Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

30 June 2012

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Statistics

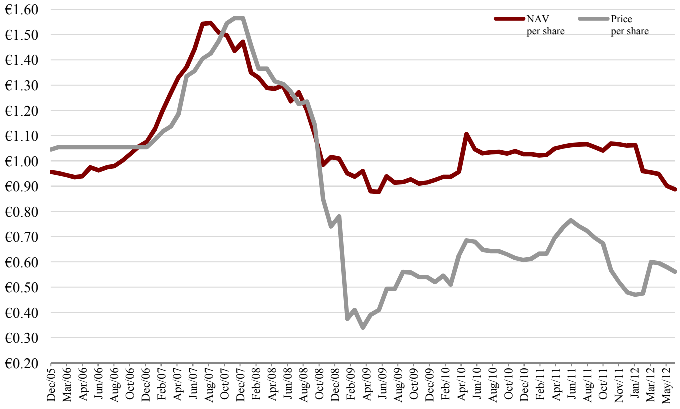
NAV per share (€)	0.8873
Share price (€)	0.5613
Total NAV (€m)	88.7
Mk Cap (€m)	56.1
# of shares (m)	100.0
NAV return since inception	-7.23%
12-month NAV CAGR	-16.65%
NAV annualized Return*	-1.15%
NAV annualized Volatility*	13.44%
Best month (NAV)	15.60%
Worst month (NAV)	-10.52%
# of months up (NAV)	42
# of months down (NAV)	36

**since inception*

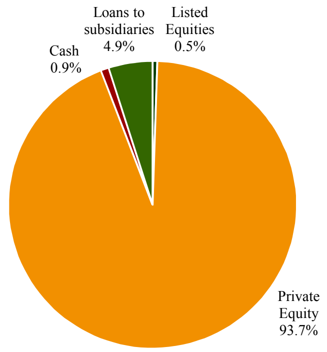
RC2 NAV returns

	2008	2009	2010	2011	2012
Jan	-8.27%	-5.65%	1.36%	-0.54%	0.11%
Feb	-1.48%	-1.51%	0.03%	0.24%	-9.68%
Mar	-3.03%	2.39%	2.07%	2.48%	-0.51%
Apr	-0.26%	-8.40%	15.60%	0.70%	-0.65%
May	0.93%	-0.26%	-5.42%	0.55%	-4.98%
Jun	-4.75%	3.08%	-1.57%	0.25%	-1.48%
Jul	2.85%	1.08%	0.53%	0.13%	
Aug	-5.55%	0.23%	0.07%	-1.10%	
Sep	-8.34%	1.20%	-0.62%	-1.25%	
Oct	-10.52%	-1.79%	0.96%	2.63%	
Nov	3.03%	0.46%	-1.15%	-0.25%	
Dec	-0.60%	1.08%	-0.06%	-0.49%	
YTD	-31.43%	-8.38%	11.07%	3.32%	-16.33%

Share price / NAV per share (€)

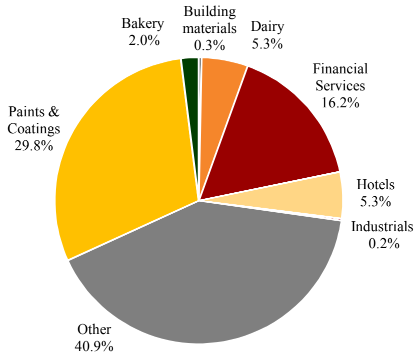


Portfolio Structure by Asset Class



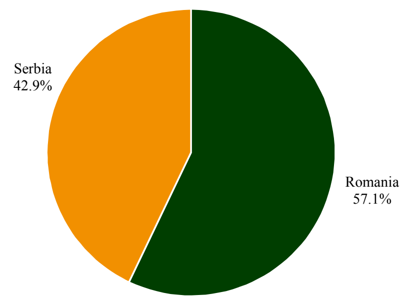
Note: EPH investment included under Serbia

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

Over the second quarter of 2012, RC2's NAV per share fell by 6.99% to €0.8873, mainly as a result of a lower valuation of the Fund's investment in Policolor, and a fall in the Albalact share price.

However, in spite of difficult market conditions, Policolor, Albalact and Top Factoring reported significantly higher EBITDA over the first half of 2012 compared to the same period last year, whilst EPH's divisional results were mixed.

EPH's Copper Processing business continued to be affected by the recession in Italy, which remains one of its main export markets. Novkabel, EPH's cable production business, also experienced a fall in volumes, mainly due to weak demand in Serbia. However, the company's investment and restructuring plan is beginning to pay off, as the EBITDA loss was much lower than originally budgeted. EPH's Milling division continued to perform above budget, generating healthy cashflow over the quarter, whilst Klas, its bakery business, continued to perform poorly, as it suffered from increased flour prices and stronger competition on its main Belgrade market. EPH has not yet been able to relocate its production to its new satellite plant on the outskirts of Belgrade, where its production costs are expected to be significantly lower.

The Policolor Group managed to improve its EBITDA over the first half of 2012 compared to the same period last year, in spite of lower sales, and the disruption to its Resins business caused by a fire in early January. Meanwhile, the Group has continued to advance its discussions for the sale of its excess real estate in Bucharest.

Top Factoring has continued to grow strongly over the second quarter, resulting in overall 2012 first half sales doubling over the same period last year, and the EBITDA line increasing by a factor of five. RC2 has now started the process of selling Top Factoring by means of an organized sales process.

Albalact's sales were flat in local currency terms, and slightly down in euros over the first half of 2012 compared to the same period last year due to the depreciation of the local currency. However, the EBITDA result increased by 36% in euro terms, helped by sales of higher value-added products and lower operating costs.

During the first half of 2012, the Mamaia Hotel's occupancy rate doubled over the same period last year. However, the all-important high season is only due to start in July.

At the end of the quarter, the Fund had cash and cash equivalent balances of approximately €1.6m, compared to €0.2m at the end of December. The Fund's borrowings (excluding borrowings of investee companies) amounted to €3.7m as at 30 June.

Yours truly,

New Europe Capital

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. Over 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 by early 2012 in exchange for non-core assets. In February 2012, RC2 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)	2010A*	2011A*	2012B	1H11**	1H12**	1H12B
Income Statement						
Net Sales	232.2	219.4	215.6	121.4	94.0	107.8
EBITDA	6.3	4.8	10.1	4.6	3.3	4.1
EBITDA margin	2.7%	2.2%	4.7%	3.8%	3.5%	3.8%
Profit after Tax	(1.9)	(4.9)	3.4	0.6	0.4	0.7
Net margin	-0.8%	-2.2%	1.6%	0.5%	0.4%	0.7%

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

The intensification of the economic crisis in Europe and in particular the depressed construction industry in Italy caused EPM's sales to underperform in the first half of 2012, resulting in volumes sold coming in 16.5% below budget. However, part of the decrease in Italian sales was compensated by increased sales on the more profitable ex-Yugoslav markets, and by developing new customers on the German and Russian markets. As a result of refocusing both the product line and the markets served, and operational improvements (including the higher use of copper scrap, an optimized copper content in brass alloys, and substantial reduction in technological inventories), EPM managed to generate a gross profit of €10.8m for the first half of 2012, slightly below the budgeted €11.6m. EBITDA for the first six months of 2012 was €3.3m, 20.0% below the budget.

Management expects the second half of 2012 to remain challenging on Western and Central European markets, and is currently focused on developing new customers on the German and CIS markets, namely Ukraine and Kazakhstan, and also on making further steps in improving operations.

The debt restructuring programme aimed at converting around €60m of debt into a combination of short term and long term maturities has been approved by a majority of EPH's bankers.

Cable Production

(EUR '000)	2010A*	2011A*	2012B	1H11**	1H12**	1H12B
Income Statement						
Net Sales	23,693	36,779	41,030	15,780	15,705	16,230
EBITDA	(2,372)	(387)	493	(915)	(197)	(646)
EBITDA margin	-10.0%	-1.1%	1.2%	-5.8%	-1.3%	-4.0%
Profit after Tax	(174)	(387)	(1,097)	(2,491)	(3,661)	(1,469)
Net margin	-0.7%	-1.1%	-2.7%	-15.8%	-23.3%	-9.1%

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

During the first half of 2012, Novkabel, EPH's cable producer, continued to experience difficulties on the domestic market, mainly due to the absence of major public-sector tenders in Serbia. However, an improved product and market mix and higher sales on the Russian market resulted in improved profitability, with gross profit coming in at €3.3m, 10% above the budget, and EBITDA at a negative €-0.2m, compared to a negative €-0.9m generated the year before. The sharp depreciation of the local currency during the first half of 2012 resulted in foreign exchange losses of €2.4m, mainly on the revaluation of the company's euro-denominated debts to the EPH group, on which there is no overall impact at Group level.

Of the additional €3.2m of remaining investments required to fulfil EPH's investment obligations to the Serbian Privatization Agency and to finalize the relocation of production from the current six plants to three plants, thereby freeing up 22ha of surplus real estate in the industrial part of Novi Sad, Serbia's second largest city, management plan to invest around €300,000 by the end of the year, in order to put into operation a new oil rubber cables facility.

Bakeries

(EUR '000)	2010A*	2011A*	2012B	1H11**	1H12**	1H12B
Income Statement						
Net Sales	22,111	20,260	19,471	11,007	8,668	9,215
EBITDA	(139)	(438)	882	(115)	(602)	(305)
EBITDA margin	-0.6%	-2.2%	4.5%	-1.0%	-6.9%	-3.3%
Profit after Tax	(2,734)	(1,286)	(1,804)	(440)	(1,348)	(658)
Net margin	-12.4%	-6.3%	-9.3%	-4.0%	-15.5%	-7.1%

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

During the first half of 2012, EPH's bakery division experienced a 21% year-on-year fall in sales, mainly due to government controls on the price of bread, devaluation of the local currency and increased competition on the Belgrade market. Furthermore, increases in wheat and flour prices further eroded the bakery's profitability, with EBITDA for the first six months coming in at a negative €-0.6m, well below the budgeted €-0.3m. Furthermore, the company's new plant, which is expected to generate annual cost savings of €1.2m, was not operational during the first half of the year.

Milling

(EUR '000)	2010A*	2011A*	2012B	1H11**	1H12**	1H12B
Income Statement						
Net Sales	15,066	13,687	13,169	8,142	6,004	5,835
EBITDA	2,412	2,873	1,769	2,031	1,156	836
EBITDA margin	16.0%	21.0%	13.4%	24.9%	19.3%	14.3%
Profit after Tax	(735)	1,782	757	2,200	1,107	551
Net margin	-4.9%	13.0%	5.7%	27.0%	18.4%	9.4%

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

During the first half of 2012, Zitomlin, EPH's flour mill, continued to perform above budget. Volumes sold amounted to 23,800 tons, 3.1% above the budget and in line with the first half of 2011, while the average flour price (0.22 €/kg) was somewhat below the budgeted 0.24 €/kg. However, rising wheat and flour prices coupled with a low average cost of inventories, resulted in EBITDA of €1.2m, almost 40% above the budgeted €0.8m.

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 thermo-insulation materials, resins and specialty chemicals. The Group comprises Policolor SA, an unlisted Romanian company, and Orgachim AD, its 77.5% owned Bulgarian subsidiary which is quoted on the Bulgarian Stock Exchange. Policolor and related parties launched a tender offer to buy out the remaining minorities of Orgachim at the end of March, followed by a squeeze-out and delisting procedure initiated in July.

Group Financial results

(EUR '000)	2010A*	2011A**	2012B	1H11 A**	1H12 A**
Income statement (according to IFRS)					
Sales revenues	**67,187**	**73,517**	**71,108**	**35,049**	**31,181**
Other operating revenues	1,737	623	1	324	292
Total operating revenues	**68,924**	**74,140**	**71,110**	**35,373**	**31,473**
Total Operating Expenses	(67,924)	(74,389)	(67,333)	(33,778)	(29,649)
Operating profit	**1,000**	**(249)**	**3,777**	**1,595**	**1,824**
Operating margin	*1.5%*	*-0.3%*	*5.3%*	*4.5%*	*5.8%*
EBITDA	**4,209**	**3,162**	**6,733**	**3,246**	**3,505**
EBITDA margin	*6.1%*	*4.3%*	*9.5%*	*9.2%*	*11.1%*
Financial Profit/(Loss)	(740)	(1,200)	(785)	(408)	(683)
Other extraordinary items	(1,214)	-	-	(534)	(297)
Profit before tax	**(953)**	**(1,449)**	**2,992**	**653**	**844**
Income tax	(441)	(0)	(388)	7	(6)
Profit after tax	**(1,394)**	**(1,450)**	**2,604**	**660**	**838**
Minority interest	(28)	97	45	(141)	102
Profit for the year	**(1,422)**	**(1,353)**	**2,649**	**519**	**940**
Avg exchange rate (RON/EUR)	*4.210*	*4.238*	*4.300*	*4.225*	*4.353*

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

In the first half of 2012, the Group's consolidated sales fell by 11% year-on-year, from €35.4m to €31.5, mainly due to sales of resins to third parties being affected by a fire at the resins plant in January, but also due to the 5% year-on-year depreciation of the Leu against the euro, which affected the Group's Romanian sales. However, the EBITDA grew 8% from €3.2m to €3.5m, due to an improved gross margin and a better management of operating costs.

Paints and Coatings

The Group's second quarter sales of architectural coatings fell 13% on the previous year, resulting in a year-on-year fall of 17% over the first half, compared to a more severe 25% fall over the first quarter. Meanwhile, sales at Klar, the auto refinish and special industrial coatings division, grew 16% over the second quarter, and were flat over the first half compared to the previous year.

Chemicals (Resins and Anhydrides)

The chemicals division produces resins and anhydrides. The company's resins plant suffered a fire in early January, forcing the Group to find alternative solutions for their production. Eventually, an idle plant was rented from a competitor, whilst other resins are being produced for Orgachim by another local firm. The priority has been to ensure there are sufficient resins for Policolor's internal needs, and to continue servicing longstanding clients. External sales of resins amounted to €610,000 over the first six months of 2012, compared to €5.7m over the same period in 2011. Meanwhile, management is processing the insurance claim for damage to equipment, the resins building and for business interruption. Sales of anhydrides to third parties over the first half of 2012 increased by 54% year-on-year to €8.1m.

Real Estate

Policolor owns 14ha of land located on the eastern periphery of Bucharest. Policolor is in discussions for the sale of the plot and is seeking to resolve a number of issues in order to effect the sale, including the relocation of the remaining automotive production to another site.

Top Factoring

Background

Top Factoring ("Top Factoring" or the "Group") 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 being 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)	2010A	2011A	2012B	1H11	1H12
Combined Group Income Statement					
Total Gross Operating Revenues	**2,702**	**5,401**	**9,727**	**2,154**	**4,273**
Debt portfolios	1,681	4,452	8,821	1,693	3,763
Agency contracts	1,021	949	906	461	510
B2C	928	949	906	461	510
B2B	93	0	0	0	0
Total Operating Expenses	**(2,320)**	**(4,209)**	**(6,872)**	**(1,856)**	**(2,783)**
Amortization of debt portfolios	(510)	(1,562)	(3,525)	(654)	(1,109)
Other operating expenses	(1,810)	(2,647)	(3,347)	(1,202)	(1,674)
Operating Profit	**381**	**1,192**	**2,856**	**298**	**1,490**
EBITDA	**435**	**1,249**	**2,938**	**316**	**1,530**
EBITDA margin	*16.1%*	*23.1%*	*30.2%*	*14.7%*	*35.8%*
Financial Profit/(Loss)	13	(143)	(225)	(62)	(81)
Profit before Tax	**394**	**1,050**	**2,631**	**236**	**1,409**
Income Tax	(2)	(80)	(263)	-	-
Profit after Tax	**392**	**970**	**2,368**	**236**	**1,409**
Net margin	*14.5%*	*18.0%*	*24.3%*	*11.0%*	*33.0%*
Avg exchange rate (RON/EUR)	*4.210*	*4.238*	*4.420*	*4.180*	*4.389*

Note: IFRS (unaudited, combined accounts)

In 2012, the Group changed its portfolio amortisation policy from the straight line to the effective interest rate method. Consequently, both 2010 and 2011 financial statements have been restated to the new methodology, and the 2012 budget has also been adjusted.

The Group's 2012 first-half gross operating revenues increased almost twofold from €2.2m to €4.3m year-on-year, with the EBITDA increasing five times from €0.3m to €1.5m.

The debt purchase line accounted for 88% of gross operating revenues, with the balance of 12% being generated by agency contracts. Collections from proprietary telecoms portfolios accounted for 69% of the Group's total proprietary collections over the first semester.

Operations

In addition to the portfolios acquired on a monthly basis as part of a framework agreement signed with a Romanian bank in February, the Group acquired a banking portfolio in April, consisting of 1,600 cases with a total nominal value of €7m.

At the end of June, the Group owned eighteen debt packages (eleven telecoms and seven banking), made up of 730,000 cases with a total face value of €183m.

Albalact

Background

Albalact SA ("Albalact" or the "Company") is a Romanian dairy producer 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 42.7%, with the remaining 31.9% representing the free float. With Albalact's market capitalization decreasing by 31.5% over the quarter, RC2's shareholding in Albalact had a market value of €4.7m as at 30 June, compared to €6.8m at the end of the previous quarter.

Financial results

(EUR '000)	2010A*	2011A*	2012B	1H11**	1H12**
Standalone Income Statement					
Sales Revenues	**62,058**	**79,814**	**87,298**	**39,685**	**37,800**
Other operating revenues	733	2,267		997	782
Total Operating Revenues	**62,790**	**82,081**	**87,298**	**40,682**	**38,582**
Total Operating Expenses	(61,731)	(79,842)		(40,011)	(37,106)
Operating Profit	**1,060**	**2,238**		**671**	**1,475**
Operating margin	*1.7%*	*2.7%*		*1.6%*	*3.8%*
EBITDA	**4,257**	**5,009**	**6,371**	**2,105**	**2,858**
EBITDA margin	*6.8%*	*6.1%*	*7.3%*	*5.2%*	*7.4%*
Financial Profit/(Loss)	(780)	(632)		(42)	(504)
Profit before Tax	**280**	**1,607**	**2,333**	**629**	**972**
Income Tax	(142)	(246)	(373)	(87)	(156)
Profit after Tax	**138**	**1,361**	**1,960**	**542**	**815**
Net margin	*0.2%*	*1.7%*	*2.2%*	*1.3%*	*2.1%*
Avg exchange rate (RON/EUR)	*4.210*	*4.238*	*4.389*	*4.180*	*4.389*

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

Albalact's Leu-denominated sales were flat year-on-year in the first half of 2012. However, the 5% year-on-year depreciation of the Leu against the euro resulted in a fall in the Company's euro-denominated sales from €39.7m to €37.8 (the full-year budget for 2012 presented above has also been restated to reflect the average RON:EUR exchange rate for the first half of the year).

The EBITDA line increased by 36% from €2.1m in the first half of 2011 to €2.9m over the same period this year, helped by a 7% year-on-year fall in operating expenses. The unrealized foreign exchange loss generated by the revaluation of the Company's euro-denominated loans amounted to €570,000. Overall, the net profit came in at €0.8m, up from €0.5m the year before.

Operations

Fresh products (milk, sour cream and yoghurts) were the largest contributor to Albalact's first half sales (75%), followed by butter (16%) and cheese (9%).

The marketing focus on yoghurts seems to have paid off, as this product category experienced a 90% year-on-year increase in sales by value. Yoghurts' contribution to the total turnover was 11% in the first of half of 2012, up from 5.8% during the same period last year.

A new fresh cheese production line was commissioned in April, resulting in the Company launching a new range of cheese products in May.

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

(EUR '000)	2010A*	2011A**	2012B	1H11**	1H12**
Income Statement					
Sales Revenues	**1,591**	**1,664**	**2,079**	**306**	**453**
Other operating revenues	232	9		27	5
Total Operating Revenues	**1,823**	**1,673**	**2,079**	**332**	**457**
Total Operating Expenses	(2,111)	(1,565)	(1,790)	(613)	(687)
Operating Profit	**(288)**	**108**	**289**	**(280)**	**(230)**
Operating margin	*neg.*	*6.5%*	*13.9%*	*neg.*	*neg.*
EBITDA	**(61)**	**455**	**554**	**(103)**	**(96)**
EBITDA margin	*neg.*	*27.2%*	*26.7%*	*neg.*	*neg.*
Financial Profit/(Loss)	(135)	(153)	(116)	(73)	(122)
Profit before Tax	**(423)**	**(45)**	**174**	**(353)**	**(352)**
Income Tax	(5)	0	(28)	0	0
Profit after Tax	**(428)**	**(45)**	**146**	**(353)**	**(352)**
Net margin	*neg.*	*neg.*	*7.0%*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*4.210*	*4.238*	*4.308*	*4.180*	*4.389*

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

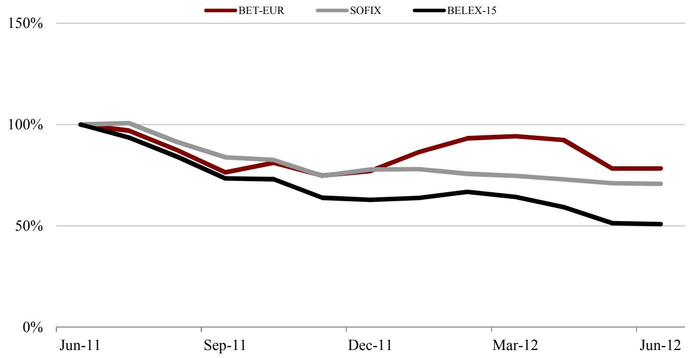
The Hotel managed to generate sufficient off-season revenues over the first quarter to justify it remaining open (it had been closed over the first quarter of 2011), and generated overall revenues for the first half of 2012 of €0.5m, a 37.7% year-on-year increase. During the first half, accommodation revenues increased by 62% year-on-year and accounted for 50% of revenues, while the Food & Beverage department generated revenues of €0.2m (up 31% year-on-year), or 46% of total sales. Due to higher expenses relating to the Hotel being open during the first quarter, the six-month EBITDA loss was flat year-on-year at €0.1m.

Operations

The occupancy rate was 15% over the first half of 2012, a twofold increase on the rate recorded over the same period last year. Management expects the occupancy rate to reach 74% in July and 77% in August, while the September rate is expected to be 33%.

Capital Market Developments

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



Commentary

Over the second quarter, the Romanian BET-EUR, the Serbian BELEX-15, and the Bulgarian SOFIX indices fell by 16.9%, 5.2% and 21.0%, respectively, all in euro terms.

Over the last twelve months, the Romanian market (BET-EUR) fell by 21.8%, while the SOFIX and BELEX-15 indices fell by 29.2% and 49.2%, respectively. By comparison, over the same period, the MSCI Emerging Market index was down 19.2%, the MSCI Emerging Market Eastern Europe index lost 6.2%, whilst the FTSE100 and S&P indices gained 4.9% and 18.3%, respectively.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	0.3%	3M12	0.5%	3M12	-1.3%	3M12
Inflation (y-o-y)	2.0%	6M12	1.6%	6M12	5.5%	Jun-12
Ind. prod. growth (y-o-y)	-0.2%	May-12	0.9%	May-12	-3.1%	Jun-12
Trade balance (EUR bn)	-3.5	5M12	-1.7	5M12	-2.7	5M12
y-o-y	*-4.4%*		*147.3%*		*11.1%*	
FDI (EUR bn)	0.5	5M12	0.5	5M12	-0.2	5M12
y-o-y change	*-45.2%*		*556.2%*		*n/a*	
Total external debt/GDP	69.6%	May-12	89.7%	May-12	77.4%	May-12
Reserves to short-term debt	116.3%	May-12	139.2%	May-12	2631.6%	May-12
Loans-to-deposits	118.6%	Jun-12	95.1%	May-12	132.8%	Apr-12
Public sector debt-to-GDP	34.9%	May-12	16.7%	Apr-12	49.0%	Jun-12

Commentary

Romania

Romania's first quarter GDP fell by 0.1% quarter-on-quarter, but year-on-year it increased by 0.3%. Although exports no longer helped GDP growth, having fallen by 0.4% year-on-year in the first quarter, individual consumption increased by 0.3% year-on-year.

Between January and May 2012 the trade deficit fell by 4.4% compared to the same period last year (from €3.7bn to €3.5bn), even though exports to EU countries were flat at €13.2bn. The positive evolution of the trade deficit, coupled with higher current net transfers (up 13% year-on-year) resulted in the January to May current account deficit falling by 22.2% year-on-year. The current account deficit stood at 1.4% of GDP as at May 2012, whilst the IMF expects the overall 2012 deficit to come in below 5% of GDP. FDI flows were €0.5bn, down 45% year-on-year, and covered 24% of the current account deficit. The Romanian Leu lost 3% against the euro since the beginning of the year in the context of the turmoil on European markets due to the sovereign debt crisis. The National Bank of Romania has kept its key interest rate unchanged at 5.25%, whilst Romania's annual CPI fell from 3.1% at the end of December 2011 to 2.0% at the end of June.

Over the first half, the budget deficit came in at 1.1% of GDP, within the 2.2% annual budget deficit threshold agreed with the IMF. Romania's total external debt was €98.4bn at the end of May, flat year-on-year. The public sector debt was €47.5bn at the end of May, up 6% year-to-date but still relatively low at 35% of GDP. The National Bank of Romania's foreign reserves (excluding gold) amounted to €33.5bn at the end of May, allowing it to cover the country's short-term external debts of €28.8bn.

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €51.0bn at the end of June, up 6.3% year-on-year in RON terms. At the same time, the deposits stock amounted to €42.5bn at the end of June, up 9.6% year-on-year in RON terms. Positively, corporate loans increased by 2.9% year-to-date to account for 52% of the total loan stock at the end of June. While household loans increased by only 1.1% year-to-date, household deposits increased by 5.5% year-to-date and accounted for 62% of total deposits. The Romanian banking system's total loans-to-deposits ratio was 119% at the end of the second quarter. Overdue loans accounted for 11% of the total loan stock at the end of June (compared to 9.5% at the end of 2011).

The frictions between President Basescu and Parliament culminated in the President being suspended in early July. Basescu appears to have survived an impeachment vote following a referendum organized on 29 July, as the mandatory turnout of 50% plus one was not achieved. However, the final decision will be taken by the country's Constitutional Court, based on a review of whether the electoral registers are correct and up-to-date. If the court invalidates the referendum, the President should return to office, with the next presidential election due in 2014.

Bulgaria

Bulgaria's first quarter GDP was flat compared to the previous quarter, but increased by 0.5% year-on-year. Private consumption increased by 1% year-on-year in the first quarter, and accounted for 77% of the annual GDP growth. After falling over the first quarter due to lower exports to the EU, Bulgaria's year-on-year industrial production was up in April and May (+0.5% and +0.9%, respectively).

Bulgaria's annual CPI rate was 1.6% in June, down from the 2% recorded at the end of 2011, and one of the lowest in the EU (the EU's average inflation rate was 2.4% in June). Between January to May, Bulgaria's current account deficit was €0.7bn, or 1.7% of GDP, compared to a deficit of 0.3% in the same period of 2011. The worsening current account balance was the result of a growing trade deficit, which increased from €0.7bn between January to May 2011 to €1.7bn over the same period this year. After falling in the first quarter compared to the same period in 2011, mainly as a result of stopping electricity exports due to bad weather at home, Bulgaria's exports started to recover in the second quarter, resulting in exports increasing by 0.9% year-on-year over the first half of 2012, while imports grew by 12.1% year-on-year. FDI inflows were €474m over the period, up from €72m over the same period in 2011.

Bulgaria recorded a budget surplus of 0.1% over the first five months of 2012, a marked improvement over the 0.8% budget deficit recorded during the same period last year. Bulgaria's public sector debt was 16.7% of GDP at the end of April, up from 15.5% at the end of 2011. Bulgaria successfully placed €950m of 5-year eurobonds at a yield of 4.436% in July. The issue will be used to repay €818m of bonds maturing in January 2013. The country's reserves to short-term debt ratio was 139% at the end of May.

The Bulgarian banking system's total loans-to-deposits ratio was 95% at the end of May, down from 98.6% at the end of 2011. Whilst loans to non-financial institutions were flat year-to-date at €26.6bn, the deposit base increased by 4% (from €27bn to €28bn). Overdue loans accounted for 23.6% of total loans at the end of June, up from 21.9% at the end of 2011.

Serbia

Serbia's GDP fell by 1.3% year-on-year during the first quarter of 2012, this being the first fall in Serbian GDP since the last quarter of 2009. The freezing of the deal with the IMF in January 2012, the withdrawal of US Steel from the market, and the extremely cold temperatures in February which caused the temporary shutdown of several major industrial producers, all contributed to the fall in GDP. During January-May 2012, exports recorded a 0.2% year-on-year fall, while imports grew by 4.5%. This resulted in the trade deficit widening to €2.7bn in May, an 11.1% year-on-year increase.

Industrial production fell by 3.1% year-on-year between January and May. Following the 12.8% month-on-month decrease in February caused by extremely bad weather conditions, industrial production recovered in March, recording a 19.1% month-on-month growth. The weak growth in April (+1.1% month-on-month) and the fall in May (-0.9% month-on-month) was also the result of the on-going recession in many EU countries which represent important Serbian export markets.

The disinflationary trend of 2011 and early 2012 came to an end in the second quarter, with the CPI coming in at 5.5% year-on-year in June, compared to 3.2% in March, but still within the NBS's targeted range for the month (4.2% ± 1.5%). Inflationary pressures are expected to continue in the second half of the year, backed by the local currency's ongoing depreciation, increases in regulated prices, and the summer drought which, according to preliminary reports, will significantly reduce the wheat and corn harvests.

Negative FDI of €0.2bn during January-May 2012 was also a result of Telekom Serbia (the state-owned telecommunications company) buying back its own shares from Greek operator OTE.

Tomislav Nikolic, the leader of the Serbian Progressive Party (SNS), won the presidential elections held on 6 May. Furthermore, the SNS managed to win 73 out of 250 seats in the National Assembly, allowing it to form a new ruling coalition, together with the Socialist (SPS) and United Regions (URS) parties.

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