



# Bulgarian National Bank

**REPORT • January – June 2013**



BANQUE NATIONALE DE BULGARIE





# **Bulgarian National Bank**

---

## **REPORT • January – June 2013**

Published by the Bulgarian National Bank  
1, Knyaz Alexander I Square, 1000 Sofia  
Tel.: (+359 2) 9145 1351, 9145 1209, 9145 1231, 9145 1978  
Fax: (+359 2) 980 2425, 980 6493  
Website: [www.bnb.bg](http://www.bnb.bg)  
Printed in the BNB Printing Centre

© Bulgarian National Bank, 2013

ISSN 1313-3454

The BNB January – June 2013 Report employs data published prior to 18 October 2013. Materials and information in the Report may be quoted or reproduced without further permission. Due acknowledgment is requested.

The cover shows an engraving of the BNB building from the 1938 banknote with a nominal value of 5000 leva.

Honourable Chair of the National Assembly,  
Honourable People's Representatives,

Under the provisions of Article 1, paragraph 2 and Article 50 of the Law on the Bulgarian National Bank, I have the honour of presenting the Bank's Semi-annual Report for the period ending 30 June 2013.

A handwritten signature in black ink, appearing to read 'Ivan Iskrov', written over a horizontal line.

Ivan Iskrov  
Governor  
of the Bulgarian National Bank

BNB Governing Council



Sitting from left to right: Penka Kratunova, Ivan Iskrov, Boryana Pencheva.  
Standing from left to right: Tsvetan Gunev, Kalin Hristov, Statty Stattev, Dimitar Kostov.

## Governing Council

---

**Ivan Iskrov**

Governor

**Dimitar Kostov**

Deputy Governor

Banking Department

**Kalin Hristov**

Deputy Governor

Issue Department

**Tsvetan Gunev\***

Deputy Governor

Banking Supervision Department

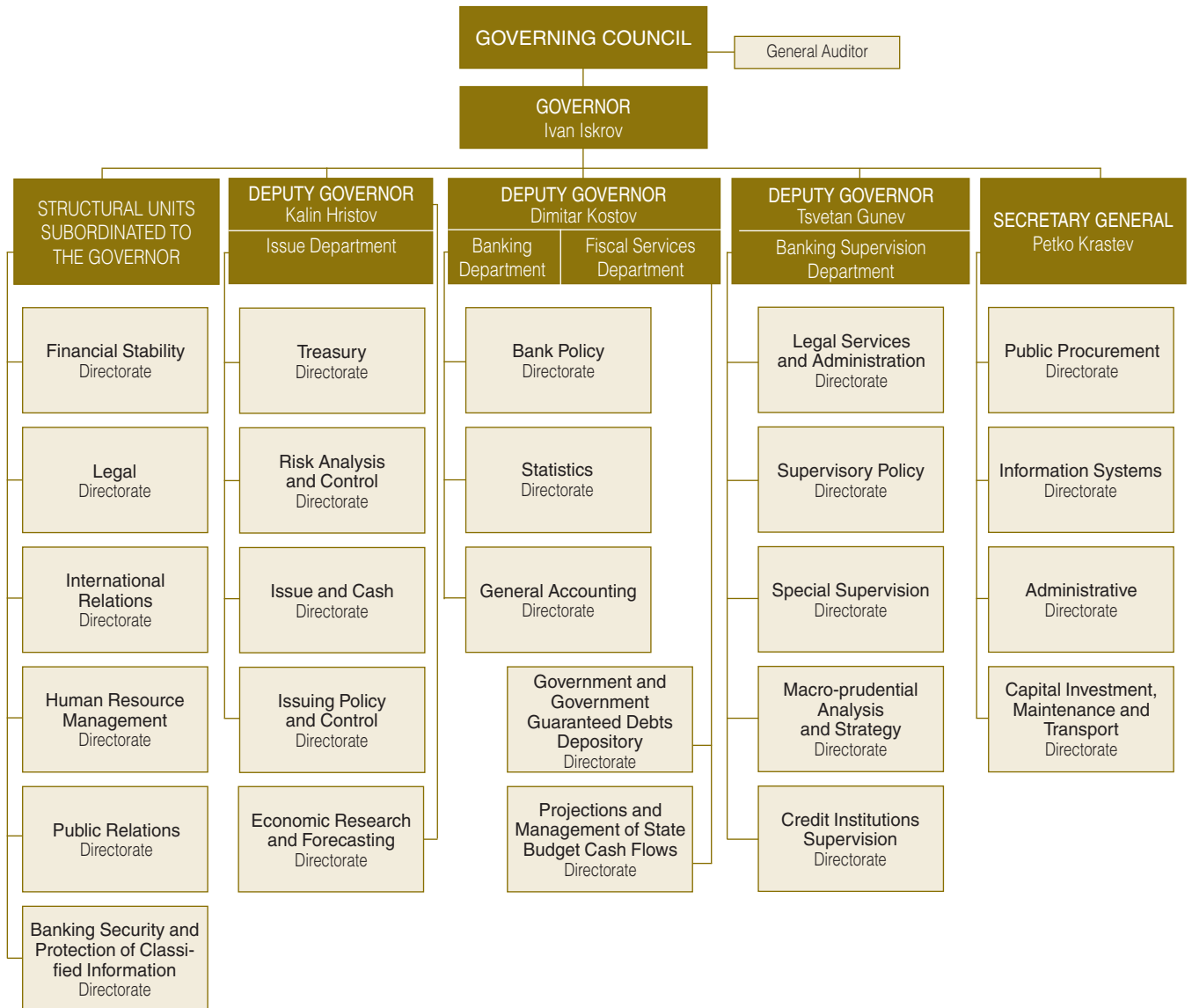
**Penka Kratunova**

**Boryana Pencheva**

**Statty Stattev**

\* Tsvetan Gunev is a Deputy Governor of the BNB in charge of the Banking Supervision Department since 16 June 2013. Until 15 June 2013 Rumen Simeonov was a Deputy Governor in charge of this department.

# Organisational Structure of the BNB



## Contents

Summary	9
I. Economic Development in the First Half of 2013	13
1. The External Environment	13
2. The Bulgarian Economy	16
II. Gross International Reserves	27
1. The Amount and Structure of Gross International Reserves	27
2. Gross International Reserve Risk and Yield	29
III. Payment Systems	34
1. Payment Systems and Securities Settlement Systems	35
2. Payment System Oversight	38
IV. Bank Reserves at the BNB	39
V. Cash in Circulation	41
VI. Maintaining Banking Stability and Protecting Depositors	45
1. The Banking System	45
2. Assessment of the Financial Performance of Financial Institutions Registered under the Law on Credit Institutions Article 3, Paragraph 2	52
3. Banking Supervision	53
VII. The Central Credit Register	57
VIII. The Fiscal Agent and State Depository Function	59
IX. Participation in the ESCB and in the Activities of EU Institutions	64
X. International Issues	68
XI. Statistics	69
XII. Research	71
XIII. Information Systems	72
XIV. Human Resources Management	73
XV. Facilities Management	75
XVI. BNB Internal Audit	76
XVII. BNB Budget Implementation in the First Half of 2013	78
1. Operating Expenditure	78
2. The Investment Programme	79
XVIII. Bulgarian National Bank Consolidated Financial Statements as of 30 June 2013 (unaudited)	81
Major Resolutions of the BNB Governing Council between 1 January and 30 June 2013	112
Appendix (CD)	



## Abbreviations

BIR	Base interest rate
BIS	Bank for International Settlements, Basle, Switzerland
BISERA	System for servicing customer payments initiated for execution at a designated time
BNB	Bulgarian National Bank
BORICA	Banking Organization for Payments Initiated by Cards
BSE	Bulgarian Stock Exchange
BTC	Bulgarian Telecommunication Company
CEFTA	Central European Free Trade Association
CIF	Cost, Insurance, Freight
CM	Council of Ministers
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EFTA	European Free Trade Association
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
FLIRBs	Front-loaded Interest Reduction Bonds
FOB	Free on Board
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
HICP	Harmonized Index of Consumer Prices
IFO	Institute of Economic Research, Germany
IMF	International Monetary Fund
LBNB	Law on the Bulgarian National Bank
MF	Ministry of Finance
MFIs	Monetary financial institutions
NLO	National labour office
NSI	National Statistical Institute
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
RINGS	Real-time Interbank Gross Settlement System
SBL	State Budget Law
SDR	Special Drawing Rights
TFP	Transitional and Final Provisions
VAT	Value Added Tax
ZUNK	Bulgarian abbreviation of the Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990 (LSNC)

## Summary

In the first half of 2013, global economic activity continued recovering at the moderate rate of 1.6 per cent annual growth, with regional deviations. The United States and Japanese economies continued improving slowly. Chinese real growth slowed while remaining high compared with the rest of the world. The annual rate of decline of euro area real GDP switched to 0.3 per cent growth on a chain basis in the second quarter, signalling an end to a recession spanning six quarters. Global business climate indicators started improving, especially in the second quarter. Lower international food and energy prices brought global inflation down to 3.4 per cent on an annual basis in June.

The trend to easing international financial market tension, observed since mid-2012, continued into 2013. Markets remained jittery, however, about developed countries' finances, key macroeconomic indicators, and the policies of larger central banks. Significant price fluctuations attended good and bad news. In February and March, market expectations worsened due to weaker than expected macroeconomic data for the euro area, especially compared with sustained US improvement. The Cyprus financial crisis, though brief, occasioned distress, as did the lengthy formation of an Italian cabinet. By late March and early April, Cyprus had a rescue plan, Italy had a cabinet, and European Financial Stability Mechanism and Financial Stability Facility loans to Italy and Portugal were extended from 12.5 to 19.5 years, easing market tensions. In May, Fitch upgraded Greece's credit rating to B- with a stable outlook, calming markets further. Prices moved again in the last two months of the half-year as the US Federal Reserve System announced a tailing off of quantitative easing. This occasioned expectations of a new global interest rate cycle, triggering a rapid change in market sentiment and hiking long-term interest. By the end of June, yield in the ten-year maturity sector of benchmark German bonds reached 1.73 per cent, the two-year maturity sector reaching 0.19 per cent. The gold price dropped greatly in the half-year, by 26.98 per cent in US dollars and 25.90 per cent in euro.

Recession in the euro area and continuing uncertainty in the external environment curbed Bulgarian growth. In the first half of 2013, real GDP rose slightly by 0.2 per cent on an annual basis. Households kept saving and spent little. Businesses invested conservatively. Net exports contributed most to real GDP growth at 2.8 percentage points. Inventories' contribution was negative by 3 percentage points. Exports rose 8 per cent in real terms on an annual basis, weak domestic demand keeping imports subdued. Higher real and nominal growth of exports than that of imports cut trade deficit to EUR 1236.7 million from EUR 2096.5 million in the first half of 2012. The current and capital account balance was in surplus by EUR 200.4 million from a EUR 869.1 million deficit a year earlier.

Relatively weak trading and corporate spending cuts continued eroding employment. The 0.5 per cent annual basis fall was far below those of 2009 to 2012, however. Unemployment reached 13.4 per cent from 12.6 per cent in the corresponding period last year. Labour productivity grew 0.7 per cent. Gross pay growth slowed to 4 per cent.

Lower international food and fuel prices and lower administered household power prices curbed annual inflation to 2.3 per cent, with inflation between January and June negative at -0.8 per cent.

The downward growth trend of M3 broad money continued. Monetary aggregates restructured, with growing overnight deposits and moderate quasi-money growth. Private sector credit growth continued falling, claims on non-financial corporations

rising 1.8 per cent as weak trading subdued demand. Claims on households fell 0.9 per cent on an annual basis, overdrafts and consumer credit declining moderately at 2.3 and 1.1 per cent. Housing loans rose slightly by 0.1 per cent.

Revenue and grants into the consolidated state budget rose 7.1 per cent on the first half of last year. This was largely due to grants (3.2 percentage points), mostly from European Union Structural and Cohesion Funds. Tax revenue rose 2.4 percentage points, mostly from higher value added tax and social and healthcare insurance. Direct tax revenue fell 4.7 per cent. The time deposit interest tax introduced in early 2013 brought BGN 39.9 million. Government spending rose 7.7 per cent. Welfare contributed most at 3.1 percentage points and rising 7 per cent by the close of the second quarter. Following 19.6 per cent growth in 2012, government capital spending grew just 1.2 per cent on an annual basis in the half-year. Consolidated fiscal programme deficit for the period was BGN 7.8 million.

The Law on the Bulgarian National Bank (LBNB) sets the BNB's primary objective as maintaining price stability through national currency stability. The Bank invests gross international reserves to legal constraints and prudent investment principles, regulates and supervises banks in Bulgaria to ensure system stability and protect depositors, oversees payment systems, and regulates and supervises payment and electronic money institutions. As issuing bank, it prints, mints, stores, and scraps cash. The Bank is the state's fiscal agent and depository. It participates in the European System of Central Banks and other European Union bodies.

By the end of June 2013, the market value of gross international reserves was EUR 14,590 million: a EUR 962 million fall on the end of 2012. Net income from international reserve management, the result of investing gross international reserves, was EUR -0.98 million. A currency imbalance yield of EUR -412.74 million resulted from the change in the EUR price of monetary gold and EUR 0.05 million interest on Issue Department balance sheet liabilities. Net income for the half-year was EUR -413.77 million or -3.15 per cent.

Investing international reserves, the Bank was mindful of uncertainty and fluctuations in sovereign bond prices. The primary objectives of high security and liquidity directed most investment into German and French bonds with up to three-year maturities, German government guaranteed debt, and short-term deposits. By the end of the half-year, some 82 per cent of the reserve were invested into assets with the highest credit quality.

The uncertain international environment and slow recovery continued hampering bank intermediacy. Uncertain prospects diluted business credit demand. Households continued saving, boosting system deposits and preferring to repay debt rather than borrow. Deposits rising faster than credit maintained high banking liquidity. The liquid asset ratio reached 25.9 per cent. Banks increased foreign assets, repaid external obligations, invested in mostly Bulgarian government bonds, and lent despite low demand.

Classified exposure growth continued falling, as it had done since the second half of 2012. The share of exposures past due over 90 days in gross loans (excluding loans to credit institutions) rose to 17.1 per cent from 16.6 at the end of 2012. The ratio of net non-performing loans (past due over 90 days) to net loans rose to 10.7 per cent. Banks countered sharpened credit risk by increasing provisions against impairment and specific credit risks. Coverage ratios for exposures past due over 90 days (including loss ones) rose to 71.5 per cent. Credit institutions boosted capital surpluses, maintaining accumulated capital buffers. Individual institutions' capital positions related adequately to their risk profiles.

By 30 June 2013, the banking system made BGN 318 million profit, down BGN 6 million on the first half of 2012. Given 4.7 per cent assets growth, return on assets (ROA) fell slightly from 0.83 to 0.77 per cent on an annual basis. Attracted additional

capital resources reflecting banks' strengthened capital positions cut the return on balance sheet equity and reserves (ROE) from 6.49 to 6.15 per cent.

Payment systems provided good payment flow continuity. Supervision limited system risk and improved reliability and efficiency. The BNB's RINGS system processed 87.4 per cent of payments by value: 489,087 payments for BGN 403,198 million. The number of payments through the TARGET2-BNB national system component for euro payments rose 39.8 per cent.

Issue and cash operations encompass production, safeguarding, and handling of Bulgarian cash. Sorting machines at the BNB and the Cash Services Company tested 397 million banknotes and 88.4 million coins. In late June 2013, 326.6 million banknotes worth BGN 8971 million circulated: 97.83 per cent of cash outside BNB vaults by value. The average banknote was worth BGN 27.47. Circulating coins numbered 1538.2 million, worth BGN 193 million: 2.10 per cent of cash outside BNB vaults. The average coin was worth BGN 0.13. Two commemorative coins were circulated in the half-year. Retained non-genuine Bulgarian banknotes represented 0.000285 per cent of circulating banknote numbers. Retained non-genuine Bulgarian coins represented 0.000022 per cent of circulating coin numbers. To ensure cash circulation integrity and security, the BNB performed four full and 12 spot on-site checks into credit institution and service provider cash handling.

The Bank advises the Ministry of Finance of budget entities' domestic bank account details and acts as government debt agent under market rate contracts. The IOBFR system issued 446 statistical reporting forms for the budget (up 5 per cent on the same period of 2012) including 152 on the fiscal reserve. The 16 government securities auctions *via* the GSAS system netted BGN 1460.6 million nominal or 1.8 times more than in the same period last year. The ESROT system logged BGN 1736.2 million worth of initial government securities acquisitions and repayments on maturing issues, up 46.1 per cent on an annual basis.

The European Commission obtained approval for financial regulations centring on the euro area. In April, Parliament and Council reached political agreement on two regulations creating a single supervisory mechanism. In June, Council adopted a general approach on the credit institution and investment firm recovery and resolution directive. June saw adoption of the capital requirements regulation and directive.

In ESCB, European Commission, Council, European Systemic Risk Board, European Banking Authority, and Council for European Affairs committees and working groups, the BNB contributed to Bulgarian positions on important business and financial issues. The Bank supported EU and euro area legislative and institutional amendments, while insisting on the need to preserve the single market.

The Bank continued cooperating extensively with Balkan central banks and supporting their preparations for EU entry. Successful technical assistance projects financed by the EU and managed by the ECB enhanced BNB regional technical assistance capacity.





# I. Economic Development in the First Half of 2013

## 1. The External Environment

In the first half of 2013 global economic activity continued rising, though at the lower annual growth rate of 1.6 per cent.<sup>1</sup> Regional diversity was great. The United States and Japan continued gradual recoveries. Chinese growth continued slowing. The annual rate of decline in euro area real GDP began slowing. The second quarter saw 0.3 per cent growth, signalling an end to a recession spanning six quarters.

Global industrial output rose 2.5 per cent on average from the first half of 2012. World trade grew at 1 per cent a year on -0.2 per cent in 2012.<sup>2,3</sup>

### Major Macroeconomic Indicators (period averages)

(per cent)

	Growth				Inflation				Unemployment			
	2011	2012	2013		2011	2012	2013		2011	2012	2013	
			I	II			I	II			I	II
EU-27	1.7	-0.4	-1.5	-0.2	3.1	2.6	2.0	1.6	9.7	10.5	10.9	10.9
Euro area-17	1.5	-0.6	-1.8	-0.5	2.7	2.5	1.9	1.4	10.2	11.4	12	12.1
EU-7	3.3	0.7	0.1	0.8	3.9	3.7	2.1	1.4	9.3	9.4	9.6	9.5
EU-3	1.5	0.2	-1.0	0.7	4.0	2.6	2.4	2.3	8.0	7.9	7.8	7.8
United States	1.8	2.8	1.3	1.6	3.1	2.1	1.7	1.4	9.0	8.1	7.7	7.6
Japan	-0.6	2.0	0.3	1.2	-0.3	0.0	-0.6	-0.3	4.6	4.4	4.2	4.0
China	9.3	7.7	7.7	7.5	5.4	2.7	2.4	2.4	4.1	4.1	4.1	4.1

**Notes:** The EU-7 are countries joining since 2004 less those now in the euro area. The EU-3 are Denmark, Sweden, and the United Kingdom. EU-7 and EU-3 indicators are calculated by weighing time series by country weights in group GDP for growth, in group labour force for unemployment, and the weights of the EU-27 in HICP, calculated by Eurostat for inflation. Real GDP is calculated on an annual basis using non-seasonally adjusted data.

**Sources:** Eurostat, Bureau of Labor Statistics, Bureau of Economic Analysis, Statistics Bureau of Japan, the National Bureau of Statistics of China, BNB estimates.

Euro area economic activity showed early improvement signs. The rate of annual real GDP decline moderated and second quarter growth was 0.3 per cent on a quarterly basis, after six consecutive quarters of recession. Household consumption and gross capital formation growth also accelerated in the second quarter. Leading consumer and business confidence indicators began improving. Seasonally adjusted unemployment rose to 12.1 per cent in the second quarter from 11.4 per cent at the end of 2012.

In the first half of 2013 US economic activity continued improving on an annual basis. In the first quarter the government expenditure drop resulting from automatic measures activated in early March hit consumer and investment sentiment. In the second quarter, however, annual growth accelerated. Unemployment continued falling to 7.6 per cent in the second quarter.<sup>4</sup>

Global inflation fell slightly to 3.4 per cent annually in June.<sup>5</sup> Inflation rose in developing countries and fell in developed ones. Lower international food and energy prices contributed most to the global slowdown. In June euro area inflation fell to 1.6 per

<sup>1</sup> Based on seasonally adjusted World Bank data from 11 September 2013.

<sup>2</sup> *Ibid.*

<sup>3</sup> International Monetary Fund data from 11 September 2013.

<sup>4</sup> Seasonally adjusted data.

<sup>5</sup> International Monetary Fund data from 11 September 2013.

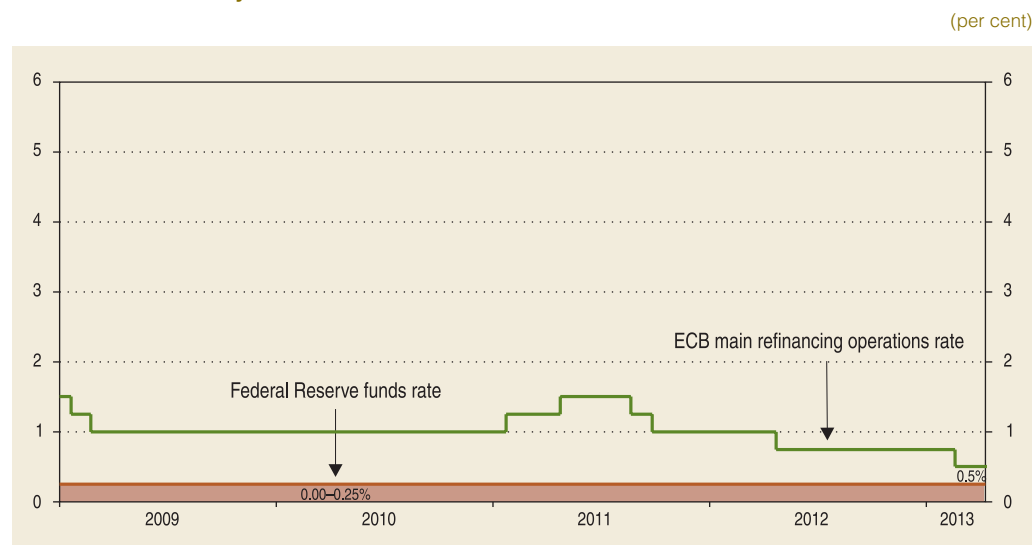
cent on an annual basis from 2.2 per cent in December 2012, core inflation declining to 1.2 per cent in June from 1.5 per cent in December.<sup>6, 7</sup> US consumer price inflation was 1.8 per cent, core inflation rising insignificantly to 1.6 per cent on June 2012.<sup>8</sup>

Brent crude prices fell, especially in March and April. Oil traded at USD 108/EUR 82.2 a barrel on average, peaking at USD 116.5/EUR 87.2 in February and falling to USD 102.9/EUR 79 in April. On an annual basis, oil prices fell 5.1 per cent in US dollars and 6.2 per cent in euro. Food prices fell on the first half of 2012, the average food price index dropping 2 per cent. Commodity prices also fell, the non-energy commodities index dipping 2.9 per cent. Metal prices dropped considerably by 4.7 per cent on average.

International financial markets remained jittery, changes in market sentiment affecting business and household expectations. The gradual calming underway since mid-2012 continued into early 2013. It followed less drastic than expected US fiscal consolidation measures and euro area banks' early repayment of liquidity from the ECB's December 2011 and February 2012 long-term operations.

In March 2013, however, tension returned to the markets. Concerns about the Cyprus banking crisis and its implications for more vulnerable euro area countries promoted moves into low risk assets, boosting demand for German government bonds and depressing their yield. The Cyprus bailout of late March slowly calmed the markets, restoring euro area periphery countries' bond spreads to pre-crisis levels. The formation of an Italian cabinet after general elections in late February and Moody's confirmed country rating also helped calm markets.

### Federal Reserve System and ECB Main Interest Rates



Sources: the ECB, the Federal Reserve System.

In May, the ECB cut its main refinancing operations rate by 25 basis points to 0.50 per cent and its marginal lending rate by 50 basis points to 1 per cent, leaving deposit rates unchanged at 0 per cent. The ECB also announced it would continue providing unlimited main, short and long-term refinancing until at least July 2014. Euro area banks continued early repayments of long-term ECB financing extended in December 2011 and February 2012, refunding 62 per cent of it in net terms in the half year. Excess banking system liquidity was EUR 263 billion: a 19 month low.<sup>9</sup> The ECB

<sup>6</sup> Measured by the Harmonised Index of Consumer Prices (HICP).

<sup>7</sup> Core inflation excludes energy, food, alcohol, and tobacco prices.

<sup>8</sup> US inflation measured by the consumer price index, excluding food and fuel prices.

<sup>9</sup> Excess liquidity is the difference between the volume of ECB refinancing operations plus the two covered bond purchase programmes and the amount of autonomous factors and required reserves.

balance sheet declined 19.5 per cent on the end of 2012. Despite early repayment of long-term refinancing, euro area money market interest rates remained broadly unchanged from the last quarter of 2012. EONIA reference overnight interest ranged between 0.06 and 0.21 per cent, its average hovering at 0.08 per cent.

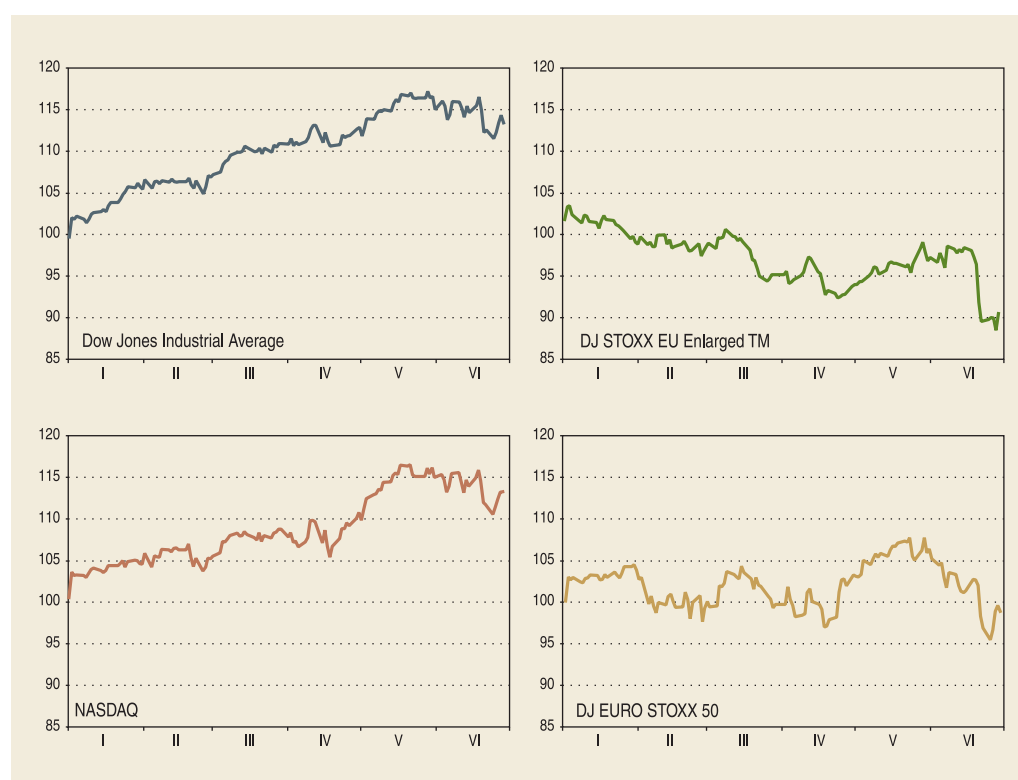
The US Federal Open Market Committee decided to continue buying USD 45 billion of US government bonds and USD 40 billion of mortgage backed securities a month, as it had done since mid-2012. It also decided to reinvest earnings from bonds into more bonds and earnings from government debt securities and mortgage bonds into more mortgage bonds. The federal funds target rate remained 0 to 0.25 per cent.

In May, the Federal Reserve System stated it might curb or end additional monetary stimuli if economic activity and labour markets continue improving. This dramatically boosted US government bond yields across the curve, especially its long end. Euro area periphery debt yields also rose greatly, core ones rising less.<sup>10</sup>

In the first months of the year US stock market indices rose, especially in May. The strong macroeconomic indicators boosted market optimism. In June, the Dow Jones Industrial rose 14.4 per cent and the NASDAQ Composite 13.7 per cent on December 2012.

European stock indices showed no clear improvement and had divergent dynamics. Signs of weak economic activity in early 2013 hit market sentiment despite improving macroeconomic indicators and decreased the main refinancing rate in the second quarter. The Dow Jones EURO STOXX 50 rose 1.1 per cent and the Dow Jones STOXX EU Enlarged TM fell 5 per cent on December 2012.

### Main Stock Exchange Indices in the First Half of 2013



Note: Indices are calculated in US dollars, December 2012 = 100.

<sup>10</sup> For details on euro area and US government bond yields, see Chapter II.



## 2. The Bulgarian Economy

Euro area recession in 2012 and continuing global uncertainty curbed Bulgarian growth and subdued economic activity in the first half of 2013. Real GDP rose 0.2 per cent on an annual basis from 1 per cent in the first half of 2012.<sup>11</sup> Firms continued investing conservatively. After a 0.2 per cent fall in the second half of 2012, fixed capital investment fell another 0.9 per cent. Relatively high unemployment and weak recovery boosted household savings and curbed spending. Net exports contributed most to real GDP growth at 2.8 percentage points. Real terms goods and service exports rose 8 per cent on an annual basis as Bulgaria's main trading partners economies improved. Goods and service imports performed similarly, albeit growing less. Declining inventories eroded GDP growth most at 3 percentage points.

### Real GDP Growth and Contribution by Component of Final Consumption

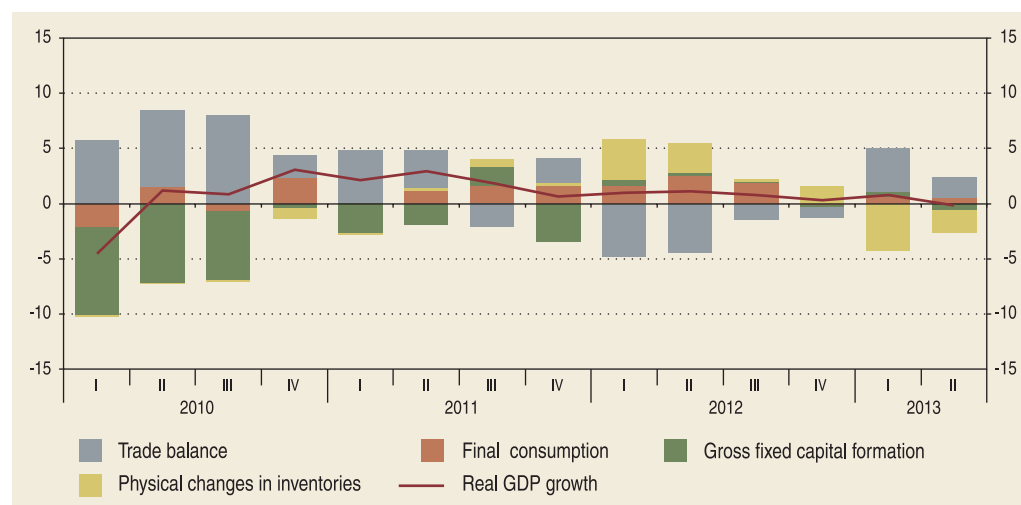
(on the corresponding period of 2012; non-seasonally adjusted data)

	2012				2013	
	January – June		July – December		January – June	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
GDP	1.0	-	0.6	-	0.2	-
Final consumption	2.6	2.1	1.1	0.8	0.7	0.6
Household consumption	3.4	2.2	1.7	1.0	0.0	0.0
NPISH consumption	24.9	0.1	6.1	0.0	4.0	0.0
Final consumption expenditure of the general government sector	-1.4	-0.1	-3.1	-0.2	3.1	0.3
Collective consumption	-1.4	-0.1	0.5	0.0	3.9	0.3
Gross fixed capital formation	2.1	0.4	-0.2	0.0	-0.9	-0.2
Physical changes in inventories	-	3.1	-	0.9	-	-3.0
Exports (goods and services), net	-	-4.6	-	-1.2	-	2.8
Exports (goods and services)	0.4	0.3	-1.0	-0.7	8.0	5.4
Imports (goods and services)	6.7	-4.9	1.0	-0.5	3.3	-2.7

Sources: NSI, BNB.

### Real GDP Growth and Contribution by Component of Final Consumption

(per cent, percentage points on corresponding quarters in 2012)



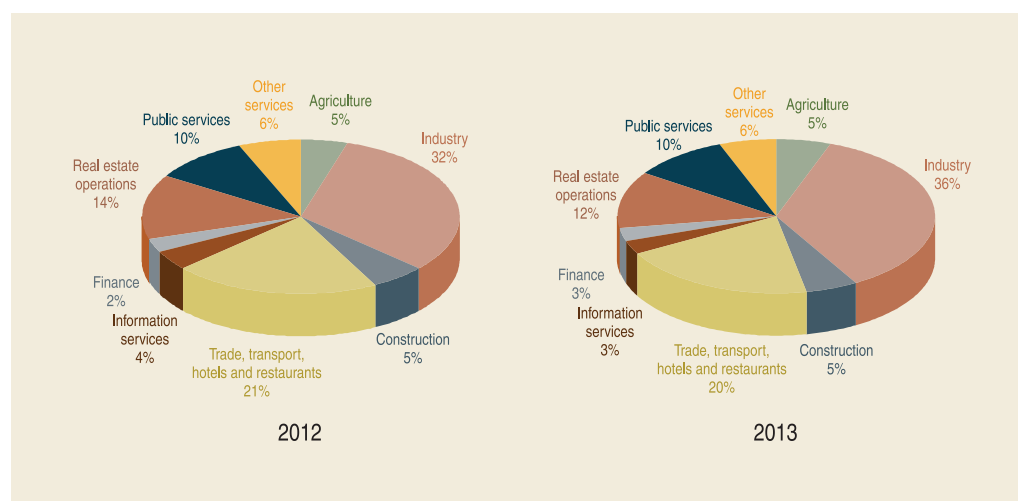
Sources: NSI, BNB.

<sup>11</sup> Non-seasonally adjusted data.

In the first half of 2013 government consumption boosted economic growth. Public sector pay and operating expenditure contributed most to annual growth at 0.6 percentage points from their 0.2 percentage point negative contribution in 2012.<sup>12</sup>

The labour market stabilised, employment contraction slowing significantly and boosting household demand slightly. Nevertheless, high current and expected unemployment and economic activity uncertainty continued prompting households to save rather than spend, keeping real household demand at its early 2012 level.

### Structure of Fixed Asset Expenditure by Sector in the First Half of 2013



Note: Preliminary data for 2013.

Sources: NSI, BNB.

Fixed capital investment fell 0.9 per cent in real terms on the same period of 2012. Worsened business expectations of future economic activity and slowing foreign direct investment inflows fuelled the decrease. NSI preliminary data showed that nominal expenditure on acquiring fixed assets dropped 1.7 per cent on an annual basis. Declines hit almost all sectors except industry and agriculture, where fixed asset expenditure grew 3.6 and 0.8 per cent. Increased industry investment reflected mainly optimisation in this export oriented sector and higher capacity utilisation in 2012.

### Gross Value Added Change in Real Terms and Contribution by Industry

(on the corresponding period of 2012, non-seasonally adjusted data)

	2012				2013	
	January – June		July – December		January – June	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
Gross value added	-0.2	-	0.7	-	0.1	-
Agriculture and forestry	9.9	0.2	0.3	0.2	12.2	0.4
Industry*	1.0	0.3	0.5	0.1	-2.1	-0.7
Services	-1.2	-0.8	0.7	0.4	0.7	0.4

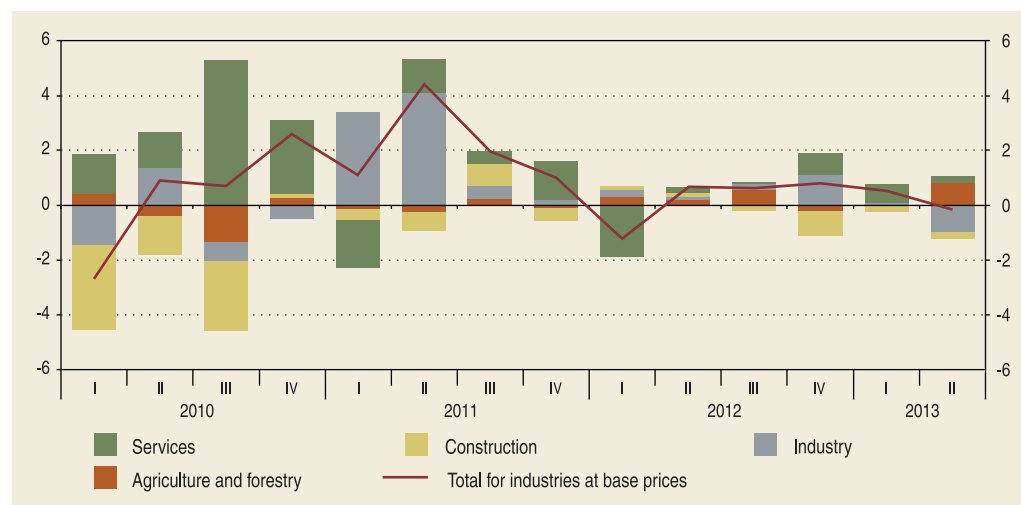
\* Industry and construction.

Sources: NSI, BNB.

<sup>12</sup> Employee compensation growth partly reflected increased army and police social security contributions, while operating expenditure growth mainly reflected higher EU Structural and Cohesion Fund take-up.

### Gross Value Added Change in Real Terms and Contribution by Industry

(per cent, percentage points on corresponding quarter of 2012)



Sources: NSI, BNB.

Gross value added annual growth hovered at zero from -0.2 per cent in the first half of 2012 due to industrial sector contraction. Industrial value added fell because of slower domestic demand growth and higher-than-expected external demand for finished and semi-finished goods stocks. Economic activity in construction also declined, falling civil and engineering construction volumes contributing most. Services contributed to overall value added growth, mostly through higher demand in financial and insurance, trade, transport, hotels and restaurants, creation and dissemination of information and author products, telecommunications and real estate operations.

In the first half of 2013 employment stabilised, national account data showing just 0.5 per cent annual basis fall in the number of employed after a long decline. After a 1.7 per cent first quarter annual fall, employment rose 0.7 per cent in the second quarter for the first time since 2009. Employment rose in agriculture, forestry, fishery and services subsectors less affected by the crisis (creation and dissemination of information and author products, telecommunications and professional activities and scientific research, administrative and ancillary activities). Industry<sup>13</sup> and trade, transport, and hotels and restaurants contributed most to unemployment. Industrial employment fell 3.1 per cent as in 2012. Employment in trade, transport, hotels and restaurants fell 1.8 per cent from 3.2 per cent in 2012. Labour force survey data show employment rising 0.5 per cent on an annual basis in the first two quarters.

The labour survey showed a slight year-on-year rise in average unemployment to 13.4 per cent over the first half year (12.6 per cent in the same period of 2012). The average number of unemployed persons registered with the Employment Agency rose slightly to 11.5 per cent from 11.2 per cent in the same period of 2012. As in 2012, including active job seekers who had been economically inactive in prior years boosted the number. The number of discouraged people declined on an annual basis to 227 thousand from 243 thousand. The slight increase in labour supply and overall decline in working age persons maintained the upward trend in 15 to 64 year old economic activity ratio, which began in 2012. Between January and June, it averaged 67.7 per cent from 66 per cent a year earlier.

Labour survey data show that long-term unemployment (over a year) contributed more to increased unemployment than short-term (up to a year). The share of long-

<sup>13</sup> Industry and construction.

term unemployed rose slightly to 55.4 per cent of all unemployed from 54.7 per cent in the same period of 2012.

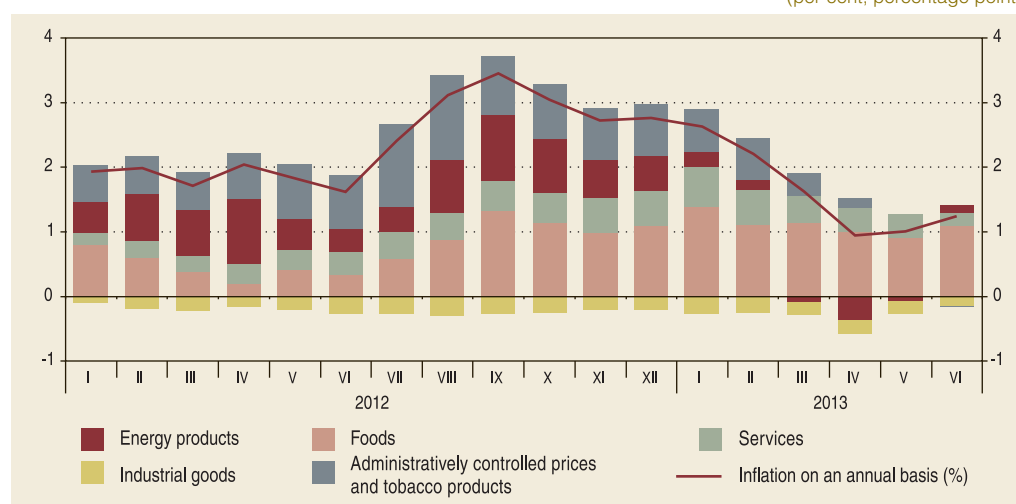
Labour productivity<sup>14</sup> growth slowed to 0.7 per cent a year from 4.1 and 2.7 per cent in the first and second halves of 2012. Industry and trade, transport, and hotels and restaurants contributed most to the fall. Industry and trade, transport, hotels and restaurants had the major contribution to the lower growth of labour productivity. It also fell on an annual basis in the sectors creation and dissemination of information and author products, telecommunications and professional activities and scientific research, administrative and ancillary activities, though at slower rates compared with those in 2012. Higher labour productivity growth was recorded in agriculture, forestry and fishery, and real estate operations.

Short-term employment and labour costs statistics showed slowing gross wage growth. Gross pay grew 4 per cent on an annual basis from 10.9 and 10.3 per cent in the first and second halves of 2012. Sectoral pay dynamics broadly corresponded to lower productivity growth. Pay growth slowed more in most services subsectors and less in industry. Agriculture, forestry and fishery, general government, education, healthcare, and social sector pay rose faster.

Annual inflation continued falling as it had done since late 2012, reaching 1.2 per cent in June from 2.8 per cent in December 2012.<sup>15</sup> Cheaper administered household power and world oil price falls resulting in cheaper fuel and services were the main reasons. The oil price moderated energy product prices in the first quarter, prompting a slight second quarter fall. Lower household power prices in March and marginally cheaper pharmaceuticals contributed most to 0 per cent inflation in administratively set goods and service prices by June from 5 per cent in December. Food inflation remained higher at 4.3 per cent in June than overall consumer price inflation, mainly because of unprocessed foods prices.

### Annual Inflation Rate and Contributions by Major Goods and Services Groups

(per cent, percentage points)



Sources: NSI, BNB.

<sup>14</sup> Real GDP measures labour productivity in the overall economy. Sectoral real terms added value measures sectoral productivity.

<sup>15</sup> The analysis employs HICP data.



### Inflation Accumulated since the Year's Start and Contribution of Major Goods and Service Groups to It

	January–June 2012		January–June 2013	
Inflation (per cent)	0.7		-0.8	
	Inflation by group (per cent)	Contribution, percentage points	Inflation by group (per cent)	Contribution, percentage points
<b>Foods</b>	<b>0.3</b>	<b>0.09</b>	<b>0.4</b>	<b>0.11</b>
Processed foods	0.1	0.02	0.1	0.02
Unprocessed foods	0.8	0.06	1.0	0.09
<b>Services</b>	<b>0.6</b>	<b>0.14</b>	<b>-0.7</b>	<b>-0.18</b>
Catering	0.8	0.04	1.3	0.07
Transport	3.1	0.14	-1.3	-0.04
Telecommunications	-0.4	-0.02	-0.6	-0.03
Other services	-0.1	-0.01	-1.6	-0.17
<b>Energy products</b>	<b>3.9</b>	<b>0.34</b>	<b>-1.0</b>	<b>-0.09</b>
Transport fuels	3.9	0.32	-0.8	-0.07
<b>Industrial goods</b>	<b>-1.2</b>	<b>-0.24</b>	<b>-0.9</b>	<b>-0.17</b>
Administratively controlled prices	2.2	0.36	-2.6	-0.47
<b>Tobacco products</b>	<b>0.0</b>	<b>0.00</b>	<b>0.2</b>	<b>0.01</b>

**Note:** This structure corresponds to the Eurostat classification. Tobacco products and administratively priced goods and services are shown separately. The administratively controlled price index is calculated through the elementary aggregates level in the consumer basket.

**Sources:** NSI, BNB.

The recent years' trend to comparatively low core inflation<sup>16</sup> continued, the indicator reaching 0.1 per cent in June from 0.7 per cent in December. This reflected world prices and subdued household demand. Non-food prices (excluding fuels) continued falling on an annual basis and service price growth slowed to 0.8 per cent from 2.1 per cent in late 2012. Non-food prices were mainly driven by a steady drop in durable goods prices. Fuel prices curbed transportation price growth greatly, contributing most to lower services inflation. By late June, their index dipped slightly from the same period of 2012. Catering prices, with a relatively higher weight in the consumer price index, continued growing sustainably by 4 per cent on the same period last year.

In the first six months of 2013 the current and capital account had a EUR 200.4 million surplus from a EUR 869.1 million deficit at the same time last year. This was mainly due to a EUR 126.9 million positive current account balance from a deficit of EUR 924.6 million over the same period last year. Capital account surplus was also larger at EUR 73.5 million from EUR 55.5 million.

The trade deficit fell to EUR 1236.7 million from EUR 2096.5 million between January and June 2012. The balance of net current transfers and lower deficit on the income account improved, net current transfers reaching EUR 1460.5 million from EUR 1193.5 million in the same period of the previous year through higher government revenue. Income account deficit fell by EUR 20.9 million to EUR 621.7 million mainly because of stronger inflows in the form of compensation of employees and lower loan income payments.

The trade deficit reduction reflected 7.8 per cent nominal export growth and 0.7 per cent nominal import contraction. Most commodity export groups reported growth. Machines, transport facilities, appliances, instruments, weapons (2.7 percentage points), animal and plant products, foods, drink and tobacco (2.3 percentage points) and mineral products and fuels (1.7 percentage points) contributed most. Exports to EU countries recovered, contributing 3.9 percentage points to nominal export growth to match third country export growth. Price falls in most commodity groups limited

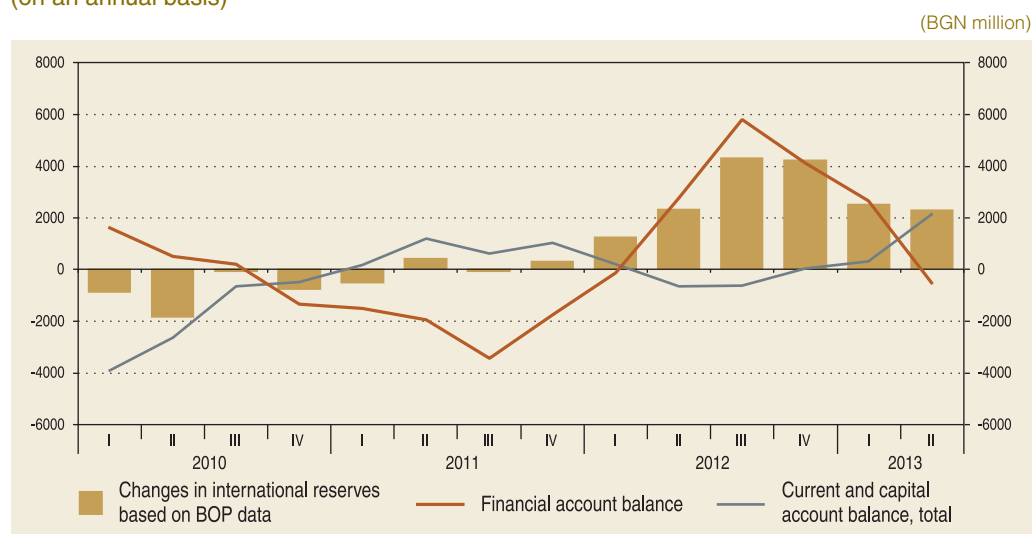
<sup>16</sup> Core inflation excludes food, energy products, controlled price goods and services, and tobacco products.

nominal export growth. Subdued investment and lower world energy prices were the main reasons for the nominal import falls in investment goods and energy products with -2.2 and -0.8 percentage point contributions. Consumer goods and raw materials imports by end use of imports recorded positive growth, contributing 1.2 and 0.8 percentage points to the overall imports.

Preliminary balance of payments data show EUR 688 million of foreign direct investment inflows (1.7 per cent of GDP on an annual basis), attracted funds in the form of equity contributing greatly. Investment went mainly into transport (EUR 166.3 million) and financial intermediation (EUR 137.9 million).

The financial account deficit was EUR 1038.2 million from a EUR 1331.5 million surplus the same time last year. Amid buoyantly growing resident funds, banks continued boosting foreign assets and repaying external liabilities, contributing most to the deficit. In the first half year banks increased foreign assets by EUR 932.8 million (portfolio and other investment), decreasing foreign liabilities by EUR 309.7 million (mainly other investment). Government operations also contributed to the financial account deficit, pushing down the liability side of portfolio investment by EUR 341.9 million. They comprised mostly nominal payments of EUR 818.5 million on euro-denominated Bulgarian global bonds maturing in January. This affected balance of payments flows (in the part held by non-residents) and external debt (EUR 301.4 million and EUR 309.1 million). FDI inflows contributed to the contraction of the financial account deficit.

### Current Account, Capital and Financial Account, and International Reserve Movements (on an annual basis)



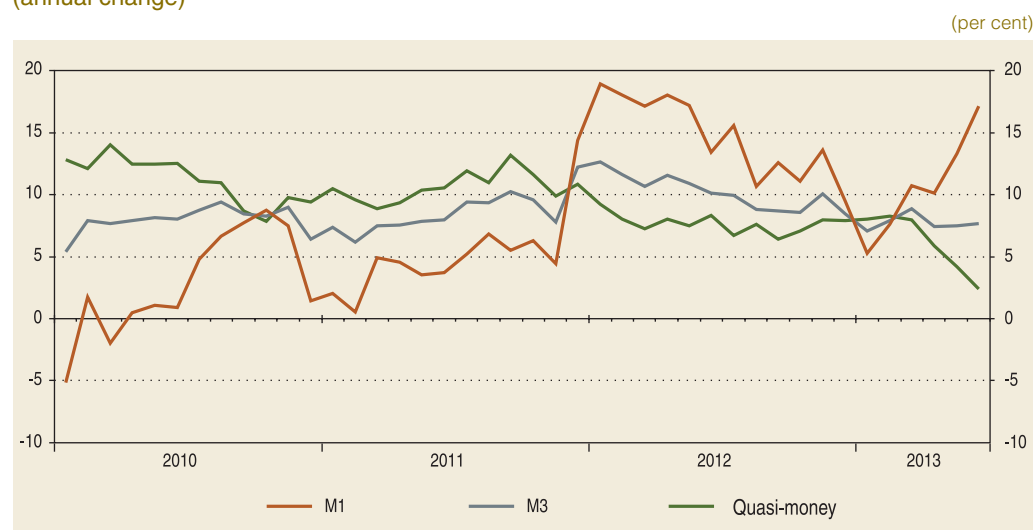
Source: BNB.

Gross external debt fell to EUR 37.3 billion as of June, down EUR 310 million on December. General government, banks and other sectors contributed most, while debt on attracted FDI continued rising. General government debt fell EUR 259.4 million, repayments on EUR global bonds in January contributing most. Bank debt fell EUR 254.3 million over the period, reflecting EUR 537.2 million payments on short-term deposits and the EUR 208.9 million rise in received short-term loans. Other sectors' debt contracted EUR 87 million following net long-term loan net repayments of EUR 270.3 million. Intercompany credit grew by EUR 290.7 million. Intercompany loans comprised 42.7 per cent of total gross external debt from 41.6 per cent in December. Loans and deposits of EUR 2401.7 million<sup>17</sup> were received, and principal obligations of EUR 2797.5 million were serviced.

<sup>17</sup> Revolving and trade credit excluded.

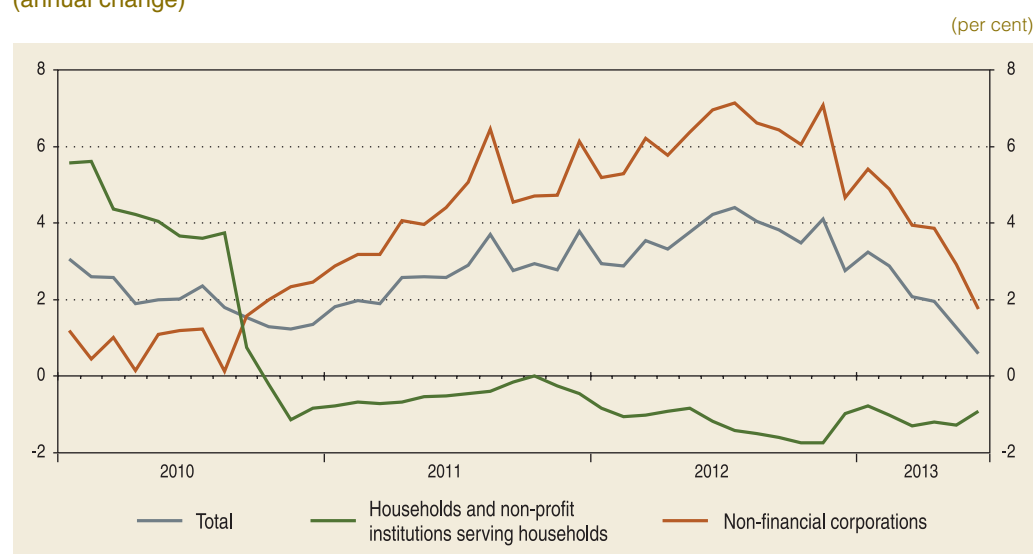
External current, capital, and financial transactions decreased BNB international reserves by EUR 517.8 million, valuation adjustments and price revaluations excluded. If changes in international foreign reserves on the BNB Issue Department balance sheet were taken into account, including valuation adjustments and price revaluations, the decrease is estimated at EUR 962.1 million.

### Monetary Aggregates (annual change)



Source: BNB.

### Claims on Non-government Sector (annual change)



Source: BNB.

Broad monetary aggregate M3 growth continued slowing, falling to 7.7 per cent from 8.4 per cent in December. This was entirely down to moderating quasi-money growth, growth of the narrow aggregate M1 accelerating to 17.1 per cent from 9.5 per cent in December. Overnight deposits contributed most to this at 14.3 percentage points, while annual growth of currency outside banks gradually declined to 7.8 per cent from 9.1 per cent in December. Residents' bank deposits rose 5.7 per cent on an annual basis, households contributing most. Non-resident deposits declined 15.2 per cent.

Monetary aggregate dynamics revealed a structural change in household deposits since the fourth quarter of 2012. Deposits redeemable at notice and overnight

deposits are preferred to deposits with agreed maturity. This reflects the term deposit interest tax introduced in early 2013.

The private sector credit moderation in progress since August 2012 continued. Claims on the non-government sector grew 0.6 per cent from 2.8 per cent by last December. This cut the claims on the non-government sector to GDP ratio 1.4 percentage points to 70.5 per cent. Non-financial corporations curbed credit growth most. Claims on them grew 1.8 per cent on an annual basis from 4.7 per cent by December. Low business credit demand reflected low economic activity. Breakdown by sector shows that energy<sup>18</sup> and real estate operations had an essential negative contribution to the annual growth in loans to non-financial corporations. Trade,<sup>19</sup> professional activities and scientific research, agriculture, forestry and fishery recorded the highest positive contribution. Households preferred to save and repay debt, claims on them declining 0.9 per cent on an annual basis.<sup>20</sup> Broken down by category, overdrafts and consumer loans posted moderation in their annual decline (up 2.3 and 1.1 per cent respectively by end-June). Concurrently, housing loans reported a slower positive growth rate of 0.1 per cent in the middle of the year.

The BNB quarterly lending survey showed banks easing lending standards for both households (in the second quarter) and corporations (in the first quarter). Major drivers included stiff competition and the lower costs and greater amount of attracted funds. Banks nevertheless pleaded strict lending criteria prompted by collateral and credit risk, macroeconomic developments, and the climate in industries occupying large shares in bank credit portfolios.

Bulgarian banks continued financing their lending by deposits from residents (households and non-financial corporations). Household deposits, the main source of finance, rose BGN 1072 million. Overall resident deposits rose BGN 1181 million. The continuing growth allowed banks to boost their foreign assets, repay external liabilities and invest in bonds, primarily Bulgarian government ones. Banking liquidity remained high, the liquid asset ratio reaching 25.9 per cent.

Trading euro with the BNB is banks' major lev liquidity management tool. It exemplifies the currency board's main function of buying and selling national currency on demand against euro at the fixed exchange rate under the Law on the Bulgarian National Bank.<sup>21</sup> Total foreign currency market turnover in the first half year was EUR 280.5 billion, down 7.2 per cent on the same period of 2012.<sup>22</sup> The major segments of interbank trading and transactions with the BNB declined. Trading between banks and final customers increased. Turnover between banks (excluding the BNB) fell by EUR 141.7 million. At 94.7 per cent euro, 5 per cent US dollars and 0.3 per cent others, the interbank currency trading structure saw no great change; the share of USD transactions rose 1 per cent. Final customer trading turnover increased, structure remaining broadly unchanged at 85.5 per cent euro, 13 per cent US dollars and 1.5 per cent others. Banks sold EUR 1.4 billion to final customers and EUR 1.1 billion net to the BNB.

Ample banking liquidity kept interbank money market interest low, especially across long-term maturity sectors. Average interbank deposit and repo interest fell to 0.03 per cent from 0.12 per cent in 2012. The spread between LEONIA and EONIA remained negative the whole half year, reaching 6 basis points on average against 13 in 2012. Interest on actual overnight transactions continued falling in Bulgaria and the euro area after ECB main refinancing operations rate cuts in July 2012 and May 2013 and

<sup>18</sup> Production and distribution of power, heating, and gaseous fuels.

<sup>19</sup> Trade; automotive maintenance.

<sup>20</sup> Data on household deposits and loans include NPISHs in line with monetary statistics classifications.

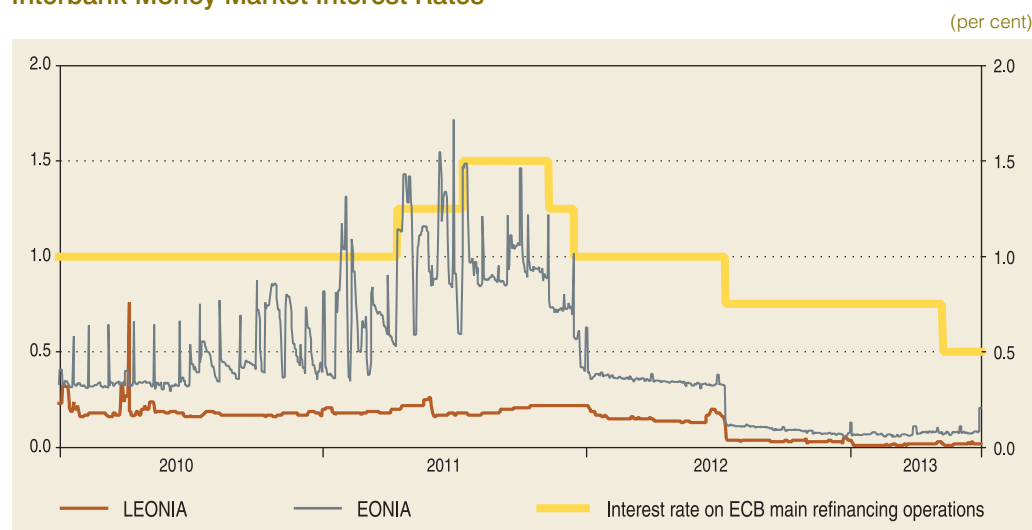
<sup>21</sup> See Chapter II.

<sup>22</sup> This comprises transactions by banks and the BNB in foreign currency against levs with a spot value date of up to two business days and includes the double volume of trade between the BNB and banks, as well as interbank trading.



continuing unlimited liquidity allotment on main, monthly, and long-term refinancing operations. Quotations in long-term maturity sectors decreased on an annual basis by 151 basis points within the six-month horizon and by 230 basis points within the annual horizon.

### Interbank Money Market Interest Rates



Sources: BNB, ECB.

The total volume of interbank money market transactions was BGN 23.1 billion, up 10.4 per cent on the same period of 2012. Deposits comprised 65.7 per cent of turnover and government securities repos 34.3 per cent. Overnight transactions dominated the structure of deposit operations at 84.8 per cent.

### Interbank Money Market Yield Curve



Note: Average SOFIBOR/SOFIBID Index.

Source: BNB.

The consolidated fiscal programme cash balance was negative at BGN 7.8 million from a BGN 61.9 million surplus this time last year.

Total government revenue and grants rose 7.1 per cent on the same period last year, mainly reflecting grants (3.2 percentage points), primarily EU Cohesion and Structural Funds. Tax revenue contributed 2.4 percentage points, largely through higher value added tax and social and health insurance contributions. Annual VAT revenue growth (5.6 per cent) was entirely due to higher VAT revenue from home and intra Community

transactions (net). The 8.4 per cent increase in social and health insurance contributions reflected the 20 percentage point rise in social security contributions by special bodies' employees.<sup>23</sup> A significant decline in excise revenue in early 2013 slowed to -1.3 per cent by June. Direct tax revenue fell 4.7 per cent on an annual basis. Corporate tax revenue also fell by 5.3 per cent a year after early 2013 assessment and settlement amendments.<sup>24</sup> Despite BGN 39.9 million revenue from the new deposit interest tax, income tax receipts fell 4.2 per cent from the same time last year.<sup>25</sup> Non-tax revenue rose 9.7 per cent, mainly from levies and sundry ministry and agency revenue.

Total government expenditure rose 7.7 per cent. At 3.1 percentage points, welfare accounted for the largest contribution, rising 7 per cent. Growing social spending included a 9.3 per cent average pension increase from 1 April and caretaker cabinet steps to support the most vulnerable groups in society and boost employment. After high nominal growth of 19.6 per cent in 2012, capital expenditure rose by 1.2 per cent annually in the first half of 2013.<sup>26</sup> MF monthly data on the consolidated fiscal programme show that, unlike last year, investment growth between January and June was entirely driven by higher national budget capital expenditure (6.8 per cent), capital expenditure on EU funds shrinking 2.5 per cent on an annual basis.

The budget was mainly financed by a BGN 1296 million home market positive net government bond issue.<sup>27</sup> Government securities issued since early 2013 totalled BGN 1460.6 million compared with BGN 733.8 million in the same period last year. Net external financing remained negative at BGN -1364.6 million, reflecting mostly repayments of BGN 1546.2 million on global bonds maturing January 2013. BGN 327.1 million from the fiscal reserve (BGN 5753.9 million by the end of June) also financed the budget. At the same time, BGN 245.1 million were transferred into the Fund for Guaranteeing the Stability of the State Pension System (the Silver Fund) part of the fiscal reserve, boosting accumulated funds to BGN 2332 million.

USD-denominated global bonds maturing 2015 traded on the secondary market at 110.3 *per* BGN 100 nominal (1.47 per cent yield) from BGN 113.9 (1.29 per cent) at the year's start. Bulgarian Eurobonds maturing 2017 performed similarly, quoted at 107.2 (2.35 annual yield) in late June from 109.2 (1.66 per cent) in January. USD-denominated ZUNK bond prices hovered around nominal.

In the first six months of 2013 the Bulgarian Stock Exchange SOFIX and BG40 indices tended upwards, the average SOFIX value rising 32.7 per cent and the BG40 22.5 per cent on December 2012. Both indices, however, remained at levels well below those before 2008. Secondary market share trading expanded 306.1 per cent to BGN 724.9 million, BGN 158 million of it on the alternative market. *Bourse* bond turnover rose 154.5 per cent to BGN 128.8 million. Over the counter deals accounted for BGN 231.3 million of equity<sup>28</sup> and BGN 31.3 million of bonds. Market capitalisation of the Bulgarian Stock Exchange, Sofia, was BGN 10.6 billion or 13.4 per cent of GDP from 12.7 per cent at the close of 2012.

<sup>23</sup> Social security contributions reflected a rise in army and police social security contributions and thus had no bearing on the overall consolidated fiscal programme balance. They also included BGN 168.8 million of payments on undesignated liabilities mainly into the Social Security and National Health Insurance Fund and in income and other taxes (based on MF consolidated fiscal programme data by end-June).

<sup>24</sup> For further details, see the Economic Review 1/2013, p. 53.

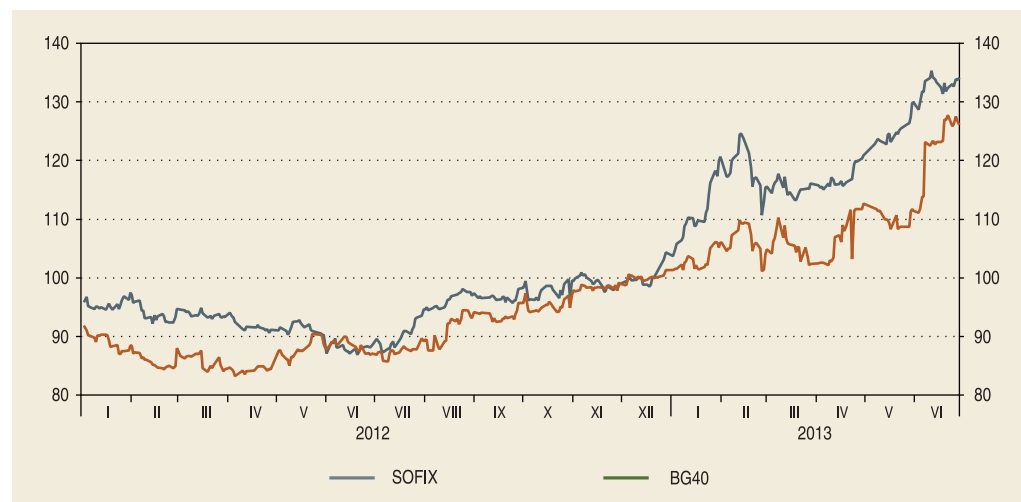
<sup>25</sup> According to the MF monthly consolidated fiscal programme bulletin.

<sup>26</sup> Including government reserve growth.

<sup>27</sup> For more information on government bond primary and secondary markets, see Chapter VIII.

<sup>28</sup> Major floor and over the counter transactions involved, *inter alia*, Kaolin AD (almost BGN 200 million), Corporate Commercial Bank AD, ELARG Agricultural Land Opportunity Fund REIT (in liquidation), Bulgartabac Holding AD, Sopharma AD, and Agro Finance REIT.

### Bulgarian Stock Exchange Indices (December 2012 = 100)



Sources: the BNB, the Bulgarian Stock Exchange.

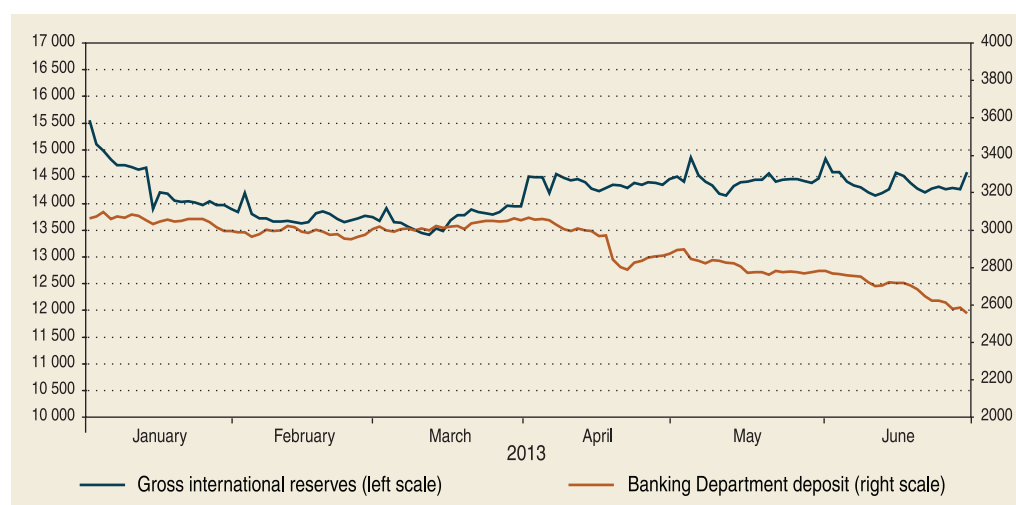
## II. Gross International Reserves

The BNB manages gross international reserves to the Law on the Bulgarian National Bank, investment constraints, business procedures and methodologies, and international financial market opportunities. Reserves comprise the assets on the Issue Department's balance sheet. They have to provide complete cover for monetary liabilities at the fixed lev euro rate.<sup>29</sup> The excess of gross international reserves over monetary liabilities is the Banking Department deposit item or the net value of the Issue Department balance sheet.<sup>30</sup>

### Gross International Reserves and Banking Department Deposit

(EUR million)

(EUR million)



**Note:** The chart shows daily movements by the Issue Department balance sheet and the Banking Department Deposit in the Issue Department balance sheet, including the two tranches of Special Drawing Rights worth SDR 611 million received by the BNB in August and September 2009 upon general SDR allocation by the IMF.

**Source:** BNB.

## 1. The Amount and Structure of Gross International Reserves

By the end of June 2013, the market value of gross international reserves was EUR 14,590 million: EUR 962.1 million less than at the end of 2012.<sup>31</sup> BNB reserve currency sales to banks against levs, less cash in circulation, and significant world gold price falls caused the 6.2 per cent decline.

<sup>29</sup> The Law on the BNB Article 28, paragraph 2 defines the Bank's monetary obligations as all circulating cash issued by it and all account balances with the Bank, except IMF ones. Article 28, paragraph 3 lists gross international reserve assets: monetary gold; Special Drawing Rights; cash in freely convertible foreign currency; funds in freely convertible foreign currency held by the BNB on accounts with foreign central banks or other financial institutions or international financial organisations with one of the two highest ratings by two internationally recognised credit rating agencies; securities issued by foreign countries, central banks, other foreign financial institutions, or international financial organisations with one of the two highest credit ratings; the balance on accounts receivable and payable on BNB forward or repo agreements with (or guaranteed by) foreign central banks, public international financial organisations or other foreign financial institutions with one of the two highest credit ratings from two internationally recognised credit agencies; and BNB futures and options binding non-residents and payable in freely convertible foreign currency. The Law calls for asset market values.

<sup>30</sup> The Law on the BNB Article 28, paragraph 1 provides that "the aggregate amount of the BNB's monetary liabilities shall not exceed the lev equivalent of gross international reserves," the equivalent based on the fixed exchange rate.

<sup>31</sup> Further in this Chapter, the two tranches totalling SDR 611 million received by the BNB in August and September 2009 upon general SDR allocation by the IMF with the total income on them and balances in commercial banks' accounts in the TARGET2-BNB national system component are not included in the analysis of changes in BNB gross international reserves. For further details, see BNB Annual Report 2009, p. 25.

## External Cash Flows in Foreign Currency

(EUR million)

	January – June 2012	January – June 2013
<b>I. Purchases and sales of euro</b>		
at tills	-5	-13
in banks	-494	-820
bank purchases	22,114	16,721
bank sales	-22,609	-17,541
<b>Subtotal I</b>	<b>-500</b>	<b>-833</b>
<b>II. Currency flows with banks, the MF, etc.</b>		
Minimum Required Reserves	349	-11
Government and other depositors (total)	453	219
<b>Subtotal II</b>	<b>802</b>	<b>208</b>
<b>Total I+II</b>	<b>302</b>	<b>-624</b>

Note: Average data for the period. Figures may not add up due to rounding.

Source: BNB.

EUR 219 million receipts into government and other depositors' accounts (mostly into the European Commission's BNB foreign currency account) made the largest contribution to external flows. Net sales of reserve currency to commercial banks resulted in an outflow of EUR 820 million. The trend was similar to the reduction in international reserves in the first half of 2012 when the BNB sold EUR 494 million. Maintaining minimum reserves with the BNB, commercial banks' foreign exchange accounts amounted to EUR 11 million, unlike the same period of 2012 when these net funds were EUR 349 million.

## Currency Structure of Gross International Reserves

(per cent)

Currency	Issue Department Balance Sheet	
	2012	January to June 2013
EUR	86.44	87.96
USD	0.19	0.04
XAU	13.04	11.68
XDR	0.31	0.30
CHF	0.01	0.01

Note: End of day data period averages. Figures may not add up due to rounding.

Source: BNB.

By June 2013, the share of gold in the structure of gross international reserves declined from 2012. The volume of monetary gold did not change, though its value and share in gross international reserves fell as world gold prices in euro fell and the USD/EUR rate changed (see the charts, p. 31–32).

## Gross International Reserves by Financial Instrument

(per cent)

Financial instruments	2012	January – June 2013
Vault cash*	6.79	5.25
Deposits**	25.65	18.45
Securities**	67.55	76.30

Note: End of day period averages. Figures may not add up due to rounding.

\* Account balances, payments, and monetary gold.

\*\* Including instruments in foreign currency and gold.

Source: BNB.

The share of securities in assets by financial instrument grew at the expense of deposits, mainly reflecting the very low interest rates on euro-denominated short-term deposits in the interbank money markets.

## Gross International Reserves by Residual Term to Maturity

(per cent)

Maturity Sectors	2012	January – June 2013
Up to a year	64.85	61.02
One to three years	31.95	36.44
Three to five years	1.92	1.78
Five to ten years	1.15	0.74
Over ten years	0.13	0.01

Note: End of day period averages. Figures may not add up due to rounding.

Source: BNB.

The structure of assets by residual term to maturity did not change much from last year. An average of 61.02 per cent of assets continued to be in the up to a year sector: current accounts, short-term deposits in foreign currency and gold, and short-term securities.

## 2. Gross International Reserve Risk and Yield

### The Market Environment

International financial markets continued to be very sensitive to news on the finances and major macroeconomic indicators of advanced economies and leading central banks' policies. Market tension subsided in early 2013, but alternating good and bad news caused significant later fluctuations in financial asset prices and market participants' sentiment.<sup>32</sup>

Agreement on the US budget and lower cuts in it, and news that euro area banks were repaying ECB long-term financing from December 2011 and February 2012 early cut market tensions at the year's start.

In February and March, lower-than-expected euro area macroeconomic data hit market expectations, particularly compared with steadily improving US indicators. The Cypriot crisis, though brief, unsettled markets. The wait between Italian elections in February and cabinet formation in April did not help.

In late March and April positive news bolstered sentiment. Cyprus got a bailout, Italy got a new government, and European Financial Stabilisation Mechanism (EFSM) and European Financial Stability Facility (EFSF) loans to Ireland and Portugal had maturities extended from 12.5 to 19.5 years. In May, Fitch upgraded Greece's credit rating to B-minus/stable outlook.

The same month, the Federal Reserve announced a possible reduction or gradual lowering of monetary stimulus to the economy. Resulting concerns about a new interest rate cycle ushered market restructuring.

On 8 May the ECB cut the main refinancing operations rate 25 basis points to 0.5 per cent and the marginal lending facility rate by 50 basis points to 1 per cent, with deposit interest unchanged at 0 per cent. The Federal Reserve kept the federal funds interest rate at 0 to 0.25 per cent and continued the monthly purchases of mortgage backed securities and US treasury bonds begun in 2012.

### Euro Area and US Sovereign Bond Yields

Yield on German government bonds reflected the above factors. Lower-than-expected euro area data, political instability in Spain and Italy, and uncertainty over Cyprus pressured yield; early repayment of ECB three-year operation loans and successful long-term debt issues by Ireland and Portugal boosted it. Federal Reserve intentions to cut US monetary stimuli also boosted long-term euro area government bond yields. The May ECB interest cut had a transient effect. By late June, yield on two-year German benchmark bonds rose 20 basis points on the end of 2012 to 0.19 per cent, ten-year bonds rising 41 basis points to 1.73 per cent.

<sup>32</sup> See also Chapter I.

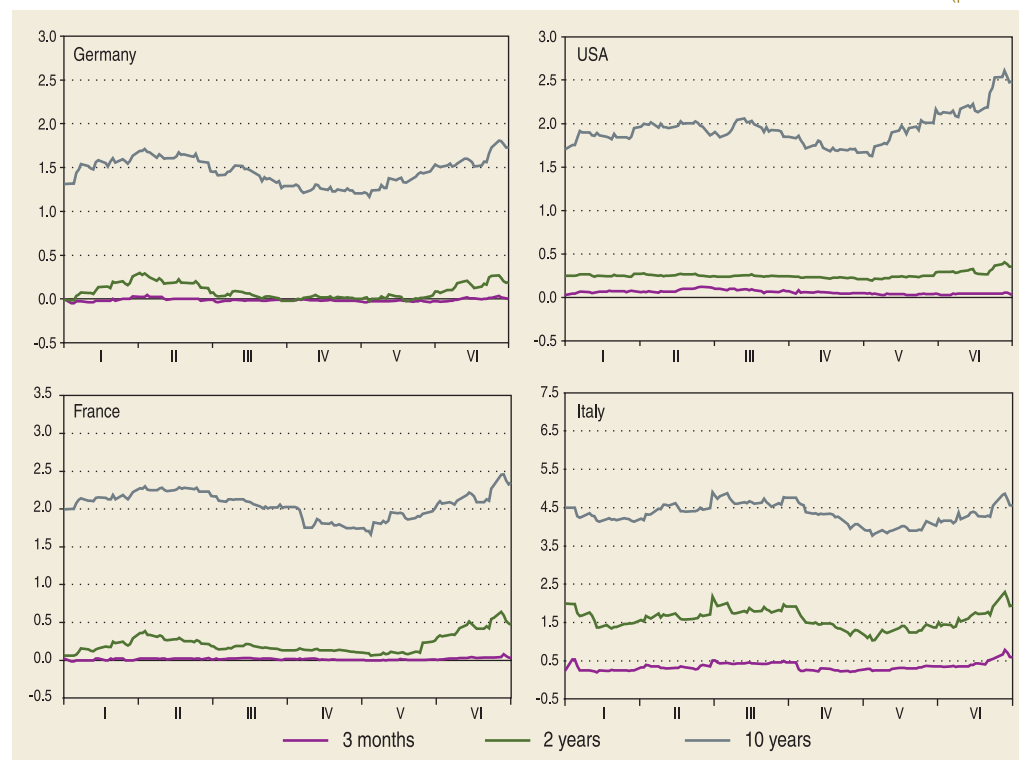


Euro area periphery bond yields followed the German benchmark. In early 2013, spreads followed a downward trend as Portugal and Ireland fulfilled 2013 bond issue programmes early, re-entering the markets. Eurogroup agreement on the outlines of European Stability Mechanism direct bank recapitalisation also helped narrow Irish and Portuguese bond spreads. By the end of the half-year, yield spreads narrowed most for Portuguese (43 basis points to 329 in the two-year and 97 basis points to 472 in the ten-year maturity sectors), Irish (43 basis points to 177 in the two-year and 77 basis points to 255 in the eight-year sectors)<sup>33</sup> and Spanish bonds (92 basis points to 208 in the two-year and 91 basis points to 304 in the ten-year sectors). Two-year Italian bond yield spread fell to 175 basis points (down 26), ten-year bonds reaching 282 basis points (down 36).

Worsening French and Dutch macroeconomic indicators widened these countries' bond yield spreads compared with German ones. Dutch five and ten-year bond yield spreads widened by 41 basis points to 54 and 21 to 39 basis points, French two and five-year paper rising 20 basis points to 28 and 26 basis points to 59.

### Government Bond Yield to Maturity in the First Half of 2013

(per cent)



US bond yield moved within relatively narrow ranges in the first quarter. Demand for low-risk assets drove this amid continuing euro area uncertainty and the adoption of a less restrictive US consolidation package. Early in the second quarter the difference grew after lower-than-expected Europe and China macroeconomics data and steady US improvement. Signs of improving US housing and labour markets prompted the May announcement of possible reductions in Federal Reserve government bond purchases, followed by steady yield rises. By the end of the second quarter, two-year bond yield rose 12 basis points to 0.36 per cent (an 11 basis point rise in the first half-year), while ten-year bonds rose 65 basis points to 2.49 per cent (73 basis points in the first half-year). Stronger dynamics in the medium and long-term maturity sectors pushed the yield curve slope, spread in the two to ten-year sectors rising from 151 basis points early in the year to 213 basis points by mid-year.

<sup>33</sup> The difference between eight-year Irish and German bond yields is due to the lack of quotations for ten-year Irish bonds before March 2013.

## Gold and Exchange Rates

In early 2013, the US dollar and euro gold price fell to within the broad range of USD 1224 to 1695 *per* troy ounce.<sup>34</sup> The half-year fall was 26.98 per cent in US dollars and 25.90 per cent in euro to USD 1224 and EUR 940.9 *per* troy ounce by the end of June. Good first quarter US economy data weakened demand for safe havens and had the strongest effect. In mid-April, the gold price fell 12.4 per cent in two days. This reflected the closure of gold collateralised exchange traded funds positions and expectations that the Central Bank of Cyprus would contribute EUR 400 million to the Cypriot bailout plan through gold reserve sales, with possible contagion across the euro area. Technical sales depressed the price further after it passed USD 1500 *per* troy ounce. It fell substantially when the Federal Reserve System announced gradual reductions in asset purchases until the year's end.

The US dollar appreciated 1.5 per cent against the euro, especially in the second quarter. The USD/EUR rate moved within the narrow range of 0.73 to 0.78, with smaller fluctuations than prior periods. First quarter preliminary data on euro area GDP suggested a 0.2 per cent decline, helping depress the euro. The Federal Reserve announcement of possible changes in government bond purchases helped the US dollar appreciate by 0.7671 against the euro by mid-year.

### The USD/EUR Exchange Rate



### Troy Ounce Gold Price in US Dollars



<sup>34</sup> Composite spot price, Bloomberg.

## Troy Ounce Gold Price in Euro



## Major Risk Types

BNB gross international reserve investment adhered to the risk tolerance set by the Governing Council for Issue Department balance sheet net value.<sup>35</sup> Value at risk (VaR) and maximum loss threshold measures defined with reference to Issue Department balance sheet net value set the strategic risk budget.<sup>36</sup>

On an annual basis, the reported volatility in the net value<sup>37</sup> in the review period was 17.95 per cent. Currency risk contributed some 95 per cent due to the open position in monetary gold.

International reserve **interest rate risk** measured by reserves' average modified duration was 0.91 years. The duration was slightly higher than the 0.82 average in 2012.

The provision that the sum of the absolute values of open foreign currency positions<sup>38</sup> in currencies other than SDR and monetary gold should not exceed 2 per cent of the market value of monetary liabilities in these currencies constrained **currency risk**. There were minimal open positions in currencies, the open monetary gold position in the Issue Department balance sheet posing the main currency risk.

**Credit risk** remained a major factor in European government bond trading. There was no significant change in credit risk management, except for a shortening of foreign currency deposit maturity limits by some BNB counterparties in reaction to the Cyprus crisis. Over the first half of 2013, the Bank continued curbing government debt credit risk by dividing issuers into three inherent credit risk groups. A minimum of 35 per cent of international reserves remained in the least risky Group I. To achieve its main objectives of high international reserve security and liquidity, the BNB continued investing most of its assets into German and French government bonds with up to three-year maturities, German government guaranteed debt, and short-term deposits.

By mid-year, some 82 per cent per cent of the international reserve was invested into assets with the highest AAA long-term credit rating, this value averaging 77 per cent over the half-year.

Strict monitoring and control of investment restrictions and business procedures for international reserve management constrained **operational risk**.

<sup>35</sup> Net value means the Banking Department Deposit item in the Issue Department balance sheet.

<sup>36</sup> Net value risk measured by  $VaR = -X\%$  ( $X > 0$ ) at 95 per cent confidence level and allowing for normal yield allocation means that 95 per cent of the time maximum net value loss would not exceed  $X$  per cent. Maximum loss threshold is the highest loss where adverse scenarios have materialised in the past.

<sup>37</sup> Standard deviation of net value yield.

<sup>38</sup> An open foreign currency position is the difference between the value of assets and liabilities in any currency other than the euro.

## Profitability and Efficiency

Net income from assets in euro is the sum of three components: i. income from investing gross international reserves into original currency, ii. currency imbalance yield,<sup>39</sup> and iii. expenditure on liabilities. In the half year, BNB income from international reserve investment was EUR -0.98 million. Currency imbalance yield was EUR -412.74 million due to the 25.9 per cent EUR monetary gold price drop (see charts, p. 31–32). Interest paid on Issue Department balance sheet liabilities was EUR 0.05 million.<sup>40</sup> The three components brought net earnings from international reserve to EUR -413.77 million: -3.15 per cent net rate of return in the first half of 2013.

### Income and Profitability\* of International Reserves in the First Half of 2013

Quarter	Net income (EUR million)	Net profitability (per cent)	Income (EUR million)	Profitability (per cent)	Income (EUR million)	Profitability (per cent)	Expenditure (EUR million)	Profitability (per cent)
			on assets**		on currency revaluation of assets and liabilities		on liabilities	
	(1)+(2)+(3)		(1)		(2)		(3)	
First quarter	-22.25	-0.16	8.12	0.074	-30.34	-0.23	-0.03	0.00
Second quarter	-391.52	-3.00	-9.10	-0.068	-382.40	-2.93	-0.02	0.00
<b>Total</b>	<b>-413.77</b>	<b>-3.15</b>	<b>-0.98</b>	<b>0.01</b>	<b>-412.74</b>	<b>-3.15</b>	<b>-0.05</b>	<b>0.00</b>

\* Profitability is shown for the first six months of 2013. Annual profitability would be almost double.

\*\* Profitability is calculated daily and accumulated. Profitability in the first quarter was 0.0740 per cent and income was EUR 8.12 million. Profitability in the second quarter was -0.0681 per cent and income was EUR -9.10 million. Half-year profitability approximately matches the sum of quarterly profitability at 0.01 per cent. Income, the sum of the two quarters' incomes, was negative due to the higher asset volume over the second quarter.

Source: BNB.

International reserves are split operationally into portfolios by currency and investment goal, each with a benchmark, investment goals, and investment limits set by the BNB. To diversify management styles and reduce operational risk, most euro denominated assets continued to be split into two investment portfolios (Investment 1 and Investment 2) with identical limits and benchmarks, managed by different BNB teams. Securities in Investment 3 are less liquid, being mainly intended to be held until maturity. By 30 June 2013, external managers at international financial institutions managed some 7 per cent of international reserves. Beside additional diversification, using external managers helped exchange expertise in international market investment management. Liquid portfolios mainly assist immediate BNB currency payment needs.

### Portfolio Profitability and Risk in the First Half of 2013

Portfolio and type of asset	Profitability		Risk <sup>1</sup>		Information ratio <sup>4</sup>
	Absolute (per cent)	Relative <sup>2</sup> (b.p.)	Absolute (b.p.)	Relative <sup>3</sup> (b.p.)	
Investment 1, EUR	-0.09	1	39	8	0.33
Investment 2, EUR	-0.10	0	44	7	0.13
Investment 3, EUR	1.72	-	163	-	-
External manager A, EUR	-0.19	-2	51	8	-0.47
External manager B, EUR	-0.25	-8	51	12	-1.35
Liquidity, EUR	0.02	2	1	1	-
Liquidity, gold	0.08	6	3	3	-
Liquidity, USD	0.04	2	5	5	-

<sup>1</sup> Risk means the standard deviation of yield.

<sup>2</sup> Positive relative yield for a given portfolio is excess over benchmark yield. Negative relative yield is interpreted as opportunity cost in portfolio management.

<sup>3</sup> Relative risk against benchmark indicates deviation between portfolio and benchmark risk characteristics through active portfolio management. Annual risk is shown.

<sup>4</sup> The information coefficient indicator is the ratio between portfolio relative yield and relative risk. Annual figures are shown.

Source: BNB.

<sup>39</sup> Currency imbalance yield is the result of the effects of exchange rate movements on assets' and liabilities' open foreign currency positions.

<sup>40</sup> Data on the Issue Department liabilities are not entered directly into the information system for international reserve management; they are provided to it via the accounting system interface.

## III. Payment Systems

Organising, supporting, and developing national payment systems by implementing and overseeing efficient payment mechanisms is a Bank duty under the Law on the BNB. The Bank's major goals are to curb systemic risk and facilitate Bulgarian integration into the euro area payment infrastructure.

Lev settlement systems are:

- RINGS, a real time gross settlement system operated by the BNB;
- Ancillary systems settling transactions in RINGS:
  - BISERA, for settling customer transfers at a designated time, operated by BORICA–Bankservice AD;
  - BORICA, for servicing bank card payments in Bulgaria, operated by BORICA–Bankservice AD;
  - SEP, for mobile telephone payments, operated by SEP Bulgaria AD.

Euro settlement systems are:

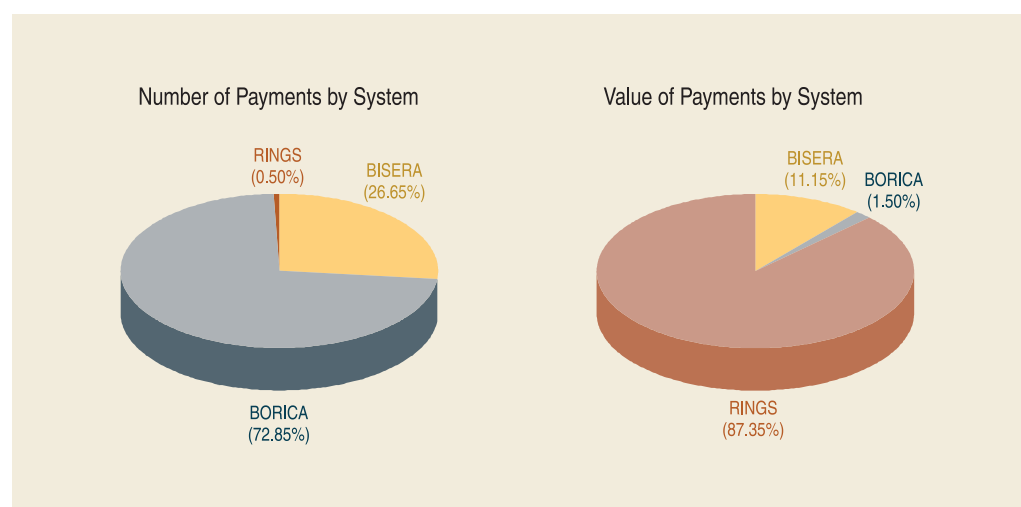
- The TARGET2 national system component, TARGET2-BNB, run by the BNB;
- The TARGET2-BNB ancillary BISERA7-EUR for servicing customer transfers at a designated time, operated by BORICA–Bankservice AD.

Securities settlement systems are:

- The book-entry government securities settlement system, run by the BNB;
- The book-entry securities registration and servicing system, run by the Central Depository.

In the first six months of 2013, RINGS processed over 87.4 per cent of payments by value in Bulgaria. Values around 80 per cent are optimal for the operation of real time gross settlement systems. In addition, RINGS processed 0.5 per cent of lev payments.

### Inland Lev Payments by System in the First Half of 2013



Note: SEP is missing due to low numerical and value shares.

Source: BNB.

In the first half year transactions processed by BORICA rose 8.7 per cent in value and 10.7 per cent in number on the first half of 2012. ATM withdrawal value and number rose 2.7 and 6.9 per cent. POS terminal transaction numbers fell 9.5 per cent, value falling 15.2 per cent. BISERA payment value grew 6.6 per cent on the first half of 2012, numbers dropping 5 per cent. At the close of the half year seven domestic banks participated in SEP. Transactions through the system declined 60.9 per cent in value and 76.9 per cent in number from the first half of 2012.

Over the first half of 2013 Central Depository transaction value rose 125.3 per cent on the first half of 2012, the number rising 57.4 per cent.

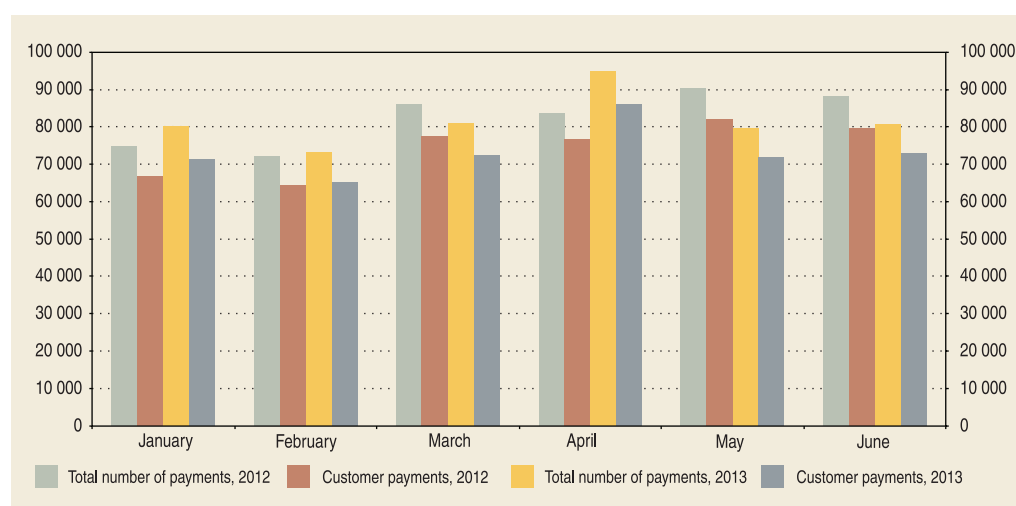
## 1. Payment Systems and Securities Settlement Systems

### RINGS Real-Time Gross Settlement System

Processing most payments in Bulgaria through the Real Time Gross Settlement System (RINGS) cuts payment risk: one of the major goals of a central bank. Over the review period RINGS processed 489,087 payments for BGN 403,198 million: down 1.1 per cent in number and 2 per cent in value on the first half of 2012. There were 439,632 customer payments for BGN 81,683 million, or 89.9 per cent by number and 20.3 per cent by value. On average there were 3944 daily payments worth BGN 3252 million. In the half year, 72.6 per cent of payments went through by noon and 89 per cent by 2:30 pm. As regards system traffic, 83 per cent of RINGS payments went through by 2:30 pm. On 30 June, 31 banks participated in RINGS.

In the first half of 2012 no payments were rejected by the close of a RINGS' system day due to insufficient funds in participants' accounts, indicating good liquidity management by banks. There was no recourse to the Reserve Collateral Pool: an interbank mechanism guaranteeing settlement of payment and securities system orders. In the review period RINGS offered 99.97 per cent availability.<sup>41</sup>

### RINGS Payment Numbers in the First Half of 2012 and 2013



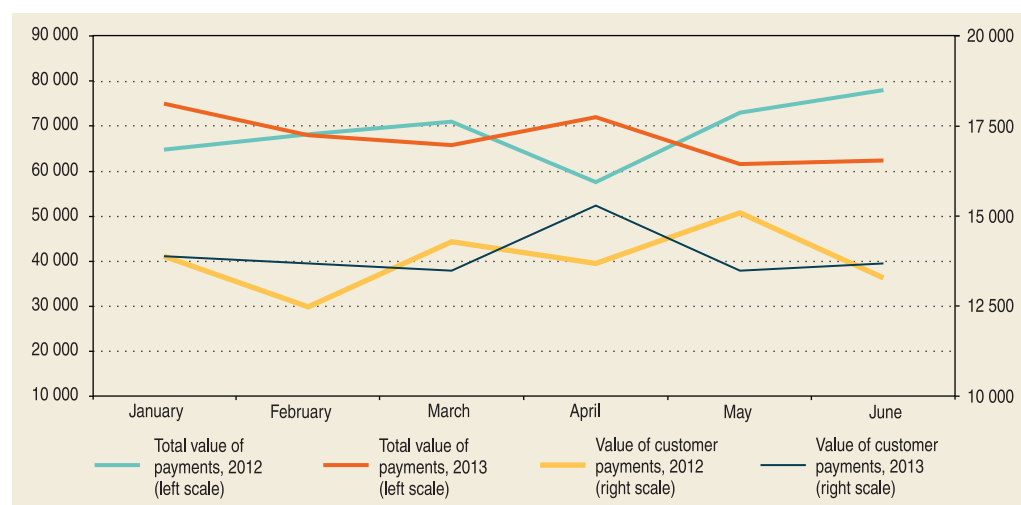
Source: BNB.

<sup>41</sup> The ratio of time when the system is operational to scheduled operating time.



### RINGS Payment Value in the First Half of 2012 and 2013

(BGN million)



Source: BNB.

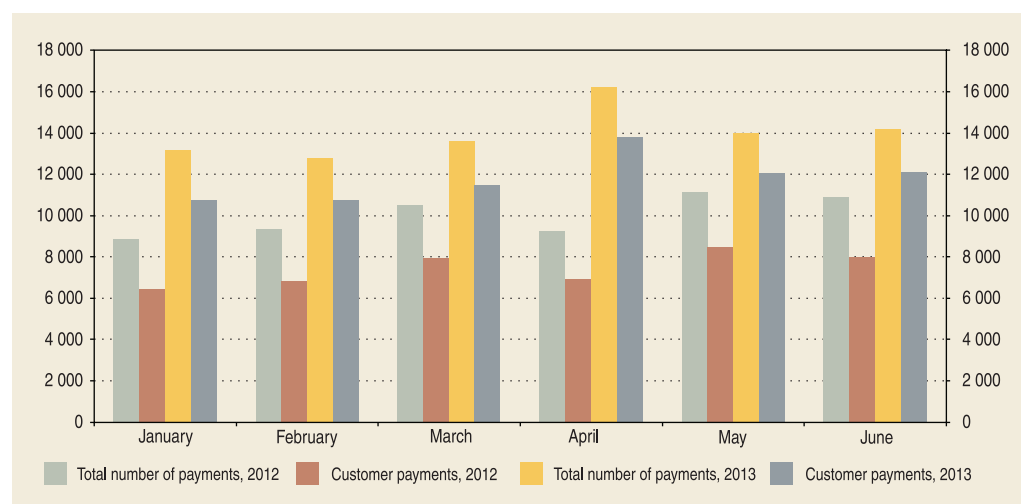
#### TARGET2-BNB National System Component

TARGET2 settles gross euro payments in real time using central bank money. It is a Single Shared Platform (SSP) system, each participating connected central bank running a system component. The BNB is responsible for business relations in TARGET2-BNB and for coordination with the ECB and participating central banks. By 30 June 2013 the ECB and 23 EU central banks connected with TARGET2.

TARGET2-BNB includes the BNB, 23 direct participant banks, three addressable BIC holders, and the BISERA7-EUR ancillary system.<sup>42</sup>

In the first half of 2013 TARGET2-BNB processed 83,960 payments for EUR 151,479 million, including 70,831 customer payments for EUR 3928 million. Compared with the first half of 2012, the number of settled transactions rose 39.8 per cent, their value falling 1 per cent.

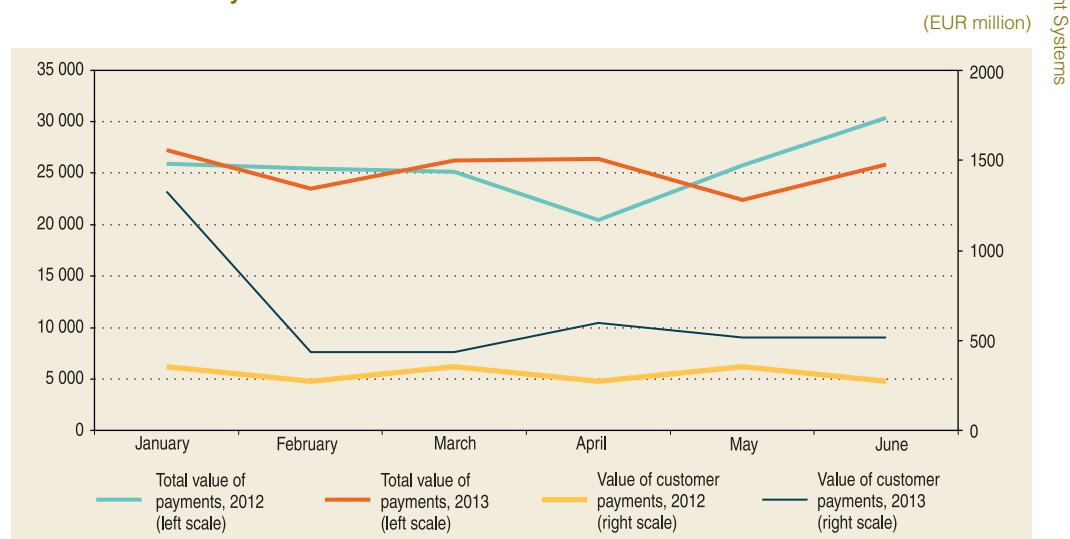
### TARGET2-BNB Payment Numbers in the First Half of 2012 and 2013



Source: BNB.

<sup>42</sup> For an up-to-date list of TARGET2 participants through TARGET2-BNB, see [www.bnb.bg/PaymentSystem/PSTARGET2/PSTARGETList/index](http://www.bnb.bg/PaymentSystem/PSTARGET2/PSTARGETList/index). By 30 June 2013, BISERA7-EUR included 15 of 23 TARGET2-BNB direct participant banks.

### TARGET2-BNB Payment Value in the First Half of 2012 and 2013



Source: BNB.

Payments by other system components to banks were 89.3 per cent by number and 87.4 per cent by value of TARGET2-BNB payments. There were 672 average daily payments through TARGET2-BNB, daily average value reaching EUR 1212 million: up 42 per cent on the first half of 2012. The daily number peak was 1140, with a daily value peak of EUR 2091 million.

The BISERA7-EUR ancillary system processes customer transfers in euro at a designated time. In the first half of 2013 this system processed 11,917 payments, worth EUR 128 million: up 25.83 per cent in number and 26.13 per cent in value on the corresponding period of 2012.

#### Bulgarian Payment and Settlement System Development

The Single Euro Payments Area (SEPA) was a significant initiative to harmonise EU small payment practice and standards. New pan European instruments to transform divergent small payments infrastructures into a single euro payments area, a key element in SEPA, boost security and efficiency through economies of scale. Credit transfers and card payments launched in early 2008, followed by direct debits in November 2009.

By mid-year all banks and foreign bank branches in Bulgaria could handle SEPA credit transfers. The share of SEPA payments by Bulgarian banks and foreign bank branches was some 51.5 per cent of all customer euro payments within the scope of Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro.

BISERA7-EUR operated by BORICA–Bankservice AD handles only SEPA payments: credit transfer and direct debit. To ensure bank reachability<sup>43</sup> for SEPA payments with foreign banks, BISERA7-EUR connected with SEPA Clearer and Equens. This allows SEPA crediting between banks in Bulgaria and other EU countries, mainly Germany, Greece, Italy, the Netherlands, and Poland, plus Switzerland. Connecting with the Polish EuroELIXIR system by late 2013 will expand Bulgarian banks' access to SEPA.

By 30 June 2013, 81.7 per cent of Bulgarian cards (80.2 per cent of debit and 96.4 per cent of credit cards) were to the EMV standard.<sup>44</sup> EMV implementation was practically complete by June 2013, with 100 per cent of ATMs and 96.3 per cent of POS terminals migrated.

<sup>43</sup> Reachability means making SEPA payments to and from each bank account in SEPA countries.

<sup>44</sup> The EMV global smart card standard by Europay, Mastercard, and Visa boosts security and curbs abuse.

## 2. Payment System Oversight

Payment systems supervision limits system risk, boosts system reliability and efficiency and monitors observance of standards and recommendations by the Bank for International Settlements, the International Organization of Securities Commissions, and ECB and ESCB.

By June 2013 the Bank completed five supervisory inspections initiated in late 2012 on compliance with the Law on Payment Services and Payment Systems. The Bank checked two companies under the Law's Article 114, items 2 and 4, Article 120 and Article 115, paragraph 3.

The year saw these changes to relevant BNB registers:

- 97 agents listed and 34 delisted onto/from the public register of licensed payment institutions and their branches and agents under Article 17;
- three agents listed and one delisted onto/from the public register of licensed electronic money institutions and their branches and agents under Article 17;
- 26 payment institutions from other EU countries operating in Bulgaria listed onto the BNB Ordinance No 16 of 16 July 2009 Article 7 public register; 91 agents of payment services providers from other EU countries listed and 46 agents delisted;
- 5 electronic money institutions licensed elsewhere in the EU and issuing, distributing, and redeeming electronic money in Bulgaria listed onto the BNB Ordinance No 16 Article 39 public register.

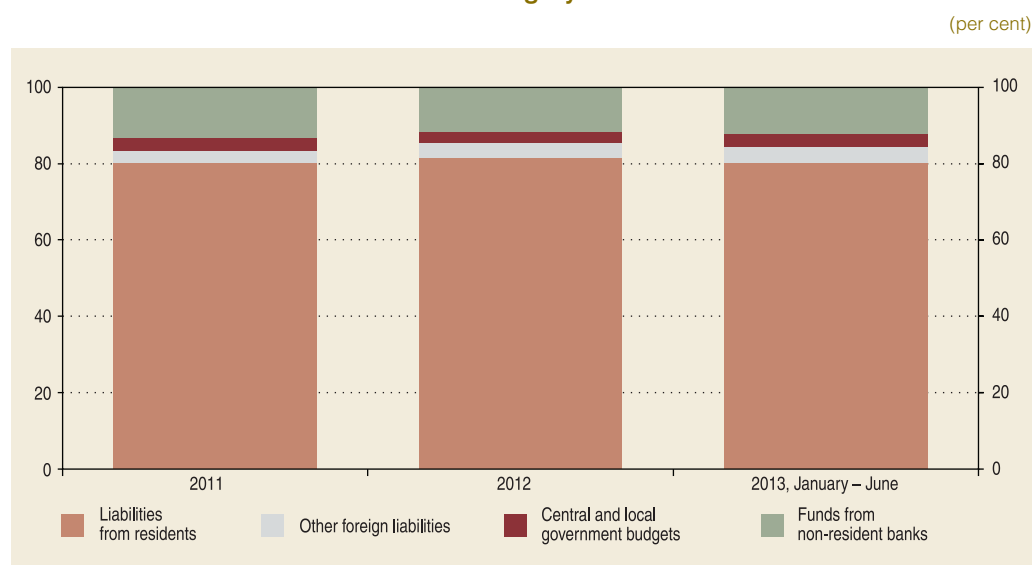
The half-year saw inspections of 100 payment service consumer complaints submitted to the BNB under the Law on Payment Services and Payment Systems.

## IV. Bank Reserves at the BNB

Over the first half of 2013 bank reserves reflected the slowing growth of attracted residents' funds. The average daily value of attracted bank funds for reserve calculation purposes (excluding central and local government funds) rose 8.6 per cent on the first half of 2012, or 12.8 and 5 per cent in lev and foreign currency liabilities. Funds from residents (excluding central and local government) rose 6.4 per cent on average, those from non-residents 20.4 per cent. Central and local budget liabilities grew by 17.9 per cent.

Changes in the structure of attracted funds through the year depressed the effective implicit ratio of minimum required reserves slightly to 8.8 from 8.9 per cent last year.<sup>45</sup> Reserve assets covering this ratio include funds on banks' BNB accounts (7.7 percentage points) and half the cash balances recognised as reserve assets (1.1 percentage points). The 1.1 per cent drop in lev reserves from their average level in the first half of 2012 and high 27.9 per cent growth in euro reserves marked enduring trends. The share of euro assets rose to 35.7 per cent from 30 per cent a year earlier.

### Structure of Attracted Funds in the Banking System\*



\* Average daily value for reserve calculation purposes.

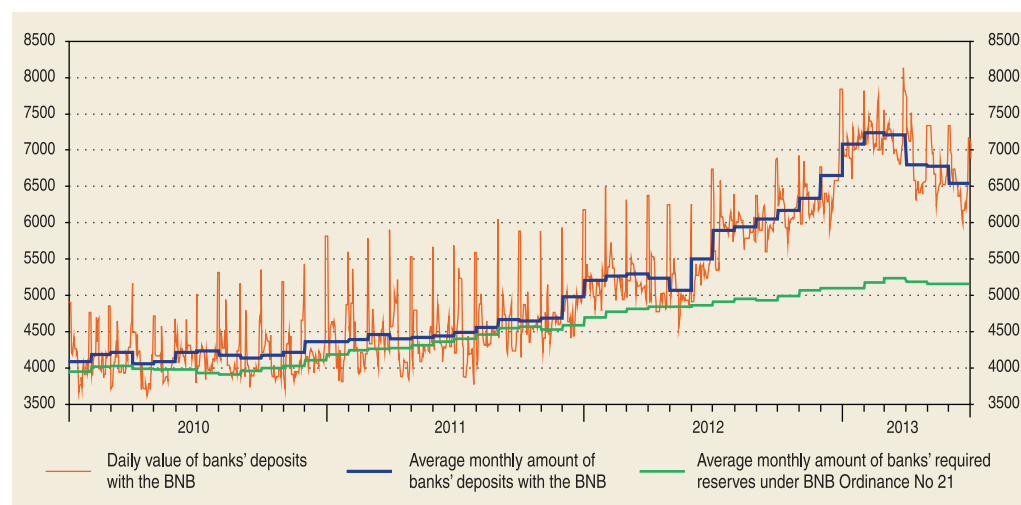
Source: BNB.

Banks' excess funds on their BNB Ordinance 21 reserve accounts declined to 7.4 per cent from 8.7 in 2012. Banks continued maintaining relatively high TARGET2-BNB account balances. They peaked in February at 22.7 per cent of all bank accounts with the BNB, dropping gradually to 17.8 per cent by June. Reasons for maintaining high excess reserve and TARGET2-BNB funds were euro area overnight money market excess liquidity, ECB monetary policy, deposit base growth, relatively low credit demand, and cautious lending policy.

<sup>45</sup> According to BNB Ordinance No 21, banks maintain minimum reserves of 10 per cent of their deposit base except reserves on funds attracted from abroad (5 per cent) and on government and local budget funds (0 per cent).

## Bank Reserves at the BNB

(BGN million)



Source: BNB.

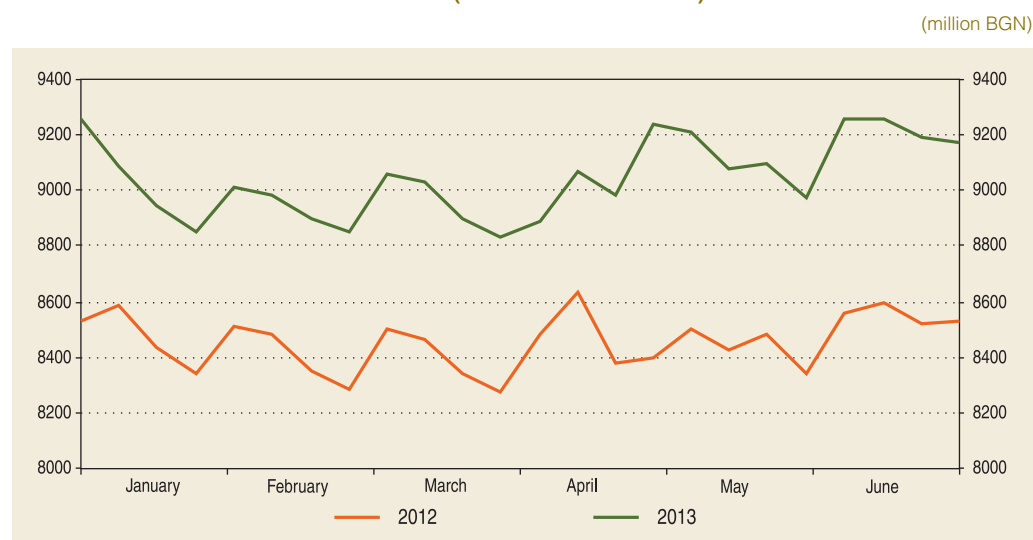
## V. Cash in Circulation

The Bulgarian National Bank holds the Bulgarian cash monopoly.<sup>46</sup> Its cash is legal tender mandatorily acceptable at face value. The BNB prints banknotes, mints coins, and preserves and scraps uncirculated or withdrawn cash.

### Banknotes and Coins in Circulation (Outside BNB Vaults)

Circulating cash<sup>47</sup> by 30 June 2013 was worth BGN 9170.2 million, down BGN 379.8 million or 3.98 per cent on the end of 2012 mainly due to seasonal factors, and up BGN 646.7 or 7.59 per cent in a year.

### Banknotes and Coins in Circulation (Outside BNB Vaults)



Source: BNB.

The steady rise in circulating cash since early 2012 continued into 2013. From January to June circulating cash rose 6.10 to 10.03 per cent on an annual basis. Cash demand grew most in April due to many holidays in that month.

By late June, 326.6 million banknotes worth BGN 8971 million circulated. This was 16.4 million less in number (4.79 per cent) and BGN 383.9 million less in value (4.10 per cent) on the end of 2012. Over the year, however, banknotes grew 16.3 million in number (5.25 per cent) and BGN 631.2 million in value (7.57 per cent). Banknotes comprised 97.83 per cent of the total nominal value of cash outside BNB vaults by 30 June 2013, down 0.13 percentage points since early 2013.

As regards the number of circulating banknotes, since the start of the year the lowest BGN 2 and 5 denominations grew 2.90 and 2.36 per cent. Others declined, BGN 10 and 20 banknotes substantially so by 7.1 million (9.67 per cent) and 7.9 million (7.01 per cent) and BGN 100 and 50 by 0.68 and 4.23 per cent.

On the end of June 2012, BGN 50 and 100 numbers continued growing faster than others, driving circulating cash growth. BGN 2 banknote numbers grew faster than in prior years. On the end of June 2012, the number of BGN 50 and BGN 100 banknotes rose by 4.9 million (8.45 per cent) and 2.8 million (11.03 per cent). The numbers of other denominations also grew, BGN 2 by 2.6 million (7.33 per cent) and BGN 20 by 4 million (4.02 per cent).

<sup>46</sup> The Law on the Bulgarian National Bank Article 2, paragraph 5 and Article 25.

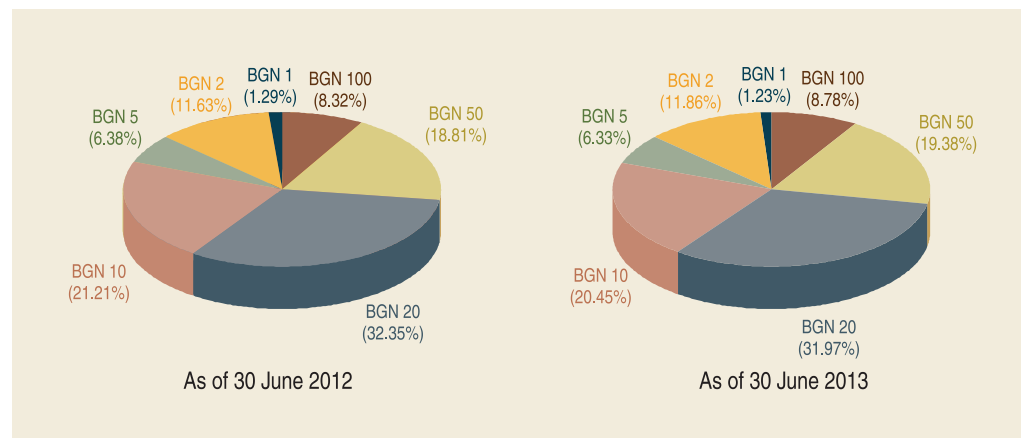
<sup>47</sup> Banknotes and circulating and commemorative coins issued after 5 July 1999.



BGN 50 banknotes had the largest value share in denominations. By the end of June, 63.3 million of them worth BGN 3164.4 million circulated: 35.27 per cent of the value of circulating banknotes. BGN 100 and BGN 20 followed with 31.94 and 23.28 per cent value shares.

By 30 June 2013 BGN 10 and BGN 20 banknotes continued comprising over half (52.42 per cent) of circulating banknotes. BGN 20 banknotes numbered 104.4 million and BGN 10 banknotes 66.8 million, or 31.97 and 20.45 per cent of circulating banknotes. BGN 100 and BGN 50 banknotes followed at 8.78 and 19.38 per cent.

### Denomination Shares in Circulating Banknote Numbers

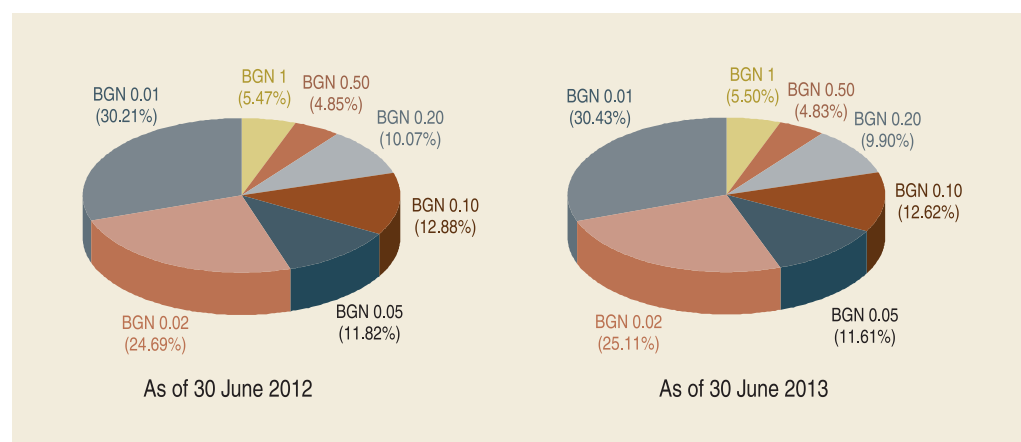


Source: BNB.

The average banknote circulating on 30 June 2013 was worth BGN 27.47, up BGN 0.20 on 2012 and BGN 0.59 (2.19 per cent) on June 2012, mainly due to the rise in BGN 100 and BGN 50 banknotes.

By the end of June 2013, 1538.2 million coins worth BGN 193 million circulated.<sup>48</sup> Since the start of 2013 coins outside BNB vaults rose by 42.9 million in number (2.87 per cent) and BGN 3.8 million in value (2.02 per cent). In a year, the number rose by 124.5 million (8.81 per cent) and the value by BGN 15 million (8.45 per cent). By 30 June 2013 the value share of coins was 2.10 per cent of cash outside BNB vaults.

### Denomination Shares in Circulating Coin Numbers



Source: BNB.

<sup>48</sup> Commemorative coins excluded.

By 30 June 2013 the numerical shares of BGN 0.01, BGN 0.02, and BGN 1 coins rose 0.22, 0.42 and 0.03 percentage points. The shares of BGN 0.05, BGN 0.10, BGN 0.20, and BGN 0.50 coins fell between 0.02 and 0.26 percentage points on the end of June 2012. A steady rise in circulating BGN 0.01 and 0.02 coins changed coin value structure. Since the end of 2012, the share of BGN 0.01 coins rose 0.05 percentage points (from 2.38 to 2.43 per cent) in the total value of circulating coins, while that of BGN 0.02 coins rose 0.08 percentage points (from 3.92 to 4.00 per cent). In a year, they grew 0.03 and 0.08 percentage points. By 30 June 2013 BGN 1 coins rose 0.37 percentage points in value on an annual basis. Within a one-year horizon the shares of coins of other nominals (BGN 0.05, 0.10, 0.20, and 0.50) fell 0.07, 0.18, 0.22 and 0.01 percentage points of all coins. By the end of June, the average circulating coin was worth BGN 0.13, as in late 2012.

There was BGN 6.3 million worth of commemorative coins outside BNB vaults, comprising 0.07 per cent of circulating cash value.

#### **Non-genuine Banknotes and Coins**

Over the first half of 2013, the BNB retained 930 non-genuine Bulgarian banknotes, 889 after entering circulation. The share of retained non-genuine banknotes remained very low at 0.000285 per cent of banknotes in circulation by the end of June 2013.

At 49.26 per cent, BGN 20 banknotes had the largest share of retained non-genuine banknotes in the first half-year. By 30 June they comprised 0.000441 per cent of circulating BGN 20 banknotes. The share of non-genuine BGN 10 banknotes was 25.16 per cent, while that of BGN 50 banknotes was 22.58 per cent of non-genuine banknotes retained in the half-year. Non-genuine BGN 2, 5, and 100 banknotes numbered 26 (2.80 per cent of retained non-genuine banknotes).

Non-genuine Bulgarian coins retained in the half-year numbered 345: 294 BGN 0.50, 43 BGN 0.20 and eight BGN 1 coins. The share of retained non-genuine Bulgarian coins in the circulating coins by 30 June 2013 was 0.000022 per cent.

In the first half of 2013 the National Analysis Centre retained 1284 euro banknotes, 1580 US dollar banknotes, and 67 assorted foreign banknotes.

#### **BNB Issue and Cash Activities**

BNB issue and cash operations include: banknote printing and coin minting; acceptance, delivery, repaying, processing, authenticity and fitness checking of Bulgarian banknotes and coins and foreign exchange; exchanging damaged cash; and destroying unfit Bulgarian banknotes and coins.

Between January and June 2013, the Bank supplied 30.4 million new banknotes and 48 million new coins under contracts with producers. The total nominal value of supplied new cash was BGN 1325.6 million. In the first half-year the Bank launched the two commemorative coins planned in its 2013 minting program under the Law on the BNB Article 25, paragraph 1.<sup>49</sup>

BNB banknote and coin deposits and withdrawals totalled BGN 14,102 million by the end of June. Banks deposited BGN 7241.1 million of cash, up BGN 697.7 million or 10.66 per cent on the same period of 2012. In the first six months of 2013, BGN 6860.9 million of cash was withdrawn, up BGN 522.9 million or 8.25 per cent in a year.

In the first half of 2013 sorting machines at the BNB and Cash Services Company<sup>50</sup> tested 397 million banknotes and 88.4 million coins. Compared with the corresponding period of 2012, processed banknote numbers rose 8.94 per cent, coins rising 2.19 per cent. BGN 10 and BGN 20 banknotes and BGN 0.10, BGN 0.20, and BGN 1.00 coins were most frequently processed by value.

<sup>49</sup> For information on new banknotes and circulating and commemorative coin issues, see the BNB website.

<sup>50</sup> The Cash Services Company is a BNB Ordinance No 18 cash handler and service supplier owned by the BNB and four commercial banks.

By the end of June 2013 banknotes failing fitness standards numbered 40.4 million, down 2.6 million (5.95 per cent) on the same period of 2012. In the first half-year BGN 2, BGN 10, and BGN 20 banknotes had the largest share of banknotes unfit for circulation (21.50, 25.88, and 28.89 per cent).

Fitness sorting detected 408.7 thousand unfit coins, down 34.6 thousand or 7.81 per cent on the first half of 2012. The half-year saw demonetisation of unfit precious and base metal circulating and commemorative coins.

Over the half-year, BNB reserve currency purchases came to EUR 0.17 million, including EUR 0.09 million from budget organisations and EUR 0.08 million from individuals. Over the same period, BNB reserve currency sales were EUR 12.9 million, including EUR 9.69 million to individuals and EUR 3.2 million to budget organisations.

In the first half of 2013, the BNB performed four full and 12 partial checks of credit institution and service provider observance of cash handling and banknote recycling regulations. They addressed cash handling procedures, ATM banknote quality, and equipment compliance with Ordinance No 18 on the Control over Quality of Banknotes and Coins in Cash Circulation.

## VI. Maintaining Banking Stability and Protecting Depositors

### 1. The Banking System

Banks continued adapting to the uncertain home and foreign environment. Mid-year financial accounts showed continuing balance restructuring to cut costs and boost profits. Set banks not only shed staff and cut branch networks, but also changed business strategies regarding offered services, customer and business sectors.

Lending remained subdued. The moderate growth in classified loans since the second half of 2012 continued. The growing share of loans past due over 90 days continued pressuring profitability through lower interest income and extra impairment costs. Efforts to cut administrative spending had little effect on the financial result which slipped from the first half of 2012.

Capital position management helped strengthen banking's regulatory capital. Capital surplus rose, safeguarding buffers accumulated in recent years. System liquidity remained high amid weak credit demand and growing consumer deposits. Lower interest on new deposits did not greatly affect consumer propensity to save and household deposits continued to increase. Nevertheless, since the year start this main source of bank funding began growing more slowly.

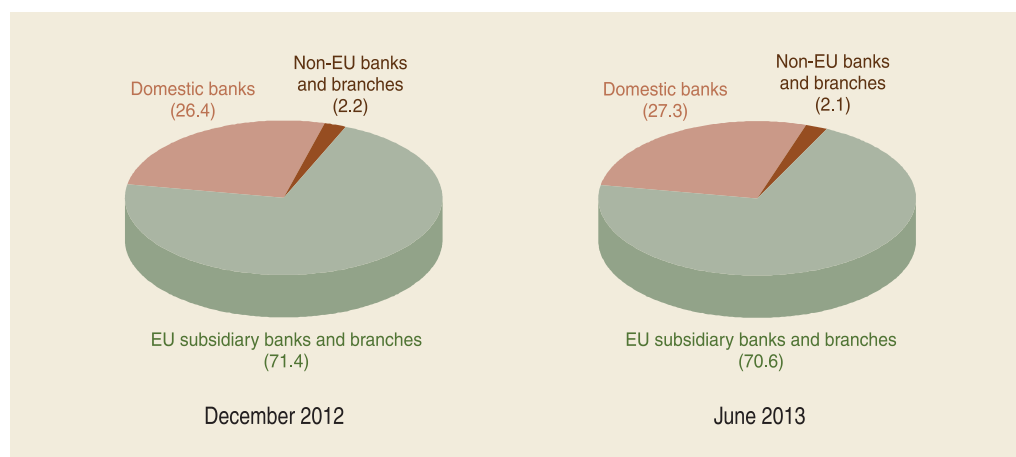
#### Structural Changes in the Banks' Balance Sheet

Banks' assets rose 1.0 per cent or BGN 786 million to BGN 83.2 billion. The system balance sheet figure grew less fast on an annual basis, by 4.7 per cent or BGN 3.8 billion from 5.9 per cent or BGN 4.4 billion in the year to June 2012.

Divergent balance sheet developments regrouped credit institutions by assets. The big five now include three EU subsidiaries and two home banks with a 49.9 per cent market share. Banks with mainly Bulgarian equity continued boosting system assets, increasing their share to 27.3 per cent. EU subsidiary banks' market share fell to 64.9 per cent and that of EU bank branches to 5.7 per cent. The assets of banks and branches from outside the EU reported a decline, their market share falling marginally to 2.1 per cent from 2.2 in December.

#### Home and Foreign Bank Market Shares by Assets

(per cent)

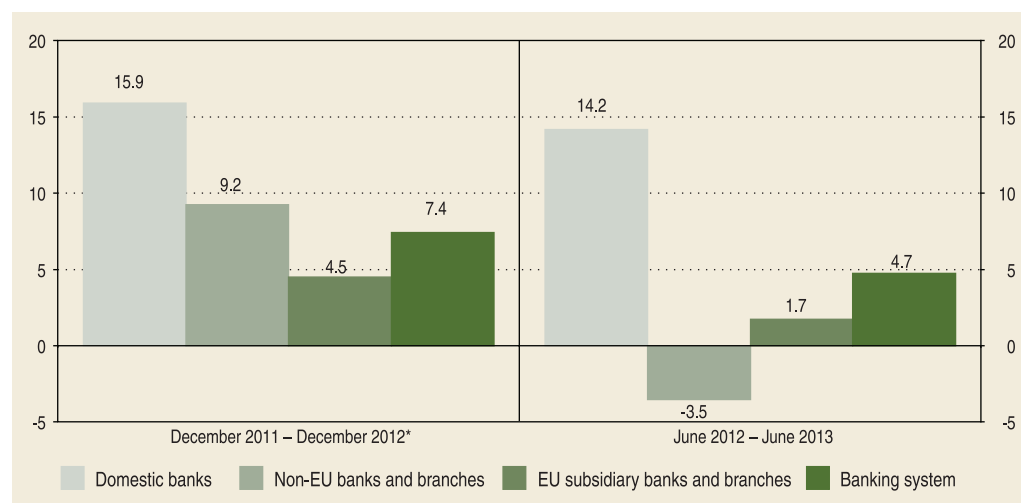


Source: BNB.

## Asset Dynamics of Home and Foreign Banks and the Banking System

(annual change)

(per cent)



\* Audited annual data.

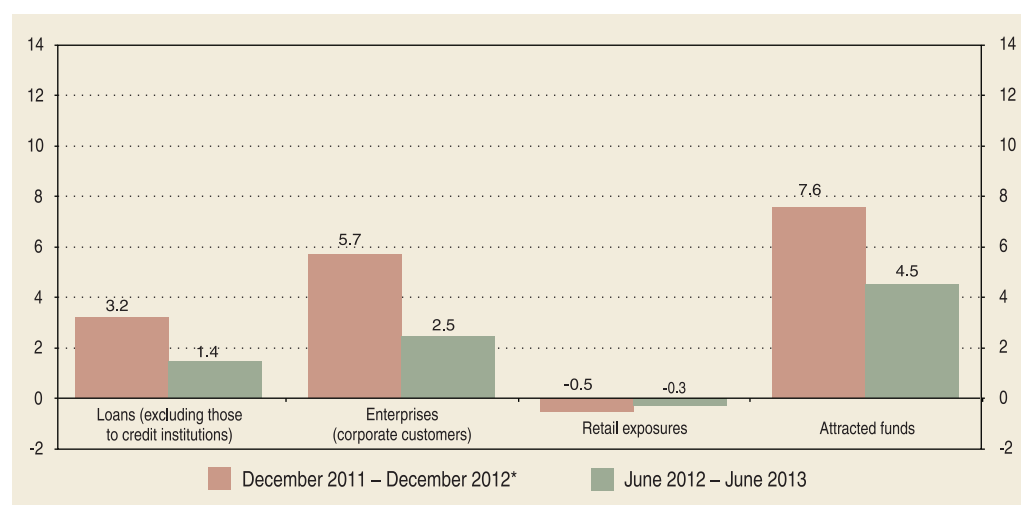
Source: BNB.

Banks' balance sheet structure did not change much. The relative weight of investment in securities in assets rose somewhat at the expense of cash. The share of loans (excluding loans to credit institutions) contracted to 63.5 per cent from 64.6 at the end of 2012 through increased placements in credit institutions and loan impairment. The share of advances (placements in credit institutions) rose to 9.4 per cent of assets. Cash fell BGN 770 million, its asset share falling to 10.4 per cent from 11.5 in December 2012. The total amount of securities rose BGN 775 million, mostly through assets available for sale, whose share rose to 12.4 per cent. More than two thirds of this growth was due to the increase in foreign issuers' debt instruments. The steady rise in consumer deposits moderated to 9.8 per cent a year from 15.3 per cent in the year to June 2012. The 81.7 per cent rise in residents' funds reflected falling non-residents' funds and especially credit institution deposits. The share of levs in attracted funds rose on an annual basis at the expense of euro.

## Dynamics of Selected Financial Indicators

(annual change)

(per cent)



\* Audited annual data.

Source: BNB.

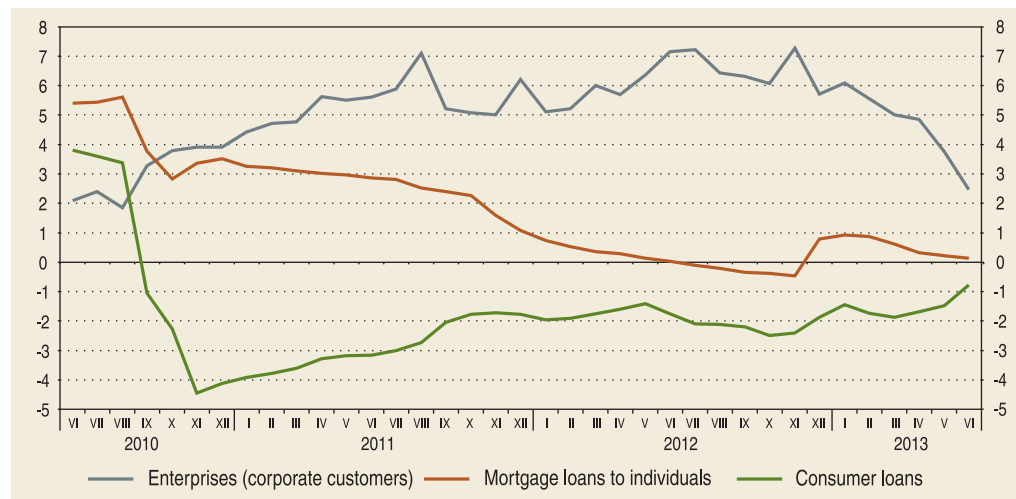
**Lending** A slack economy and limited consumer spending continued depressing the credit portfolio, with significant monthly fluctuations in set segments and banks. Rising lending by the big five did not offset lending falls at smaller institutions and foreign bank branches. At BGN 57.6 billion, gross loans (excluding loans to credit institutions) was down 0.4 per cent or BGN 203 million on December.<sup>51</sup> Corporate borrowing fell BGN 112 million or 0.3 per cent, only home institutions lending more. Small and medium banks boosted consumer credit by BGN 38 million or 0.4 per cent. Mortgage lending fell BGN 75 million or 0.8 per cent, resulting in a contraction. Non-credit institution and central government borrowing dropped, while claims from credit institutions rose by BGN 953 million or 13.8 per cent.

Loans and advances' currency structure revealed changes in credit portfolio segments. The share of positions in levs rose to 35.9 per cent, other currencies remaining unchanged at 4.2 per cent, while euro contracted to 59.9 per cent. Over a year, gross system lending (excluding loans to credit institutions) rose BGN 817 million or 1.4 per cent, corporate lending contributing most, while consumer lending fell.

### Dynamics of Gross Loans to Corporations and Retail Exposures

(annual change)

(per cent)



Source: BNB.

### Attracted Funds

At BGN 544 million (0.8 per cent) attracted funds grew less than the 3.7 per cent in the first half of 2012 and the 4.5 per cent on an annual basis. The BGN 1.3 billion rise in funds from business, individuals and households offset the BGN 849 million fall in credit institutions' funds. Lower deposit interest barely affected rising savings which grew BGN 1.2 billion (3.4 per cent). More than half of this went to home banks, boosting their market position in the segment to 32.3 per cent. Funds from institutions other than credit institutions rose by BGN 134 million (0.6 per cent) through local banks' active efforts. Subordinated term debt and debt/equity (hybrid) instruments rose by BGN 45 million (2.2 per cent). The share of funds from individuals and households rose to 52.1 per cent.

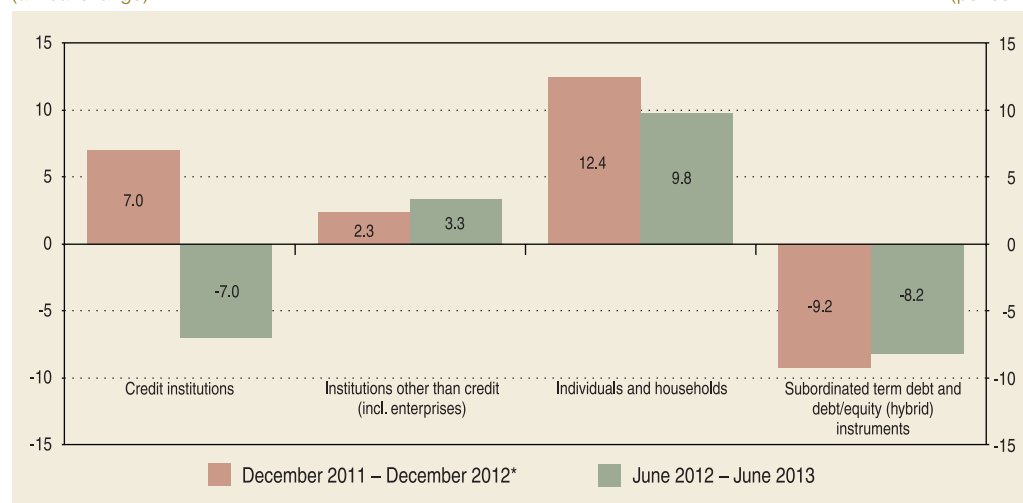
<sup>51</sup> Minor credit growth differences with Section I reflect methodological differences in calculating credit portfolios for statistical and supervisory purposes.



### Share of Attracted Funds

(annual change)

(per cent)



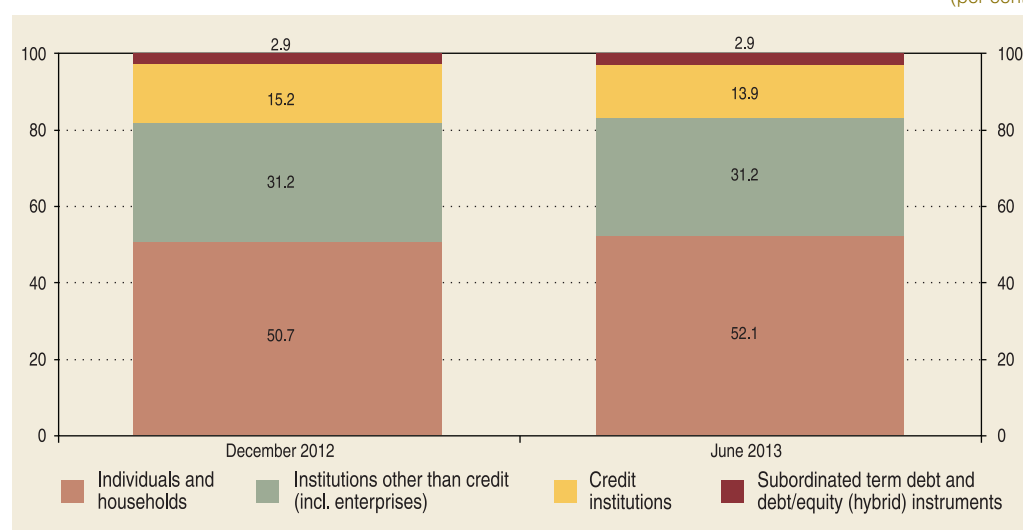
\* Audited annual data.

Source: BNB.

In the year to June 2013 individuals and households' deposits grew BGN 3.3 billion (9.8 per cent). The BGN 716 million rise in funds from institutions other than credit failed to offset the BGN 747 million fall in credit institutions' funds. This changed the currency structure of attracted funds, the lev component reaching 48.3 from 45.8 per cent at the end of 2012, euro falling to 44.7 per cent, and others to 7.0 per cent.

### Structure of Attracted Funds

(per cent)



Source: BNB.

#### Balance Sheet Equity

Banking system balance sheet equity rose by BGN 183 million (1.7 per cent) on the end of 2012 and BGN 455 million (4.2 per cent) in a year. Issued capital rose BGN 28 million, premium reserves BGN 81 million, and reserves including retained profits BGN 301 million. Revaluation reserves or financial assets available for sale fell BGN 18 million.

#### Profitability Dynamics

Financial and operating income fell BGN 41 million (2.2 per cent) on the first half of 2012. Interest income and expenditure fell BGN 121 million (5 per cent) and BGN 43 million (3.9 per cent). At BGN 499 million impairment costs fell 7.9 per cent on this time last year. Non-interest income was BGN 557 million or BGN 16 million more

than that reported a year ago. Administrative expenditure rose BGN 7 million to BGN 855 million. Mid-year system profit fell BGN 6 million on the first half of 2012 at BGN 318 million.

### Banking System Risk Profile

The amount and quality of credit institutions' buffers were not affected by risks due to their successful management in the first half of 2013. Credit risk remained top priority and the quality of off credit portfolio assets remained high. Despite a moderate growth in classified loans, subdued lending and the related interest income could not offset impairment cost pressure on profitability. Lower credit portfolio quality together with continuing growth in attracted funds made banks lower the price of attracted resource to optimise net interest income. Individual credit institutions' capital positions reflected their risk profiles. High banking system liquidity resulted from growing consumer savings and relatively weak corporate and consumer credit demand.

### Asset Quality

While banks remained sensitive to credit risk, credit portfolio impairment moderated further. Classified loans rose BGN 76 million (0.6 per cent) in the first half year and BGN 5 million in a year due to effective credit risk management. The favourable downward trend contributed to 0.04 per cent annual classified loan growth from 13.7 per cent in the year to June 2012. Classified loans accounted for under 24 per cent of the gross banking portfolio at the end of the half-year from 23.8 per cent at the close of 2012.

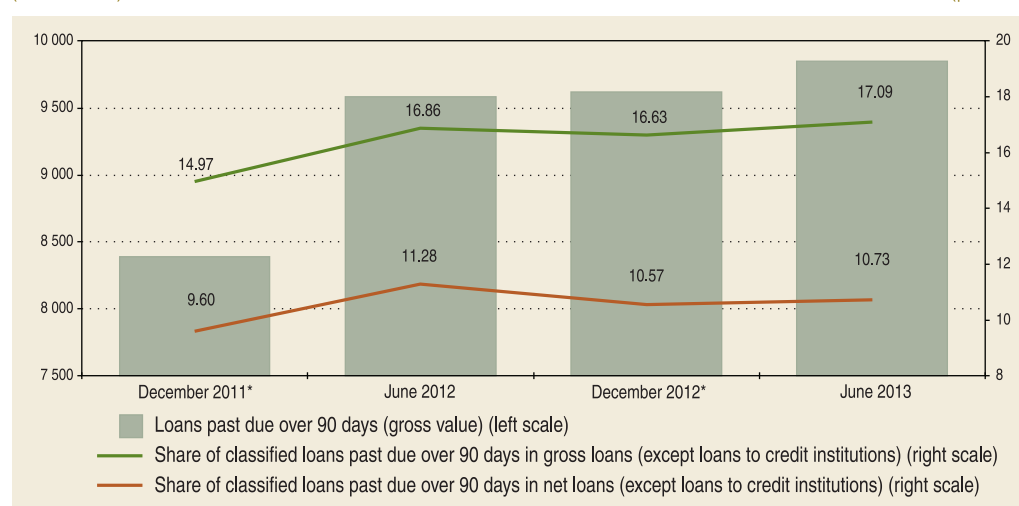
The product overview showed classified corporate loans still with the largest share at 27.1 per cent. The non-performing retail exposure share grew to 18.7 per cent mostly because of mortgages. The classified share of consumer loans remained below historical levels at 14.3 per cent for the whole credit portfolio, while that of problem mortgage loans used for house purchase reached 23 per cent.

Exposures past due over 90 and over 180 days rose BGN 234 million (2.4 per cent). The share of both categories in gross loans (excluding ones to credit institutions) rose to 17.1 by 30 June from 16.6 per cent at the end of 2012.

### Classified Loans Past Due over 90 Days

(BGN million)

(per cent)



\* Audited annual data .

Source: BNB.

The net non-performing loans past due over 90 days<sup>52</sup> to net loans ratio also rose to 10.7 per cent, while remaining lower than the gross ratio. The larger share of net nonperforming loans reflected mainly BGN 146 million corporate exposure growth.

<sup>52</sup> Net non-performing loans are gross value less impairment cost.

Non-performing mortgages and consumer loans increased BGN 59 million and BGN 18 million. Banks responded to sharpened credit risk by raising provisions.

The quality of assets other than loans remained good. The share of investment in Bulgarian government securities remained high at 55.1 per cent of debt and equity instruments. The share of equity instruments remained low at 2.7 per cent of total securities acquired. Investment in banks remained low risk with 77.1 per cent sold to non-resident institutions, of which 62.1 per cent in the group. Currency risk was limited to placements in other currencies which comprised 15.4 per cent of total investment in credit institutions.

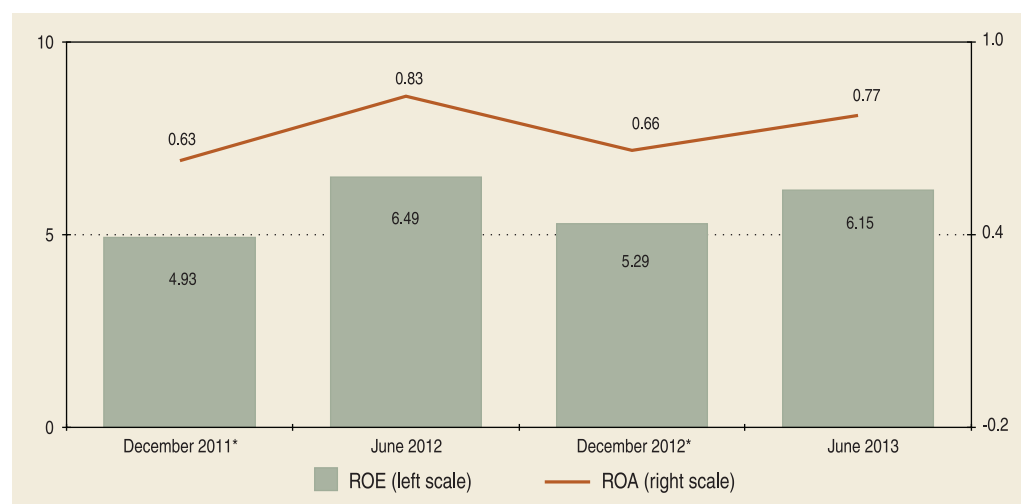
## Profitability

Worsening credit portfolio quality, reduced capacity to boost income through new products and services and continuing pricing changes hit banks' capacity to generate income over the first six months of 2013. Steadily falling deposit interest cut interest spending from mid-2012, yet interest income also fell as credit portfolios shrank and non-performing loans rose. Falling impairment costs and greater contribution by charges helped profitability. At BGN 318 million, mid-year system profit was down 1.8 per cent on a year ago. Given 4.7 per cent asset growth, return on assets (ROA) fell slightly from 0.83 to 0.77 per cent over the year. Attracted additional capital resources reflecting banks' strengthened capital positions cut return on balance sheet equity and reserves (ROE) from 6.49 to 6.15 per cent.

### Return on Assets and Return on Equity

(per cent)

(per cent)



\* Audited annual data.

Source: BNB.

Rising interest liabilities and falling interest income cut net interest margin from 3.66 to 3.29 per cent in a year. In the year to June 2013 banks' interest bearing assets rose BGN 3.3 billion, but most went into securities whose low current yield failed to offset declining interest income.

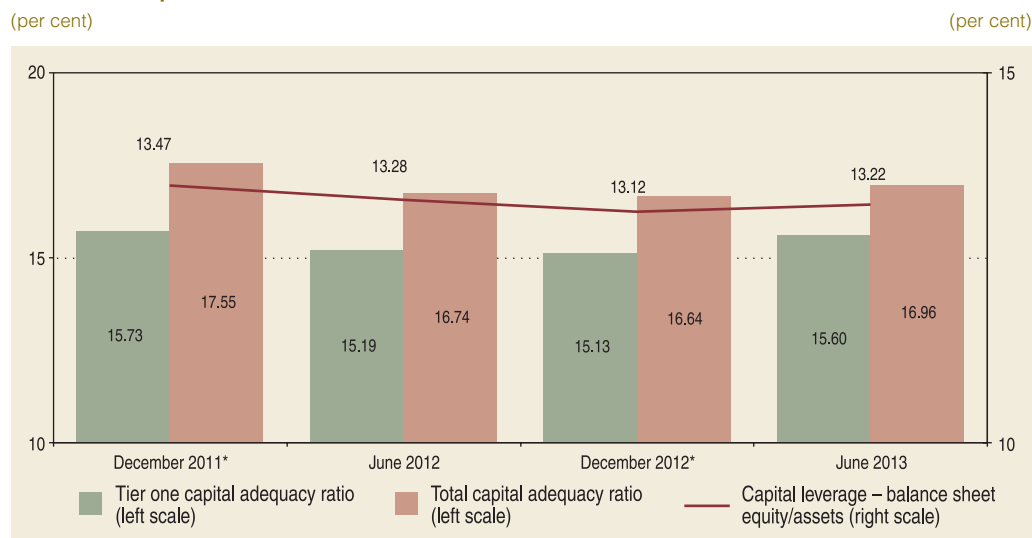
## Equity

Banking system capital position strengthened and regulatory capital quality remained high. Supervisory recommendations kept own funds and tier one capital far above regulatory requirements. Capital surplus rose BGN 188 million to BGN 2.7 billion.

Tier one capital growth of BGN 293 million after regulatory levies strengthened the capital buffer. Raising registered capital and premium reserves, reserves, and hybrid instruments gave extra protection. Tier two capital fell BGN 77 million through maturing subordinated term debt and reductions (mainly specific credit risk provisions). Capital requirements rose BGN 28 million (0.4 per cent), mainly through general credit risk

(BGN 23 million) and related requirements (BGN 9 million). This boosted tier one capital adequacy to 15.60 per cent and total capital adequacy to 16.96 per cent.

### Selected Capital Indicators



\* Audited annual data.

Source: BNB.

Leverage (balance sheet equity to assets) also improved to levels above the EU average.

A percentage point increase in the structure of own funds (the tier one to capital base ratio) hiked tier one capital to 92 per cent. Eleven banks had own funds entirely comprising tier one capital (issued capital and reserves), enabling them to attract additional capital for expansion.

Over the review period the structure of capital requirements for credit, market and operational risk remained unchanged. Credit risk occupied 58.2 per cent of them. The weight of its most significant segment, corporate exposures, fell to 55.1 per cent from 55.9 at the end of 2012. Operational risk contributed an almost unchanged 7.7 per cent, while position, foreign currency and commodity risks (market risk) remained below 1 per cent at 0.8 per cent.

### Liquidity

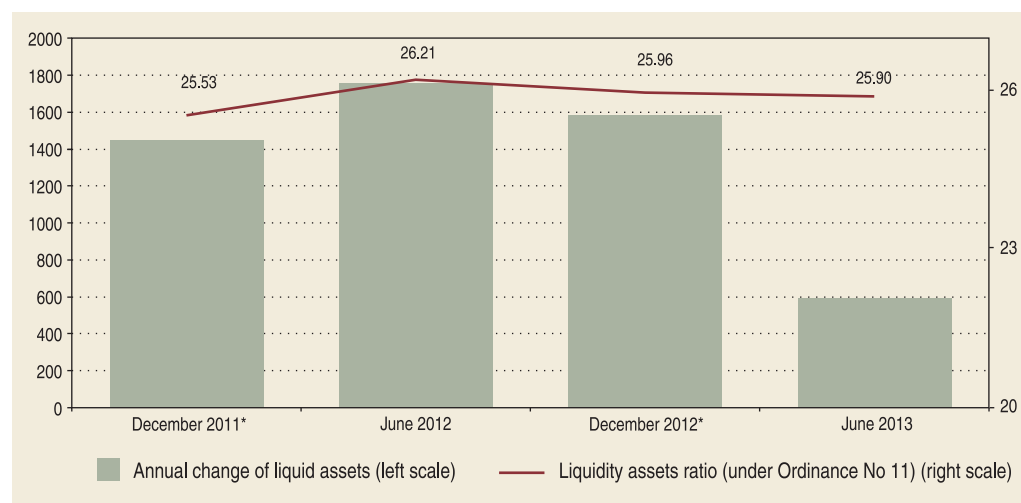
Credit institutions' liquidity management enjoyed stable incoming resource, mainly in the form of deposits from individuals, alongside low credit demand. The liquid assets ratio moved between 25 and 27 per cent, ending at 25.90 by late June.

Between January and June 2013 liquid assets rose BGN 93 million (0.5 per cent) to BGN 18.5 billion. Liquid assets' structure changed with cash falling by BGN 770 million in favour of a BGN 752 million rise in funds on current accounts with other banks and interbank deposits of up to seven days and a BGN 296 million rise in tradable debt securities issued by financial institutions. In a year, the share of cash on current accounts with other banks and international deposits of up to seven days central bank contracted to 33.0 from 37.7 per cent of liquid assets and that of tradable sovereign, central bank or financial institution debt rose 2 percentage points to 14.8 and 2.1 per cent respectively. The share of cash also rose from 45.5 per cent to 46.9 per cent.

### Selected Liquidity Indicators

(BGN million)

(per cent)



\* Audited annual data.

Source: BNB.

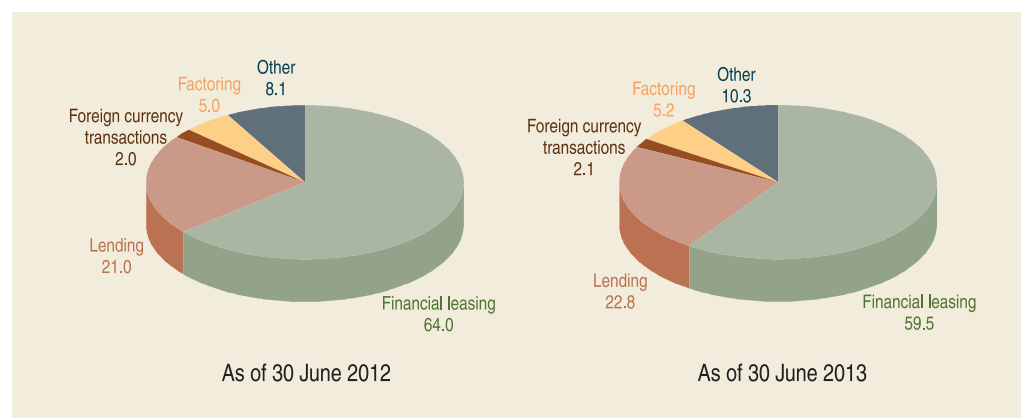
## 2. Assessment of the Financial Performance of Financial Institutions Registered under the Law on Credit Institutions Article 3, Paragraph 2

Of the 279 registered financial institutions, 12 registered in the first half of 2013 by declaring as scope of activity mainly lending with own funds and ten (three of them lessors) deregistered. Lenders (117) and financial lessors (69) continued to dominate.

Assets totalled BGN 6.6 billion or 4.2 per cent less than at the end of 2012.<sup>53</sup> Financial institutions had a relative share of 8 per cent of banking system assets. The figure share of the 20 largest institutions reflected the overall decline in the sector's balance sheet figure, dropping to 68.5 per cent. The drop resulted from lessor contraction and voluntary deregistration from the BNB Register of Financial Institutions. Lenders and factorers continued expanding, the number of registered companies increasing alongside their market share.

### Structure of Law on Credit Institutions Article 3, Paragraph 2 Financial Institutions' Assets

(per cent)



Note: The sum may not add up to 100 owing to rounding.

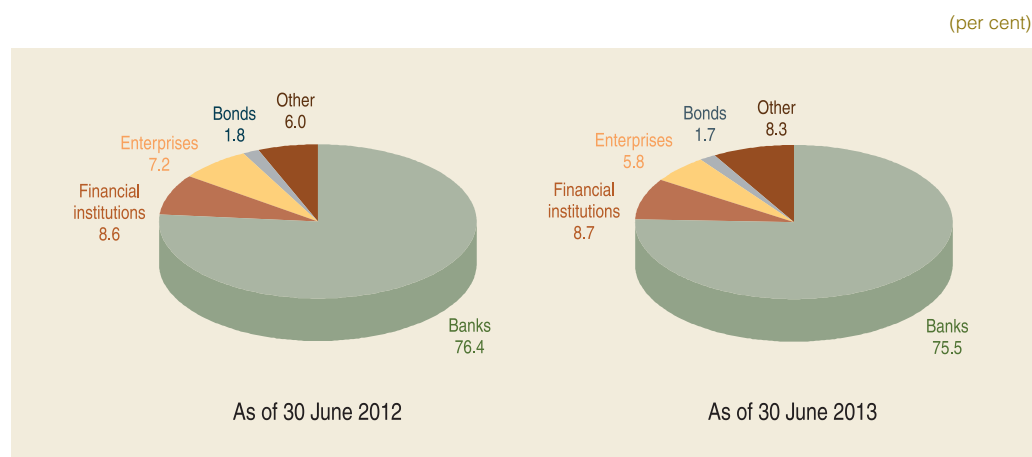
Source: BNB.

<sup>53</sup> The balance sheet figure was calculated from the supervisory purpose financial statements of 250 companies.

In the structure of assets, the share of loans and receivables (including financial leases) fell to 72 per cent (BGN 4.8 billion), while that of cash rose to 11.3 per cent. Financial lease claims fell by 5.7 per cent in the half year and 12 per cent in the year. The currency composition of loans and receivables shows lev denominated exposures rising to 43 per cent and euro falling to 55 per cent.

Gross lending (including financial leases) fell 4 per cent to BGN 5.3 billion by end-June. Financial lease claims occupied the largest share of the gross credit portfolio at 62.4 per cent, followed by consumer and business credit at 19.5 and 17.6 per cent. Loan quality (including financial leases) continued to worsen over the review period. At BGN 2.7 billion gross impaired loans occupied over half the gross credit portfolio. By the end of June loans past due over 90 days comprised 25.3 per cent of this from 24.1 per cent at the end of 2012, those overdue for sundry reasons comprising 15.2 per cent from 14.3 per cent at the end of 2012. Impairment costs went up to BGN 930 million.

### Sources of Law on Credit Institutions Article 3, Paragraph 2 Financial Institutions' Attracted Funds



Source: BNB.

The BGN 5 billion attracted from financial institutions fell by 8.3 per cent on December 2012. At BGN 3.8 billion, bank funding remained the sector's main source of finance, representing 75.5 per cent of total attracted funds from 72.2 per cent in late 2012. The share of euro funding rose to 75.7 per cent, levs falling to 22.9 per cent.

These financial institutions made BGN 169 million profit, up BGN 76 million on the first half of 2012. Lenders' rising earnings offset lessors' losses. Net interest income of financial institutions rose 9.6 per cent (BGN 20 million) on June 2012 reflecting lower interest expenses. Administrative and impairment costs rose 10.7 per cent (BGN 13 million) and 19.7 per cent (BGN 11 million).

Current liquidity ratio<sup>54</sup> rose to 15.7 per cent from 13.7 per cent at the end of 2012. Equity reached BGN 1.3 billion. The capital position improved BGN 190 million on June 2012 through new equity minima split by business areas.

## 3. Banking Supervision

### Supervisory Policy

Supervision supplements the regulatory framework, aligns it with EU amendments on strengthening banks' capital positions, improving liquidity management, and tackling the financial crisis through other measures. Work focused on the CRD IV legislative package replacing the Capital Requirements Directive with two new legislative instruments: a Directive on access to the activity of credit institution business and

<sup>54</sup> The ratio of current assets to current liabilities.

### Supervisory Monitoring of Credit Institutions

a Regulation on prudential requirements for credit institutions and investment firms.<sup>55</sup> The two instruments enact the Basel Committee on Banking Supervision's Third Accord (Basel III) on EU capital standards and measures. The regulation applies directly, calling for significant changes to Bulgarian Law, foremost the Law on Credit Institutions and BNB Ordinances No 9 and No 11. It also repeals BNB Ordinance No 8 on the capital adequacy of credit institutions and Ordinance No 7 on the large exposures of banks.<sup>56</sup>

In June 2013 the BNB assessed the impact of the new regulatory framework on the Bulgarian banking market, focusing on liquidity requirements.

Supervisors reviewed and assessed individual banks through offsite reports and onsite inspections. Quarterly analyses of bank risk levels and the dynamics, and CAEL assessment ratings of individual banks' risk profiles relied on regular financial and supervisory reports. The half year saw 11 supervisory inspections focusing on institutions' behaviour in the current macroeconomic environment, reviews of problem exposure risk management, and exposure renegotiation, restructuring and effective collectability. On-site inspections also reviewed banks' daily business such as the fitness of risk monitoring and controlling systems, profitability assessment, capital adequacy and liquidity risk management, and regulatory observance. A review of credit institutions' own capital adequacy analyses for 2012 assessed ability to tackle current and future risks.

The half year saw 23 formal regulatory framework breaches. Supervisors issued 141 recommendations. Most breaches concerned pinpointing risk, measuring or revaluing risk exposures to accounting and supervisory standards, and using supervisory regulation instruments.

Supervisors worked closely with supervisory colleges in which the BNB participates as a competent supervising authority of European bank groups' subsidiaries. This involved preparing 2012 risk assessments as part of group level liquidity and capital requirement rulings.

### Macro- prudential Analyses and Strategies

These analyses and strategies focused on the assessment of risks related to credit institutions' business and the sustainability of the banking system using methods for early identification and possible risk sharpening. Home and external instability called for continuous monitoring and analysing of the changing financial indicators of individual banks and the system.

Rising banking sensitivity to home and EU processes called for improved risk measurement and evaluation. A special analysis of banking exposure to more sensitive business sectors accompanied regular stress tests. A study also addressed the Bulgarian banking system's business model parameters and drivers, including individual banks' business models.

Communicating risk analyses and business forecasts within the banking community broadened knowledge of major factors governing risk acuity and effect. Supervisors also kept the public advised of their work through periodical publications and standard supervisory and financial reports. Rating agencies made use of published information and analyses.

<sup>55</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013.

<sup>56</sup> Also see Chapter IX.



**Special  
Supervision**

Priorities in the first half of 2013 were to establish reliable ways to prevent dirty money flowing through the banking sector, assessing consumer problems, and deepening analyses for registering and systematically supervising financial institutions at the macro and micro levels.

Risk based supervision of the banking system involved six banks. Inspectors assessed measures against money laundering and terrorist financing and procedures for implementing EU policy on weapons of mass destruction non-proliferation. Bank managements received recommendations to tighten monitoring and control.

Cooperation with the Special Prosecution Service, the National Investigation Agency, the State National Security Agency and judicial bodies contributed to effective prosecution of landmark cases. Prosecution service requests involved examining 23 banks, with results sent as criminal proceedings evidence. The Bank helped legal authorities with cases for which international legal assistance was required.

Cooperation continued with the Ministry of Foreign Affairs on issues related to United Nations resolutions and the statute of diplomatic representations subject to restrictions. Banks received timely advice to coordinate sanctions in the banking sector.

A successive thorough analysis addressed the draft National Action Plan on Implementing the Money Laundering Countering Strategy, the Bank sending an opinion and proposals to the Council of Ministers for consideration by a joint working party.

Analysing and preparing proposals for the draft fourth directive on preventing money laundering and terrorist financing by the financial system received additional funds. When the European Commission opened consultations in April, it received an opinion towards Bulgaria's framework position on the draft regulation on fund transfer information.

Coordination meetings between the Bulgarian Deposit Insurance Fund and the BNB improved information flows and set new criteria for Law on Bank Deposit Guarantee inspections.

A study addressed the risks of the exchange traded funds (ETFs) and contracts for differences (CFDs) investment products. It focused on the EU legal framework and market practice on responsible mortgage lending and relationships with borrowers with repayment difficulties. Outcomes made their way into the Warning to Consumers, Good Practice for Responsible Mortgage Lending and Good Practice for the Treatment of Borrowers in Mortgage Payment Difficulties on the European Banking Authority website.

Early 2013 saw new capital requirements for Law on Credit Institutions Article 3, paragraph 2 financial institutions. Tighter criteria resulted in BNB register listings and delistings.<sup>57</sup> A new automatic information procedure improved information processing efficiency.

Several financial institutions cooperated with the Prosecution Service and the Ministry of Interior in criminal investigations. On-site inspections, including bank counter inspections, checked financial statement inconsistencies.

**Licensing,  
Permits, and  
Approvals**

There was no credit institution licensing work in the half year.

Capital instruments remained at the centre of banks' attention. On issuing BGN 30.1 million of debt to cover tier one capital requirements, Investbank received leave to include it in its equity. Crédit Agricole Bulgaria used the same procedure on issuing EUR 2 million debt. The Central Cooperative Bank increased tier two capital by attracting BGN 45 million of subordinated term debt.

<sup>57</sup> See Section II of this Chapter.

There were no significant changes in banks' shareholder structures or management bodies. CIBANK, Crédit Agricole Bulgaria and TBI Bank elected new members to their managements. The supervisory bodies of ten EU member state institutions advised the BNB of intent to provide cross border services in Bulgaria, bringing their number to 222. No new EU member state bank branches opened. The Regional Investment Bank of Latvia closed its branch.

There were no serious supervisory measures. One subsidiary bank received instructions to improve credit risk management (supervisory reclassification of risk exposures, correcting accounting entries, changing risk exposure policy assessment and methodology for recording factoring transactions) after a set securitisation entry in its annual financial accounts. Another bank received a recommendation to change conditions on a deposit product which constituted bad practice and raised doubts about the transparency of some of its parameters. The bank implemented the recommendation.

BNB supervisory powers under the Law on the BNB aim to maintain banking system stability and protect depositor interests, but do not seek to protect financial services consumers. The Bank continued receiving complaints from banks and their customers. Since most fell within the purview of the Consumer Protection Commission, the BNB referred them to it.

## VII. The Central Credit Register

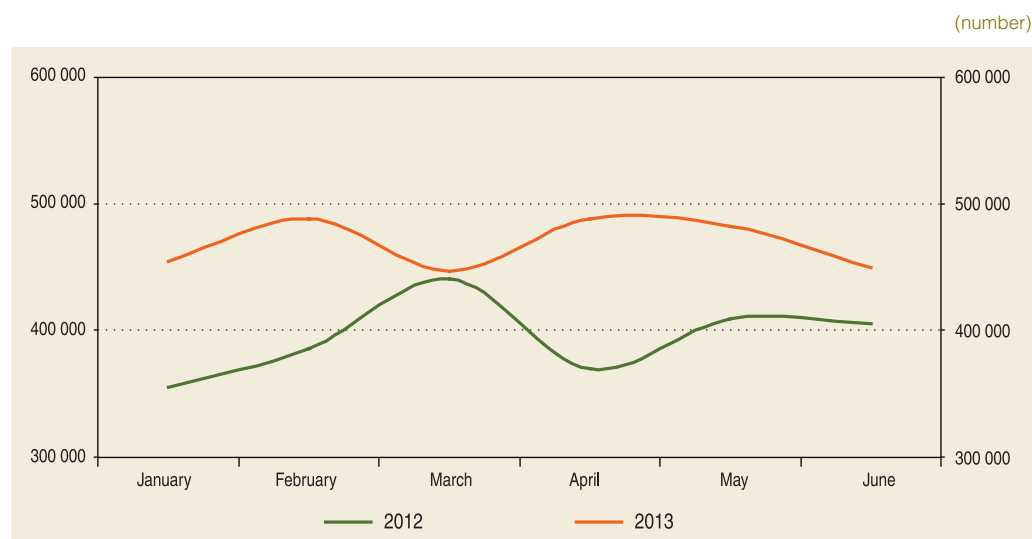
The Law on Credit Institutions Article 56 mandates the Bulgarian National Bank with monitoring debt to Bulgarian banks, financial institutions, payment institutions, and electronic money institutions (reporting units). Ordinance No 22 on the Central Credit Register (CCR) regulates this.

The CCR lists all bank, financial institution, payment institution, and electronic money institution loans, irrespective of amount. Loans to government and the Bulgarian National Bank are exempt, as are agreed overdrafts under BGN 1000 classified as standard under Ordinance No 9 on the Evaluation and Classification of Risk Exposures of Banks and Allocation of Specific Provisions for Credit Risk.

Over the first half of 2013, 14 new financial institutions entered the CCR information system. Five financial institutions and a bank left it under Ordinance No 22 Articles 8 and 9, termination of operations and deletion from the Banking Supervision Department public register. By 30 June 2013 there were 202 participants: 30 banks, 171 financial institutions, and one payment institution.

The CCR listed 4053 thousand loans from 4051 thousand a year earlier. Balance sheet exposure rose to BGN 62,460 million from BGN 61,973 million. The 2130 thousand borrowers included 2023 thousand individuals, 96 thousand legal entities, 4 thousand foreigners, and 7 thousand self-employed people.

### CCR Searches in the First Halves of 2012 and 2013



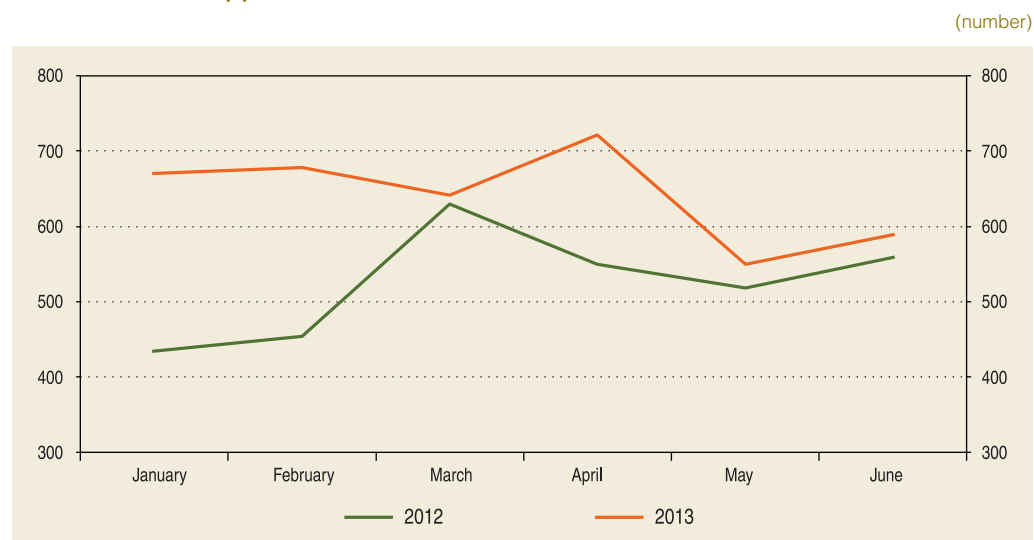
Source: BNB.

Customer borrowing information includes loan servicing histories, loan status, and arrears on current and repaid loans going back five years. The creditworthiness assessment and analysis help maintain portfolio quality.

Between January and June 2013 banks, financial institutions, payment institutions, and electronic money institutions conducted 2811 thousand digital certificate searches on 2194 thousand individuals and 617 thousand legal entities. This was 445 thousand more than in the same period of 2012. There were some 468 thousand monthly searches on average.

Ordinance No 22 Articles 21 and 22 govern information disclosure on individual and legal entity debt. Access involves applying and remitting a published fee. In the first half-year, 3748 individuals and 103 legal entities applied for CCR statements: altogether 3851 from 3146 in the same period of 2012.

### CCR Statement Applications in the First Halves of 2012 and 2013



Source: BNB.

CCR system functionalities and statement types changed in the half-year to boost quality.

## VIII. The Fiscal Agent and State Depository Function

The Bulgarian National Bank acts as the state's fiscal agent and official depository under the Law on the BNB. It submits information on budget entities' domestic bank accounts and acts as government debt agent under contracts negotiated to market conditions and prices with the Ministry of Finance (MF).

The Bank operates and develops the GSAS system for conducting government securities auctions, the ESROT electronic system for registering and servicing government securities trading, the GSSS government securities settlement system, the Register of Special Pledges, the AS ROAD automated system for registering and servicing external debt and the IOBFR system for budget and fiscal reserve information servicing.

Agency fees and commissions increased 31.7 per cent on the first half of 2012 to BGN 1171 thousand. This reflected higher fees and commissions from auctions, primary market government bond registration and settlement, and new fiscal service prices for euro-denominated government bond settlement under Article 43, paragraph 1 of the Law on the BNB.

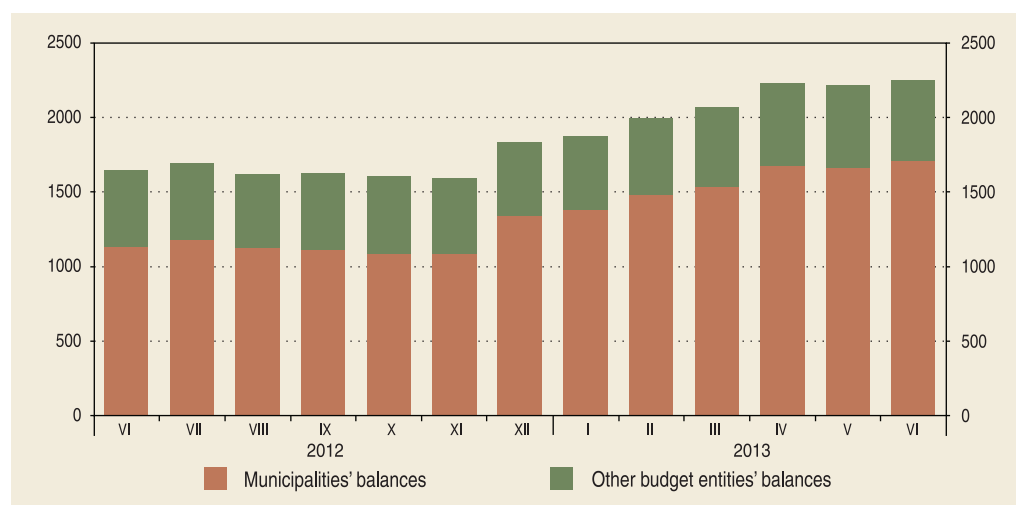
### Information Service

Daily and periodical statements on budget, extra budgetary, deposit, foreign currency, and letter-of-credit accounts of budget entities and municipalities in leva and foreign currency with the BNB and other banks in Bulgaria were regularly submitted to the MF *via* IOBFR. The Bank monitored security pledged by banks under the State Budget Law and tallied it with balances for the MF daily.

There were 24 budget servicing banks (including the BNB) with IOBFR access compared to 22 in the first half of 2012. Summarised information put the balance of budget entities' accounts at BGN 7715.2 million on 30 June 2013, up 21 per cent on 30 June 2012.<sup>58</sup> Of this, 71 per cent (BGN 5471.1 million) was in BNB accounts and the rest with domestic banks. These banks' account balances rose 36 per cent on 30 June 2012, reflecting mainly increased municipalities' accounts balances.

### Budget Entities' Account Balances with Domestic Banks (excluding the BNB)

(BGN million)



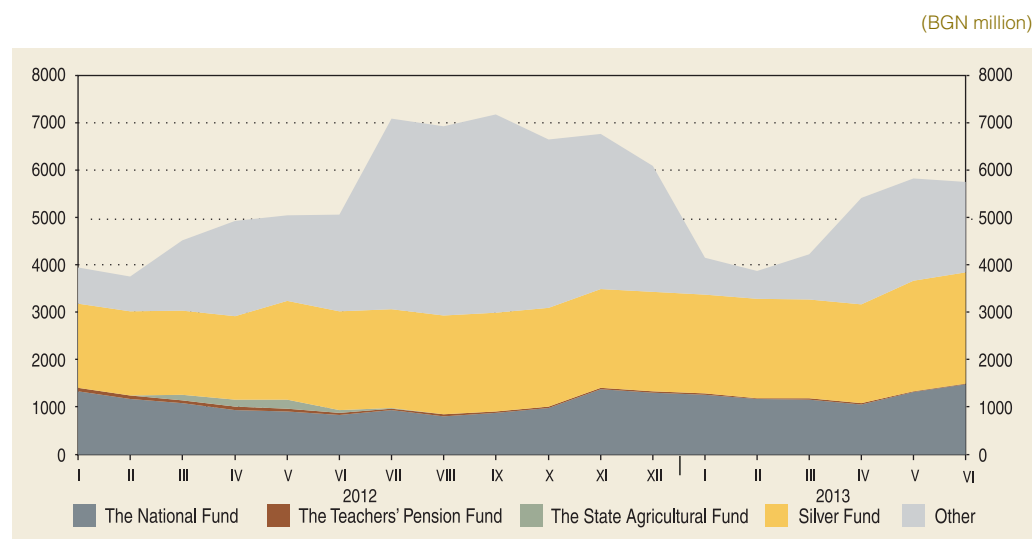
Source: BNB.

<sup>58</sup> Balances on foreign currency accounts are recalculated in leva at the BNB exchange rate for the relevant currency on 30 June 2013.

Almost 60 per cent of non BNB balances were at five banks, as a year ago. Four of them were the same in both periods, two reporting a significant increase in balances.

Three quarters of budget funds were in fiscal reserve bank accounts.<sup>59</sup> On 30 June 2013, this was BGN 5753.9 million, of which BGN 3832.8 million in the Fund for Guaranteeing the Stability of the State Pension System (the Silver Fund), the MF National Fund, the State Agricultural Fund, and the Teachers' Pension Fund. A year earlier, the fiscal reserve was BGN 5061.8 million, with BGN 3022.7 million in the said funds.

### Fiscal Reserve Structure



Source: BNB.

The AS ROAD system provided information on Bulgaria's foreign financial obligations, for which the BNB is calculating and paying agent.<sup>60</sup> On MF advice, the system logged the EUR 94.6 million fourth tranche of the European Investment Bank loan. There were 17 regular payments of EUR 939.7 million in coordination with the MF: EUR 838.1 million principal and EUR 101.6 million interest.<sup>61</sup> By 30 June 2013 AS ROAD showed EUR 2704.2 million of obligations from EUR 2517.5 million a year earlier.<sup>62</sup> Euro-denominated debt continued occupying the largest share at 68.7 per cent, followed by USD and JPY at 30.7 and 0.6 per cent.

### Servicing Government Securities Trading

There were 16 MF scheduled government securities auctions.<sup>63</sup> They offered five issues: one unscheduled short-term, two medium-term, and two long-term. Average residual term was three years four months, much shorter than the five years three months of the first half of 2012. The early 2012 seven-year issue in EUR had most openings (five). The MF offered BGN 1460.6 million of securities. The nominal value of bids was BGN 3003.6 million. Average bid-to-cover ratio was 2.06, with 93 bids *per* auction on average. Banks bid BGN 1248.4 million and non-bank institutions BGN 641.2 million. Private pension funds were most active with 7.7 per cent of bids, followed by the Bulgarian Deposit Insurance Fund (5.5 per cent), the National Insurance Institute (2 per cent), and insurance corporations (1.6 per cent).

<sup>59</sup> The MF sets the scope of bank accounts whose 30 June 2013 balances are in the fiscal reserve under Council of Ministers' Decree No 1 of 2013 on the 2013 State Budget.

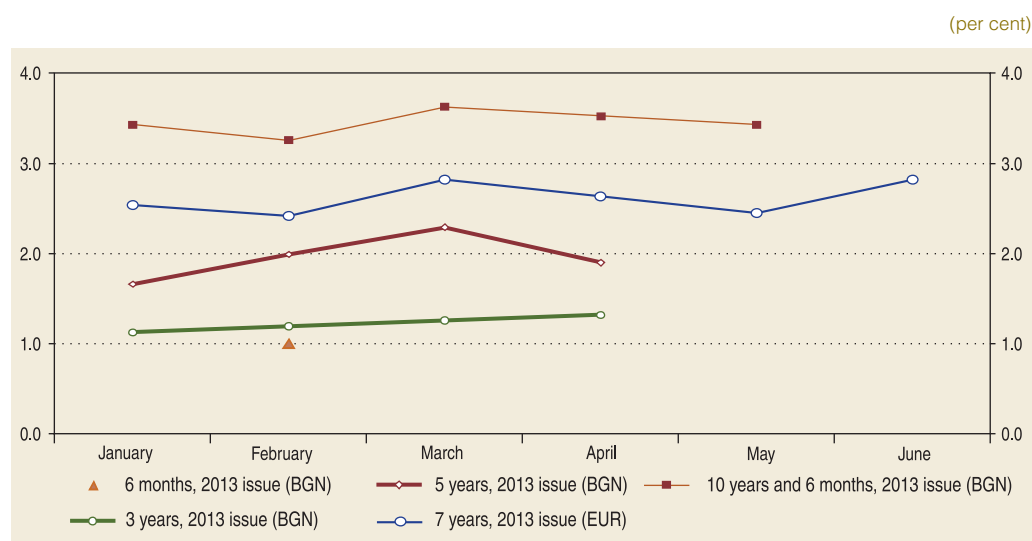
<sup>60</sup> Under the government debt agency agreement between the BNB and MF.

<sup>61</sup> Payments were recalculated in euro at the BNB rate for 30 June 2013.

<sup>62</sup> Debt was recalculated in euro at the BNB rate for 30 June 2013.

<sup>63</sup> In the first half year the issuer changed its issuing calendar by cancelling two three-month issue auctions and one three-year issue auction and announcing an unscheduled six-month issue auction.

### Average Annual Yield Attained at Domestic Government Securities Auctions in the First Half of 2013

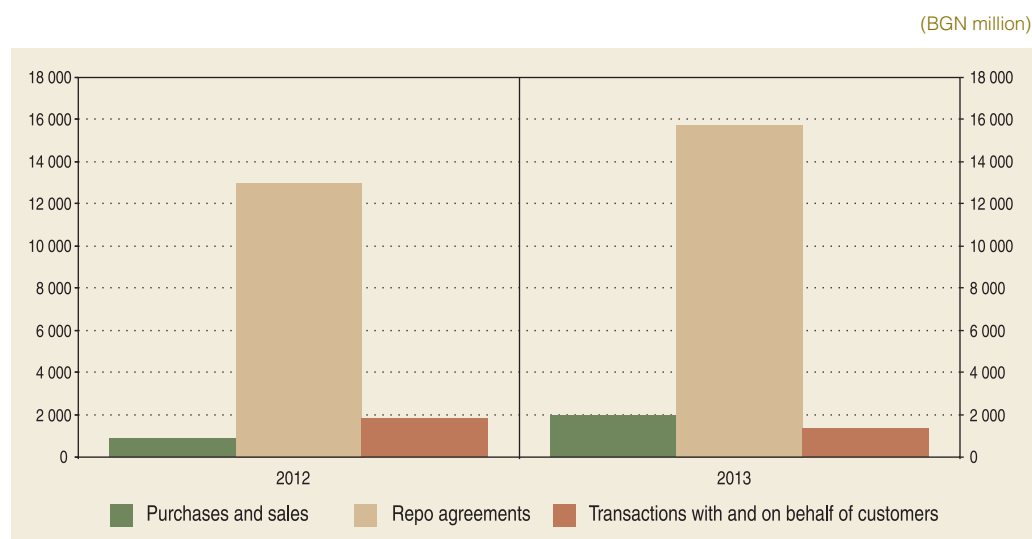


Source: BNB.

The Ministry sold BGN 1460.6 million of bonds (including the lev equivalent of EUR 100 million) or 100 per cent of the scheduled volume. Of this, BGN 195.6 million (13.4 per cent) was denominated in euro. More than two thirds went to primary and non-primary dealer banks.

Average annual auction yields of lev-denominated six-month, three-year, five-year and 10.5-year issues were 1.00, 1.23, 1.98, and 3.44 per cent, with 2.61 per cent for euro-denominated seven-year issues.

### Volume of Transactions in Tradable Government Securities in the First Six Months of 2013

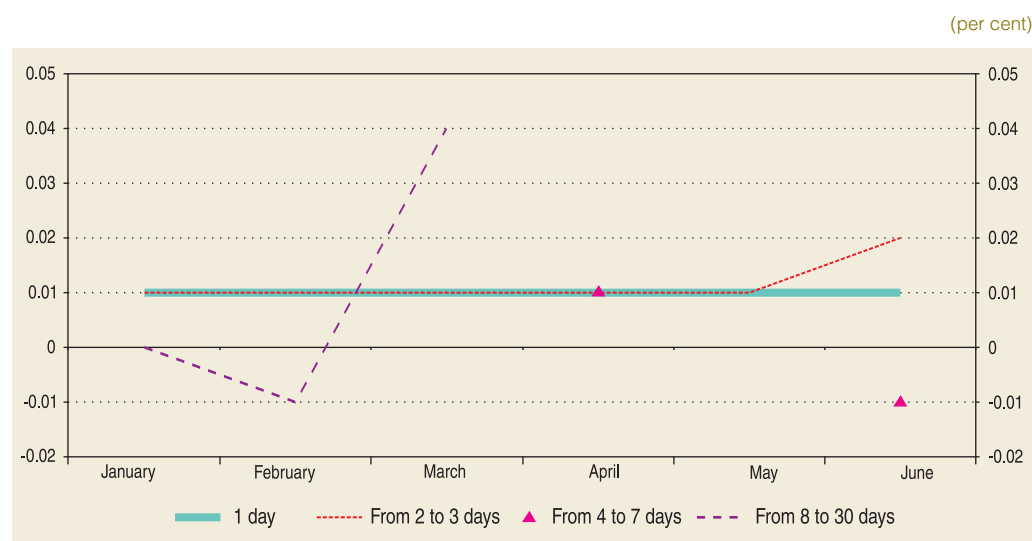


Source: BNB.

Over the first half of 2013 secondary market trade featured more transactions compared with the same period of the previous year. ESROT registered BGN 29,016.4 million nominal government securities transaction volume, up 34.4 per cent on this time last year. Repos accounted for 54.3 per cent, followed by blocking and unblocking transactions at 34.4 per cent, purchases and sales at 6.7 per cent, and transactions with or between ESROT participants' customers at 4.6 per cent.



### Average-Weighted Annual Yield of Repo Agreements in Government Securities over the First Half of 2013

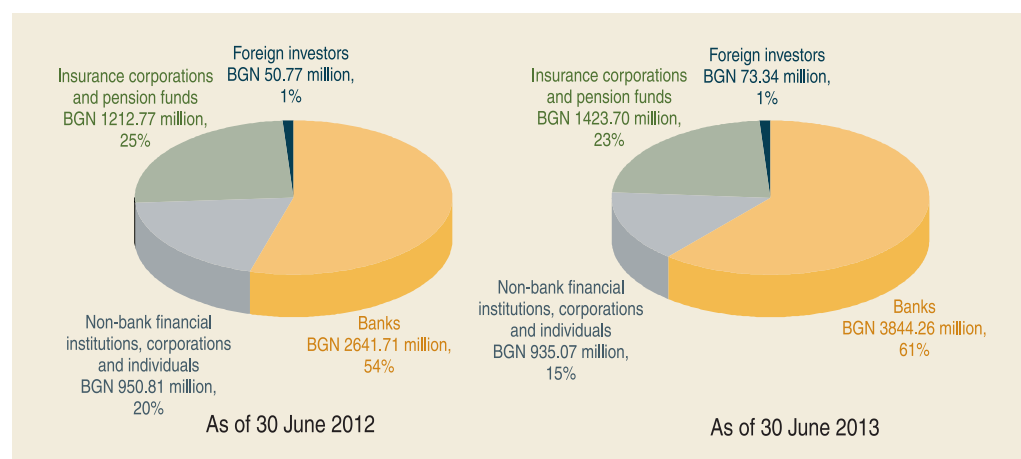


Source: BNB.

Repos with flows of funds on current accounts dominated the secondary market (89.9 per cent of volume), with one-day ones most attractive (50.8 per cent). High banking liquidity held average annual repo yield close to zero or even negative for set maturities in set months. Yield fluctuated more early in the year, mainly in longer-term (8–30 day) repos. International financial market fluctuations kept ESROT participants away from repos longer than 30 days. Free of payment repos continued declining, most of them for government bonds denominated and redeemable in euro.

ESROT logged BGN 1939.2 million of sales and purchases, most in January. Government securities traded across the whole yield curve, offer and bid spreads widening on the first half of 2012. The half year saw a slight excess of medium over long-term issues, despite their significantly lower volume share. Average annual yield of the 10.5-year reference issue moved from 3.27 to 3.40 per cent, significantly lower than in the first six months of 2012 (5.30 per cent in January to 5.07 per cent in June).

### Holders of Government Securities Issued in the Domestic Market



Source: BNB.

Operations with or between ESROT participants' customers accounted for BGN 1342.4 million. The segment was most buoyant in February. Given institutional investor preferences for longer-term government debt, issues denominated in levs and euro with

residual terms of five or more years were most liquid. The secondary market liquidity ratio was 3.03 from 3.23 in the first half of 2012, reflecting the increase in circulating government bonds.<sup>64</sup>

Government bonds in bank portfolios rose greatly by BGN 1202.6 million. Those in insurance and pension fund portfolios also rose BGN 210.9 million, 90 per cent of them long-term (over five years). On 30 June 61 per cent of government bonds were with banks, 23 per cent with insurance corporations and pension funds, 15 per cent with non-bank financial institutions, corporations and individuals, and 1 per cent with foreign investors, from 54, 25, 20 and 1 per cent a year earlier.

ESROT offered 99.9 per cent availability,<sup>65</sup> outages handled by interaction between BNB systems.

System participants numbered 31: 26 government securities subdepository banks, three non-bank investment intermediaries, the Reserve Collateral Pool, and the MF.

On 30 June 2013 there were 1441 accounts in the government securities settlement system under Ordinance No 31 on Government Securities Settlement. Of them, 28 were for MF bonds, 594 for participants' own portfolios, 428 for participants' customers, and 391 for encumbered bonds. Account nominals tallied with outstanding issues at BGN 6276.4 million.

#### **System Development**

The BNB completed consultations with the MF and the Association of Banks in Bulgaria on amending MF and BNB Ordinance No 5 on the Terms and Procedure for Acquisition, Redemption and Trade in Government Securities and Ordinance No 31 on Government Securities Settlement and the Tariff of Fees and Commissions Charged on Processing Government Securities Transactions. A new government debt agency agreement under the LBNB Article 43 reflects the inclusion of the BNB government securities depository into TARGET2-BNB and settlement in EUR for primary and secondary market government bonds denominated and payable in euro. The Bank is expanding GSAS functionality. ESROT and GSSS technical and functional updates continued, with full scale internal testing including customers.

At MF request, an agreement with international central securities depository Clearstream Banking Luxembourg (CBL) opened a direct link to the BNB government securities depository. This enables cross-border transfers of domestic market government bonds, integrating Bulgaria into European financial market infrastructure. Draft amendments to Ordinance No 5 now include aspects of cross-border government securities settlement. ESROT updates for this new business followed consultations with the issuer and market participants.

<sup>64</sup> The ratio between the volume of secondary market government securities transactions in the first half of 2013 and the volume of circulating government securities by 30 June 2013.

<sup>65</sup> See footnote 41.

## IX. Participation in the ESCB and in the Activities of EU Institutions

EU financial stability and growth remained top priorities for European bodies. There was agreement on Commission proposals for financial sector regulation and banking union. In April the Parliament and the Council reached a political agreement on the single supervisory mechanism (SSM)<sup>66</sup> package of two regulations. On 26 and 27 June, Ecofin adopted a general approach on the Directive on credit institution and investment firm recovery and resolution. Euro area finance ministers outlined the operational framework for direct recapitalisation of banks by the European Stability Mechanism pending the Single Supervisory Mechanism. The Two-pack for enhanced euro area budget surveillance, complementing the 2011 Six-pack, should increase euro area member state budget transparency and boost fiscal policy coordination.

The BNB helped formulate Bulgarian positions on financial regulation and voiced them at ESCB, Commission, EU Council, European Systemic Risk Board, and Council for European Affairs committees and working groups.

### European System of Central Banks

The BNB Governor sits on the ECB General Council with EU central bank governors and the ECB President and Vice President. BNB representatives sit on 12 ESCB committees, 32 working groups, the Human Resources Conference, and the Competitiveness Research Network.<sup>67</sup>

The Bank helps elaborate ECB instruments on monetary and banking infrastructure, payment and settlement systems, statistical reporting and research, and central banking.

EU member states have to consult the ECB on relevant legislation. In the half year, the BNB was active in drafting an ECB opinion on the Executive Board proposal for capping interest on member state government deposits with national central banks.

As part of ESCB communications policy, the Bank continued to translate the ECB 2013 Annual Report, the June 2013 Convergence Report, and Monthly Bulletin chapter summaries in Bulgarian and helped in the publication and dissemination of ECB statutory publications.

### European Systemic Risk Board, European Banking Authority, Colleges of Supervisors

The BNB was active in the ESRB and participated in its General Board meetings.<sup>68</sup> Alongside monitoring and countering systemic risks facing EU finances, the Board addressed the Single Supervisory Mechanism's effects on the current macroprudential policies framework in the EU and on ESRB's activities.

In 2013 the Board adopted a recommendation on macroprudential policy intermediate objectives and tools. This called on national macroprudential authorities to develop strategies, select appropriate tools for intermediate and final objectives, and analyse the effects of macroprudential tools and their cross border effects. The BNB

<sup>66</sup> The two-pack includes a Council regulation conferring specific tasks on the European Central Bank relating to the prudential supervision of credit institutions and b) Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with the Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. On 12 September 2013 Parliament approved the instruments. Council approval is pending.

<sup>67</sup> The Accounting and Monetary Income Committee (AMICO), the Financial Stability Committee (FSC), the Banknotes Committee (BANCO), the Eurosystem/ESCB Communications Committee (ECCO), the Information Technology Committee (ITC), the Internal Auditors' Committee (IAC), the International Relations Committee (IRC), the Legal Committee (LEGCO), the Market Operations Committee (MOC), the Monetary Policy Committee (MPC), the Payment and Settlement Systems Committee (PSSC), the Statistics Committee (STC), and the Eurosystem/ESCB Human Resources Conference.

<sup>68</sup> The Bank is represented on the ESRB General Board, Advisory Technical Committee, and three working groups.

highlighted its experience of helping banks fortify capital bases and liquidity buffers before and during the global crisis using macroprudential anticyclical tools like those now recommended.

The ESRB carefully monitored the systemic risk assessment aspects of emerging technical standards for the European Commission's proposed CRD IV capital requirements package. It responded to the EBA Consultation Papers on implementing technical standards for supervisory reporting on forbearance and on non-performing exposures and asset encumbrance reporting.

BNB experts participated in public consultations on the Basel III capital requirements framework and on European Banking Authority and other committees and working groups drafting and enforcing international capital standards for banks. The new framework comes into force on 1 January 2014. The mandatory capital conservation buffer, discretionary counter cyclical buffer, discretionary buffers for systemically important international and domestic institutions, and liquidity and leverage requirements being added to prudential supervision rules and techniques will make supervisory authorities more flexible on adequate banking system capitalisation.

In the first half of 2013 the EBA published guidelines on assessing the suitability of management body members and key executives. They address insufficient commercial law harmonisation, different management structures, and inconsistencies in current procedures. The guidelines set out criteria, minimum requirements, and policies for central banks and banks.

Competent EBA member national authorities assessed draft technical standards on information exchange between home and host supervisors on EU bank groups conducting activities, whether through branches or through the freedom to provide services, in other member states. Information falls into the two categories of going concern and liquidity stress situations. Anticipated flows are mainly from home to host supervisors. Experts also worked on EBA technical standards stemming from the regulation and the capital requirements directive.

**European  
Council,  
Ecofin  
Council and  
Economic  
and Financial  
Committee**

Supporting economic recovery, job creation, and fiscal consolidation fostering growth remained top priority for European bodies.

The March 2013 European Council debated the economic and social situation comprehensively in setting the thrust of member state and European Union economic policy for 2013. Debate focused on the implementation of resolutions, in particular the Compact for Growth and Jobs. The heads of state and government assessed progress towards banking union and charted new steps to strengthen Economic and Monetary Union.

In April Bulgaria presented its third European Semester National Reform Programme and 2013 to 2016 Convergence Programme. They took into account European Commission 2013 Annual Growth Report priorities. The Bank helped elaborate and coordinate relevant parts of them. On 9 July Ecofin made recommendations on the public finance, pension reform, labour market, education and innovation, business environment improvement and administrative capacity strengthening, EU funds absorption, and judicial reform aspects of the Programmes.

In April European Commission Comprehensive Reviews on the 13 member states in the Alert Mechanism Report, including Bulgaria, did not recommend excessive macroeconomic imbalance procedures to Council. Recognising efforts to safeguard financial stability, Bulgaria's financial sector was assessed positively for the second year running. The Review notes an improved balance of payments current account and lower private sector debt.

The second legislative package on enhanced economic governance comprising two regulations for euro area member states came into force in late May.

The regulations improve coordination and monitoring of draft euro area budget to increase EMU budgetary discipline. Closer monitoring of member states experiencing or facing serious financial instability should speed their return to normality and halt contagion.

The BNB was represented at the highest level at April's informal Ecofin meeting of EU economy and finance **ministers and central bank governors**. Topics included economic prospects, risks to financial stability, banking union, and boosting medium term economic development. On banking union, member states agreed to amend the Treaties and provide a solid legal base for a single supervisory mechanism and a single restructuring mechanism. The BNB and the Bulgarian government having consistently campaigned for their positions, Bulgaria joined the declaration on Treaty changes.

In early 2013, Ecofin consented to 11 member states<sup>69</sup> adopting financial transaction taxes (FTT) under the enhanced cooperation mechanism in the Treaty on the Functioning of the European Union. To protect the interests of states opposing tax harmonisation, Bulgaria, Denmark, Hungary, Poland, Romania, and Sweden appended a declaration that their interests ought to be taken into account in drafting FTT legislation to the meeting's minutes.

In December 2012, Ecofin agreed on the Commission's two proposals for a single euro area supervisory mechanism (SSM). After intensive negotiations, Parliament agreed to SSM politically in April.<sup>70</sup> Membership is voluntary for non-euro area member states. The Bank maintained the position, shared by government, that Bulgaria should not join before euro area entry, as this would transfer significant supervisory powers to the ECB. Even if they joined, non-euro area central banks would not enjoy ECB and ESM support instruments or participate in decisions on single supervision. The BNB expects the SSM to affect supervisory cooperation on international bank and financial groups on the local market.

At its 26 and 27 June 2013 meeting Ecofin adopted a general approach on the directive establishing a framework for recovery and resolution of credit institutions and investment firms.<sup>71</sup> The Bank campaigned for deposits not to form part of bail-in tools. Bulgaria insisted on national flexibility in applying the common framework, and enough time for non-euro area states to adjust to the new restructuring rules in particular. Balancing home and host country interests in cross border bank crises had to be included in the package. These principles, which other non-euro area countries also backed, found their way into the Ecofin general approach. It gives bail-in tool flexibility to national authorities and comes into force three years after the 2015 term on which many member states and some bodies insisted in consultations.

The final CRD IV package, including the directive and regulation on credit institution capital requirements was adopted in June 2013, replacing existing capital requirements directives. Issues of importance to Bulgaria were national capital requirements flexibility, currency risk provisions, supervisory sanction disclosure, and centralised liquidity management in liquidity subgroups. CRD IV took into account most national positions.

Debate on the proposed Directive on deposit guarantee schemes awaited the agreement on EU credit institution and investment firm recovery and resolution, being related to it. On the latter proposal, the BNB supported government preference for keeping the current 20 business day settlement period and for settling in national currency or euro.

Intensive debate continued on the proposed directive on credit agreement for customer relating to residential immovable property. Bulgaria commented on proposed Parliament amendments to the draft at Commission, Parliament and Council tripartite

<sup>69</sup> Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, and Spain.

<sup>70</sup> See footnote 66.

<sup>71</sup> General approaches are political agreements within the Council before first readings of legislative proposals in Parliament. They speed work and ease first reading agreements between Council and Parliament.

meetings. Supporting the provisions on consumer advice, encouraging financial awareness, determining loan interest, and lending in foreign currency, it insisted that standard advertising information should omit the passage on currency risk in foreign currency loans as the currency board removed it in the Bulgarian case. There was broad consensus by 22 April.

BNB representatives at Economic and Financial Committee meetings debated economic governance and restoring confidence in the financial sector. In the context of the third European Semester, the Committee assessed EU financial stability, national fiscal and macroeconomic policy monitoring, the single supervisory mechanism, the European position on the growth framework, international monetary system reform, and financial regulation discussed by the G20, IMF, and Financial Stability Board. On measures to reinforce the banking sector, the BNB consistently argued that Bulgarian banks' high capital and liquidity levels and accumulated capital buffers guaranteed stability.

## X. International Issues

### International Financial Institutions

The Law on the BNB encourages the Bank to participate in international organisations furthering exchange, monetary, and credit cooperation. Where Bulgaria participates in international financial institutions, the BNB is the nation's fiscal agent and depository.

The Bank holds equity in the Bank for International Settlements (BIS). The BNB Governor sat on BIS central bank governors' bimonthly meetings: a major forum for debate on developments and prospects before the global economy and financial markets. At the Annual General Shareholder Meeting in late June, the BIS Governors allocated net profit, the BNB receiving a EUR 2.9 million dividend. Central and Eastern European and ECB representatives met at the international BIS Working Party Meeting on 14 and 15 March in Sofia.

The BNB Governor represents Bulgaria on the IMF Board of Governors. On 21 February the National Assembly increased Bulgaria's IMF quota in line with the IMF Board of Governors' 15 December 2010 Resolution 66-2 management and quota reform.

The BNB attended the World Bank Netherlands Constituency meeting in Tbilisi, Georgia in late May. Debate addressed banking union, prospects and challenges before economic growth, and the Poverty Reduction Strategy.

A BNB Deputy Governor is EBRD Alternate Governor for Bulgaria. For the first time in EBRD history, the Minister of Finance as Governor for Bulgaria chaired the May 2013 Annual EBRD Meeting in Istanbul, Turkey.

In January the BNB paid USD 8500 annual dues to the International Accounting Standards Committee Foundation.

### Cooperation and Technical Assistance with Central Banks

The Bank continued assisting regional central banks' preparations for EU accession. Technical assistance projects funded by the EU and managed by the ECB enhanced the Bank's experience and capacity.

The two year ECB technical assistance project on strengthening the Central Bank of Serbia's institutional capacity ended in January. It involved 21 EU central banks including the BNB. The Bank helped the National Bank of Serbia draft a pre-accession action plan, address a direct reporting system for balance of payments statistical purposes, and match external debt statistics to IMF requirements. Along with nine others, the Bank participates in a Serbian-requested project extension to 31 December 2013 as key partner in financial stability.

The ECB technical assistance programme for the National Bank of the Republic of Macedonia continued. Meetings addressed Macedonian legislation and EU requirements.

National Bank of Ukraine representatives visited the BNB in June to exchange experience on new Financial Action Task Force (FATF) recommendations on preventing money laundering and terrorist financing.

The Bank participates at the highest level in the Central Asia, Black Sea Region and Balkan Countries' Central Bank Governors' Club, and the Group of Banking Supervisors from South Eastern Europe.



## XI. Statistics

The BNB gathers, compiles, and disseminates statistics to the Law on the Bulgarian National Bank Article 42 and the Statute of the ESCB and the ECB Article 5. The Bank also provides statistics to the European Systemic Risk Board to 2009 amendments to Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the ECB.

Monetary and interest rate statistics continued implementing methodological guidelines to Regulation (EC) No 25/2009 of the ECB of 19 December 2008 on the balance sheet of the monetary financial institutions sector (Recast) (ECB/2008/32) and Regulation (EC) No 290/2009 of 31 March 2009 amending Regulation (EC) No 63/2002 (ECB/2001/18) concerning statistics on interest rates applied by monetary financial institutions to deposits and loans *vis-à-vis* households and non-financial corporations (ECB/2009/7). These instruments broaden the information provided by monetary financial institutions, their counterparties and their operations.

Discussions on ECB methodological requirements on monetary and financial statistics guidelines progressed alongside preparations for the new European System of Accounts (ESA 2010) expected in 2014 and new statistical information user requirements.

The ESCB intends to harmonise insurance and reinsurance statistical reporting. The Bank prepared for this by surveying ECB reporting units on expected costs. Regular data provision to the ECB Register of Institutions and Affiliates Database (RIAD) continued. RIAD augmentation involved analysing proposed structure and contents changes, new information sources, and possible action. The BNB successfully transmitted test data to the new RIAD information platform.

In the first half of 2013 balance of payments and international investment position statistics continued to use information collected directly from residents. Work advanced on introducing the Balance of Payments Manual sixth edition (IMF, 2008) by 2014. Preparations are complex due to the need to harmonise methodology with the European System of Accounts (ESA 2010) and the OECD Benchmark Definition of Foreign Direct Investment fourth edition (2008). The sixth edition of the Balance of Payments Manual significantly changes definitions and presentation of balance of payments balance sheet and international investment position items. Amendments to Ordinance No 27 of the BNB on the Balance of Payments Statistics and the International Investment Position are in draft.

Work to boost data quality management for the ESCB Centralised Securities Database project and compile a Bulgarian securities database continued. The Bank took part in the ESCB Securities Holdings Statistics project. This affects other statistics and financial stability analyses.

The BNB continued compiling data on General Government sector quarterly financial accounts under Regulation (EC) No 501/2004 of the European Parliament and of the Council of 10 March 2004, and reporting government finances to ECB requirements. Quarterly financial accounts statistics for all economic sectors (stock data) followed Guideline ECB/2002/7 (recast) on the statistical reporting requirements of the ECB in the field of quarterly financial accounts.

Joint working groups with the National Statistical Institute focused on the European System of Accounts (ESA '2010) and the OECD Benchmark Definition of Foreign Direct Investment fourth edition (2008). Work on augmenting the methodology for compiling quarterly and annual financial accounts continued with NSI assistance.

The ECB and the BIS continued receiving macroeconomic indicator information with NSI assistance. There were regular updates and metadata certification under the Special Data Dissemination Standard to IMF methodology and dissemination schedule using NSI and Ministry of Finance statistics.

Development of an integrated statistical information system to automate statistical receipt, control, processing, and dissemination began. This will alleviate the reporting burden on respondents and satisfy growing user demands for statistical quality and promptness. Implementing the SDMX-ML standard for data exchange between international bodies involved test data transmissions to the ECB.

## XII. Research

Economic research, analyses of the Bulgarian economy, and macroeconomic forecasting back the Bank's management in making decisions and economic policy. In the first half of 2013 research focused on developing financial sector macroeconomic model, studying the competitiveness of Bulgarian economy, alternative economic modelling approaches, the macroeconomic effect of fiscal policy, and developing macroeconomic models for forecasting.

The 2013 and 2014 Research Plan addressed individual economic processes and forecasting. Work focused on Bulgarian export competitiveness, a dynamic stochastic general equilibrium model for the financial sector and macro financial models binding financial stability to the state of the economy, the effect of demand on inflation, alternative economic modelling, fiscal multipliers research, European output developments since 2008, and modelling the relationship between monetary aggregates and inflation. Testing and honing the basic model for BNB macroeconomic forecasting continued. Research featured in reports and seminars for relevant experts, academia, and non-governmental organisations.

In June 2013, the BNB and the Bank of England Centre for Central Banking Studies held a training session on econometric modelling attended by Albanian, Macedonian, Montenegrin, Romanian, Russian, Turkish, and Ukrainian central bank representatives.

The Guest Researcher Programme supports research and helps establish fruitful cooperation with Bulgarian and foreign authorities. Two guest researchers were in the Programme in early 2013.

The BNB *Discussion Papers* research series encourages the research potential of Bulgarian economic science and practice. The Discussion Papers Editorial Board reviewed two submissions in the first half of 2013.

The quarterly *Economic Review* presents information and analyses of balance of payments dynamics, monetary aggregates, the latter's bearing on the real economy and prices, and the external environment. This publication presents short-term quantitative assessments of developments in major macroeconomic indicators like inflation, growth, exports, imports, the balance of trade, and the balance of payments current account. It publishes the results of BNB analyses of individual macroeconomic issues.

## XIII. Information Systems

BNB information infrastructure aims to maintain information systems' integrity, prevent downtime caused by technical issues, develop new applications and ECB/ESCB projects, and implement information security policy and procedures.

All systems, including financial information ones, were up to date and reliable. The RINGS system servicing lev payments in Bulgaria, the TARGET2-BNB national system component, and the SWIFT Alliance services and products related to these systems suffered no technical issues.

A new portal for BNB services to banks and financial institutions went live after testing, alongside a procedure for creating and using user IDs and passwords.

A new version of the Cash System (the BNB cash reporting, control and management system) went live after successful transfer, testing and reconciliation with the SAP and SOFI accounting systems.

A new version of the CCR information system providing services to external users using private cloud<sup>72</sup> technology went live. Based on a virtual firewall, the new conceptual solution will read across to other BNB services<sup>73</sup>. Applications are evolving continuously to match tighter regulations and rising user expectations.

Work in hand involved the secure ESCB e-mail system expected to go live in late 2013, expanding the OBIS Core Banking Information System, including the BNB as an ancillary government bond settlement and registration system into TARGET2, upgrading BNB voice communications to 10 Gbit/s, and linking the old and new BNB websites by an IP connection with data encryption technologies, dynamic routing and VLAN.

There was also a survey and analysis of RINGS and SWIFT connectivity within the RINGS Architecture Project, synchronising the Novell eDirectory and the Microsoft Active Directory, installing two Cisco ASAs and two Cisco Ironports, upgrading the CheckPoint<sup>74</sup> firewall cluster, and configuring test and production environments for systems with demilitarized firewall zone resources.

The Bank took part in ECB/ESCB projects. To curtail the risk of business discontinuity between the BNB and the ECB, the second reserve CoreNet circle for connectivity with the ESCB moved to the Bank's Cash Centre with a thorough upgrade of servers for ESCB data exchange, including the operational system and specialised software.

The BNB IT Security Committee added a procedure for installing, configuring, maintaining and monitoring network devices to the information security policy. Work on integrating operational risk management process automation software was expected to end by the close of the year.

<sup>72</sup> Private cloud, internal cloud or corporate cloud is proprietary architecture for hosting services to a finite number of users behind a firewall.

<sup>73</sup> Firewall is hardware/software protection of private networks from external parties.

<sup>74</sup> Check Point Software Technologies Ltd. is an IT security company.

## XIV. Human Resources Management

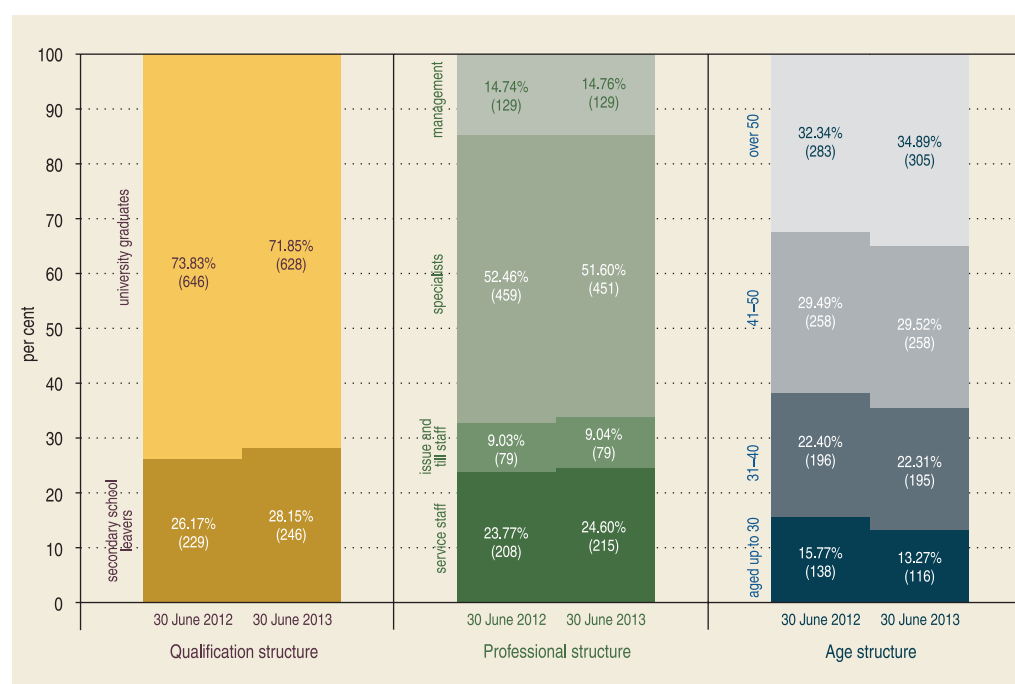
In the first half of 2013 major human resource management priorities rest on boosting further efficiency through education and professional training, maintaining solid administrative and analytical capacity, implementing a performance related pay policy depending on employees' individual results and ensuring a pleasant, healthy and safe working environment.

By the end of June staff numbered 874 from 875 a year earlier. The BNB appointed 14 full time employees against 30 in the same period of 2012. Eighteen left (14 in the same period of 2012). Turnover remained low, reflecting a strong organisational culture and tradition, effective teamwork, training and professional advancement opportunities, and a sociable environment.

In the staff educational structure, university graduates decreased slightly by 2 percentage points in favour of school leavers. This was mainly due to seasonal staff. The share of university graduates was 72 per cent. On 30 June, 19 BNB employees were reading for doctors degrees (five more than this time last year).

### Staff Structure

(per cent, number)



Source: the BNB.

Staff category structure saw no significant change from the same period last year. Specialists occupied the largest share at 51.6 per cent followed by service staff and managers.

Staff age structure changed little. The share of employees aged up to 30 fell 2.5 percentage points. Those of the 31 to 40 and 41 to 50 age groups were unchanged. The 51-60 and over 60 age groups increased their weights by 2.56 percentage points. This reflected gradual increases in pensionable age and the higher age of seasonally employed personnel.

Women made up 64 per cent of staff and men 36 per cent.

Different modes of labour mobility broadened professional expertise and intensified exchanges of experience across business areas within the Bank. As in the first half of 2012, eight employees moved jobs internally.

Pay continued to reflect performance and each employee's contribution to the attainment of Bank targets.

Employees enjoyed plenty of opportunities to train with national and international organisations, foreign banks, and international financial institutions under the Annual Training and Qualifications Programme. They went on distance learning programmes, vocational training and seminars, language learning, information technology and specialised courses in Bulgaria and abroad.

In the first half year 23 employees, of whom five reading for doctors' and ten for masters' degrees, boosted their educational attainments without stopping work. Strong interest in distance learning programmes continued, 15 employees joining four programmes on reserve management and internal audit.

Employees from various offices went on specialised training on, *inter alia*, changes in bank and financial legislation, administration, labour and social security, health and safety at work, and public tendering.

The BNB continued working with European and international bodies offering specialised courses in areas of importance for central banks and supervisors. More than 120 staff went on courses, seminars, and conferences abroad, including ones held by ESCB committees and European supervision bodies.

English and German language tuition was attended by 34 employees. It aimed to provide language proficiency levels consistent with job descriptions. English was most widely sought.

The BNB provided professional training opportunities for operating, servicing, and maintaining machines and other equipment requiring competence certificates by national and internal rules.

The Bank continued providing career opportunities for young people and encouraging students to opt for research and academic knowledge. The programme offering scholarships for master's and doctor's degrees continued enjoying strong interest. Two master's and one doctor's degree scholarships were awarded in early 2013 after a competition. The Bank was at the March student training and career forum and the April professional training and development forum hosted by the Sofia University of the National and World Economy. At these fora, the Bank promoted its internship, scholarship, guest researcher programmes, and career openings. Participation gave a successful start to the traineeship programme in early June.

## XV. Facilities Management

The BNB operates from owned premises and properties. This provides the degree of independence, security and protection required of an institution of national importance.

Property management expenditure was in line with the BNB budget implementation. It included construction, refurbishment and modernisation, deliveries and equipment, maintenance (transformers, power supply, distribution boards, diesel generators, backup power supply, plant rooms, pressure boilers, lifts, HVAC installations and heaters), vehicles, supplying assets and cash processing consumables, and optimising power, heating, and water use at BNB premises.

No properties were bought or sold in the first half of 2013.



## XVI. BNB Internal Audit

Audits follow an Annual Internal Audit Programme approved by the Governing Council. Five audits followed a risk evaluation of major BNB functions. Two were under the ESCB Internal Auditor Committee programme.

There were three monetary policy and asset management audits:

- Control system efficiency and risks in banknote conceptual and detail design, security, quality control and preproduction. It was intended to review these processes and assess control system efficiency and risks;
- Risk control and analysis in gross international reserve management. Main thrusts were obtaining reasonable assurance of adequate and effective control, assessing corporate governance and risk management, and examining workflows and planning efficiency;
- Management of gross international reserves. Main thrusts were obtaining reasonable assurance of control adequacy and assessing corporate governance, risk management, significant information reliability and integrity, legal compliance, the internal framework, and workflow and planning efficiency.

Audits of human resource management and social policy reviewed functions, assessed risks, and sought reasonable assurance of management and control efficiency.

### BNB Internal Audit Programme Audits

Function	Audits
Monetary policy and asset management	Banknote conceptual and detail design, security, quality control and preproduction
Monetary policy and asset management	Risk control and analysis in managing gross international reserves
Monetary policy and asset management	Gross international foreign reserve management
Human resource management and social policy	Social policy
BNB Internal Audit	Follow up on recommendations from earlier Internal Audit Programme audits

Source: BNB.

The half year saw an audit on implementing recommendations from earlier audits and management adequacy, effectiveness, and promptness.

An audit of payment and securities settlement addressed SWIFT system and service under the 2013 ESCB Internal Auditor Committee programme and the BNB Internal Audit Programme. It assessed internal organisation adequacy and efficiency, including SWIFT component management and functions subject to ESCB central bank oversight.

Also audited was the implementation of recommendations from earlier ESCB Internal Auditor Committee programme audits. It followed up implementation of recommendations and assessed adequacy, effectiveness, and timeliness of actions undertaken by the managers of respective units.

### ESCB Internal Auditors Committee Programme Audits

BNB Function	Audits
Payment and Securities Settlement systems	SWIFT system and service
BNB Internal Audit	Implementation of recommendations from earlier ESCB Internal Auditors Committee programme audits

Source: BNB.

In the first half of 2013 the Chief Auditor coordinated Internal Audit Unit work with external auditors KPMG Bulgaria. The Republic of Bulgaria Audit Office helped the inspecting team examine the 2012 Bank operating surplus payable into the budget and the BNB budget report. Internal auditors continued giving opinions on draft internal regulations of major BNB and subsidiary functions and produced a risk management glossary.

## XVII. BNB Budget Implementation in the First Half of 2013

The Governing Council adopted the 2012 Budget by Resolution No 82 of 22 November 2012. This report comprises two sections under the Internal Rules on Drafting, Implementing, and Reporting the BNB Budget: Operating Expenditure; the Investment Programme.

### 1. Operating Expenditure

In the first half of 2013, the BNB spent BGN 37,874 thousand or 47.7 per cent of annual budget.

Currency circulation cost BGN 6959 thousand: 18.4 per cent of operating expenditure for the first half of 2013 or 65.5 per cent of budget. Banknote production cost BGN 3655 thousand, of which BGN 3054 thousand for coins, including BGN 2538 thousand for circulating coins. The commemorative coin programme cost BGN 516 thousand. Machines for servicing circulating cash cost BGN 87 thousand. Consumables for banknote and coin processing cost BGN 50 thousand.

Premise rentals at the State Mint and the Cash Services Company cost BGN 81 thousand.

Materials, services, and depreciation cost BGN 16,938 thousand: 44.7 per cent of operating expenditure for the first half-year or 42.8 per cent of annual budget. Materials cost BGN 461 thousand, a 1.2 per cent share of operating expenditure in the half-year. Vehicle fleet fuel and spares (BGN 167 thousand) and office consumables (BGN 132 thousand) had the largest share in this group. External services cost BGN 8255 thousand or 21.8 per cent of half-year operating spend. Software maintenance came to BGN 1773 thousand, a significant share. The Bank spent BGN 1132 thousand on its security contract with the Ministry of the Interior Security Police Administration and the National Fire Safety and Public Protection Service. Property and refuse collection levies cost BGN 708 thousand. Major building maintenance cost BGN 1165 thousand. Equipment maintenance cost BGN 698 thousand. Bloomberg, Reuters, internet and other system provision cost BGN 543 thousand. Mandatory TARGET2 modules cost BGN 562 thousand. Power bills cost BGN 387 thousand, with heating and water at BGN 133 thousand. Property insurance premia cost BGN 87 thousand. Consultancy services (BGN 35 thousand) concerned mainly legal issues related to the Banking and Financial History Research and Publications Programme Council and surveys and technical passports for BNB premises. Depreciation cost BGN 8222 thousand in the half-year, its share in operating spend at 21.7 per cent.

Payroll spending was BGN 11,029 thousand: 49.4 per cent of annual budget or 29.1 per cent of Bank operating expenditure. In accordance with IAS 19, Income of Hired Persons, and further to licensed valuation, the Bank reported BGN 1371 thousand of current retirement obligations and unused paid leave, including social security contributions.

In the first six months social expenditure was BGN 1614 thousand: 71.6 per cent of annual budget or 4.3 per cent of operating expenditure.

Miscellaneous administrative spending was BGN 518 thousand: 26.3 per cent of annual budget or 1.4 per cent of half-year operating expenditure.

Inland travel, worth BGN 31 thousand, involved mainly regional cash centre logistics and checks. Foreign travel cost BGN 106 thousand.

The annual BNB Staff Education and Professional Training Programme cost BGN 316 thousand in the first half-year. BNB employees went on distance learning programmes organised by Bulgarian organisations, foreign banks and international financial institutions, language and professional training courses, and seminars at home and abroad.

Representative and protocol spend was BGN 62 thousand, or 0.2 per cent of operating expenditure.

The Bank spent BGN 816 thousand, or 29.4 per cent of annual projections, on ESCB participation: 2.2 per cent of operating expenditure. BNB representatives' work in ESCB and EU committees, working groups and other bodies cost BGN 369 thousand. The annual fee for European Banking Authority membership was BGN 412 thousand.

## 2. The Investment Programme

In the first half of 2013 the BNB invested BGN 3030 thousand, or 21.6 per cent of annual budget.

Investment Programme implementation involved tenders, contractor selection, and negotiations. Some procurement remained to be finalised in the second half-year, implementation of other aspects pending. Certain projects were postponed, contributing to lower than budgeted spending.

In the half year, the Bank did not invest into construction, refurbishment, or modernisation.

Machine and equipment, vehicle, and other equipment investment was BGN 139 thousand: 4.5 per cent of approved annual funds and 4.6 per cent of investment for the first half-year. This included equipment for the Bank's headquarters and staff recreation homes.

Information system investment was BGN 2891 thousand: 28.3 per cent of projected funds and 95.4 per cent of investment for the half-year. The item focuses on keeping Bank technological infrastructure up to date. The Bank invested BGN 99 thousand into expanding system functionality and BGN 795 thousand on software licences.

Hardware costs of BGN 1997 thousand went on updating, expanding, and backing up existing systems.

### BNB Budget Implementation as of 30 June 2013

Indicators	Report 30 June 2013 (BGN'000)	Budget 2013 (BGN'000)	Budget implementation (per cent)
<b>Section I. Operating Expenditure</b>	<b>37,874</b>	<b>79,475</b>	<b>47.7</b>
Currency circulation expenditure	6,959	10,622	65.5
Materials, services, depreciation	16,938	39,533	42.8
Staff expenditure	11,029	22,320	49.4
Social activity expenditure	1,614	2,254	71.6
Sundry administrative expenditure	518	1,966	26.3
BNB expenditure on ESCB membership	816	2,780	29.4
<b>Section II. Investment Programme</b>	<b>3,030</b>	<b>14,038</b>	<b>21.6</b>
Expenditure on construction, refurbishment, modernisation	0	565	0.0
Expenditure on machines, vehicles, sundry equipment	139	3,077	4.5
Expenditure on BNB computerisation	2,891	10,200	28.3
Investment related to ESCB membership	0	196	0.0

Source: BNB.



# XVIII. Bulgarian National Bank Consolidated Financial Statements as of 30 June 2013 (unaudited)

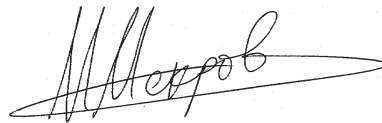
Statement of Responsibilities of the Governing Council of the Bulgarian National Bank .....	82
Consolidated Statement of Comprehensive Income for the Period Ended 30 June 2013 (unaudited) .....	83
Consolidated Statement of Financial Position as of 30 June 2013 (unaudited) .....	84
Consolidated Statement of Cash Flows for the Period Ended 30 June 2013 (unaudited) .....	85
Consolidated Statement of Changes in Equity for the Period Ended 30 June 2013 (unaudited) .....	86
Notes to the Consolidated Financial Statements .....	87

## Statement of Responsibilities of the Governing Council of the Bulgarian National Bank

*The Law on the Bulgarian National Bank requires the Governing Council to prepare financial statements to present the Bank's financial position and performance for the period.*

*The financial statements of the Bulgarian National Bank approved by the Governing Council are prepared in accordance with the International Financial Reporting Standards adopted by the European Commission.*

*The Governing Council of the Bulgarian National Bank is responsible for maintaining proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bulgarian National Bank. It has overall responsibility for taking such steps so as to safeguard the assets of the Bulgarian National Bank and to prevent or detect fraud and other irregularities.*

A handwritten signature in black ink, appearing to read 'Ivan Iskrov', with a long horizontal stroke extending to the right.

Ivan Iskrov  
Governor of the BNB

## Consolidated Statement of Comprehensive Income for the Period Ended 30 June 2013 (unaudited)

(BGN'000)

	Note	30 June 2013	30 June 2012
Interest income	7	212,650	211,023
Interest expense	7	(622)	(1,202)
<b>Net interest income</b>		<b>212,028</b>	<b>209,821</b>
Fee and commission income		4,819	4,464
Fee and commission expense		(2,030)	(1,773)
<b>Net fee and commission income</b>		<b>2,789</b>	<b>2,691</b>
Net income from financial assets and liabilities at fair value through profit or loss	8	(1,074,583)	45,987
Other operating income	9	27,458	29 417
<b>Total income from banking operations</b>		<b>(832,308)</b>	<b>287,916</b>
Administrative expenses	10	(54,467)	(52,947)
<b>Profit for the period</b>		<b>(886,775)</b>	<b>234,969</b>
<b>Other comprehensive income</b>			
Other comprehensive income		(17)	(75)
<b>Other comprehensive income, total</b>		<b>(17)</b>	<b>(75)</b>
<b>Total comprehensive income for the period</b>		<b>(886,792)</b>	<b>234,894</b>
<b>Profit attributable to:</b>			
Equity holder of the Bank		(886,807)	234,896
Non-controlling interest		32	73
<b>Profit for the period</b>		<b>(886,775)</b>	<b>234,969</b>
<b>Total comprehensive income attributable to:</b>			
Equity holder of the Bank		(886,824)	234,821
Non-controlling interest		32	73
<b>Total comprehensive income for the period</b>		<b>(886,792)</b>	<b>234,894</b>

The accompanying notes on pages 87 to 111 form an integral part of the Consolidated Financial Statements.



## Consolidated Statement of Financial Position as of 30 June 2013 (unaudited)

(BGN'000)

	Note	30 June 2013	31 December 2012
<b>ASSETS</b>			
Cash and deposits in foreign currencies	11	6,371,960	9,376,167
Gold, instruments in gold and other precious metals	12	2,349,315	3,207,354
Financial assets at fair value through profit or loss	13	19,771,289	17,801,193
Financial assets available for sale	14	1,495,652	1,515,709
Tangible assets	15	216,435	223,558
Intangible assets	16	5,609	6,368
Other assets	17	67,654	62,004
<b>Total assets</b>		<b>30,277,914</b>	<b>32,192,353</b>
<b>LIABILITIES</b>			
Banknotes and coins in circulation	18	9,170,093	9,549,921
Due to banks and other financial institutions	19	7,624,555	7,845,160
Liabilities to government institutions and other liabilities	20	6,679,302	6,952,197
Borrowings against Bulgaria's participation in international financial institutions	21	2,737,021	2,775,165
Other liabilities	22	90,407	100,748
<b>Total liabilities</b>		<b>26,301,378</b>	<b>27,223,191</b>
<b>EQUITY</b>			
Capital	23	20,000	20,000
Reserves	23	3,952,307	4,944,965
Non-controlling interest	24	4,229	4,197
<b>Total equity</b>		<b>3,976,536</b>	<b>4,969,162</b>
<b>Total liabilities and equity</b>		<b>30,277,914</b>	<b>32,192,353</b>

The accompanying notes on pages 87 to 111 form an integral part of the Consolidated Financial Statements.

# Consolidated Statement of Cash Flows for the Period Ended 30 June 2013 (unaudited)

(BGN'000)

	Note	30 June 2013	30 June 2012
<b>Operating activities</b>			
Net (loss)/profit		(886,775)	234,969
<b>Adjustments:</b>			
Dividend income		(8,796)	(8,621)
Depreciation and amortisation	15, 16	11,592	12,865
Loss on disposal of tangible assets		249	232
Loss/(Profit) on financial assets and liabilities arising from market movements		922,696	(125,752)
(Profit) of associates		-	-
Other adjustments		(17)	(56)
<b>Net cash flow from operating activities before changes in operating assets and liabilities</b>		<b>38,949</b>	<b>113,637</b>
<b>Change in operating assets</b>			
(Increase) in gold, instruments in gold and other precious metals		(2,057)	(1,082)
(Increase) in financial assets at fair value through profit or loss		(2,050,783)	(1,291,016)
(Increase) in other assets		(2,128)	(5,820)
<b>Change in operating liabilities</b>			
(Decrease) in currency in circulation		(379,828)	(205,376)
(Decrease)/increase in due to banks and other financial institutions		(220,605)	561,647
(Decrease)/increase in due to government institutions and other liabilities		(272,895)	596,902
Increase in borrowings from IMF of total allocation of SDR		-	-
(Decrease) in other liabilities		(10,341)	(15,918)
<b>Net cash inflow from operating activities</b>		<b>(2,899,688)</b>	<b>(247,026)</b>
<b>Investing activities</b>			
Acquisition of tangible and intangible assets		(3,959)	(9,347)
Dividends received		8,796	8,621
Other investments		-	-
<b>Net cash flow used in/(from) investing activities</b>		<b>4,837</b>	<b>(726)</b>
<b>Financing activities</b>			
Payments to the Government		(105,834)	(180,528)
<b>Net cash flow used in financing activities</b>		<b>(105,834)</b>	<b>(180,528)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(3,000,685)</b>	<b>(428,280)</b>
<b>Cash and cash equivalents at beginning of period</b>		<b>9,417,131</b>	<b>6,764,467</b>
<b>Cash and cash equivalents at end of period</b>	11, 17	<b>6,416,446</b>	<b>6,336,187</b>

The accompanying notes on pages 87 to 111 form an integral part of the Consolidated Financial Statements.

## Consolidated Statement of Changes in Equity for the Period Ended 30 June 2013 (unaudited)

(BGN'000)

Source of changes in equity	Capital	Revaluation of non- monetary assets	Special and other reserves	Total capital and reserves	Non- controlling interest	Total equity
<b>Balance as of 1 January 2012</b>	<b>20,000</b>	<b>138,773</b>	<b>4,615 192</b>	<b>4,773,965</b>	<b>4,091</b>	<b>4,778,056</b>
Profit for the period	-	-	234,896	234,896	73	<b>234,969</b>
Other comprehensive income:						
- other income	-	(42)	(33)	(75)	-	<b>(75)</b>
Other comprehensive income, total	-	(42)	(33)	(75)	-	<b>(75)</b>
Total comprehensive income for the period	-	(42)	234,863	234,821	73	<b>234,894</b>
Other movements	-	747	(747)	-	-	-
Contributions by and distributions to owners:						
- contribution to the budget of the Repub- lic of Bulgaria	-	-	(180,528)	(180,528)	-	<b>(180,528)</b>
Transactions with owners, total	-	-	(180,528)	(180,528)	-	<b>(180,528)</b>
<b>Balance as of 30 June 2012</b>	<b>20,000</b>	<b>139,478</b>	<b>4,668,780</b>	<b>4,828,258</b>	<b>4,164</b>	<b>4,832,422</b>
<b>Balance as of 1 January 2013</b>	<b>20,000</b>	<b>138,538</b>	<b>4,806,427</b>	<b>4,964,965</b>	<b>4,197</b>	<b>4,969,162</b>
Profit/loss for the period	-	-	(886,807)	(886,807)	32	<b>(886,775)</b>
Other comprehensive income:						
- other income	-	(11)	(6)	(17)	-	<b>(17)</b>
Other comprehensive income, total	-	(11)	(6)	(17)	-	<b>(17)</b>
Total comprehensive income for the period	-	(11)	(886,813)	(886,824)	32	<b>(886,792)</b>
Other movements	-	-	-	-	-	-
Contributions by and distributions to owners:						
- contribution to the budget of the Repub- lic of Bulgaria	-	-	(105,834)	(105,834)	-	<b>(105,834)</b>
Transactions with owners, total	-	-	(105,834)	(105,834)	-	<b>(105,834)</b>
<b>Balance as of 30 June 2013</b>	<b>20,000</b>	<b>138,527</b>	<b>3,813,780</b>	<b>3,972,307</b>	<b>4,229</b>	<b>3,976,536</b>

The accompanying notes on pages 87 to 111 form an integral part of the Consolidated Financial Statements.

## Notes to the Consolidated Financial Statements

### 1. Statute and Principal Activities

The Bulgarian National Bank (the 'Bank') is 100 per cent owned by the Bulgarian state and is the central bank of the Republic of Bulgaria. The operation of the Bank is governed by the Law on the Bulgarian National Bank (LBNB), which has been effective since 10 June 1997.

Under this Law, the principal activities of the Bank may be summarised as:

- Maintaining price stability through ensuring national currency stability;
- Exclusive right to issue banknotes and coins;
- Regulation and supervision of other banks' activities in the country with a view to banking system stability maintenance;
- Establishment and operation of efficient payment systems;
- Regulation and supervision over the activity of payment system operators, payment institutions and electronic money institutions in the country;
- The Bank shall not extend credit and guarantees in any form whatsoever, including through purchase of debt instruments, to the Council of Ministers, municipalities, as well as to other government and municipal institutions, organisations and enterprises;
- The Bank may not provide credit to banks except in the case of liquidity risk threatening to affect the stability of the banking system;
- The Bank may not deal in Bulgarian government securities;
- The Bank may not issue Bulgarian levs in excess of the Bulgarian lev equivalent of the gross international reserves;
- The Bank acts as the fiscal agent and depository for the State.

The Governing Council of the BNB approved the Consolidated Financial Statements, set out on pages 81 to 111, on 14 November 2013.

### 2. Applicable Standards

These Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Commission.

### 3. Basis of Preparation

The Financial Statements are presented in Bulgarian levs rounded to the nearest thousand (BGN'000), which are the functional currency of the Bank. They are prepared on a historical cost basis, except for derivative financial instruments, financial assets and liabilities at fair value through profit or loss, available-for-sale assets and properties presented at fair value.

When preparing the financial statements in conformity with IFRSs, the Bank makes judgement, estimates and assumption that affect the reported amounts of assets and liabilities for the following financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under certain circumstances.

### 4. Basis of Consolidation

#### *Subsidiaries*

Subsidiaries are the entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. All receivables and payables, income and expenses, as well as intragroup profits resulting from transactions between Group companies are eliminated unless they are immaterial. The share in the net assets of the Bank's subsidiaries, which corresponds to the minority shareholders' proportionate share, is disclosed separately from Capital and Reserves under the Non-controlling Interest item.

### *Associated companies*

Associates are those entities in which the Bank has significant influence, but which are neither a subsidiary enterprise, nor a joint venture. Investments in associates are accounted for in the Bank's Consolidated Financial Statements using the equity method as an amount corresponding to the Bank's share in the associates' own funds as of the end of the reporting period. The Bank's share of associates' net results subsequent to acquisition is disclosed in the 'profit or loss' as investment income/expenses and is added to/subtracted from the carrying value of the investment.

## **5. Significant Accounting Policies**

### **(a) Income recognition**

Interest income and expense are recognised in the 'profit or loss' using the effective interest rate method. The effective interest rate is the rate which precisely discounts the estimated future cash payments and income over the term of the financial asset or liability to the carrying amount of the asset or liability. The effective interest rate is determined on the initial recognition of the financial asset or liability and does not change thereafter.

The calculation of the effective interest rate includes all transaction costs and fees and points that are integral part of the effective interest rate. Transaction costs include incremental costs directly attributable to the acquisition, issue or derecognition of a financial asset or liability.

Interest income and expense in the 'profit or loss' include:

- interest on financial assets and liabilities measured at amortised cost calculated using the effective interest rate method;
- interest on investment securities available for sale calculated using the effective interest rate method.

Dividend income is recognised in the profit or loss when the Bank establishes the right to receive income. Foreign currency differences arising from available-for-sale investments are recognised in the profit or loss.

Net gains/losses from financial assets and liabilities at fair value through profit or loss include net gains from operations in securities, net gains from operations in foreign currency, net revaluation gains on securities, net gains from gold revaluation, net gains from revaluation of futures, and net gains from revaluation of assets and liabilities denominated in foreign currencies.

### **(b) Financial instruments**

#### **1) Classification**

For the purposes of measuring financial instruments subsequent to initial recognition, the Bank classifies the financial instruments into four categories:

Financial instruments at fair value through profit or loss are those that the Bank holds primarily for the purpose of short-term profit. These include investments that are not designated for any particular purpose and effective hedging instruments and liabilities from short-term sales of financial instruments. Net receivables under derivatives held for trading (positive fair value), as well as options purchased, if any, are reported as trading assets. All net liabilities under derivatives for trading (negative fair value), as well as options written, if any, are reported as trading liabilities.

Loans and receivables are instruments issued by the Bank through providing money to a debtor other than those created with the intention of short-term profit taking.

Held-to-maturity financial assets are assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

Available-for-sale financial assets are all assets that can not be classified in any other category and are classified as available for sale, as well as those financial assets designated as available for sale at initial recognition.

#### **2) Recognition**

The Bank recognises trading financial assets and investments, the Bank's loans and receivables, and financial liabilities at amortised cost on the date at which they are originated. All other financial assets and financial liabilities are initially recognised on

the trade date at which the Bank becomes a party to the contractual provisions of the instrument. From that moment on, any changes in their fair value are recognised by the Bank as income or expense.

Financial instruments are initially measured at fair value, and for those financial instruments which are not recognised at fair value through profit or loss the amount recognised includes directly attributable acquisition costs.

### **3) Amortised cost measurement**

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured upon the initial recognition, minus principal repayments, plus or minus cumulative amortisation using an effective interest rate for the difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

### **4) Fair value measurement and disclosure principles**

Fair value is the amount for which an asset could be exchanged or a liability be settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

Whenever possible, the Bank measures the fair value of an instrument using quoted prices in an active market of that instrument. A market is considered as active if quoted prices are regularly published and easily accessible and represent actual and direct market transactions on an arm's length basis.

If the market for a financial instrument is not active, the Bank establishes the fair value using valuation techniques. They include using recent arm's length transactions between knowledgeable, willing parties (if available), comparison with the current fair values of other instruments, that are substantially the same discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, *i.e.*, the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (*i.e.*, without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Where the Bank has positions with offsetting risks, mid-market prices are used to measure them and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

### **5) Derecognition**

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to the receipt of the contractual cash flows from the financial asset in the transaction in which substantially all risks and rewards of ownership of the financial asset are transferred. Any holding in

transferred financial assets, which has been originated or kept by the Bank, is recognised as a separate asset or liability.

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expired.

The Bank enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or the substantial risks and rewards of the transferred assets or a part of them. If a part of or all substantial risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position. Transfers of assets with retention of a part of or all substantial risks and rewards are, for instance, securities lending or repurchase agreements.

In transactions where the Bank neither retains nor transfers all substantial risks and rewards of ownership of a financial asset, it derecognises the asset if it does not retain the control of that asset. The rights and obligations retained in the transfer are recognised separately as assets and as liabilities respectively. In transactions where control of the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which the Bank is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract, depending on whether the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

#### **6) Offsetting**

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to offset the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank's trading operations.

#### **7) Impairment of assets**

Financial assets which are not carried at fair value through profit or loss are reviewed at each reporting date to determine whether there is evidence of impairment. Financial assets are impaired if there is objective evidence of impairment as a result of a loss event that occurred after the initial recognition of the asset and that the loss event had an impact on the future cash flows which can be reliably estimated.

Objective evidence of impairment loss from financial assets, including equity instruments, is a default or a borrower's inability to repay his obligations, restructuring of loans under unfavourable financial conditions for the Bank, indications that a borrower or the issuer of a financial instrument would go out of business, the disappearance of an active security market, or other public information. Furthermore, in case of a continuous or significant fall in the market value of an investment in equity instruments, there is objective evidence of impairment of these equity instruments.

The Bank considers the need of impairment of loans or investments held to maturity at both individual and group level. All individually significant loans and investments held to maturity are evaluated for specific impairment. All individually significant loans and investments held to maturity on which no specific impairment losses have been charged are evaluated on a portfolio basis. Loans and held-to-maturity investments that are not individually significant are collectively assessed for impairment by grouping together loans and held-to-maturity investment securities with similar risk characteristics. In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.



Impairment losses from assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted by the original effective interest rate of the asset. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired asset continues to be recognised through unwinding of the discount. When a subsequent event reduces impairment loss, the reduction in the impairment loss is reversed through profit and loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. If, in a subsequent period, the fair value of an impaired debt security available for sale increases and the increase can be objectively linked to an event that occurred after the impairment loss had been recognised in profit and loss, then the impairment loss is reversed and the reversed amount is recognised in profit and loss. However, any subsequent recovery in the fair value of an impaired equity instrument available for sale is directly recognised in other comprehensive income.

#### **8) Financial assets and liabilities held for trading**

Financial assets at fair value through profit or loss include instruments which the Bank holds principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed as a whole with the purpose of short-term profit.

Initially, the financial assets and liabilities for trading are recognised at fair value in the statement of financial position and transaction costs are recognised directly in profit or loss. All changes in the fair value are recognised as net income from trading operations in profit or loss.

#### **9) Investments**

##### *(1) Held-to-maturity investments*

Held-to-maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity, are not designated at fair value through the profit or loss, and are not available for sale financial assets.

Held-to-maturity investments are carried at amortised cost on the basis of an effective interest rate method. In case of sale or reclassification of more than an insignificant part of the assets held to maturity that are not falling due in the immediate future, there should be a reclassification of the entire portfolio of investments held to maturity in the group of available for sale investments. As a result of this reclassification, the Bank may not classify investments as held to maturity in the current year and the following two years.

##### *(2) Financial assets available for sale*

Available-for-sale investments are non-derivative assets that cannot be classified in any other category of financial assets. Equity investments not quoted in the market and whose fair value cannot be reliably measured are carried at cost. All other available-for-sale assets are carried at fair value.

Differences in the fair value are recognised directly in other comprehensive income until the investment is sold or fully impaired when the cumulative gains and losses recognised in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

#### **(c) Gold and other precious metals**

The BNB as a central bank maintains particular volumes of gold as part of Bulgaria's international reserves. In compliance with the requirements of the Law on the BNB, the Bank may take any necessary action in connection with the acquisition, possession and sale of gross international reserves, including monetary gold. Consequently, monetary gold as part of international reserves may be immediately used by the BNB without further constraints which determines it as a monetary asset. Pursuant to the requirements of the *General provisions for defining the valuation basis in the financial statements* to the IFRS, the Bank defines the recognition and valuation of the monetary gold as an



asset reported at fair value through profit or loss as the most reliable and appropriate base for a subsequent valuation of this financial asset.

Gold and other precious metals are measured at market value based on the London Bullion Market fixing in euro at the reporting date.

#### (d) Equity investments

For the purposes of measuring the equity investments subsequent to initial recognition, they are classified as available-for-sale financial assets and are measured at fair value.

Details of investments held by the Bank are set out in note 14.

#### (e) Property, plant, equipment and intangible assets

The Bank presents land and buildings in the statements of financial position at revalued amount as per the alternative approach allowed in IAS 16 *Property, Plant and Equipment*. The other groups of property, plant, equipment and intangible assets are measured in the statement of the financial position at cost, less accumulated depreciation, and impairment losses.

Land and buildings are measured at fair value which is regularly assessed by professionally qualified valuers. The revaluation of property is done asset by asset, and any accumulated depreciation at the revaluation date is derecognised against the gross carrying amount of the asset, and the net amount restated to the revalued amount of the asset. When the value of assets increases as a result of revaluation, the increase is reflected directly in the other comprehensive income. When the value of assets decreases as a result of revaluation, the decrease is recognised by decreasing the revaluation reserve in equity, and in case of a shortage the difference is recognised as an expense in the profit or loss.

##### 1) Subsequent expenditure

The separately accounted for expenditure incurred to replace a component of an item of property, plant and equipment are capitalized. All other subsequent expenditures are capitalized only when future economic benefits embodied in the item of property, plant and equipment will flow to the Bank. All other expenditures are recognised in the "profit or loss" as an expense as incurred.

##### 2) Depreciation

Depreciation is provided on a straight-line basis at prescribed rates designed to write down the cost of revalued amount of property, plant, equipment and intangible assets over their estimated useful lives. Land is not depreciated. The annual depreciation rates used are as follows.

	(%)
Buildings	2 – 4
Plant & Equipment	3 – 15
Computers	30 – 33.3
Fixtures and fittings	15 – 20
Motor vehicles	8 – 25
Intangible fixed assets	20 – 25

Expenditures incurred for the acquisition of property, plant, equipment and intangible assets are not depreciated until they are brought into use.

##### 3) Calculation of recoverable amount of assets

The recoverable amount of the Bank's property, plant and equipment is the greater of the net selling price or value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using the Bank's incremental borrowing rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

##### 4) Reversals of impairment

In respect of property, plant and equipment, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only up to the amount of the asset's carrying amount before recognizing impairment loss.

**(f) Foreign exchange**

Gains and losses arising in foreign currencies are translated to BGN at the official rates of exchange on the transaction date. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated at the official exchange rate of the Bank on that day. Foreign currency gains and losses resulting from the revaluation of monetary assets and liabilities are recognized in the profit or loss. Non-monetary assets and liabilities denominated in foreign currency are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Outstanding forward contracts in foreign currency are marked to market. The gains and losses on revaluation of outstanding forward contracts are recognized in the profit or loss.

The exchange rates of the major foreign currencies as of 30 June 2013 and 31 December 2012 are as follows:

Currency	30 June 2013	31 December 2012
US dollars	1 : BGN 1.49528	1 : BGN 1.48360
Euro	1 : BGN 1.95583	1 : BGN 1.95583
Special drawing rights	1 : BGN 2.24884	1 : BGN 2.28017
Gold	1 troy ounce : BGN 1803.06	1 troy ounce : BGN 2463.73

**(g) Taxation**

The Bank is not subject to income tax from its core activities. Income tax from subsidiaries for the period comprises current tax and deferred tax. Current tax comprises tax payable calculated on the basis of the expected taxable income for the period, using the effective tax rate or the current one at the reporting date. Deferred tax is derived using the balance sheet liability method on all temporary differences between the amounts used for taxation purposes and the carrying amounts of assets and liabilities.

The deferred tax is calculated using tax rates which are expected to be applied for the period of asset realization or liability settlement. The effect on the deferred tax from changes in the tax rates is recorded in the statement of comprehensive income up to the amount already charged or reported directly as other comprehensive income.

A deferred tax asset is recognised up to the amount to which it is probable to acquire future taxable profits against which the unused tax losses or tax credit could be utilized. The deferred tax assets are reduced to the extent that it is no longer probable to realise relevant tax benefit.

**(h) Profit distribution policy of the Bank**

The Bank's policy of distribution of profit from banking operations is defined in the Law on the BNB. Internal rules for preparation of financial statements and accounting policies were adopted upon a decision of the Governing Council effective from 1 January 2007, which are in compliance with Article 36, paragraphs 1 and 2 of the Law on the BNB. According to these rules, the Bank allocates to special reserves unrealised net gains and losses arising from revaluation of assets and liabilities denominated in foreign currency or gold. According to the requirements of Article 8, paragraph 2 of the Law on the BNB, the Bank sets aside 25 per cent of the excess of its annual revenue over its annual expenditure into a Reserve Fund. According to Article 8, paragraph 3 of the Law on the BNB, after the allocation to the Reserve Fund, the Bank may allocate reserves to cover market risk losses and other reserves upon a decision of the Governing Council. Subsequent to the allocation of reserves as required by the Law on the BNB, the Bank stipulates the remainder to be paid into the State Budget. The distribution of excess of revenue over expenditure is set out in note 23.

**(i) Cash in hand and deposits in foreign currency**

Cash and cash equivalents consist of cash in hand, current accounts and time deposits with maturities of less than three months.

**(j) Employee benefits**

The Bank has the obligation to pay certain amounts to each employee who retires in accordance with the requirements of Article 222, § 3 of the Labour Code in Bulgaria. According to these Labour Code requirements, on termination of the employment contract of an employee who has become entitled to retirement, the employer is obliged to pay him/her compensation amounting to twice his/her gross monthly salary. If, at the date of retirement, the employee has been employed by the Bank for ten or more years, the amount of the compensation is six gross monthly salaries. As at the date of the statement of financial position, the Bank's Management estimates the approximate amount of the potential expenditures for every employee based on an actuarial report using the projected unit credit method. The estimated amount of the obligation and the main assumptions, on the bases of which the estimation of the obligation has been made, are disclosed in note 10 to the financial statements.

***Termination benefits***

Termination benefits are recognised as an expense when the Bank is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Bank has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

***Short-term employee benefits***

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Bank has a present constructive obligation to pay this amount as a result of past services provided by the employee, and the obligation can be estimated reliably. The Bank recognises as a liability the undiscounted amount of the estimated costs related to annual leave expected to be paid in exchange for the employee's service for the period completed.

**(k) New IFRS and interpretations (IFRIC) not yet adopted as at the reporting date**

A number of new standards, amendments to standards and interpretations endorsed for adoption by the European Commission may be adopted earlier – for the period ending 30 June 2013. These amendments to IFRS have not been adopted when preparing these Consolidated Financial Statements and the Bank does not intend to apply them earlier.

***Standards, interpretations and amendments to standards that have not been early adopted–endorsed by the European Commission:***

- IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities and IAS 27 Separate Financial Statements (2011) superseding IAS 27 Consolidated and Separate Financial Statements (2008) and IAS 28 Investments in Associates and Joint Ventures (2011) superseding IAS 28 Investments in Associates (2008) which are to be applied no later than the start date of the first financial year beginning on or after 1 January 2014.
- Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities shall be applied no later than the start date of the first financial year beginning on or after 1 January 2014. The Bank is in the process of analysing the amendments; however it does not expect that they will have any significant impact on the financial statements.
- Amendments to IAS 36 Recoverable Amount Disclosures for Non-Financial Assets shall be applied no later than the start date of the first financial year beginning on or after January 2014. The Bank is in the process of analysing the amendments; however, it does not expect that they will have any significant impact on the financial statements.
- Amendments to IAS 39 Novation of Derivatives shall be applied no later than the start date of the first financial year beginning on or after 1 January 2014. The Bank is in the process of analysing the amendments; however it does not expect that they will have any significant impact on the financial statements.

***Standards, interpretations and amendments to standards, issued by the IAS Board and the IFRS Interpretations Committee which so far the European Commission has not endorsed for adoption***

Management believes that it is appropriate to disclose that the following new or revised standards, new interpretations and amendments to existing standards, already issued by the International Accounting Standards Board (IASB) as at the reporting date, were not yet endorsed for adoption by the European Commission; therefore, they were not applied in preparing these Financial Statements. The actual effective dates for their adoption will depend on the endorsement decision by the EC.

- IFRS 9 Financial Instruments (issued in November 2009) and Amendments to IFRS 9 (issued in October 2010) will be applied as of 1 January 2015 and are expected to change the classification and measurement of financial instruments.
- Amendments to IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities will be applied as of 1 January 2014.

## **6. Financial Risk Management Policy Disclosure**

### **(a) Introduction and overview**

The Bank is exposed to the following types of risk in relation to the operations with financial instruments:

- credit risk;
- liquidity risk;
- market risk;
- operational risk.

This note provides information on the Bank's goals, exposures to each of the above types of risk and the policies and processes for risk measurement and management.

#### ***General provisions of risk management***

In the process of gross international reserve management, the Bank aims to achieve high security and liquidity of assets, first, and then to maximise returns in the context of international market conditions. Its investment strategy depends mainly on the specific function of a central bank operating under currency board arrangement and in full compliance with the requirements of the Law on the BNB.

The major portion of BNB's international reserves is invested in relatively low credit risk assets such as discount and coupon securities issued by governments, government agencies or supranational financial institutions, and short-term foreign currency and gold deposits placed with first-rate foreign banks. The remaining portion is held in SDRs and in monetary gold kept in the Bank's vaults.

The risks to the international reserves are managed by an independent risk management unit. It is directly responsible for the strategic asset allocation and the determination of the international reserves benchmark, and prepares and submits for approval the investment management limits. On a quarterly basis, an overall review is made of the changes in the market conditions, the amount and structure of international reserves, and if required, the investment limits and model portfolios (benchmarks) are updated. The monitoring of underlying limits, rules, and procedures is undertaken on a daily basis. Reports are regularly prepared both for the needs of international reserves operating management, and for providing updated information to the Bank's management.

All approved financial instruments and asset classes in which the BNB can invest are set out in internal documents. The documents define the main portfolios and the respective model portfolios (benchmarks), as well as limits for credit, interest rate, currency and operational risk, and list the approved debt instrument issuers which the BNB can invest in and the foreign financial institutions acting as BNB counterparties.

The international reserves management is governed by rules of behaviour and procedures regulating the performance of the functions and tasks of the main structural units involved in the process.

### **(b) Credit risk**

The BNB is exposed to credit risk through its trading operations and investment activities and in cases where it acts as an intermediary on behalf of the government or other

public institutions. The Bank assumes credit risk also in operations of purchases and sales of foreign currency with banks. In general, this credit risk is associated with the probability of insolvency of a BNB's counterparty or the insolvency of an issuer, in whose debt instruments the Bank has invested its own funds. The credit risk in managing BNB's gross international reserves is assessed in line with the requirements of Article 28, paragraph 3 of the Law on the BNB. According to these requirements, the BNB may invest in debt instruments issued by foreign governments, central banks, other foreign financial institutions or international financial organisations whose debts are rated with one of the top two grades by two internationally recognised credit rating agencies and are payable in freely convertible currency in line with internally developed methodology as per the requirements of Article 28 of the LBNB.

According to these requirements, the approved types of financial instruments for investment of funds in managing the international reserves are as follows:

- Investment programmes with central banks;
- Automatic borrowings/lending of securities with the main depository;
- Deposits in foreign currency (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- Deposits in gold (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- Commercial securities (of up to 1 year term to maturity), issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks, and other financial institutions – issuers of European covered bonds;
- Bonds issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks and other financial institutions – issuers of covered bonds.

All bonds must be with a one-off payment of their face value on the maturity date and without any embedded option;

- Purchases and sales of foreign currency with a value date of up to 2 business days.

Two basic types of limits are set which are calculated based on the market value of foreign currency reserves – 1) maximum or minimum limit on the weight of each asset class and 2) individual maximum acceptable exposure of the BNB to an issuer/counterparty (concentration limit).

### (c) Liquidity risk

Liquidity risk arises in the funding of the Bank's core activities and in the management of positions. It is primarily manifested in two aspects: the first aspect is risk for the Bank of being unable to meet its obligations when due and the second aspect comprises the risk of its being unable to sell an asset on international markets at a fair value within an appropriate time frame in compliance with the respective market conventions.

The BNB seeks to maintain a balance between the maturity of liabilities and that of assets through investments in financial instruments with a range of maturities. The instruments for attracting funds, which are provided to customers on the liability side, are primarily deposit/investment accounts and settlement accounts. The Bank maintains minimum level of liquidity by type of currency on a daily basis to ensure all BNB payments in foreign currency. To better manage the risk arising from liquidation of positions in financial instruments, the latter are grouped by liquidity rank subject to the level of difficulty (*i.e.* discount from the fair value), at which they could be sold on the market in time of crisis. Limits are set for the different types of financial instruments based on the liquidity ranks.

As part of its overall liquidity risk management strategy, the Bank has defined requirements for the management of a portfolio of liquid assets denominated in euro and for maintaining assets denominated in other currencies for the purposes of meeting its cash inflows and outflows.

The Bank's financial assets and liabilities, analysed by residual term to maturity from the date of the statement of financial position to the date of any subsequent agreement or contractual maturity, are as follows:

(BGN'000)

	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Undefined maturity	Total
As of 30 June 2013							
<b>Financial assets</b>							
Cash and deposits in foreign currencies	5,996,190	97,802	277,968	-	-	-	6,371,960
Gold, instruments in gold, and other precious metals	1,391,323	-	-	-	-	957,992	2,349,315
Financial assets at fair value through profit or loss	278,211	1,588,665	6,979,276	10,726,247	198,890	-	19,771,289
Financial assets available for sale	76,688	-	-	-	-	1,418,964	1,495,652
Other assets	13,210	11,332	18,554	1,390	-	-	44,486
<b>Total financial assets</b>	<b>7,755,622</b>	<b>1,697,799</b>	<b>7,275,798</b>	<b>10,727,637</b>	<b>198,890</b>	<b>2,376,956</b>	<b>30,032,702</b>
<b>Financial liabilities</b>							
Banknotes and coins in circulation	-	-	-	-	-	9,170,093	9,170,093
Due to banks and other financial institutions	7,624,555	-	-	-	-	-	7,624,555
Liabilities to government institutions and other borrowings	6,657,788	-	21,514	-	-	-	6,679,302
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,737,021	2,737,021
<b>Total financial liabilities</b>	<b>14,282,343</b>	<b>-</b>	<b>21,514</b>	<b>-</b>	<b>-</b>	<b>11,907,114</b>	<b>26,210,971</b>
<b>Asset-liability maturity mismatch</b>	<b>(6,526,721)</b>	<b>1,697,799</b>	<b>7,254,284</b>	<b>10,727,637</b>	<b>198,890</b>	<b>(9,530,158)</b>	<b>3,821,731</b>
As of 31 December 2012							
<b>Financial assets</b>							
Cash and deposits in foreign currencies	9,376,167	-	-	-	-	-	9,376,167
Gold, instruments in gold, and other precious metals	1,898,930	-	-	-	-	1,308,424	3,207,354
Financial assets at fair value through profit or loss	595,538	892,795	5,702,448	10,328,839	281,573	-	17,801,193
Financial assets available for sale	77,757	-	-	-	-	1,437,952	1,515,709
Other assets	8,906	11,000	21,058	-	-	-	40,964
<b>Total financial assets</b>	<b>11,957,298</b>	<b>903,795</b>	<b>5,723,506</b>	<b>10,328,839</b>	<b>281,573</b>	<b>2,746,376</b>	<b>31,941,387</b>
<b>Financial liabilities</b>							
Banknotes and coins in circulation	-	-	-	-	-	9,549,921	9,549,921
Due to banks and other financial institutions	7,845,160	-	-	-	-	-	7,845,160
Liabilities to government institutions and other borrowings	6,770,169	21,514	160,514	-	-	-	6,952,197
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,775,165	2,775,165
<b>Total financial liabilities</b>	<b>14,615,329</b>	<b>21,514</b>	<b>160,514</b>	<b>-</b>	<b>-</b>	<b>12,325,086</b>	<b>27,122,443</b>
<b>Asset-liability maturity mismatch</b>	<b>(2,658,031)</b>	<b>882,281</b>	<b>5,562,992</b>	<b>10,328,839</b>	<b>281,573</b>	<b>(9,578,710)</b>	<b>4,818,944</b>

The outstanding contractual maturities of the Bank's financial liabilities are as follows:

(BGN'000)

	Book value	Gross nominal outgoing cash flow	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years
<b>As of 30 June 2013</b>							
Banknotes and coins in circulation	9,170,093	9,170,093	-	-	-	-	9,170,093
Due to banks and other financial institutions	7,624,555	7,624,555	7,624,555	-	-	-	-
Liabilities to government institutions and other borrowings	6,679,302	6,679,302	6,657,788	-	21,514	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,737,021	2,737,021	-	-	-	-	2,737,021
	<b>26,210,971</b>	<b>26,210,971</b>	<b>14,282,343</b>	<b>-</b>	<b>21,514</b>	<b>-</b>	<b>11,907,114</b>
<b>As of 31 December 2012</b>							
Banknotes and coins in circulation	9,549,921	9,549,921	-	-	-	-	9,549,921
Due to banks and other financial institutions	7,845,160	7,845,160	7,845,160	-	-	-	-
Liabilities to government institutions and other borrowings	6,952,197	6,952,306	6,770,171	21,514	160,621	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,775,165	2,775,165	-	-	-	-	2,775,165
	<b>27,122,443</b>	<b>27,122,552</b>	<b>14,615,331</b>	<b>21,514</b>	<b>160,621</b>	<b>-</b>	<b>12,325,086</b>

#### (d) Market risk

##### *Market risk*

All financial instruments are subject to market risk, *i.e.* the risk of impairment as a result of changes in the market conditions. The instruments are evaluated on a daily basis at fair market value which best reflects current market conditions for the respective type of financial instrument. The Bank manages its portfolios in response to changing market conditions and to changes in the liability structure of Issue Department balance sheet. Exposure to market risk is managed in accordance with the risk limits set in the *Investment Limits for the Management of the Gross International Reserves*.

The table below presents one important measure of market risk, *i.e.* Value at Risk (VaR). VaR is an indicator of the maximum loss over a certain period of time (holding period) and with a certain probability (called confidence level or confidence interval). The VaR used in this report is based on a 95% confidence level and a one-day holding period.

For the calculation of the total risk, the currency risk and the interest rate risk the empiric distributions, derived from time series of 30 daily observations of total income, currency income and interest income of assets, respectively, have been used. The correlation between the currency and interest rate risk is also presented. For each of the parameters, the value as of the last date for the period, the average for the whole period, as well as the minimum and maximum have been calculated.

(BGN'000)

	As of 30 June 2013	Average	Maximum	Minimum
Currency risk	(73,767)	(55,226)	(106,489)	(31,324)
Interest rate risk	(11,993)	(5,200)	(11,474)	(695)
Correlation (per cent)	0.19	0.14	0.60	(0.41)
<b>Overall risk</b>	<b>(68,663)</b>	<b>(56,632)</b>	<b>(104,945)</b>	<b>(31,734)</b>
	As of 31 December 2012	Average	Maximum	Minimum
Currency risk	(45,500)	(30,633)	(58,452)	(13,641)
Interest rate risk	(2,569)	(4,109)	(7,756)	(558)
Correlation (per cent)	0.18	0.17	0.62	(0.26)
<b>Overall risk</b>	<b>(43,651)</b>	<b>(30,609)</b>	<b>(55,072)</b>	<b>(14,952)</b>



### Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations, which impacts the prices of interest-earning assets (including investments) and interest-bearing liabilities. The Bank uses modified duration as a key measurement for interest rate risk. Modified duration measures the effect of the change in the market value of an asset (liability) in percentage points in response to 1 basis point (1/100th of 1 per cent) change in the interest rate levels. In addition, portfolios' technical parameters such as protuberance (convexity), duration in a fixed point of the yield curve, etc. are monitored on a daily basis. For each portfolio held by the BNB, the interest rate is limited by a model portfolio (benchmark) and by the investment limits for a maximum deviation of the modified duration of the portfolio from that of the respective benchmark.

Assets and liabilities with floating interest rates involve the risk of changes in the base which serves to determine the interest rates.

(BGN'000)

	Total	Floating rate instruments	Fixed rate instruments		
			Up to 1 month	From 1 to 3 months	Over 3 months
As of 30 June 2013					
<b>Interest-earning assets</b>					
Cash and deposits in foreign currencies	6,336,715	2,500,114	3,460,886	97,792	277,923
Gold, instruments in gold and other precious metals	1,391,291	-	1,391,291	-	-
Financial assets at fair value through profit or loss	19,743,991	848,063	77,997	1,501,057	17,316,874
Financial assets available for sale	76,688	-	76,688	-	-
Other interest-earning assets	44,486	6,589	6,621	11,332	19,944
<b>Total</b>	<b>27,593,171</b>	<b>3,354,766</b>	<b>5,013,483</b>	<b>1,610,181</b>	<b>17,614,741</b>
<b>Interest-bearing liabilities</b>					
Due to banks and other financial institutions	7,624,555	-	7,624,555	-	-
Liabilities to government institutions and other borrowings	3,013,724	-	2,992,210	-	21,514
Borrowings against Bulgaria's participation in international financial institutions	1,373,762	1,373,762	-	-	-
<b>Total</b>	<b>12,012,041</b>	<b>1,373,762</b>	<b>10,616,765</b>	<b>-</b>	<b>21,514</b>
<b>Interest-bearing assets/liability gap</b>	<b>15,581,130</b>	<b>1,981,004</b>	<b>(5,603,282)</b>	<b>1,610,181</b>	<b>17,593,227</b>
As of 31 December 2012					
<b>Interest-earning assets</b>					
Cash and deposits in foreign currencies	9,312,713	3,757,976	5,554,737	-	-
Gold, instruments in gold and other precious metals	1,898,799	-	1,898,799	-	-
Financial assets at fair value through profit or loss	17,755,040	1,008,804	587,958	893,303	15,264,975
Financial assets available for sale	77,757	-	77,757	-	-
Other interest-earning assets	40,964	5,939	2,967	11,000	21,058
<b>Total</b>	<b>29,085,273</b>	<b>4,772,719</b>	<b>8,122,218</b>	<b>904,303</b>	<b>15,286,033</b>
<b>Interest-bearing liabilities</b>					
Due to banks and other financial institutions	7,845,160	-	7,845,160	-	-
Liabilities to government institutions and other borrowings	3,137,548	-	2,955,656	21,514	160,378
Borrowings against Bulgaria's participation in international financial institutions	1,392,900	1,392,900	-	-	-
<b>Total</b>	<b>12,375,608</b>	<b>1,392,900</b>	<b>10,800,816</b>	<b>21,514</b>	<b>160,378</b>
<b>Interest-bearing assets/liability gap</b>	<b>16,709,665</b>	<b>3,379,819</b>	<b>(2,678,598)</b>	<b>882,789</b>	<b>15,125,655</b>

For managing interest rate risk and the band of interest rate changes, the sensitivity of financial assets and liabilities to various standard and non-standard interest rate movement scenarios are monitored.

The standard scenarios include the following changes in yield curves: 1) 100 basis points instant and parallel increase; 2) 100 basis points instant and parallel decrease; 3) 50 basis points parallel increase in the yield curves for a period of 12 months, and 4) 50 basis points parallel decrease in the yield curves also for a period of 12 months. The second two scenarios assume that the change in yields takes place at the beginning of the period and over the one-year period the yield curve remains unchanged.



The analysis of the sensitivity of the Bank's assets (to first approximation) to changes in interest rates, assuming a constant spread of assets and liabilities and expectations for parallel movements of the yield curves of the relevant assets, is as follows:

(BGN'000)

	100 b.p. parallel increase	100 b.p. parallel decrease	50 b.p. parallel increase in 1 year	50 b.p. parallel decrease in 1 year
As of 30 June 2013	(252,207)	252,207	51,332	68,005
As of 31 December 2012	(230,899)	230,899	30,313	27,870

### Currency risk

For the Bank a currency risk exists where there is a mismatch between the currency structure of assets and that of liabilities. From an accounting point of view, the Bank is exposed to currency risk when entering into transactions with financial instruments denominated in foreign currencies other than the euro.

With the introduction of the currency board arrangement in Bulgaria and the pegging of the Bulgarian currency to the euro, the Bank's financial statements, prepared in Bulgarian levs, are affected by movements in the exchange rate of the lev against the currencies other than the euro.

To minimize currency risk, there is a limit to the mismatches between the currency structure of assets and that of liabilities. According to Article 31, paragraph 3 of the Law on the BNB, the total market value of assets in a foreign currency other than the euro, SDR and monetary gold, may not deviate by more than +/-2 per cent from the market value of the liabilities denominated in these currencies.

(BGN'000)

	30 June 2013	31 December 2012
<b>Assets</b>		
Bulgarian lev, euro and currencies of euro area countries*	25,114,568	26,120,887
US dollar	6,666	29,355
Japanese yen	61	131
Pound sterling	196	232
SDR	2,836,956	2,876,171
Gold	2,316,370	3,162,928
Other	3,097	2,649
	<b>30,277,914</b>	<b>32,192,353</b>
<b>Liabilities, Capital and Reserves</b>		
Bulgarian lev, euro and currencies of euro area countries	27,530,233	29,384,535
US dollar	6,717	29,235
Japanese yen	2	-
Pound sterling	68	3
SDR	2,737,828	2,775,978
Other	3,066	2,602
	<b>30,277,914</b>	<b>32,192,353</b>
<b>Net position</b>		
Bulgarian lev, euro and currencies of euro area countries	(2,415,665)	(3,263,648)
US dollar	(51)	120
Japanese yen	59	131
Pound sterling	128	229
SDR	99,128	100,193
Gold	2,316,370	3,162,928
Other	31	47

\* Currencies of Member States prior to their accession to the euro area, which are bought by the central banks.

## (e) Using accounting judgements and assumptions

The Governing Council discusses the development, selection and disclosure of critical accounting policies and assumptions, as well as their application.

These disclosures supplement the notes to the financial risk management.

The Bank is operating in a complicated global economic and financial environment which also affects the Bulgarian market and could have negative implications for the Bank's performance and risk. Management has already taken measures, and its major priorities in the next few years will still be to keep the Bank's stable liquidity position and the continuous improvement in its evaluation methods, international reserves quality control and management.

### *Major sources of uncertainty for evaluation*

#### *1) Determination of fair values*

The determination of fair values of financial assets and liabilities for which there is no observable market price requires the use of valuation techniques described in the accounting policy. For financial instruments that trade infrequently and whose price is not transparent, the fair value is less objective and requires an expert's judgement depending on liquidity, concentration, market factors uncertainty, pricing assumptions, and other risks affecting the particular instrument.

#### *2) Valuation of financial instruments*

The Bank measures the fair value of financial instruments using the following hierarchy of methods:

- **Level 1:** Quoted market price or closing price for positions for which there is a reliable market;
- **Level 2:** Valuation techniques based on observable market information about yield curve. This category of methods is used to measure debt securities for which there is no reliable market.
- **Level 3:** Valuation techniques, where inputs on financial assets and liabilities are not based on observable market data.

The fair values of financial assets and liabilities traded in international financial markets for which there is available market information are based on market quotations or closing market prices. The use of observable market prices and information reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. The availability of actual market prices and information varies depending on products and markets and changes because of specific events and the general conditions of financial markets. The Bank determines the fair values of all other financial instruments for which there are no current market quotes by using a valuation technique based on a net present value. The net present value is computed by means of market yield curves and credit spreads, where necessary, for the relevant instrument. The purpose of the valuation techniques is to determine a fair value which reflects the price of the financial instrument on the reporting date.

The Bank has established a control framework with respect to the measurement of fair values. The fair values of financial instruments controls are set by an independent risk analysis and control unit. Specific controls include: checking the actual price information; regular reviews of current valuation models and, if necessary, development, approval and introduction of new valuation models; follow-up verification by means of analysis and comparison of data from various information sources, etc.

The table below analyses financial instruments reported at fair value using valuation models. The data does not include equity instruments reported at acquisition cost (Note 14).

(BGN'000)

	Level 1: Market quotes in active markets	Level 2: Valuation techniques using market data	Total
<b>30 June 2013</b>			
Cash and deposits in foreign currency	6,371,960	-	6,371,960
Gold, instruments in gold and other precious metals	2,349,315	-	2,349,315
Financial assets at fair value through profit or loss	19,771,289	-	19,771,289
<b>Total</b>	<b>28,492,564</b>	<b>-</b>	<b>28,492,564</b>
<b>31 December 2012</b>			
Cash and deposits in foreign currency	9,376,167	-	9,376,167
Gold, instruments in gold and other precious metals	3,207,354	-	3,207,354
Financial assets at fair value through profit or loss	17,703,397	97,796	17,801,193
<b>Total</b>	<b>30,286,918</b>	<b>97,796</b>	<b>30,384,714</b>

## 7. Interest Income and Expense

(BGN'000)

	30 June 2013	30 June 2012
Interest income		
– securities	209,722	202,840
– deposits	2,927	8,182
– other	1	1
	<u>212,650</u>	<u>211,023</u>
Interest expense		
– deposits	622	1,202
– other	-	-
	<u>622</u>	<u>1,202</u>

Interest paid on foreign currency government deposits as at 30 June 2013 is BGN 2 thousand. Interest paid on foreign currency deposits of other organisations as at 30 June 2013 is BGN 107 thousand.

## 8. Net Profit/Losses from Financial Assets and Liabilities at Fair Value through Profit or Loss

(BGN'000)

	30 June 2013	30 June 2012
Net (losses) from operations in securities	(174,006)	(96,719)
Net gains from operations in foreign currency	198	194
Net revaluation gains on futures	48	553
Net revaluation (losses)/gains on securities	(39,665)	61,968
Net revaluation (losses)/gains on foreign currency assets and liabilities	(1,062)	1,242
Net revaluation (losses)/gains on gold	(860,096)	78,749
	<u>(1,074,583)</u>	<u>45,987</u>

Net losses from financial assets and liabilities carried at fair value through profit or loss as at 30 June 2013 with the largest loss from gold revaluation of BGN 860,096 thousand resulting from the drastic fall in the price of gold. The market price of gold determined

based on the London Bullion Market fixing in euro fell by 26,8% from BGN 2463.73 *per* troy ounce as at 31 December 2012 down to BGN 1803.06 as at 28 June 2013.

The primary factor behind the net losses from securities transactions of BGN 174,006 thousand and from securities revaluation of BGN 39,665 thousand was the significant increase (between 5 and 85 b.p. across sectors and issuers) of the market yield on the securities in which the BNB invests, leading to a fall in their prices. An additional contributing factor is that the market yield on securities is still behind its coupon yield, therefore they are sold at a premium above their par value.

## 9. Other Operating Income

(BGN'000)

	30 June 2013	30 June 2012
Income from subsidiaries	17,634	19,938
Income from associated companies	-	-
Income from sale of coins	486	347
Dividend income	8,796	8,621
Other income, net	542	511
	<u>27,458</u>	<u>29,417</u>

Dividend income includes dividends from BNB's participation in BIS, Basle amounting to BGN 5,696 thousand and from BNB's participation in BORICA-Bankservice of BGN 3,100 thousand.

## 10. Total Administrative Expenses

(BGN'000)

	30 June 2013	30 June 2012
Personnel costs	16,540	16,171
Administrative expenses	23,797	21,958
Depreciation	11,592	12,865
Other expenses	2,538	1,953
	<u>54,467</u>	<u>52,947</u>

Personnel costs include salaries, social and health insurance costs charged under the local legislation provisions as of 30 June 2013, and social activities costs, respectively for the BNB: BGN 12,644 thousand, for the Printing Works of the BNB Corp.: BGN 2408 thousand, and for the Bulgarian Mint EAD BGN 1488 thousand. The number of employees of the Bank and its subsidiaries is 1244 as of 30 June 2013 (30 June 2012 – 1243), including the BNB staff of 874 as of 30 June 2013 (30 June 2012 – 875).

Based on actuarial calculations, the Bank has accrued compensation liabilities for personnel on retirement and for unused paid annual leave at BGN 1371 thousand (30 June 2012 – BGN 1256 thousand). The retirement and unused paid annual leave compensation for the Bank's subsidiaries as of 30 June 2013 are BGN 13 thousand (30 June 2012: BGN 175 thousand).

Administrative expenses include the BNB's currency circulation expenses of BGN 6959 thousand for the as of 30 June 2013 (30 June 2012: BGN 3028 thousand).

## 11. Cash and Deposits in Foreign Currencies

(BGN'000)

	30 June 2013	31 December 2012
Cash in foreign currencies	34,923	61,274
Current accounts in other banks	2,498,265	3,708,545
Deposits in foreign currencies	3,838,772	5,606,348
	<u>6,371,960</u>	<u>9,376,167</u>

Cash and deposits in foreign currencies with correspondents are disclosed as follows:

(BGN'000)

	30 June 2013	31 December 2012
Euro area residents		
In EUR	2,176,699	4,988,011
In other currencies	1	2
	2,176,700	4,988,013
Non-euro area residents		
In EUR	2,810,956	2,969,733
In other currencies	1,384,304	1,418,421
	4,195,260	4,388,154
	6,371,960	9,376,167

## 12. Gold, Instruments in Gold, and Other Precious Metals

	30 June 2013		31 December 2012	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	925,047	513	1,263,999
Gold deposits in standard form	771	1,391,323	771	1,898,930
Gold in other form	16	29,187	16	39,882
Other precious metals		3,758		4,543
		2,349,315		3,207,354

Gold in standard form includes gold held for safekeeping with a depository and deposits. Deposits in gold are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognised rating agencies and bear interest between 0.07 per cent and 0.35 per cent annually.

Gold in other form includes commemorative gold coins of BGN 24,663 thousand.

Other precious metals include silver commemorative coins of BGN 425 thousand and platinum commemorative coins of BGN 3191 thousand.

## 13. Financial Assets at Fair Value through Profit or Loss

(BGN'000)

Securities at fair value through profit or loss	30 June 2013	31 December 2012
Foreign treasury bills, notes and bonds	19,771,289	17,801,193
	19,771,289	17,801,193

Securities comprise both coupon and discount securities denominated in euro. The maximum coupon interest of the EUR-denominated securities was 2.45 per cent in 2013 (31 December 2012 – 2.43 per cent).

As at 30 June 2013 there were no securities pledged as collateral on futures transactions.

The securities issued by foreign governments and other issuers or relevant issuers with credit rating graded by at least two of the six internationally recognised credit rating agencies – Standard&Poor's, Fitch Ratings, Moody's, DBRS, R&I and JCR are disclosed as follows:

(BGN'000)

	Issuer's credit rating	30 June 2013	31 December 2012
Investment graded securities by the emission/issuer credit rating	AAA	14,793,523	15,329,029
	AA+	1,536,410	554,126
	AA	299,011	322,808
	AA-	2,909,058	1,492,674
	A+	82,610	81,710
	A	150,677	20,846
		<u>19,771,289</u>	<u>17,801,193</u>

#### 14. Financial Assets Available for Sale

(BGN'000)

	30 June 2013	31 December 2012
Republic of Bulgaria's quota in the IMF	1,439,707	1,459,765
Equity investments in international financial institutions	29,693	29,693
Investments in Associates	26,252	26,251
	<u>1,495,652</u>	<u>1,515,709</u>

The Republic of Bulgaria's quota in the IMF is SDR 640,200 thousand. BGN 76,688 thousand of the Republic of Bulgaria's quota in the IMF represents the reserve tranche held with the IMF. The IMF pays remuneration (interest) to those members who have a remunerated reserve tranche position, at an average rate of 0.07 per cent.

Equity investments in international financial institutions include the equity investment in the Bank for International Settlements (BIS), Basle, and 25 per cent of the equity investment in BIS, Basle is paid up. As of 30 June 2013 the current value of 10,000 thousand shares in SDR amounts to BGN 22,802 thousand while as of 31 December 2012 it was BGN 22,802 thousand (ref. note 28). The capital subscribed, but not paid-in has an option to be paid in within three months upon a decision of the BIS Board of Governors.

Equity investments in international financial institutions do not exceed 10 per cent of the subscribed share capital of the respective institution.

Investments in international financial institutions also include BNB's equity investment in ECB. BNB is a member of ESCB. In accordance with the 2010 amendments to the regulatory frameworks of the national central banks of the countries which have not adopted the euro, these pay effectively 3.75 per cent of the subscribed equity investment. The BNB's capital contribution in the ECB is EUR 3505 thousand or BGN 6855 thousand.

The Bank holds 100 per cent and 95.6 per cent, respectively, of the capital of Bulgarian Mint EAD and Printing Works of the BNB Corp.

The Bank exercises significant influence on the financial and operational policies of the associated companies listed below, and its investments in domestic companies can be analysed as follows:

Name of institution	Share holding per cent	Principal activity
<b>Associated companies</b>		
BORICA-Bankservice AD	36.11	Interbank card payments
International Bank Institute OOD	44.23	Financial training and research
Cash Services Company AD	20.00	Handling of sealed parcels of Bulgarian coins and banknotes transferred from the BNB and the banks

## 15. Tangible Assets

(BGN'000)

	Land and buildings	Plant and equipment	IT equipment	Office equipment	Other equipment (including motor vehicles)	Tangible assets in progress	Total
As of 1 January 2013	184,256	113,635	37,397	9,538	6,695	13,059	364,580
Additions	-	863	4	16	8	2,166	3,057
Disposals	-	(234)	(264)	(2)	(9)	(190)	(699)
Transfers	-	129	1,671	115	-	(1,915)	-
Revaluation	-	-	-	-	-	-	-
As of 30 June 2013	184,256	114,393	38,808	9,667	6,694	13,120	366,938
<b>Depreciation and Impairment loss</b>							
As of 1 January 2013	(28,677)	(71,917)	(28,901)	(6,014)	(5,513)	-	(141,022)
Charge for the period	(2,886)	(4,147)	(2,272)	(439)	(187)	-	(9,931)
On disposals	-	-177	264	1	8	-	450
Revaluation	-	-	-	-	-	-	-
As of 30 June 2013	(31,563)	(75,887)	(30,909)	(6,452)	(5,692)	-	(150,503)
<b>Net book value as of 30 June 2013</b>	<b>152,693</b>	<b>38,506</b>	<b>7,899</b>	<b>3,215</b>	<b>1,002</b>	<b>13,120</b>	<b>216,435</b>
<b>Net book value as of 31 December 2012</b>	<b>155,579</b>	<b>41,718</b>	<b>8,496</b>	<b>3,524</b>	<b>1,182</b>	<b>13,059</b>	<b>223,558</b>
As of 1 January 2012	184,803	111,192	34,348	9,142	6,653	2,343	348,481
Additions	58	2,209	133	96	51	16,831	19,378
Disposals	(1,319)	(419)	(1,817)	(32)	(16)	(376)	(3,979)
Transfers	14	653	4,733	332	7	(5,739)	-
Revaluation	700	-	-	-	-	-	700
As of 31 December 2012	184,256	113,635	37,397	9,538	6,695	13,059	364,580
<b>Depreciation and Impairment loss</b>							
As of 1 January 2012	(23,256)	(64,066)	(25,710)	(5,142)	(5,088)	-	(123,262)
Charge for the period	(5,816)	(8,269)	(4,959)	(902)	(442)	-	(20,388)
On disposals	87	418	1,768	30	17	-	2,320
Revaluation	308	-	-	-	-	-	308
As of 31 December 2012	(28,677)	(71,917)	(28,901)	(6,014)	(5,513)	-	(141,022)
<b>Net book value as of 31 December 2012</b>	<b>155,579</b>	<b>41,718</b>	<b>8,496</b>	<b>3,524</b>	<b>1,182</b>	<b>13,059</b>	<b>223,558</b>
<b>Net book value as of 31 December 2011</b>	<b>161,547</b>	<b>47,126</b>	<b>8,638</b>	<b>4,000</b>	<b>1,565</b>	<b>2,343</b>	<b>225,219</b>

When revaluating non-current tangible assets, the Bank writes off the accrued depreciation at the expense of the gross book value of assets, and their net value is recalculated against their revaluation.

## 16. Intangible Assets

(BGN'000)

	Software	Other intangible assets	Intangible assets in progress	Total
As of 1 January 2013	44,265	152	-	44,417
Additions	4	4	894	902
Disposals	(13)	-	-	(13)
Transfers	864	-	(864)	-
As of 30 June 2013	45,120	156	30	45,306
<b>Depreciation and impairment loss</b>				
As of 1 January 2013	(37,948)	(101)	0	(38,049)
Charge for the period	(1,647)	(14)	-	(1,661)
On disposals	13	-	-	13
As of 30 June 2013	(39,582)	(115)	-	(39,697)
<b>Net book value as of 30 June 2013</b>	<b>5,538</b>	<b>41</b>	<b>30</b>	<b>5,609</b>
<b>Net book value as of 31 December 2012</b>	<b>6,317</b>	<b>51</b>	<b>-</b>	<b>6,368</b>

Software includes, as of 30 June 2013, licenses purchased by the BNB to the total amount of BGN 795 thousand (31 December 2012: BGN 995 thousand), and software products to the amount of BGN 99 thousand (31 December 2012: BGN 1823 thousand).

(BGN'000)

	Software	Other intangible assets	Intangible assets in progress	Total
As of 1 January 2012	41,326	152	-	41 478
Additions	117	-	2,843	2 960
Disposals	(21)	-	-	(21)
Transfers	2,843	-	(2,843)	-
As of 31 December 2012	44,265	152	-	44 417
<b>Depreciation and impairment loss</b>				
As of 1 January 2012	(33,717)	(74)	-	(33 791)
Charge for the period	(4,252)	(27)	-	(4 279)
On disposals	21	-	-	21
As of 31 December 2012	(37,948)	(101)	-	(38 049)
<b>Net book value as of 31 December 2012</b>	<b>6,317</b>	<b>51</b>	<b>-</b>	<b>6 368</b>
<b>Net book value as of 31 December 2011</b>	<b>7,609</b>	<b>78</b>	<b>-</b>	<b>7 687</b>

Software includes, as of 31 December 2012, licenses acquired by the BNB to the total amount of BGN 995 thousand (31 December 2011: BGN 372 thousand), and software products to the amount of BGN 1823 thousand (31 December 2011: BGN 1354 thousand).

## 17. Other Assets

(BGN'000)

	30 June 2013	31 December 2012
Cash held by subsidiaries with local banks	44,486	40,964
Commemorative coins for sale	343	353
Inventories	14,051	15,581
Accounts receivable	3,754	2,762
Deferred charges	981	1,712
Other receivables	4,039	632
	<b>67,654</b>	<b>62,004</b>

Cash held by subsidiaries with local banks comprise BGN 37,897 thousand of Printing Works of the BNB Corp and BGN 6589 thousand of Bulgarian Mint EAD.



**18. Banknotes and Coins in Circulation**

(BGN'000)

	30 June 2013	31 December 2012
Banknotes in circulation	8,970,786	9,354,746
Coins in circulation	199,307	195,175
	<u>9,170,093</u>	<u>9,549,921</u>

**19. Due to Banks and Other Financial Institutions**

(BGN'000)

	30 June 2013	31 December 2012
Demand deposits from banks and other financial institutions		
– in BGN	4,757,431	5,082,592
– in foreign currency	2,867,124	2,762,568
	<u>7,624,555</u>	<u>7,845,160</u>

The Bank does not pay interest on demand deposits from banks and other financial institutions. Demand deposits include BGN 5,162,063 thousand representing the required reserves, which all local banks are required to maintain on accounts with the BNB (31 December 2012: BGN 5,007,673 thousand).

**20. Liabilities to Government Institutions and Other Liabilities**

(BGN'000)

	30 June 2013	31 December 2012.
Current accounts		
– in BGN	2,737,369	1,742,186
– in foreign currency	928,209	2,072,463
Time deposit accounts		
– in BGN	2,603,000	2,684,000
– in foreign currency	410,724	453,548
	<u>6,679,302</u>	<u>6,952,197</u>

Deposits and currency accounts of government institutions with the Bank comprise funds held on behalf of state budget and other government organisations. No interest is payable on the current accounts.

Government deposit accounts in euro and in levs earn annual interest of 0.00 per cent.

**21. Borrowings against Bulgaria's Participation in International Financial Institutions**

The borrowings against Bulgaria's participation in the IMF as of 30 June 2013 amount to BGN 1,364,763 thousand: SDR 604,475 thousand (as of 31 December 2012: BGN 1,385,694 thousand: SDR 604,475 thousand).

Borrowings from the IMF are denominated in SDRs. Borrowings related to Bulgaria's quota in the IMF are non-interest bearing with no stated maturity. This note includes account No 1 of the IMF for administrative expenses in levs amounting to BGN 3665 thousand (as of 31 December 2012: BGN 3721 thousand).

The Bank's borrowings from the IMF of the general and special allocation of SDRs amount to SDR 474,586,534 and SDR 136,289,102, respectively. Repayment will take place on IMF's demand. Under Article XX of IMF Statute, the Bank receives interest on the existing SDRs and pays a fee on its borrowings from the general and special allocation at the same interest rate.

## 22. Other Liabilities

(BGN'000)

	30 June 2013	31 December 2012
Funds of EU institutions and bodies	65,999	80,678
Salaries and social security payable	4,306	2,430
Deferred income	84	1,052
Other liabilities	20,018	16,588
	<b>90,407</b>	<b>100,748</b>

"Funds of EU institutions and bodies" include European Commission's funds and European Investment Bank's funds. Pursuant to Article 9 of Council Regulation No 1150 of 2000 and Bulgaria's participation in the funding of the EU budget, the Bank opened accounts of the European Commission. As of 30 June 2013 the funds on these accounts were BGN 29,088 thousand. In 2011 the Bank opened accounts with the European Investment Bank (EIB) for the purposes of a financial arrangement between the Bulgarian government and the EIB, with the funds on these accounts amounting to BGN 36,911 thousand as of 30 June 2013.

## 23. Capital and Reserves

The capital of the Bank is determined by the Law on the BNB and amounts to BGN 20,000 thousand.

Non-monetary asset revaluation reserves comprises the net change in fair value of property, equity investments and other non-monetary assets.

Pursuant to Article 36 of the Law on the Bulgarian National Bank, unrealised gains/losses arising from the revaluation of assets and liabilities denominated in foreign currencies or gold are transferred to a special reserve account and form special reserves.

Other reserves include the transfers to reserves of 25 per cent of the annual excess of revenue over expenditure after the allocation to special reserves, upon a decision of the BNB Governing Council.

As of 30 June 2013 profit distribution in accordance with the profit distribution policy disclosed in note 5 (h) is as follows:

(BGN'000)

	30 June 2013	30 June 2012
<b>Profit for the period</b>	<b>(886,775)</b>	<b>234,969</b>
Allocation to special reserve under Article 36 of the Law on the BNB		
Unrealised (gains)/loss from gold revaluation	860,096	(78,749)
Unrealised (gains)/loss from revaluation of financial assets at fair value through profit or loss	80,639	(68,303)
Unrealised foreign currency valuation (gains)/loss	1,062	(1,242)
Other unrealised (gains)/loss	-	-
<b>Result after allocation to special reserve, including</b>	<b>55,022</b>	<b>86,675</b>

## 24. Non-controlling Interest

Printing Works of the BNB Corp is a joint-stock company with two shareholders: the BNB and the Government represented by the Ministry of Finance. The BNB holds 95.6 per cent of the company's capital and the State holds the remaining 4.4 per cent of the company's capital.

## 25. Monetary Liabilities and Gross International Reserves

(BGN'000)

	30 June 2013	31 December 2012
<b>Gross international reserves</b>		
Cash and deposits in foreign currencies	6,371,960	9,376,167
Monetary gold and other instruments in gold	2,316,370	3,162,928
Security investments	19,771,289	17,801,193
Equity investments and quota in the IMF	76,688	77,757
	<u>28,536,307</u>	<u>30,418,045</u>
<b>Monetary liabilities</b>		
Currency in circulation	9,170,093	9,549,921
Due to banks and other financial institutions	7,164,688	7,843,045
Liabilities to government institutions	5,471,073	5,811,193
Other liabilities	1,734,095	1,223,797
	<u>23,539,949</u>	<u>24,427,956</u>
Surplus of gross international reserves over monetary liabilities	<u>4,996,358</u>	<u>5,990,089</u>

Interest receivable and interest payable are carried to the relevant financial assets and liabilities.

Monetary gold and other instruments in gold are revalued on a daily basis based on the euro fixing of the London Bullion Market closing price.

## 26. Related Party Transactions

**Bulgarian Government***International Monetary Fund*

As of 30 June 2013, the Republic of Bulgaria has not received funds under IMF agreements.

The Republic of Bulgaria's quota in the IMF is secured by promissory notes jointly signed by the Bank and the Government (ref. note 21).

*Government bank accounts*

Government budget organizations have current accounts and time deposits with the Bank (ref. note 20).

*Fiduciary activities*

In accordance with the Law on the BNB and under the terms agreed upon with the Minister of Finance, the BNB acts as an agent in government or government-guaranteed debts. With regard to this role, BNB performs agent and central depository services related to the administration and management of government securities issued by the Ministry of Finance. The Bank receives commission for providing these services. These government securities are not assets or liabilities of the BNB and are not recognised in its consolidated statement of financial position. The Bank is not exposed to any credit risk relating to government securities as it does not guarantee them. As of 30 June 2013, the par value of the government securities held in custody was BGN 6,276,364 thousand (31 December 2012: BGN 4,980,975 thousand).

## 27. Subsidiaries

(%)

Ownership interest	30 June 2013	31 December 2012
Bulgarian Mint EAD	100	100
Printing Works of the BNB Corp (ref. note 24)	95.6	95.6

The net income from subsidiaries for the period comprises net profit of BGN 114 thousand from the Bulgarian Mint EAD (30 June 2012: BGN 430 thousand) and BGN 719 thousand from the Printing Works of the BNB Corp (30 June 2012: BGN 1666 thousand).

## 28. Commitments and Contingencies

### 1) *Participation in the Bank for International Settlements*

The Bank holds 8000 shares of the capital of BIS, Basle, each amounting to SDR 5000. Twenty-five per cent of the equity investment in BIS, Basle is paid up. The capital subscribed but not paid in is with an option to be paid in within three months following a decision of the BIS Board of Governors. The contingent amount as of 30 June 2013 is BGN 68,405 thousand (31 December 2012: BGN 68,405 thousand).

### 2) *IMF quota and borrowings*

The IMF quota is secured by promissory notes jointly signed by the Bank and the Government of the Republic of Bulgaria amounting to BGN 1,364,763 thousand.

### 3) *Capital commitments*

As of 30 June 2013 the Bank has committed to BGN 36 thousand to purchase non-current assets (31 December 2012: BGN 184 thousand).

### 4) *Other commitments and liabilities*

There are no other outstanding guarantees, letters of credit or commitments to purchase or sell either gold, other precious metals or foreign currency.

## 29. Events Occurred after the Reporting Date

There are no events after the reporting date that require additional disclosure or adjustments to the Bank's Financial Statements.

## Major Resolutions of the BNB Governing Council between 1 January and 30 June 2013

- |                    |  |
|--------------------|--|
| <b>31 January</b>  | The BNB Governing Council awarded the BNB scholarships for 2013.   |
| <b>21 February</b> | <p>The BNB Governing Council adopted Ordinance on Amendment of BNB Ordinance No 18 on the Control over Quality of Banknotes and Coins in Cash Circulation.</p> <p>The BNB Governing Council approved an amendment to the RINGS Tariff.</p> <p>As of 25 March 2013 the BNB put into circulation a partially gold-plated silver commemorative coin 'Tsar Samuil' of the 'Medieval Bulgarian Rulers' series with a nominal value of BGN 10, issue 2013.</p> |
| <b>19 March</b>    | The BNB Governing Council adopted the Report on the BNB Budget Implementation as of 31 December 2012.  |
| <b>9 April</b>     | As of 20 May 2013 the Bulgarian National Bank put in circulation a gold commemorative coin 'St. Constantin and St. Helena' of the 'Bulgarian Iconography' series with a nominal value of BGN 100, issue 2013.  |
| <b>25 April</b>    | The BNB Annual Report for 2012 was approved.   |
| <b>6 June</b>      | The BNB Governing Council approved the Report on Budget Implementation of Administrative Expenditure of the Bulgarian Deposit Insurance Fund for 2012.   |
| <b>27 June</b>     | As of 29 July 2013 the Bulgarian National Bank put in circulation a silver commemorative coin '110th Anniversary of the Ilinden-Preobrazhenie Uprising' with a nominal value of BGN 10, issue 2013.  |