Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

30 June 2014

neweuropecapital

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Statistics

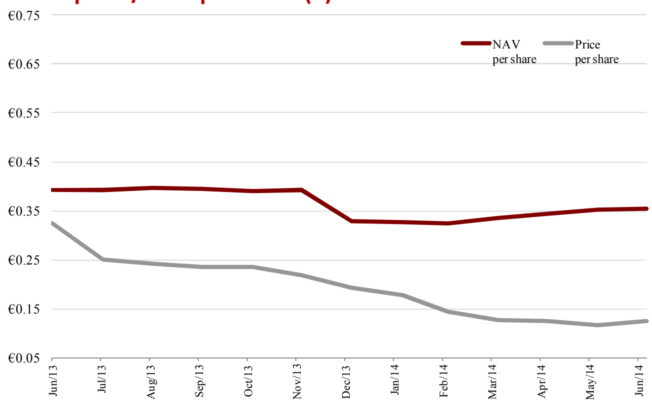
NAV per share (€)	0.3539
Share price (€)	0.1250
Total NAV (€m)	35.4
Mk Cap (€m)	12.5
# of shares (m)	100.0
NAV return since inception	-63.00%
12-month NAV CAGR	-9.90%
NAV annualized Return*	-11.04%
NAV annualized Volatility*	20.45%
Best month (NAV)	15.60%
Worst month (NAV)	-33.53%
# of months up (NAV)	52
# of months down (NAV)	50

*since inception

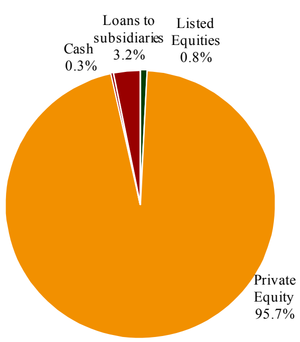
RC2 NAV returns

	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%	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%	
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%	7.82%

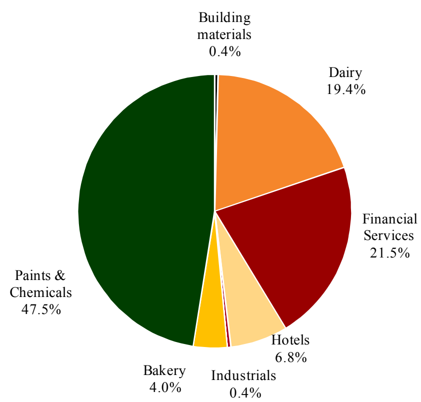
Share price / NAV per share (€)



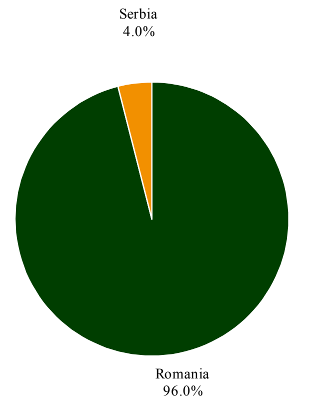
Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Portfolio Structure by Geography



Message from the Investment Manager and Advisers

Dear Shareholders

RC2's NAV per share increased by 5.8% over the quarter from €0.3345 at the end of March to €0.3539, mainly as a result of a 32.4% increase in the Alabalact share price over the quarter, as well as the receipt of €0.6m of dividends from the Top Factoring Group.

Albalact and Top Factoring posted strong results in the first semester of 2014, with Albalact increasing its euro-denominated sales revenues by 10% and its recurring EBITDA following a similar trend, while Top Factoring's EBITDA improved from €1.4m to €2.4m, although much of that was due to the write-up of the valuation of its proprietary portfolios pursuant to quarterly impairment tests.

Policolor's results were more mixed, with the paints and coatings division performing satisfactorily, but the overall Group sales and EBITDA came in below last year and below budget due to weak anhydrides sales and a delayed re-start of the Group's resins factory. Policolor has agreed to sell its Bucharest site for €18.3m, to be received over the next three years. The deal should generate net proceeds of approximately €6.6m for Policolor over the coming three years, after deducting the costs of building a new factory on which to relocate Policolor's production (estimated at €8.0m), the demolition and environmental clean-up costs for the site (estimated at €1.0m), and the estimated capital gains tax on the sale (€2.7m).

Mamaia Resort Hotels reported lower sales and profitability compared to the first half of 2013, mainly due to the Hotel being closed due to refurbishment works over the first four months of the year.

There has been no improvement in the status of East Point Holdings since it was written down to zero by the Fund as at December 2013.

In May, RC2 exchanged half of its shareholder loans to Klas (the bakery division of East Point Holdings Ltd) for a 40.9% shareholding in the company, increasing its shareholding to 52.0%. Klas continued to perform poorly during the second quarter, primarily due to ongoing falls in its sales. Although a new management team managed to halve the monthly EBITDA loss from €0.2m in January to €0.1m in May, Klas had to sell its 24.9% shareholding in a regional bakery for €0.8m in July, in order to boost up its much depleted working capital.

At the end of the quarter, the Fund had cash and cash equivalents of approximately €0.1m, compared to €0.5m at the end of March. As at 30th June, the Fund's borrowings (excluding borrowings of investee companies) amounted to €6.0m, whilst overdue liabilities amounted to €1.8m. During the quarter, the Fund received €0.6m in dividends from Top Factoring Group and secured a bridge loan of €6.75m from Ion Florescu, a Director of the Fund, of which €5.75m was drawn at the end of the quarter. The Fund has also announced that it is planning to launch a convertible bond to refinance its liabilities and provide working capital to the Fund.

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	1H13**	1H14**	1H14B
Consolidated Income statement (according to IFRS)						
Total operating revenues	**58,663**	**55,711**	**71,095**	**29,703**	**25,186**	**34,480**
Total operating expenses	**(58,246)**	**(55,935)**	**(68,907)**	**(29,706)**	**(25,338)**	**(33,716)**
Operating profit	**417**	**(224)**	**2,188**	**(3)**	**(152)**	**764**
Operating margin	*0.7%*	*neg.*	*3.0%*	*neg.*	*neg.*	*2.2%*
EBITDA	**3,645**	**3,053**	**5,891**	**1,732**	**1,577**	**2,595**
EBITDA margin	*6.2%*	*5.5%*	*8.0%*	*5.8%*	*6.3%*	*7.5%*
Financial Profit/(Loss)	(1,126)	(983)	(788)	(475)	(385)	(360)
Profit before tax	**(709)**	**(1,207)**	**1,400**	**(478)**	**(537)**	**405**
Income tax	(219)	(178)		(163)	(109)	-
Profit after tax	**(928)**	**(1,385)**		**(641)**	**(646)**	**405**
Minority interest	260	106		58	64	
Profit for the year	**(668)**	**(1,279)**		**(583)**	**(581)**	
avg exchange rate (RON/EUR)	*4.450*	*4.450*	*4.420*	*4.392*	*4.465*	*4.420*

*Note: * audited, ** unaudited*

The Group's consolidated sales for the first half of the year of €25.2m were 27% below budget and 15% lower than the first half 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. Net sales at the paints and coatings divisions increased from €18.3m in the first half of 2013 to €19m in the same period of 2014, up 4% year-on-year and 13% below budget. The sales of paints in Bulgaria, a market where the Group holds the leadership position, increased by 8.6% year-on-year, while in Romania sales grew by 1.6% year-on-year.

The Group generated an EBITDA of €1.6m, similar to 2013 but significantly lower than the budget due to the lower sales at the resins and chemicals divisions. Higher net sales and tight cost controls led to an 11% year-on-year improvement in the EBITDA of the paints and coatings division, from €2.1m to €2.3m.

The Group's net debt amounted to €20m as of 30 June 2014.

Operations

The recent changes in the sales strategy made by the Romanian decorative coatings division have started to show results, as, according to the most recent study of the presence of decorative paints in urban retail outlets performed by Vektor Marktforschung (which excludes key accounts such as the large DIY stores, which were not audited), Policolor's numerical distribution has increased from 47% in May 2013 to 57% in April 2014. The division is continuing its efforts to improve its presence on the market, with higher marketing spend, including trade promotions, a media campaign and product re-brandings.

The auto coatings division is also undergoing strategic changes in terms of product portfolio and route-to-market, due to sharpening competition on this market. The product portfolio was enhanced by adding a value range of products at the beginning of the year, and a premium range will be launched in August in order to address most of the market's segments. In the meantime, the R&D department continues its efforts to improve the mainstream range of the division's auto refinish products. According to press reports, the auto coatings market in Romania amounted to €40m in 2013, with Policolor's division having a market share of 21%, making it the second player on the market.

Orgachim Resins' net sales to third parties, although up 14% year-on-year, were 50% below budget due to the re-start of the resins plant being delayed to April.

The anhydrides plant was stopped for five of the first six months of 2014 due to unfavourable market conditions, and sales to third parties were 61% below budget and 65% below last year's sales.

Prospects

Policolor has agreed to sell its Bucharest site for € 18.3m, to be received over the next three years. The deal should generate net proceeds of approximately €6.6m for Policolor over the coming three years, after deducting the costs of building a new factory on which to relocate Policolor's production (estimated at €8.0m), the demolition and environmental clean-up costs for the site (estimated at €1.0m), and the estimated capital gains tax on the sale (€2.7m).

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	1H13**	1H14**	1H14B
Combined Group Income Statement						
Total Gross Operating Revenues	**8,787**	**9,753**	**12,615**	**4,401**	**5,789**	**5,988**
Debt portfolios (collections)	7,531	8,712	11,590	3,913	5,360	5,466
Agency contracts	1,256	1,041	1,026	488	429	522
Amortization and fair value adjustments of debt portfolios	(3,441)	(3,303)	(5,870)	(1,308)	(1,348)	(2,595)
Total Net Operating Revenues	**5,346**	**6,451**	**6,745**	**3,093**	**4,441**	**3,393**
Total Operating Expenses	**(3,689)**	**(3,947)**	**(4,564)**	**(1,704)**	**(2,143)**	**(2,142)**
Operating Profit	**1,658**	**2,504**	**2,181**	**1,389**	**2,299**	**1,251**
EBITDA	**1,745**	**2,612**	**2,323**	**1,443**	**2,367**	**1,322**
EBITDA margin	*32.6%*	*40.5%*	*34.4%*	*46.7%*	*53.3%*	*39.0%*
Financial Profit/(Loss)	(234)	(313)	(322)	(99)	(40)	(151)
Profit before Tax	**1,423**	**2,191**	**1,859**	**1,290**	**2,259**	**1,099**
Income Tax	(161)	(293)	(232)	(161)	(282)	(137)
Profit after Tax	**1,262**	**1,898**	**1,627**	**1,128**	**1,977**	**962**
Net margin	*23.6%*	*29.4%*	*24.1%*	*36.5%*	*44.5%*	*28.4%*
Avg exchange rate (RON/EUR)	*4.456*	*4.419*	*4.420*	*4.392*	*4.465*	*4.420*

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

The Group generated gross revenues of €5.8m in the first semester of 2014, up 32% year-on-year but slightly below the budget due to fewer portfolio acquisitions.

The June quarterly impairment test resulted in a net write-up of €88,000, in addition to the €1.3m write-up already booked in March. The write-ups, which are booked together with amortization expense and therefore impact the net revenues, are the result of higher than expected collections on proprietary portfolios. The first semester EBITDA, which takes into account the portfolio write-ups, was €2.4m, significantly up on last year's €1.4m. Due to the excellent performance of proprietary portfolios over the first semester, the Group is now expecting to make EBITDA of €3m in 2014, compared to a budget target of €2.5m.

In the first half of 2014, the debt purchase line accounted for 90% of net operating revenues, of which banking portfolios contributed 75%. The agency business generated revenues of €0.4m, a 12% year-on-year fall due to increased competition on this market segment.

In the first half of 2014, the Group distributed €1.65m of its retained earnings as dividends, of which €1.5m was paid to RC2.

Operations

In May, the Group won an auction organized by a Romanian telecom player and acquired a portfolio made up of 38,000 cases with a total face value of €6.6m. The Group invested a total of €1.9m in debt portfolio acquisitions in the first half of 2014, which was financed by a combination of bank loans and equity. The Group now owns 51 debt packages (fourteen telecoms and thirty seven banking) made up of 914,000 cases with a total face value of €257m.

Gross collections from proprietary portfolios increased from €3.9m in the first half of 2013 to €5.4m in the same period of 2014. The call centre department generated 70% of gross collections in the first half, followed by the legal and field departments, which generated 20% and 10% of total collections, respectively.

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 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 32.4% over the quarter, the value of RC2's shareholding increased from €6.0m as at 31 March 2014 to €8.1m as at 30 June 2014.

Financial results

(EUR '000)	2012*	2013*	2014B	1H13**	1H14**
Standalone Income Statement					
Sales Revenues	**77,164**	**90,829**		**46,577**	**51,146**
Other operating revenues	192	5,264		136	6,001
Total Operating Revenues	**77,356**	**96,093**	**114,280**	**46,714**	**57,147**
Total Operating Expenses	(74,946)	(93,275)	(110,768)	(45,249)	(54,113)
Operating Profit	**2,410**	**2,818**	**3,512**	**1,465**	**3,034**
Operating margin	*3.1%*	*2.9%*	*3.1%*	*3.1%*	*5.3%*
Recurring EBITDA	**5,655**	**5,894**		**2,915**	**3,180**
EBITDA from non-recurring sale of non-core assets	(429)	-			1,594
Total EBITDA	**5,225**	**5,894**	**6,966**	**2,915**	**4,774**
EBITDA margin	*6.8%*	*6.1%*	*6.1%*	*6.2%*	*8.4%*
Financial Profit/(Loss)	(450)	(591)	(584)	(280)	240
Profit before Tax	**1,960**	**2,227**	**2,927**	**1,185**	**3,274**
Income Tax	(317)	(326)	(468)	(174)	(278)
Profit after Tax	**1,643**	**1,901**	**2,459**	**1,011**	**2,996**
Net margin	*2.1%*	*2.0%*	*2.2%*	*2.2%*	*5.2%*
Avg exchange rate (RON/EUR)	*4.456*	*4.419*	*4.450*	*4.392*	*4.465*

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

The above results do not consolidate Albalact's subsidiaries.

Albalact's euro-denominated sales revenues increased by 10% year-on-year in the first semester of 2014, mainly driven by an increase in its yogurt, milk and cheese sales. The operating profitability was stable year-on-year, with recurring EBITDA increasing by 9% over the first semester.

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 in the consolidated accounts.

Operations

In the first six months of 2014, Albalact invested €8m in yogurt and milk processing equipment to enable the company to expand its portfolio with new types of packaging (PET and HDPE) to fuel future growth.

In June 2014 the Company strengthened its management team by appointing Stephane Batoux as CEO, replacing the founding shareholder Raul Ciurtin who became non-executive Chairman. Prior to joining Albalact, Stephane Batoux was the CEO of Coca Cola Romania, and he had previously been the head of Danone's operations in the Balkans.

According to local press reports based on various players' published 2013 results, Albalact was the second largest dairy producer on the Romanian market, with revenues of €96m in 2013 (up 24% year-on-year), while Danone continues to be the market leader even though its sales fell by 4% to €109m in 2013. The third largest player, Friesland Campina, suffered a 11% year-on-year fall in revenues to €82m.

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	1H13**	1H14**	1H14B
Income Statement						
Sales Revenues	**1,775**	**1,922**	**2,216**	**506**	**491**	**562**
Other operating revenues	42	9	17	5	92	4
Total Operating Revenues	**1,817**	**1,931**	**2,234**	**511**	**582**	**566**
Total Operating Expenses	(1,606)	(1,714)	(2,033)	(664)	(851)	(933)
Operating Profit	**210**	**217**	**201**	**(153)**	**(268)**	**(367)**
Operating margin	*11.6%*	*11.2%*	*9.0%*	*neg.*	*neg.*	*neg.*
EBITDA	**455**	**422**	**474**	**(48)**	**(171)**	**(235)**
EBITDA margin	*25.0%*	*21.9%*	*21.2%*	*neg.*	*neg.*	*neg.*
Financial Profit/(Loss)	(182)	(114)	(132)	(65)	(2)	(64)
Profit before Tax	**28**	**103**	**68**	**(219)**	**(270)**	**(431)**
Income Tax	-	-	-	-	-	-
Profit after Tax	**28**	**103**	**68**	**(219)**	**(270)**	**(431)**
Net margin	*1.5%*	*5.4%*	*3.0%*	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*4.456*	*4.419*	*4.420*	*4.392*	*4.465*	*4.420*

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

Sales revenues over the first half of the year were €0.5m, virtually unchanged over the year, and 13% below budget, mainly due to the Hotel being closed for renovation works for most of the first four months of the year, while the budget assumed that these works would be finalized earlier. Accommodation revenues increased by 8% year-on-year and accounted for 49% of the Hotel's turnover. The Food & Beverage department generated revenues of €236,000, down 9% year-on-year and equal to 48% of sales.

The six-month 2014 EBITDA loss of €171,000 is higher than the previous year's, as it includes €100,000 of refurbishment works which can be expensed through the income statement The Company invested a total of €330,000 for the renovation works, of which 80% was financed by a bank loan. As at the end of June, the Company's net debt amounted to €1.7m.

The occupancy rate was 11.6% over the first half of 2014, a decrease on the 15.7% recorded over the same period last year, due to the Hotel being only open for major events during the renovation works. The average net tariff has increased from €21.5 over the first half of 2013 to €27.2, an effect of the refurbished rooms and public spaces.

Bad weather in July led to an occupancy rate of only 65% in the month (compared to 67% in July 2013 and 80% in the July 2014 budget), while for August, the Hotel has firm bookings which should increase the August occupancy rate to over 80%.

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 had €1.1m of a shareholder loan to Klas outstanding as at 30th June.

Financial results and operations

(EUR '000)	2012A*	2013**	2014B	1H13**	1H14**	1H14B
Income Statement						
Net Sales	**16,826**	**14,593**	**13,811**	**7,778**	**5,720**	**7,642**
EBITDA	**(1,308)**	**(2,078)**	**(756)**	**(931)**	**(844)**	**(247)**
EBITDA margin	*-7.8%*	*-14.2%*	*-5.5%*	*-12.0%*	*-14.8%*	*-3.2%*
Profit after Tax	**(6,852)**	**(4,812)**	**(2,697)**	**(2,265)**	**(1,607)**	**(1,217)**
Net margin	*-40.7%*	*-33.0%*	*-19.5%*	*-29.1%*	*-28.1%*	*-15.9%*

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

In May, RC2 exchanged half its shareholder loan to Klas for a 40.9% direct shareholding in the company, increasing its stake to 52%.

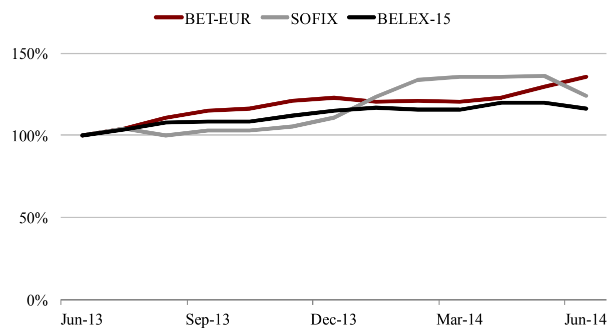
Klas continued its downward sales trend, having experienced a 16.4% year-on-year fall in sales volumes in 1H2014. The new General Manager, who was appointed in March, was not able to turn sales around, but he managed to halve the monthly EBITDA loss from €0.2m in January to €0.1m in May and June, primarily due to strict cost controls and lower employee wages (the workforce was reduced from 510 in January to approximately 440 in June).

The company is definitely not going to hit the 2014 budget, which was prepared by the previous management, and in July Klas had to sell its 24.9% shareholding in a regional bakery for €0.8m, in order to boost up its much depleted working capital reserves.

The new management is currently negotiating a financing line with local banks, which would be invested in further staff reductions and in further boosting working capital.

Capital Market Developments

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



Commentary

During the second quarter, the Romanian BET index increased by 12.8%, whilst the Bulgarian SOFIX index fell by 8.2% and the Serbian BELEX-15 index was up 0.6% all in euro terms. Over the year, the BET, the SOFIX and the BELEX-15 indices have gained 35.7%, 24.3% and 16.2%, respectively, all in euro terms.

By comparison, over the second quarter, the MSCI Emerging Market Eastern Europe index gained 7%, the MSCI Emerging Market index was up 6.3%, and the FTSE100 and S&P indices increased by 5.4% and 5.3%, respectively, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	2.6%	6M14	1.2%	3M14	0.1%	3M14
Inflation (y-o-y)	0.7%	Jun-14	-1.9%	Jun-14	1.3%	Jun-14
Ind. prod. growth (y-o-y)	11.5%	Jun-14	0.6%	Jun-14	-7.0%	May-14
Trade balance (EUR bn)	-2.3	5M14	-1.4	5M14	-1.6	5M14
y-o-y	*5.4%*		*50.8%*		*-23.6%*	
FDI (EUR bn)	1.1	5M14	0.3	5M14	0.0	5M14
y-o-y change	*13.9%*		*-33.8%*		*n/a*	
Total external debt/GDP	63.6%	May-14	93.7%	May-14	79.9%	Jun-14
Reserves to short-term debt	170.9%	May-14	142.2%	May-14	3571.2%	May-14
Loans-to-deposits	100.6%	Jun-14	95.9%	Jun-14	121.3%	Jun-14
Public sector debt-to-GDP	38.7%	May-14	19.7%	Jun-14	63.8%	Jun-14

Commentary

Romania

According to Eurostat, Romania's GDP fell by 0.2% quarter-on-quarter in the first quarter, as opposed to initially released data from the Romanian Statistics Institute which suggested an increase of 0.2%. Romania's GDP grew by 1.4% year-on-year in the second quarter, but, disappointingly, fell by 1.0% compared to the previous quarter. Overall, Romania's GDP grew by 2.6% year-on-year in the first half of 2014. Romania's industrial production increased by 10.4% year-on-year over the first semester, and by 11.5% year-on-year in June, the second highest annual increase to date in 2014 (after the 13.3% increase recorded in May).

The CPI continued its downward trend, mainly triggered by falling food prices, with Romania recording a 0.7% increase in prices in June, compared to a 1.6% increase at the end of 2013. Accordingly, the National Bank of Romania ("NBR") has reduced its 2014 inflation rate projection from 3.3% to 2.2%.

After falling 1.6% against the euro over the first quarter, the Romanian leu recovered in the second quarter, resulting in an overall increase of 2.2% over the first semester. According to statements to the media by the Governor of the NBR, the appreciation of the leu was triggered by increased inflows of capital within the context of the Ukrainian crisis.

Over the first half of 2014, the budget deficit came in at €0.8bn, down 48% year-on-year and equivalent to 0.5% of GDP, as revenues increased by 2.9% whilst expenses fell by 0.3%. The Government is targeting a budget deficit of 2.2% of GDP for 2014.

From January to May, Romania's trade deficit grew by 5.4% year-on-year. This increase, together with a 78% increase in the income deficit, resulted in a current account deficit of €351m (compared to a €191m positive balance over the same period of the prior year). FDI flows amounted to €1.1bn, up 13.9% year-on-year. Equity investments accounted for 83% of total FDI flows, with intra-group loans accounting for the balance of 17%.

Romania's total external debt was €94.1bn at the end of May, down 2.1% year-to-date and equivalent to 64% of GDP. The public debt was 38.7% of GDP at the end of May, virtually unchanged from the end of 2013. Short term debt accounted for 5.4% of the total public debt at the end of May, with medium and long term debt accounting for the balance of 94.6%.

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €49.1bn at the end of June, continuing its downward trend since the beginning of the year (-1.4% year-to-date in RON terms). Both corporate loans and household lending have fallen since the beginning of the year, by 0.9% and 1.6%, respectively. On a similar note, the deposit base fell by 0.7% year-on-year in RON terms, amounting to €48.8bn at the end of June. The NPL ratio was 22.2% at the end of April, up from 21.9% at the beginning of the year.

After Moody's increased Romania's credit rating outlook from negative to stable in April, Standard & Poor's upgraded Romania's rating to investment grade in May on the grounds of improved external balances and progress on fiscal consolidation.

Bulgaria

Bulgaria's second quarter GDP grew by 1.6% year-on-year and by 0.5% quarter-on-quarter, whilst industrial production increased by 0.6% year-on-year in June.

The socialist-led government resigned at the end of July after the socialists achieved poor results in the European parliamentary elections held in May. The Bulgarian parliament was dissolved, and an interim government is due to be formed in early August ahead of general elections scheduled for October. The political turmoil was further aggravated by a run on the locally-owned Corporate Commercial Bank, which is the fourth largest Bulgarian bank. The political instability led to Standard & Poor's lowering its long-term Bulgarian sovereign rating one notch from BBB to BBB- in July.

Over the first semester, Bulgaria's current account deficit was €0.2bn, or 0.6% of GDP, compared to a deficit of 0.2% over the same period in 2013. The worsening current account balance was the result of a deepening trade deficit which increased from €1.0bn over the first half of 2013 to €1.4bn, as exports fell by 5.4% while imports shrank by only 0.1%. FDI inflows were €0.3bn over the period, down from €0.5bn over the same period in 2013.

Bulgaria recorded a 1.9% year-on-year fall in prices in June, compared to a 1.6% fall in December 2013.

Bulgaria's first semester budget deficit amounted to €0.5bn, or 1.2% of GDP, having increased from a deficit of €4m, over the same period of 2013, and from a deficit of €0.4bn at the end of the first quarter. Bulgaria maintains a substantial buffer in the form of a fiscal reserve, which stood at €3.4bn, or 8% of GDP, at the end of June 2014. Bulgaria's public sector debt was 19.7% of GDP at the end of June, up from 18.1% at the end of 2013, following the issues of €0.6bn of five-month treasury bills, and a €1.5bn eurobond, both being raised to provide a buffer of liquidity to Bulgaria's banking system.

The Bulgarian banking system's loans to non-financial institutions amounted to €27.9bn at the end of June, up 1.6% year-to-date, whilst the deposit base increased by 0.4% from €29.0 to €29.1bn. However, the deposit base fell 1.3% on a quarter-on-quarter basis.

Serbia

During the first quarter of 2014, Serbia's GDP grew by only 0.1%, mainly due to weak private and public spending. Due to the severe rainfall that hit Serbia in mid-May, which caused massive flooding in western and central parts of Serbia, the National Bank of Serbia ("NBS") expects GDP to shrink by 0.4% in 2014. Following the floods, the European Commission pledged almost €1bn in aid to Serbia. The Serbian government intends to spend the money on the energy and agriculture sectors, which suffered the heaviest damage.

Industrial output shrank by 7% year-on-year in May, mainly due to the severe negative effects of the flooding. The significant fall in energy production (-20.3% y-o-y) was partially countered by an increase in the production of motor vehicles (+22.3% year-on-year) and basic metals (+21.8% year-on-year).

As a result of low demand, a stable local currency and continued disinflationary pressures, the CPI came in at 1.3% year-on-year in June 2014, well below the targeted range of the NBS (4% ± 1.5%).

During the first half of 2014, exports reached €4.6bn (+14% year-on-year), while imports rose by only 1.6% year-on-year, to €6.2bn. Consequently, the trade deficit reached €1.6bn, representing a 21.9% year-on-year decline.

The government will decide on further fiscal consolidation measures after the 2014 budget revision by the parliament planned for mid-September. The measures are expected to include a 10% fall in public sector wages and pensions, and lay-offs of public sector employees. Other consolidation measures are expected to target fiscal evasion, especially cigarette and tobacco smuggling.

In July, Parliament adopted a set of long-awaited bills aimed at improving the business environment and speeding up the sale of loss-making state-owned enterprises, including a new privatization law and a number of changes to the bankruptcy law. The new legislation should enable the government to tackle the sale or closure of 584 companies still in the Privatization Agency's portfolio, which employ some 100,000 people, including 161 companies which are undergoing restructuring. These laws are also a pre-condition for the release of a World Bank budgetary support loan of US$ 250m.

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