Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

30 June 2015

neweuropecapital

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Statistics

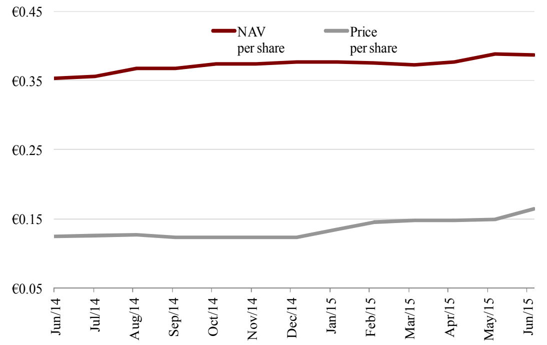
NAV per share (€) - undiluted	0.3867
NAV per share (€) - fully diluted	0.2897
Total NAV (€ m) - undiluted	38.7
Total NAV (€ m) - fully diluted	47.1
Share price (€)	0.1650
Mk Cap (€ m)	16.5
# of shares (m) - undiluted	100.0
# of shares (m) - fully diluted	162.6
NAV return since inception†	-59.58%
12-month NAV CAGR†	9.26%
NAV annualized Return*†	-9.09%
NAV annualized Volatility*†	19.46%
Best month (NAV)†	15.60%
Worst month (NAV)†	-33.53%
# of months up (NAV)†	60
# of months down (NAV)†	54

*† undiluted basis * since inception*

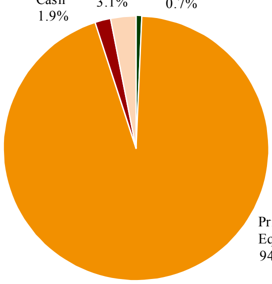
RC2 NAV returns (undiluted basis)

	2011	2012	2013	2014	2015
Jan	-0.54%	0.12%	-31.58%	-0.65%	-0.07%
Feb	0.24%	-9.69%	-0.51%	-0.34%	-0.34%
Mar	2.48%	-0.50%	-0.62%	2.94%	-0.70%
Apr	0.70%	-0.66%	0.29%	2.73%	0.93%
May	0.55%	-4.98%	-33.53%	2.70%	3.11%
Jun	0.25%	-1.47%	-0.85%	0.28%	-0.38%
Jul	0.13%	-0.73%	-0.28%	0.44%	
Aug	-1.10%	0.61%	1.27%	3.23%	
Sep	-1.25%	0.01%	-0.69%	0.01%	
Oct	2.63%	-0.82%	-0.72%	1.87%	
Nov	-0.25%	-0.36%	0.43%	0.15%	
Dec	-0.49%	0.29%	-16.44%	0.73%	
YTD	3.32%	-17.17%	-62.64%	14.91%	2.53%

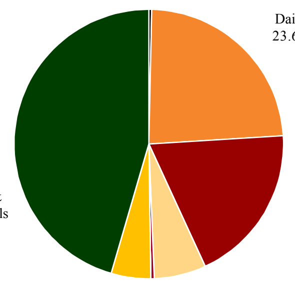
Share price / undiluted NAV per share (€)



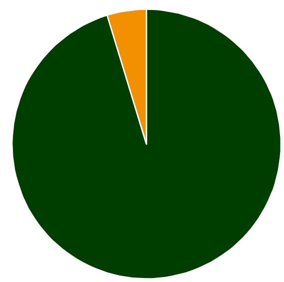
Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Portfolio Structure by Geography



Message from the Adviser

Dear Shareholders

Over the second quarter of 2015, RC2's NAV per share grew by 3.68% from €0.3729 to €0.3867, both on an undiluted basis, due to the receipt of dividends from Top Factoring and the growth of the Albalact share price.

Romania GDP growth of 3.7% over the second quarter was the second highest in the EU, whilst Bulgaria achieved a more modest 2.2%, and Serbian GDP growth accelerated to 0.9% over the first half of 2015. Romania's reduction of its VAT rate on basic foodstuffs which came into effect at the beginning of June is to be followed by a reduction in the standard VAT rate from 24% to 20% as of January 2016, and a further reduction to 19% as of January 2017. The government is now pursuing a policy of fiscal relaxation, encouraged by the economic growth figures, low inflation, a stable currency against the euro and growing tax receipts which together resulted in a budget surplus over the first seven months of 2015.

The Policolor Group's consolidated operating revenues in the first half of 2015 were 11.7% below budget but 14.7% above the same period of 2014. The Group's results reflect a good performance at the paints and coatings division, with the discrepancy from the budgeted Group EBITDA mainly coming from a €0.3m loss at the Bulgarian anhydrides division in the aftermath of the sharp oil price fall in late 2014. The Bucharest land sale is progressing, with Policolor having cashed an additional €1.0m down-payment in June (taking the total paid to date to €3.0m). The balance of €15.2m is to be received over 2015-17, with €8.6m due by the end of this year.

Top Factoring Group continued to perform above expectations, with EBITDA of €2.8m over the first half, boosted by net write ups of the value of its proprietary portfolios of €1.8m and €0.3m at the respective March and June quarterly impairment tests, such write-ups reflecting gross collections 7.2% over budget. In June, RC2 used part of the €1.7m dividend it received from the Top Factoring Group to acquire 7.7% of Glasro from the founding shareholder for €0.5m.

Albalact's EBITDA grew an impressive 48.5% in the first half of 2015, compared to the same period last year, reaching €4.5m. RC2 has managed to remove the pledge over a third of its shares in Albalact, whilst the remaining 17.8% remains pledged in respect of a loan to the Top Factoring Group.

Mamaia's first half sales were slightly ahead of budget at €0.56m, and up 12.5% year-on-year, mainly due to higher food & beverage revenues which were up 23% year-on-year. The six-month 2015 EBITDA loss of €98,000 was slightly higher than budgeted mainly due to higher personnel costs

There has been no improvement in the performance of East Point Holdings ("EPH") since the investment was written down to zero as at December 2013.

Klas continued to perform poorly with sales trailing 58% behind budget, and down 57% year-on-year. Following a reappraisal of the likely realisable value of Klas's Juzni Bulevar site by independent valuers in June, the value of RC2's investment was written down by €0.5m.

At the end of the quarter, the Fund had cash and cash equivalents of approximately €1.1m, compared to €0.3m at the end of March. The increase is primarily due to the receipt of dividends from Glasro.

Yours truly,

New Europe Capital

Policolor Group

Background

RC2 has a 40.0% shareholding in Policolor, the parent company of the Policolor Group ("Policolor" or the "Group"), which operates along the following business lines: coatings (architectural, automotive and industrial), resins and specialty chemicals. The Romanian company Policolor SA and its 100% owned Bulgarian subsidiary Orgachim AD form the largest producer of coatings in Romania and Bulgaria. The Group also includes Orgachim Resins, the leading supplier of resins in South East Europe, and Ruse Chemicals, a producer of anhydrides. All the Group companies are unlisted.

Group Financial results

(EUR '000)	2013*	2014*	2015B	1H14**	1H15**	1H15B
Consolidated Income statement (according to IFRS)						
Sales	**54,150**	**52,852**	**65,552**	**24,670**	**28,293**	**32,028**
Total operating expenses	(55,935)	(54,346)	(63,993)	(24,772)	(28,905)	(32,176)
Operating profit	**(224)**	**(1,494)**	**1,559**	**(102)**	**(612)**	**(149)**
Operating margin	*neg.*	*neg.*	*2.4%*	*neg.*	*neg.*	*neg.*
Recurring EBITDA	3,055	2,437	4,271	1,645	1,282	1,821
Non-recurring items		(414)	1,000	(17)	(48)	(16)
Total EBITDA	**3,055**	**2,023**	**5,271**	**1,628**	**1,234**	**1,805**
EBITDA margin	*5.6%*	*3.8%*	*8.0%*	*6.6%*	*4.4%*	*5.6%*
Net extraordinary result (land sale)		(149)	10,891	(50)	(164)	(132)
Financial Profit/(Loss)	(983)	(957)	(2,009)	(385)	285	(354)
Profit before tax	**(1,207)**	**(2,600)**	**10,441**	**(538)**	**(491)**	**(635)**
Income tax	(178)	114	(2,654)	(109)		
Profit after tax	**(1,385)**	**(2,486)**	**7,788**	**(646)**	**(491)**	**(635)**
Minority interest	106	48				
Profit for the year	**(1,279)**	**(2,438)**	**7,788**			
avg exchange rate (RON/EUR)	*4.45*	*4.45*	*4.50*	*4.46*	*4.45*	*4.45*

*Note: * audited, ** unaudited*

The Group generated consolidated operating revenues of €28.3m in the first half of 2015, 11.7% below budget but 14.7% above the same period of 2014. The Group consolidated results reflect a good performance by the paints and coatings business, and a hit at the Bulgarian anhydrides division in the aftermath of the sharp oil price fall in late 2014, which resulted in a one-off loss of €0.3m, being the biggest contributor to the discrepancy from the budgeted EBITDA.

Overall paints and coatings sales grew by 2.3% year-on-year in the first semester. Orgachim Resins' first half sales of €6.7m were 45% over budget, whilst the EBITDA came in at €0.5m (3.5 times the budget,). It is particularly encouraging that since Orgachim Resins re-opened its re-built plant in May 2014, it has been able to swiftly recover its leadership position within the South East European region, whilst it has also managed to open sales channels in more distant EU markets (such as Netherlands, France and Italy).

Production at the anhydrides plant re-started in mid-May. The division managed to generate sales of €4.4m in the first half, 26.5% above the same period of 2014.

Operations

At the end of June, Policolor received a further €1m down-payment in relation to the sale of its main Bucharest site, bringing the total received to date to €3m. It is due to receive staged payments of a further €15.2m over 2015-17, with €8.6m due by the end of this year.

Policolor is in documentation stage for the construction of its new paints factory in Bucharest, with applications for various authorisations having been submitted to the local town hall.

Over the first half of 2015, the Romanian construction sector grew by 10.9% year-on-year, well above the European average growth of 0.2%, whilst Bulgaria reported a 1.9% year-on-year fall.

Top Factoring Group

Background

RC2 invests in Romanian non-performing loans through its 100%-owned subsidiary Glasro Holdings Ltd ("Glasro"), and also owns a 93% interest in Top Factoring, a Romanian receivables collection company. Top Factoring and Glasro are together referred to as the "Top Factoring Group" or the "Group".

Group Financial Results

EUR '000	2013*	2014*	2015B	1H14**	1H15**	1H15B
Combined Group Income Statement						
Gross revenues	**9,753**	**12,354**	**12,559**	**5,789**	**6,606**	**6,176**
Amortization and fair value adjustments of debt portfolios	(3,303)	(4,207)	(5,533)	(1,348)	(1,447)	(2,748)
Total Net revenues	**6,451**	**8,147**	**7,027**	**4,441**	**5,159**	**3,428**
Debt Portfolios	5,409	7,252	6,269	4,012	4,762	3,045
Agency agreements	1,041	894	757	429	397	383
EBITDA	2,612	3,587	1,701	2,367	2,809	809
EBITDA margin	*40.5%*	*44.0%*	*24.2%*	*53.3%*	*54.4%*	*23.6%*
Profit after tax	1,898	2,347	1,048	1,977	2,190	469
Net Margin	*29.4%*	*28.8%*	*14.9%*	*44.5%*	*42.5%*	*13.7%*
Avg exchange rate (RON/EUR)	*4.42*	*4.44*	*4.42*	*4.46*	*4.45*	*4.42*

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

Gross revenues (made up of gross collections on proprietary portfolios and agency revenues) amounted to €6.6m in the first half of 2015, up 14.1% year-on-year and 7% above budget.

The March quarterly impairment test resulted in a net write up of €1.8m, reflecting higher than expected collections on existing portfolios. This was followed by a €0.3m write-up in June.

Over the first semester, the debt purchase line accounted for 92% of net operating revenues, of which banking portfolios contributed 82%. The agency business generated revenues of €0.4m, stable year-on-year.

The first semester EBITDA, which takes into account the portfolio write-ups, was €2.8m, significantly up on the budgeted €0.8m, due to the excellent performance of proprietary portfolios.

Operations

Glasro invested €3m in new portfolios over the first half of 2015, financed by a combination of bank loans and equity.

Gross collections from proprietary portfolios increased from €5.4m in the first half of 2014 to €6.2m. The share of collections generated by the field and legal departments increased to 12% and 26%, respectively, compared to 10% and 20%, respectively, in the first half of 2014, reflecting an increasing ability to squeeze higher revenues from proprietary portfolios. The balance of 62% was collected by the call centre.

In June, Glasro distributed dividends of €1.7m to RC2, out of its 2014 retained earnings. In June, RC2 used part of these dividends to acquire a 7.7% shareholding in Glasro for €0.5m, thereby reaching 100% ownership.

Albalact

Background

Albalact SA ("Albalact" or the "Company") is a publicly quoted Romanian dairy company in which RC2 holds a 25.4% stake under its Private Equity Programme. A local entrepreneur (Mr Raul Ciurtin) and his family own 42.5%, with 28.8% representing the free float and 3.3% representing treasury shares acquired within a buy-back program. With Albalact's market capitalization increasing by 9.4% over the quarter, the value of RC2's shareholding increased from €9.8m as at 31 March 2015 to €10.7m as at 30 June 2015.

Financial results

EUR '000	2013*	2014*	2015B	1H14**	1H15**
Consolidated Income Statement					
Sales Revenues	**87,270**	**91,826**	**114,283**	**43,813**	**46,549**
Total Operating Revenues	**87,502**	**94,807**	**114,283**	**46,151**	**47,376**
Total Operating Expenses	(85,410)	(93,490)		(45,324)	(45,566)
Operating Profit	**2,092**	**1,317**		**826**	**1,811**
Operating margin	*2.4%*	*1.4%*		*1.8%*	*3.8%*
EBITDA	**5,834**	**6,040**	**6,966**	**3,020**	**4,483**
EBITDA margin	*6.7%*	*6.4%*	*6.1%*	*6.5%*	*9.5%*
Profit before Tax	**1,346**	**360**		**859**	**1,572**
Income Tax	(238)	(177)		(265)	(458)
Profit after Tax	**1,107**	**183**		**594**	**1,114**
Minority Interest	3	11		6	6
Profit for the year	1,110	194		600	1,120
Net margin	*1.3%*	*0.2%*		*1.3%*	*2.4%*
Avg exchange rate (RON/EUR)	*4.42*	*4.44*	*4.45*	*4.46*	*4.45*

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

Albalact's financial statements presented above consolidate the performance of its two subsidiaries: Raraul SA, a dairy producer in which Albalact holds a 99.01% shareholding, and wholly-owned Albalact Logistics SRL, which was created in March 2014 to take over the logistics assets and activities of Albalact. Together the three companies are referred to as the "Albalact Group".

Albalact generated euro-denominated sales of €46.5m in the first half of 2015, up 6.2% year-on-year primarily driven by an increase in yoghurt and fresh milk sales. EBITDA was up by a much more impressive 48.5%, reaching €4.5m, driven by a change in the product mix towards higher value-added categories, and by a fall in the market price of raw milk, itself driven by the removal of the EU's national production quota system; the ban on exports to Russia; and weaker demand from China.

Operations

The management team is working on enhancing the portfolio structure by an increasing focus on cheese products, and the launch of a new "health conscious" range under its flagship *Zuzu* brand.

The decrease of the VAT rate for basic foodstuffs from 24% to 9% starting on 1st June is expected to have a positive effect on Albalact's sales.

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 the city of Constanta. In March 2008, RC2 acquired 63% of the Company, with the remaining 37% being owned by a Romanian private individual.

Financial results and operations

(EUR '000)	2013*	2014*	2015B	1H14**	1H15**	1H15B
Income Statement						
Sales Revenues	**1,922**	**1,972**	**2,129**	**491**	**554**	**537**
Total Operating Revenues	**1,931**	**2,045**	**2,129**	**498**	**560**	**547**
Total Operating Expenses	(1,714)	(2,106)	(1,923)	(810)	(749)	(777)
Operating Profit	**217**	**(61)**	**207**	**(312)**	**(189)**	**(229)**
Operating margin	*11.2%*	*neg.*	*9.7%*	*neg.*	*neg.*	*neg.*
EBITDA	**422**	**253**	**487**	**(215)**	**(98)**	**(89)**
EBITDA margin	*21.9%*	*12.4%*	*22.9%*	*neg.*	*neg.*	*neg.*
Profit after Tax	**103**	**(158)**	**107**	**(331)**	**(237)**	**(281)**
Net margin	*5.4%*	*neg.*	*5.0%*	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*4.42*	*4.44*	*4.45*	*4.46*	*4.45*	*4.45*

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

At the beginning of 2015, the Romanian government announced a reduction in the VAT rate from 24% to 9% on all food and beverage services sold as a package with accommodation services.

Sales revenues over the first semester were €0.56m, up 12.5% year-on-year, and 2.4% above budget, mainly due to higher food & beverage revenues which were up 23% year-on-year and amounted to 52% of sales.

The six-month 2015 EBITDA loss of €98,000 was slightly higher than the budgeted loss of €89,000, mainly due to higher personnel costs (+13%, from €193,000 to €216,000) as the management had to increase salaries to improve personnel retention, one of the most important operational issues for the business. EBITDA came in approximately the same as last year, if one excludes approximately €100,000 of additional costs for refurbishment works which were expensed in 2014.

Operations

The occupancy rate of 11.8% over the first semester was almost unchanged on the 11.4% achieved over the same period last year.

Klas

Background

Klas DOO ("Klas" or the "'Company"), the former bakery division of East Point Holdings Ltd is 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 €1.4m of a shareholder loan to Klas outstanding as at 30th June.

Financial results and operations

EUR'000	*2013**	*2014**	*2015B*	*1H14***	*1H15***
Income Statement					
Net sales	**14,593**	**10,654**	**8,299**	**5,720**	**2,446**
EBITDA	**(2,078)**	**(2,266)**	**(388)**	**(844)**	**(936)**
EBITDA margin	*neg.*	*neg.*	*neg.*	*neg.*	*neg.*
Profit after tax	**(4,812)**	**(2,826)**	**(1,664)**	**(1,607)**	**(605)**
Net margin	*neg.*	*neg.*	*neg.*	*neg.*	*neg.*

*Note: * audited ** management accounts*

Sales experienced a year-on-year fall of 57% with a further deterioration in the EBITDA margin. This poor performance is due to a combination of a loss in market share, under-recovery of the fixed costs of production and severe pressure on margins from competitors, most, if not all, of which are trading at a loss. Additionally, included in EBITDA are redundancy costs of €0.3m. The redundancy programme for 250 staff has now been fully implemented, with staff levels now at 280 employees.

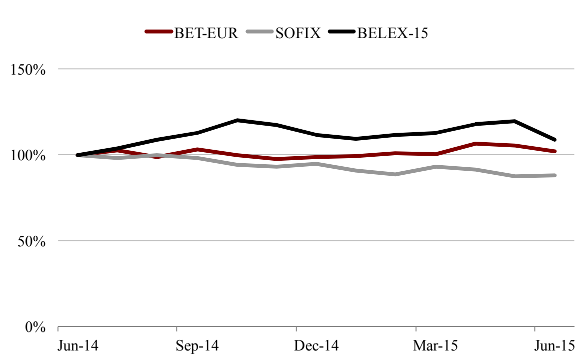
Daily production volumes, having fallen to just 26 tons in January, have slowly recovered to 32 tons in June. Management expects to reach the projected break-even level of 36 tons a day in October.

During the first half of 2015, management was actively engaged in marketing the former factory premises at Juzni Bulevar in central Belgrade. Based on the results of these efforts, it became clear that the asking price of €3.5m was in excess of market expectations and a more realistic guide price was needed.

Accordingly, independent valuers were consulted and they concluded that €2.4m would be more appropriate. As the value of RC2's shares in Klas also reflects the value of this site, the independent valuer has reflected the new site valuation, reducing the value of RC2's shares by €0.5m.

Capital Market Developments

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



Commentary

During the second quarter, the Romanian BET index increased by 1.6%, whilst the Bulgarian SOFIX and the Serbian BELEX-15 indices fell by 5.6% and 3.3% respectively, all in euro terms. By comparison, over the second quarter, the MSCI Emerging Market Eastern Europe index gained 0.2%, whilst the MSCI Emerging Market, the FTSE100 index and the S&P indices lost 4.0%, 1.9% and 4.0%, respectively, all in euro terms.

Over the year, the BET and the BELEX-15 indices gained 1.8% and 9%, respectively, whilst the SOFIX fell by 12%, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	3.8%	6M15	2.7%	6M15	0.9%	Jun-15
Inflation (y-o-y)	-1.7%	Jul-15	-0.2%	Jul-15	1.9%	Jun-15
Ind. prod. growth (y-o-y)	2.7%	Jun-15	5.7%	Jun-15	18.6%	Jun-15
Trade balance (EUR bn)	-3.3	6M15	-1.2	6M15	-1.7	6M 15
y-o-y	*15.5%*		*-33.1%*		*-5.9%*	
FDI (EUR bn)	1.7	6M15	0.8	6M15	0.7	6M 15
y-o-y change	*52.1%*		*6.6%*		*n.a*	
Total external debt/GDP	57.6%	Jun-15	89.3%	Jun-15	79.3%	Jun-15
Reserves to short-term debt	148.9%	Jun-15	247.6%	Jun-15	383.2%	Jun-15
Loans-to-deposits	92.6%	Jul-15	85.5%	Jul-15	112.6%	Jun-15
Public sector debt-to-GDP	38.4%	Jun-15	28.7%	Jun-15	71.3%	Jun-15

Commentary

Romania

Romania had the second highest economic growth in the EU during the second quarter, with its GDP increasing by 3.7% year-on-year. Overall, GDP grew by 3.8% year-on-year during the first half of 2015. The GDP growth was helped by private consumption, which increased by 5.4% year-on-year. Due to a 3.1% year-on-year increase, industrial production was also one of the main contributors to GDP growth in the first half.

The VAT rate on basic food stuffs was cut from 24% to 9% in June, contributing to a 1.7% year-on-year overall fall in prices in July. The Romanian leu has been volatile against the euro mainly due to worries about the Greek debt situation, but stabilized at 0.2% above its level at the beginning of the year (as of the end of June).

Over the first seven months of 2015, Romania achieved a budget surplus of €1.7bn, equivalent of 1.06% of GDP, compared to a 0.15% deficit over the same period of 2014. Budgetary receipts increased by 9.9% year-on-year, mainly triggered by higher VAT collections. VAT collections made up 25.5% of total budgetary receipts and increased by 15.5% year-on-year, the results of a better collection process. Total budgetary expenses increased by only 2.9% year-on-year, with personnel and social expenditures, which account for 58% of total expenses, increasing by 5.6%. The budgetary surplus was realized at the expense of low capital expenditures, which fell by 15.1% year-on-year, from €1.33bn to €1.67bn and now make up only 0.7% of GDP.

In early September, parliament approved a set of fiscal relaxation measures: reducing the standard VAT rate from 24% to 20% as of January 2016 and a further cut to 19% as of January 2017 (reversing the sudden increase from 19% to 24% in July 2010). Also, from 2017, the dividend tax rate is to be cut from 16% to 5%, and the extra excise on fuel as well as the tax on special constructions are due to be cancelled. International institutions (the IMF, the European Commission, Fitch Ratings), and the National Bank of Romania, as well as various local economists, have expressed concerns at the scale of the planned fiscal relaxation, but the government has countered with the argument that tax collections have continued to rise, even after the reduction in the VAT rate on basic foodstuffs in June.

Over the first six months, the trade gap widened by 15.5% year-on-year (from €-2.9bn to €-3.3bn), as exports increased by only 5.9% whilst imports grew by 6.9%. The negative evolution of the trade balance was the main trigger of a current account deficit of €0.29bn (which nevertheless was lower than the deficit of €0.86bn over the same period of last year). Over the first half of 2015, FDI flows amounted to €1.7bn, up from €1.2bn over the same period of 2014, as intra-group loans increased by €638m whilst equity investments fell by €171m.

Romania's total external debt was €90.9bn at the end of June, -3.7% year-to-date and the equivalent of 57.6% of GDP. The total public debt was 38.4% of GDP at the end of June, down from 39.8% at the end of 2014, as Romania reimbursed €979m of its €12.4bn loan from the IMF. Romania still has to repay €800m by March 2016.

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €48.2bn at the end of July, and was up 0.3% year-to-date in RON terms. By contrast, the overall deposit base fell by 1.1% year-to-date in RON terms, and amounted to €52.0bn at the end of July. The NPL ratio was 12.8% at the end of June, down from 13.9% at the end of 2014. Although interest rates have been kept at record low levels, with the National Bank of Romania further decreasing the base rate from 2.5% at the beginning of the year to 1.75% in early May, lending to the private sector remains weak: loans to companies fell by 0.6% year-to-date, while loans to households increased by 1.4%, suggesting that consumers are beginning to spend more. Loans in domestic currency accounted for 48.7% of the total loan stock at the end of July, compared to 43.8% at the end of 2014.

Bulgaria

Bulgaria's second quarter GDP grew by 2.2% year-on-year and by 0.4% quarter-on-quarter. Overall it grew by 2.7% year-on-year over the first half of 2015, triggered by improved private consumption (+0.8% year-on-year) and higher exports (+12.6%). Bulgarian industrial production grew by 5.7% year-on-year in June.

Bulgaria recorded a 0.2% year-on-year fall in prices in July, compared to a 0.9% fall in December 2014.

Over the first half of 2015, Bulgaria achieved a budget surplus of €0.46bn, or 1.1% of GDP, which compares to a 1.2% GDP budget deficit recorded during the same period of 2014. The surplus was triggered by a 15% increase in tax revenues (from €7.2bn to €8.3bn), the result of the authorities' efforts to apply better collection policies, whilst total budgetary expenses grew by only 2.1% (from €7.5bn to €7.6bn).

Bulgaria's public sector debt was 28.7% of GDP at the end of June, up from 26.9% at the end of 2014, following the issuance of three eurobonds worth a combined €3.1bn in March. The issue fulfilled the bulk of the 2015 financing requirements.

Deflation translated into cost competitiveness and lead to a strong increase in exports over the first half (+12.6% year-on-year), whilst imports grew by just 5.5%. Overall, Bulgaria's trade deficit improved from €1.8bn in the first half of 2014 to €1.2bn in the same period of this year. The improvement in the trade deficit led to a current account surplus of €0.3bn, or 0.8% of GDP, compared to a deficit of 0.4% in the same period of 2014. FDI inflows were €0.8bn in the first semester, up 6.6% compared to the same period of 2014. Equity investments accounted for only 21% of total FDI flows, although this was higher than the 14% recorded in the first half of 2014.

The Bulgarian banking system's loans to non-financial institutions fell by 0.8% year-to-date, and amounted to €25.1bn at the end of July. On a similar note, the deposit base decreased by 0.6% from €29.5 at the end of December to €29.3bn at the end of July. Overdue loans accounted for 23.9% of total loans at the end of July.

Serbia

The positive trends recorded in the first quarter of 2015 have persisted, with Serbia experiencing year-on-year GDP growth of 0.9%. This growth is primarily based on a continued recovery of industrial production and exports, overcoming the effects of last year's floods. In particular, there was an 18.6% year-on-year growth in industrial production. The National Bank of Serbia (NBS) has now revised its annual GDP growth forecast from negative 0.5% to positive 0.5%, reflecting the fact that inflation is weak, energy prices have fallen, and there is increased demand from overseas markets for Serbian manufactured goods and agricultural products.

The government has felt sufficiently encouraged by the incipient economic recovery to announce increases of 2% in pensions and of 3% to 4% in public sector wages effective November. These increases will require the consent of the IMF under the terms of the current Stand-By Agreement, and are in part intended to improve living standards amidst the on-going public sector redundancy programmes.

With inflationary pressures easing and a positive current account trend, the NBS surprised the markets with two cuts of 50bps to its key lending rate, bringing it to 6.0%. This relaxation in monetary policy should incentivise banks to increase lending, but they are still hampered by NPLs, which represented 22.6% of all loans at the end of March.

During the second quarter, the Serbian Dinar depreciated by 0.3% against the Euro, as opposed to a 0.6% appreciation in the first quarter. This deprecation was primarily the result of an increase in the perceived risk premium due to the Greek crisis, as measured by the EMB Risk Premium Index. Nonetheless, Fitch reaffirmed the country's B+ with stable outlook rating in July.

Important Information