Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

30 September 2013

neweuropecapital

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Statistics

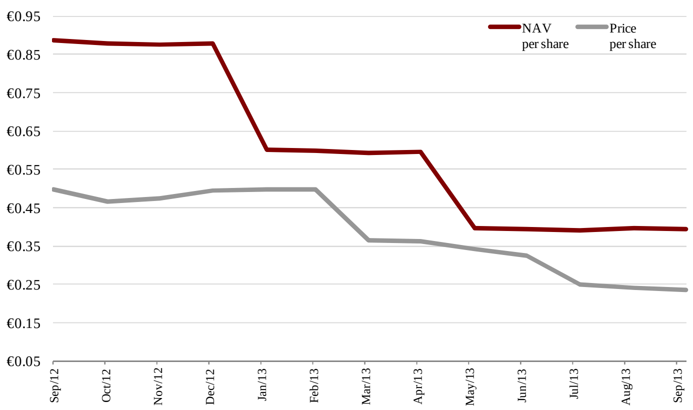
NAV per share (€)	0.3939
Share price (€)	0.2350
Total NAV (€m)	39.4
Mk Cap (€m)	23.5
# of shares (m)	100.0
NAV return since inception	-58.82%
12-month NAV CAGR	-55.56%
NAV annualized Return*	-10.82%
NAV annualized Volatility*	20.54%
Best month (NAV)	15.60%
Worst month (NAV)	-33.53%
# of months up (NAV)	47
# of months down (NAV)	46

**since inception*

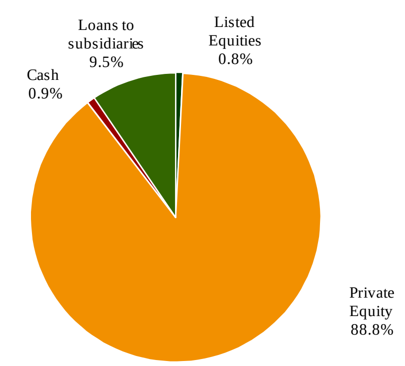
RC2 NAV returns

	2009	2010	2011	2012	2013
Jan	-5.65%	1.36%	-0.54%	0.11%	-31.58%
Feb	-1.51%	0.03%	0.24%	-9.68%	-0.50%
Mar	2.39%	2.07%	2.48%	-0.51%	-0.64%
Apr	-8.40%	15.60%	0.70%	-0.65%	0.29%
May	-0.26%	-5.42%	0.55%	-4.98%	-33.53%
Jun	3.08%	-1.57%	0.25%	-1.48%	-0.83%
Jul	1.08%	0.53%	0.13%	-0.73%	-0.28%
Aug	0.23%	0.07%	-1.10%	0.61%	1.28%
Sep	1.20%	-0.62%	-1.25%	0.01%	-0.71%
Oct	-1.79%	0.96%	2.63%	-0.81%	
Nov	0.46%	-1.15%	-0.25%	-0.38%	
Dec	1.08%	-0.06%	-0.49%	0.30%	
YTD	-8.38%	11.07%	3.32%	-17.17%	-55.16%

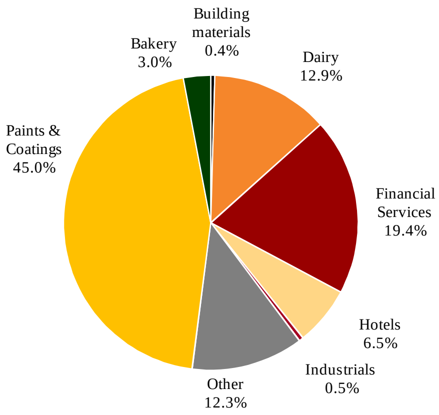
Share price / NAV per share (€)



Portfolio Structure by Asset Class

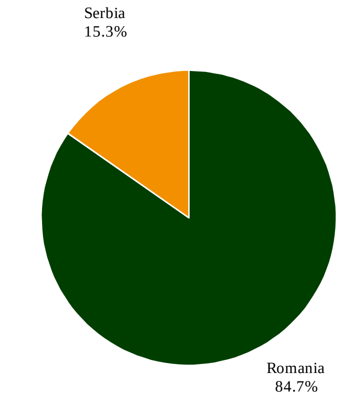


Equity Portfolio Structure by Sector



Note: EPH investment included under Other

Portfolio Structure by Geography



Note: EPH investment included under Serbia

Message from the Investment Manager and Advisers

Dear Shareholders

RC2's NAV per share was virtually unchanged over the third quarter, coming in at €0.3939 per share at the end of the period. The valuations of the main private equity investments were unchanged, as the annual valuation exercise takes place at the end of the year.

During the period, Policolor's Bulgarian subsidiary Orgachim was demerged into three separate companies, active in paints and coatings, resins and chemicals (anhydrides). This was primarily done to enable the separate sale of each business line. The demerger has disrupted the preparation of third quarter results for the Policolor group, and they are therefore not presented here.

Top Factoring and Albalact continued to perform well, with Top Factoring beating its budget for the first nine months, whilst Albalact saw its euro-denominated sales grow by 25.4% compared to the same period last year, and its EBITDA increase by a healthy 14.6%. Mamaia Resort Hotels also performed satisfactorily, with revenues growing by 8.1% compared to the same period last year, and EBITDA up 11.5%, although both came in below budget.

East Point Holdings continued to significantly underperform against both its budget and the 2012 results, in particular due to the lack of trade finance at its copper division, but also due to poor results at its bakery and cable divisions. Fortunately, the Serbian authorities approved the start-up of operations at the Bakery division's new plant, which should allow the shutdown of production at its existing main production facility, freeing it up for sale as real estate its site in central Belgrade, and enabling a number of operating savings.

Progress on exits was slow, with the organized sales process for Top Factoring not yielding any significant breakthrough.

At the end of the quarter, the Fund had cash and cash equivalents of approximately €0.4m, compared to €0.1m at the end of the previous quarter. At the end of the quarter, the Fund's borrowings (excluding borrowings of investee companies) amounted to €4.1m, whilst overdue amounts owed to the Investment Manager and Advisers amounted to €4.1m.

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"), the largest producer of coatings (architectural, automotive and industrial) in Romania and Bulgaria, and a producer of resins and specialty chemicals. The Group comprises Policolor SA, a Romanian company, and Orgachim AD, its 91% owned Bulgarian subsidiary, which has now been split into three separate companies, as further described below. Both Policolor and Orgachim are unlisted.

Orgachim demerger

Orgachim was demerged into three companies in September, reflecting its three business lines: Orgachim AD will continue to manufacture and sell paints and coatings; Orgachim Resins AD is the successor company for the manufacture of resins; and Ruse Chemicals AD has taken over the production of anhydrides. All three companies are 91%-owned by Policolor by means of an SPV set up to own Orgachim a number of years ago. The demerger will enable the separate sale of each business line.

Due to the disruption resulting from the demerger, the Group's management accounts for the third quarter are not yet finalized and therefore have not been included in this report.

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)	2011*	2012*	2013B	9M12**	9M13**	9M13B
Combined Group Income Statement						
Total Gross Operating Revenues	**5,549**	**8,787**	**9,517**	**6,454**	**6,841**	**6,783**
Debt portfolios (collections)	4,571	7,531	8,526	5,657	6,061	6,043
Agency contracts	978	1,256	992	797	780	740
Amortization and fair value adjustments of debt portfolios	(1,274)	(3,441)	(3,464)	(1,575)	(2,287)	(2,358)
Total Net Operating Revenues	**4,275**	**5,346**	**6,054**	**4,879**	**4,554**	**4,425**
Total Operating Expenses	**(2,940)**	**(3,689)**	**(3,659)**	**(2,434)**	**(2,588)**	**(2,522)**
Operating Profit	**1,335**	**1,658**	**2,395**	**2,445**	**1,966**	**1,903**
EBITDA	**1,398**	**1,745**	**2,504**	**2,469**	**2,047**	**1,984**
EBITDA margin	*32.7%*	*32.6%*	*41.4%*	*50.6%*	*45.0%*	*44.8%*
Financial Profit/(Loss)	(150)	(234)	(196)	(132)	(176)	(147)
Profit before Tax	**1,185**	**1,423**	**2,198**	**2,313**	**1,789**	**1,756**
Income Tax	(111)	(161)	(275)	(143)	(224)	(219)
Profit after Tax	**1,074**	**1,262**	**1,924**	**2,171**	**1,566**	**1,536**
Net margin	*25.1%*	*23.6%*	*31.8%*	*44.5%*	*34.4%*	*34.7%*
Avg exchange rate (RON/EUR)	*4.238*	*4.456*	*4.400*	*4.433*	*4.408*	*4.400*

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

The Group's 2013 nine-month gross operating revenues of €6.8m were up 6% year-on-year, and slightly (+0.8%) above budget. In terms of profitability, EBITDA was €2m, and the Group is on track to meet its 2013 budgeted EBITDA of €2.5m.

Following an impairment test performed at the end of September, the Group recorded a write-up adjustment of €75,000 as a result of most of its portfolios performing slightly above budget in the third quarter.

The debt purchase line accounted for 83% of net operating revenues, of which banking portfolios generated 63% (up from 24% between January and September 2012). Agency contracts generated the remaining 17% of net revenues.

Operations

In October, the Group signed its second framework agreement with a Romanian bank, whereby Top Factoring acquires NPL portfolios which meet certain pre-established criteria on a monthly basis. The agreement is valid until the end of 2014.

The Group now owns 36 debt packages (twelve telecoms and twenty four banking) made up of 809,000 cases with a total face value of €225m. The Group's call centre generated 80% of gross collections between January and September 2013 with legal collection accounting for 12% of gross collections and the field collection department generating the remaining 8%.

East Point Holdings Ltd

Background

East Point Holdings Ltd ("EPH" or the "Group") is a Cyprus-based holding company which operates along the following main business lines: Copper Processing, Cable Production, Bakeries, Milling and Real Estate. RC2 acquired a 21.3% shareholding in 2008. In April 2010, RC2 increased its shareholding to 42% in exchange for waiving certain claims against EPH's other shareholders for zero consideration. At the same time, Darby, the private equity arm of Franklin Templeton Investments, exchanged a mezzanine loan for 24.7% of EPH's equity. During 2011, RC2 increased its shareholding from 42.0% to 59.0%, pursuant to an asset swap agreed with EPH's founding shareholders, whereby the founding shareholders of the business were due to exit the business completely in exchange for non-core assets. RC2 then completed the final phase of the asset swap, increasing its shareholding in EPH from 59.0% to 63.0%. In March 2010, RC2 acquired a direct 11.1% shareholding in Klas DOO ("Klas"), the holding company for EPH's Bakeries business, for €2.7m.

Copper Processing (EPM)

(EUR m)	2011A	2012	2013B	9M12	9M13	9M13B
Income Statement						
Net Sales	219.4	181.7	200.3	142.0	101.2	151.0
EBITDA	4.8	5.8	8.5	4.0	1.0	6.5
EBITDA margin	*2.2%*	*3.2%*	*4.2%*	*2.9%*	*0.9%*	*4.3%*
Profit after Tax	(4.9)	(1.0)	2.4	(2.9)	(2.1)	2.0
Net margin	*-2.2%*	*-0.5%*	*1.2%*	*-2.0%*	*-2.1%*	*1.3%*

Note: unaudited management accounts

The difficulties caused by insufficient trade finance lines continued in the third quarter of 2013. As a result of existing providers capping the availability of their lines, EPH's copper division experienced a 27.7% year-on-year decrease in volumes sold. Consequently, the EBITDA margin fell to 0.9% between January and September 2013, compared to 2.9% during the same period last year. EPH's management is actively attempting to access new trade finance facilities and has initiated the process with several local and international financial institutions.

Cable Production

(EUR '000)	2011A*	2012A*	2013B	9M12**	9M13**	9M13B
Income Statement						
Net Sales	36,779	32,385	36,890	27,901	18,780	23,721
EBITDA	(387)	(162)	286	51	(2,199)	(1,156)
EBITDA margin	*-1.1%*	*-0.5%*	*0.8%*	*0.2%*	*-11.7%*	*-4.9%*
Profit after Tax	(387)	(1,466)	(1,019)	(4,124)	(3,680)	(2,119)
Net margin	*-1.1%*	*-4.5%*	*-2.8%*	*-14.8%*	*-19.6%*	*-8.9%*

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

Novkabel, EPH's cable producer, experienced a pick-up in sales in the third quarter, after a significant fall in volumes sold in the first half of 2013, caused by reduced purchases from Russian oil and gas companies, the largest and most profitable export market for Novkabel. As a result, the decrease in volumes sold came in at 12.4% year-on-year between January and September 2013. The EBITDA margin improved from a negative 16.2% over the first half of the year to a negative 5.6% in the third quarter. However, the overall negative EBITDA margin of 11.7% for the first nine months of 2013 remains well below the break-even EBITDA generated during the same period of 2012.

Milling

(EUR '000)	2011A*	2012A*	2013B	9M12**	9M13**	9M13B
Income Statement						
Net Sales	13,687	12,437	12,680	9,003	7,708	7,924
EBITDA	2,873	2,275	1,252	1,517	920	767
EBITDA margin	*21.0%*	*18.3%*	*9.9%*	*16.9%*	*11.9%*	*9.7%*
Profit after Tax	1,782	1,696	1,069	785	974	654
Net margin	*13.0%*	*13.6%*	*8.4%*	*8.7%*	*12.6%*	*8.3%*

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

Zitomlin, EPH's flour mill, continued to perform above budget mainly as a result of management keeping wheat inventories at minimum levels prior to the abundant July harvest. The EBITDA margin came in at 11.9% over the first nine months, compared to a budgeted 9.7%. Management expects increased pressure on the gross margin in the last quarter of 2013, due to a very good July harvest and the resulting fall in wheat prices.

Bakeries

(EUR '000)	2011A*	2012A*	2013B	9M12**	9M13**	9M13B
Income Statement						
Net Sales	20,260	16,826	16,823	12,508	11,301	10,856
EBITDA	(438)	(1,308)	(73)	(954)	(1,797)	(715)
EBITDA margin	*-2.2%*	*-7.8%*	*-0.4%*	*-7.6%*	*-15.9%*	*-6.6%*
Profit after Tax	(1,286)	(6,852)	(2,416)	(2,511)	(3,252)	(2,315)
Net margin	*-6.3%*	*-40.7%*	*-14.4%*	*-20.1%*	*-28.8%*	*-21.3%*

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

During the first nine months of 2013, Klas - EPH's bakery division - experienced falling sales and delays in obtaining an operating permit for its new plant on the outskirts of Belgrade. The EBITDA margin came in negative at 15.9%, compared to a negative 7.6% during the same period of 2012. After issuing the fire protection permit for the company's new plant in early August, the Serbian authorities finally issued an operating permit in September. As this was the final step in the investment obligation under its privatization agreement, the Serbian Privatization Agency has released BPI - Klas's main production subsidiary - from its privatization obligations. Klas plans to finalize the transfer of production to the new factory in the fourth quarter, which management expects would generate substantial annual cost savings.

Albalact

Background

Albalact SA ("Albalact" or the "Company") is a Romanian dairy company quoted on the RASDAQ section of the Bucharest Stock Exchange in which RC2 owns a 25.4% stake under its Private Equity Programme. A local entrepreneur and his family own 45%, with the remaining 29.6% representing the free float. With Albalact's market capitalization increasing by 5% over the quarter, the value of RC2's shareholding was up from €5.3m as at 30 June to €5.6m as at 30 September.

Financial results

(EUR '000)	2011A*	2012*	2013B	9M12**	9M13**
Standalone Income Statement					
Sales Revenues	**79,814**	**77,164**	**87,374**	**55,717**	**69,852**
Other operating revenues	2,267	192	(594)	509	185
Total Operating Revenues	**82,081**	**77,356**	**86,780**	**56,227**	**70,037**
Total Operating Expenses	(79,842)	(74,946)	(83,411)	(54,749)	(68,188)
Operating Profit	**2,238**	**2,410**	3,369	**1,477**	**1,849**
Operating margin	*2.7%*	*3.1%*	*3.9%*	*2.6%*	*2.6%*
Recurring EBITDA	**3,598**	**5,655**	**6,065**	**3,566**	**4,087**
EBITDA from non-recurring sale of non-core assets	1,412	(429)	-	-	-
Total EBITDA	**5,009**	**5,225**	**6,065**	**3,566**	**4,087**
EBITDA margin	*6.1%*	*6.8%*	*7.0%*	*6.3%*	*5.8%*
Financial Profit/(Loss)	(632)	(450)	384	(735)	(374)
Profit before Tax	**1,607**	**1,960**	**3,753**	**743**	**1,474**
Income Tax	(246)	(317)	(600)	(129)	(243)
Profit after Tax	**1,361**	**1,643**	**3,152**	**614**	**1,232**
Net margin	*1.7%*	*2.1%*	*3.6%*	*1.1%*	*1.8%*
Avg exchange rate (RON/EUR)	*4.238*	*4.456*	*4.400*	*4.433*	*4.408*

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

Albalact's nine month sales grew by 25.4% year-on-year helped by higher sales of fresh milk, yoghurts and cheese. The sales growth is extremely positive as diary consumption was unchanged over the year according to key local players, whilst, according to the Romania Statistics Institute, domestic dairy production increased by 6% over the first eight months of 2013 compared to the same period last year.

The EBITDA margin over the first nine months came in slightly below the previous year as a result of higher raw milk costs, as well as, albeit to a lesser extent, increased marketing and distribution expenses. EBITDA was €4.1m, up 14.6% year-on-year, while the net profit amounted to €1.2m, a twofold increase over the same period last year, helped by a better performance of the local currency against the euro.

Operations

Fresh products (milk, sour cream and yoghurts) were the largest contributors to Albalact's January to September 2013 sales (76%), followed by butter (12%) and cheese (12%). Yoghurt sales increased by 60% year-on-year, bringing their share of total sales to 16%, which is up from 12% during the same period last year.

Following its entry in the fresh cheese segment in May 2012, this category's share of total sales reached 10%, up from the 8% achieved in 2012.

At an EGM held on the 24th September, Albalact shareholders approved a buyback programme for up to 20% of the Company's share capital. Albalact will be able to buy its shares at prices corresponding to a market capitalization of between €14.8m and €23.7m. The market capitalization as of end-September was €21.9m.

The same shareholder meeting also approved transferring Albalact's distribution and logistics activities to a newly-set up wholly-owned subsidiary.

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.

(EUR '000)	2011A*	2012A**	2013B	9M12***	9M13***	9M13B
Income Statement						
Sales Revenues	**1,664**	**1,775**	**2,021**	**1,670**	**1,785**	**1,860**
Other operating revenues	7	42	26	11	31	16
Total Operating Revenues	**1,671**	**1,817**	**2,047**	**1,680**	**1,816**	**1,877**
Total Operating Expenses	(1,563)	(1,606)	(1,662)	(1,383)	(1,440)	(1,430)
Operating Profit	**108**	**210**	**385**	**297**	**377**	**446**
Operating margin	*6.5%*	*11.6%*	*18.8%*	*17.7%*	*20.7%*	*23.8%*
EBITDA	**437**	**455**	**601**	**478**	**533**	**608**
EBITDA margin	*26.2%*	*25.0%*	*29.4%*	*28.4%*	*29.3%*	*32.4%*
Financial Profit/(Loss)	(153)	(182)	(120)	(171)	(90)	(135)
Profit before Tax	**(45)**	**28**	**265**	**125**	**287**	**311**
Income Tax	-	-	-	-	(5)	-
Profit after Tax	**(45)**	**28**	**265**	**125**	**282**	**311**
Net margin	*neg.*	*1.5%*	*12.9%*	*7.5%*	*15.5%*	*16.6%*
Avg exchange rate (RON/EUR)	*4.238*	*4.456*	*4.400*	*4.433*	*4.408*	*4.400*

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

During the first nine months, accommodation revenues increased by 2% year-on-year and accounted for 52% of revenues, while the Food & Beverage department generated revenues of €0.8m (up 10.5% year-on-year), or 43% of total sales. The increase in revenues from the Food & Beverage department is the consequence of an increased focus on its performance in 2013. Overall, the Hotel generated revenues of €1.8m, up 8% year-on-year. EBITDA came in at €533,000, up 11% year-on-year. The Company performed slightly below budget (-3%) in terms of operating revenues, and missed the nine month budgeted EBITDA by 12%. As at the end of September, the Company's total indebtedness amounted to €1.7m. The Company is in the process of accessing a bank loan for an €0.7m investment programme aimed at improving the functionality of the Hotel over the low season, as well as improving the public areas (restaurant, reception and lobby).

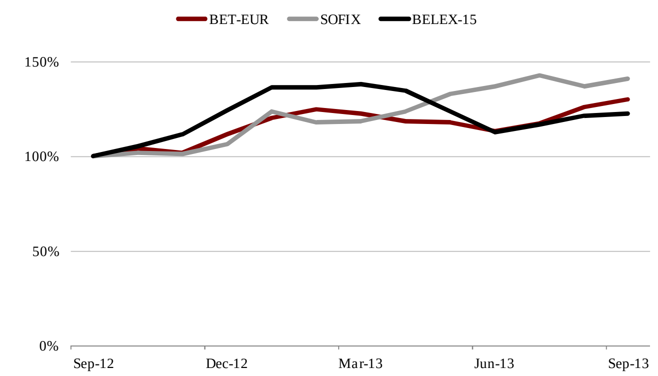
Operations

The Company generated additional revenues of €30,000 from operating the beach in front of the Hotel, for which it was awarded a 10-year concession in May.

The occupancy rate was 30.1% over the first nine months, slightly up on the 29.6% achieved over the same period last year. The average net tariff was approximately €41 over the summer months, virtually unchanged on the same period last year.

Capital Market Developments

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



Commentary

Over the third quarter, the Romanian BET, the Bulgarian SOFIX and the Serbian BELEX-15 indices gained 14.9%, 2.8% and 8.5%, respectively, all in euro terms.

Over the past year, the BET-EUR index has gained 30.1%, the SOFIX 40.8%, and the BELEX-15 22.3%, all in euro-terms. By comparison, over the last year, the MSCI Emerging Market Eastern Europe index lost 4.9%, the MSCI Emerging Market index lost 6.3%, while the FTSE100 index was up 7.3% and the S&P index was up 11.1%, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	1.8%	6M13	0.3%	6M13	1.5%	6M13
Inflation (y-o-y)	1.9%	Sep-13	-1.6%	Sep-13	4.9%	Sep-13
Ind. prod. growth (y-o-y)	5.6%	Aug-13	0.5%	Sep-13	5.7%	Aug-13
Trade balance (EUR bn)	-3.7	8M13	-1.3	8M13	-2.9	8M13
y-o-y	*-41.4%*		*-45.8%*		*-27.0%*	
FDI (EUR bn)	1.1	8M13	0.8	8M13	0.5	8M13
y-o-y change	*-35.9%*		*-51.5%*		*n/a*	
Total external debt/GDP	68.3%	Aug-13	90.8%	Aug-13	83.3%	Jul-13
Reserves to short-term debt	163.5%	Aug-13	145.0%	Aug-13	3454.0%	Jul-13
Loans-to-deposits	108.6%	Sep-13	97.6%	Sep-13	111.3%	Aug-13
Public sector debt-to-GDP	36.9%	Aug-13	17.1%	Jul-13	58.1%	Sep-13

Commentary

Romania

Romania's GDP grew by 1.4% year-on-year in the second quarter, and by 0.5% compared to the previous quarter. Overall, Romania's GDP grew by 1.8% year-on-year in the first half of 2013. The biggest contributor to GDP growth was industry which grew by 3.9% year-on-year in the first half of 2013, whilst Romania's agricultural output increased by 6.1% year-on-year, even though the effects of a bumper harvest were not fully reflected in the six month figures.

Between January and August, the trade deficit continued to improve, having shrunk by 41.4% compared to the same period last year (from €6.4bn to €3.7bn) due to exports growing by 7.9% year-on-year, whilst imports fell by 0.8%. The increase in exports was supported by a positive evolution in industrial production. The improvement in the trade balance, together with a €1.8bn positive balance of services (compared to €0.6bn over the same period last year), resulted in a current account deficit of €0.2bn, compared to a deficit of €4.2bn over the first eight months of 2012. FDI flows amounted to €1.1bn, down 36% year-on-year.

The Romanian leu was virtually unchanged against the euro over the quarter, but recorded a slight 0.7% depreciation against the euro year-to-date.

Romania's CPI fell from 5% at the end of 2012 to 1.9% at the end of September, mainly the result of a 2.7% fall in food prices, especially of bakery products as the VAT rate for these products was reduced from 24% to 9% starting September.

Over the first nine months of 2013, the budget deficit came in at €1.8bn, up 13.6% year-on-year and equivalent to 1.3% of GDP, as revenues increased by only 4.4% year-on-year, while expenses grew by 4.8%. The Romanian Government has revised its 2013 target budget deficit to 2.5% of GDP (up from a first revision to 2.3% performed in the first semester, and from a 2.1% target set at the beginning of the year). According to the Ministry of Finance, the latest revision is a consequence of lower than expected revenues and increased investment expenses for projects co-financed with EU funds. Positively, the EU funds' absorption rate jumped from 15.3% at the end of June to 25% at the end of October.

Romania's total external debt was €97.3bn at the end of August, down 2.4% year-to-date and equivalent to 68.3% of GDP (and down from 75.1% of GDP at the beginning of the year). The fall was mainly the result of Romania repaying €3.2bn of a €12.4bn loan it was granted by the IMF in March 2009, with €1.7bn remaining to be paid by the end of 2013. Public sector debt was €52.1bn at the end of August, up 3.8% year-to-date and equivalent to 36.9% of GDP. The increase in public debt was mainly triggered by Romania successfully placing USD 1.5bn of 10-year US Dollar denominated bonds at a yield of 4.5% in February. The NBR's foreign reserves (excluding gold) amounted to €32.2m at the end of August, up from €31.2bn at the end of 2012

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €50.0bn at the end of September, continuing its downward trend since the beginning of the year (-1.2% year-to-date in RON terms). Both corporate loans and household lending have fallen since the beginning of the year, by 2.0% and 0.7%, respectively. By contrast, the deposit base grew by 4.1% year-on-year in RON terms, and amounted to €46.0bn at the end of September. Household deposits have increased by 3.5% year-to-date and accounted for 62% of total deposits at the end of September. Overdue loans accounted for 15% of the total loan stock at the end of September, compared to 13% at the end of 2012.

Bulgaria

Bulgaria's GDP grew by 0.2% year-on-year in the second quarter, but fell slightly (-0.1%) compared to the previous quarter. Overall, Bulgaria's GDP grew by 0.3% year-on-year in the first half of 2013. The IMF cut its projection for Bulgaria's 2013 GDP growth from 1% (announced during a mission visit at the end of June) to 0.5%.

Bulgaria's current account balance was a positive €1.3bn, or 3.1% of GDP, compared to a deficit of 0.7% over the same period in 2012. The improved current account balance was the result of a shrinking trade deficit compared to the same period last year (from €2.5bn to €1.3bn), as exports increased by 7.9% whilst imports fell by 0.4%.

Bulgaria recorded a 1.6% fall in prices in September, the lowest CPI value in the last 14 years. The biggest fall came from electricity prices which fell by 11.1% year-on-year. The government reduced electricity prices in order to placate the social unrest which started in January due to higher electricity prices.

Bulgaria's budget deficit over the first nine months of 2013 came in at €184m, or 0.5% of GDP, compared to a surplus of €127m over the same period in 2012. While revenues increased by 6.6%, expenses grew by 9.5%, with the increase being triggered mainly by higher wages and social and healthcare benefits which rose by 12.7% year-on-year. In August, the Bulgarian Government revised its budget deficit target for the year to 2% of GDP, from an initial target of 1.3%. The 2014 budget approved by the Bulgarian government and submitted to parliament for approval provides for a budget deficit of 1.8% of GDP. The budget is based on estimated 2012 economic growth of 1.8%. Bulgaria's public sector debt was 17.1% of GDP at the end of July, down from 18.9% at the end of 2012.

Whilst loans to non-financial institutions fell slightly from €27.5bn at the beginning of the year to €27.4bn at the end of the third quarter (-0.3%), the deposit base increased by 5.2%, reaching €28.1m at the end of September. Overdue loans accounted for 22.9% of total loans at the end of September, flat month-on-month but an increase on the 22.4% recorded at the end of 2012.

Serbia

During the first half of 2013, Serbia's GDP grew by 1.5% year-on-year, mainly as a result of strong exports growth driven by the start of serial car production at the new FIAT factory, and a good agricultural season. The National Bank of Serbia (NBS) is now projecting 2% full year GDP growth for 2013. Industrial production rose by 5.7% year-on-year between January and August, mainly as a result of the FIAT production and an increase in refined petroleum products.

The budget deficit for the first nine months of 2013 reached €1.4bn (5.6% of GDP), mainly as a result of weaker than planned revenues. As a result, in October the government announced a new set of consolidation measures for 2014 which include: reductions in above-average wages in the public sector, a decrease in subsidies to state-owned enterprises, and an increase in the lower VAT rate from 8% to 10%. Certain structural reforms are also planned for 2014, including amendments to the Labour Law, and the simplification of administrative procedures. These measures are expected to generate around €0.6bn in cost-savings in 2014.

The CPI continued its downward trend, reaching 4.9% in September, mainly as a result of a fall in the prices of agricultural products, low aggregate demand and relative stability of the local currency. The NBS expects inflation to remain within their targeted range (4% ± 1.5%) up to the end of the year. As a result of falling inflation and reduced fiscal risks, the NBS decided to cut its key interest rate by 50bp to 10.5%.

During the first eight months of 2013, exports grew by 25% year-on-year (mainly due to the export of FIAT cars), while imports grew by only 3%. Consequently, the trade deficit fell 27% to €2.9bn.

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