financial sector.

The National Bank of Serbia decided to cut its key policy rate by 0.25pp to 4.25% in February, after keeping it level at 4.5% for thee consecutive months. This further relaxation of monetary policy was supported by low inflationary pressures and a desire to stimulate aggregate demand. Commercial bank lending has now started to grow again, with a 0.6% year-on-year increase in total loans at the end of February.

Against this favourable background, the government called early parliamentary elections on 24 April and secured a renewed mandate, albeit with a reduced majority. The overriding aim of the next four years is to pursue structural reforms, in particular with the privatization of utilities, and to progress Serbia's prospective accession to the EU. The government has set a target of 2018 for the adoption of all EU -mandated legislation prior to accession.

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