

Romania: Will economic growth come back to strong performance?



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After five challenging years Romania's economic performance proved that it has become one of the leaders of the European recovery and exceeded expectations with GDP growth rising by 3.5% in 2013. However, the slowdown of the growth in 2014 shows another picture.

Looking into the details of Romanian growth outperforming the 2013 CEE average of 1.2%, it can be concluded that significant contributions came from the agricultural sector as well as industry, particularly car production supplying mainly foreign customers.

Can those factors be considered as sustainable contributors to future economic performance in Romania, especially as the country has reentered into a technical recession in the first two quarters of 2014? In this Panorama we will also look into the agricultural sector as a crucial sector for the Romanian economy employing nearly a third of its workforce. The transport sector in Romania is also an important pillar of the country's economy. The Romanian transport companies, with the second largest fleet of goods vehicles in the CEE region and attractive labour costs, are well equipped to satisfy increasing demand for transport services and international trade. This Panorama will answer the question of whether they are current 'blue chips' for whom the only problem at the moment could be 'complaining' about the huge demand for their services. Last but not least, the Panorama briefly investigates the risk levels of particular sectors of the Romanian economy.

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Contact: www.coface.at, susanne.kroenes@coface.com

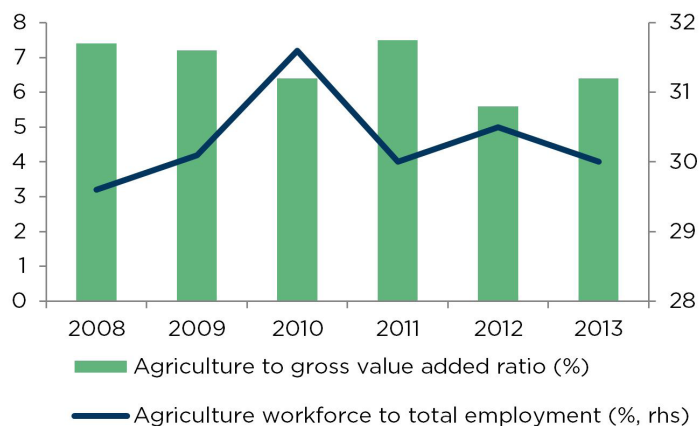
By **Grzegorz Sielewicz**
Economist, Central Europe

Recent developments

STRONGER ECONOMIC GROWTH THAN ITS PEERS IN 2013

Romania is the country which is most dependent on the agricultural sector in the entire European Union – the share of agriculture, forestry and fishing in gross value added averaged 7.3% in 2005-2013, with almost 31% of the working population employed in this sector (in that period the European Union's averages amounted to 1.7% and 5.4%, respectively and the CEE averages were 4.1% and 11%, respectively). Therefore, economic output is strongly related to weather conditions, which tend to be supportive for this country, located as it is in Southern Europe. However, droughts in 2012 were the main reason behind poor performance in agriculture and translated directly into a decrease in domestic demand which resulted in a slump of the GDP growth rate from 2.2% in 2011 to 0.7% in 2012.

CHART 1: Share of agriculture in the economy



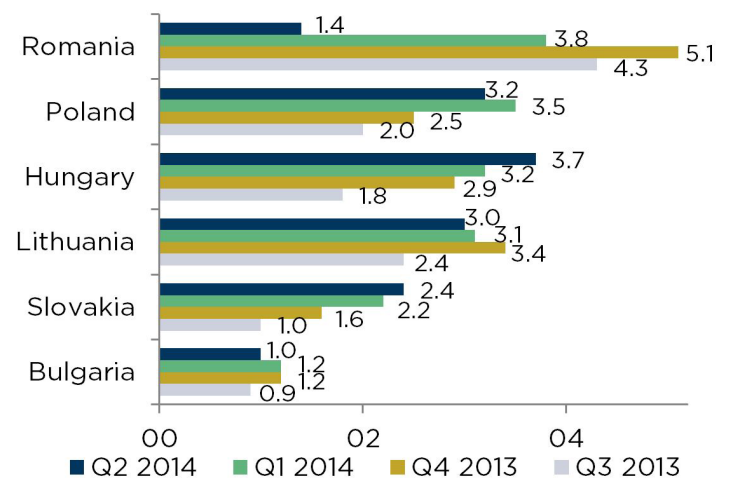
Source: Eurostat

On the contrary, Romania experienced a very good harvest in the summer of 2013, leading to positive supply shocks. That factor combined with strong exports, which rallied 13% in the second quarter of 2013 and 19.4% in the third quarter of 2013, made Romania the fastest growing economy in the European Union (4.2% yoy in Q3 2013 and 5.1% yoy in Q4 2013).

The sustainability of the recovery is questionable – as the agro sector is not a constant positive contributor towards GDP creation it will be difficult to keep up such an intense growth in foreign trade. Domestic demand should finally bottom out with the support of decreasing inflation, but it will not grow as fast as the export rate.

Romania remained the EU growth leader at the beginning of 2014 – its real GDP growth amounted to 3.8% in the first quarter according to Eurostat statistics. However the slowdown in the second quarter was much deeper than expected due to deterioration of trade balance and slowing industry production. It resulted in a GDP growth of -1.0% q/q and 1.4% y/y in the 2nd quarter of this year. In 2014, Coface forecasts the Romanian GDP growth rate of 2.5% in the entire 2014, especially base effects will be evident in the second half of the year.

CHART 2: Real GDP growth rates (% y/y)

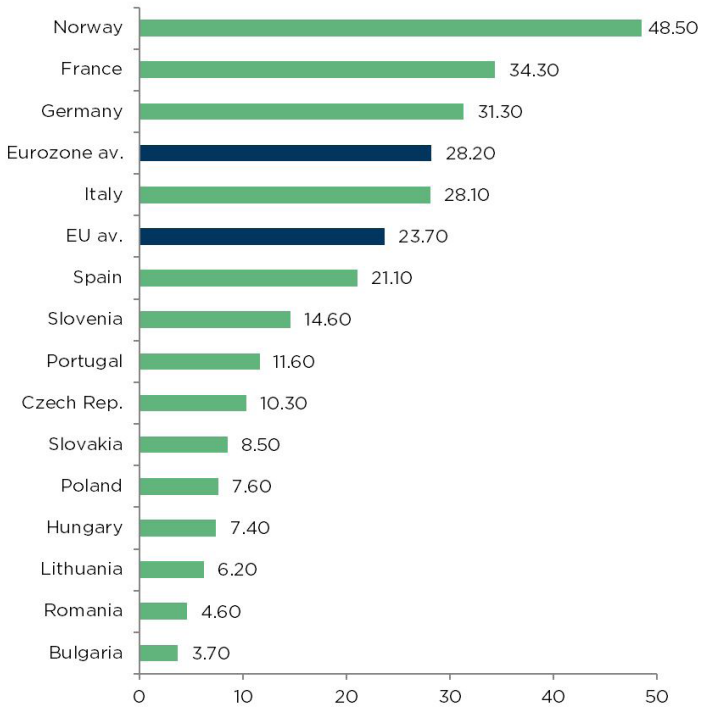


Source: Eurostat

Alongside Bulgaria, Romania offers the most attractive hourly labour costs in the European Union (EUR 3.70 and EUR 4.60 respectively). As such it is able to produce more cheaply than its regional peers, and a very large part of the increase in exports was supported by the growing automotive sector, with local factories of Dacia (Renault Group) and Ford. The recovery already initiated in Western Europe as the main trading partner of not only Romania but Eastern Europe in general makes the CEE prospects more positive. Moreover, they not only supply European consumers, but also use the opportunity for outsourcing as well as providing components and intermediate goods to other manufacturers – countries like Germany are experiencing strong demand for their quality products coming from the growing middle class in emerging economies, mainly in Asia. Despite such attractive labour costs, Romania has not obtained a significant amount of foreign capital. The net FDI flows amounted to EUR 2,137 million in 2012, constituting half of Poland's net flows and a quarter of those of the Czech

Republic. On the other hand, Romania's net FDI flows were roughly the same as in Slovakia and 44% higher than in Bulgaria.

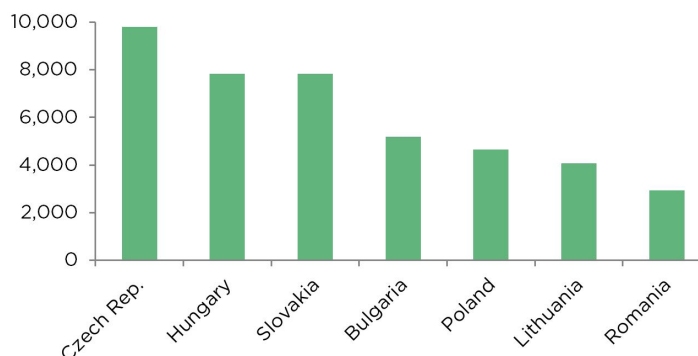
CHART 3: Average labour cost levels in selected EU economies (EUR/hour)



Source: Eurostat

The sectors which reported significant capital investments in 2012 were industry overall (EUR 1,072 million) including manufacturing (EUR 529 million) and energy (EUR 497 million), financial services, insurance (EUR 646 million) and construction and real estate (EUR 295 million) according to the Foreign Direct Investment Statistical Survey published by the National Bank of Romania. Consequently, the final FDI stock came in at EUR 58,915 million at the end of 2012, i.e. 7% more than a year before.

CHART 4: FDI stock per capita (EUR)



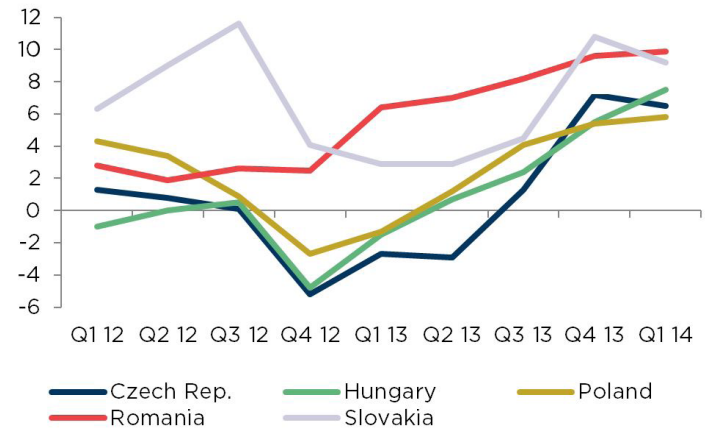
Source: Eurostat

In terms of FDI stock, the most significant share of investors came from the Netherlands (22% of the FDI stock at end-2012), Austria (19%), Germany (11%) and France (9%). Nevertheless, in terms of FDI stock per capita, Romania underperforms in a regional comparison. It only accounts for EUR 2,943 compared to EUR 5,183 in Bulgaria and EUR 7,820 in Hungary.

Supply side shows signs of improvement

In the first quarter of 2014, industrial production in Romania rose by 9.9% on yearly basis compared to 1.7% for the whole EU and 1.3% for the eurozone. In recent months Romania has experienced one of the highest growth rates among all EU countries.

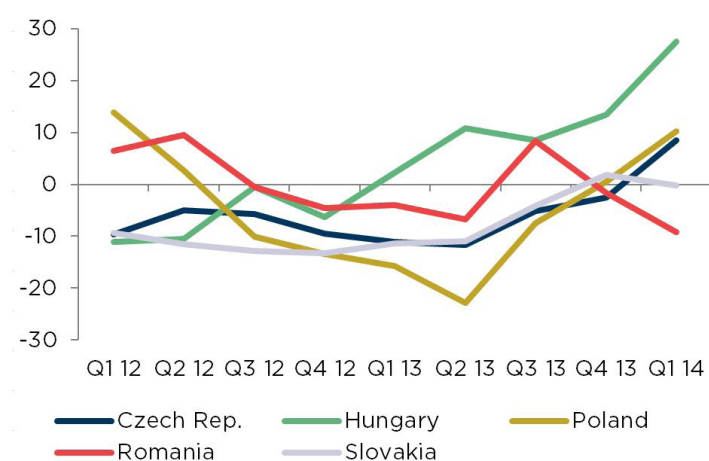
CHART 5: Industrial production (% y/y dynamics)



Source: Eurostat

Furthermore, industrial production has registered constant growth during the past two years in contrast to the volatile results of other CEE economies.

CHART 6: Construction output (% y/y development)



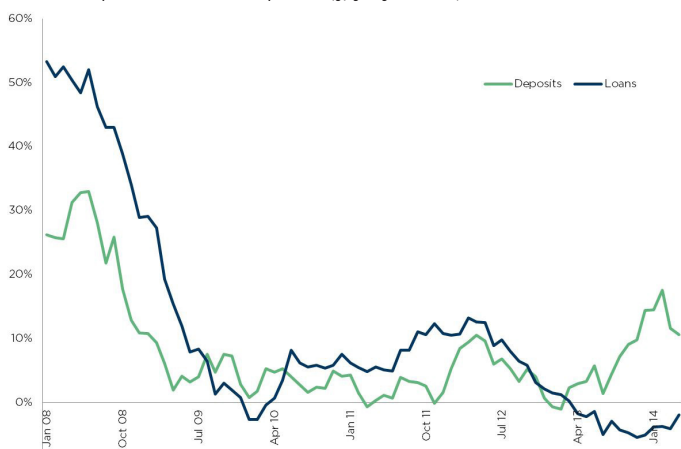
Source: Eurostat

This picture is accompanied by a stable level of confidence in industry which currently equals the EU 28 average according to surveys reported by Eurostat.

The construction sector is still suffering from the difficult situation it experienced previously. Only some European countries have shown slight increases in indicators, which, however, cannot be defined as sustainable improvement. The dynamics of the construction sector in Romania have been in line with the evolution of the European Union's average in recent months.

The crucial reasons for low investment activity by companies included a slowdown of private consumption and the deleveraging of the private sector in Romania. The latter referred mainly to local households (described further below); however, corporates suffering from subdued internal demand were more focused on repaying existing loans than incurring new ones. As such, the numbers of new loans has decreased significantly from a peak recorded especially in 2008 and currently they are stuck in negative territory.

CHART 7: Corporate loans vs deposits (y/y dynamics)



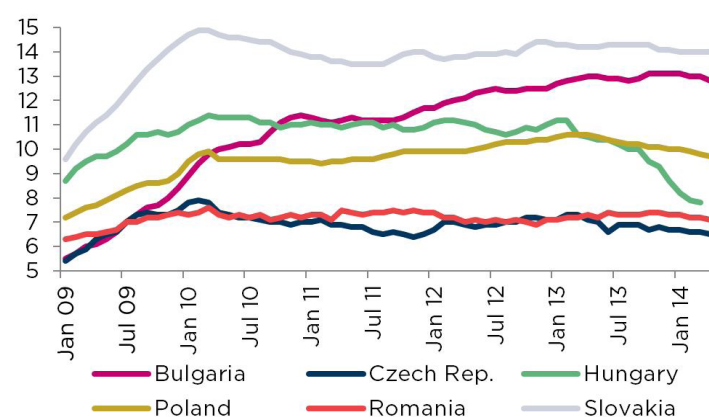
Source: National Bank of Romania

Demand side - stable, but a boost would be welcomed

The unemployment rate remains stable in Romania. Indeed, even since 2009 it has been the least volatile among all EU countries, ranging from 6.3% to 7.6%. The current figure as at April 2014 amounted to 7.1%, i.e. lower than in neighbouring Bulgaria (11.9%) as well as Poland (9.7%) or Slovakia (13.9%). The low volatility of the Romanian labour market can be attributed to a transition of the workforce from industry to agriculture whenever market sectors have suffered difficulties.

Local peaks of increased employment in the agricultural sector can be observed in chart 1 as a consequence of the recession or slowdown of the Romanian economy. These persons have shifted temporarily to agricultural production targeted towards their own needs rather than for trading at markets.

CHART 8: Unemployment rate (%)



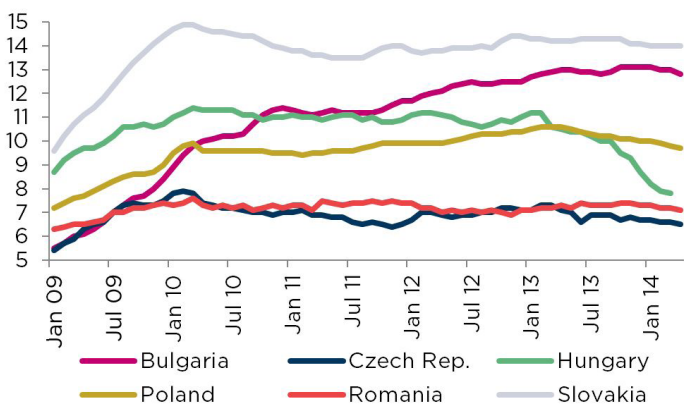
Source: Eurostat

The volume of retail sales is growing in CEE countries, although consumption is bottoming out. The highest increases are being recorded by the Baltic States; however, Romania also noticed significant growth levels in recent months. The growth was negatively affected by the decrease of fuel prices. The yearly growth of the retail trade in Romania of 9.2% is the highest of all EU countries. Compared to a year ago, consumers are spending more money on food and beverages as well as non-food products. The latter have been highly dynamic, impacted to some extent by a base effect, as previously Romanian households have been reluctant to spend money on anything but their primary needs. Unlike Romania, retail sales in the Czech Republic and Slovakia have stayed at roughly the same levels as in 2010. The savings rate of households has been negative in Romania for several years, indicating that households are spending more than they receive as regular income and are financing some of the expenditure through credit, gains from the sale of assets (financial or non-financial) or by running down cash and deposits. It stood at -3.8% in 2010, then deteriorated to -8.5% in 2012, and according to the European Commission forecast it will reach -11.3% in 2013¹. This proves that the deleveraging process remains the crucial factor for a full economic recovery. Romania is the only EU country recording a negative savings rate by households. The rates of its

¹ European Economic Forecast, Spring 2014, European Commission

CEE peers ranged in 2012 from 4.8% in Poland through 7.4% in Hungary to 10.6% in the Czech Republic.

CHART 9: Retail sales (2010=100)



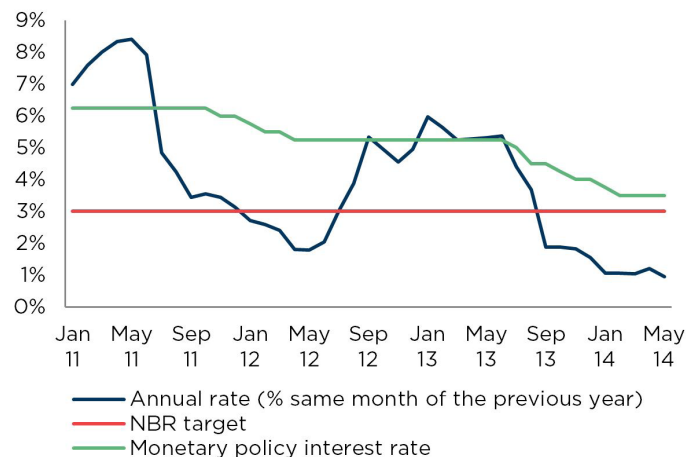
Source: Eurostat

Although the highest inflation rate in the entire EU (3.2% in 2013) could point to strong consumer demand, household spending was constrained by the deleveraging of the private sector. The negative development of loans continued in the second half of 2012 and first half of 2013. In the same time period the high inflation rate mainly reflected a strong price increase in unprocessed foods (12.4% in May 2013) due to a difficult agricultural year in 2012. Moreover, households' expenditure on consumption was further constrained by the unfavourable base effect, an increase of electricity prices by 6% as well as prices of excisable products affected by a higher exchange rate.

By contrast, the good agricultural year of 2013 was supportive for price disinflation, especially the decrease of VAT on bread related products (from 24% to 9%) which was introduced in September last year. The latest inflation figure of 0.9% in May 2014 will increase towards the end of the year, being impacted by the introduction of fuel related excise tax, the loss of the base effect related to the decrease of VAT on bread related products, the gradual recovery of consumption as well as European Parliament and presidential elections triggering an increase in governmental spending. Factors hampering an increase of the economic growth rate in Romania as well as in many other countries of the region included the ongoing deleveraging process in the private sector which has affected domestic demand. Earlier, following the accession of the CEE countries to the European Union there was increased flexibility in the financial markets with foreign banks providing financing of loans. Credit booms were recorded in CEE countries:

in the case of Romania yearly credit growth was more than 60% in 2008. Similar levels were recorded by Bulgaria at that time as well as in the Baltic economies a year before. Other CEE countries also recorded high annual increases of 30% at that time.

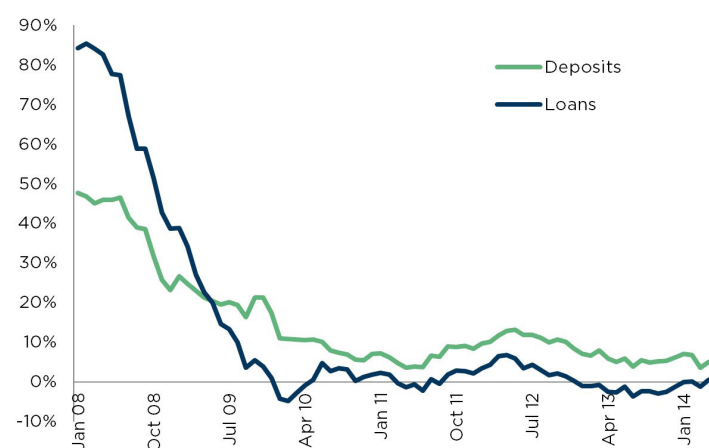
CHART 10: Evolution of inflation (%)



Source: National Bank of Romania

The collapse of Lehman Brothers triggered a period of volatility in financial markets and worsened access to credit. On the supply side, the availability of credit was constrained by the cautious approach of banks, which themselves suffered from a rising number of non-performing loans and reduced foreign financing. On the demand side, household and company confidence deteriorated in line with their weakening financial situation and increased interest payments on existing loans, of which a substantial number were denominated in foreign currencies and were as such exposed to exchange rate risks. As a result the availability of new loans was severely restricted.

CHART 11: Loans vs deposits of households (y/y dynamics)



Source: Eurostat

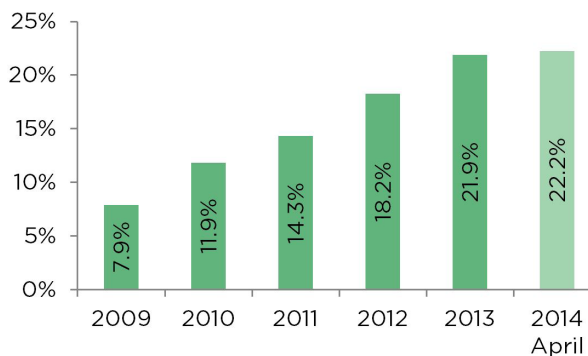
The numbers of new loans started to increase moderately in Romania in 2011. However, since the second half of 2012 the deleveraging process has escalated and the first rebound from a negative territory was only seen last month.

The banking sector is still suffering from a high share of non-performing loans

As described above, credit booms were recorded in CEE economies including Romania prior to the financial crisis. The permissive approach of banks in granting new loans even for questionable customers inflamed the credit crunch. They started to suffer from uncollectable payments which had a direct impact on banks' balance sheets. Although banks are currently much more prudent in providing new loans, non-performing loans (NPL) are still a concern for banks due to their rising share of the portfolio. Since 2009, when NPLs accounted for 7.9%, a gradual increase to currently 22.2% (April 2014) has been observed. Banks remain weak in terms of profitability and NPLs still take

up a substantial part of their portfolios. The banking sector still generates risks and has not significantly improved since the years of the crisis in 2008 and 2009. Nevertheless, the deleveraging process should come to a crucial stage in the medium term and the stabilization of NPLs is foreseeable.

CHART 12: Non-performing loans ratio



Source: National Bank of Romania

/ Sectoral Trends

TRANSPORT SECTOR: THE EUROZONE RECOVERY GENERATES BETTER PROSPECTS

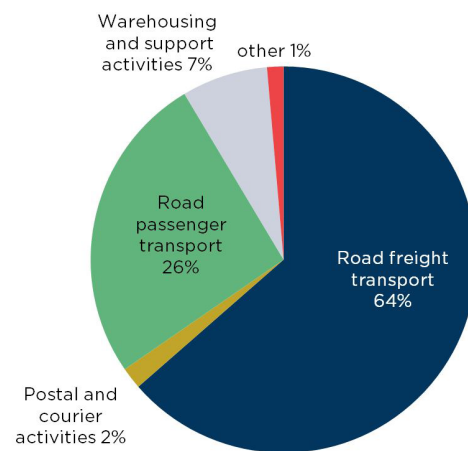
The transport sector in Romania is an important pillar of the country's economy. The volume of freight transport amounted to 108% of GDP in 2012, i.e. above the EU average of 95%, but lower than most of its regional peers, with Bulgaria and Poland recording the highest shares – 174% and 137% respectively. Freight transport by roads dominates as in other European countries; however, an international comparison proves that its share of 53% is noticeably below the EU average of 75%. In Romania, the remaining two quarters of the breakdown of freight transport are accounted for almost equally by rail transport and inland waterways.

Romania's location in the south of Europe provides an opportunity for it to connect East with West. In particular, the country has direct access to the countries of the former Soviet Union and covers the Balkans, Greece, Turkey and Western Europe, with Italy reasonably close. The Pan-European transport routes also include Romania, with corridor IV coming from Dresden through Prague, Vienna, Budapest, Bucharest, Sofia and Thessaloniki to Istanbul as well as corridor IX from Helsinki through St. Petersburg, Kiev, Bucharest to Alexandroupolis with a branch to Moscow and other branches to Klaipeda, Kaliningrad, Minsk and Odessa. Moreover, there is also the waterway corridor VII of 2,300 kilometres length on the River Danube (Northwest-Southeast).

The volume of traffic has changed tremendously since the early 1990s due to a significant improvement in social and economic conditions. Whereas car ownership in Romania was 60 cars per 1,000 inhabitants in 1990, it has more than tripled since then and amounted to 203 cars in 2011. The estimates show that it even exceeded 400 cars in Bucharest and will continue to grow. As in other European capital cities where car ownership figures have already reached 600-800 cars per 1,000 inhabitants, it has also become an important infrastructural concern for Romania. Moreover, the transport pattern has changed in those years, with rail traffic accounting for two thirds of the overall structure in 1990, but with road traffic currently becoming increasingly dominant².

Domestic roads in Romania consisted of 550 kilometres of motorways and 83,635 kilometres of other roads in 2012. The total length of motorways was similar to Bulgaria, although it was much higher in Hungary and Poland (1,515 and 1,365 respectively). The infrastructure of the transport system can be explained by the geographical attributes of the countries. Nevertheless, the length of motorways per 1000 km² leaves Romania last in a comparison with its peers, with just 2 kilometres as compared to 4 in Poland, 5 in Bulgaria and 16 in Hungary.

CHART 13: Number of enterprises by mode of transport in Romania



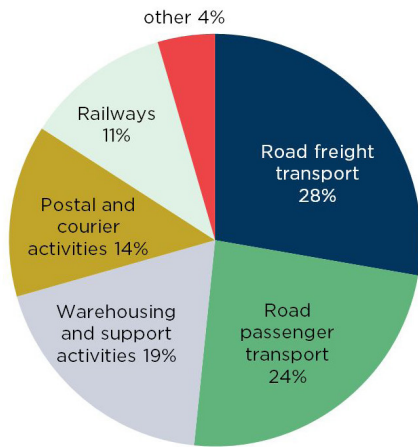
Source: Transport Statistical Pocketbook 2013

Transport companies in Romania account for 3% of those operating in the entire European Union. The dominance of road freight transport is also reflected in the highest share of enterprises active in that sector (64% as compared to the EU average of 52%). Nevertheless, the share accounted for by the transport business also includes passenger transport, and the sector is dominated by small and medium-sized enterprises.

Coface Romania has conducted an analysis of companies whose main activity is defined as road transport. The research targeted 27,252 companies which filed financial statements on business activities carried out during 2013. According to financial statements published by the Ministry of Finance, those companies generated a total turnover of RON 27 billion and employed 130,233 persons, i.e. they accounted for 3.5% of the number of employees registered in the economy.

² Michael M. Stanciu, Search Corporation, "A personal view on the road transportation infrastructure programme for Romania" presentation.

CHART 14: Employment by mode of transport in Romania



Source: Transport Statistical Pocketbook 2013

Analyses of road transport companies by their turnover lead to the following conclusions:

- a quarter of companies that have filed statements for 2012 have not carried out any activities
- half of the active companies registered a turnover of less than EUR 100,000/year (2013), but the share of value accounted for by this segment is only 7% of total turnover

- only 1010 companies in this sector recorded an annual turnover exceeding EUR 1 million; they represented 4% of total active companies, but generated about 64% of the revenues recorded in the entire sector.

As indicated above, the road transport of goods accounts for the largest share of the entire sector. These companies play the most important economic and social role in the sector. They generate 63% of the turnover recorded in the entire sector and 67% of the total value of assets and liabilities.

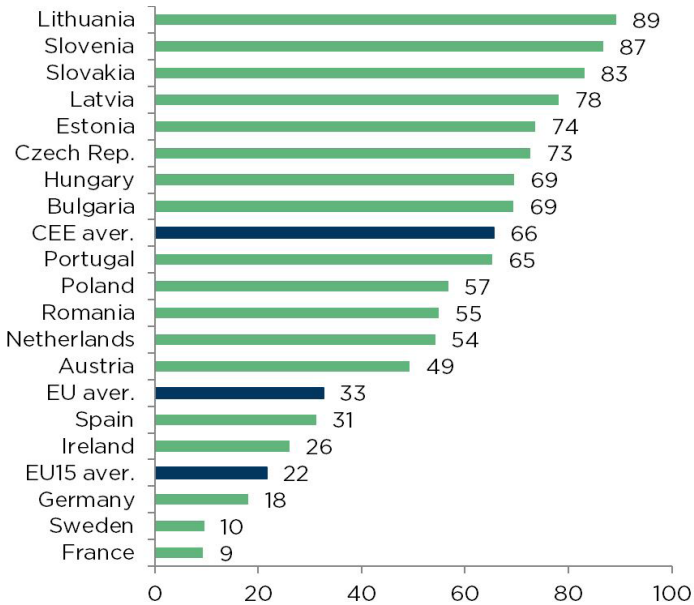
After analysing the profit and loss accounts as well as the balance sheets of companies operating in the road transport sector, it can be concluded that only 4 out of 10 companies recorded a contraction of turnover in 2013. The remaining companies recorded a growth in revenues. Within that group, 35% of all companies active in the sector recorded growth of over 25% in turnover. Despite that, net profit has evolved much more weakly, both in terms of absolute values and its dynamics.

CHART 15: Companies in the road transport sector by turnover (2013)

| Turnover range (EUR millions) | Number of companies | Share (companies) | Total turnover (EUR) | Share (turnover) | Average turnover (EUR) |
|-------------------------------|---------------------|-------------------|----------------------|------------------|------------------------|
| 0 - no activity | 6,654 | 24% | - | - | - |
| 0-0.1 | 13,767 | 51% | 435,748,440 | 7% | 31,652 |
| 0.1-0.5 | 4,901 | 18% | 1,079,895,929 | 18% | 220,342 |
| 0.5-1.0 | 920 | 3% | 642,706,072 | 11% | 698,594 |
| 1 - 5 | 855 | 3% | 1,730,676,119 | 29% | 2,024,183 |
| 5 - 10 | 86 | 0% | 578,606,009 | 10% | 6,727,977 |
| 10 - 50 | 64 | 0% | 1,184,506,286 | 20% | 18,507,911 |
| 50-100 | 4 | 0% | 229,616,572 | 4% | 57,404,143 |
| above 100 | 1 | 0% | 127,832,951 | 2% | 127,832,951 |
| Total | 27,252 | 100% | 6,009,588,378 | 100% | 220,519 |

Source: Ministry of Finance of Romania, data processed by Coface Romania

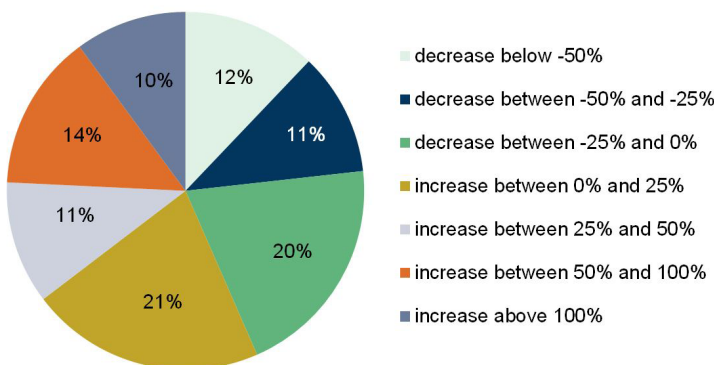
CHART 16: International haulage as a percentage of total haulage (% , 2011)



Source: Transport Statistical Pocketbook 2013

Nearly half of the companies recorded a net loss at the end of 2013 and for half of those the loss was greater than 20%. On the other hand, only 10% of companies had profit increases of 20% or more. Since the net profit recorded in the entire sector was 1.2%, it can be concluded that large losses were recorded by companies with below-average sizes.

CHART 17: Road transport companies: distribution of turnover (2013)



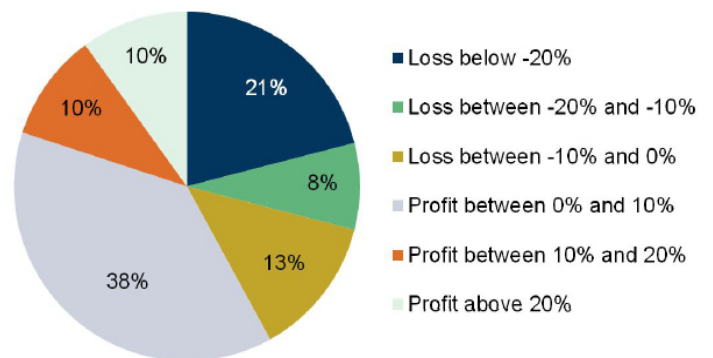
Source: Coface Romania

Road transport companies performed in line with the entire transportation and storage sector, which recorded also a net profit of 1.2%. There were a number of sectors that were less profitable, with a net profit

margin of -4.3% in accommodation and food service activities -3.4% in construction and -1.4% in chemicals. Nevertheless, most of the sectors in the Romanian economy were able to become more profitable - this was the case for wholesale and retail trade (net profit of 1.3%) as well as IT (8.5%). On the other hand, companies were often exposed to a long waiting periods for their receivables which impacted their overall financial performance in many cases.

The construction sector, for example, was still suffering from this situation, as the Days of Sales Outstanding (DSO) indicator was 215 days. The DSO represents the average number of days that a company takes to collect revenue after a sale has been made. Even worse rotation was experienced in the real estate activities with a DSO of 333 days. Against this backdrop, the transportation and storage sector performed somewhat better with a DSO of 94 days.

CHART 18: Road transport companies: net profit distribution (2013)



Source: Coface Romania

In the road transport of goods sector, the market is characterized by:

- a large number of mostly independent companies, each one with a reduced capacity to influence or control the market
- a large number of buyers
- reduced barriers to entry into or exit from the market
- reduced barriers for buyers who can find substitute services relatively easily.

CHART 19: Profitability of particular sectors in Romania (2013)

| Sector | DSO | Debt Level | Net Result Margin |
|---|-----|------------|-------------------|
| Wholesale and retail trade | 91 | 77% | 1.3% |
| Construction | 215 | 86% | -3.4% |
| Manufacture of wood and wood products | 92 | 66% | 2.6% |
| Manufacture of non-metallic mineral products | 102 | 73% | 1.2% |
| Chemical substances and products manufacturing | 83 | 66% | -1.4% |
| Accommodation and food service activities | 82 | 77% | -4.3% |
| Food and beverages | 102 | 70% | 0.8% |
| Metalurgy | 101 | 65% | -2.5% |
| Financial and Insurance Activities | 291 | 66% | 6.2% |
| IT | 127 | 42% | 8.5% |
| Electricity, gas, steam and air conditioning supply | 141 | 43% | 5.4% |
| Health and social care | 104 | 39% | 7.2% |
| Transportation and storage | 122 | 61% | 1.2% |
| Real estate activities | 333 | 76% | -12.4% |

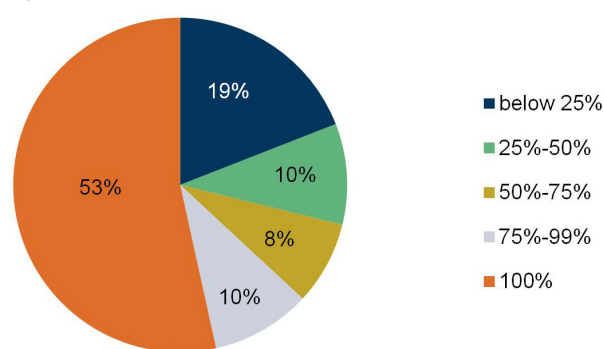
Source: Coface Romania

Companies operating in the sector face significant competition, and long-term investments are necessary to expand business and make it competitive. Companies analysed during 2013 allocated significant investments to expand their fixed assets. Thus, eliminating the impact impairments, the CAPEX share of total assets was 26% for 2013, however only 5 out of 100 companies having doubled the value of their assets.

Given the pace of annual amortization of 22% recorded during 2013, it is possible that fixed assets and the long-term investment horizon will be extended. The share of corporate fixed assets in total assets decreased slightly to 45% in 2013 compared to the level of 49% recorded in the previous year.

The sector has a high share of indebted companies. 5 out of 10 companies exhibit a negative capitalization rate (an equivalent of debt above 100%). These are predominantly small or below-average size companies.

CHART 20: Road transport companies: share of short term debt in total debt (2013)



Source: Coface Romania

Moreover, funding resources are focused mainly on the short term, with 53% of companies fully exposed to short-term debt and in case of 18% of companies it represents more than half of total liabilities. In such circumstances, companies recorded an extension of payment terms at average due to the deterioration of working capital and the cash conversion cycle transi-

tion to negative values. This confirms that payments of liabilities are extended and probable necessity of using external funding. In the long term this results in companies experiencing payment difficulties and leads to decreased credibility.

Outlook and risks

The year 2014 offers better prospects for the most significant trading partners of Romania. The eurozone recovery will help exports to grow, while stable internal demand will support imports. This situation will create higher demand for transport services, with companies recording an increase in their turnover. As already discussed above, the road transport sector in Romania has a very low level of concentration. The combined market share of the leading 10 players is just 10%.

The improved demand for transport services will not translate directly into an increase of net profits of all companies operating in the sector. The intense competition can result in prices being pushed down and the acceptance of lower margins amid stable fixed costs. Moreover, the transport sector requires regular investments, especially in vehicle fleets in the case of road goods transport. This is determined not only by the age of the fleet but also imposed by regularly increased European emission standards, with the current Euro VI standard required for new heavy duty vehicle registrations as of 1 January 2014.

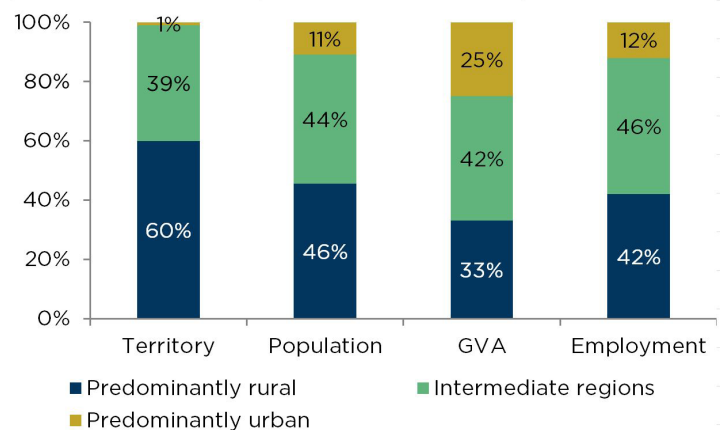
One of the European Commission's recent recommendations concerned the low general economic competitiveness of Romania. The main challenges include its underdeveloped transport and information and communication technology (ICT) infrastructure. It was also concerned about the rail transport sector, with the length of its network considered to be excessive with respect to the volume of traffic and the capacity to finance it, as well as private railway companies perceiving discrimination. Moreover, poor maintenance of the railway network has affected safety and reliability. In the case of road transport, it has been noted that a high rate of growth of the vehicle fleet and the low quality of the road infrastructure are hampering business and the economy. Last but not least, freight transport on inland waterways remains far below its potential, particularly on the Danube.³

³ European Commission Council recommendation on Romania's 2014 national reform programme and delivering a Council opinion on Romania's 2014 convergence program.

Agriculture sector: generating a significant but volatile impact

In Romania, the agricultural sector represents a basic branch of the national economy which has significant economic and social importance and implications. Agriculture, hunting and fishing created 6.4% of the total gross value added in 2013. With an agricultural area of nearly 16 million hectares, Romania could be (after Poland with 17 million hectares of agricultural area) the second largest producer of agricultural products in the CEE region. At the same time, 66% of Romanian territory is taken up by agriculture, with 46% of the population living in predominantly rural regions.

CHART 21: Importance of Regions in Romania



Source: European Commission, Directorate General for Agriculture and Rural Development, 2013 Rural Development Report

Agricultural production registered a 25% increase during 2013, according to the data published by Eurostat. A significant part of agricultural production is based on self-managed activities (with no purpose to earn money), and the agricultural sector is affected by low productivity, with the results highly dependent on the weather conditions. Agriculture generates approximately 6% of GDP, and the results of this sector can have a significant influence on overall GDP, generating a high level of volatility with a poor and unpredictable level of sustainability.

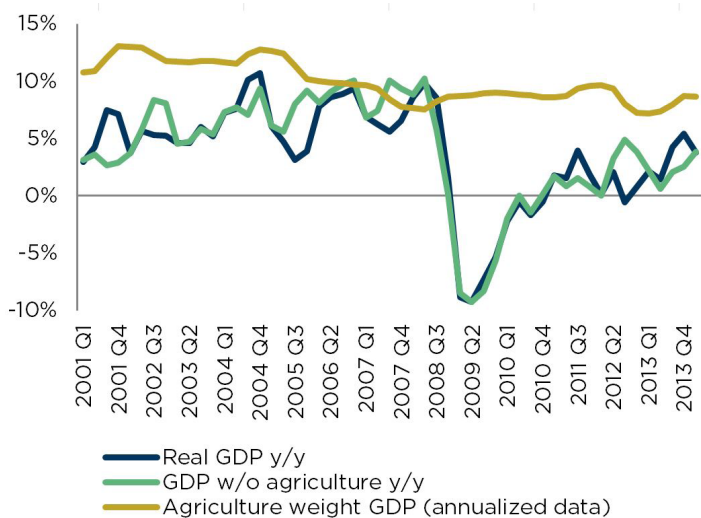
Having removed the positive impact of agriculture in GDP as shown in chart 22, the following conclusions can be made:

- The actual increase registered in 2012 would have been 2.9% compared to the 0.6% actually registered, whereby agriculture had a negative impact on

GDP (-2pp).

- The actual economic growth in 2013 compared to the previous year would have been only 1.7% compared to 3.5%.
- Thus, two consecutive years (2012 and 2013) registered extremely different growth figures (0.6% and 3.5%), but this looks completely different (with 2012 better than 2013) if the effect of agriculture is adjusted (2.9% adjusted increase in 2012, compared to 1.7% adjusted increase in 2013).

CHART 22: Agriculture in GDP



Source: National Institute of Statistics

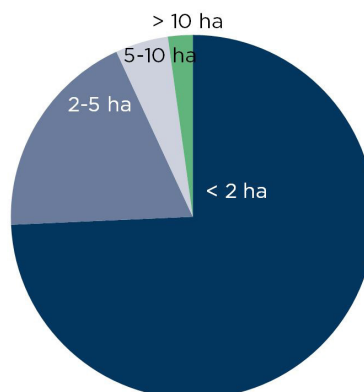
There are nearly 3.9 million agricultural holdings in Romania. Small farms with below 2 hectares of utilized agricultural area (UAA) constitute the majority of them (74% of the total). As such, their production capacities remain low with most holding up to 5 livestock units⁴ and their economic size⁵ not exceeding EUR 2,000. Similarly to worldwide trends, the Romanian agricultural sector is attracting fewer young people than it did in the past.

Persons below 35 years constituted just 7% of the total number of holders, i.e. 30% less than in 2003. Among various methods, one of the easiest ones to evaluate wages in agriculture is the level of income that the sector generates.

⁴ Livestock unit (LSU) is an equivalent to a dairy cow. The number of animals (heads) is converted into LSU using a set of coefficients reflecting the feed requirements of the different animal categories.

⁵ For each activity on a farm, a standard gross margin is estimated, based on the area (or the number of heads) and a regional coefficient. The sum of all margins, for all activities of a given farm, is its economic size, expressed in EUR.

CHART 23: Structure of agricultural holdings (by UAA)

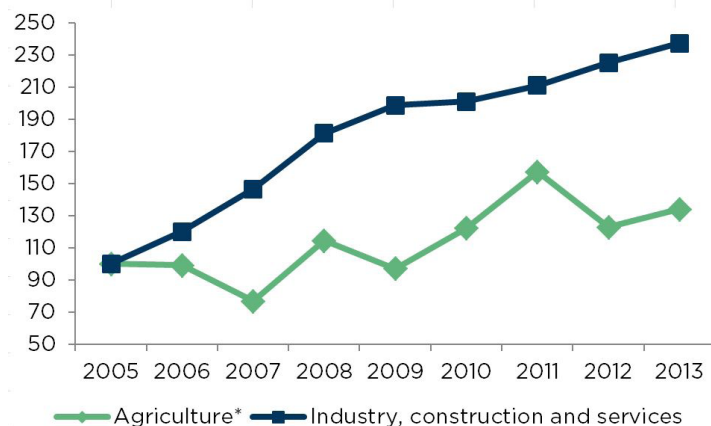


Source: Agricultural Census 2010, Eurostat

Unlike the main sectors of business, it has not experienced positive trends but has fluctuated depending on better or worse weather conditions experienced over the last few years. Nevertheless, it has been below the average growth of other sectors.

CHART 24: Evolution of agricultural income compared to wages and salaries in other sectors of the economy (2005=100)

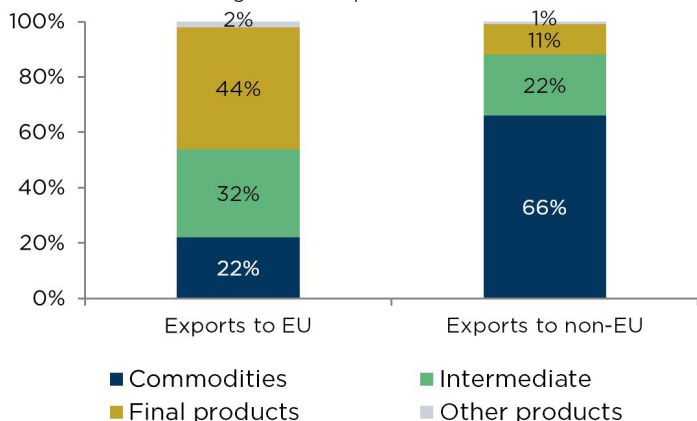
* calculated as indicator A: index of the real income of factors in agriculture per annual work unit



Source: Eurostat, Coface calculations

In 2013 the output of agricultural goods in Romania amounted to EUR 17 billion, accounting for nearly 5% of the EU-28's agricultural output. The crop output (¾ of the share) included mostly maize, forage plants, vegetables and horticultural products, wheat and spelt as well as potatoes. The animal output (¼ of the share) included mostly milk, pigs, eggs and poultry. The total output of the agricultural sector was 29% higher than in 2012 as compared to a decrease of 20% in 2012/2011.

CHART 25: Structure of agricultural exports

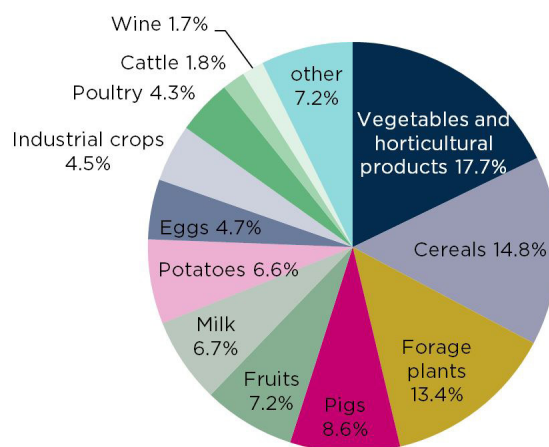


Source: Directorate General for Agriculture and Rural Development, based on COMEXT data

However, completely different weather conditions in 2012 and 2013 mainly caused such great volatility. The significant share of the agricultural sector in the Romanian economy also results in its products being exported worldwide. The total external trade in agricultural products amounted to EUR 4.1 billion, i.e. more than 9% of total Romanian exports. EU countries are the main receivers of those exports; however, trade with non-EU countries is becoming more and more significant in the exports portfolio. The latter increased by 11% year-on-year in 2012, rising to 30% of all agricultural exports. In the same period, EU trade decreased

by 3%. The foreign demand for particular agricultural products depends on the trading partner.

CHART 26: Components of agricultural output (2009-2013 average)



Source: Eurostat, Economic Accounts for Agriculture (values at constant producer prices)

Whereas exports to EU countries are dominated by final products, non-EU countries prefer to be supplied with commodities. However, thanks to this situation, total external trade is well balanced, with similar shares of commodities, intermediate and final products.

CHART 27: Agricultural output

| | 2011 | 2012 | 2013 | 2012/2011 | 2013/2012 |
|------------------------|-------------|--------|--------|-----------|-----------|
| | EUR million | | | % change | |
| Output of agriculture: | 18,048 | 14,410 | 18,527 | -20.2 | 28.6 |
| Crop output | 12,781 | 9,008 | 12,596 | -29.5 | 39.8 |
| Animal output: | 3,889 | 3,992 | 4,360 | 2.7 | 9.2 |
| Animals | 1,719 | 1,751 | 2,049 | 1.9 | 17.0 |
| Animal products | 2,169 | 2,241 | 2,310 | 3.3 | 3.1 |
| Agricultural services | 128 | 120 | n/a | -6.6 | n/a |
| Secondary activities | 1,249 | 1,289 | 1,430 | 3.2 | 10.9 |

Source: EC Romania Factsheet, Eurostat, Economic Accounts for Agriculture (values at current basic prices)

Outlook and risks

The share of agriculture in Eastern European economies is higher than in the remainder of the European Union. The countries benefit from resources aimed at making the agricultural sector more efficient; however, measures have also been introduced to encourage an increase in employment in sectors which generate more productivity. Nevertheless, agriculture will remain a significant contributor towards Romanian economic performance.

Thanks to its location and relatively large size among European countries, Romania has been able to become a grain exporter competing with its neighbours on the Black Sea. According to the International Grains Council (IGC), Romania's total grain production in 2014 will be 17.2 million tonnes, down from 19.6 million the year before. The figure includes 6.8 million tonnes of wheat, down from 7.2 million, and 8.6 million tonnes of maize, down from 10.4 million. The forecast barley production is 1.2 million tonnes, down from 1.4 million. On the other hand, according to reports by the grain trader Toepfer, Romania's wheat crop will rise by 12% y/y to 8.3 million tonnes in 2014 - the highest level in 27 years. It is also anticipated that Romania will export some 4 million tonnes of wheat from this year's crop. The country would thus become the third largest wheat exporter in the EU and the 11th largest global wheat exporter. In terms of production, Romania will rank third in the EU. However, local farmers have often

complained that overoptimistic estimates by Toepfer in the past were aimed at pushing the prices down. Farmers are more willing to provide their assessments when at least 25% of the crop has been harvested.

On the external side, Romania can benefit from the turmoil in Ukraine. The recent turbulence has created an opportunity for Romania to become a major player on the grains market in the Black Sea Basin. Russia and Ukraine remain significant producers of grain there, respectively producing four and three times more than Romania. Nevertheless, their production is forecasted to decrease this year - in the case of Russia by 4% and in the case of Ukraine by as much as 10%. Facing stable worldwide demand, Romania will be able to address its production capacities and influence export prices.

Nevertheless, the Russia-Ukraine crisis generates more threats than opportunities. CEE economies have sizeable trade relations with those countries, but also they are dependent on Russian gas. In the case of Romania that dependence is not very high - it imports 24% of its total supplies from Russia, whereas 76% is obtained from its own domestic production. Bulgaria and Hungary are much more dependent on supplies from Russia - their imports exceed 80% of total supplies, while the Baltics are wholly dependent on Russian gas. Moreover, military actions and fighting in neighbouring Ukraine diminish consumer and business confidence.

Sector Barometer

Textile and clothing

The textile and clothing sector in Romania exhibits very high risks.

Textile companies are competing more intensely and looking for locations with more attractive production costs. This includes labour costs, which are offered at peerless levels by Asian textile manufacturers. This can be confirmed in many countries of the Eastern European region, but Romanian companies seem to be suffering especially. The insolvency rate in the sector was 15% in 2013, making textile and clothing the riskiest sector in the whole economy.

In 2013, Romania's textile, garment and footwear exports stood at EUR 5.093 billion, i.e. 7% less than in 2004. In the same period, the share of total exports accounted for by textiles fell to 10% from nearly one-third. The European Union is Romania's main partner in the textile and clothing trade. It absorbs 93% of Romanian products, with the largest quantities going to Italy, Germany, France and the UK. Romanian textile companies have benefited from some relocation of production within Europe, but the majority of them are stuck in the subcontractor trap, whereas plenty of companies in other CEE countries (notably in Lithuania and Slovenia) have shifted to become co-producers.

Construction

The construction sector in Romania faces high risks.

The construction sector continues to be in a poor state in the CEE region and is still ranked as a negative performer. However, some stabilization can be expected as a result of the inflow of EU funds from the new Multiannual Financial Framework for 2014-2020 from which CEE countries are due to receive more than EUR 300 billion, including an allocation of EUR 31 billion for Romania. The new framework will trigger infrastructure projects; however, due to procedural issues it will be seen in companies' results in 2015 at the earliest.

In 2013, as many as 133 Romanian construction companies out of 1,000 active entities declared insolvency. This represents more than 14% of all insolvencies in Romania in 2013, whereas the construction sector only accounted for 8% of the country's total GDP. The current outlook is not favourable – construction in Romania is in negative territory with some upturns mostly

in summer periods. In other Eastern Europe countries and the European Union in general, it seems to have started to rebound, fuelled by a warm winter and a statistical base effect.

| Sectors | Risk level | Sectors | Risk level |
|----------------------|------------|------------|------------|
| Mechanicals | ● | Agrofood | ● |
| Construction | ● | Chemicals | ● |
| Metals | ● | Wood Paper | ● |
| Transport | ● | Energy | ● |
| Pharmaceuticals | ● | Retail | ● |
| Textile and clothing | ● | Services | ● |

● Moderate risk ● Medium risk ● High risk ● Very high risk

Retail

The retail sector in Romania presents a medium level of risk.

As indicated in the macroeconomic part of this Panorama, retail sales are growing, supported by a stable unemployment rate. Households feel more confident about the economic recovery; however, their purchasing decisions are still influenced by the experience of the economic downturn, which was severe and affected many customers. As such, retailers found the market extremely difficult and many went out of business. This also concerned global chains such as the French retail Group Bresson with its 15 Bricostore shops acquired by Kingfisher, or Debenhams closing its 6 stores. Local entities, especially small ones, have experienced even worse conditions and were often forced into consolidation processes in order to survive on the market.

The current perspectives have improved to some extent, although the now careful shopping habits of Romanians will continue to affect the sector. The demand for low-priced products will continue to be high, but an increasing consumption of non-grocery products will be also observed in line with rising consumer confidence. Online shopping is becoming a more important part of the retail sector, as Romanian consumers are not only pleased to save time, but also to take advantage of lower costs. In the case of traditional shopping, the dominance of multinational retailers will remain, with their attempts to explore channels where they have not been present so far and where competition is not so fierce.



Conclusions

In 2013 the real GDP growth of the Romanian economy exceeded expectations – it increased by 3.5% y/y in 2013, with the strongest rise of 5.1% y/y in the last quarter. Although internal demand shows some signs of improvement it is still sluggish, mostly due to the ongoing deleveraging process. As such, the main contributor towards last year's growth came from the external side, which recorded a strong increase in exports (by 13.5%).

This intense growth in exports was the result of good weather conditions and the ability to generate a significant supply of produce thanks to a strong harvest. Alongside crop exports, car production was also a significant contributor to Romanian external trade. As a country offering some of the lowest labour costs in the EU, it was chosen by OEMs to locate their factories there: mainly Ford, but also Renault which provided a 'second life' for the Romanian Dacia brand. Better prospects for the international automotive sector along with free production capacity in Romania generated a strong contribution towards the country's value added.

Romania benefited from increases in agricultural production more than other countries of the CEE region, as its share in the total economy is the highest among the countries of the region. Nevertheless, the positive contribution of agriculture cannot be viewed as a permanent factor of the country's output. Moreover, as shown in our sector barometer, the agrofood sector presents a medium level of risk with many small entities

fighting for profits under pressure from fixed costs.

The transport sector offers more positive prospects given an increase in demand for such services, mainly thanks to the recovery of the eurozone, the main trading partner of Romania. The country focuses on trading with the European Union, which takes 70% of its exports. The majority of that is transported by roads. Nevertheless, our analysis confirmed that competition in the sector remains strong and companies have to invest in fixed assets to generate a competitive advantage. As much as 50% of companies have a negative capitalization rate, i.e. the equivalent of a debt level over 100%.

The Romanian economy will not repeat the pace of the growth recorded last year. The recently published figures of the GDP growth in the second quarter of this year proved a contraction even deeper than expected. Coface forecasts that real GDP growth will be 2.5% in 2014, compared to 3.5% in 2013. Expectations for agricultural output in 2014 are mixed, but the most realistic scenario seems to be that the harvest will be lower than in 2013. Exports will be still driven by the sustainability of demand for new cars, which makes a strong contribution to the outcome of Romanian industry. Internal demand will also show signs of improvement, with rising household expenditure, which, however, is still constrained by the sluggish growth in credit. The growth of fixed asset investments will not rebound in line with private consumption, as companies are still not fully convinced about the sustainability of the economic recovery.

Coface Contacts in CEE

Coface Austria & Coface Central Europe

Stubenring 24 - 1010 Vienna
T. +43 (1) 515 54-0 - F. +43 (1) 512 44 15
www.coface.at

Coface Albania

serviced by Coface Croatia

Avenija Dubrovnik 46/III - 10 000 Zagreb
T. +385 (1) 469 75 00 - F. +385 (1) 469 75 35
www.coface.hr

Coface Belarus

serviced by Coface Russia

1st Tverskaya-Yamskaya str., 23, bld. 1 - 125047 Moscow
T. +7 (495) 785 57 10 - F. +7 (495) 785 76 24
www.coface.ru

Coface Bosnia & Herzegovina

serviced by Coface Croatia

Avenija Dubrovnik 46/III - 10 000 Zagreb
T. +385 (1) 469 75 00 - F. +385 (1) 469 75 35
www.coface.hr

Coface Bulgaria

42 Petar Parchevich str. - 1000 Sofia
T. +359 (2) 920 7125 - F. +359 (2) 9207150
www.coface.bg

Coface Croatia

Avenija Dubrovnik 46/III - 10 000 Zagreb
T. +385 (1) 469 75 00 - F. +385 (1) 469 75 35
www.coface.hr

Coface Czech

I.P. Pavlova 5 - 120 00 Prague
T. +420 246 85 411- F. +420 246 085 429
www.coface.cz

Coface Estonia

serviced by Coface Latvia

Berzaunes 11a - 1039 Riga
T. +371 (6) 732 34 60 - F. +371 (6) 782 03 80
www.coface.lv

Coface Hungary

Tüzoltó utca 57 - 1094 Budapest
T. +36 (1) 299 20 70 - F. +36 (1) 887 03 25
www.coface.hu

Coface Latvia

Berzaunes 11a - 1039 Riga
T. +371 (6) 732 34 60 - F. +371 (6) 782 03 80
www.coface.lv

Coface Lithuania

Vilnius str. 23 - 01402 Vilnius
T. +370 (5) 279 17 27 - F. +370 (5) 279 17 54
www.coface.lt

Coface Macedonia

serviced by Coface Croatia

Avenija Dubrovnik 46/III - 10 000 Zagreb
T. +385 (1) 469 75 00 - F. +385 (1) 469 75 35
www.coface.hr

Coface Moldova

serviced by Coface Romania

Calea Floreasca 39 - Et. 2-4 - Sector 1 - 014453 Bucharest
T. +40 (21) 231 60 20 - F. +40 (21) 231 60 22
www.coface.ro

Coface Montenegro

serviced by Coface Serbia

Bulevar Oslobođenja 111 - 11000 Belgrade
T. +381 (11) 397 60 51 - F. +381 (11) 397 09 75
www.coface.rs

Coface Poland

Al. Jerozolimskie 136 - 02 305 Warsaw
T. +48 (22) 465 00 00 - F. +48 (22) 465 00 55
www.coface.pl

Coface Romania

Calea Floreasca 39 - Et. 2-3 - Sector 1 - 014453 Bucharest
T. +40 (21) 231 60 20 - F. +40 (21) 231 60 22
www.coface.ro

Coface Serbia

Bulevar Oslobođenja 111 - 11000 Belgrade
T. +381 (11) 397 60 51 - F. +381 (11) 397 09 75
www.coface.rs

Coface Slovakia

Soltésovej 14 - 81108 Bratislava
T. +421 (2) 6720 1611 - F. +421 (2) 6241 0359
www.coface.sk

Coface Slovenia

Slovenceva 22 - 1000 Ljubljana
T. +386 (1) 425 90 65 - F. +386 (1) 425 91 30
www.coface.si

Coface Ukraine

Borisa Gmiri str., 4, of. 10 - 02140 Kiev
T. +380 (44) 585 31 60 - F. +380 (44) 585 31 60
www.coface.ua