

BULGARIAN NATIONAL BANK

ANNUAL REPORT • 1995



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**Honorable Mr. Chairman
of the National Assembly!
Honorable members of Parliament!**

In accordance with the provisions of the Law on the Bulgarian National Bank, Article 1, paragraph 2, the Bulgarian National Bank reports its activities before the National Assembly. Pursuant to Article 54 of this Law, I have the honor to submit the 1995 annual report of the Bulgarian National Bank.

A handwritten signature in black ink, appearing to read 'Lyubomir Filipov', with a stylized, cursive script.

**Lyubomir Filipov
Governor of the Bulgarian
National Bank**

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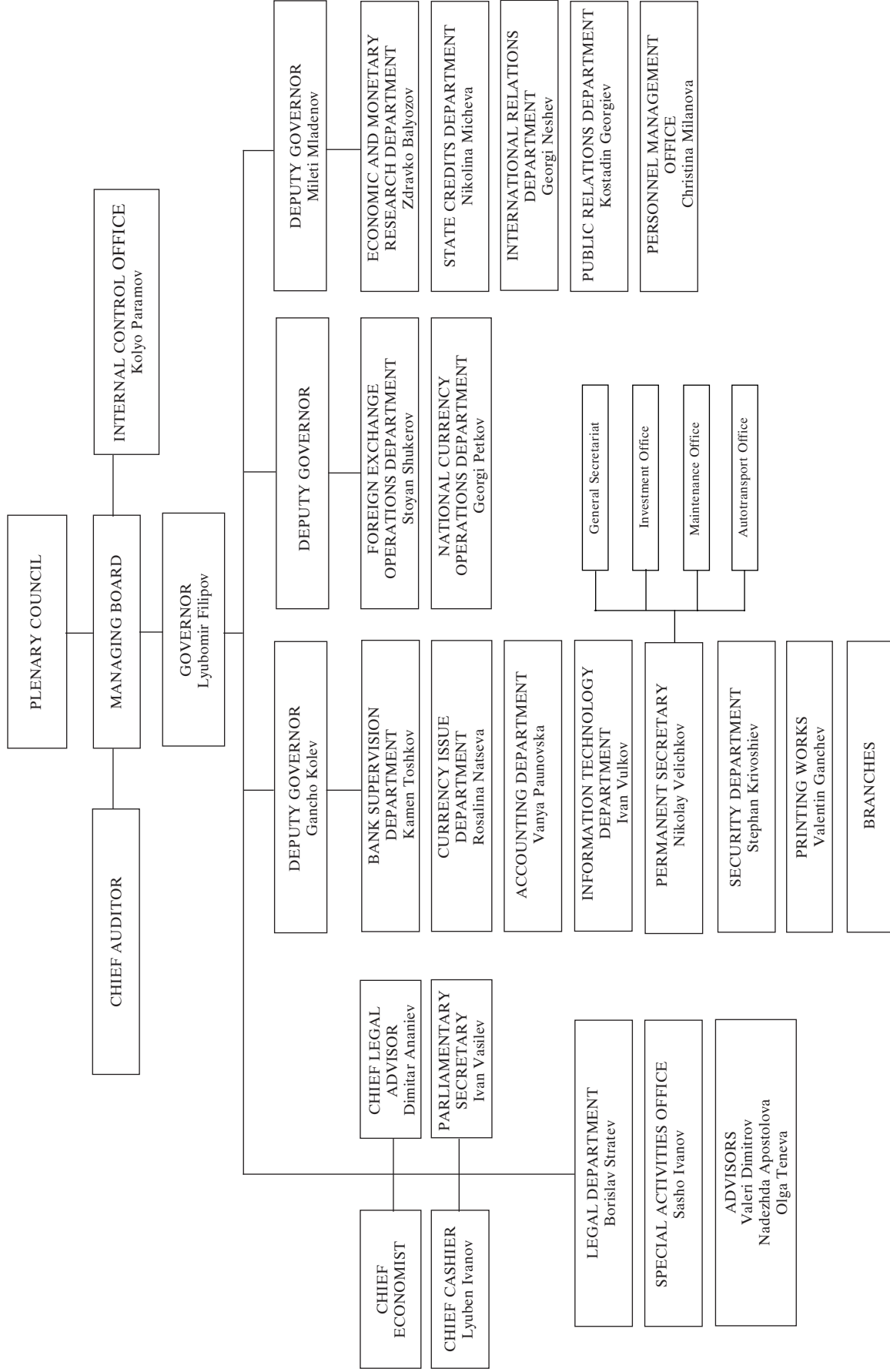
Kamen Toshkov
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Stoyan Shukerov
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¹ Prof. Todor Vulchev was a Governor of the BNB and a member of the Plenary Council and the Managing Board until 24 January 1996.

² Lyubomir Filipov has been a Governor of the BNB since 24 January 1996.

Organizational Structure of the BNB

(as of 1 April 1996)



Contents

I.	Major Trends in the Development of the World Economy	
1.	Developed Countries _____	11
2.	Countries in Transition to a Market Economy _____	13
3.	Developing Countries _____	15
II.	General Characteristics of the Economy	
1.	Gross Domestic Product _____	19
2.	Employment _____	22
3.	Income and Expenditure of Households _____	25
4.	Prices _____	28
5.	Foreign Trade _____	33
6.	Balance of Payments _____	38
7.	Foreign Debt _____	40
III.	Fiscal Policy	
1.	Consolidated State Budget _____	45
2.	Budget Deficit _____	46
3.	Budget Deficit Financing _____	47
4.	Domestic Government Debt _____	49
IV.	Monetary Policy	
1.	Money Supply _____	55
2.	Reserve Money and Money Multiplier _____	57
3.	Domestic Credit _____	60
4.	Monetary Instruments and the Money Market _____	62
5.	Interest Rates on Commercial Bank Operations _____	67
6.	Issuing Activities _____	70
7.	Foreign Exchange Policy _____	73
V.	Bank Supervision	
1.	Licenses _____	84
2.	Off-site Inspection _____	84
3.	On-site Inspection _____	85
4.	State of the Banking System _____	86
VI.	Financial Results of BNB Activities _____	99
VII.	Development of the Banking and Settlement System	
1.	Development of the Settlement System _____	107
2.	Legal Regulation of Bank Activities _____	108
3.	Relations with International Financial Institutions _____	109
4.	Personnel and Qualification _____	110
VIII.	Major Trends in Monetary Policy in 1996 and 1997 _____	111
	Appendix _____	119

Abbreviations

BGL (Lev)	<i>National Currency of the Republic of Bulgaria</i>
BISERA	<i>Banking Integrated System for Electronic Transfer</i>
BNB	<i>Bulgarian National Bank</i>
CGB	<i>Central Government Budget</i>
CIS	<i>Commonwealth of Independent States</i>
CM	<i>Council of Ministers</i>
COMECON	<i>Council for Mutual Economic Assistance</i>
EBRD	<i>European Bank for Reconstruction and Development</i>
ECU	<i>European Currency Unit</i>
EFTA	<i>European Free Trade Association</i>
EIB	<i>European Investment Bank</i>
EU	<i>European Union</i>
GDP	<i>Gross Domestic Product</i>
IMF	<i>International Monetary Fund</i>
LBCA	<i>Law on Banks and Credit Activity</i>
LGB	<i>Long-term Government Bonds</i>
LSNC	<i>Law on Settlement of Nonperforming Credits Negotiated prior to 31 December 1990</i>
MF	<i>Ministry of Finance</i>
NSI	<i>National Statistical Institute</i>
OECD	<i>Organization for Economic Cooperation and Development</i>
SBL	<i>State Budget Law</i>
SDR	<i>Special Drawing Right</i>
SII	<i>State Insurance Institute</i>
SSB	<i>State Savings Bank</i>
STF	<i>Systemic Transformation Facility</i>
TIRFC	<i>Tariff for the Interest Rates, Fees and Commissions Charged by the BNB and Applied to its Domestic Operations</i>

I. Major Trends in the Development of the World Economy

Favorable trends developing in the world economy since 1994 were sustained in 1995. According to estimates of the World Bank and the IMF, *world output* continued to increase at the same growth rate as in the previous year – 2.8%. This growth rate is only 10 basis points below the average in 1981 – 1990 and twice higher than the average in 1990 – 1993. It is indicative of the complete emergence of the world economy from the recession of the 90s and its return to a long-run trend of growth. *World trade*, measured in real growth in global exports, once again posted an unusually high growth rate of 9.1%. This rate is only 10 basis points less than in the previous year and twice higher than the average in 1981 – 1990.

In 1995, all *developed countries*, with the exception of Japan, witnessed positive economic growth, combined with a slightly lower and moderate GDP growth rate, relatively low inflation, low nominal and real interest rates, and balanced exchange rates of major international currencies based on fundamental, rate-forming factors. The major economic problems of this group of countries are related to persistently high unemployment and the ongoing process of fiscal consolidation. Most of the *former socialist countries in transition to a market economy*, with the exceptions of Russia and certain other former Soviet republics, returned to positive economic growth. This followed the deep structural crisis they experienced in the early 90s. In addition, these countries largely succeeded in curbing inflation and bringing down interest rate levels and to a lesser extent unemployment. Nevertheless, these countries are still facing challenges, particularly chronic deficits in their state budget and current accounts. In 1995, *developing countries* marked further real economic growth, sustaining the relatively stable levels of the past few years.

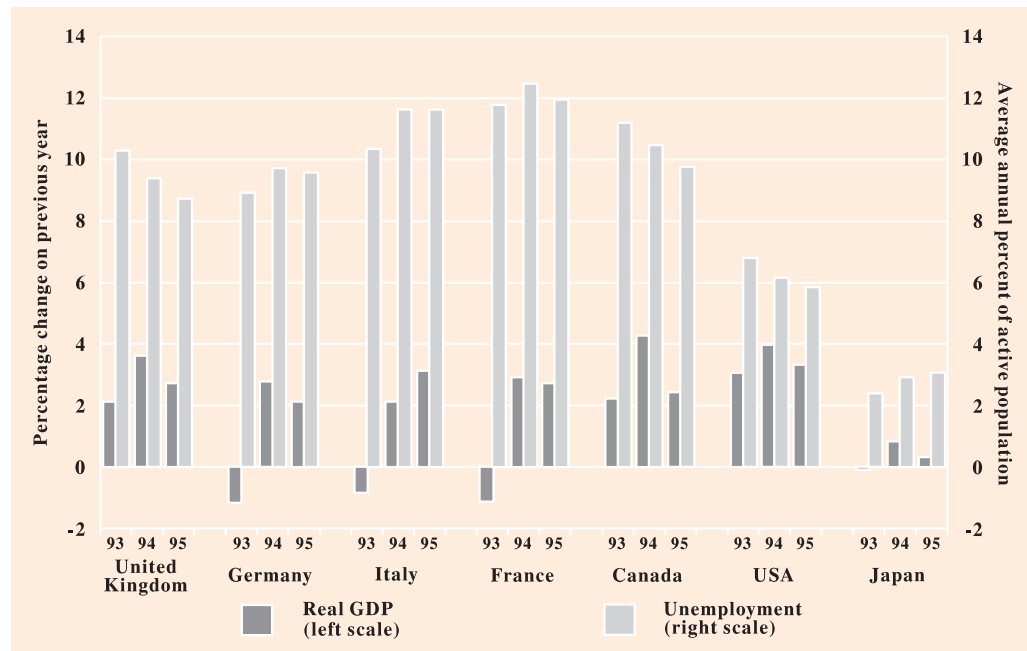
Based on forecasts of the World Bank, IMF, OECD and other major international institutions, world output and trade are expected to grow further in 1996 by some 3% and 7.6% respectively. A favorable external environment in 1995 – 1996 provides new opportunities to boost exports and output and strengthen the real growth of the Bulgarian economy.

1. Developed Countries

Following a fast recovery in the economies of most developed countries in 1994, a slowdown in the economic growth rate of these countries occurred in 1995. Nevertheless, growth rates remained at relatively high rates ranging between 2 – 3% as output neared production potential. Moreover, the growth rates of these countries are likely to accelerate slightly, but this is unlikely to cause an upward revision of inflationary expectations. The basic interest rate level continued to fall with the effect of spurring growth; almost all countries, availing the favorable market conditions, undertook medium- and long-term measures for fiscal consolidation which in turn contributed to lower interest rates. The labor market, especially in Europe, however, reacted rather slowly to the positive macroeconomic developments. Even the possible acceleration in economic growth is unlikely to cause serious reduction in the relatively high unemployment rate (over 10%).

REAL GDP AND UNEMPLOYMENT IN MAJOR DEVELOPED COUNTRIES*

(%)

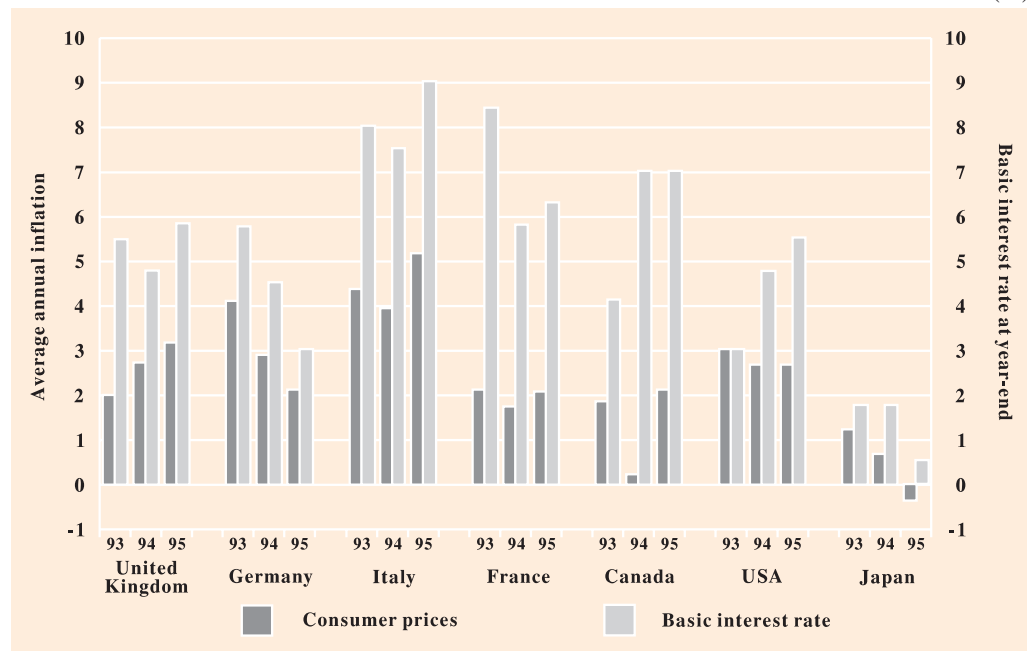


* Data for 1995 is based on preliminary estimates.

Source: OECD, IMF.

INFLATION AND BASIC INTEREST RATE IN MAJOR DEVELOPED COUNTRIES*

(%)



* Data for 1995 is based on preliminary estimates. The money market interest rate is used for the United Kingdom.

Source: OECD, IMF.

Western Europe

Despite the slowdown in economic growth in western Europe, most economies in the region operated near normal production capacities. Inflation remained at very low levels – 2.5% on average. Interest rate levels were also low thus stimulating investment and growth. The most serious problem in the region is persistently high unemployment. With respect to the expected convergence to the Maastricht fiscal

criteria, some western European countries will face the challenge to fight moderately high budget deficits.

In 1995, the most significant slowdown in output growth, by 2.7% or more than one percentage point, a relatively high rate for western countries, occurred in the *United Kingdom*, the first country in western Europe to emerge from recession. This is a result of the slow growth in exports reflecting a global slowdown in economic activity and restrictive monetary and fiscal policies. No significant changes are expected to occur in the macroeconomic indicators of the country in 1996. *Germany* reported a slight decrease (of 20 basis points) in the real GDP growth in 1995 – 2.1% with projections of 2.8%. The slowdown is attributable to reduced investment consistent with high wages and a sharp devaluation of the Deutschemmark at the beginning of 1995. Unemployment fell slightly. Further subdued inflation allowed for a slight easing of the monetary policy which caused a drop in the basic interest rates. Economic growth is projected to accelerate somewhat in 1996. *France* also witnessed a slowdown in economic growth rates. In 1995, unemployment in the country decreased slightly. Interest rates, however, rose. The most significant rise was effected in short-term rates which depressed consumer demand and investments. The budget deficit causes concern, given the generous social security system. *Italy* alone of the four strongest economies in Europe, did not experience a slowdown in GDP growth. Rather, the country registered an acceleration of GDP growth of one percentage point to 3.1%, attributable mainly to increased investment and exports. At the same time, inflation also accelerated while unemployment remained far above the country's estimates for the natural rate of unemployment.

USA

The unusually high growth in US economic activity in 1994 was curbed in 1995 to just over 3%, approximately one percentage point less than in the previous year. Inflation fell slightly and hit unusually low levels compared with corresponding stages of prior business cycles. Unemployment also declined, by 0.5 percentage of a point, stabilizing around its natural unemployment rate estimates. Following the Mexican crisis, the US dollar devalued dramatically in the spring but returned to its previous level in the early autumn and winter. The budget deficit was further reduced. Estimates for 1996 point to little increase in economic growth coupled with a stable level of inflation and a negligible decrease in the current account deficit.

Japan

The economy of Japan, despite signals of bottoming-out of the downturn in early 1995, still could not enter the recovery stage. Estimates for real GDP growth in 1995 were just above the zero with insignificant deflation and a slight increase in unemployment. Easing of monetary policy, prompted by an unusually strong yen in the first half-year, and the consecutive package of fiscal policy measures to stimulate turnaround in output introduced in September 1995, are expected to produce positive effects in 1996 with GDP growth estimates of about 2%.

2. Countries in Transition to a Market Economy

In 1995, most of the countries in transition to a market economy repeated 1994 economic growth. Even in Russia, Ukraine and several other former Soviet republics which witnessed a further drop in output, strong stabilization processes were underway which should contribute to eventual economic recovery.

Central Europe

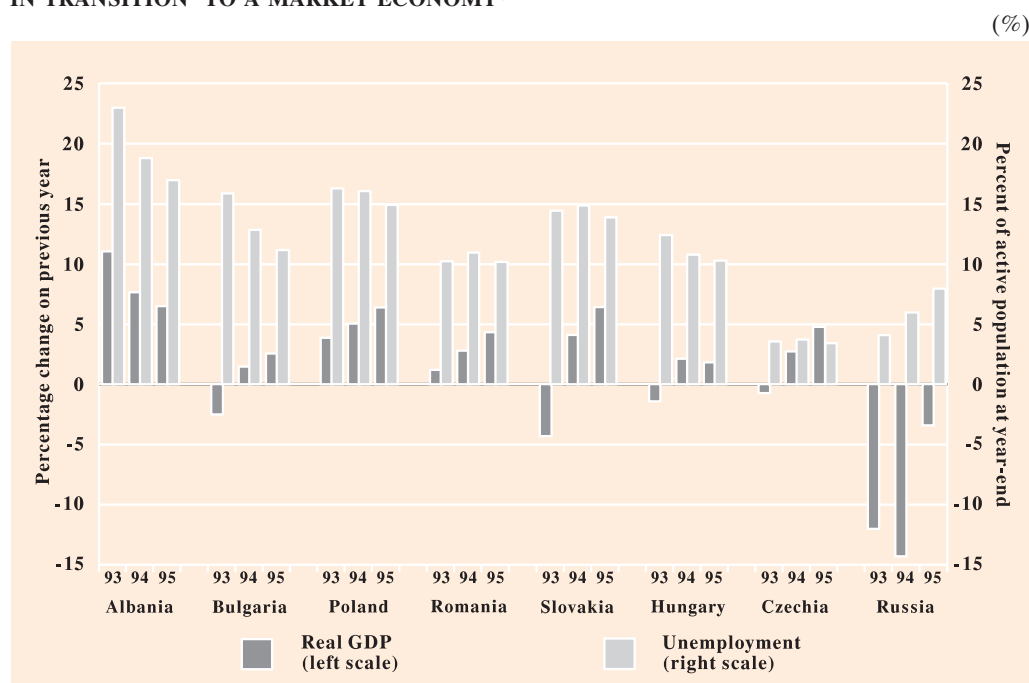
Most central European countries experienced real GDP growth though below 1995 forecasts. *The Czech Republic* saw better macroeconomic performance than that of the other economies in transition: unemployment, inflation and interest rates all remained among the lowest levels in the region. Its fiscal policy did not induce permanent deficits. However, its balance of payments was problematic: in 1995 its current account was slightly negative and a significant inflow into its capital account was reported. This led to an ineffectively high level of reserves and an easing of monetary policy, by sterilization of capital flows with possible inflationary effects.

Poland continued to register positive growth rates for a fourth consecutive year. In 1995, the country witnessed the highest real GDP growth among the transition economies – 6.5% – with a moderate reduction in inflation and interest rates. In 1995, unemployment decreased substantially while the deficits on its state budget and current account remained at moderate levels. The issue of capital inflow and their possible inflationary effects is also a concern for Poland, though not so acute as in the Czech Republic. Macroeconomic indicators for *Hungary* were hardly improved. GDP growth slowed by 1%, inflation accelerated by 30%, and unemployment declined slightly. Budget and trade deficits remain a major concern for the Hungarian economy, in spite of their slight reduction in 1995. In contrast to Hungary, *Slovakia's* macroeconomic indicators improved considerably from one year ago. A GDP growth rate of 6% is comparable with that of Poland. Inflation in Slovakia was reduced to a single-digit, near that of the Czech Republic, while its budget deficit was cut to 3% of GDP and its current account was slightly positive. However, unemployment remained high despite a fall in 1995.

Balkan Peninsula

Economic output growth stabilized and accelerated on the Balkan Peninsula. In *Albania*, GDP growth nearly matched that of Poland, while in *Romania* and *Bulgaria* it was less than half that of Poland. Unemployment and inflation remained high in Albania, while in Romania and especially Bulgaria, these indicators exhibited a marked improvement. Slow and faltering privatization and market reforms, however, might have the potential to reverse the favorable macroeconomic trend in the economies of these countries. *Slovenia* continued to be the country with the most improved macroeconomic performance among the *former Yugoslav republics*. However, statistical data for most of these countries is still incomplete and unreliable.

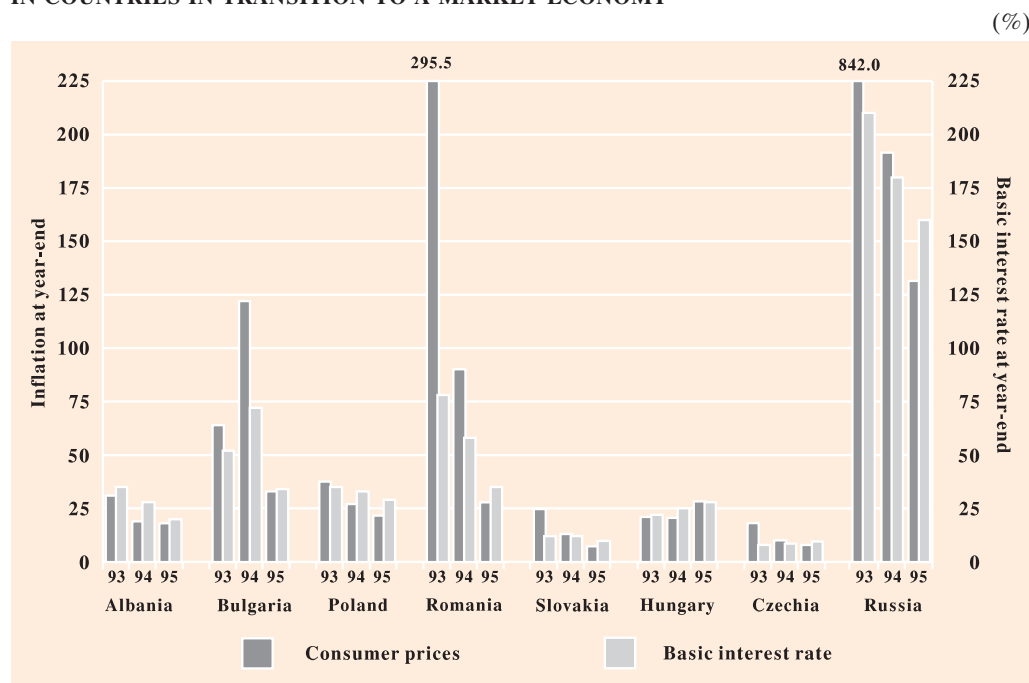
REAL GDP AND UNEMPLOYMENT IN COUNTRIES IN TRANSITION TO A MARKET ECONOMY*



* Data for 1995 is based on preliminary estimates.

Source: OECD, Bank for International Settlements, EBRD, IMF, PlanEcon.

INFLATION AND BASIC INTEREST RATE IN COUNTRIES IN TRANSITION TO A MARKET ECONOMY*



* Data for 1995 is based on preliminary estimates.

Source: OECD, Bank for International Settlements, EBRD, IMF, PlanEcon.

Former Soviet Union Republics

In 1995, positive economic developments prevailed in the republics of the former Soviet Union. In terms of the extent of economic progress, *the Baltic states*, with the exception of Latvia which regressed to financial instability, neared that of the central European states. Even *Russia* and *Ukraine* had signs of an imminent economic recovery. In Russia, the drop in output was reduced to 2% and positive growth is expected to occur in 1996. Inflation remained in triple digits but this is significantly lower than in the previous few years. Unemployment rose to 8%, remaining far below the high levels of its former COMECON partners. Its budget deficit was reduced almost threefold to 4% of GDP and a surplus of USD 3.5 billion was reported on its current account.

3. Developing Countries

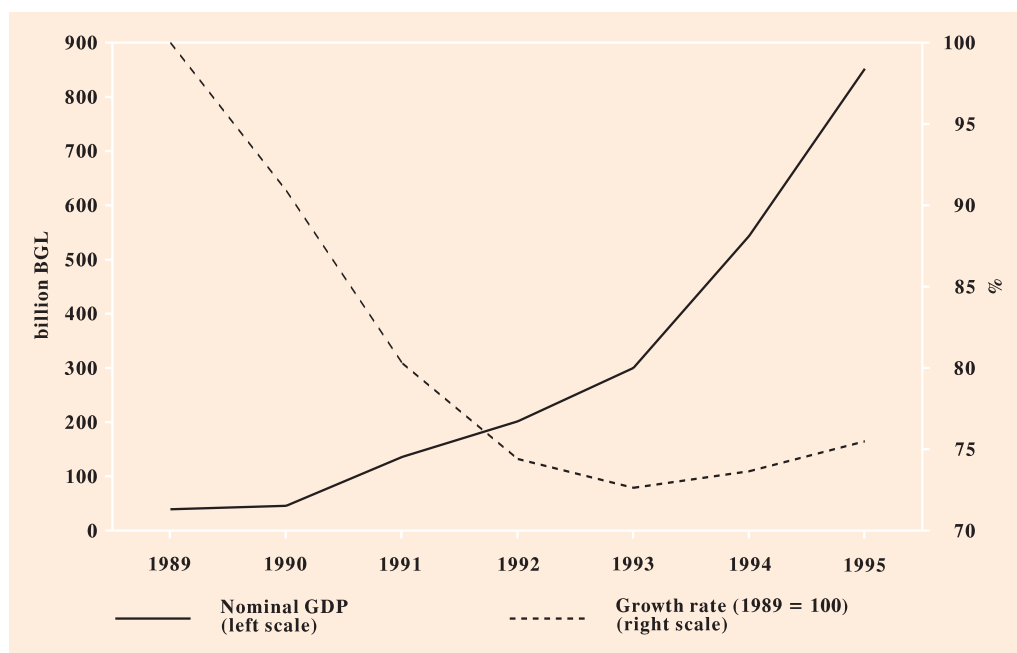
Bulgaria's commitment to integration with the west European process, the lifting of the embargo on Yugoslavia, and renewed economic relationships with former COMECON partners were the factors reflected in the decreased role of developing countries in Bulgaria's economic recovery. Nevertheless, certain countries and groups of countries continued to provide raw materials at acceptable prices for the Bulgarian economy or market access for Bulgarian exports. Rapid economic growth – 4.7% on average in 1995 and 4.9% in 1994 – in these countries is a prerequisite to intensify foreign trade contacts with them.

II. General Characteristics of the Economy

1. Gross Domestic Product

In 1995, the nominal gross domestic product (GDP) of the Republic of Bulgaria reached BGL 871.4 billion.¹ In real terms, the 1995 GDP increased by 2.6% relative to the previous year, indicating real growth for the second year in a row since 1989.²

NOMINAL GDP IN 1989 – 1995



Source: NSI, BNB.

GDP by Component of Final Demand

In 1995, domestic demand remained a key factor determining GDP growth. In contrast to previous years, foreign trade relations improved, resulting in positive net exports for the first time after 1991. Final demand was 3.2% less than in 1994 at constant prices, with government purchases of goods and services declining more significantly again. For the first time in recent years, gross investment saw positive growth in real terms, which helped stabilize aggregate domestic demand. In 1995, net exports³ of goods and services amounted to approximately BGL 4 billion, or 0.5% of GDP.

Household consumption was BGL 613.6 billion, a decrease of 1.9% against 1994 in real terms. Government consumption of goods and services totaled BGL 126.5 billion, a 9.4% decrease in real terms. In 1995, gross investment in the economy accounted for approximately BGL 127.3 billion at current prices. At 1994 prices, gross investment totaled BGL 78.5 billion, with the bulk of real growth at-

¹ As per National Statistical Institute (NSI) preliminary data.

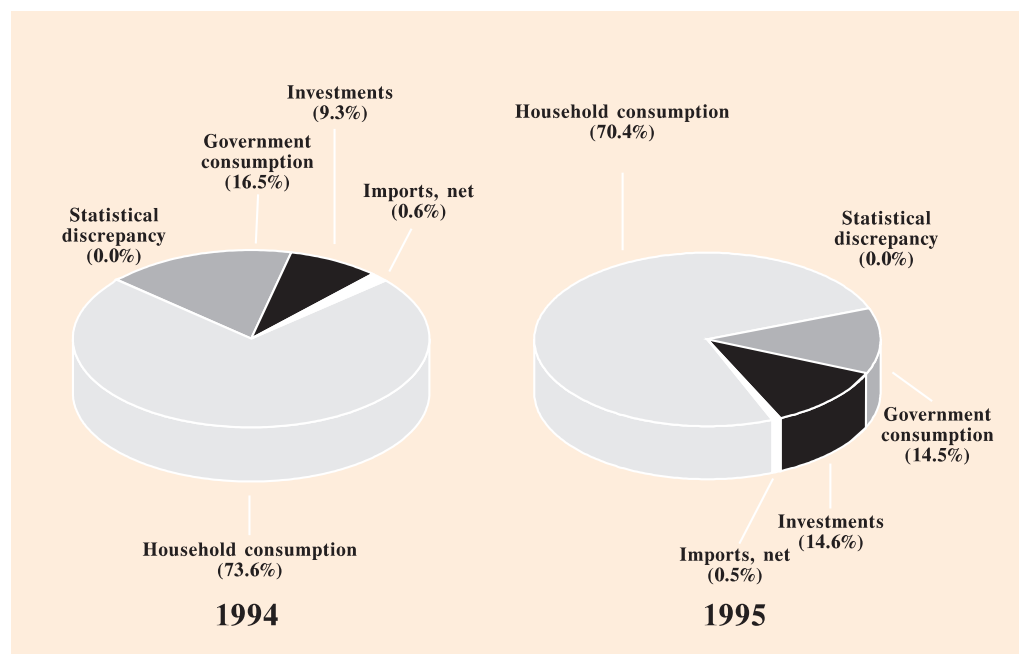
² Rates of change in GDP for each year are calculated at prices of the previous year.

³ The NSI reported the balance on tourist services in net exports.

tributable to the increase in fixed capital. A trend toward a real increase in investment occurred for the first time after the launch of market-oriented reform. Only sustainable future growth in investment will lead to technological innovation in Bulgaria's economy and will strengthen competitiveness of exports, promoting anti-inflationary long-term economic growth.

Different developments in final demand component rates in 1995 led to certain structural changes. The share of household consumption decreased by over three percentage points from 1994, falling to 70.4%. The share of government purchases declined two percentage points. The fall in the shares of these components of final demand was attributable primarily to a 5.3 percentage point increase in gross investment.

GDP BY COMPONENT OF FINAL DEMAND



Source: NSI, BNB.

GDP Structure by Branch of Economy

Relatively increased external demand and enhanced investment activity in 1995 brought about changes in the structure of output by branch of economy, contributing to the ongoing recovery in industry. The value added in this key branch of the economy exceeded BGL 211.7 billion, an increase of 0.5% from 1994 in real terms. Enhanced external demand favored growth in the following industries: ferrous metallurgy, cellulose and paper, chemical and oil processing, glass, china and earthenware. This contributed to real growth in coal mining, electricity and thermal power generation. However, this is indicative of the high degree of energy consumption by output and the importance of government price regulation in the real economic growth recently achieved. Nevertheless, some branches, mostly those which had either lost their external markets or produce consumer goods, continued to face challenges. The value added of some industrial branches with sizable shares in output as electrical and electronic industry, machine building and metal processing, and food industry declined in real terms.

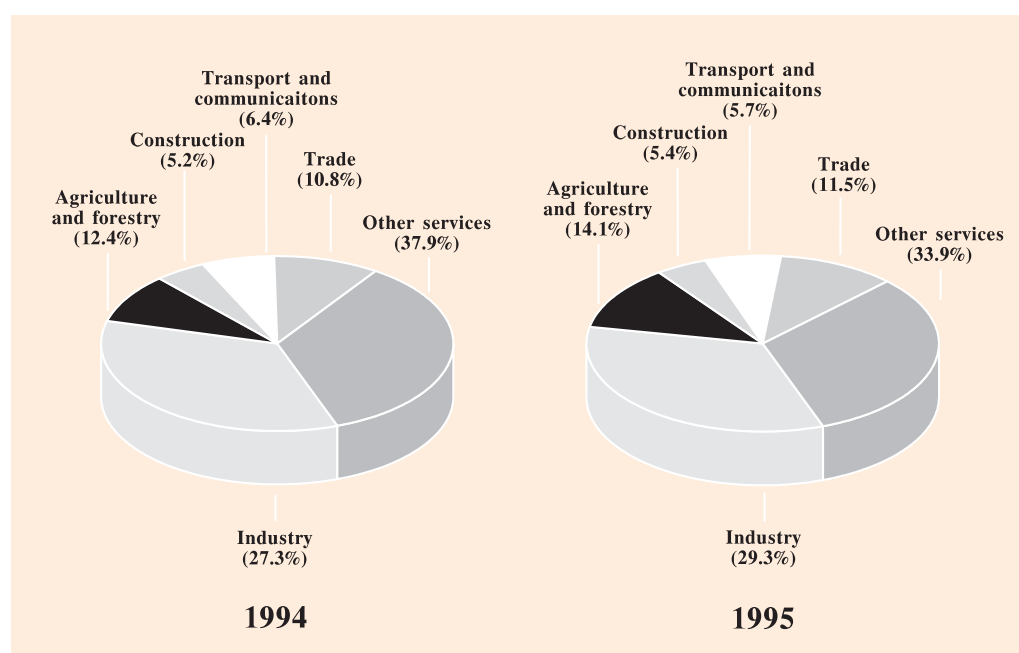
The recovery in agriculture and forestry and construction continued in 1995, though at a slower pace than in the previous year. Besides the relatively favorable meteorological conditions, the ever expanding private sector in agriculture also contributed to this effect. Private producers supplied over 81% of total agricultural produce. Value added growth in construction is also associated with the expansion of the private sector: more than 64% of the output in construction is produced by private construction companies.

Increased output in key economic branches such as industry, agriculture and forestry in 1995 prompted real growth in services relating to shipment and communications, trade and business services. However, a continuing real decline in value added was registered in so-called “Other Services.”⁴ This suggests that economic policy has not been directed to encourage factors of production, hence ensuring long-term economic growth.

In 1995, GDP structure by branch of economy diverged from those in the previous years of reform⁵. The downward trend in industry’s share was reversed. The share of industry increased by two percentage points to 29.3% compared with 1994, while the share of “Other Services” declined by approximately four percentage points to 33.9%.

The economic recovery in the past two years led to a positive production performance in the public-sector companies⁶. However, taking into account the financial operations of these companies, their losses in 1995 exceeded BGL 53 billion, and financial indebtedness at year-end reached BGL 514 billion.⁷ This suggests that the public sector remains very financially dependent; debts on bank loans accounted for the largest share, over 40% of total public-sector debts, followed by intercorporate debts (18.6%).

STRUCTURE OF GDP BY BRANCH OF ECONOMY



Source: NSI, BNB.

The huge indebtedness of public-sector companies coupled with their declining liquidity made a number of them insolvent. In 1995, public-sector companies repaid only 54% of interest accrued on bank loans and around 75% of the principal on loans which had matured. Along with the overall real economic growth in 1995, this signals an emergence of adverse trends in the financial sector, despite the 1994 purging of banks’ portfolios from debts of public nonfinancial enterprises, inherited from the centrally-planned economy. The emergence of these trends illustrates the poor production efficiency of the public nonfinancial sector, which fails to adjust to

⁴ The sector “Other Services” includes the following: public utilities, science and scientific research, education, culture and arts, health care, social security, sports, leisure and tourism, finance, credit and insurance, management.

⁵ The structure of GDP by branch of economy is based on current prices.

⁶ According to NSI preliminary data on public nonfinancial enterprises (state and cooperative, excluding agricultural).

⁷ Financial indebtedness of enterprises includes debts on bank loans, intercorporate debts, debts to the state budget, personnel, social security and other obligations.

market requirements and merely compensates for its high production costs by increasing financial indebtedness.

Sectoral Structure of GDP

The private sector in the Bulgarian economy continued to expand. The value added in the private sector in 1995 was about BGL 389.6 billion at current prices, and its share grew to 49.6%⁸. Value added from services, totaling more than BGL 221 billion, had the largest share in total value added in the private sector (56%), with over 1/3 of this produced from trade, transport and communications. The share of the private sector continued to grow in industry, construction, agriculture and forestry. However, the growth rates of these industries in the private sector are much slower, since these industries in general require larger investments in fixed capital than the services sector.

PRIVATE SECTOR SHARE IN THE GROSS VALUE ADDED

Indicators	1992 ²	1993 ²	1994 ¹	1995 ¹
Private sector – total	18.4	25.0	43.0	49.6
Agriculture and forestry	6.7	7.2	10.3	11.5
Industry	4.3	6.3	7.1	10.2
Services	7.4	11.5	25.5	27.9

¹ Preliminary data.

² Share in GDP.

Source: NSI.

2. Employment

In 1995, the number of employed⁹ persons in the economy increased, though at a slow pace. The turnaround in the trend of a sustainable decline in employment, typical of the recession, was a result of the economic recovery which has occurred since mid-1995. Average annual employment reached 3,311,000 persons¹⁰, a 2% increase compared with 1994. This growth in employment is entirely due to the increase in the number of persons employed in the private sector. The number of persons employed in the private sector increased by 15.6%, reaching 1,349,000 persons.

Changes in employment in individual branches reflected the discontinued decline in output and the shift of a substantial number of the employed from the public to the private sector. During 1995, employment in industrial branches continued to decline, while the number of employed in services increased (2.9%).

Industry

Total employment in industry decreased by 5.1% in 1995. Jobs in the largest economic branch continued to decrease, irrespective of the rise in output. This is due to public-sector enterprises where the average payroll employment decreased by 10,500 persons. Falling employment combined with a growth in output and sales, indicate more efficient use of professional qualifications of employees in spite of the delayed restructuring in industry branches. During 1995, the subbranches¹¹ experiencing the most dramatic drop in employment were the food processing (11.4%), machine building and metal processing (11%), publishing and printing industry and other industry branches (34.6%). Limited access to the traditional international markets, especially the former COMECON countries and the Near East, were the major factors responsible for the dramatic drop in employment in these industries.

⁸ Gross value added represents the difference between GDP and the adjustment, including financial intermediation services indirectly measured (FISIM), VAT and import duties.

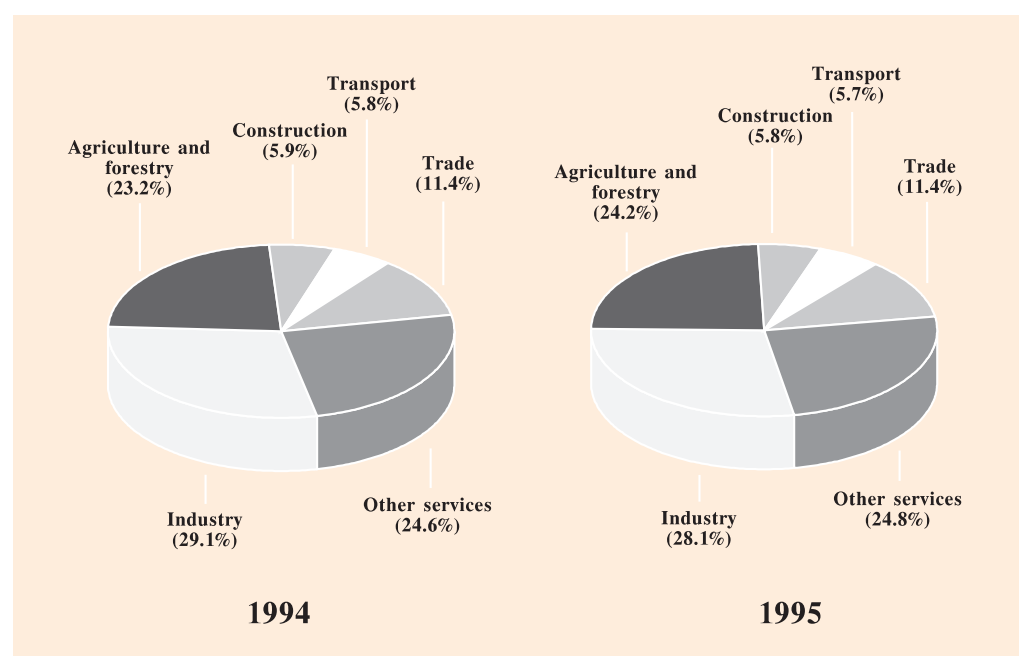
⁹ According to NSI data, unless stated otherwise.

¹⁰ Preliminary data.

¹¹ Data on employment by subbranch of economy refers only to the public industrial branch.

At the other extreme were the industries selling their output primarily in the domestic market. Increased industrial output and sales of goods created new jobs. Considerable growth in the number of employed was registered in the cellulose and paper industry (8%), glass, china and earthenware industry (5.3%), and construction materials (1.6%). Government support to the energy sector boosted both output and creation of new jobs (1.2%) in this sector, and similarly in the oil and natural gas industries (1.2%).

STRUCTURE OF EMPLOYMENT BY BRANCH OF ECONOMY



Source: NSI, BNB.

Agriculture and Forestry

In 1995, those employed in agriculture and forestry numbered 802,000. Employment in agriculture and forestry increased by 6.7%, largely a result of the expansion in the private sector. On a year-earlier level, persons employed in the state and cooperative sector fell by 28% while those employed in the private sector rose by 14.9%. Restitution of agricultural land continued, now in its fourth year, prompting a shift of a substantial percentage of employed in the public sector (over 83%) to the private sector. As a result, the share of employment in agriculture and forestry ranked first among other branches in the private sector.

Construction

Reduced investment opportunities had an adverse effect on employment in construction. In 1995, employment in construction declined by 0.4%, and since economic reform it has halved, declining 53.5% versus the 1989 level. In 1995, over 15,000 persons were dismissed in the public sector, while employment in the private sector increased by 13,000 persons. Construction's share in total employment fell to 5.8%.

Transport

Since 1995, employment in transport has declined insignificantly (0.4%). Against the background of overall improvement in employment in services, the decline in jobs in transport is attributable to a continuing fall in public-sector services. Given the specific character of this sector and slow rate of privatization, the private sector grew slower, particularly automobile transport.

Trade

Employment in the trade sector witnessed significant growth (2.9%) in 1995. Private sector trade was among the fastest developing sectors, providing approximately 70% of the country's total trade. Employment in private-sector trade rose by 25,000 persons. Its share increased from 67.7% in 1994 to 73.1% in 1995. This was

sufficient to offset reduced employment in the public sector (16,000 persons dismissed) and the share of employed in trade grew by four percentage points of total employment compared with 1994.

Other Services

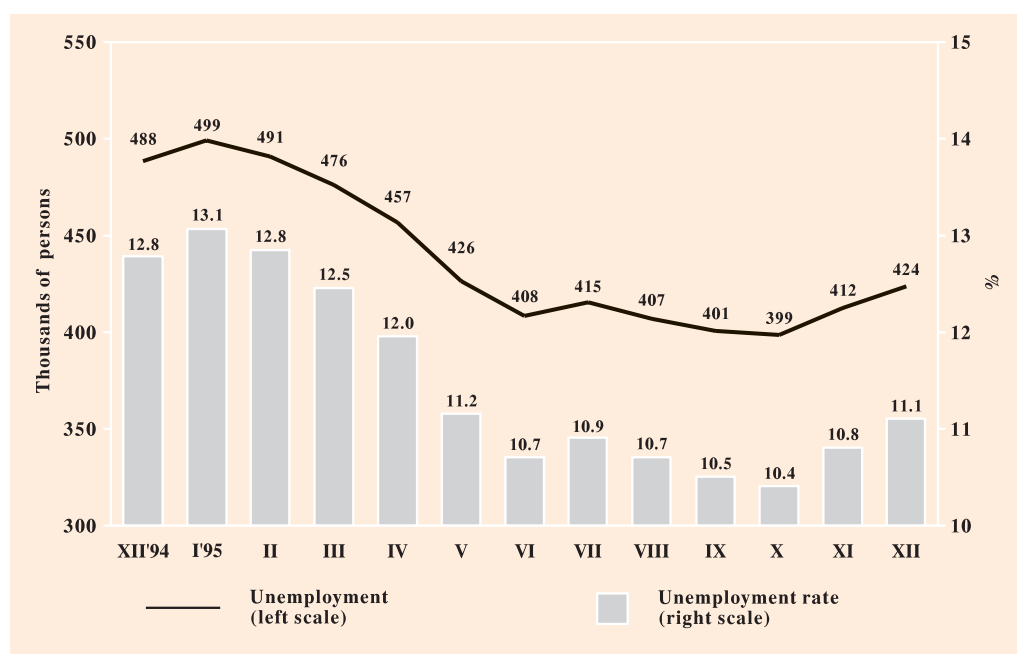
In 1995, average payroll employment witnessed the largest growth (2.9%). Most subbranches matched last year's employment level. Employment in science and scientific research contracted significantly, 6.6% and 0.6% respectively. Continuing extensive development of the financial sector led to an 8% increase in the number of employed compared with 1994. During the reporting period, increased employment in management was sustained (18.8%), with substantial growth in the number of employed in the private sector.

Unemployment

By the end of 1995, the number of registered unemployed in labor offices totaled 423,773 persons¹², a decrease of 65,000 persons (13.2%) from end-1994. This significant decline was the result of the deletion from labor-office registration lists of a significant number of unemployed which broadly exceeded the newly registered jobless. This ratio reflects two trends developing since 1995. First, excessive demand over number of job vacancies discouraged people from finding a job in the long run, deterring them from reentering labor-office registration lists. Second, given the modest economic recovery, the number of vacancies rose which increased the chances of some unemployment groups in finding jobs.

Despite the seasonal changes in 1995, unemployment declined. The rate of unemployment, expressed as a ratio of registered unemployed to the total labor force (employed plus unemployed), fell from 12.8% at end-1994 to 11.1% at end-1995. The monthly rate of unemployment decline in the country was 1.5%.

UNEMPLOYMENT IN 1995



Source: MLSS, BNB.

¹² Data on unemployment is obtained from labor offices at the Ministry of Labor and Social Security (MLSS). As per NSI surveys on employment and unemployment, the number of unemployed in the country exceeded by 200,000 persons that of MLSS data. The common criteria of unemployed (according to the definition of the International Labor Organization) is a person who: 1) has lost his job, 2) is looking actively for a job, 3) does not refuse a job. The data of the MLSS proved to be closer to this classification.

**NUMBER OF UNEMPLOYED AND COMPENSATION,
BENEFIT AND RETRAINING EXPENDITURE**

Indicators	December 1991	December 1992	December 1993	December 1994	December 1995
Unemployed, number	419,123	576,893	626,141	488,442	423,773
Unemployed receiving compensation, number	173,185	198,510	195,422	170,784	139,309
Share of unemployed receiving compensation, %	41.3	34.4	31.2	35.0	31.4
Compensation and benefit expenditure per one unemployed, BGL	486	630	1,065	1,832	2,964
Retraining expenditure per one unemployed, BGL	2.41	6.05	7.50	15.08	22.13

Source: MLSS.

Major Trends

Significant changes in 1995 among all unemployment groups reflected the following major trends:

- the decline in unemployment among those aged 30 and under was the largest, while a smaller decline was registered among those aged 50 and over. Against the background of a lack of professional alternatives for people over 50, young people demonstrate a high degree of professional adaptability. During 1995, unemployment in the group of people aged 30 and under declined by 15.4% against a mere 7.5% decline among those aged 50 and over;
- the number of unemployed with higher professional qualification declined faster against those with lower professional qualification. The demand for highly qualified employees contributed substantially to the larger reduction in unemployed specialists (21.1%). This is particularly true for university graduates who make up a mere 4.2% of all the unemployed. At the same time, the number of jobless unskilled persons declined more slowly (7.2%);
- the differences in unemployment by sex remained. More positions were offered to men and women were preferred in layoffs. The reduction in the number of unemployed women compared to men lagged by more than four percentage points.

3. Income and Expenditure of Households

Income

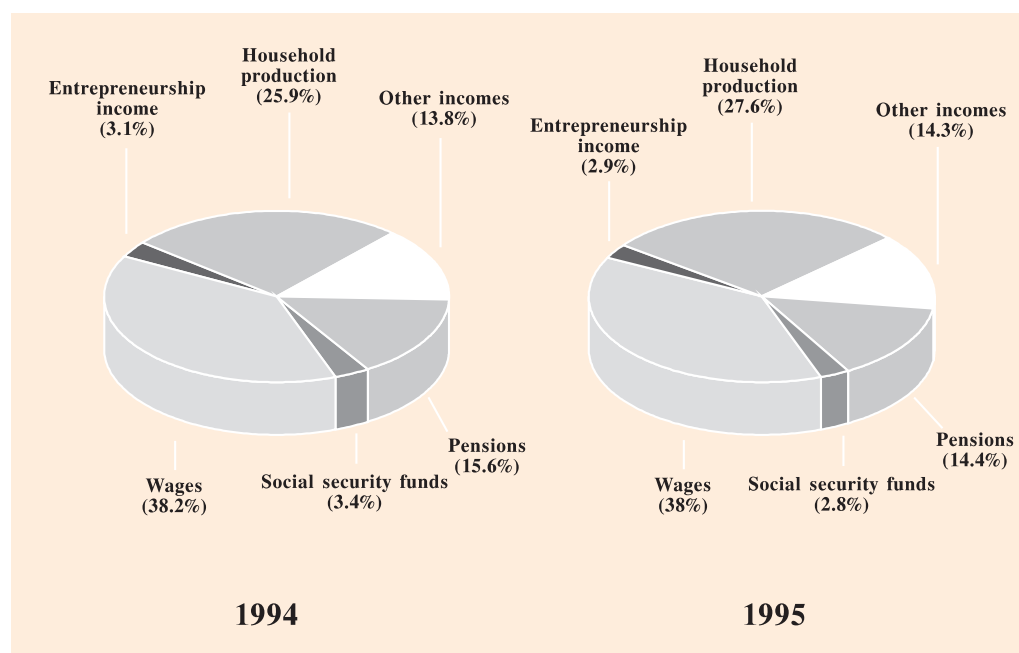
During 1995, the gross income of the population¹³ (monetary and natural) grew by 48%. However, real income declined by 8.7%, due to the faster rate of growth in consumer price index. Income erosion would have been even greater if the 57.4% growth in gross income from household production (27.6% in 1995 against 5.2% in 1990) had ceased. Income from wages nearly matched the average growth rate of gross income. Consequently, the share of wages in the gross income structure remained approximately 38%. Social income grew at different rates: faster growth was seen in pensions, while scholarships increased much more slowly. Insufficient budgetary funds to compensate this type of monetary income led to a significant drop in their real amount and cast doubt on the provision of social support for some social groups. The share of social benefits decreased from 19% in 1994 to 17.2% in 1995.

During the reporting period, income from entrepreneurship rose by 40% in nominal terms. Coupled with income received from household production, it provided approximately 30.5% of the total income of households.

On a year-earlier basis, nominal monetary income of the population increased 45.3%. However, increased consumer prices over that same period affected the purchasing power of the households, reducing it by 10.3%.

¹³ Data is obtained from the NSI household budget survey. As of mid-1995, publishing household monetary income and expenditure balance sheets was discontinued.

STRUCTURE OF GROSS INCOME OF THE POPULATION



Source: NSI, BNB.

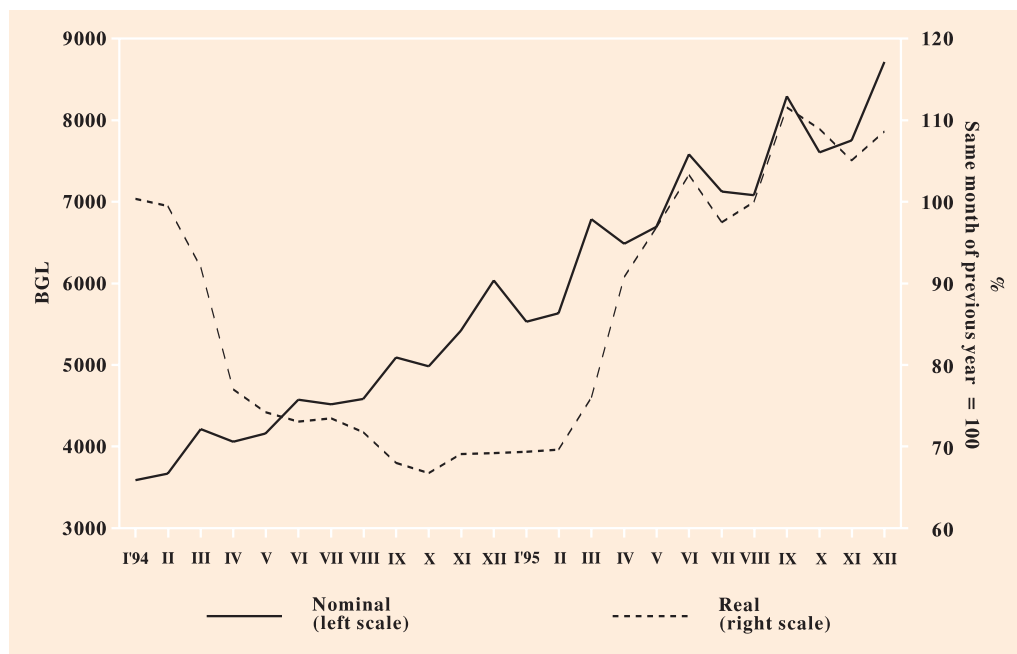
Wage

In 1995, the average monthly wage¹⁴ in the state and cooperative sector reached BGL 7,460, up 54.7% since 1994. The average annual inflation rate eroded the real wage by 4.6%. This was a relatively small decline in real wages since the start of 1991 economic reform. Reduced purchasing power of wages was attributable to rapid price growth and ongoing recession in most economic sectors, hence incapability to raise wages faster irrespective of 6.5% layoffs. In 1995, the wage bill fund in the public sector grew by only 41.7% against more than a 20 percentage point faster increase in consumer price in annual average terms. This was due to constraints on wage bill funds, now in its fifth year, used by the government as one of the major stabilization measures.

In 1995, most economic sectors reported a decline in the real average wage. The largest drop was registered in communications (11.5%), coal mining (10.5%) and ferrous metallurgy (8.1%). The real average wage increased in cellulose and paper (9.5%) and the glass, china and earthenware industries (6.9%). Within a sectoral context, a substantial differentiation in wages remained in 1995, although the signs of narrowing occurred. Branches under loose financial constraints, namely budget subsidies and government regulated prices, were higher-paid than the average. Wages in ferrous metallurgy exceeded by 65% the average remuneration. High wages were also paid in the energy sector and coal mining, respectively 60.9% and 51.6% above the average in the country. At the other extreme were the loss-making sectors due to dissolved foreign markets, lack of input materials, and contraction in consumer demand. Dramatic deterioration in the agricultural and forestry, sewing, textile and fur industries resulted in wages 25% – 40% below the average in the country. Recently, traditionally low wages were paid in sectors directly supported by the budget except for management where wages were 13.2% higher than the average wage. Despite the serious problems which occurred in the financial system, persons employed in this sector were paid the highest wages, 89.5% above the average wage.

¹⁴ According to preliminary data, excluding women on maternity leave.

AVERAGE WAGE IN THE PUBLIC SECTOR



Source: NSI, BNB.

Pensions

In 1995, BGL 70 billion was disbursed in pensions, an increase of 37.4% versus 1994. Over the year, no significant changes occurred in the number of pensioners. By the end of 1995, pensioners totaled 2,424,000, down 0.6% on end-1994. However, their number stays too high for the capacities of currently existing social security system, since pensions are paid from the current contributions of those employed. Inability to provide additional funds from the state budget additionally contributed to the slower growth of the pension fund relative to the inflation rate. The average monthly pension in 1995 was BGL 2,765, versus BGL 1,714 in 1994. Actually, the real amount of the average pension remained unchanged. The reduced purchasing power of the average pension affected since the start of economic reform have placed pensioners permanently in the low-income segment of the population.

Expenditure

In 1995, gross expenditure (monetary and natural) of the population grew by 47%¹⁵. In real terms, expenditures declined by 9.3% compared with the previous year. The continuously deteriorating structure of gross expenditure was directly reflected in the impoverishment of the population. Food purchases grew in 1995, accounting for the largest share of gross expenditure (46.2%). Nevertheless, expenditures on foodstuffs decreased by 6.7% in real terms from a year ago.

Compared with 1994, all other expenditure groups showed a decline in their real amounts. The only exception were expenditures on hygiene and health care which slightly increased in real terms (6.1%) due to increases in prices of medical services and drugs, the bulk of which was previously free of charge.

Monetary expenditure by the population mirrored the structure and recent trends in gross expenditure. Food purchases, amounting to 40%, garnered the largest share of gross monetary expenditure as well. It increased by 1.2 percentage points from the previous year. Payments on clothing and footwear, housing, furniture, education, transport, communications and electricity slightly increased their share of monetary expenditure. All the aforementioned structural changes adversely affected the amount and quality of consumption, which deteriorated further in 1995.

¹⁵ Data is obtained from the monthly survey of household budgets.

STRUCTURE OF GROSS HOUSEHOLD EXPENDITURE

(%)

Indicators	1994	1995
Total expenditures	100.0	100.0
Food	45.0	46.2
Drink	2.0	1.7
Tobacco products	2.4	2.2
Housing	4.2	3.6
Electricity for households	4.3	4.5
Home furniture	4.6	4.3
Clothing, footwear and haberdashery	7.4	7.7
Personal hygiene and health care	3.2	3.8
Education and leisure	3.0	3.1
Transport and communications	8.0	7.2
Household production	4.6	4.2
Other expenditures	11.6	11.5

Source: NSI.

4. Prices

In 1995, the moderate stabilization in output was combined with a significant decline in inflation. However, the expected structural changes in output and employment did not occur prompting the formation of bottlenecks in the economy. One should not assume that the economy has already adjusted to the internal and external changes effected since the beginning of reform. Besides the BNB monetary policy, a number of other factors also contributed to the dramatically reduced inflation: relative political stability, government control on prices of essential resources (fuels, energy) and staple goods, inflow of short-term foreign capital, and enhanced external demand for Bulgarian products. These last two factors significantly contributed to the stability of the national currency and did much to suppress inflationary expectations.

Liberalization of fixed prices or price ceilings was not completed within the preset terms.¹⁶ This considerably contributed to the low inflation rate, particularly during the autumn and winter, but did not fully compensate for the lag in the upward trend in the price level from previous periods. While in the first half of 1995 most of the fixed prices and price ceilings were raised in compliance with the preagreed terms, in the second half of the year only energy, thermal power and coal prices were raised, but a sufficient level was not reached. This had a temporary effect on consumer protection, but resulted in distorting price signals sent to the real economy and impeding effective allocation of scarce resources to more efficient uses in the long run. Given the high external and internal indebtedness of the country, inconsistencies in the process of price liberalization may further delay the restructuring of the economy and the adjustment cycle would be needlessly extended, and thus it might very well trigger higher inflation in the future.

Consumer Prices¹⁷

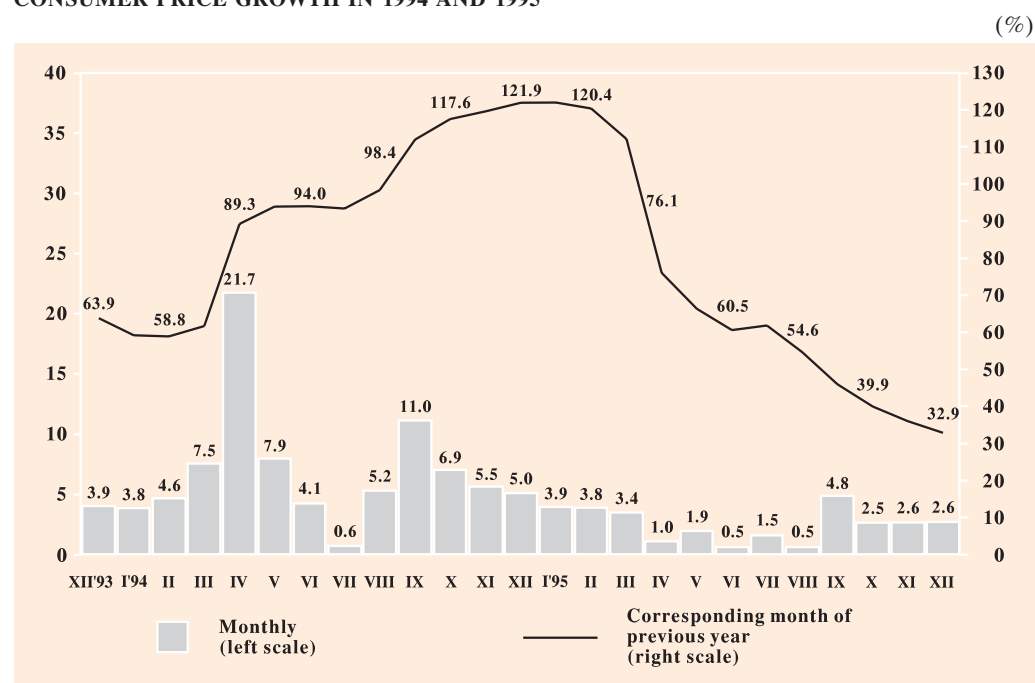
In December 1995, the price of the NSI consumer basket was 32.9% higher than a year earlier. For the first time since the start of economic reforms in 1991, inflation was lower than the rate projected in the macroeconomic framework of the state budget. The rate of the consumer basket changes in December 1995 declined

¹⁶ In 1995, the Law on Prices (State Gazette, issue 87 of 29 September 1995) was adopted in Bulgaria. It forms the legal framework for the price controls on goods and services and the state regulation and control over prices. The Law envisages several types of price regulation by the government (Art. 10): setting fixed prices or price ceilings on goods and services; limit markups, discounts and commissions; minimum prices; protective procurement prices; formulation of rules and norms concerning setting of prices, including computation of output and sales costs; introduction of a temporary ban up to six months on changes in the prices of particular goods and services.

¹⁷ Inflation in Bulgaria is measured through consumer price changes. In 1995, the NSI did not substantially modify the consumer basket of goods and services on which monitoring of price movement is based. The weights used for the calculation of the consumer price index are the 1992 household incomes.

over three and a half times faster than in December 1994. In 1995, the consumer price index grew in average annual terms by 62.1%, approximately 34 percentage points less than in 1994. Monthly movements in the general consumer price index were not so marked as in the previous year, lacking dramatic price jumps.

CONSUMER PRICE GROWTH IN 1994 AND 1995



Source: NSI, BNB.

Within the general consumer price index, prices of services rose most significantly – typical of years following periods of high inflation. In December 1995, the price level of services was 57.1% higher than in December 1994. Over the same period, nonfood prices rose by 36.4%, while food prices increased by only 23.6%. The lower general consumer price index is due primarily to the developments in the food prices index. The latter price index saw the lowest increase compared with the other group indices, and food expenditures comprised the largest share (48.1%) in the composition of the consumer basket. The major factors responsible for relatively stable food prices are reduced solvency in consumer demand, increased output of some agricultural products, and control over the prices of monitored goods by fixing the maximum permissible markup to their producers.

DEVIATION OF GROUP INDICES FROM GENERAL CONSUMER PRICE INDEX

Index	1993	1994	1995
Food	-3.5	17.6	-9.3
Nonfood	-8.0	-3.9	3.5
Services	29.8	-61.3	24.2
Average deviation	13.8	27.6	12.3
Coefficient of variation, %	23.1	35.6	25.2

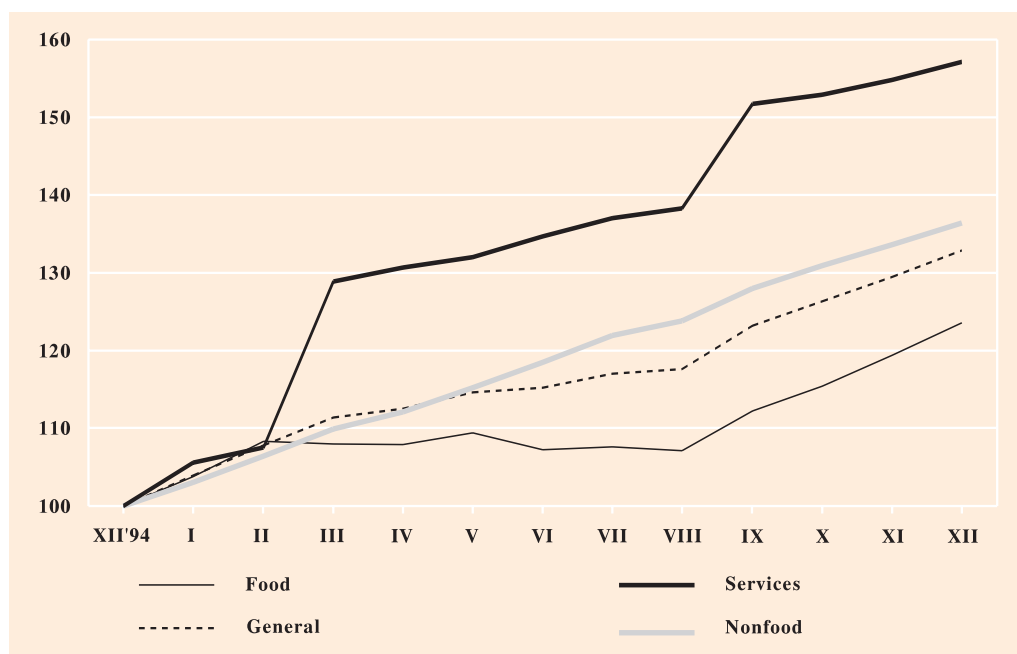
Source: NSI, BNB.

In 1995, adjustment of the relative prices of consumer goods and services continued. However, less significant divergence between the group price indices and the general consumer price index occurred. As in the previous two years, the services price index diverged most notably, but in the opposite direction compared with 1994. With services, which are private sector dominated, price adjustment lags behind the general trend of inflation and price changes matched expectations. The effects of the price controls policy tended to slow the growth rate of the services

price index. Prices of transportation and communications services rose by only 20.1%, while prices of telephone, cable and postal services remained unchanged.

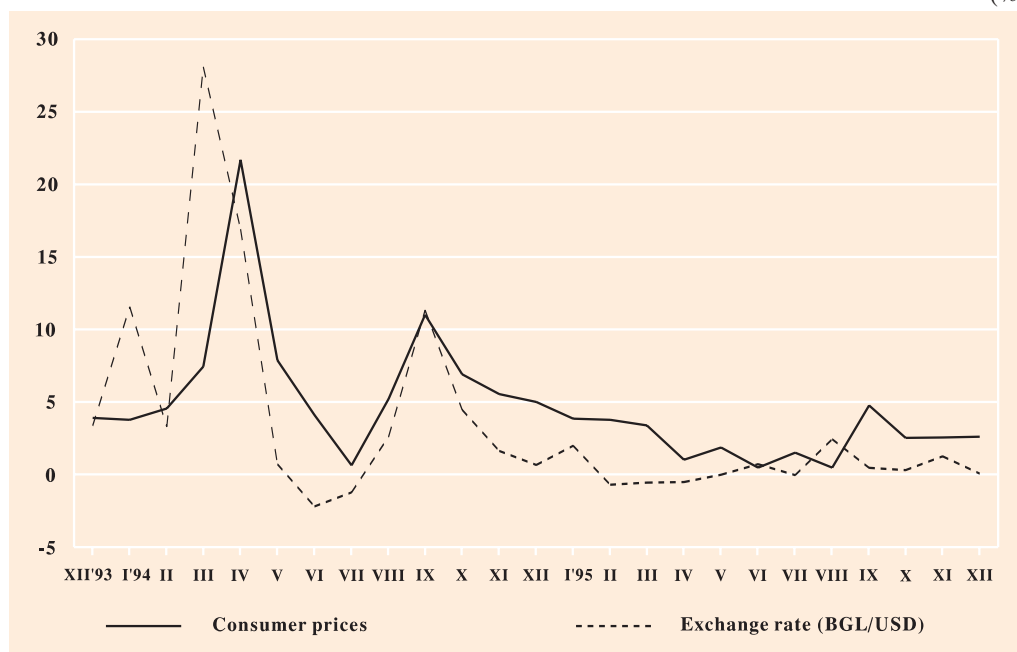
Developments in the nonfood price index nearly mirrored those in the general consumer price index. Since nonfood prices are extremely sensitive to changes in the exchange rate, this was due mainly to the stable nominal exchange rate over the reporting period.¹⁸

CONSUMER PRICE INDICES IN 1995 (December 1994 = 100)



Source: NSI, BNB.

MONTHLY FLUCTUATIONS IN CONSUMER PRICES AND CENTRAL EXCHANGE RATE (%)



Source: NSI, BNB.

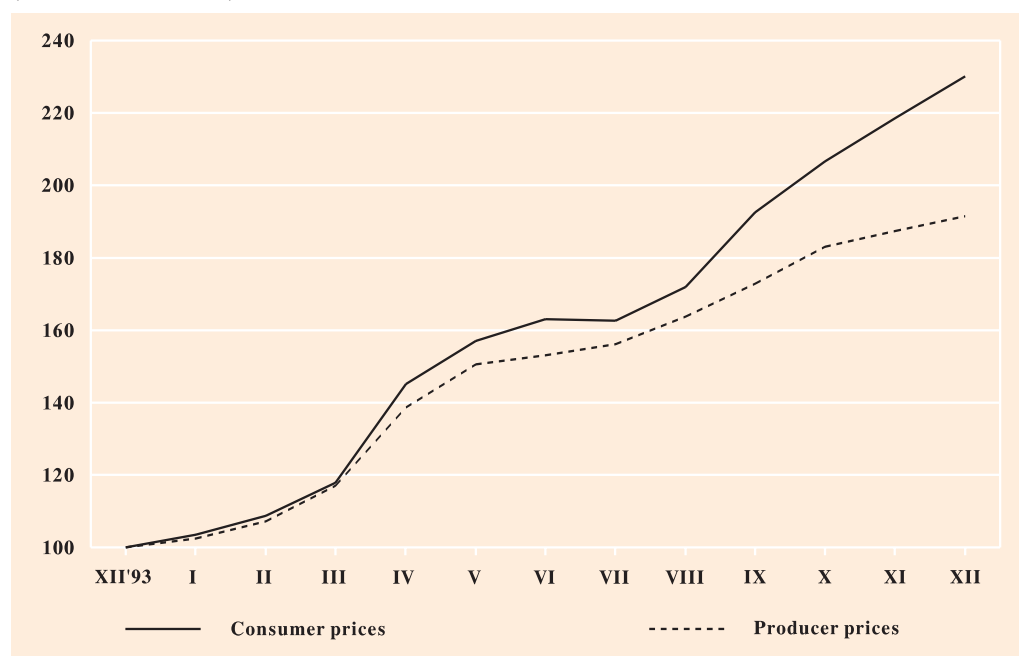
¹⁸ The reason is that the number of so-called tradable goods in nonfoodstuffs was the largest relative to the other groups in the consumer basket.

Producer Prices¹⁹

For the first time since the initiation of reforms, the industrial output producer price index grew faster than the consumer price index.²⁰ In December 1995, the producer prices of industrial output rose by 33.5% from last year's same period, a decrease of 58 percentage points. During the 12 months of 1995, consumer goods prices rose by 29.5%. The more rapid rise in producer prices in 1995 is attributable to both enhanced external demand for Bulgarian goods and government price regulation of some consumer goods. This pushed the producer costs for certain goods and services higher than consumer prices, and thus the subsidization of the producers (nonfinancial state-owned enterprises) of these goods and services was replaced by their growing financial indebtedness. The preservation of the monopoly of producers' protection of consumers in the short run was at the expense of generating serious imbalances in the financial sector.

The trend of the general industrial output producer price index growing faster than the consumer price index of goods continued in 1995 during the months of accelerated devaluation of the lev and in those immediately following. In periods of a stable exchange rate, the general industrial output producer price index almost matched or was just below the consumer price index of goods. This suggests that movements in the exchange rate may help to channel financial resources more efficiently but the existing mechanism of ceilings and fixed prices on fuels and energy inputs did not assist in boosting the competitiveness of Bulgarian products. As has been evidenced by the commodity structure of Bulgaria's exports in recent years, the stimulating effect of the exchange rate in the short run has not been combined with economic restructuring and orientation to less energy-intensive but export-oriented output.

**INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES
AND INDICES OF CONSUMER PRICES IN 1994
(December 1993=100)**



Source: NSI, BNB.

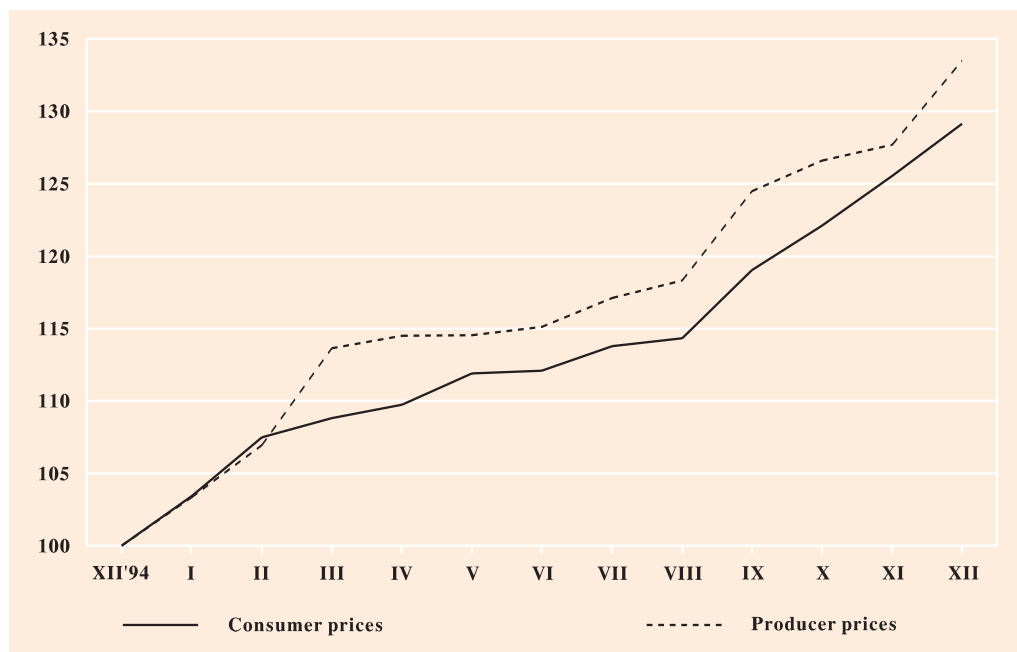
The various industrial output producer price indices diverged from the general index, which confirms the conclusion that price controls distort the signals sent to the real economy and do not allow for more efficient distribution of scarce re-

¹⁹ In 1995, the NSI did not change the methods of calculation of industrial output producer price indices. This index is narrow and is a particularly reliable source of information on the progress in the real sector.

²⁰ Comparing consumer price indices with commodity industrial output producer price indices is more relevant than comparing the general indices, since the sample used in the calculation of industrial output producer price indices does not include services.

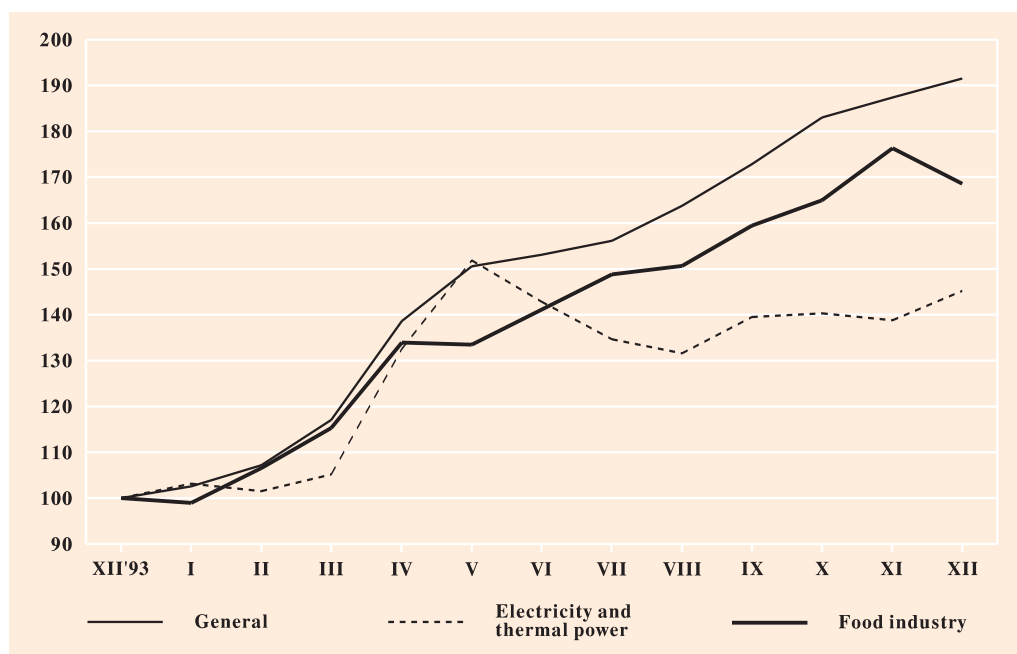
sources. Producer prices for the following key industrial sectors rose faster than the general index of industrial output producer prices: the food industry and energy and thermal power generation. These industries have made up for the lag in the previous year through higher production costs. On the other hand, government controlled consumer prices helped reduce the inflation rate over the year. This suggests that inflation in Bulgaria has evolved as a typically cost-push inflation since reform initiation. Price controls in the short run only distort the role of prices as the driving force for structural changes in the economy to promote long-term noninflationary growth.

**INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES
AND INDICES OF CONSUMER PRICES IN 1995
(December 1994 = 100)**



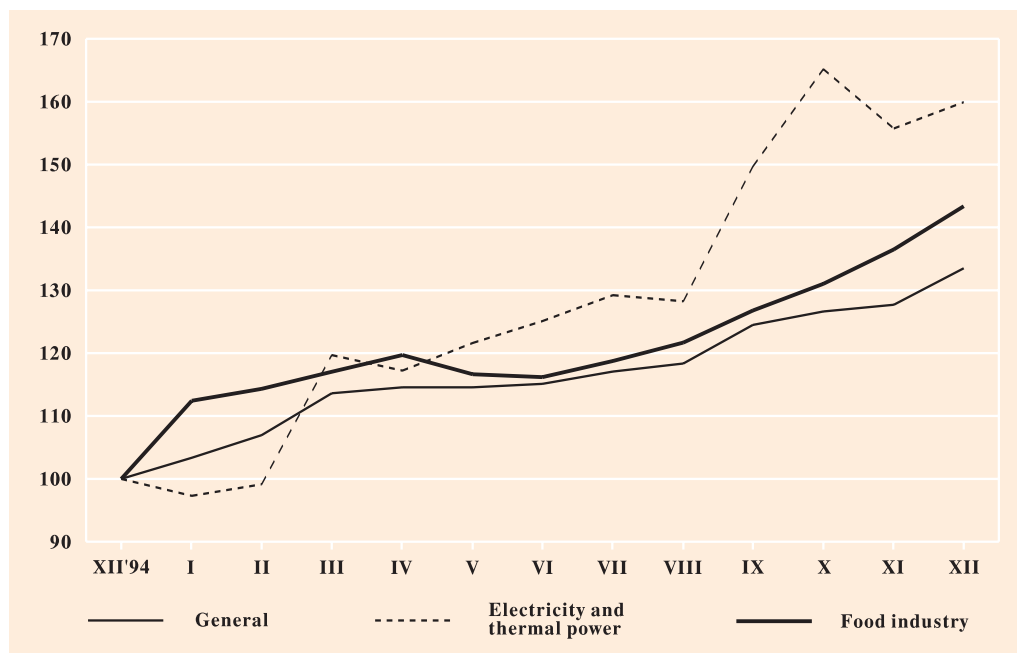
Source: NSI, BNB.

INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES IN 1994



Source: NSI, BNB.

INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES IN 1995



Source: NSI, BNB.

5. Foreign Trade

In 1995, foreign trade operated under entirely different conditions from previous years – signs of recovery in the real sector, a stable exchange rate, significantly reduced inflation, and a relatively stable foreign trade regime. These conditions helped to boost foreign trade activity. Economic growth in EU countries prompted an increase in aggregate demand and imports respectively. The countries in transition to a market economy entered a stage of economic recovery, consistent with economic growth.

Developments in Exports and Imports

According to preliminary NSI data, the volume of foreign trade turnover in 1995, in lev terms at current prices, totaled BGL 682.7 billion²¹, an increase of BGL 239.4 billion or 54% compared with 1994. Exports amounted to BGL 343.3 billion, increasing by BGL 127.1 billion (58.8%), and imports totaled BGL 339.4 billion, a BGL 112.4 billion increase (49.5%).²² The trade balance ran a surplus of BGL 3.9 billion in 1995, against a deficit of BGL -10.8 billion in 1994.

In 1995, the competitiveness of Bulgaria's exports was determined by various factors. The trend toward a real gain in the value of the lev was sustained. Between December 1994 and December 1995, the consumer price index was 132.9, the real effective exchange rate index based on major trading partners was 102.1, and that based on major currencies was 107.1.²³ Nominal effective exchange rate indices, calculated on the basis of a basket of major currencies and trading partners, was 115.3 and 110.2 respectively, and the lev appeared to be more markedly overvalued during the second half of the year.

²¹ As per the NSI statistics, exports are reported at FOB prices, and imports at CIF prices.

²² Note that because it is a customary practice of the NSI to revise preliminary data, the 1995 data cannot be considered a final estimate. As no indices on average export and import prices are calculated, the estimates of foreign trade's growth rates should be viewed more cautiously.

²³ The index of the real effective exchange rate by major currencies is calculated on the basis of a basket of three currencies (USD, DEM and CHF) respectively distributed at 75:20:5. The index based on major trade partners is calculated using a basket of five currencies (DEM, ITL, GRD, TRL, and FRF) distributed at 40.5:18.8:18.1:13.3:9.3.

Due to some imperfections in the real effective exchange rate calculated using a basket of currencies based on producer and consumer prices and due to some methodological reasons, it is difficult to assess precisely its impact on exports and imports. The major risks that stem from lev overvaluation and limited competitiveness are subsequent deterioration in the trade balance and depressive effects on the economy's growth rates. Notably, a sharp devaluation of the national currency may have more serious consequences for the economy – higher inflation, increased forex substitution, drain of capital, and loss of confidence in the economic policy pursued.

Lev appreciation and associated weakened competitiveness did not affect foreign trade volumes in 1995 because other factors were in play to offset the real effective exchange rate impact. These factors included subsidized prices of energy, coupled with a large share of energy-intensive exports like those produced by the chemical and metallurgical industries, accounting for a substantial share in Bulgarian exports. Despite the subsidized prices of energy inputs, many exporting enterprises either did not pay regularly, or were unable to pay at all. The low solvency of these enterprises, on the one hand, and inflation, on the other, substantially increased their indebtedness, which made the maintenance of low export prices possible. Prices were another factor contributing to the high values in exports in 1995 as the US dollar devalued against major European currencies during the first half of the year.²⁴ A large proportion of the receipts from exports to the European Union, 38% of total exports, were in European currencies. All other things being equal, the devaluation of the dollar has led to higher receipts from exports in dollar terms, without prompting an increase in their physical volume. After the collapse of COMECON, Bulgaria's foreign trade relationships were severed, resulting in more than a double decrease in turnover. Even the high rates of foreign trade turnover in 1995 remained far below the level attained in the late 80s. Bearing this in mind, the results in 1995 should be viewed as a gradual recovery rather than mere growth.

Foreign trade continued to account for a significant share of GDP which is typical of an open economy. The foreign trade share in GDP marked a negligible decline of 1.5 percentage points, but can still be regarded as high.

FOREIGN TRADE SHARE IN GDP

	(%)						
Indicators	1989	1990	1991	1992	1993	1994	1995*
Exports	34.5	23.3	42.3	45.6	34.4	39.8	40.3
Imports	32.3	22.7	33.3	51.9	46.8	41.8	39.8
Turnover	66.8	46.0	75.6	97.5	81.2	81.6	80.1

* The 1995 data is preliminary.

Source: NSI.

Data on foreign trade suggests that exports were essential for economic growth in 1995. Quarterly developments in the trade balance in general preserved their seasonal cyclical characteristics.

²⁴ During the first half of 1995, the US dollar lost 13 – 16% of its value against major European currencies compared with the same period of 1994.

EXPORTS AND IMPORTS DYNAMICS ON A QUARTERLY BASIS

(million BGL at current prices)

Indicators	I	II	III	IV
1994				
Trade balance	-15,501.6	1,460.8	-557.5	3,782.5
Exports, FOB	34,276.6	55,674.7	58,874.2	67,368.9
Imports, CIF	49,778.2	54,213.9	59,431.7	63,586.4
1995*				
Trade balance	-2,501.0	-981.6	10,199.4	-2,781.5
Exports, FOB	76,927.8	86,639.9	95,574.9	84,195.0
Imports, CIF	79,428.8	87,621.5	85,375.5	86,976.5

* The 1995 data is preliminary.

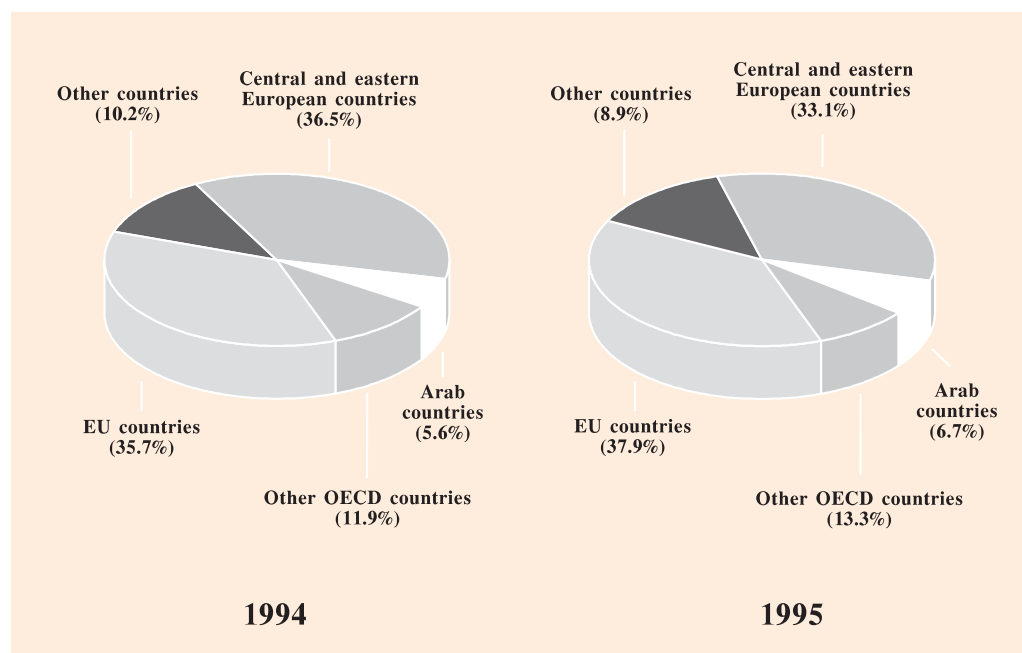
Source: NSI.

Geographic Structure of Exports and Imports

The geographic structure of foreign trade remained generally stable. It was oriented in three major directions: the European Union, central and eastern Europe and the Balkan countries.

The trade agreement which entered into force in early 1994 was essential for foreign trade growth. It provides for asymmetrical trade preferences and selective liberalization by sector. Bulgaria's textile and clothing imports to the EU continued to be treated in restrictive terms. Trade liberalization of agricultural goods was slow and restrictive since these goods are a sensitive issue for the EU and its general agricultural policy.

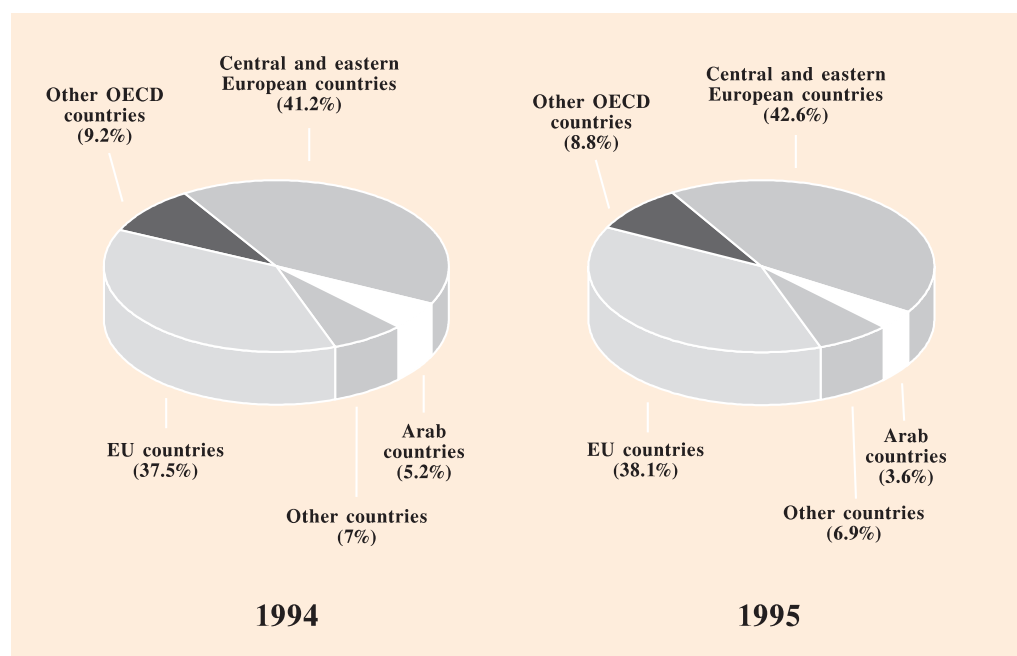
GEOGRAPHIC STRUCTURE OF EXPORTS



Source: NSI, BNB.

In terms of absolute volume, foreign trade with central and eastern European countries remained unsatisfactory. In their pursuit of swift economic and political integration with western Europe, the countries in the region seem to underestimate the potential to restore good trade relationships. Russia continued to be Bulgaria's major trading partner.

GEOGRAPHIC STRUCTURE OF IMPORTS



Source: NSI, BNB.

In recent years, exports to the Balkan region have increased rapidly.²⁵ Much of the increase in the share to these countries was the result of exports to Macedonia. This suggests that the Balkan countries will continue to increase their share in foreign trade with Bulgaria after the embargo on the former Yugoslavia has been lifted.

Trade with Arab countries, despite the modest growth in 1995, remained far below the previous year's levels. Bulgaria's former main trading partners, Iraq and Libya, are still facing embargo sanctions, which impedes normal trade relationships with these countries. On the other hand, Bulgarian exporters were not active in seeking new markets in the region but opportunities are still there.

Commodity Structure of Exports and Imports

The commodity structure remained relatively stable. The advantages and the traditional export potential of the country combined to determine the commodity structure of exports. In this regard, the agricultural, chemical, food processing and metallurgical industries made up the largest share of exports. In the long run, the commodity structure will depend on the direction and scale of structural reform.

All commodity groups increased their absolute volumes in exports.²⁶ Vegetable and animal produce, food, drink and tobacco garnered the largest share (22.3% – a 0.9 percentage point increase from 1994), followed by base metals (20% – a 0.6 percentage point decrease)²⁷, and chemical products (19.1% – a 2.9 percentage point increase). The high share of raw materials and intermediate goods in exports made general exports, especially to OECD countries, and overall economic growth, broadly dependent on the business cycle in these countries.

In 1995, only the group of animal and vegetable products, food, drink, and tobacco reduced its share (12.1%) in imports in terms of absolute volumes. The other commodity groups increased their shares. Minerals and fuels made up the

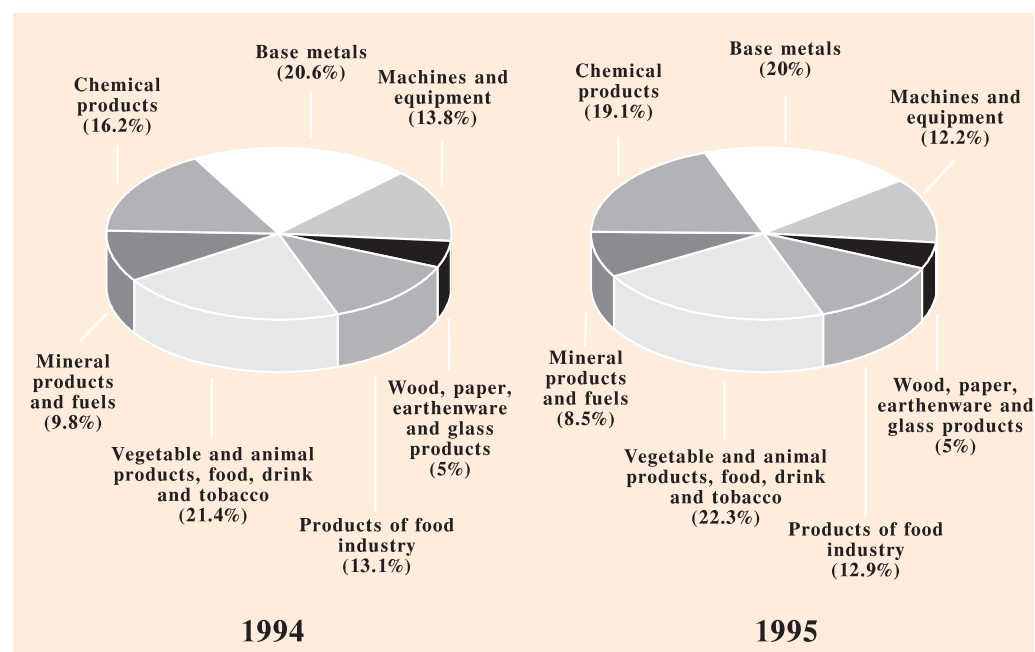
²⁵ Bulgaria's share of foreign trade with the Balkan countries (including Greece and Turkey, members of the EU and OECD respectively) in 1995 amounted to 28.6% of its exports, and 11.8% of its imports.

²⁶ For the purposes of macroeconomic analysis, the BNB continued to employ the classification of the Ministry of Trade and International Economic Cooperation (MTIEC), which reduces the 21 sections of the harmonized system (introduced by the NSI in 1992) to 7 enlarged commodity groups.

²⁷ Increased export shares of chemicals and base metals, in absolute and relative terms, were prompted in part by the rise in the prices of these goods in international markets.

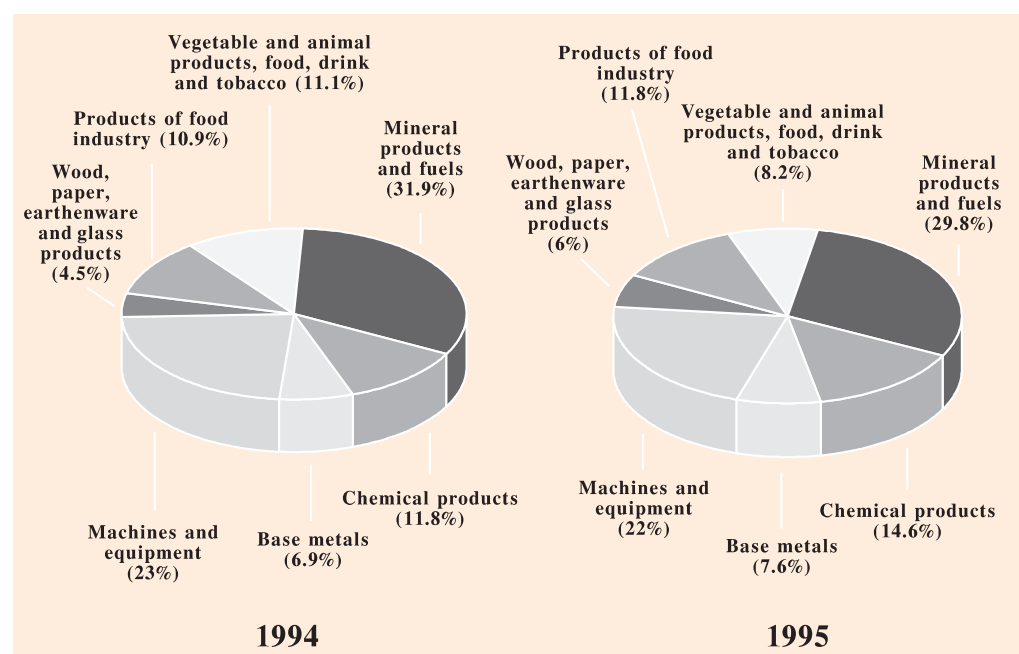
largest share of imports (29.8% – a 2.1 percentage point decrease from 1994), followed by machines and equipment (22% – a one percentage point decrease), and chemical products (14.6% – a 2.8 percentage point increase).

COMMODITY STRUCTURE OF EXPORTS



Source: MTIEC, NSI, BNB.

COMMODITY STRUCTURE OF IMPORTS



Source: MTIEC, NSI, BNB.

The commodity groups with the highest export/import ratio remained unchanged from 1994. The group of animal and vegetable products, food, drink and tobacco displayed the highest value (2.8), followed by the group of base metals and their products (2.6). The lowest values were reported on minerals and fuels (0.3), and machines and equipment (0.5).

6. Balance of Payments

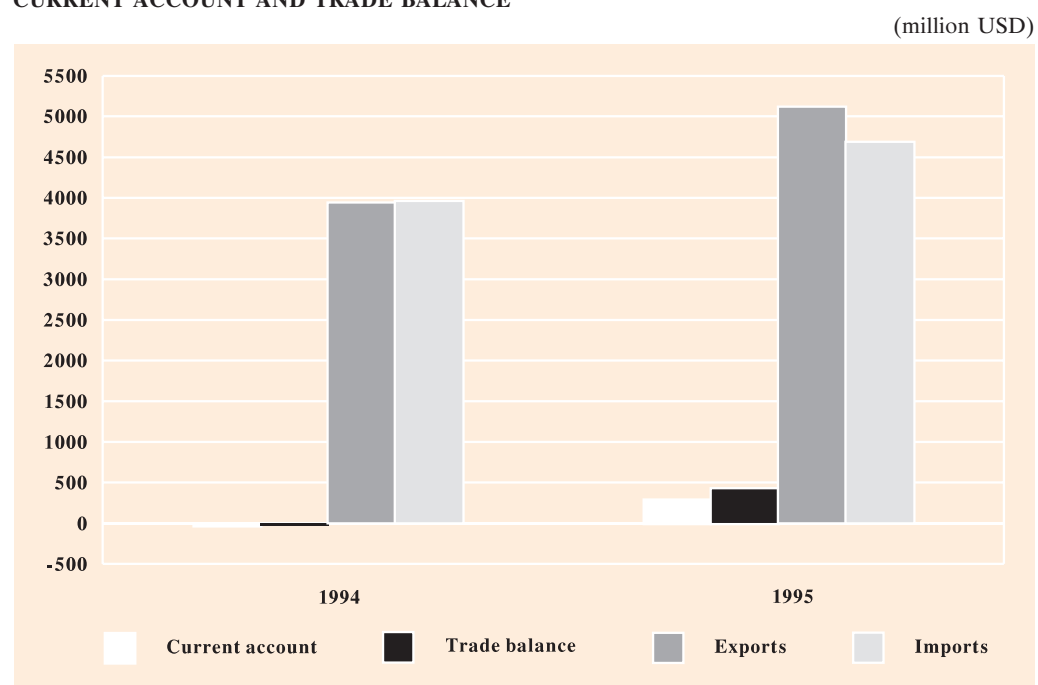
Current Account

The balance of payments current account ran a surplus of USD 333.8 million in 1995, a USD 358.6 million increase on 1994. The trade balance surplus was the main factor responsible for this (USD 427.8 million), in contrast to 1994 when a deficit of USD -16.9 million was reported.

Exports in 1995 totaled USD 5,110.3 million, a 30% increase compared with 1994. Imports amounted to USD 4,682.5 million, an 18.5% increase.

The balance on services continued to be negative, USD -226 million, deteriorating by USD 44.4 million from 1994's level. The main reason behind this was the strong deficit on interest (USD -454.9 million), largely the result of payments on Brady bonds of USD 273.3 million.

CURRENT ACCOUNT AND TRADE BALANCE



Source: BNB.

The balance on travel services was positive (USD 277.8 million), with receipts growing by USD 111.4 million from 1994, and expenditures declining by USD 48.6 million. This was due to both the larger number of foreigners visiting Bulgaria for tourism or business and to the smaller number of Bulgarians travelling abroad, the result of declining incomes of the population.

The balance on transportation services was positive, USD 38.2 million, which marks a notable improvement on 1994, when a deficit of USD -89.8 million was recorded. In 1995, receipts from transportation services rose by USD 106.3 million, and expenditures fell by USD 21.7 million.

The balance on private transfers was positive (USD 117 million), a USD 47.1 million decrease from the previous year's level. Receipts from private transfers in 1995 declined by USD 105.6 million. Expenditures also contracted, by USD 58.5 million, though at a slower rate than receipts, which explains the reduction in the balance.

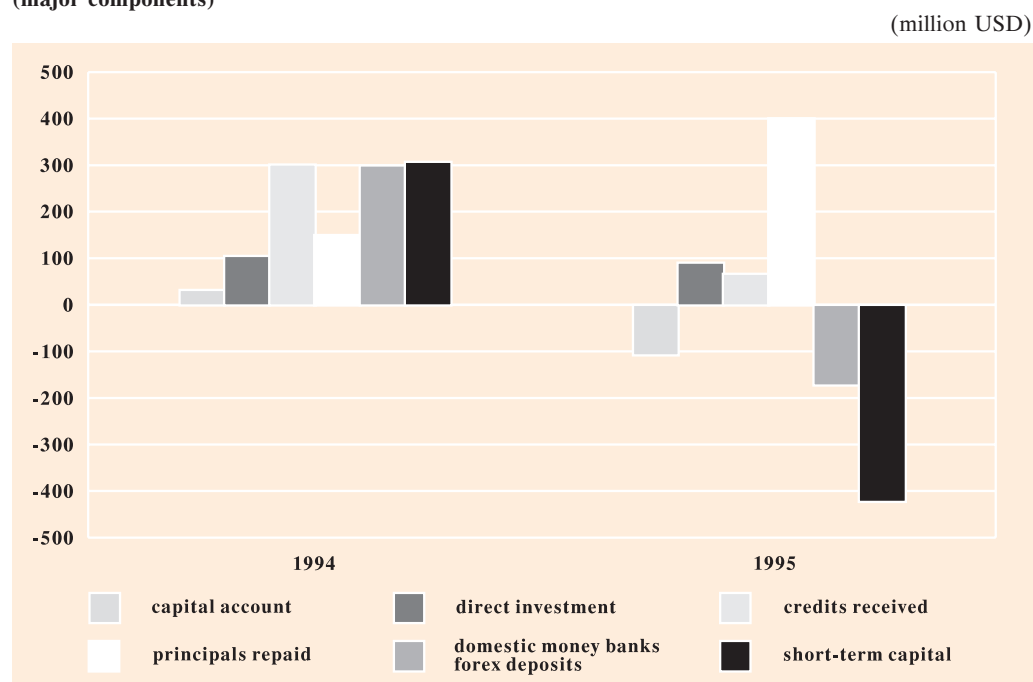
In 1995, unrequited transfers totaled USD 15 million, growing by USD 5.4 million from one year ago.

Capital Account

The capital account ran a deficit of USD -94.9 million, deteriorating by USD 126.7 million from 1994. This can be attributed to the smaller inflow of funds from official sources and large principal repayments on earlier received credits.

Foreign direct investment in the country totaled USD 90.4 million²⁸, the bulk of which (USD 66.6 million) came in the first quarter. Compared with 1994, the overall reduction of foreign direct investment in the country in 1995 amounted to USD 15 million. Economic instability both in the country and within the region, legal inconsistencies and ponderous bureaucracy are cited as the major reasons for low investment. The countries with the highest share of direct investment in Bulgaria are Greece (27.9%), Germany (15.9%), Belgium (10.8%) and the USA (9.1%). The bulk of investment in 1995 (37%) went to the production and distribution of beer and soft drinks, the purchase of Vitosha Hotel (10.7%), to bank and finance activities (9.8%), and the exploration of minerals (4.5%).

BALANCE OF PAYMENTS CAPITAL ACCOUNT (major components)



Source: BNB.

Medium- and long-term credits drawn in 1995 totaled USD 66.5 million versus USD 301.3 million in 1994. Absent agreements with the IMF and the World Bank in 1995 meant, in practice, that Bulgaria did not receive any official foreign financing, except for the last tranche of USD 45.9 million under a preagreed loan from Japan.

In 1995, principal repayments amounted to USD 400.5 million, including USD 240.1 million to the IMF. Compared with 1994, principal repayments have risen by USD 250.3 million, the significant proportion of this increase going to the IMF (USD 170.4 million).

Net repayments on earlier extended credits from Bulgaria totaled USD 295.2 million; the largest proportion was in the form of natural gas payments from Russia under the Yamburg Pipeline agreement which will lapse by end-1996.

Commercial bank deposits made abroad decreased by USD 171.4 million in 1995, while in 1994 these rose by USD 299.3 million. The reasons behind the decrease may be the relative stability of the national currency against major convertible currencies, a high interest differential during most of the year, and the lev liquidity deficiencies of some banks.

²⁸ According to MF data.

Foreign exchange reserves in months of interest payments, principals and imports constituted 2.6, a decrease of 0.14 months on 1994. Reserves in months of imports alone accounted for 3.2 versus 3 in 1994.

7. Foreign Debt

Bulgaria's official foreign debt totaled USD 9.446 billion by the end of 1995. Compared with 1994, it fell by USD 917 million. The major factors responsible for this decrease were cancelling the debt to the Russian commercial banks in accordance with the Agreement of 28 March 1995 between the Republic of Bulgaria and Russia, and an excess of principal repayments over new official credits drawn in 1995.

OFFICIAL FOREIGN DEBT OF BULGARIA

Indicators	(million USD)		
	1993	1994	1995
Official foreign debt (total)	12,472	10,363	9,446
International financial institutions ¹	1,157	1,825	1,656.5
Official creditors ²	1,368	1,408	1,528.3
Former COMECON creditors ³	611	1,591	846.1
Commercial banks and other private creditors ⁴	9,336	5,539	5,415.1
Coefficients of the official foreign debt and its service			
Foreign debt/GDP, %	115.4	103.4	76.4
Foreign debt/Exports of goods and services, %	249.9	188.2	141.4
Foreign debt service/GDP, %	2.7	5.7	7.0
Foreign debt service/Exports, %	7.9	14.4	17.3

¹ IMF, World Bank, EU, EIB and EBRD.

² On bilateral basis. Includes credits received until 1989 and other new official creditors.

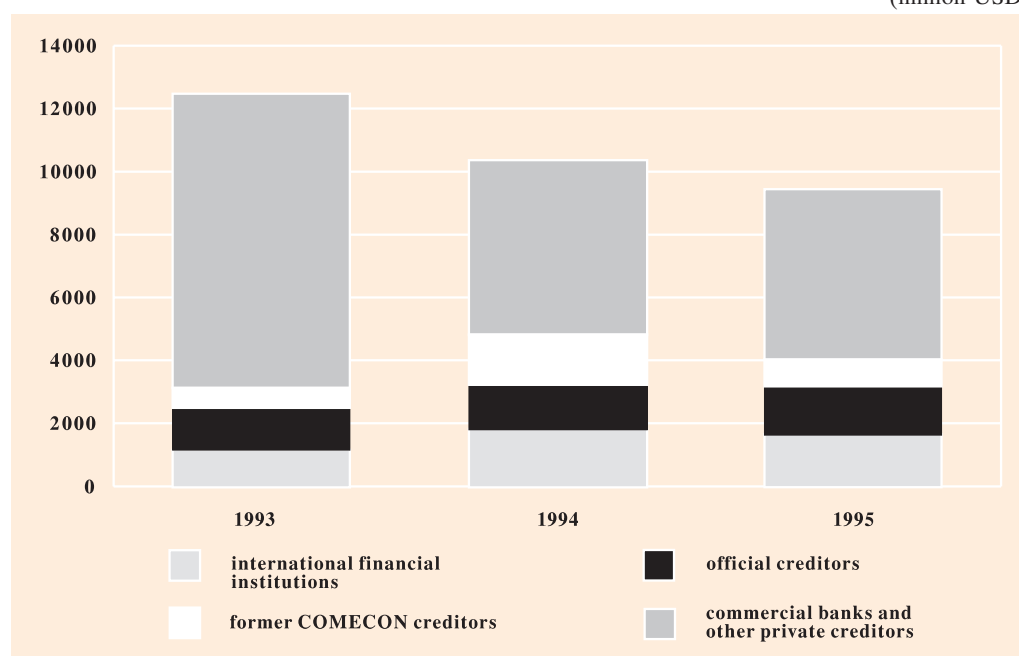
³ Debt in convertible currency to International Bank for Economic Cooperation, International Investment Bank, the National Bank of Poland. Before 1995 the debt to Russian banks was included in the debt to London Club creditors.

⁴ Including Brady bonds.

Significant changes occurred in the major ratios that measure external indebtedness of the Bulgarian economy and service of the country's foreign debt in 1995. The official foreign debt/GDP ratio fell from 103.4% in 1994 to 76.4% in 1995. The official foreign debt/receipts from export of goods ratio took the same course of change, declining from 188.2% in 1994 to 141.4% in 1995. The positive changes are due to both the growth in GDP and exports, and a reduction in the foreign debt during the year. At the same time, the indicators measuring the foreign debt service to GDP and exports in 1995 have deteriorated, the result of larger payments on the foreign debt service including interest payments on Brady bonds.

OFFICIAL FOREIGN DEBT OF BULGARIA

(million USD)



Source: BNB.

III. Fiscal Policy

The pursuit of sustainable macroeconomic equilibrium and maintenance of financial stability in the country in 1995 required a restrictive fiscal policy. This combined with the BNB's restrictive monetary policy limited consumer price growth which resulted in the most significant reduction in inflation over the past five years.

However, the anti-inflationary policy pursued by the government coupled with the economic recovery did not offset the increased expenditure on servicing the ever growing domestic debt. These factors, together with the poor performance of the revenue side of the budget, required by year-end revision of the State Budget Law (SBL) to increase the amount of the budget deficit.

1. Consolidated State Budget

The consolidated state budget includes the government budget²⁹, local budgets, the social security budget, some extrabudgetary accounts and funds³⁰. The 1995 SBL adopted the central government budget (CGB), social security budget and legal system budget.

By the end of 1995, net revenue on the consolidated state budget, obtained after the deduction of intrabudgetary transfers and funds for budget deficit financing, totaled BGL 328,328.7 million, 37.7% of GDP³¹. Net expenditures on the consolidated state budget totaled BGL 377,923.3 million, 43.4% of GDP. Compared with 1994's levels, net revenues and expenditures in reported GDP³² were 42.1% and 47.9% respectively.

Revenues and expenditures in the government budget accounted for the largest share in the consolidated state budget. By the end of 1995, government budget revenues and expenditures accounted for 60.1% and 57.6% of the consolidated state budget respectively, against 60.6% and 54% by the end of 1994.

The structure and amount of revenues and expenditures in the consolidated state budget directly reflected the changes in the structure and the amount of central government revenues and expenditures. As of 31 December 1995, revenue in the central government budget totaled BGL 197,294.1 million, 91.6% of SBL projection, and 22.6% of GDP. In 1994, central government revenues as projected by SBL were 132.9% due to the higher inflation rate, and its share of GDP was 25.5%.

As of 31 December 1995, expenditure on the central government budget totaled BGL 255,219 million, 93.3% of SBL projections, and 29.3% of GDP. By the end of 1994, expenditure on the central government budget comprised 32% of GDP. During the reporting period, current expenditure accounted for the largest share, 55.1% against 51.7% in 1994. The increased share of current expenditure in 1995 was due to the interest payments. The amount of interest payments dramatically grew due to increased government debt and the measures undertaken by the govern-

²⁹ The government budget includes the central government budget, budget of ministries and government agencies, and regional administration budgets.

³⁰ Extrabudgetary accounts and funds included in the consolidated state budget are as follows: "Professional Qualification and Unemployment Fund" and "Land Tenure and Improvement Fund" and the extrabudgetary accounts opened as per CM Decree No. 27 of 1992 and the Law on Protection of Arable Land and Pastures.

³¹ Estimated 1995 GDP totaled BGL 871.4 billion.

³² Estimated 1994 GDP totaled BGL 522.2 billion.

ment to stabilize the Economic Bank and Mineralbank. This was one of the major reasons which prompted a revision of the 1995 SBL by year-end. According to the revised 1995 SBL, expenditures on interest on internal loans are to be paid at their actual amount and the actual excess over the SBL projections may not exceed BGL 9,200 million. Compensation of interest payments over BGL 9,200 million must be provided by the Council of Ministers. As of 31 December 1995, interest payments amounted to BGL 123,927.3 million, including BGL 99,286.5 million internal interest payments, or 100.9% of the maximum amount projected by the revised SBL, and 14.2% of reported GDP. By the end of 1994, the amount of interest paid was BGL 70,674.4 million, including BGL 64,112.3 million internal interest payments, or 190.8% of SBL projections, and 13.5% of GDP. The amount of transfers extended by the CGB to cover deficits on other budgets comprised 91.9% of SBL projections due to setbacks in cash basis performance of the state budget.

2. Budget Deficit

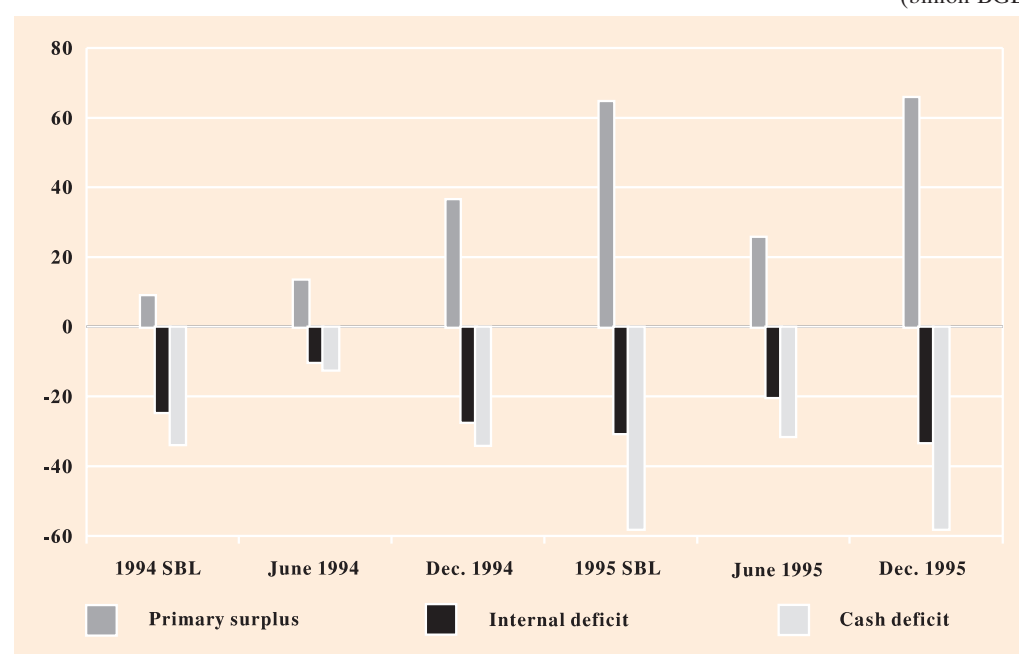
In 1995, the primary surplus on the CGB totaled BGL 66,002.4 million, 101.8% of SBL projections, and 7.6% of reported GDP. In 1994, this surplus amounted to BGL 36,630.7 million, 404.1% of SBL projections, and 7% of GDP.

As of 31 December 1995, the primary surplus on the CGB was insufficient to cover debt service expenses. After relationships between the budget and domestic creditors are considered, an internal deficit of BGL 33,284.1 million, 108.8% of SBL projections, and 3.8% of GDP, was accumulated. In 1994, the internal deficit accounted for 112% of SBL projections, or 5.3% of GDP.

As of 31 December 1995, the cash deficit of the CGB reached BGL 57,924.9 million, or 100% of projections in the revised 1995 SBL, and 6.6% of reported GDP. At the end of the previous year, the cash deficit was 6.5% of GDP.

CENTRAL GOVERNMENT BUDGET

(billion BGL)



Source: BNB.

By 31 December 1995, the Social Security budget reported a surplus of BGL 750.9 million, municipalities a surplus of BGL 112.3 million, and the legal system budget a surplus of BGL 184.1 million. The balance on extrabudgetary accounts and funds was BGL 7,285.5 million. Thus, the deficit in the consolidated state bud-

get totaled BGL 49,594.5 million, i.e. BGL 8,330.4 million less than the cash deficit reported on the CGB.

Increased government borrowing from domestic creditors and the manner of cash flow management during 1995 enhanced overall demand³³ for credit resources. By the end of 1995, credit indebtedness amounted to BGL 181,538.3 million, an increase of 69.3% compared with 1994. Credits used to cover expenses on domestic government debt service accounted for the largest share in the structure of indebtedness, 59.5%. During 1995, relatively large amount of budget deposits (including time deposits) was maintained, averaging BGL 4,677 million.

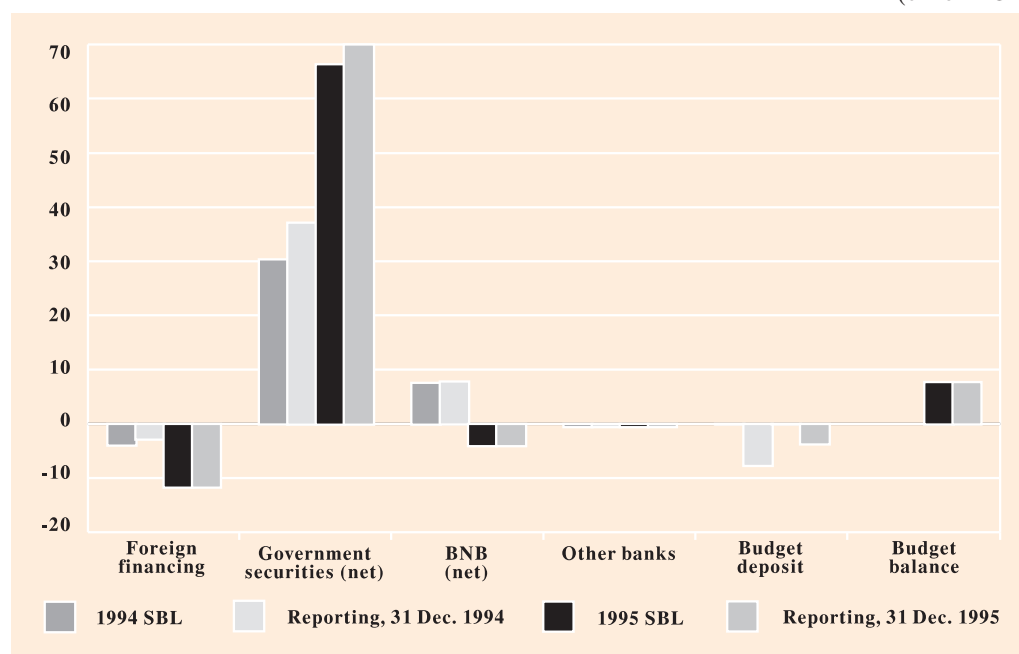
3. Budget Deficit Financing

By the end of 1995, negative net foreign financing had been reported, totaling BGL 11,713.4 million, or 100.7% of SBL estimates. Of this, repayments of overdue interest on external loans came closest to SBL projections (122.2%). In 1994, negative net foreign financing totaled BGL 2,749.8 million, or only 73% of SBL estimates.

As of 31 December 1995, net domestic financing of the CGB totaled BGL 69,638.3 million. Government securities transactions were the major source of funds for budget financing. By year-end, the amount of government securities operations netted BGL 69,938.6 million. Another source to finance the cash deficit in 1995 was the transitional balance on the 1994 CGB, totaling BGL 7,745.8 million. Since in 1995 the government budget did not use new long-term loans from financial institutions and duly repaid the old loans, net direct bank financing was negative, amounting to BGL -4,486.3 million by 31 December 1995. The CGB reported a balance of BGL 3,712.7 million, reducing net domestic financing by that amount.

CASH DEFICIT FINANCING OF THE CENTRAL GOVERNMENT BUDGET

(billion BGL)



Source: BNB.

³³ Overall budget demand for credit resources includes cash deficit plus decline in liabilities to domestic and foreign creditors.

For the first time, the 1995 SBL did not project extension of a direct long-term loan from the BNB to finance the cash deficit. Therefore, in accordance with Article 46 of the Law on the BNB, the MF was disbursed only temporary loans, or advances, totaling BGL 19 billion to cover temporary shortages of budget funds. The loans were repaid within the terms agreed.

Actual state budget revenue from the issue of government securities during 1995, as per Regulations No. 5 and target issues for companies and individuals, totaled BGL 154,488.6 million, 1.7 times more than a year ago. Maturing government securities of BGL 84,588 million were redeemed, as well as interest and discounts of BGL 64,567.3 million.

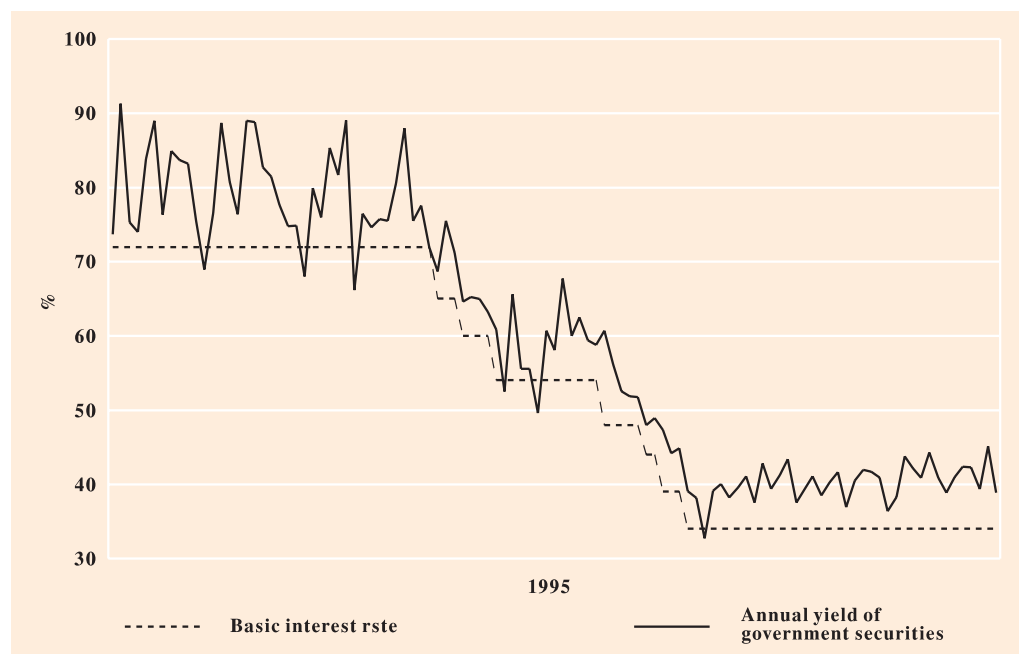
Pursuant to Regulations No. 5, 107 issues of book-entry government securities with a total nominal value of BGL 151,836.04 million were sold through the BNB to finance the budget deficit, including seven issues of discount treasury bills, 68 issues of interest-bearing treasury bills, and 32 issues of treasury bonds. As of 31 December 1995, 115 issues were in circulation, 50 issues of treasury bills and 65 issues of treasury bonds, with a total nominal value of BGL 142,940.8 million.

The aggregate nominal value of government securities offered by the MF in 1995 totaled BGL 178,901.2 million.

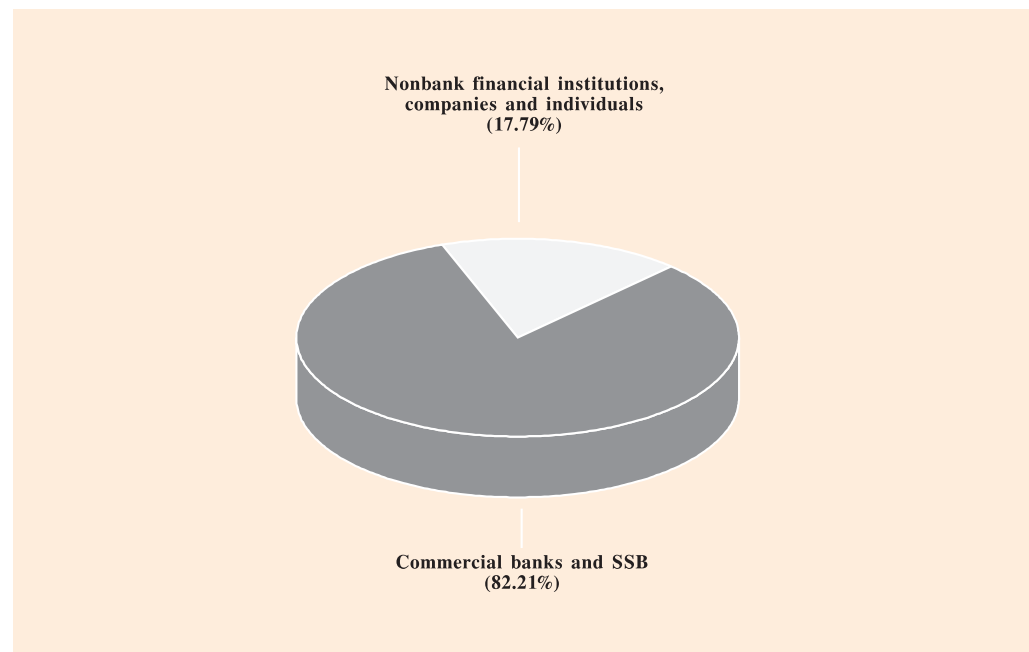
Financial institutions' bids totaled BGL 189,700 million. No auction bids were received for one treasury bonds issue, and the prices of another two issues were not approved by the MF and remained unsold.

In 1995, the bulk of the issues ensured average annual yield equal to or higher than the effective basic interest rate. The only exception were five issues sold at a discount from their nominal value and one issue of six-month treasury bills sold at a 50% fixed interest rate.

BASIC INTEREST RATE AND ANNUAL YIELD OF GOVERNMENT SECURITIES ISSUED IN THE PERIOD



HOLDERS OF GOVERNMENT SECURITIES ISSUED FOR BUDGET DEFICIT FINANCING AS OF 31 DECEMBER 1995



Source: BNB.

According to the BNB register containing information obtained from financial institutions under Article 16 of Regulations No. 5, the amount of government securities acquired by nonbank financial institutions, companies and individuals totaled BGL 26,476 million in nominal value, that is 17.79% of all outstanding issues by 31 December 1995. Of this, BGL 9,977 million were in the portfolios of insurance companies, BGL 4,679 million of target issues were bought by companies and individuals, BGL 637 million were in portfolios of financial brokerage houses, and BGL 178.4 million were acquired by companies and individuals with noncompetitive auction bids. As of 31 December 1995, the BNB net sales of government securities to individuals, under Article 12 of Regulations No. 5, totaled BGL 995.6 million.

4. Domestic Government Debt

The major factors influencing domestic government debt over 1995 were the amount of the budget deficit, increased general borrowing needs, and changes in the exchange rate and the basic interest rate. During 1995, domestic government debt increased by 26.2%, increasing from BGL 273,718.7 million in early year to BGL 345,395.4 million by year-end, 39.6% of GDP. By the end of 1994, it accounted for 52.4% of GDP.

Significant changes occurred in the structure of domestic government debt as a result of the use of government securities as a major source to finance the budget deficit. The debt on government securities, issued to finance the budget deficit, saw a net increase of BGL 79,922.6 million and reached BGL 154,762 million, including target issues earmarked for companies and individuals. In terms of maturity, the structure of government securities issues in circulation was as follows: with a term of up to one year, BGL 85,169 million or 55%; with a term of up to 5 years, BGL 58,333.5 million or 37.7%; and with a term of up to nine years, BGL 11,259.5 million or 7.3%.

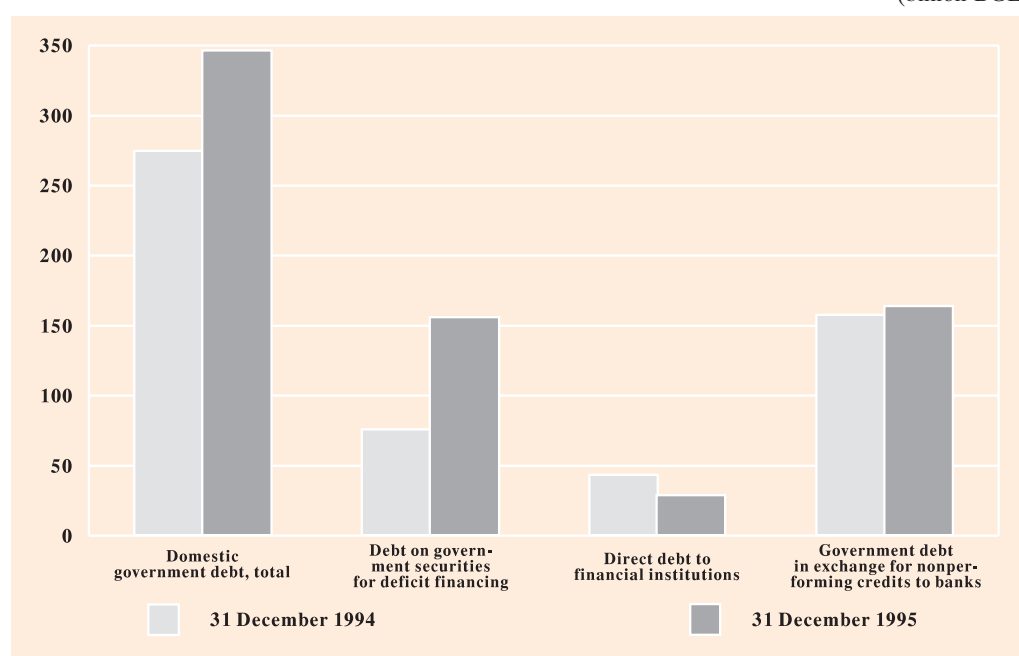
In 1995, the budget deficit was funded primarily by short-term debt instruments which comprised 74.4% of government securities issued. This, in certain periods, necessitated substantial budget expenditures in cash to service the domestic government debt. To this end, the MF efforts to ease budget expenditures through

reverse repurchase of investors' portfolios of maturing government securities and replacement of old securities by new securities with different maturity, combined with the BNB extensive employment of government securities transactions as a tool to regulate banking system liquidity, helped restructure domestic debt payments of BGL 39,029.8 million, including principals and interest. This amounted to 26.2% of the debt service expenditure on government securities, issued to fund the budget deficit.

In pursuance of MF policy aimed at improving domestic government debt management and promoting its market orientation, direct debt of BGL 10,021.96 million to the BNB was securitized. It was replaced by four extra issues of nine-year government bonds. This transformation did not affect cash basis performance of the budget, and helped restructure the debt, which favored market orientation and management of the debt. This, coupled with regular repayment installments of BGL 4,013.3 million led to a decrease in direct debt to the central bank from BGL 40,086.8 million in early 1995 to BGL 26,051.5 million by year-end, or by 35%.

STRUCTURE OF DOMESTIC GOVERNMENT DEBT

(billion BGL)



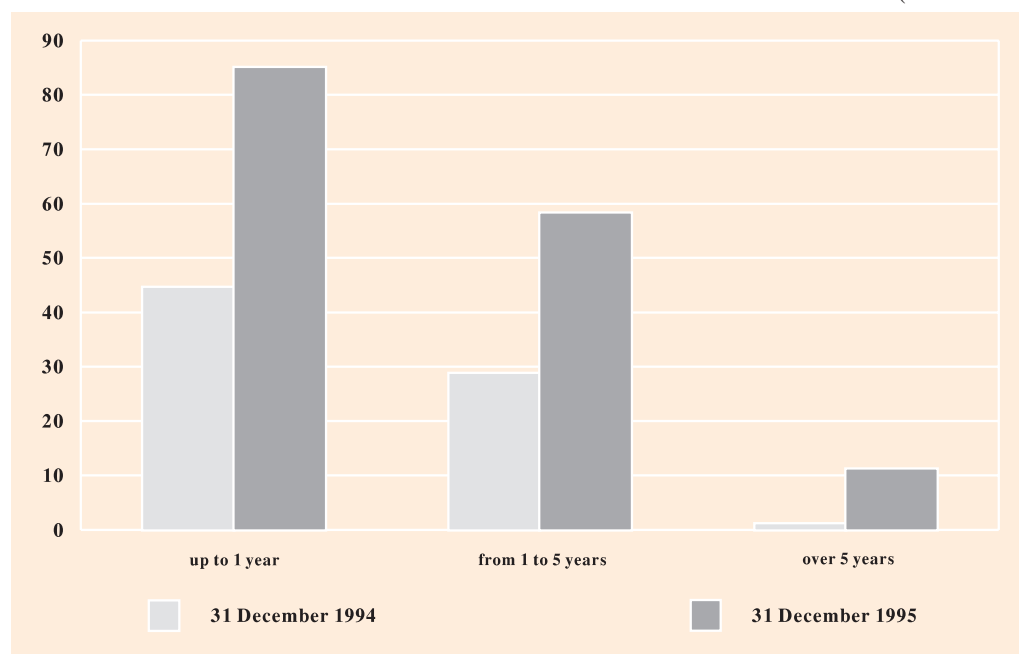
Source: BNB.

Direct debt to the State Savings Bank (SSB) and the State Insurance Institute (SII) was regularly serviced and decreased from BGL 2,210.9 million in early year to BGL 1,737.9 million by year-end, or by 21.4%.

Debt on long-term government bonds issued to settle nonperforming credits of state-owned companies to banks and outstanding debt of municipalities on credits extended by the SSB on housing construction increased from BGL 156,581.6 million in early 1995 to BGL 162,843.8 million by year-end, or by 4%. This increase was primarily a result of the change in the exchange rate and newly issued medium-term bonds of BGL 2,600 million, issued to settle unpaid obligations of municipalities on credits extended by the SSB on housing construction. The effective decrease of BGL 1,615.9 million was the result of the utilization of these securities in privatization deals and in repayment of nonperforming credits of state-owned companies assumed as government debt.

**MATURITY STRUCTURE OF GOVERNMENT SECURITIES IN CIRCULATION
ISSUED FOR BUDGET DEFICIT FINANCING**

(billion BGL)



Source: BNB.

Significant changes occurred in the structure of debt on long-term government bonds. In pursuance of CM Decree No. 89 of 1995 for rehabilitation of the Economic Bank Ltd. and Mineralbank Ltd., a portion of long-term bonds, issued under Article 5 of the LSNC in the amount of USD 837.7 million, and bonds issued under CM Decree No. 234 of 1992, CM Decree No. 3 of 1994 and Article 4 of the LSNC, worth BGL 2,387.5 million and included in the portfolios of these banks, was replaced by 7-year government bonds of BGL 58,314.7 million. These bonds ensure higher yield and interest equal to the effective basic interest rate, payable twice a year.

