Reconstruction Capital II Ltd

Quarterly Report

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neweuropecapital

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Statistics

NAV per share (€)	0.9037
Share price (€)	0.4925
Total NAV (€ m)	90.4
Mk Cap (€ m)	49.3
# of shares (m)	100.0
Return since inception	-5.52%
12-month CAGR	-26.89%
Annualized Return*	-1.61%
Annualized Volatility*	14.60%
Best month	6.93%
Worst month	-10.52%
# of months up	22
# of months down	20

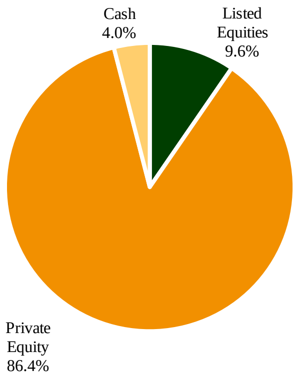
** since inception*

RC2 NAV returns

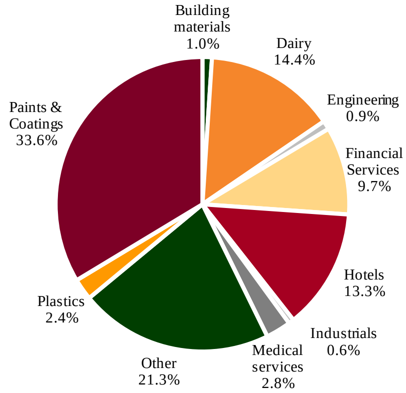
	2006	2007	2008	2009
Jan	-0.61%	4.70%	-8.27%	-5.65%
Feb	-0.73%	6.17%	-1.48%	-1.51%
Mar	-0.87%	5.90%	-3.03%	2.39%
Apr	0.44%	5.05%	-0.26%	-8.40%
May	3.73%	3.08%	0.93%	-0.26%
Jun	-1.25%	5.19%	-4.75%	3.08%
Jul	1.23%	6.93%	2.85%	-
Aug	0.61%	0.22%	-5.55%	-
Sep	2.18%	-2.50%	-8.34%	-
Oct	2.74%	-0.69%	-10.52%	-
Nov	2.80%	-4.09%	3.03%	-
Dec	1.70%	2.46%	-0.60%	-
YTD	12.47%	36.74%	-31.43%	-10.40%

Share price / NAV per share (€)

Portfolio Structure by Asset Class

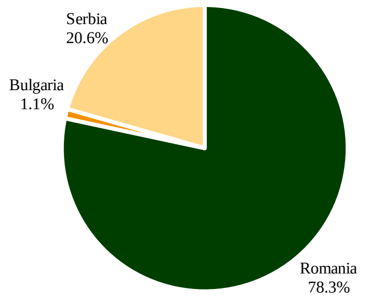


Equity Portfolio Structure by Sector



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

At the end of the 2nd quarter, RC2's NAV per share was EUR 0.9037, down 5.8% over the quarter. On the other hand, RC2's share price gained 44.9% over the same period closing at EUR 0.4925, thereby narrowing the discount to NAV to 45.5%.

At Policolor, the Fund's largest investment, EBITDA for 1H09 was almost double the EBITDA for the whole of 2008, as a result of the EBITDA margin increasing from 2.6% in 2008 to 11.0%. This is a remarkable achievement by the new management team which joined Policolor in 4Q08, considering the contraction in demand in Policolor's core markets of Romania and Bulgaria.

Throughput at East Point Holdings' flagship grain silo in Constanta port for 1H09 increased almost six-fold over the same period last year to 0.8m tons, generating a new record of volumes handled over any twelve month period. In a similarly positive note, sales at EPH's copper products division held up remarkably well in spite of the global economic recession, with volumes sold unchanged over the same period last year. On the other hand, results at EPH's river shipping division (where a new CEO took charge as of 1st June) were severely impacted by a heavy reduction in demand for iron ore shipments from the central Europe's steel industry.

At Albalact, sales were up 31% in RON and 13% in euros, even though the Romanian dairy market suffered from consumers' falling purchasing power. In addition, the investments and cost saving measures implemented last year seem to have paid off, with the EBITDA margin almost doubling from 6.7% in 1H08 to 12.1% in 1H09.

With the exception of Mamaia Resort Hotels, the other main investee companies held under RC2's Private Equity Programme reported considerable improvements in their operating results compared to the same period last year.

The macroeconomic picture continues to be negative with GDP having contracted in all of RC2's countries of operation. However the devaluation of the local currencies in the first quarter (except for Bulgaria where the leva kept its peg to the euro) and falling domestic private consumption has contributed to a rebalancing of the economic models of these countries, with local current-account deficits shrinking substantially: -73% in Romania over 6M09, -50% in Serbia over 4M09 and -44% in Bulgaria over 5M09.

RC2 continued to focus on growing and improving the profitability of the Private Equity investments. At the end of June, the Fund, which has no gearing, had cash balances of approximately €3.6m. In addition, the more liquid listed investments held under the Trading Programme could, if needed, be sold in order to fund follow-on investments in investee companies held under RC2's Private Equity Programme.

Yours truly,

New Europe Capital

Policolor Group

Background

The Policolor Group ("Policolor" or the "Group") is the leading producer of coatings in Romania and Bulgaria. The Group comprises Policolor SA, a private Romanian company, and Orgachim AD, its 64%-owned Bulgarian subsidiary which is quoted on the Bulgarian Stock Exchange. RC2 has shareholdings in both companies: 40% of Policolor share capital and 2.4% of Orgachim.

Financial results

(EUR '000)	2007A*	2008A*	1H09 B	1H09**
Income statement				
Sales revenues	**94,643**	**100,632**	**48,161**	**38,167**
Other operating revenues	1,907	2,002	-	1,062
Total operating revenues	**96,550**	**102,634**	**48,161**	**39,229**
Total Operating Expenses	(95,900)	(105,678)	(45,991)	(37,343)
Operating profit	**650**	**(3,044)**	**2,170**	**1,886**
Operating margin	*0.7%*	*neg.*	*4.5%*	*4.8%*
EBITDA	**6,692**	**2,619**	**4,453**	**4,296**
EBITDA margin	*6.9%*	*2.6%*	*9.2%*	*11.0%*
Financial Profit/(Loss)	(1,312)	(1,773)	(1,128)	(656)
Restructuring costs	-	-	(325)	-
Profit before tax	**(662)**	**(4,817)**	717	904
Profit before Tax	(1,341)	443	(124)	(116)
Profit after tax	**(2,003)**	**(4,374)**	**593**	**788**
Profit margin	*neg.*	*neg.*	-	*2.0%*
Minority interest	(1,143)	646	51	124
Profit after Tax	**(3,146)**	**(3,729)**	**644**	**912**
Avg exchange rate (RON/EUR)	*3.337*	*3.683*	-	*4.229*

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

The new management team appointed in October 2008 has made substantial progress in transforming the Group into an efficient coatings producer, with the EBITDA margin increasing from 2.6% over 2008 to 11.0% in the first half of 2009, in spite of the strong recessions in Romania and Bulgaria particularly affecting those countries' construction industries. At net profit level, the Group result was also positive in contrast to 2008. However, Orgachim, which has an exposure to the chemicals industry through its anhydrides division, continued to make a loss over the period.

Overall, the Group has managed to meet its targets for the first half of the year, which is an exceptional result considering the difficult environment in which it is operating.

Operations

Policolor is a complex group active not only in all the main categories of coatings (architectural, industrial and automotive), but also in insulation systems for the construction industry, resins, and anhydrides (which are chemicals used in the coatings and plastics industries). Furthermore, the Group has historically internalized a number of non-core functions, such as transportation, merchandising, and retail (the Group operates 13 shops in Romania and Bulgaria).

Under the previous management, all activities were bundled together within Policolor and Orgachim, with limited visibility on the efficiency of the various activities and functions, and a centralized management structure.

The new management team has reorganized the Group into six strategic business units (architectural coatings, industrial coatings, automotive coatings, insulation systems, resins and anhydrides) each one with its own management team responsible for its own P&L. Production remains a centralized function servicing all the SBU's, but the merchandising activity has been externalized to an outside company, whilst the insulation systems SBU and the transportation functions have been moved into newly-created subsidiaries of the Group. Finally, the Policolor Group had previously opened subsidiaries in the Ukraine, Serbia and Georgia with a view to developing sales into these markets. This turned out to be a serious loss-maker, with the Group lacking the skills and management depth to develop these markets systematically. Accordingly, the new management has closed down these operations, with any sales into these markets now being effected via specialized local agents and distributors.

The new management team has reduced the Group headcount from 1,859 in October 2008 to 1,056 at present. So far, 707 employees have been laid off; 87 merchandising agents have been externalized to an employee leasing company which now receives a commission on sales achieved by the merchandisers; and a further 9 have been externalized to security and cleaning companies unrelated to the Policolor Group.

East Point Holdings Ltd

Background

East Point Holdings Ltd ("EPH" or the "Group") is a Cyprus-based holding company with significant business interests across South East Europe in which RC2 acquired a 21.3% shareholding in 2008. The bulk of the Group's operations are in Serbia and Romania, but it is also active in other countries, including Hungary and Austria, and has a network of sales, procurement and representative offices in New York, Moscow, Frankfurt, Beijing and Sofia. EPH operates along the following main business lines: Agribusiness, Milling, Copper Processing, Cable Production, Bakeries, River Shipping, Real Estate and Other. RC2 has the right to convert its shares in EPH into shares in sub-holding companies mirroring each of its business lines pursuant to a reorganization programme agreed with EPH and its shareholders.

Overview

The Company has only released its consolidated results for the first quarter.

EURm	2007A*	2008A**	1Q09**
Income statement (according to IFRS)			
Sales	379.6	481.9	111.0
COGS	(348.8)	(410.6)	(87.5)
Gross profit	30.8	71.2	23.4
SG&A expenses	(17.6)	(37.7)	(12.2)
Other operating income/(expense)	15.6	(16.1)	(3.5)
EBITDA	28.8	17.5	7.7
EBIT	20.9	12.1	3.7
Net interest income (expenses)	(13.9)	(12.2)	(3.5)
FX gain (loss)	(0.5)	(8.2)	(6.6)
Share of profit (loss) of associates	(0.3)	(0.7)	(0.5)
Net income before tax	6.1	(9.1)	(6.8)
Income tax	(0.4)	(1.3)	(0.3)
Net income/(loss)	5.8	(10.4)	(7.1)
Minority interest	(0.7)	0.2	0.5
Net income after minority interest	5.1	(10.2)	(6.6)

*Note: * audited, restated from USD to EUR at yearly average exchange rate*
*** unaudited management accounts*

For the first quarter of 2009, the bulk of EPH's businesses performed in line with the Group budget: annualised sales were down by only 3% whilst EBITDA came in slightly above budget (+2%) at €7.7, compared to €30.9m budgeted for the whole year.

High financing charges at the River Shipping and Copper Processing businesses acted as a drag on the Group's profitability whilst the devaluation of the Serbian Dinar and the RON caused high non-cash charges as EUR-denominated loans were translated into the respective local currency, thereby depressing the bottom line. However, the respective local currencies stabilized during the second quarter.

Agribusiness

Throughput at EPH's flagship grains silo in Constanta reached 0.8m tons in 1H09 (+576% year-on-year) lifting the throughput to 1.4m tons over the last twelve months, which is the best ever twelve-month period in the silo's history.

Milling

During 1H09 EPH's milling division produced 52.3 k tons, a reduction of 14.2% compared to the same period in 2008.

EPH has made progress in the reorganisation of its milling investments into a new milling sub-holding company. The minority shareholders at Zitoprodukt Backa Palanka were bought out following a squeeze-out process and the main milling company in Serbia, Zitomlin, now owns 100% of Zitoprodukt Backa Palanka, 93.1% of Sombormlin and 45.6% of Mitsides Point.

Bakeries

Over the first quarter, EPH's bakery division experienced slightly lower sales but the EBITDA level remained more or less unchanged at €0.8m.

Copper Processing

During the first three months, production at EPH's copper mill VBS declined by 18% year-on-year to 6,700 tons. However, production recorded a 18% year-on-year increase in the second quarter, resulting in the overall level being more or less flat over the first six months of 2009. The pick up in volumes has continued into July, when VBS recorded its highest ever production level since 1989 (3,600 tons).

Serbia's free trade agreement with Russia generated strong exports to this market (>1,300 tons in 1H compared to 1,500 tons budgetted for the entire year), up from nil in 2008.

VBS's employee restructuring programme was finalized in March with a headcount reduction of 100, bringing the total headcount to 935 as at 30 June 2009, compared to 1,402 when the restructuring programme started following EPH's acquisition of the mill. This brings total average monthly output per employee to 3.0 tons, a 66% increase since the beginning of the restructuring programme.

River Shipping

As a consequence of the recession in the steel industry, EPH's river shipping business transported substantially lower iron ore volumes (-33% over 1Q09 and -63% over 2Q09 year-on-year).

Furthermore, the collapse in iron volumes throughout the region resulted in overcapacity, with deeply discounted freight rates offered on the market.

EPH has responded by mothballing part of its fleet and by continuing its cost cutting measures, also with the help of a new CEO which joined in June following an international search.

Albalact

Background

Albalact SA ("Albalact") is a quoted Romanian dairy producer in which RC2 has acquired a 25.4% stake under its Private Equity Programme, whilst a local entrepreneur and his family owns approximately 48%, with the remaining 26.6% representing the free float. With Albalact's market capitalization having increased by 68.5% over the quarter, as of 30 June 2009 RC2's shareholding in Albalact had a market value of €12.6m compared to €7.4m at the end of the previous quarter.

Financial results

(EUR '000)	2007A*	2008A*	1H08**	1H09**
Income Statement				
Sales Revenues	**46,339**	**51,741**	**24,253**	**27,492**
Other operating revenues	2,550	2,496	2,632	845
Total Operating Revenues	**48,888**	**54,236**	**26,886**	**28,337**
Total Operating Expenses	(45,916)	(52,163)	(26,399)	(26,868)
Operating Profit	**2,972**	**2,074**	**487**	**1,469**
Operating margin	*6.1%*	*3.8%*	*1.8%*	*5.2%*
EBITDA	**4,858**	**4,856**	**1,806**	**3,430**
EBITDA margin	*9.9%*	*9.0%*	*6.7%*	*12.1%*
Financial Profit/(Loss)	(1,657)	(1,860)	(167)	(671)
Profit before Tax	**1,315**	**214**	**319**	**798**
Income Tax	(241)	(52)	(56)	(133)
Profit after Tax	**1,074**	**162**	**263**	**665**
Net margin	*2.2%*	*0.3%*	*1.0%*	*2.3%*
Avg exchange rate (RON/EUR)	*3.337*	*3.683*	*3.671*	*4.229*

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

Despite the global crisis which took its toll on the Romanian economy, Albalact managed to increase its sales for the first six months by 31% in local currency terms and by 13% in EUR-terms. Whilst there are no official data for the overall dairy markets' performance over the first half of the year, by way of comparison Danone reported a 10% decline in its Romanian sales over the first quarter.

Equally positive, the cost cutting measures implemented by the Company in 2008 resulted in the EBITDA margin almost doubling in the first six months of 2009 (12.1% vs 6.7% for the previous year) and the operating margin expanding from 1.8% to 5.2% year-on-year.

Prospects

Albalact has consistently gained market share in spite of strong competition from leading multinational players, and is today the largest and fastest-growing independent player on the market. The Company already has a leading position in milk (pasteurised and UHT), cream and butter.

The addition of cheese products through the acquisition of cheese-maker Raraul places the Company in a leading position in the fragmented cheese market which is expected to provide further growth prospects.

Mamaia Resort Hotels

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the Golden Tulip Mamaia Hotel (the "Hotel") next to Constanta in Romania. In March 2008, RC2 became the owner of 63% of the Company, with the remaining 37% being owned by a Romanian entrepreneur.

Financial results

(EUR '000)	2007A*	2008A*	1H08**	1H09**
Income Statement				
Sales Revenues	**1,140**	**1,643**	**356**	**333**
Other operating revenues	120	144	87	10
Total Operating Revenues	**1,260**	**1,787**	**444**	**343**
Total Operating Expenses	(1,320)	(2,113)	(606)	(866)
Operating Profit	**(60)**	**(326)**	**(162)**	**(523)**
Operating margin	*neg.*	*neg.*	*neg.*	*neg.*
EBITDA	**144**	**(109)**	**(54)**	**(415)**
EBITDA margin	*11.4%*	*neg.*	*neg.*	*neg.*
Financial Profit/(Loss)	(593)	(155)	(158)	(7)
Profit before Tax	**(653)**	**(481)**	**(320)**	**(529)**
Income Tax	0	0	0	0
Profit after Tax	**(653)**	**(481)**	**(320)**	**(529)**
Net margin	*neg.*	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*3.337*	*3.683*	*3.671*	*4.229*

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

Despite achieving occupancy rates comparable to 2008, the Company's revenues for the first six months decreased by 22.7% year-on-year, in euro terms, resulting from a combination of local currency depreciation and lower rates.

Operations

The Hotel earns most of its income in the summer months, with practically no revenues until May. The Hotel's business plan involves finalizing its conference centre so that it should be able to improve its out-of season income substantially.

Overall, the occupancy rate was just 12% over the first semester, but it jumped to 74% in July, in line with budget, and, based on confirmed bookings from agencies, the August occupancy rate is expected to exceed 80%.

Prospects

The Company is currently finalizing the financing arrangements for the completion of its conference centre and intends to start construction works in early October, after the end of the Summer season. Based on indicative offers submitted by building companies, the new conference centre should be ready by January 2009.

Romar

Background

The Romar Group ("Romar") operates seventeen clinics and seven laboratories in twelve towns across Romania and is the market leader in Occupational Health Services (OHS). RC2 owns 40% and the company's founder owns the balance of 60%. In late 2008, RC2 and the Founder have decided to put the company up for sale by means of an organized sale process and an investment banking boutique has been appointed to handle the process.

Financial results

(EUR '000)	2007A*	2008A**	1H08**	1H09**
Combined Income Statement				
Total Operating Revenues	**7,789**	**7,597**	**3,616**	**3,529**
Total Operating Expenses	(7,431)	(7,828)	(3,949)	(3,568)
Operating Profit	**358**	**(231)**	**(333)**	**(39)**
Operating margin	*4.6%*	*neg.*	*neg.*	*neg.*
EBITDA	**733**	**93**	**(192)**	**204**
EBITDA margin	*9.4%*	*neg.*	*neg.*	*5.8%*
Financial Profit/(Loss)	(93)	(79)	(34)	(45)
Earnings before Tax	**265**	**(310)**	**(367)**	**(85)**
Income Tax	(77)	-	(12)	-
Earnings after Tax	**187**	**(310)**	**(379)**	**(85)**
Net margin	*2.4%*	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*3.337*	*3.683*	*3.671*	*4.229*

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

Over the first half of 2009, revenues stood at €3.6m, basically flat when compared to the same period of 2008, a positive performance taking into account the lower levels of public funding for healthcare services. For example, the budget allocated by the Bucharest Health Insurance House to laboratory services was down 18% year on year in 2009. Romar managed to compensate for the decrease in services reimbursed by the public health houses by increasing revenues generated by Occupational Health Services ("OHS") and "walk-in" clients. OHS generated 55% of revenues, followed by walk-in clients (23% of revenues). While OHS revenues increased by 12% year-on-year from €1.7m to €2.0m, reimbursements from public health houses were 37% lower at €0.6m.

Overall, Romar's profitability has improved in the first half of 2009: 1H09 EBITDA was €0.2m, compared to a negative €0.2m over the same period of 2008.

Top Factoring

Top Factoring ("Top Factoring" or the "Company") is a receivables collection company in which RC2 owns a 93% shareholding. The remaining 7% is owned by the Company's CEO.

Financial results

(EUR '000)	2007A*	2008A*	1H08**	1H09**
Income Statement				
Total Operating Revenues	**694**	**1,205**	**408**	**571**
Total Operating Expenses	(913)	(1,883)	(724)	(645)
Operating Profit	**(220)**	**(678)**	**(316)**	**(74)**
EBITDA	**(213)**	**(641)**	**(308)**	**(56)**
Financial Profit/(Loss)	110	(15)	1	2
Profit before Tax	**(109)**	**(693)**	**(315)**	**(72)**
Income Tax	0	0	(6)	0
Profit after Tax	**(109)**	**(693)**	**(321)**	**(72)**
Avg exchange rate (RON/EUR)	*3.337*	*3.683*	*3.671*	*4.229*

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

The 1H09 results reveal a clear improvement in Top Factoring's activity, with operating revenues increasing by 40% year-on-year, from €0.4m to €0.6m.

Collections from the two packages of receivables acquired from Vodafone in December 2006 and December 2007 amounted to €0.4m, in line with the budget. So far, collections from the first Vodafone package (acquired at a cost of €0.5m) amounted to €0.8m, or 23.5% of nominal value, while collections from the second Vodafone package stood at €1.1m, or 22.8% of nominal value.

In July 2009, the Company acquired a third debt portfolio from Vodafone Romania consisting of 43,000 cases which is expected to help the company make a profit in the second half of the year.

Agency contracts generated revenues of €0.2m, far better than the same period in 2008 (€80k) and are already higher than the agency revenues achieved over the whole of 2008. In 2009, Top Factoring signed mandate agreements with four new clients and retained all its existing ones.

The B2B department, which was created in September 2008, generated revenues of €50k in 1H09.

Operations

The implementation of a new call-centre software in August 2008 and improved reporting and controlling systems triggered an improvement in the bottom line from a loss of €0.3m over the first six months of 2008 to a loss of €0.1m over January-June 2009.

Bulgarian Stock Exchange

In 2007, RC2 acquired 1.8% of the company (the "BSE") which operates the Bulgarian Stock Exchange for €482,953. The BSE is 44% owned by the Bulgarian state, 34% owned by Bulgarian brokerage firms and banks, and the balance is owned by a combination of institutions and private individuals.

In 2008 the BSE was negatively affected by the ongoing global financial crisis, resulting in revenues falling from €4.9m to €2.4m and the net profit from €2.6m to €0.3m for 2008. Due to its relatively small size, the investment is valued at cost in the Fund's NAV.

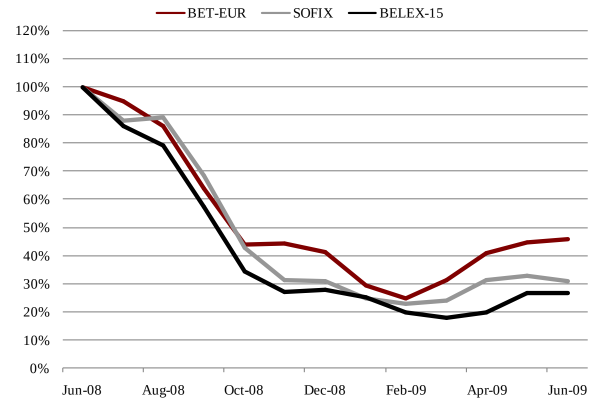
The BSE has not released any results for 2009.

(EUR '000)	2007*	2008**
Income Statement		
Revenues	**4,886**	**2,359**
Operating Expenses	**(2,057)**	**(2,271)**
Profit from operations	**2,828**	**88**
Financial income/(expenses), net	156	222
Profit before income tax	**2,984**	**310**
Income tax expense	(300)	(32)
Net profit for the year	**2,685**	**279**
Avg exchange rate (BGN/EUR)	*1.956*	*1.956*

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

Capital Market Developments

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



Commentary

Over the second quarter, the performance of the local stock markets seemed to vindicate the Investment Manager's view that they were oversold earlier in the year. In EUR-terms, the BET index was up 45.9%, the SOFIX index increased by 27.7% and the BELEX-15 index gained 51.4%.

Since the beginning of the year, the Romanian market (BET-EUR) was up by 11.4%. On the other hand, the SOFIX and BELEX-15 indices were still 0.4% and 3.5% lower respectively than six months ago. By comparison, the MSCI Emerging Markets index was up 27.5%, the MSCI Emerging Market Eastern Europe index was up 33.3%, whilst the FTSE100 and S&P indices increased by 7.5% and 1.1%, respectively.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	-7.6%	6M09	-3.5%	3M09	-3.5%	3M09
Inflation (y-o-y)	5.9%	6M09	3.7%	6M09	9.8%	6M09
Ind. prod. growth (y-o-y)	-5.9%	Jun-09	-18.7%	Jun-09	-19.5%	May-09
Trade deficit (EUR bn)	4.3	6M09	2.4	6M09	0.7	4M09
y-o-y	*-61.2%*		*-44.0%*		*-50.0%*	
FDI (EUR bn)	2.9	6M09	1.1	5M09	0.4	4M09
y-o-y change	*-43.0%*		*-53.6%*		*-22.3%*	
Total external debt/GDP	61.9%	Jun-09	107.9%	May-09	73.6%	Mar-09
Reserves to short-term debt	134.1%	Jun-09	88.7%	May-09	413.2%	Mar-09
Loans-to-deposits	117.3%	Jun-09	114.8%	Jun-09	128.1%	Mar-09

Commentary

Romania

In 1H09, Romanian GDP fell by 7.6% year-on-year. However, contracting demand resulted in lower inflation which came in at 5.86% year-on-year in June, down from 5.95% in May.

Furthermore, Romania's January-June 2009 current account deficit of €2.4bn was 73% lower than the same period in 2008. This was mainly the result of the trade deficit falling by 61.2% year-on-year to €4.3bn, as exports declined by 20.4% while imports fell by 36.6%. FDI flows, which stood at €2.9bn (down 43% year-on-year), fully covered the deficit.

The industrial sector was severely affected by the global economic decline. Over the first six months of 2009, industrial production decreased by 10.8% year-on-year. On a more positive note, June industrial production increased by 2.3% month-on-month.

In the second quarter, decreasing interest rates did not result in pressure on the leu, which gained 0.7% against the euro. The Romanian currency has lost 5.6% against the euro since the beginning of the year but exhibited less volatility in the second quarter.

The 2009 January-June fiscal deficit was 2.7% of GDP. However, the first two quarters' deeper than expected economic contraction raises the possibility of a yearly deficit of more than 7% of GDP.

Romania's total external debt position stood at €75.5bn at the end of June, or 62% of estimated 2009 GDP. According to the IMF, the external debt is projected to increase to about 64% of GDP at the end of 2009 from 53.4% at the end of 2008. The National Bank of Romania's foreign reserves (excluding gold) were €26.5bn at the end of June whilst the short-term external debt was €18.2bn at the end of June, bringing the reserves to short-term debt ratio to 134.1%.

At the end of June, total domestic non-governmental credit (which excludes loans to financial institutions) reached €47.3bn, a 1.2% monthly fall. Of this, 41% was leu-denominated and the balance of 59% was in foreign currencies. Overdue loans (€1.3bn) stood at 2.8% of total loans, an increase of 81% since the beginning of the year. The Romanian banking system's total loans-to-deposits ratio was around 117% at the end of June.

At the beginning of August, the National Bank of Romania decided to lower its key interest rate from 9% to 8.5%, while cutting the minimum reserve requirement ratios on foreign-denominated liabilities with residual maturities of up to two years to 30% (from 35%). These measures reflect slowing inflation and are intended to stimulate lending.

Bulgaria

The 5th July parliamentary elections were won by the centre-right Citizens for the European Development of Bulgaria Party ("GERB") which defeated the ruling Bulgarian Socialist Party (40% versus 18%). The key points in GERB's economic programme refer to maintaining macroeconomic stability by preserving the currency board regime and revising the 2009 budget to cut spending, and aim for a balanced budget and to start talks with the IMF for an aid package. An external financial aid package should cushion the consequences of the economic contraction and support the measures planned by the new government to mitigate the fall in GDP.

Bulgaria's CPI was up 3.7% year-on-year in June, continuing to ease from the 7.1% recorded in January.

Weakening demand led to a severe drop in industrial production which decreased by 18.7% year-on-year in June. However, the June month-on-month result was positive by 6.9%.

Out of a total external debt of €36.6bn (107.9% of GDP) at the end of May, only 12% was attributable to the public sector. The reserves-to-short-term-debt ratio was 88.7% at the end of May, continuing to worsen from 95.7% at the end of 2008. The reserves are likely to decline further, which should put pressure on the stability of the currency's peg to the euro.

The Bulgarian banking system had a total loans-to-deposit ratio of around 115%, computed at the end of June. Both loans to non-financial institutions and deposits remained virtually flat since the end of 2008: loans increased from €24.6bn to €24.8bn, while the deposit base moved from €21.4bn to €21.6bn. Non-performing loans (loans overdue by more than 90 days) increased by 150% year-on-year to €1.1bn. The National Bank of Bulgaria has received comfort letters from Bulgarian banks' foreign parents that they will maintain adequate capital and liquidity at their Bulgarian subsidiaries.

Bulgaria's budget surplus shrank to €88m at the end of 1H09 (0.3% of GDP), from a surplus of 3% of GDP at the end of 2008. The IMF officials have stated that after a history of budget surpluses, Bulgaria might end up with a 1% budget deficit in 2009.

Bulgaria's current account deficit has continued to shrink: over January-May, Bulgaria's current account deficit stood at €2.0bn, or 5.8% of GDP, compared to a €3.6bn deficit over the same period in 2008, or 10.5% of GDP. FDI inflows stood at €1.1bn over the first five months of 2009 and covered 57.5% of the current account deficit, down from 71.4% at the end of 2008. The trade deficit over the first six months of 2009 was €2.4bn, down by 44% on the same period last year.

Serbia

During the first quarter of 2009, real GDP declined by 3.5% year-on-year, following a 2.8% year-on-year growth during the fourth quarter of 2008. This was less than the 5.2% fall expected by the National Bank of Serbia ("NBS"). However, the recession in the EU, fiscal tightening, as well as increasing difficulties in obtaining finance, will most likely result in an overall contraction in 2009. As at June 2009, the EIU forecast a 4% contraction in real GDP in 2009 and a modest rebound of 0.5% in 2010.

As a result of sharp falls in the prices of agricultural goods, retail price inflation slowed significantly to 0.4% in June, bringing year-on-year retail price inflation to 9.8%, compared to 10.4% in May. Due to further expected declines in the prices of agricultural products, together with expected decreases in the prices of most commodities, disinflation is forecast by the EIU to continue, bringing the average inflation rate from 10.9% in 2008 to 9.8% in 2009, and to an expected 6.4% in 2010.

In April, the government approved an upward revision of the budget deficit to 2.3% of GDP. However, with the January-May budget deficit already amounting to 56% of the full-year plan agreed with the IMF, the budget deficit is likely to rise considerably above the April target. The government is seeking IMF approval to increase the budget deficit target from 3% to 4% of GDP.

Over the second quarter of 2009, the NBS has reduced its repo rate three times by a total of 350 bp to 13%. However, given the expected increase in inflation in May, and higher tax and fuel prices in June, resulting in increased pressure on the dinar, the NBS is unlikely to implement further rate cuts. Since the signing of the IMF agreement in March, the dinar has stabilised.

The economic slowdown has helped to reduce the January-April current-account deficit to €660m, representing a 50% year-on-year decrease compared to the same period in 2008. The EIU forecasts the current-account deficit to reach 10.4% of GDP in 2009, a substantial improvement over the 17.2% deficit of 2008. By contrast, FDI fell by 22% year-on-year over January-April but nevertheless covered a higher proportion of the current-account deficit (79%) than in the previous period (51%). However, the sale of a 51% stake in oil refiner Naftna Industrija Srbije ("NIS") to Gazprom for a consideration of €400m had a large one-off effect. Excluding the NIS sale, the year-on-year fall would have been 75%.

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