# BULGARIAN NATIONAL BANK

## ANNUAL REPORT • 1996

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

*In accordance with the provisions of the Law on the Bulgarian National Bank, Article 1, paragraph 2, the Bulgarian National Bank reports its activities before the National Assembly. Pursuant to Article 54 of this Law, I have the honor to submit the 1996 annual report of the Bulgarian National Bank.*

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

# BULGARIAN NATIONAL BANK MANAGEMENT

## MEMBERS OF THE PLENARY COUNCIL

| | |
|---|---|
| Prof. Todor Vulchev | Plamen Ilchev |
| Lubomir Filipov | Evgeni Uzunov |
| Ventseslav Dimitrov | Kamen Toshkov |
| Prof. Georgi Petrov | Rosalina Natseva |
| Dimitar Kostov | Stoyan Shukerov |
| Deyan Popov | Borislav Stratev |
| Gancho Ganchev | Zdravko Balyozov |
| Mileti Mladenov | Nikolina Micheva |
| Gancho Kolev | Andrei Nikolov |
| Dimitar Dimitrov | Lena Rousenova |

## MEMBERS OF THE MANAGING BOARD

| | |
|---|---|
| Prof. Todor Vulchev | Kamen Toshkov |
| Lubomir Filipov | Rosalina Natseva |
| Mileti Mladenov | Stoyan Shukerov |
| Gancho Kolev | Borislav Stratev |
| Dimitar Dimitrov | Zdravko Balyozov |
| Plamen Ilchev | Nikolina Micheva |
| Evgeni Uzunov | Andrei Nikolov |
| | Lena Rousenova |

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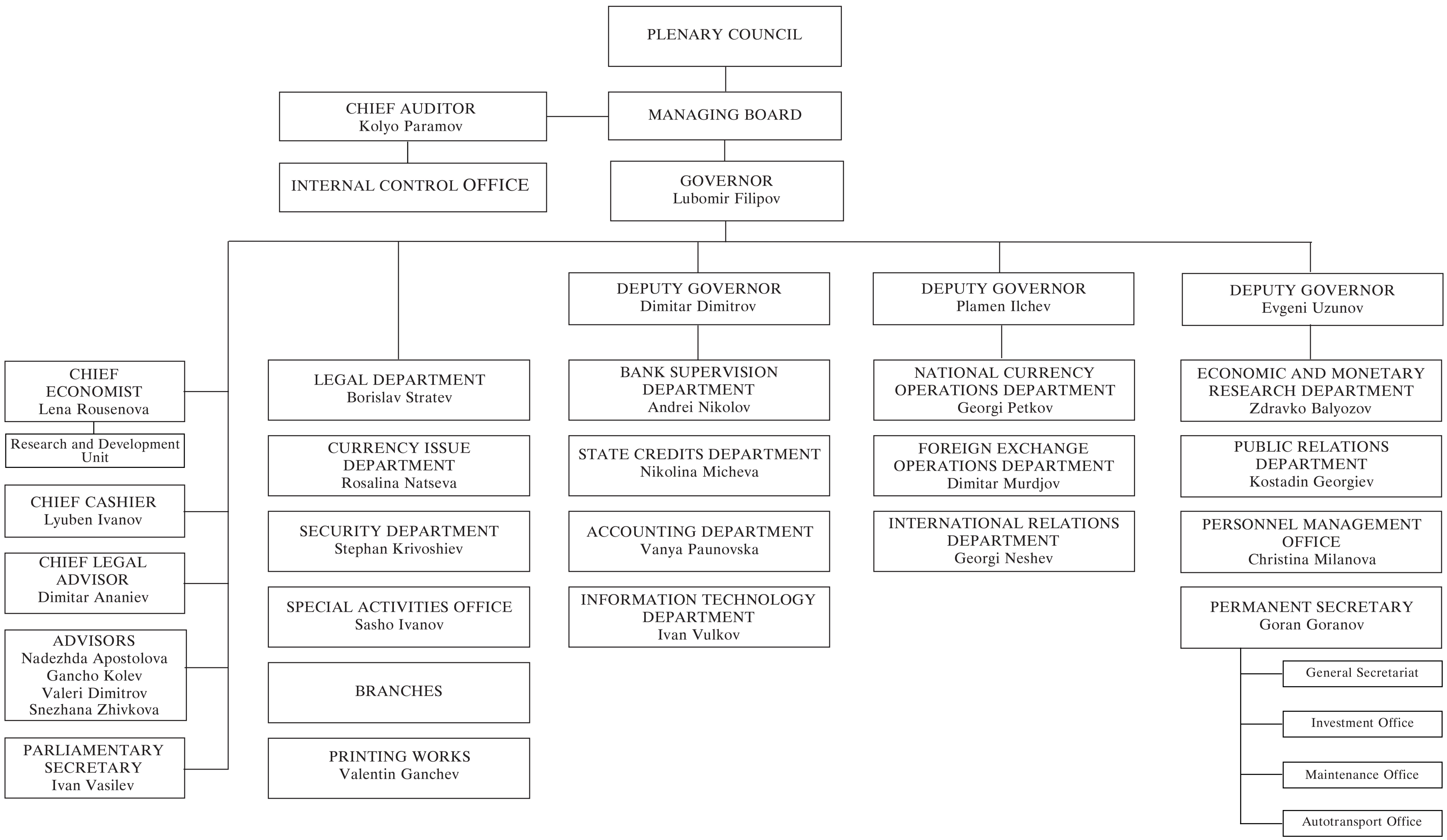
Prof. Todor Vulchev was Governor of the BNB and a member of the Plenary Council and the Managing Board until 24 January 1996. Lubomir Filipov has been Governor of the BNB since 24 January 1996. M. Mladenov and G. Kolev were Deputy Governors and members of the Plenary Council and the Managing Board until 30 June 1996. D. Dimitrov has been a Deputy Governor and a member of the Plenary Council and the Managing Board since 17 May 1996. P. Ilchev and E. Uzunov have been Deputy Governors and members of the Plenary Council and the Managing Board since 30 June 1996. K. Toshkov, R. Natseva and S. Shoukerov were members of the Plenary Council and the Managing Board until 8 July 1996. B. Stratev was a member of the Plenary Council and the Managing Board until 29 December 1996. Z. Balyozov, N. Micheva, A. Nikolov and L. Rousenova have been members of the Plenary Council and the Managing Board since 17 July 1996.

# Organizational Structure of the BNB

(as of 1 April 1997)



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## Abbreviations

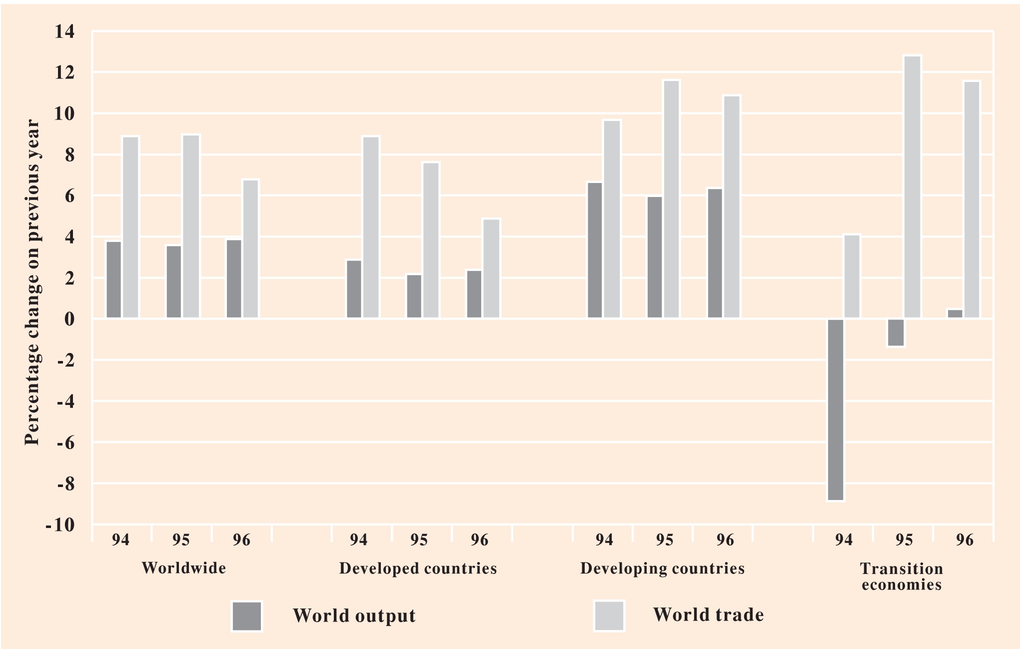
| | |
|---|---|
| BGL (Lev) | *National Currency of the Republic of Bulgaria* |
| BISERA | *Banking Integrated System for Electronic Transfer* |
| BNB | *Bulgarian National Bank* |
| BORICA | *Banking Organization for Payments Initiated by Cards* |
| CBA | *Commercial Banks Association* |
| CEE | *Central and Eastern Europe* |
| CEFTA | *Central European Free Trade Association* |
| CM | *Council of Ministers* |
| COMECON | *Council for Mutual Economic Assistance* |
| EBRD | *European Bank for Reconstruction and Development* |
| ECU | *European Currency Unit* |
| EFTA | *European Free Trade Association* |
| EIB | *European Investment Bank* |
| EU | *European Union* |
| GDP | *Gross Domestic Product* |
| IIB | *International Investment Bank* |
| IMF | *International Monetary Fund* |
| LBCA | *Law on Banks and Credit Activity* |
| LSNC | *Law on Settlement of Nonperforming Credits Negotiated prior to 31 December 1990 (ZUNK)* |
| MF | *Ministry of Finance* |
| MLSS | *Ministry of Labor and Social Security* |
| NSI | *National Statistical Institute* |
| OECD | *Organization for Economic Cooperation and Development* |
| PRUF | *Professional Retraining and Unemployment Fund* |
| SBL | *State Budget Law* |
| SDR | *Special Drawing Rights* |
| SFRD | *State Fund for Reconstruction and Development* |
| SII | *State Insurance Institute* |
| SSB | *State Savings Bank* |
| WB | *World Bank (International Bank for Reconstruction and Development – IBRD)* |

# I. Major Trends in the Development of the World Economy

According to IMF estimates[1], world output growth in 1996 is 3.8%, against 3.5% the previous year. Developed industrial countries completely emerged from the recession of the early 1990s and growth rates there approach potential, which signals their return to the long-term trend. Developing countries, particularly those from the Asian region, still witness higher growth rates than the world average. Transition economies (with a few exceptions) are in upswing, giving signs of emergence from deep structural crisis. In most of them this can be ascribed to the acceleration of privatization. World trade, measured as the exchange of goods and services, exhibited high growth rates, 6.7% on average, yet declining 2.2 percentage points on 1995.

**WORLD OUTPUT AND TRADE GROWTH**

(%)




Source: World Economic Outlook, October 1996.

According to IMF forecasts, world output in 1997 is estimated to grow about 4% compared with 1996. GDP in developed industrial countries is estimated at 2.5%, 6.2% in developing countries, and 4% in transition economies. World trade projections for 1997 point to a 7.2% growth compared with the previous year. Developed industrial countries are expected to increase their foreign trade turnover by 5.8%, a one percentage point increase on 1996. Following high export and import growth in 1995 and 1996 in developing countries and those in transition to a market economy, in 1997 this growth is expected to moderate by 0.4 and 4.1 percentage points respectively, to 10.7% and 6.2%.

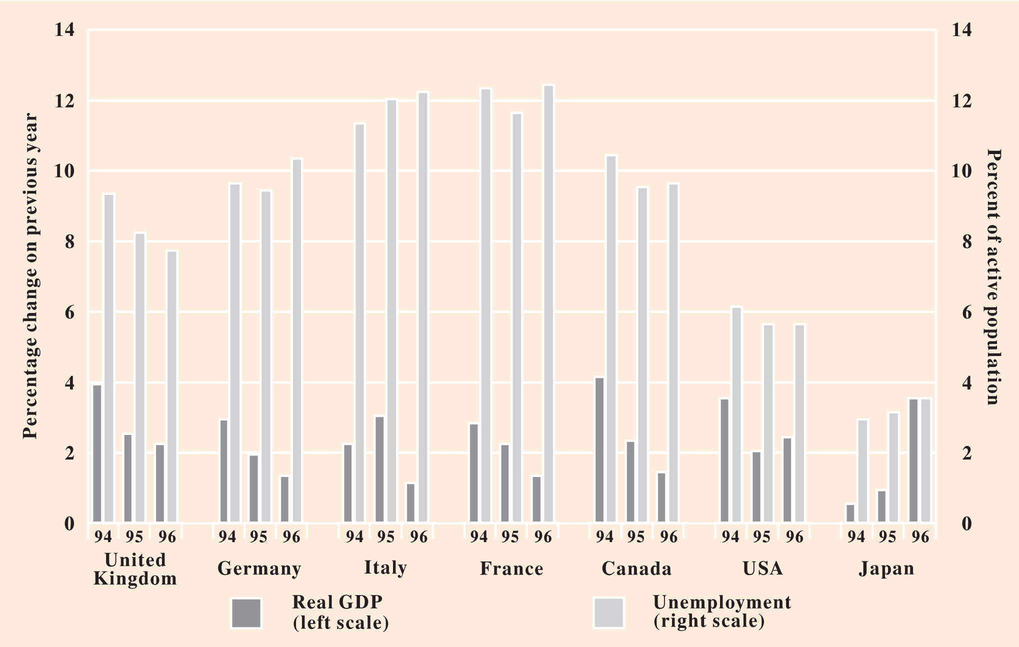
[1] World Economic Outlook, October 1996, IMF.

# 1. Developed Countries

After a modest slowdown in 1995 growth (0.7 percentage point down on 1994), developed industrial countries posted a 2.3% real GDP growth in 1996, 0.2 percentage point more than the previous year. Estimates for 1997 suggest that the upward trend will be sustained, with growth at about 2.5%. Comparatively high inflation (4% – 5% per annum), typical of the early 1990s, was cut to 2% – 3% over the last three years and projections for 1997 are for its stabilization around these levels. The

**REAL GDP AND UNEMPLOYMENT IN MAJOR DEVELOPED COUNTRIES**

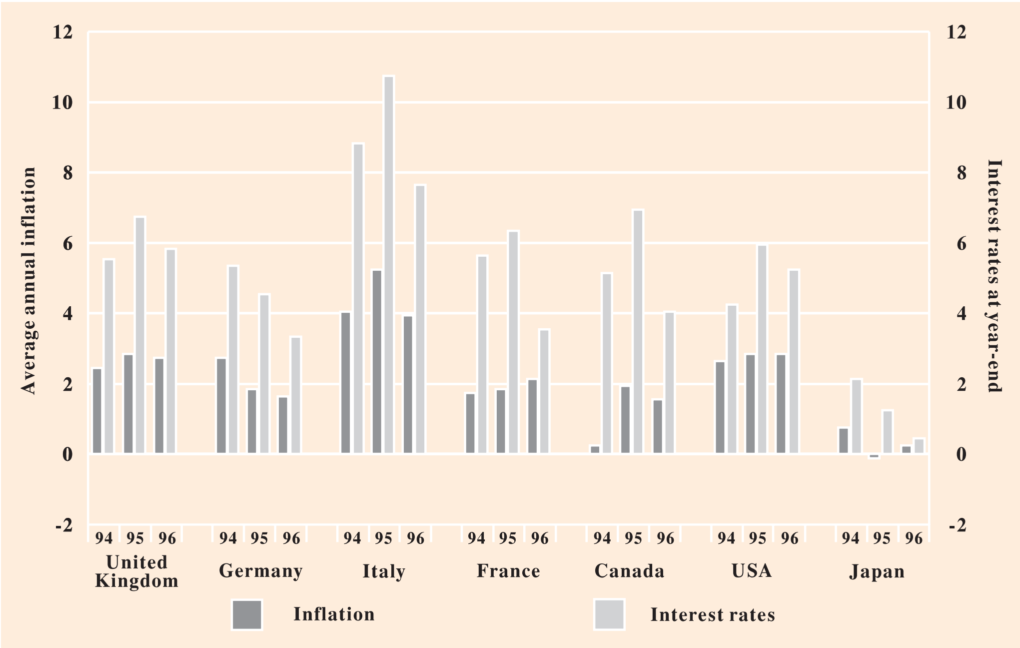
(%)




* Data for 1996 is preliminary.
Source: IMF, Bank for International Settlements.

**INFLATION AND INTEREST RATES IN MAJOR DEVELOPED COUNTRIES**

(%)




* Data for 1996 is preliminary.
Source: IMF, Bank for International Settlements.

interest rates saw a further fall and hence boosted growth; almost all countries took advantage of favorable conditions in international markets to cut budget deficits. This, in combination with low inflation, helped lower interest rates further. High unemployment (7.8%) remained a major concern blighting the more or less successful development of industrial countries. Despite expected growth, unemployment level estimates for 1997 remain high (7.8% – 8%).

**The European Union**

Growth rates in EU countries moderated in 1996: GDP growth was 1.6% against 2.8% in 1994 and 2.5% in 1995. Growth rates in these countries lagged behind those in the USA and Japan by 0.8 and 1.9 percentage points respectively. Estimates for 1997 suggest acceleration in growth which would stay within 2.5%. Consumer price inflation was 2.4% in 1996, 0.5 percentage point less than 1995. In view of the requirement in the Maastricht Treaty on budget deficit not exceeding 3% of GDP, all EU countries have succeeded in cutting budget deficits: in 1996 they were 4.4% on average for the EU against 5.2% the previous year; projections for 1997 suggest a further contraction to 3.3% – 3.5% of GDP. Low inflation levels and budget deficit contributed to lower interest rates. In 1996, short-term interest rates fell about 1.8 percentage points and reached a record low of about 4.9%. Persistently high unemployment in EU countries is still a major concern. For a fifth consecutive year it remains above 10%. In 1996, unemployment in these countries rose 0.2 percentage point and stood at 11.4%. Estimates for 1997 point to a 0.4 percentage point reduction in unemployment to about 11%.

From the perspective of export demand for Bulgarian goods and services, expected trends in EU countries for 1997 may be deemed favorable. IMF estimates indicate an increase in EU imports by 5.4% on average. Countries which traditionally take a high share of Bulgarian exports, like Germany, Italy and France, are expected to increase imports by 5%, 6.5% and 4.5% respectively.

**The USA**

For the fifth successive year after the 1991 crisis, in 1996 the US economy experienced sustainable, steady growth. Real GDP growth in 1996 is estimated at 2.4%, a 0.4 percentage point increase on the previous year. This growth was consistent with higher employment, reduced inflation and a smaller budget deficit. US dollar depreciation against benchmark convertible currencies in 1995 was consistent with a sizable rise in exports of goods and services (8.9%). In 1996, the dollar appreciated, hence eroding competitiveness (measured through the real effective exchange rate), and causing a 3.7 percentage point decline in export rates. The 1997 outlook is optimistic – real GDP is estimated to grow 2.5%, inflation about 2.3% and the unemployment rate is projected to replicate the 1996 level of 5.6%.

**Japan**

The Japanese economy eventually emerged from the deep stagnation of some three years. Real GDP rose 3.5% in 1996 against 0.5% in 1994 and 0.9% in 1995. Japanese economic policy was geared toward counteracting deflationary processes, prompted by the sharply appreciating yen in the previous year, a fall in the prices of stock exchange shares and problems in the banking system. Inflation and unemployment stood at traditionally low levels (0.2% and 3.5% respectively). Estimates for 1997 indicate a 2.7% real GDP growth, a rise in inflation to 1.2% and retention of unemployment at 3.4%. In 1996, in spite of yen devaluation against the US dollar, exports of goods and services stagnated; prospects for 1997 are much more favorable, with projected growth of about 9%.

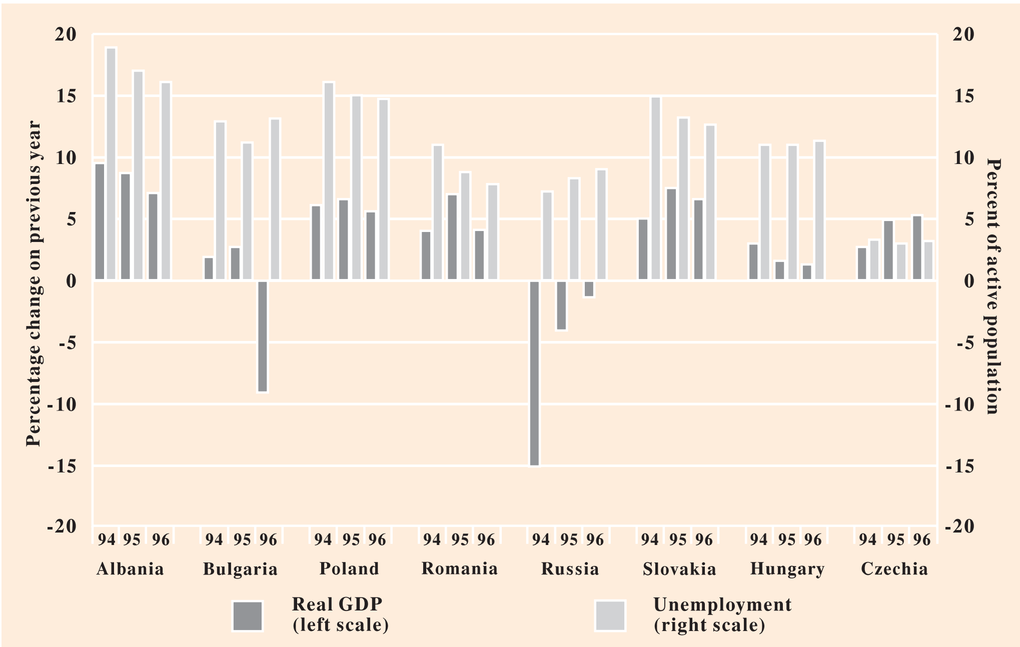
# 2. Transition Economies

Based on the experience of countries in transition to a market economy and consolidated statistical data several conclusions can be drawn that apply to all former socialist countries. First, curbing inflation is crucial for halting the decline of output, typical of the initial stage of transition. Second, steady, sustainable growth is impossible without deep structural change. Third, structural adjustment is consistent with high unemployment.

According to IMF data, for the first time since the onset of the shift to a market economy in 1996 former socialist countries as a whole experienced a positive growth of 0.4%. The countries of central and eastern Europe exhibited some 4.4% growth on average. Of these, only Bulgaria, the Ukraine and Belarus recorded output declines of 10%, 8% and 5.5% respectively. Russia[2] has not yet been able to halt the output decline but has succeeded in reducing its pace – from -15% in 1994 to -4% in 1995 and -1.3% in 1996. Other former Soviet republics posted a 0.6% real GDP growth. Tadjikistan and Azerbaidjan were facing serious economic challenges, while Armenia and Georgia surmounted crisis and recorded high economic growth: 6.5% and 8% respectively.

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

(%)




* Data for 1996 is preliminary.
Source: IMF, Bank for International Settlements.

A notable progress was made in curbing inflation in 1996. It fell from 264.8% on an annual average basis in 1994, through 128% in 1995, to about 42% in 1996. Only Bulgaria, the Ukraine and Belarus recorded inflation over 50%. For the second year in succession, inflation in the Czech Republic is below 10%. Low inflation can be credited with contributing to low interest rates, though they are still well above those in the EU. With the exception of the Czech Republic, 1996 unemployment remained high and rose in most countries from this group. The 1997 outlook is more or less optimistic. Real GDP growth in transition economies is estimated at

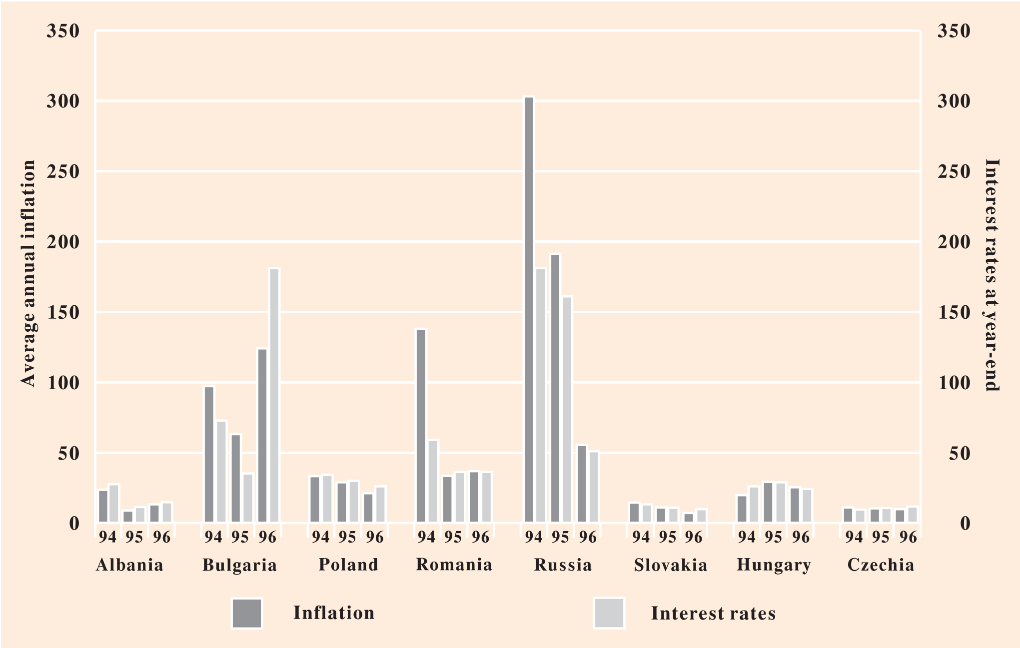
[2] Since Russia is incomparable in terms of production, trade, and other economic indicators, it is considered separately and is not included in the group of central and eastern European countries and those of the former Soviet Union.

4%, inflation at 17% and the unemployment rate is set to stay at its 1995 level. At the same time, foreign trade growth is projected to slow to between 7% and 8%, following average growth of 12% – 13% over the previous two years.

Bulgaria's exports to countries in transition to a market economy, although considerably reduced after the collapse of COMECON, still rank high in the country's export list. Liberalization of trade in these countries, expected acceleration of economic growth and free trade agreements signed with most of these countries created favorable conditions for exports in terms of foreign demand. The issue of more favorable treatment of Bulgarian exports to Russia has yet to be resolved.

**INFLATION AND INTEREST RATES IN COUNTRIES IN TRANSITION TO A MARKET ECONOMY**

(%)




* Data for 1996 is preliminary.
Source: IMF, Bank for International Settlements.

# 3. Developing Countries

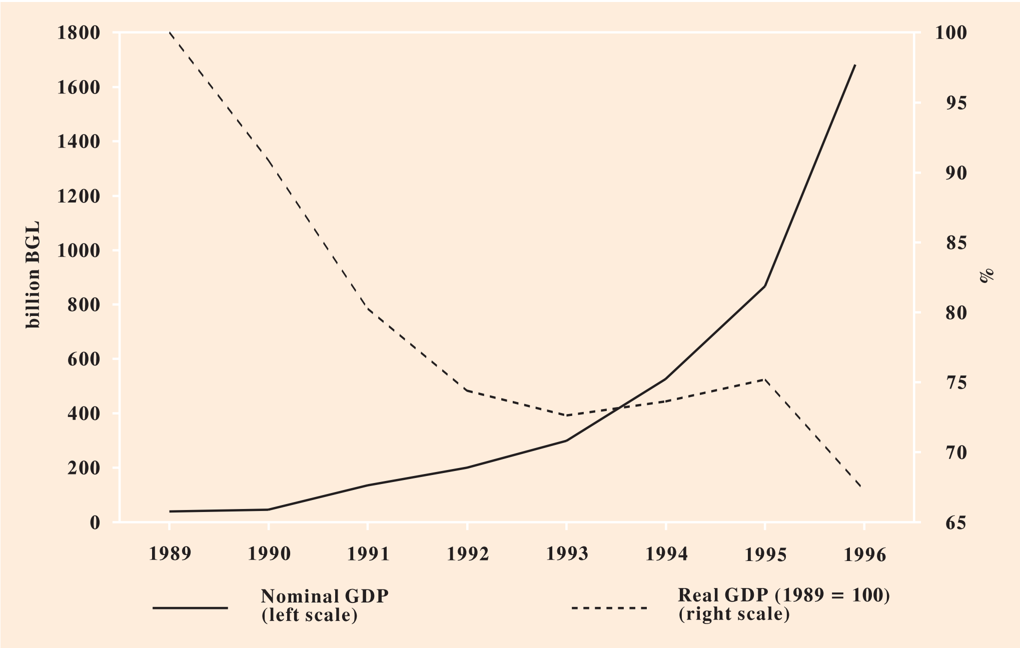
Developing countries achieved yet another high economic growth rate of 6.2% in 1996. Particularly successful were the economies of the Asian region which grew at about 7.5%, notwithstanding a moderate slowdown in the rate of growth. Inflation fell from 19.8% in 1995 to 13.3% in 1996. Foreign trade growth rates remained high, growing 10.8% on average. Bulgaria's geographical remoteness from developing countries is an obstacle to establishing more intensive trade ties. Some Arab countries with whom Bulgaria maintains traditionally good commercial relations are an exception to this.

# II. General Characteristics of the Economy

# 1. Gross Domestic Product

In 1996, the nominal gross domestic product (GDP) of the Republic of Bulgaria reached BGL 1,660 billion[3]. In real terms GDP declined by some 10.9% from the previous year, indicating the most dramatic fall after the start of market-driven reforms in 1991. Consequently the modest economic growth reported in the previous two years[4] was interrupted again.

**GROSS DOMESTIC PRODUCT**




Source: NSI, BNB.

**GDP by Component of Final Demand**

Domestic demand remained a key factor determining GDP growth. In 1996, households' final demand approximated BGL 1,284 billion, or 7.4% less than in 1995 (at constant prices). Compared with the previous year, other components of domestic demand, that is government purchases and investment in fixed capital, experienced more significant real decline. The real decrease in government purchases approximated 32%, and investment in fixed capital 13.5% compared with 1995. The falls are due to the fact that the greater part of state spending is earmarked for servicing public debt, as well as the lack of motivation to invest on the part of other economic agents.

Dramatic fluctuations in exchange rates seriously hit foreign trade in 1996 and found reflection in decreased volumes of imported and exported goods and services. Despite the significant nominal and real depreciation of the national currency, Bulgaria's economy continued to be a net importer of goods and services.

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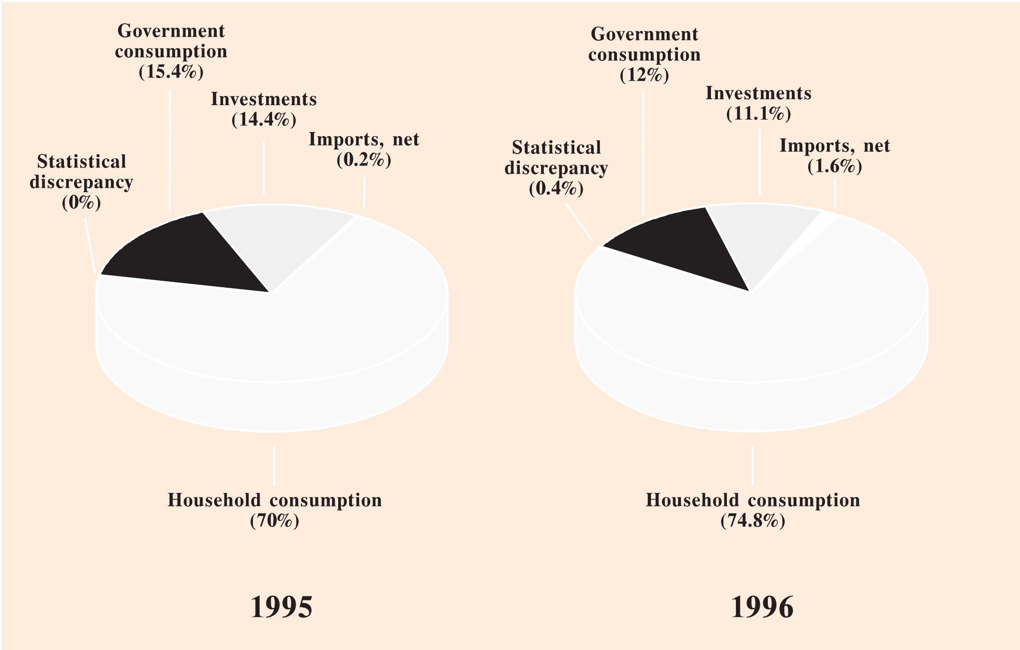
[3] National Statistical Institute (NSI) estimates.
[4] Rates of change in GDP for each of the three years are calculated at prices of the previous year.

Lack of investment in fixed capital, difficult forecasting of exchange rate movements and significant expenditures made to service government debt under the existing ownership structure in the country's economy are the major impediments to long-term economic growth. Growth requires changes in economic policy aimed at providing effective incentives to producers to increase supply of factors of production, smoothing fluctuations in major financial indicators and shifting savings into investments through restructuring of the financial system.

Changes in final demand components in 1996 resulted in changes in its structure. The shares of government purchases and investment decreased by over three percentage points, while the shares of household consumption and net imports of goods and services grew.

**GDP BY COMPONENT OF FINAL DEMAND**




Source: NSI, BNB.

## GDP Structure by Economic Sector

Amid general economic and financial instability, real added value declined in all sectors and activities. Added value attained in industry, the biggest economic branch, totaled BGL 428 billion, a 6.5% decline relative to 1995 in real terms. Worsened macroeconomic conditions coupled with unfavorable weather adversely affected agriculture. Added value attained in agriculture amounted to BGL 184 billion at current prices, or 18% less than in 1995 at constant prices. A greater-than-GDP real decline was reported in added value attained by construction and transport.

GDP structure[5] in the years following the 1991 start of transition does not facilitate the emergence of clear trends in economic restructuring. In 1996, only the share of 'Miscellaneous services'[6] grew significantly (about three percentage points) over 1995 when it had decreased due to a fall in agriculture.

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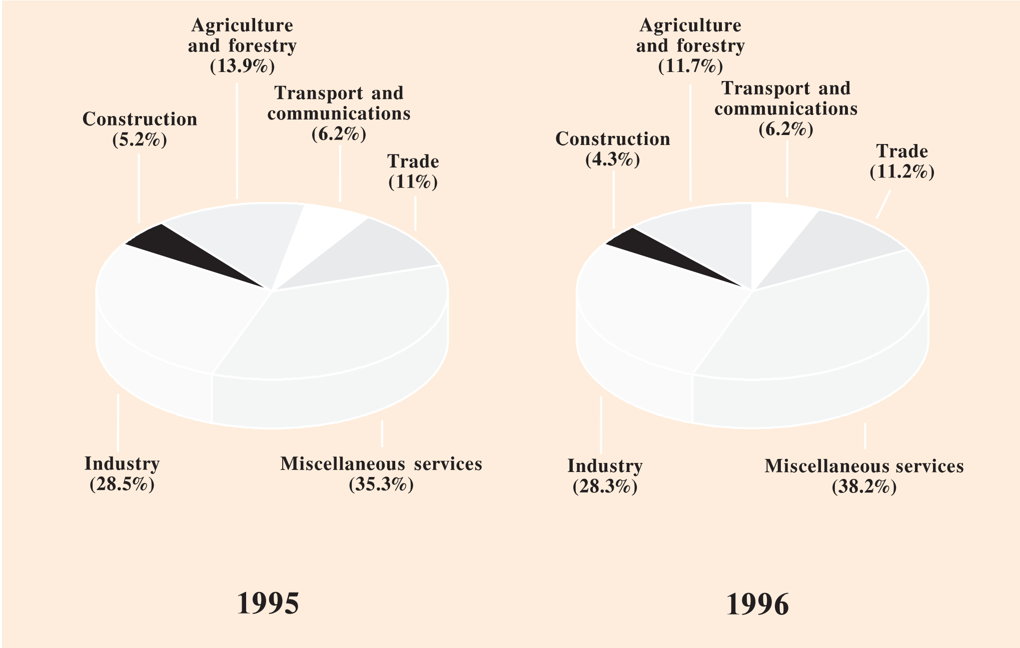
[5] The structure of GDP by economic sector is based on current prices.

[6] The 'Miscellaneous services' sector includes: public utilities, research and development, education, the arts and humanities, healthcare and social security, sports, leisure and tourism, finance, credit and insurance, management.

GDP STRUCTURE BY ECONOMIC SECTOR




Source: NSI, BNB.

**Sectoral Structure of GDP**

For the first time after the start of transition to a market economy the added value in the private sector in 1996 indicated a decrease in gross added value in the economy. Private sector's added value totaled BGL 762 billion at current prices, and its share in gross added value accounted for 47.4%. Added value in services comprised the largest share (about 61%) of private sector total added value. The expansion of the private sector into industry and agriculture is much slower, since these sectors require larger investments in fixed capital than the services sector. This reflects a slow restructuring of ownership in industry and agriculture.

PRIVATE SECTOR SHARE IN GROSS ADDED VALUE

(%)

| Indicators | 1994 | 1995 | 1996* |
|---|---|---|---|
| Private sector – total | 41.6 | 48.3 | 47.4 |
| Agriculture and forestry | 10.2 | 11.1 | 9.2 |
| Industry | 7.1 | 9.4 | 9.2 |
| Services | 24.3 | 27.8 | 29.0 |

* Preliminary data.

Source: NSI.

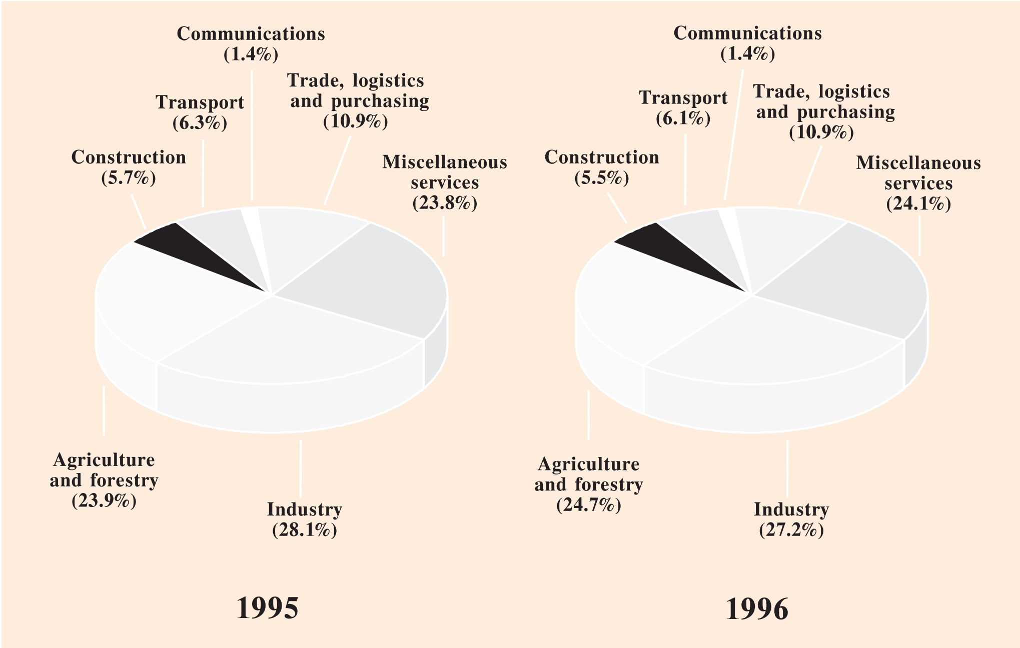
# 2. Employment

Worsened economic conditions in 1996 also affected employment. Slow growth in 1995 employment reflected unstable economic growth during this period. Over 1996, employment began decreasing again. The average annual number of persons employed was 3,279,000[7], a decrease of 2,700 from 1995. Although economic conditions deteriorated in 1996, private sector employment continued to rise reaching 1,378,000, or 3.4% more than the previous year. Despite the complex economic situation, 42% of all employees work in the private sector. Private sector employment growth is entirely at the expense of decreased 1996 public sector employment: a decline of 37% from 1991.

[7] NSI preliminary data.

Based on data about the active population, those employed and the registered unemployed, it may be assumed that between 150,000 and 200,000 persons worked in the 'shadow' economy. Probably the bulk of them work on part-time contracts hired mostly by private entrepreneurs, or on their own account without labor contracts and social security, as a way of ensuring survival.

**STRUCTURE OF EMPLOYMENT BY ECONOMIC SECTOR**




Source: NSI, BNB.

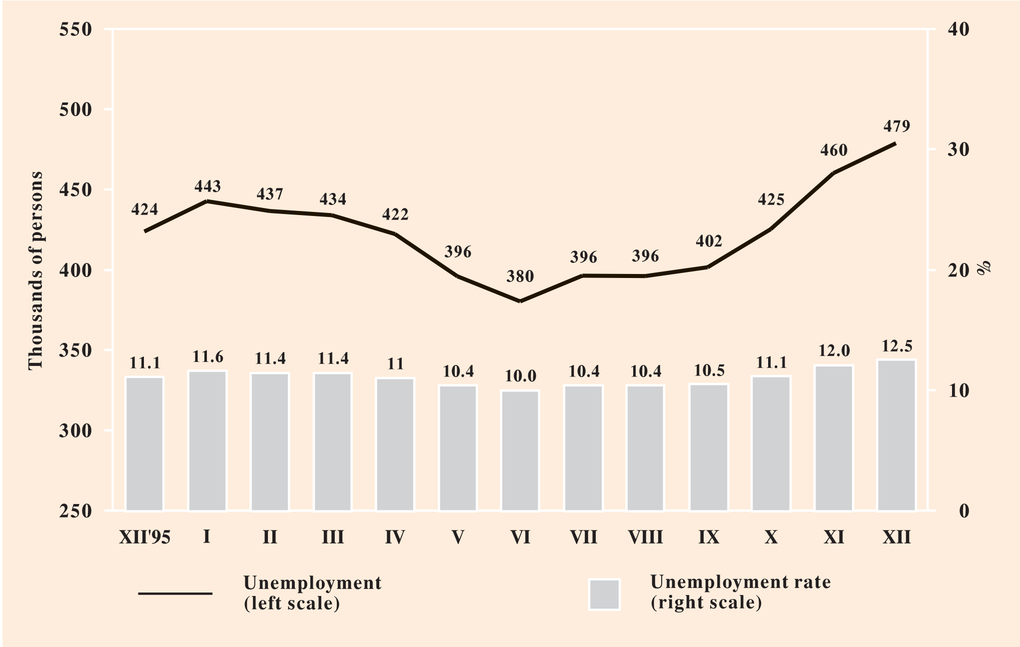
Structurally, employment in industry continued to fall, while the number of employed in services grew. The start of economic reform was accompanied by the initiation of lasting restructuring of jobs with decreasing employment in those industries with lower economic flexibility. Concurrently, some industries displayed faster employment growth. Compared with 1990, the year prior to the start of reform, employment growth was registered in communications (3.6%), agriculture (8.1%), the arts and humanities (16.9%), management (38.3%), and finance, credit and insurance (101.1%). At the other extreme were industries showing a lasting contraction in employment: research and development (-61.3%), construction (-46.3%), industry (-40.4%), transport (-17.3%), healthcare, sports and tourism (-9.6%), and education (-6.3%). Private sector employment in agriculture accounted for the largest number: 678,000 people, or almost 50% of those working in the private sector. Other private sector industries indicating growing employment are: trade and purchasing with 19.4%, industry 11%, and construction with 6.8% of all employed in this sector.

## Unemployment

By the end of 1996, the number of registered unemployed totaled 479,000[8], or 12.5% of the country's labor force. Over one year, the number of jobless increased by 36,000. Economic growth in 1994 and 1995, although unstable, helped hold down the rise of unemployment. The slight increase in unemployment by the end of each of the previous two years might be attributed to seasonal factors, while the reverse of this trend in mid-1996 signaled a new and sustained growth of unemployment consistent with worsening economic conditions in the country. Reasons behind this growth are delayed structural reform and the inefficiency of public sector enterprises.

[8] As per data released by the National Labor Office at the Ministry of Labor and Social Security (MLSS).

**UNEMPLOYMENT IN 1996**




Source: MLSS, BNB.

In structural terms, the trends toward an increase in jobless older people and a decline in unemployed people's professional qualifications intensified. The number of unemployed registering in labor offices twice or more often rose steadily, signaling the formation of a large group of permanently unemployed people. The number of jobless people receiving financial support, compensation or social benefit as persistently unemployed increased compared with early 1996. By the end of the year, 35% of all persons shed were receiving financial support from the Retraining and Unemployment Fund.

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

| Indicators | December 1992 | December 1993 | December 1994 | December 1995 | December 1996 |
|---|---|---|---|---|---|
| Unemployed, number | 576,893 | 626,141 | 488,442 | 423,773 | 478,770 |
| Unemployed receiving compensation, number | 198,510 | 195,422 | 170,784 | 139,309 | 167,756 |
| Share of unemployed receiving compensation, % | 34.4 | 31.2 | 35.0 | 31.4 | 35.0 |
| Compensation and benefit expenditure per one unemployed, BGL | 630 | 1,065 | 1,832 | 2,964 | 5,532 |
| Retraining expenditure per one unemployed, BGL | 6.05 | 7.50 | 15.08 | 22.13 | 35.60 |

Source: MLSS.

# 3. Households' Income and Expenditure

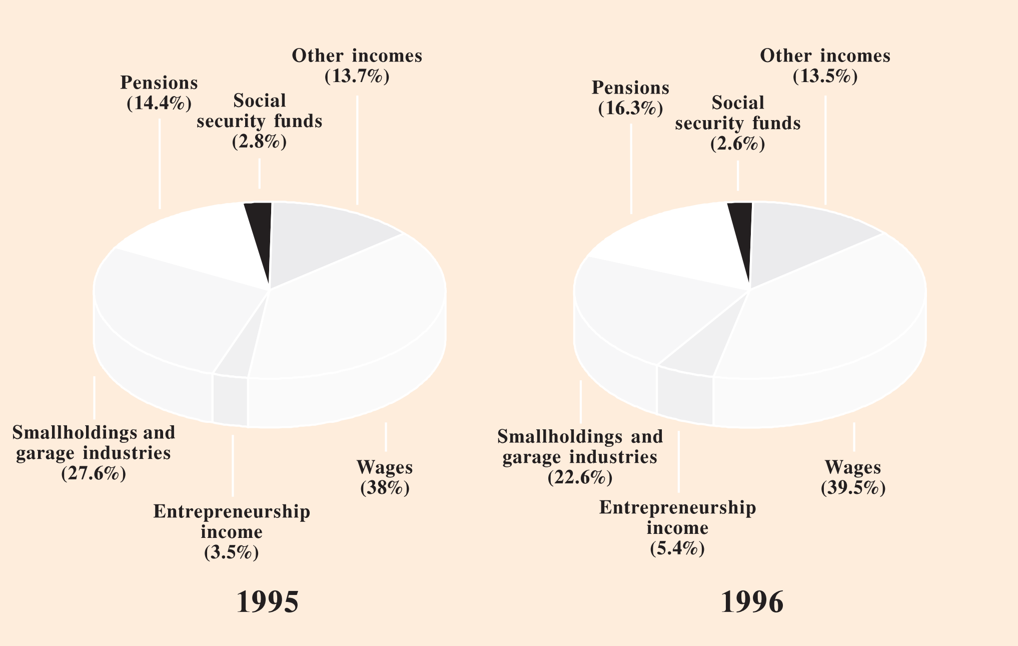
**Income**

During 1996, real public incomes continued to fall. Over the last twelve months, gross income (monetary and natural) rose by 52.8%[9] in nominal terms. However, real income declined by 31.5% due to the faster growth of consumer prices which eroded incomes' purchasing power. The distribution of the public by

[9] Data from NSI monthly household budget surveys.

income groups reveals that by end-1996 only 15.8% of the population received over BGL 5,100 monthly. Wages, pensions, smallholdings and garage industries met 78.4% of the cost of living, accounting for the largest share in 1996 gross income. Slow growth in these incomes underlies the impoverishment of the population. During the period under review, these three income sources lost 28.7%, 22.3% and 51.8% respectively of their real value. For the first time after the launch of reform in 1991, the share of income from smallholdings and garage industries showed a decrease, due mainly to unfavorable weather.

**STRUCTURE OF HOUSEHOLDS' GROSS INCOME**




Source: NSI, BNB.

Despite high 1996 inflation, real incomes from ownership, insurance and entrepreneurship continued growing: up 9.4%, 8.1% and 6.1% respectively. However, they provided a mere 5.6% of the overall public cost of living. Due to serious budget difficulties in 1996, family allowances and social benefits rose more modestly. These payments comprised only 2% of 1996 household incomes.

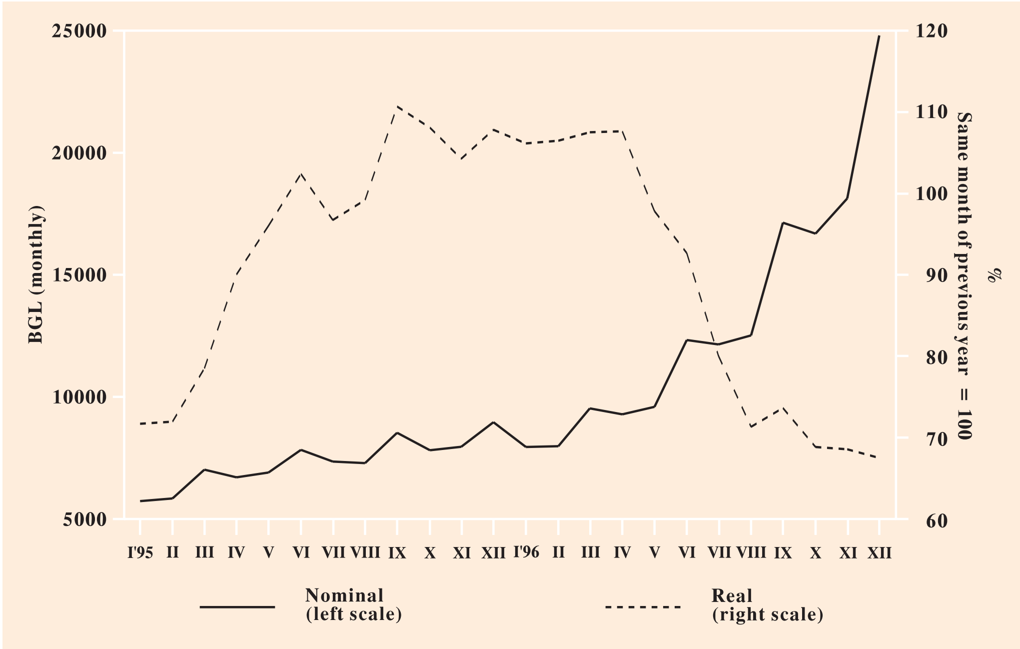
Year-on-year, nominal monetary income of the population grew faster than gross income: up 68.1%. Reduced nonmonetary income share in the cost of living is a positive process in general, but in 1996 it reflected poor agricultural output.

**Wages**

In 1996, wages continued to be the major source of households' monetary funds, irrespective of a three percentage point fall in their share of gross income. Over the period under review, wages provided 52.1% of all monetary incomes of households.

Average monthly pay in the public sector reached BGL 13,269, an increase of 74.7% over 1995. However, the high inflation rate significantly exceeded wage growth; as a result, wages lost 21.7% of their purchasing power in 1996. Since the start of economic reform, wages have lost over four-fifths of their real amount. During the second half of 1996, when inflation rate levels persistently surpassed the double-digit limit, the cost of living could barely be covered by wages; this was the major factor behind reduced household savings.

**AVERAGE WAGE IN THE PUBLIC SECTOR**




Source: NSI, BNB.

**Pensions**

The National Insurance Institute (which in 1996 took the place of the Social Security Fund) paid BGL 121.2 billion in pensions, a 73.1% increase compared with 1995. In 1996, pensioners numbered 2,381,000, down 28,000 from the previous year. Nevertheless, the ratio of employed to pensioners (1.37:1) remained far removed from standards underwriting the normal operation of a social security system. The legislative detachment of the National Insurance Institute from the budget failed to resolve the major problem: provision of sufficient funds for the indexation of pensions which lost much of their purchasing power in the transition period.

In 1996, monthly pension averaged BGL 4,145, up 75% from 1995. But high inflation eroded its real amount by 21.5%, and by the end of 1996 its purchasing power had almost halved relative to December 1995. Given the loss of purchasing power cumulative since 1991, pensioners proved to be one of the fastest impoverishing social groups.

**Expenditure**

1996 gross households' expenditure grew by 73.1%. In real terms, it declined by 22.4% compared with the previous year. Changes in the structure of gross expenditure directly reflect the impoverishment of the population. During the period under review, the shares of food, household energy, and transport and communications increased in gross expenditure. Each of these three items has low elasticity in respect of household income which explains their stronger nominal increase. All other expenditure groups indicated a significant real decline. Spending on education and leisure, furniture, clothing and footwear, losing more than a third of its share, accounted for the strongest decrease.

Changes in the structure of households' monetary expenditure, comprising 89.6% of gross expenditure, indicated analogical trends. Monetary expenditure growth was just three percentage points higher than total expenditure. More than 43% of household monetary expenditures was on food. Over 1996, the share of monetary expenditure on energy, transport and communications grew steadily, by 7.4% and 8.4% respectively.

**STRUCTURE OF HOUSEHOLDS' GROSS EXPENDITURE**

(%)

| Indicators | 1994 | 1995 | 1996 |
|---|---|---|---|
| Gross expenditure | 100.0 | 100.0 | 100.0 |
| Food | 45.0 | 46.3 | 48.2 |
| Drink | 2.0 | 1.8 | 1.8 |
| Tobacco products | 2.4 | 2.2 | 2.1 |
| Housing | 4.2 | 3.7 | 3.4 |
| Household energy | 4.3 | 4.5 | 6.7 |
| Home furniture | 4.6 | 4.3 | 3.5 |
| Clothing, footwear and haberdashery | 7.4 | 7.8 | 6.5 |
| Hygiene and healthcare | 3.2 | 3.7 | 3.6 |
| Education and leisure | 3.0 | 3.1 | 2.5 |
| Transport and communications | 8.0 | 7.1 | 7.6 |
| Smallholdings and garage industries | 4.6 | 4.0 | 3.7 |
| Other expenditures | 11.6 | 11.4 | 10.4 |

Source: NSI.

# 4. Prices

After the first quarter of 1996, the economy experienced serious inflationary pressure, similar to that experienced after initial price liberalization in 1991. The major reason behind this was the delay in structural changes in production and employment which caused bottlenecks in the economy. Such external factors as draining foreign exchange from the banking system by the end of 1995 and early 1996 added to this effect, resulting in dramatic and unexpected exchange rate fluctuations which, in turn, further intensified the problems of the financial system.

The country's economic policy failed to react adequately and on time to changes in the macroeconomic environment which further enhanced inflationary expectations by the end of the first quarter. In early 1996, the government continued to postpone price liberalization of some especially important commodities (fuels, energy), transport and communications services, as well as the prices of staple goods. This intensified distortions in the structure of relative prices and only postponed the moment when economic agents would recognize these distortions. Central bank attempts to smooth exchange rate fluctuations, mostly by interventions in the forex market and increases in the basic interest rate, had proved ineffective by end-April 1996.

Radical measures in BNB monetary policy aimed at curbing inflationary expectations in May 1996 were not supported by government with rapid structural changes in the real economy and banking system. As a result, short-term monetary policy goals relating to the exchange rate, an indicator of key importance for the inflation rate and inflationary expectations, were not achieved. Government attempts to achieve results solely by shock rises in the prices of goods and services of universal use (power, heating, fuel, telecommunications) led to a dramatic real reduction of final consumer demand, failing to overcome distortions in relative prices.

During the second half of 1996, inflation in the country displayed the main signs of cost-push inflation which increased market volatility, while distortions in relative prices were unaffected. This explains the lack of any significant change in the behavior of producers of goods and services.

**Consumer Prices**[10]

By December 1996, the price of the consumer basket rose by 310.8% compared to December 1995. This was the highest increase in consumer prices since the 1991 price liberalization. Inflation in 1996 outstripped its value for the previous year

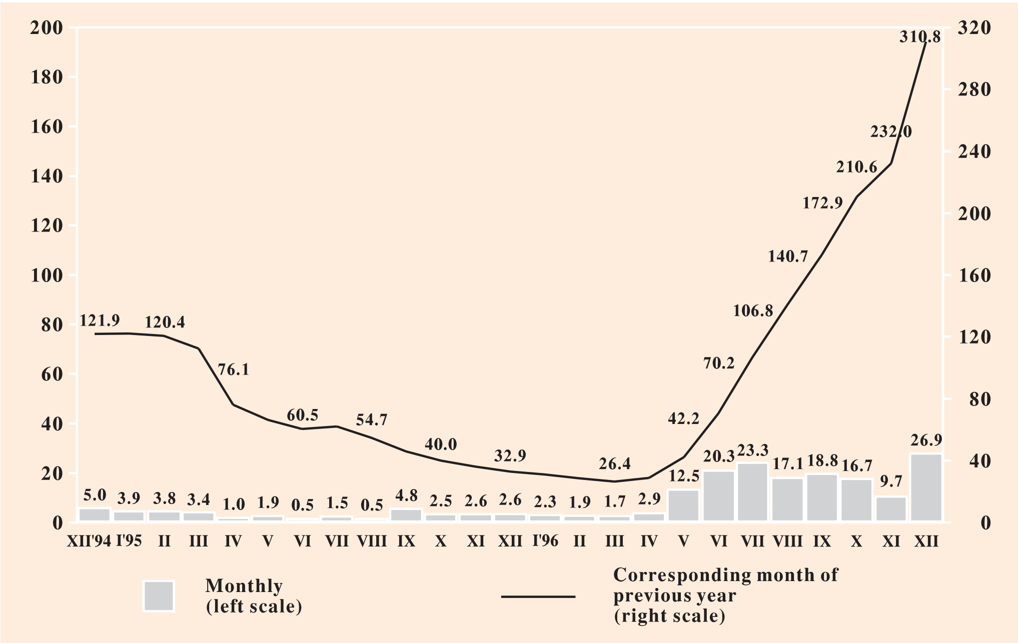
[10] In 1996, the NSI continued calculating the consumer price index using the methods adopted in early 1993. Some insignificant changes in the structure of the consumer basket were made, reflecting the need to make it consistent with the quality of the various consumer goods offered in the domestic market. Weights were also updated on the basis of household budget expenditures in 1995 instead of those of 1992.

almost tenfold. Month-by-month rises in the general consumer price index throughout the year increased as well. The highest monthly growth in consumer prices, 26.9%, occurred in December; March witnessed a monthly low of 1.7%. Consumer price dynamics differed significantly from those reported in previous years. Since seasonal factors did not play a role, developments in consumer prices related primarily to the dramatic lev devaluation, price policy inconsistency, and strong, though unstable, inflationary expectations in economic agents' behavior.

Food prices rose by 306.6%, nonfood prices 327% and services 306.7% compared with end-1995. This behavior of group price indices is typical of periods when government relies heavily on price regulation. Nonfood prices rose most significantly; since imported goods have a large share in this group, nonfood price dynamics was extremely sensitive to the depreciation of the national currency[11]. Developments in food prices in 1996 nearly mirrored those in the general consumer price index. This suggests that price disproportions accumulated in the past have not been overcome yet. Government efforts to slow price rises in foodstuffs through more comprehensive price regulation proved ineffective, which additionally impeded the process of price adjustment and contributed to the expectations of higher inflation. In contrast to the previous two years, 1996 price indices of services almost matched developments in the general consumer price index. This signals a certain automation in price adjustment in 1996, which occurred even in prices traditionally out of step with the general trend.

**CONSUMER PRICE GROWTH**

(%)




Source: NSI, BNB.

Dramatically narrowed fluctuations of group indices around the general consumer price index in 1996 relative to previous years support the definition of Bulgarian inflation as cost-push inflation. Relatively stronger deviation of the nonfood price index (where imported goods comprised the largest share) from the general price index, atypical of the previous years, reveals the important role of lev devaluation as a generator of inflationary expectations and catalyzer of inflation. Consequently, special attention should be paid to measures aimed at curbing exchange rate fluctuation and restructuring economic agents' expenditures in the new stabilization program.

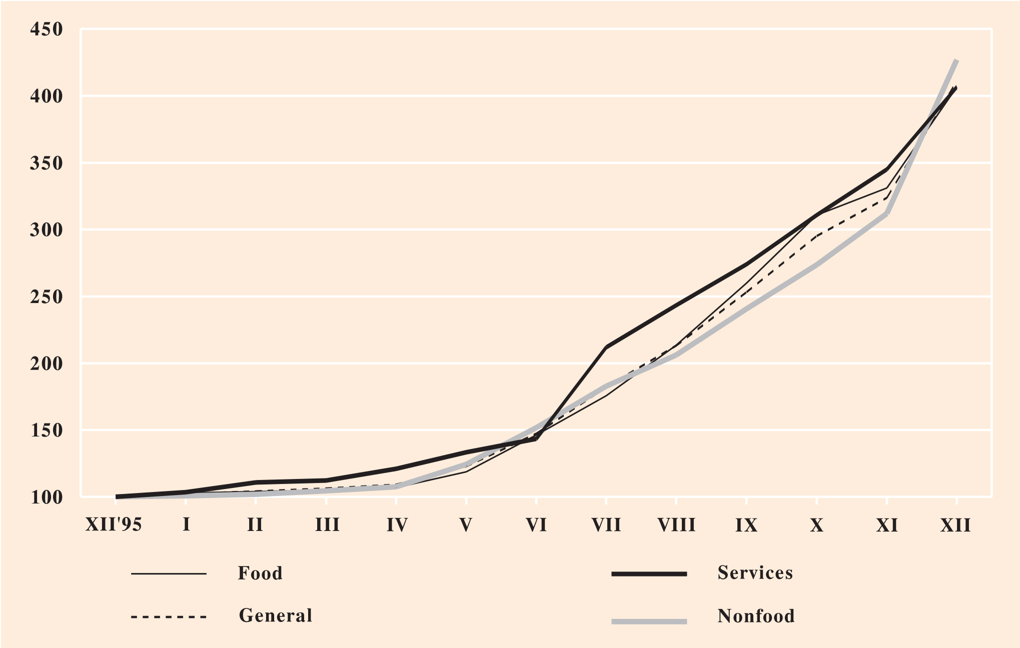
[11] Among nonfoods the number of 'tradable goods' is the largest.

**DEVIATION OF GROUP INDICES FROM GENERAL CONSUMER PRICE INDEX**

| Index | 1994 | 1995 | 1996 |
|---|---|---|---|
| Food | 17.6 | -9.3 | -4.2 |
| Nonfood | -3.9 | 3.5 | 16.2 |
| Services | -61.3 | 24.2 | -4.1 |
| Average deviation | 27.6 | 12.3 | 8.2 |
| Coefficient of variation, % | 35.6 | 25.2 | 5.0 |

Source: NSI, BNB.

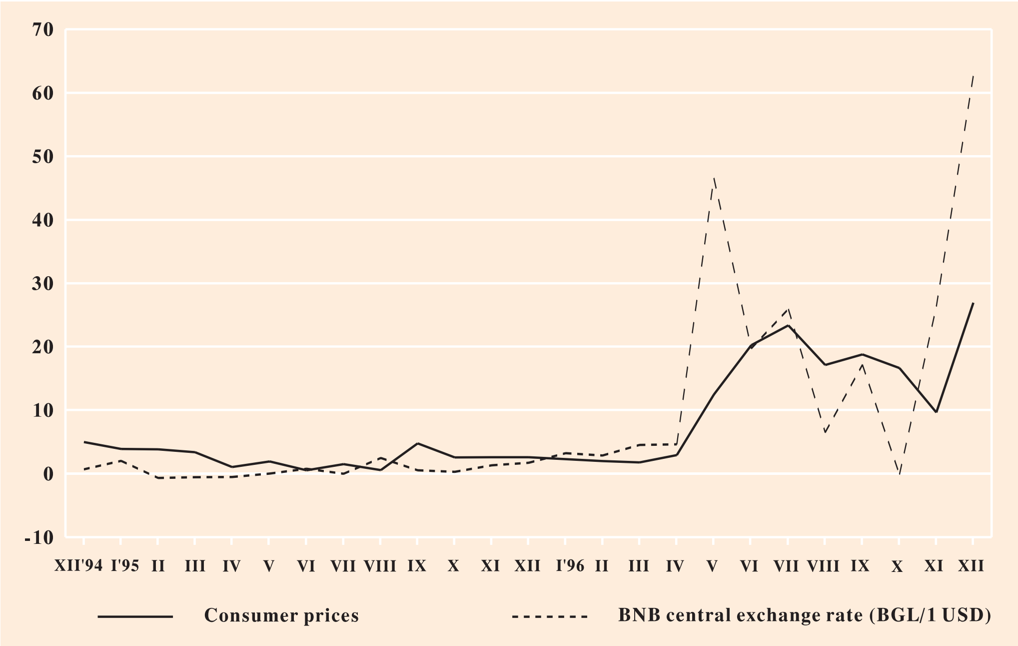
**CONSUMER PRICE INDICES IN 1996**
**(December 1995 = 100)**




Source: NSI, BNB.

**MONTHLY FLUCTUATIONS IN CONSUMER PRICES AND BNB CENTRAL EXCHANGE RATE**

(%)



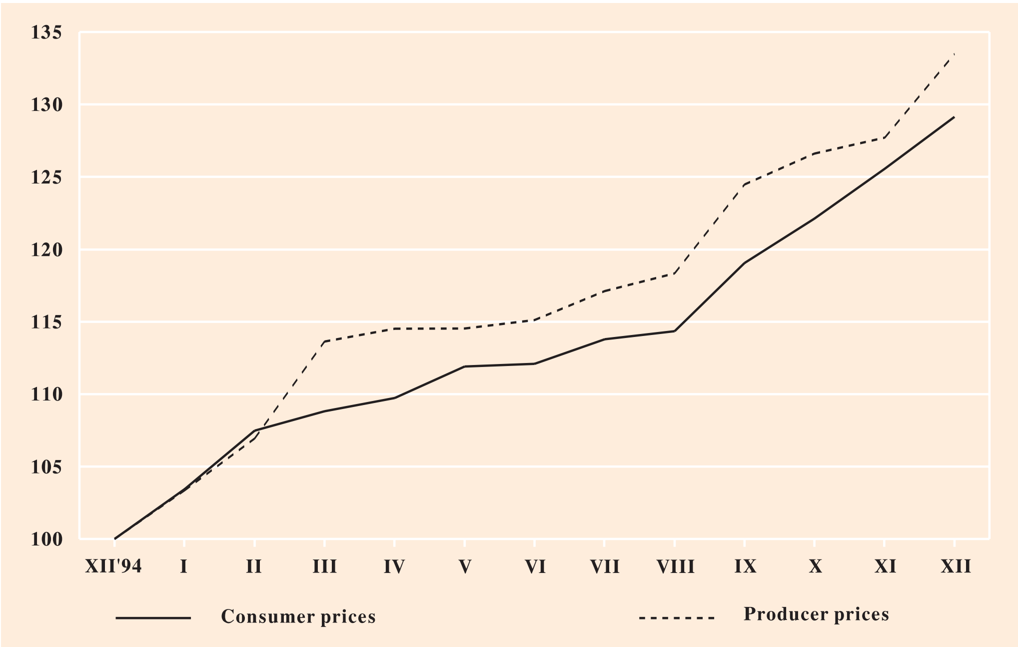

Source: NSI, BNB.

**Producer Prices**[12]

In 1996, monthly industrial producer price indices approached the level of consumer price indices[13] as they had in the previous year, and in individual months even surpassed them. Between December 1995 and December 1996, industrial producer price indices increased by 356.7%, exceeding consumer price growth by about 46 percentage points. The faster growth of producer prices relative to consumer prices is atypical of previous years and indirectly supports the definition of Bulgarian 1996 inflation as cost-push inflation. Movements in the exchange rate were the major factor responsible for developments in industrial producer prices. Depreciation of the lev contributed not only to a short-term rise in the competitiveness of domestic output and higher lev-denominated export earnings due to higher prices of imported raw materials, but also to an increase in producer prices. The government's active policy on regulated prices also contributed to considerable producer price fluctuations.

Various producer price indices moved close to the average producer price index in almost all months of the year, but stayed high in 1996. Significant departures in the monthly producer price indices of various industrial branches from the overall index suggest the following: on the one hand, industrial companies have not established permanent foreign trade relations and foreign exchange movements may lead only to a temporary rise in competitiveness in the international markets; on the other hand, industrial companies rely to a great extent on imported materials. The specifics of the Paasche index also contributed to the dramatic fluctuations of producer price indices in various industry branches, since they reflect fluctuations in output.

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

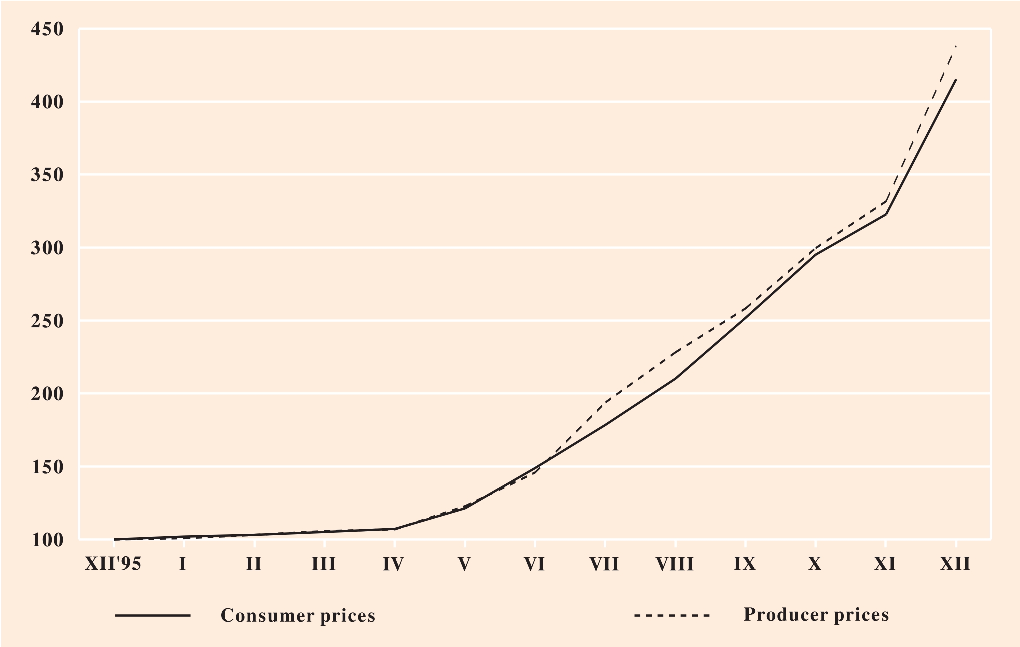



Source: NSI, BNB.

[12] During 1996, the NSI did not change the methods of calculation of industrial output producer price indices. This index is a narrow and not very reliable source of information on processes in the real sector.

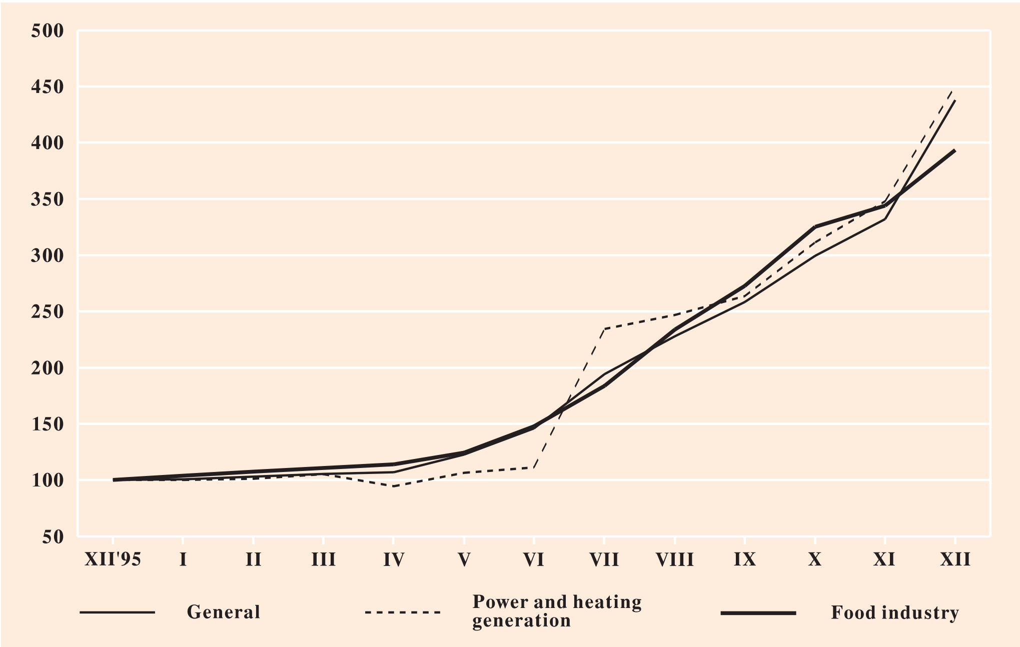
[13] It should be noted that commodity industrial output producer price indices do not reflect changes in production services prices. Comparing, though conditionally, commodity industrial output producer price indices with consumer price indices is relevant, since the latter are determined to a large extent by price indices of goods in the consumer basket.

**INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES AND INDICES OF CONSUMER PRICES IN 1996**
**(December 1995=100)**




Source: NSI, BNB.

**INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES IN 1996**




Source: NSI, BNB.

Seven industrial branches increased prices by more than the index of average producer prices. The highest increases were in printing and publishing and chemicals and oil-processing. Due to the government's active price policy and an increase in regulated prices, producer prices in power and heating generation, and coal mining increased faster than the average producer price index in the second half of 1996. By the end of the year, these indices again surpassed the general producer price index.

# 5. Foreign Trade

Bulgaria's foreign trade in 1996 was affected by both internal and external economic shocks: lower external demand, financial instability in the country, and dramatically reduced supply (attributable both to the start of restructuring in the real sector and the poor 1996 agricultural crop). These are the major factors prompting the change in foreign trade from 1995. Foreign trade turnover[14] declined by 12%, against a 39.4% growth in 1995 (partly due to the underestimated US dollar against other benchmark currencies). However, the share of foreign trade turnover in GDP continued to rise, indicating the open nature of Bulgaria's economy.

**FOREIGN TRADE SHARE IN GDP**

(%)

| Indicators | 1993 | 1994 | 1995 | 1996* |
|---|---|---|---|---|
| Exports (FOB) | 34.3 | 39.4 | 41.1 | 48.5 |
| Imports (CIF) | 43.5 | 42.7 | 43.4 | 50.7 |
| Turnover | 77.8 | 82.1 | 84.5 | 99.2 |

* The 1996 data is preliminary.

## Major Factors in Foreign Trade

**Exports**

1996 exports totaled USD 4,723.8 million, down 11.6% from 1995. Reduced trade, particularly exports, put the Bulgarian economy into an extremely difficult position. Revenues from exports of goods and services are used to cover import costs, make regular foreign debt repayments and replenish forex reserves. The reduction in exports is mainly attributable to the following:

**Weaker external demand.** EU countries occupy a significant share in the geographic structure of Bulgarian exports (38%); exports are strongly dependent on demand fluctuation in this region. Estimated GDP growth in the EU for 1996 is about 1.6%[15] against 2.5% in 1995. Slower growth rates in EU countries resulted in a lower demand for Bulgarian goods, prompting a decline in exports to the EU of important commodity groups: base metals and their products (a decrease of USD 128.7 million: 24.4%) and chemical products (a decrease of USD 51.6 million: 15.5%). Imports growth in Germany (Bulgaria's major trading partner within the EU) was just 1.8% against a 1995 growth of 6.4%. This led to an 8.3% decline in exports to Germany.

**Reduced prices of goods with low elasticity of demand.** In 1996 the supply of goods which need less reprocessing (particularly steel, including that from former Soviet republics) increased while demand for these goods lessened. This caused a reaction among European producers for the introduction of protection measures. Major Bulgarian makers had to reduce production and exports to the EU to avoid imposition of antidumping duties. The downward trend in prices will be sustained, at least in the short run, mainly because supply exceeds demand[16].

**Domestic factors.** NSI preliminary data indicates a decline in output, including that of products with a traditionally high share in exports (ferrous metallurgy: 19.6%; oil-processing: 11.1%; textile and sewing industry: 6.3%; foods: 7.5%)[17]. Factors behind this are:

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[14] According to preliminary customs data (MF Computing Center and Customs Head Office). Exports are reported at FOB prices and imports at CIF prices.
[15] Source: OECD Economic Outlook, December, p. A4.
[16] In dollar terms Bulgarian exports of ferrous metals will also be reduced in the first quarter of 1997 because of the US dollar rally against other benchmark currencies. Over that period the Deutschemark and the Swiss franc devalued against the US dollar by 7.7% and 9.5% respectively.
[17] Based on NSI data for the nine months of 1996 against the same period in 1995.

*Decreased credit supply to the real sector and high nominal interest rates.* Bulgaria's economy is heavily dependent on bank lending, current financing included. Credit indebtedness of nonfinancial (state-owned and private) enterprises contracted significantly in real terms in 1996 compared with December 1995: 71.6% in levs and 17.4% in foreign exchange. Intercorporate indebtedness declined 27.8% in real terms.

*Initiation of structural change in the financial and real sectors:* bank bankruptcies; liquidation of some loss-making enterprises; financial isolation of enterprises in financial difficulty; mass privatization.

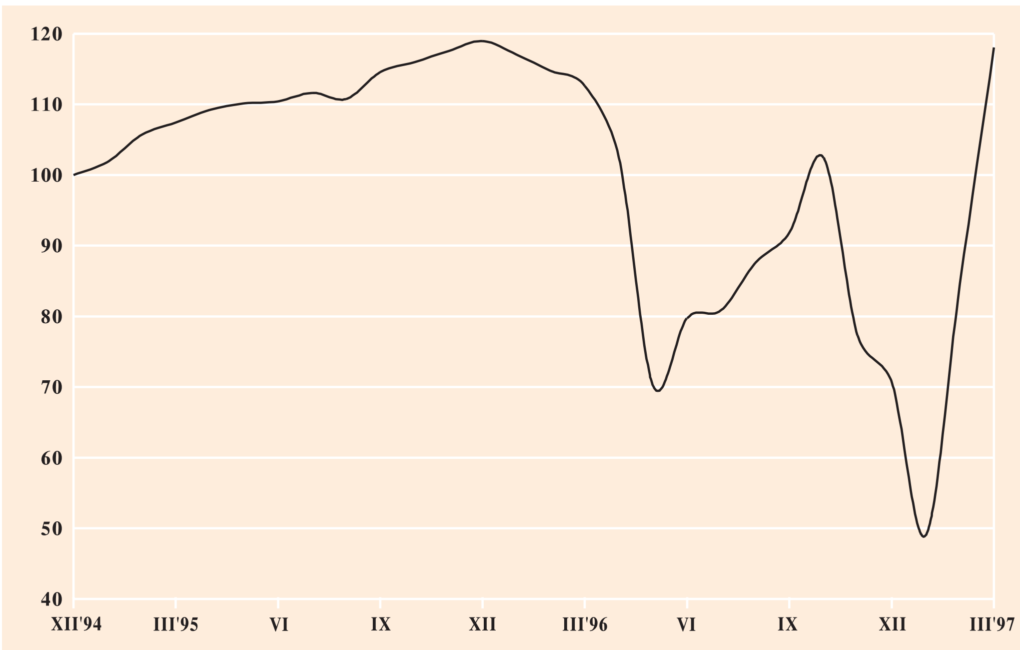
Until 1995 enterprises' energy costs were subsidized through prices. Comparatively *rapid adjustments of energy prices* in 1996 had an adverse impact on energy-intensive production.

**Export Competitiveness**

*Real exchange rate.* The real appreciation of the lev against convertible currencies in 1995 was one of the factors contributing to its nominal and real devaluation in early 1996.

In 1996 the lev devalued 572.5% in nominal terms against benchmark currencies but just 40.6% in real terms. Quarterly developments in exports reflected movements in the real exchange rate and expectations of its nominal depreciation. The greatest decline in exports occurred in the first and third quarters when the lev was most significantly overvalued. The direct relationship between inflation and the nominal exchange rate rise suggests that the sharp nominal lev devaluation in combination with other factors (for example, contraction of credit in real terms) contributed to a great extent to the decline in output and exports. The sharp devaluation of the lev resulted in higher producer costs for imported raw materials which account for 61.2% of export-oriented production. Therefore under these conditions, devaluation of the national currency should not be regarded as a factor boosting export competitiveness.

**REAL EXCHANGE RATE INDEX**




* The index of the real effective exchange rate is calculated using a basket of three currencies, distributed as follows: USD – 75%, DEM – 20%, CHF – 5%, based on the consumer price index. Values below 100 indicate a real lev devaluation.
Source: BNB, NSI, International Financial Statistics.

*Wage costs per unit of output.* In 1996 wage costs per unit of output declined significantly in real terms and in the fourth quarter stood at 14.2% of their end-1994 level. However, Bulgarian exporters could not take advantage of this because wage costs account for a small share and changes in them have an insignificant impact on competitiveness. Therefore improved competitiveness would require more extensive employment of other factors (reduced inputs, improved technological level and higher labor productivity).

**Imports**[18]

1996 imports (CIF) totaled USD 4,939.6 million, a decline of 12.4% on 1995. A major factor contributing to reduced imports was the sharp devaluation of the lev. Imports of consumer and investment goods and raw materials followed movements in the real exchange rate and only in the first quarter of 1996 was the volume of imports higher than recorded in the same quarter of 1995. During this period the lev was still overvalued and expectations of its significant depreciation were high. Thus importers moved rapidly to bring forward deliveries of imported goods.

The combined effect of cost-cutting policies (reduced government spending and decreased lending in real terms) and cost-allocation policies implemented through devaluation of the lev had a different impact on imports of individual commodity groups depending on their use.

Imports of investment goods and raw materials fell 24% compared with 1995. This was prompted to a great extent by the lack of credit resources which enterprises badly needed given the nominal devaluation of the lev. Reduced subsidies to the public sector coupled with ongoing administrative regulation of some end-products' domestic prices additionally limited the scope of enterprises to provide imports both for innovation and to maintain current production. Imports of raw materials fell 21.7% compared with 1995. The high share of raw material imports in total imports (35%) and their dramatic fall can be credited with contributing, to a great extent, to the decline in gross domestic product and exports in 1996.

**IMPORTS IN 1995 AND 1996**

| Commodity groups | 1995 | | 1996 | | Change on previous year | |
|---|---|---|---|---|---|---|
| | million USD | relative share (%) | million USD | relative share (%) | million USD | (%) |
| Consumer goods | 709.4 | 12.6 | 506.1 | 10.2 | -203.4 | -28.7 |
| Raw and other materials | 2,196.3 | 39.0 | 1,729.4 | 35.0 | -467.0 | -21.3 |
| Investment goods | 1,111.3 | 19.7 | 845.0 | 17.1 | -266.3 | -24.0 |
| Energy resources | 1,622.4 | 28.8 | 1,859.1 | 37.6 | 236.8 | 14.6 |
| Imports, total (CIF) | 5,638.0 | | 4,939.6 | | -698.4 | -12.4 |

Sources: NSI (final data for 1995), MF Computing Center and Customs Head Office (preliminary data for 1996).

The largest decline occurred in consumer good imports (down 28.7% from 1995). High inflation, minimal wage compensation in the state sector, liquidation of enterprises and higher unemployment prompted a considerable fall in households' real incomes and consumption was limited mostly to industrial consumer goods. The real lev devaluation also contributed to a shift in demand from imported to domestic consumer goods.

In 1996 only imports of energy resources increased, by 14.6%. Imports of energy commodities displayed a typically seasonal dynamic and due to the low elasticity of demand for these goods they were less affected by the lev devaluation and the lack of financial resources than other commodity groups.

Additional reasons for lower import demand, particularly in the third quarter, were the introduction of 5% temporary import surcharges between 4 June 1996 and 1 July 1997 on the customs taxable value of all commodities except some primary raw materials (crude oil, natural gas, electricity, coal, nuclear fuel, etc.) and the rise in the rate of value added tax from 18% to 22% on 1 July 1996[19].

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[18] For clearer presentation of the analysis, imports are structured in the following commodity groups: consumer goods, investment goods, raw and other materials, and energy resources. Classification criteria are based on the use of goods and factors determining imports of these groups.

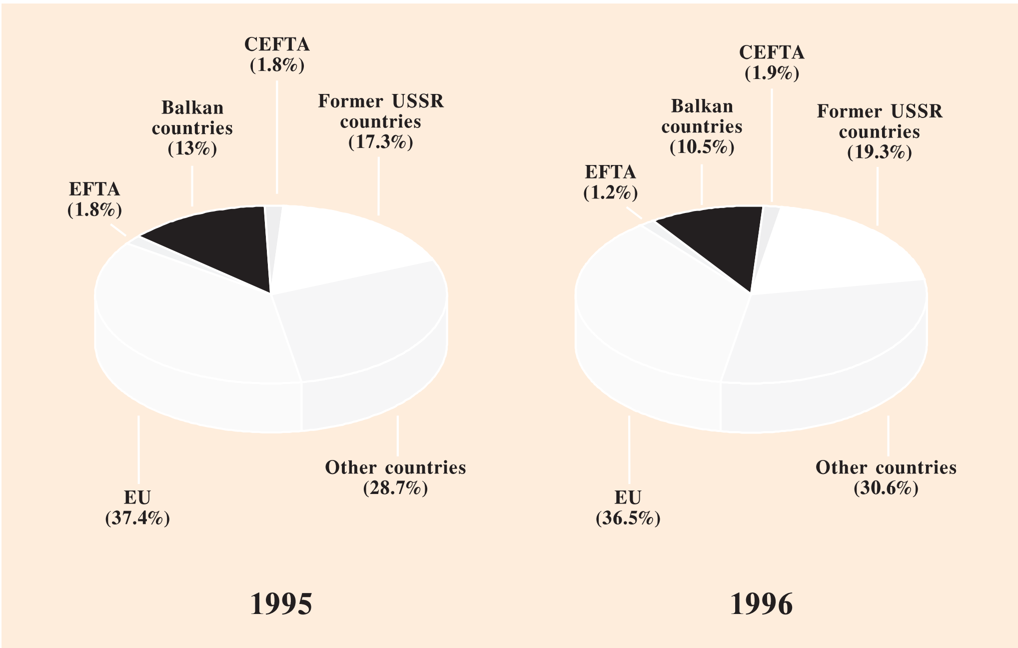
[19] The introduction of these fiscal measures had a dual effect since the reduced demand for imported goods provided stimuli to importers to undervalue the real value of imports.

## Geographic Structure of Exports and Imports

The EU countries continued to be the most significant consumers of Bulgarian goods. In 1996 36.5% of total exports went to these countries. However, export volumes to the EU decreased 13.7%. Exports to the Balkan countries declined significantly (28.3%) mainly due to dramatically reduced exports to Macedonia (a fall by USD 293.1 million, or 67.2%). The share of Balkan countries in the geographic structure also fell: from 13% to 10.5%. At the same time exports to Yugoslavia increased by USD 140.9 million (164.8%); however, this was not enough to offset dramatically reduced exports to Macedonia. Compared with 1995, exports to Central European Free Trade Association countries[20] declined 7.6%, but their share in total exports remained stable (about 1.9%). The share of exports to former Soviet republics increased to 19.3%.

The share of imports from EU countries fell 2.8 percentage points to 31.3%, whereas in terms of value imports from these countries declined 23.9%. Compared with 1995, imports from the former Soviet republics decreased by 16.7%, and by 11.5% from Russia alone due to reduced imports of crude oil. However, the share of these countries in the geographic structure rose to 36.1% and Russia's alone was 32.5%.

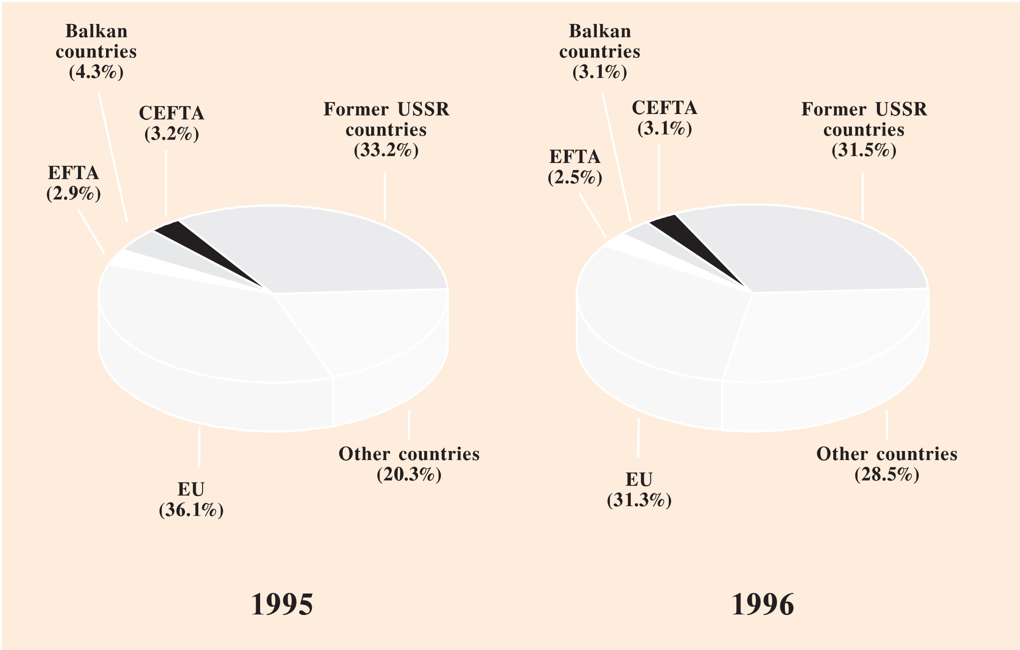
**GEOGRAPHIC STRUCTURE OF EXPORTS**




Source: NSI, BNB.

[20] Probably one reason for the slower growth rate of exports to these countries is related to the fact that there are still no agreements on more favorable trade terms with Poland and Hungary.

**GEOGRAPHIC STRUCTURE OF IMPORTS**

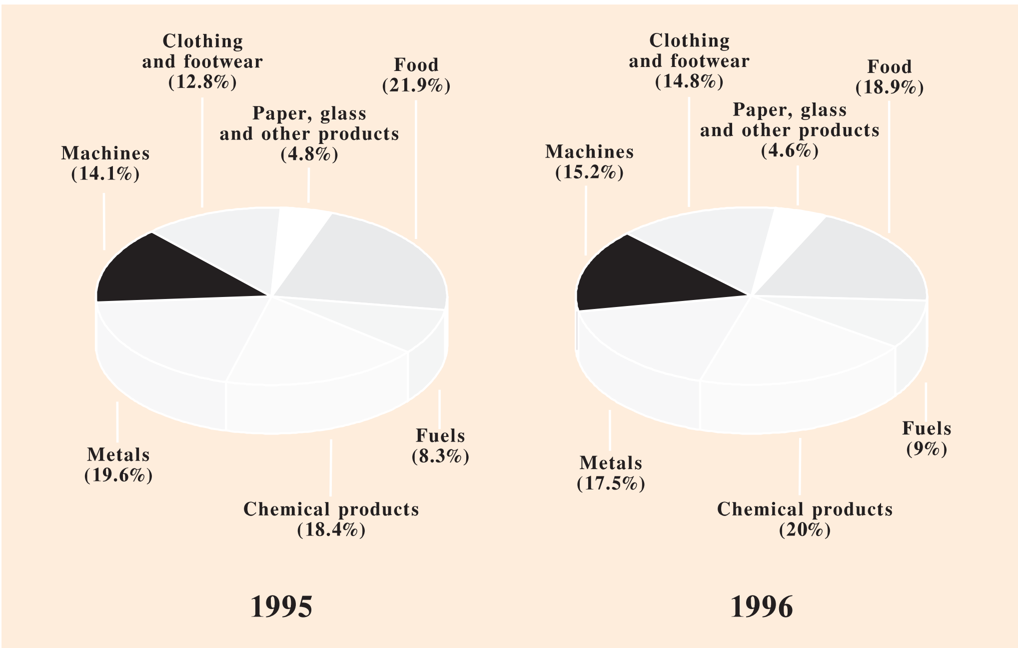



Source: NSI, BNB.

## Commodity Structure of Exports and Imports[21]

In 1996 no significant changes occurred in the commodity structure of exports and imports since the decline in foreign trade had an almost equal impact on aggregate commodity groups.

**COMMODITY STRUCTURE OF EXPORTS**



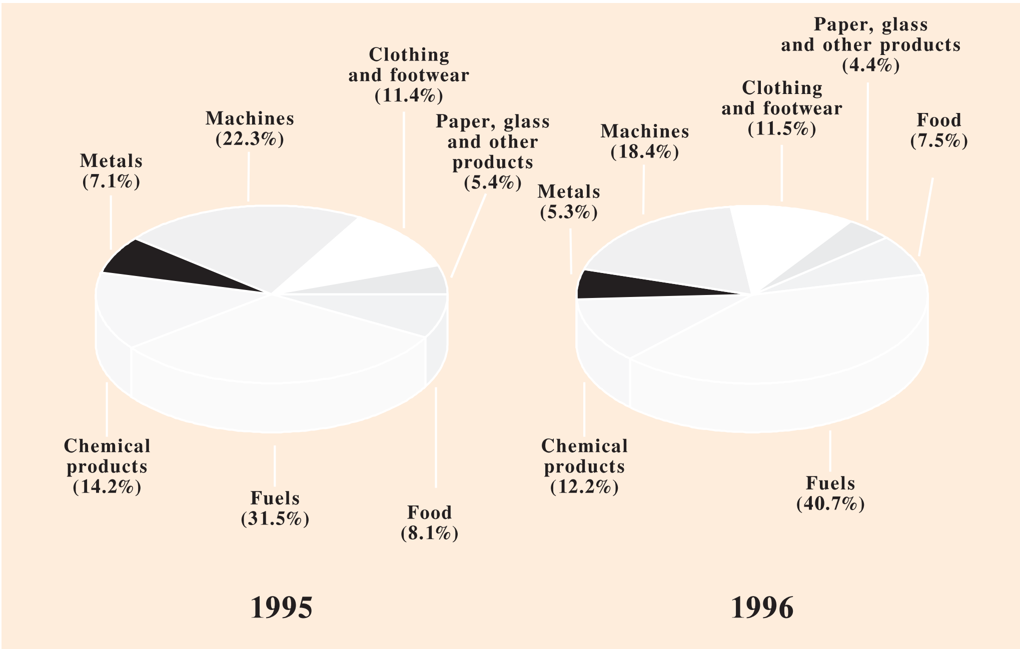

Source: NSI, BNB.

[21] Ministry of Trade and International Economic Cooperation classification is used, which reduces the 21 sections of the Republic of Bulgaria Customs Tariff (based on the Harmonized System of Goods Description and Coding) to seven enlarged commodity groups.

The greatest drop in exports occurred within the following commodity groups: cast-iron, iron and steel (38%) within the base metals aggregate group; organic chemical products (26%) within the chemical products aggregate group; tobacco and processed substitutes (20%) within the animal products, food, drink and tobacco aggregate group. Commodity groups with the biggest increase in exports are: fertilizers (5.9%, due to enhanced EU demand seeking higher yields after the poor 1995 crop), tanning and dye extracts (17.6%) within the chemical products aggregate group, and in the textile, leather, clothing, footwear, et alia aggregate group (2%).

The greatest import drop was in the aggregate commodity groups of machines (27.8%), chemical products (24.9%), and base metals (34.9%). The share of the mineral products and fuels aggregate group increased (13.1%) mainly due to growth in imports in the mineral fuels and oils group (14.6%) and the cereals group (1,092.5%) within the animal and vegetable products, food, drink and tobacco aggregate group.

**COMMODITY STRUCTURE OF IMPORTS**




Source: NSI, BNB.

# 6. Balance of Payments

**Current Account**

The balance of payments current account ended 1996 in deficit (USD -22.3 million). Compared with 1995, it improved by USD 3.3 million. The current account balance retains its 1995 ratio to GDP (-0.2%).

**MAJOR CURRENT ACCOUNT COMPONENTS**

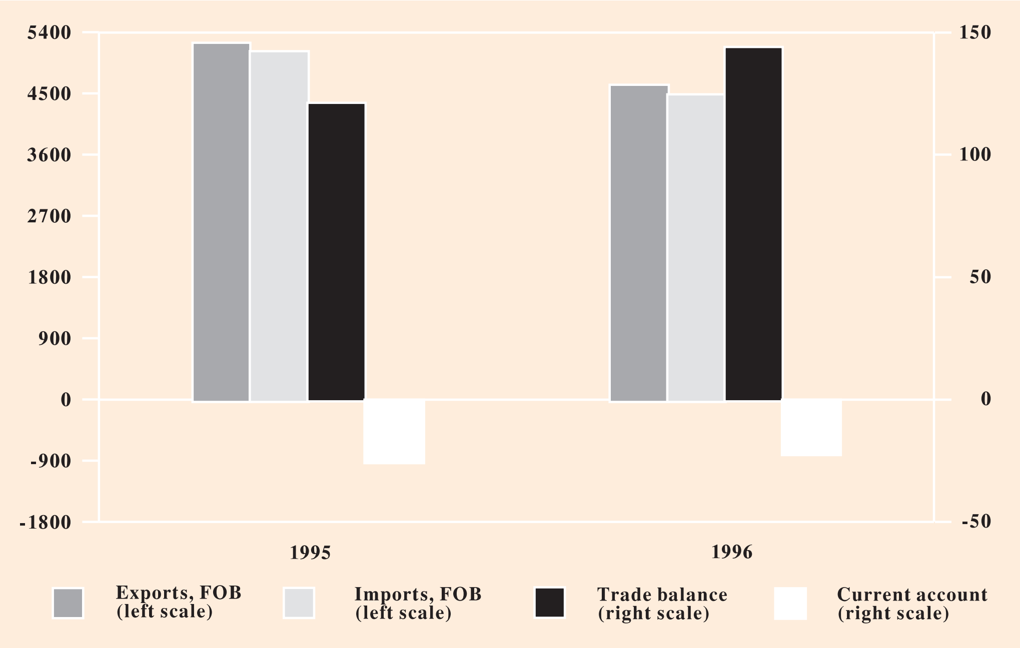
(million USD)

| Indicators | 1995 | 1996* |
|---|---|---|
| Current account | -25.6 | -22.3 |
| Trade balance | 121.0 | 144.3 |
| Exports (FOB) | 5,345.0 | 4,723.8 |
| Imports (FOB) | -5,224.0 | -4,579.5 |
| Transportation, net | -37.3 | -43.8 |
| Travel, net | 277.8 | 190.1 |
| Drawings | 472.9 | 388.5 |
| Repayments | -195.1 | -198.4 |
| Other services, net | -87.1 | -22.5 |
| Income, net | -432.0 | -394.9 |
| Drawings | 149.8 | 181.0 |
| Repayments | -581.8 | -575.8 |
| Current transfers, net | 132.0 | 104.4 |

* Preliminary data.

**CURRENT ACCOUNT AND TRADE BALANCE**

(million USD)




Source: BNB.

1996 trade balance ran a surplus of USD 144.3 million (1.5% of GDP). According to preliminary data, exports (FOB) totaled USD 4,723.8 million and imports (FOB) USD 4,579.5 million. Compared with 1995, exports declined by USD 621.2 million (11.6%) and imports by USD 644.5 million (12.3%). The trade balance improved by USD 23.3 million.

The balance on services also ended in surplus, USD 123.8 million (but it declined from 1995, when the surplus was USD 153.4 million). The major factor behind this surplus is the positive balance on travel (USD 190.1 million). Nevertheless, the downward trend in travel revenues, evolving since 1994, continued in 1996 with a decrease of USD 84.4 million from 1995.

The balance on transportation services (USD -43.8 million) deteriorated by USD 6.5 million compared with 1995. Revenues from transportation decreased by USD 63 million mainly due to reduced exports and smaller revenues from passenger transport. Transportation expenditure declined by USD 56.5 million mainly due to decreased freight transport expenditure reflecting reduced imports.

The negative balance on the Income item[22] (USD -394.9 million) primarily reflects the substantial amount of interest payments on the country's foreign debt service and the reduced amount of interest received due to a decrease in BNB forex reserves and commercial banks' foreign currency deposits since the beginning of 1996. This was the major factor contributing to the current account deficit.

Revenues from interest[23] totaled USD 139.6 million in 1996 against USD 149.8 million in 1995. During the reporting period interest received by the BNB totaled USD 34.7 million, a decrease of USD 43.3 million compared with 1995 due to a dramatic reduction in forex reserves. Interest received by commercial banks amounted to USD 59 million against USD 71.8 million in 1995.

Interest expenditure totaled USD 542.3 million (5.6% of GDP). Interest repaid by the BNB amounted to USD 29.5 million, USD 24.5 million less than in 1995. Interest repaid by the government totaled USD 437.5 million (USD 57.6 million less than the previous year), the bulk of this being Brady bond payments, USD 262 million. Actually repaid interest by commercial banks totaled USD 47.7 million in 1996, USD 20.8 million more than 1995.

The balance on current transfers ended in surplus (USD 104.4 million), a decrease of USD 27.6 million from the previous year. Revenues from transfers totaled USD 231.8 million, USD 25.1 million less than in 1995. Expenditures amounted to USD 127.4 million, USD 2.5 million more than in 1995.

### Capital and Financial Account[24]

The capital account ended in surplus (USD 65.9 million). This can be ascribed to nonfinancial assets received gratis through the year.

The financial account ran a deficit (USD -86 million) mainly due to net foreign debt service payments and resident capital outflows.

Foreign direct investment in the country totaled USD 114.5 million[25], an increase of USD 24.1 million from 1995.

Portfolio investment (net) amounted to USD 167 million in 1996, of which USD 46.3 million due to an increase in investment (assets) abroad by Bulgarian commercial banks in shares, bonds and government securities. Bulgaria's foreign liabilities decreased in net terms by USD 120.7 million (against a decrease of USD 75.4 million in 1995) mainly due to USD 196.6 million in payments on the government bond loan (Bulbank).

Long- and short-term credits extended to nonresidents, the change in commercial banks' foreign exchange deposits and some other financial claims are reported under assets in the Other investment item. Assets in the Other investment item rose by USD 660.1 million mainly due to capital flight, whereas in 1995 they diminished by USD 404.2 million.

Repayments of long-term loans previously extended by Bulgaria to other countries totaled USD 339.5 million (USD 292.6 million in 1995). These predominantly comprise repayments in kind: natural gas deliveries from Russia under the Yamburg Agreement.

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[22] Following the amendment to Council of Ministers Decree No. 15 of 1991 concerning collection of information needed for the balance of payments compilation, a more detailed form of collecting bank information, and a separate form for companies which have accounts abroad were introduced in the second half of 1996. As a result, besides interest paid and received the Income item includes compensations of employees which are recorded under Other sectors. The balance on other income in 1996 was USD 7.9 million.

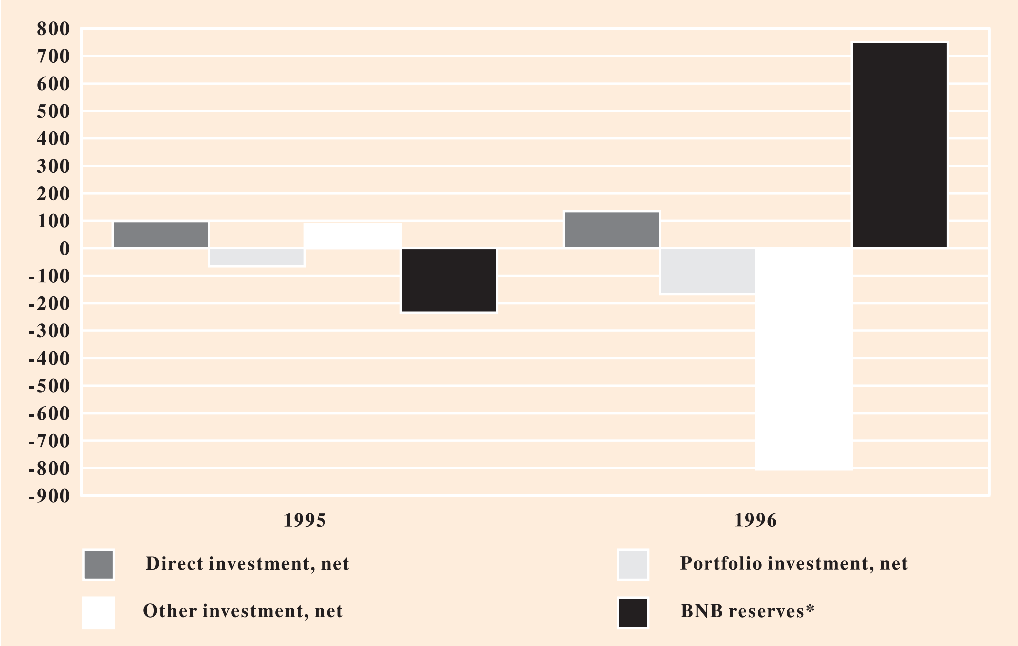
[23] According to the balance of payments methodology, interest accrued instead of actually paid interest is recorded in the Interest item.

[24] For assets in the capital and financial account, a negative sign shows an increase and a positive figure shows a decrease. For liabilities, a negative sign shows a decrease and a positive figure shows an increase. For example, payment of principals by the BNB on IMF loans is recorded with a negative sign because it reflects a decrease of Bulgaria's obligations (liabilities) to the IMF.

[25] As per Ministry of Finance data.

**BALANCE OF PAYMENTS FINANCIAL ACCOUNT**
**(major components)**

(million USD)




* For BNB reserves, a negative sign shows an increase and a positive figure shows a decrease.
Source: BNB.

Commercial banks' deposits abroad declined by USD 68.2 million in 1996, USD 103.3 million less than the 1995 decrease (USD 171.4 million).

The reporting period is characterized by capital flight which was remarkably high for the scale of the Bulgarian economy and the country's forex reserves, being the most sizable outflow since the start of economic reform in 1991. Two major forms of capital flight occurred in 1996: resident capital outflow (withdrawal of cash from foreign exchange deposits) and capital outflow abroad. The major factors responsible for the capital flight are: expectations of a drastic nominal devaluation of the lev based on the 1995 overvaluation of the lev in real terms; a fall in forex reserves; and a dramatically shaken confidence in the banking system. These factors had a different impact over different periods in 1996.

Capital flight in the first quarter of 1996 can be attributed primarily to high expectations about lev devaluation (prompted also by a negative interest rate differential), and in part to emerging signs of further erosion of confidence in the banking system. In this quarter resident capital outflow totaled USD 152 million. Expectations of a sharp and significant devaluation of the lev in combination with eroded confidence in banks contributed to capital flight abroad (USD 210 million[26]), also manifested in its traditional forms: import overvaluation and export undervaluation.

The major factor behind the substantial amount of capital flight in the second quarter is the dramatically shaken confidence in banks[27]. Deposit withdrawals from banks totaled USD 366.4 million, with USD 264.4 million drawn in May alone. The sharp devaluation of the lev and eroded confidence in the banking system resulted in a substitution of cash for foreign exchange: individuals drew their levs to buy foreign exchange which they did not redeposit into banks. Reduced foreign exchange deposits in combination with enhanced purchases of foreign exchange by companies and individuals put pressure on the exchange rate in both the interbank and cash markets[28].

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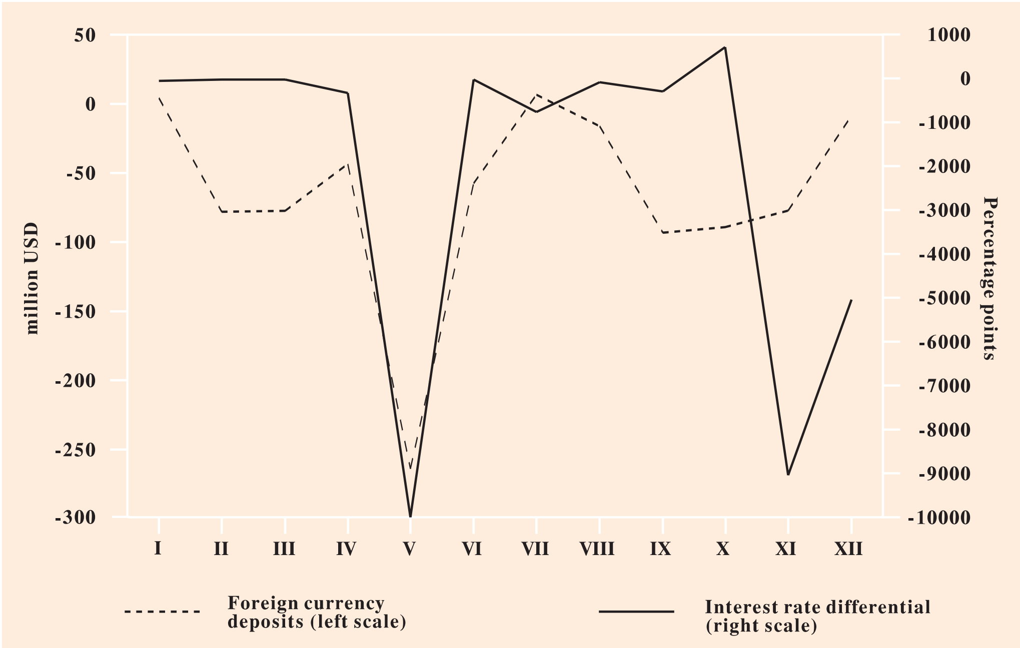
[26] As per BNB estimate.
[27] In May 1996 the BNB put two big commercial banks under conservatorship.
[28] Purchases of foreign exchange by individuals and companies having received the lev equivalent of their foreign exchange deposits under the Law on State Protection of Deposits put additional pressure on the lev.

**CHANGES IN UNCOVERED INTEREST RATE DIFFERENTIAL AND FOREIGN CURRENCY DEPOSITS IN 1996**




* The interest rate differential is equal to the interest rate on one-month deposits in levs less commercial banks' interest rate on one-month deposits in US dollars less the monthly percentage of lev devaluation to the US dollar (on an annual basis). Foreign currency deposits include household and private enterprises' deposits.

Source: BNB.

The scale and basic form of capital flight in the third and fourth quarters, particularly in between September and November, is entirely related to loss of confidence in the banking system. The significantly positive interest rate differential in October still failed to create stimuli for investment in levs and to prevent massive withdrawals of foreign currency, which had resumed in September. Fears about bank account freezing and loss of deposits in both levs and foreign currency dominated economic agents' behavior[29]. Consequently, foreign exchange deposits drawn from banks in the period between September and November reached USD 260.4 million.

In addition to these developments the process of capital flight was amplified by eroded internal and external confidence in the government's ability to meet its foreign debt obligations and by the insignificant amount of forex receipts from privatization of state-owned enterprises. Capital flight over the whole of 1996 totaled USD 1,007.3 million (10.3% of GDP), including resident capital outflow of USD 797.3 million. This capital flight, remarkably high for the scale of the Bulgarian economy, was a great shock to the balance of payments financial account. The current account deficit, sizable foreign debt principal repayments, reduced forex reserves and the country's practical isolation from international financial markets made it impossible to soften the shock.

Changes in obligations on long- and short-term loans drawn from nonresidents (including those from the IMF) are reported as liabilities in the Other investment item. Changes in obligations on attracted deposits on settlement accounts (in foreign currency and levs) of nonresidents are also reported in the Other investment liabilities item. In 1996 Bulgaria's foreign liabilities on the Other investment item decreased (net) by USD 144.5 million against a decrease of USD 316.9 million in 1995. BNB obligations decreased (net) by USD 107.9 million, while those of the government rose by USD 31.5 million. Commercial banks' short- and long-term obligations (net) fell by USD 113.9 million. Short- and long-term loans drawn by the private sector decreased (net) by USD 108.6 million.

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[29] At the end of September the BNB put nine banks under conservatorship, including several big banks.

According to commercial banks' reports, their liabilities to nonresidents on deposit and settlement accounts (in foreign exchange and levs) rose by USD 48.8 million against a decrease of USD 29.8 million in 1995.

In 1996 BNB forex reserves fell by USD 751.2 million (7.7% of GDP), the biggest fall (USD 661.6 million) taking place in the first half of the year.

# 7. Foreign Debt

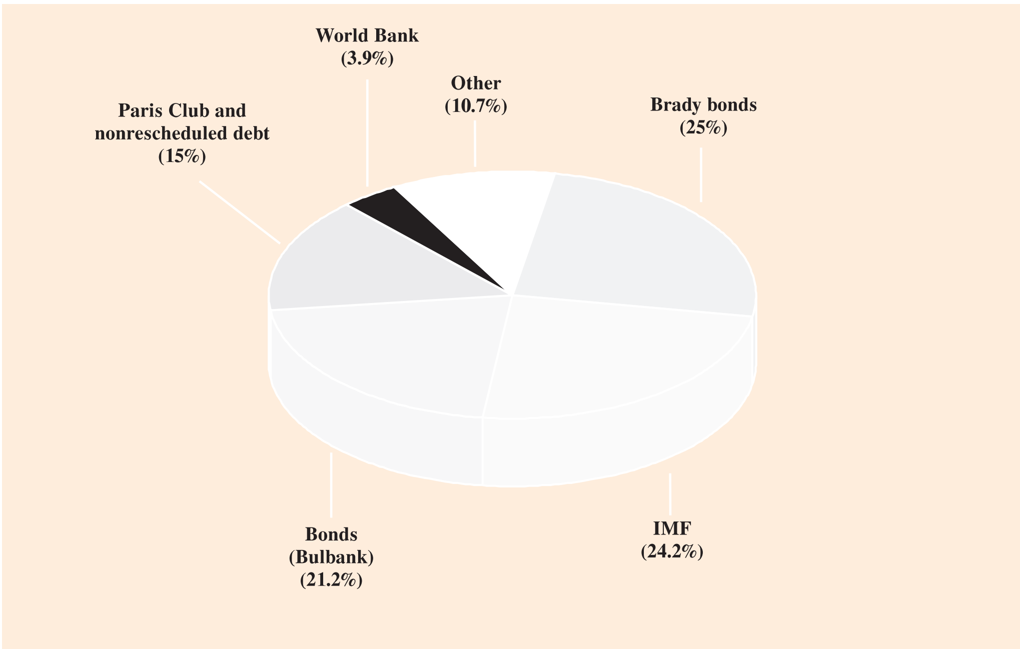
Notwithstanding political and economic crises in Bulgaria, the country serviced its official foreign debt normally.

**Foreign Debt Service**

According to preliminary data, principal and interest repayments on the gross foreign debt in 1996 totaled USD 1,048.8 million against USD 943.4 million in 1995.

With regard to creditors, interest repayments on Bulgarian Brady bonds accounted for the largest amount, USD 262 million (25% of all payments on gross foreign debt), followed by principal and interest repayments to the IMF of USD 254 million (24.2% of all payments on gross foreign debt). Significant payments were made on Bulbank bonds, USD 222.8 million (21.2% of all payments on gross foreign debt). Payments to the Paris Club and on nonrescheduled debt to official creditors totaled USD 157 million (15% of all payments on gross foreign debt).

**FOREIGN DEBT SERVICE IN 1996**




* Foreign debt service by creditor (percent of annual repayments on gross foreign debt).
Source: BNB.

In 1996 commercial banks' principal and interest repayments on the foreign debt totaled USD 43.3 million (4.1% of all payments on gross foreign debt).

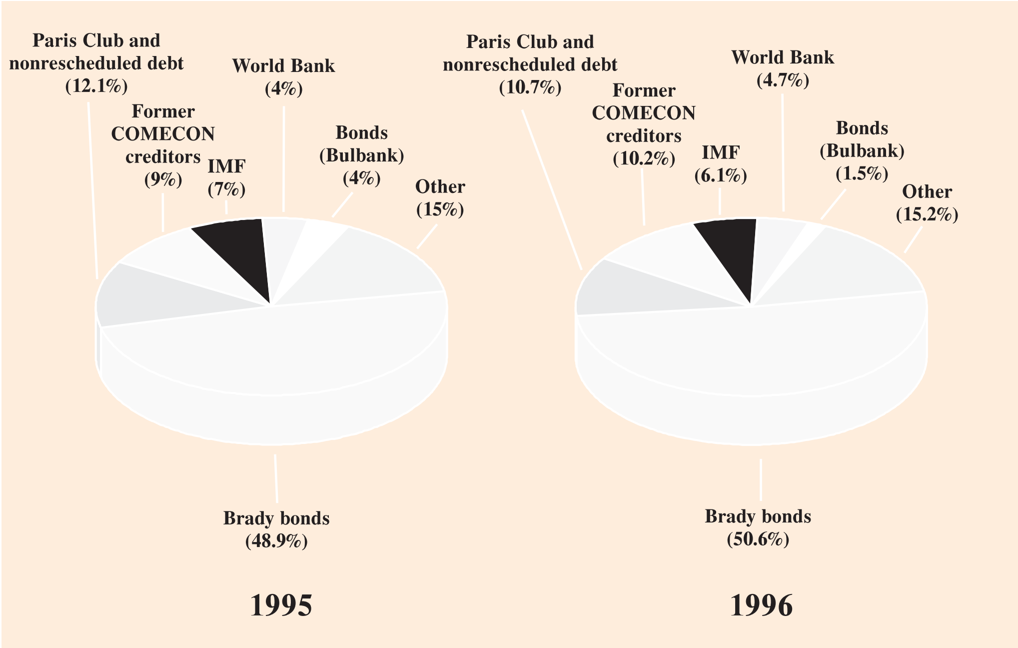
Commercial banks' arrears (which accrue to the short-term foreign debt) amounted to USD 137.1 million in 1996, mainly ascribable to Mineralbank and Economic Bank.

**Foreign Debt Amount and Structure**

According to preliminary data, gross foreign debt as of 31 December 1996 totaled USD 9,655.2 million against USD 10,229.2 million by the end of 1995: a decrease of USD 574 million.

No significant changes occurred in foreign debt structure as compared with 1995. Long-term debt was USD 8,281.6 million, 85.8% of gross foreign debt, against USD 8,841.3 million in 1995 (86.4% of foreign debt).

**GROSS FOREIGN DEBT**




* Gross foreign debt by creditor (percent of gross foreign debt).
Source: BNB.

The country's obligations to international financial institutions (the IMF, WB, EU, EBRD and the EIB) increased slightly from USD 1,657.1 million in 1995 to USD 1,714.4 million in December 1996. The share of debt to these institutions rose from 16.2% in 1995 to 17.8% of gross foreign debt on 31 December 1996. Debt on Bulgarian Brady bonds accounted for the largest share in gross foreign debt: 50.6%. Obligations to the Paris Club and nonrescheduled debt to official creditors accounted for 10.7% of gross foreign debt.

The country's short-term obligations decreased from USD 1,387.9 million in 1995 to USD 1,373.6 million in 1996. However, their share in gross foreign debt rose from 13.6% in 1995 to 14.2% in 1996, mainly as a result of reduced long-term obligations and an increase in arrears payments. Debt to former COMECON creditors accounted for 10.2% of gross foreign debt.

In 1996 the total amount of interest and principal arrears rose sharply (274.5% against 1995), from USD 66 million on 31 December 1995 to USD 181.2 million on 31 December 1996. Compared with end-1995, the share of arrears in commercial banks' foreign debt rose from 14.5% to 53.8%.

Compared with 1995, debt of resident legal entities to nonresident private creditors[30] increased from USD 89.8 million (0.9% of gross foreign debt) at the end of 1995 to USD 107.6 million (1.1% of gross foreign debt) by the end of 1996.

As of 31 December 1996, 97.7% of the country's long-term obligations (96.1% in 1995) and 75% (66% in 1995) were public and publicly guaranteed.

Government obligations accounted for the largest share, 88% of gross foreign debt. This ratio rose slightly compared with end-1995 (86.9%). As of 31 December 1996, BNB obligations comprised 6% of the foreign debt against 7.1% in 1995.

## Changes in Foreign Debt Ratios

Although in 1996 principal repayments were in excess of credits received, the significant nominal devaluation of the lev against convertible currencies, and the decline in exports and gross domestic product caused a serious deterioration of debt indicators compared with 1995.

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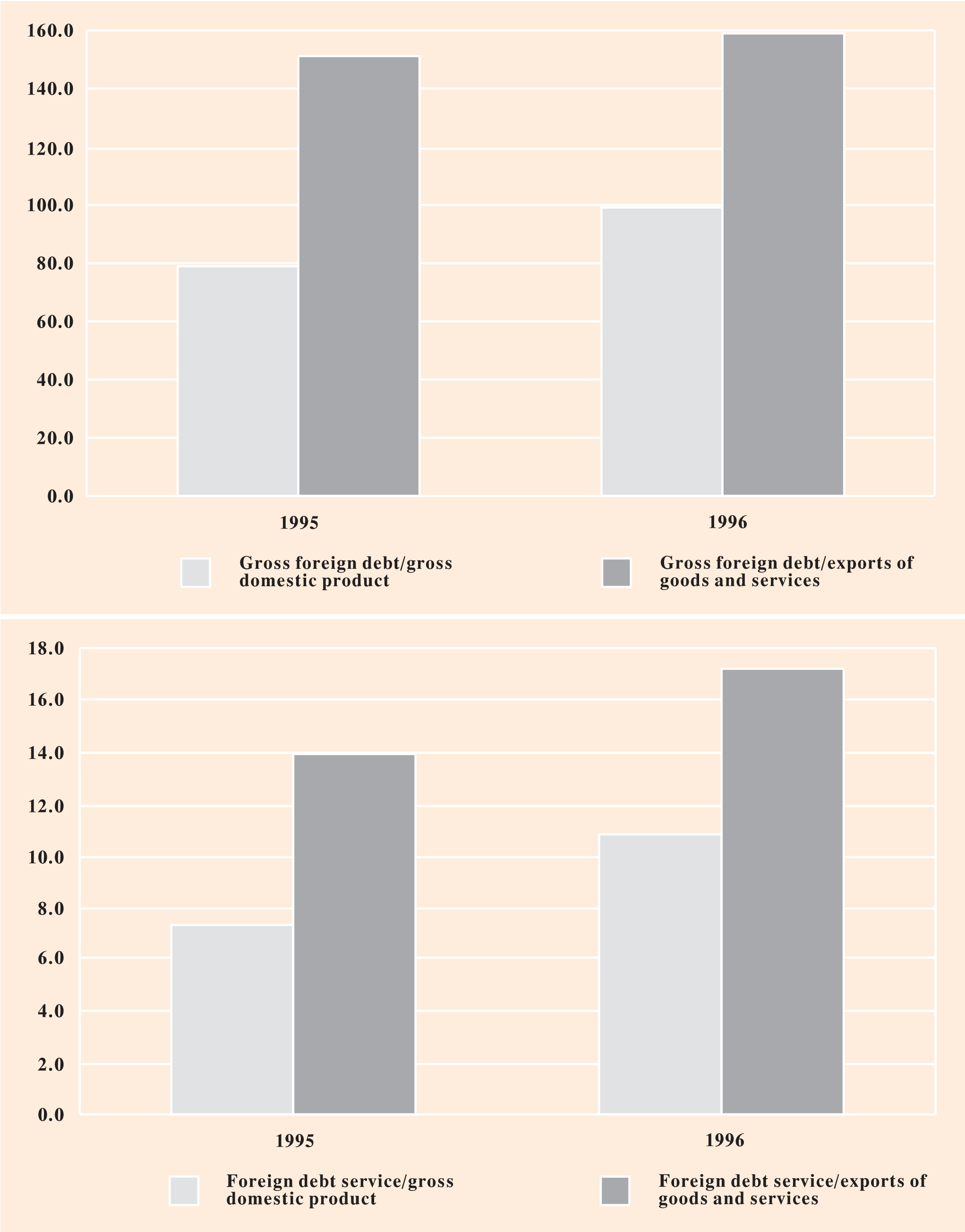
[30] Resident legal entities authorized by the Ministry of Finance to borrow from nonresidents.

**DEBT INDICATORS**

(%)




Source: BNB.

The gross foreign debt to gross domestic product ratio, indicating the relative foreign debt burden to GDP, rose by 20.4 percentage points on 1995 and reached 99.1% in 1996.

The gross foreign debt to exports of goods and services ratio, indicating the country's ability to provide revenues from exports of goods and services to service foreign debt, also worsened. It reached 158.8% in 1996 from 151% in 1995.

The foreign debt service to exports of goods and services ratio, reflecting the portion of export revenues earmarked to cover foreign debt service, exhibited similar behavior. It reached 17.2% in 1996 from 13.9% in 1995.

Deterioration of the above indicators proves that foreign debt service in 1996 was more burdensome for the Bulgarian economy than in the previous year. This conclusion is also backed by the foreign debt service to gross domestic product ratio which increased from 7.3% in 1995 to 10.8% in 1996.

# III. Fiscal Policy

Unfavorable developments in Bulgaria's economy in 1996 combined with deteriorating macroeconomic indicators strongly limited the possibilities for pursuing a restrictive fiscal policy. Delayed structural reform in the real and banking sectors and sizable accumulated losses from recent years provoked a deep financial crisis. Mechanisms employed to overcome the crisis substantially burdened the expenditure side of the budget. The blocking of budget funds in banks under conservatorship and in those in respect of which institution of bankruptcy proceedings had been petitioned put a further strain on budget performance.

Reported macroeconomic indicators for 1996 significantly deviated from those initially projected in the government's macroeconomic framework – which served as a basis for drawing up the 1996 State Budget Law (SBL) – thereby contributing to its being revised twice. The first Amendment to the State Budget Law (ASBL) established a higher level of revenues, expenditures and cash deficit. With a view to guaranteeing the provision of sources for cash deficit financing, the ASBL introduced a clause mandating the BNB to purchase, if necessary, government securities specifically issued for the purpose on a market basis. In addition, it provided for the temporary loans drawn under Article 46 of the Law on the BNB throughout the year to be securitized through issues of government securities. The second adjustment to the SBL is related to increased budget expenditures on interest payments resulting in higher cash deficit. As the possibilities of providing funding from other sources were exhausted, the second adjustment to the SBL adopted extension of a direct credit in the form of a BGL 115 billion long-term loan to the budget from the BNB, although this had a proinflationary effect.

# 1. Consolidated State Budget

The consolidated state budget includes the general government budget[31], legal system budget, social security budget, local budgets, and some extrabudgetary accounts and funds. The 1996 State Budget Law adopted the general government budget, social security budget, legal system budget, National Audit Chamber budget account and the extent of intermixing between the general government budget and municipal budgets.

By the end of December 1996, net revenue on the consolidated state budget (obtained after the deduction of intrabudgetary transfers and funds for budget deficit financing) totaled BGL 579,493.4 million, or 32.9% of reported GDP[32]. Net expenditure on the consolidated state budget totaled BGL 763,379.2 million, or 43.3% of reported GDP. By comparison, in 1995 the shares of net revenue and expenditure of reported GDP[33] were 37.9% and 43.6% respectively.

Revenues and expenditures in the general government budget accounted for the largest share in the consolidated state budget. The share of general government budget revenues in the total amount of revenues in the consolidated state budget in 1996 almost matched that of 1995: 60.4% and 60.1% respectively. The share of gen-

[31] The general government budget includes the central government budget, budgets of ministries and government agencies, regional administration budgets, and the budget account of the National Audit Chamber.
[32] Reported GDP is BGL 1,660.234 billion.
[33] Reported GDP by the end of 1995 totaled BGL 867.691 billion.

eral government budget expenditures in the total amount of expenditures in the consolidated state budget in 1996 increased significantly compared with 1995: from 57.6% to 65.2%.

The structure and amount of revenues and expenditures of the general government budget directly reflected the structure and amount of central government budget revenues and expenditures. As of 31 December 1996, revenues in the central government budget totaled BGL 349,979.4 million, 97.7% of ASBL projections, and 19.9% of reported GDP. In 1995, central government budget revenues as projected in the SBL were 91.6%, and their share in reported GDP was 22.7%. Value added tax was the major source of central government budget revenues. As of 31 December 1996, these revenues totaled BGL 116,932.7 million, 103.2% of ASBL projections. The excess of value added tax over ASBL projections primarily relates to higher inflation than assumed in the government macroframework. In 1995, revenues from value added tax comprised 77% of SBL forecasts.

As of 31 December 1996, central government budget expenditures totaled BGL 540,848.1 million, 95.9% of revised ASBL and 30.7% of GDP reported. By comparison, in 1995 expenditures on the central government budget comprised 93.3% of SBL projections and 29.4% of reported GDP. Current expenditures accounted for the largest share in central government budget expenditures. Compared with 1995, the share of current expenditures in total expenditures in 1996 has significantly increased (from 55.1% to 69.2%), a result of dramatically increased interest payments. In 1996, expenditures on interest payments comprised 63.6% of total central government budget expenditures, against 48.6% in 1995. Much of the dramatically increased interest payments in 1996 related to the amount and structure of domestic government debt, comparatively high nominal basic interest rate level, lev devaluation, assumption of expenditures on government guaranty securities issued under the Law on State Protection of Deposits, etc. As of 31 December 1996, interest payments totaled BGL 343,958.7 million, 96.5% of ASBL estimates and 19.5% of GDP reported. By comparison, interest payments in 1995 amounted to BGL 123,927.3 million, some 14.3% of reported GDP. During the period under review, the share of interest on domestic government debt in the total amount of interest payments moved up from 80.1% in 1995 to 86.2% in 1996. Transfers to cover deficits on other budgets accounted for a significant share in general government budget expenditures. By the end of 1996, these netted a total of BGL 164,919.9 million, 100.1% of ASBL estimates. Compared with 1995, their share in total expenditures has declined dramatically, from 44.5% to 30.5% respectively. In 1996, the general government budget extended temporary noninterest-bearing loans to municipalities totaling BGL 434.3 million with payments due in 1997 as per the ASBL.

## 2. Budget Deficit

As a result of restrictive fiscal policy, a primary surplus of BGL 153,090 million was reported on central government budget, or 101.9% of revised ASBL estimates, exceeding considerably the surplus reported in 1995 (BGL 66,002.4 million). The primary surplus accounted for 8.7% of GDP in 1996, against 7.6% in 1995.

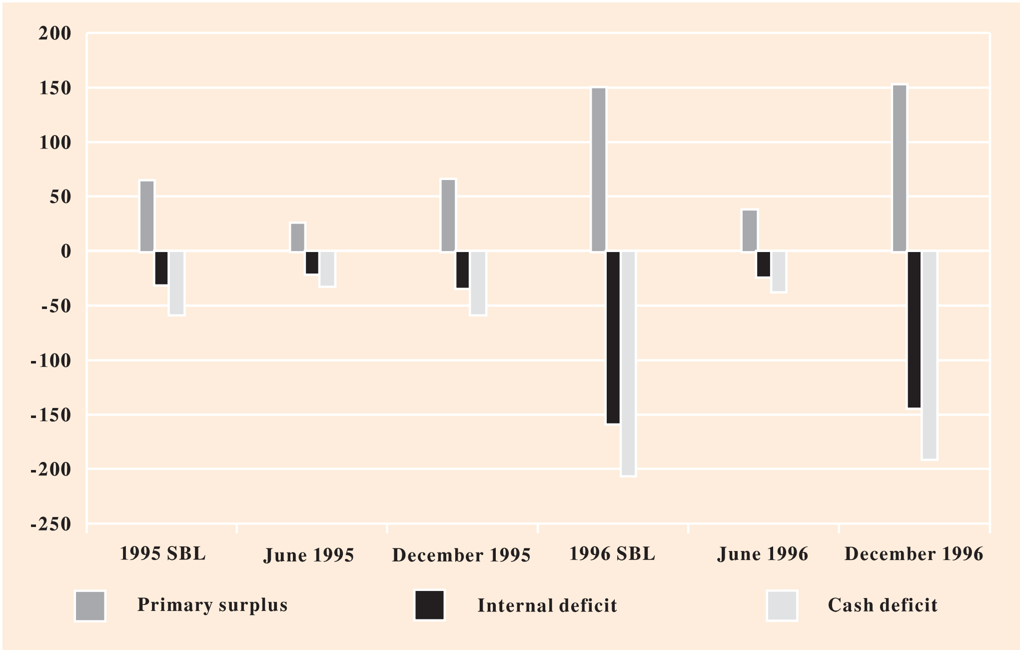
Despite the large primary surplus on the central government budget, it proved to be insufficient to cover the sizable interest payments on domestic debt service. After reporting the relationships of the budget and domestic creditors, an internal deficit of BGL 143,392.2 million was reported, 90.7% of the revised ASBL estimates and 8.1% of reported GDP. At the end of the previous year, the internal deficit accounted for just 3.8% of GDP.

As of 31 December 1996, the cash deficit on the central government budget totaled BGL 190,868.7 million, 92.6% of the revised ASBL and 10.8% of reported GDP. At the end of 1995, the cash deficit share of reported GDP was much smaller: 6.6%.

The cash deficit on the consolidated state budget by the end of 1996 totaled BGL 183,885.7 million, a 10.4% increase on reported GDP. In 1995, the share of cash deficit on the consolidated state budget was a mere 5.7% of reported GDP.

**GENERAL GOVERNMENT BUDGET BALANCES**

(billion BGL)




Source: BNB.

Dramatically increased credit indebtedness of the budget to domestic lenders coupled with the maturity structure of the debt resulted in substantial growth in general borrowing requirements. As of 31 December 1996, general borrowing requirement reached BGL 642,749.2 million, an almost fourfold increase over 1995. The trend to continuously growing general borrowing requirements further intensified the problems relating to the provision of funds to service government debt and employment of effective mechanisms to subdue inflationary pressure on the budget deficit.

# 3. Budget Deficit Financing

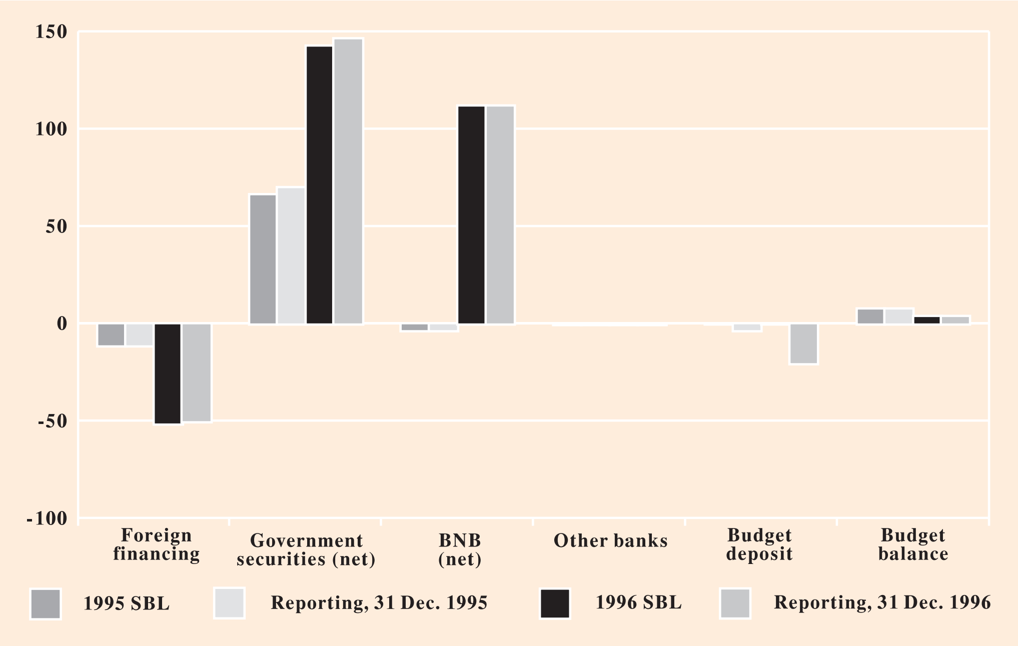
At the end of 1996, a negative net foreign financing was reported, totaling BGL 50,108.3 million, 96.6% of revised ASBL estimates. By comparison, the net negative result from overseas operations accounted for BGL 11,713.4 million in 1995, 100.7% of SBL projections.

As of 31 December 1996, net domestic financing on the central government budget totaled BGL 240,977 million, primarily resulting from government securities operations. By the end of the 1996 government securities operations netted a total of BGL 146,409.1 million, 102.6% of the revised ASBL.

The crisis in the financial system during the reporting period limited the possibilities of the primary market to realize the government securities issues. This entailed the use of direct bank lending (short- and long-term) to cover temporary cash deficiencies in the budget and to finance the cash deficit, despite their proinflationary effect. Short-term temporary loans extended under Article 46 of the Law on the BNB totaled BGL 118,089 million. By the end of 1996 BGL 70,350 million were repaid and the remainder (BGL 47,739 million) was securitized through government securities issues. Long-term loans drawn in accordance with the terms and conditions stipulated in the revised ASBL (with a redemption term of 15 years and a five-year grace period) accounted for BGL 115,000 million. During the reporting period BGL 3,463.7 million was repaid by the budget in regular installments on the debt to financial institutions accumulated in recent years. Consequently, direct bank financing (net) of the government budget totaled BGL 111,563.3 million.

**CASH DEFICIT FINANCING OF THE GENERAL GOVERNMENT BUDGET**

(billion BGL)




Source: BNB.

Transitional balances on the 1995 central government budget totaling BGL 3,712.7 million and loans repaid by municipal councils from previous years amounting to BGL 48.6 million were the other sources of cash deficit financing. By the end of 1996, after general government budget accounts were closed, a budget deposit of BGL 20,729.7 million was reported, reducing net domestic financing by that amount. In contrast to established practices, the budget deposit in 1996 included not only available funds on the general government budget account with the BNB but also balances on general government budget accounts with service banks in recognition of their liquidity deficiencies.

The following sources were used to finance general borrowing needs: government securities operations, 62.9%; temporary credits (advances), 18.4%; long-term credits, 17.9%; foreign sources, 0.8%.

In 1996, 145 issues of book-entry government securities were sold through the BNB under Regulations No. 5 for budget deficit financing with a total nominal value of BGL 430,509.94 million, including 24 discount treasury bill issues, 97 interest-bearing treasury bill issues, and 24 treasury bond issues. As of 31 December 1996, 131 issues were in circulation (67 issues of treasury bills and 64 issues of treasury bonds) with a total nominal value of BGL 323,080.6 million.

In 1996, the Ministry of Finance offered for sale government securities with a total nominal value of BGL 599,355.8 million. Financial institutions' bids tendered at the auctions totaled BGL 459,333.28 million, 76.6% of the amount offered.

During the reporting period, commercial banks continued the tendency, typical of previous periods, towards increased investment in treasury bills in the primary market while the State Savings Bank (SSB) remained a major investor in treasury bonds. Nevertheless, the SSB portfolio of government securities was reduced while those of the BNB, the State Insurance Institute and commercial banks increased. In 1996, the bulk of the issues ensured average annual yield equal to or higher than the basic interest rate operative in the respective period.

Government securities transactions in the secondary interbank market rose 1.9 times compared with 1995. During the reporting period, 20,495 transactions in government securities were concluded in the secondary market, totaling BGL 3,778,007.2 million nominal value. The BNB continued to be a major participant in the secondary market (15,581 transactions to BGL 3,552,880.6 million), although the share of transactions without BNB participation doubled.

Nonbank budget deficit financing through issues of government securities had a nominal value of BGL 55,145 million (including target government securities of BGL 4,571 million and government securities of BGL 2,596.9 million bought with noncompetitive bids by companies and individuals), or 17.1% of all outstanding issues by 31 December 1996. By comparison, in 1995 nonbank financing by government securities was BGL 26,476 million, or 17.8% of all outstanding issues as of 31 December 1995. The largest portion of government securities' sales to nonfinancial enterprises was effected by the SSB.

The Ministry of Finance continued the established practice of weekly issues of government securities targeted at nonfinancial institutions – individuals and legal entities. During the reporting period the Ministry of Finance offered for sale treasury bills from the target issues with maturity of three, six and 12 months. Initially the three-month target issue was sold at a discount from its nominal value but after the sharp rise in the basic interest rate the MF had to replace it by three-month interest-bearing treasury bills.

As of 15 November 1996, the MF offered for sale six-month index-linked treasury bills targeted at individuals. Their yield is tied to the six-month consumer goods inflation index.

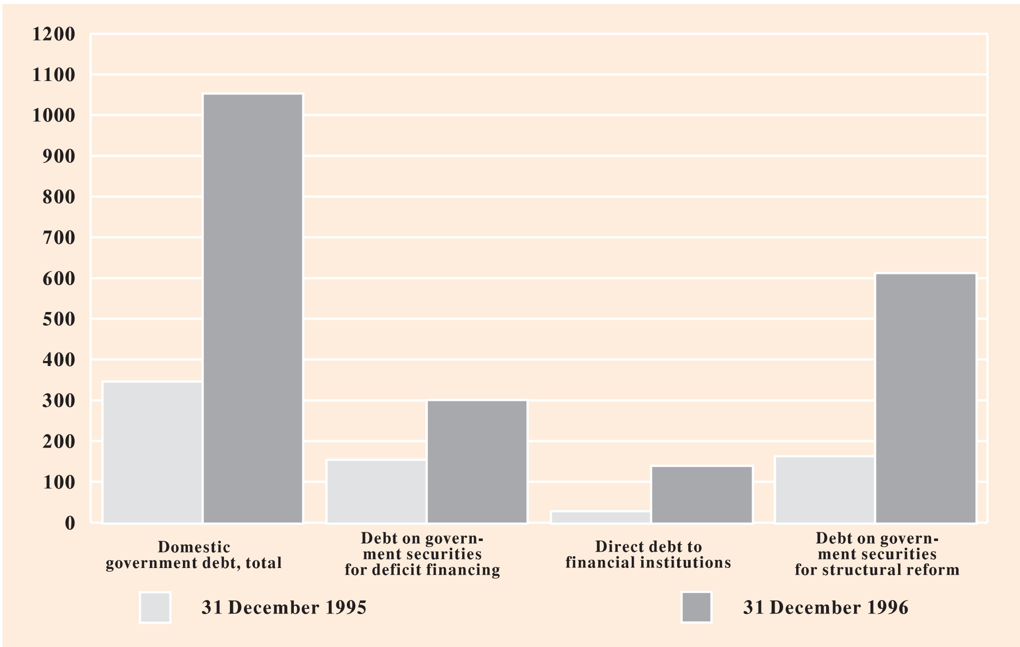
The annual effective yield of target issues for companies and individuals was higher than the basic interest rate and the rate applied on commercial banks' time deposits in levs. As of 31 December 1996, the aggregate nominal value of target government securities sold to nonfinancial institutions totaled BGL 4,558 million and BGL 13 million from index-linked issues.

# 4. Domestic Government Debt

Worsened macroeconomic conditions in 1996 combined with repeated changes in the basic interest rate, devaluation of the national currency, budget deficit and increased borrowing requirements are the main factors contributing to changes in the amount and structure of domestic government debt.

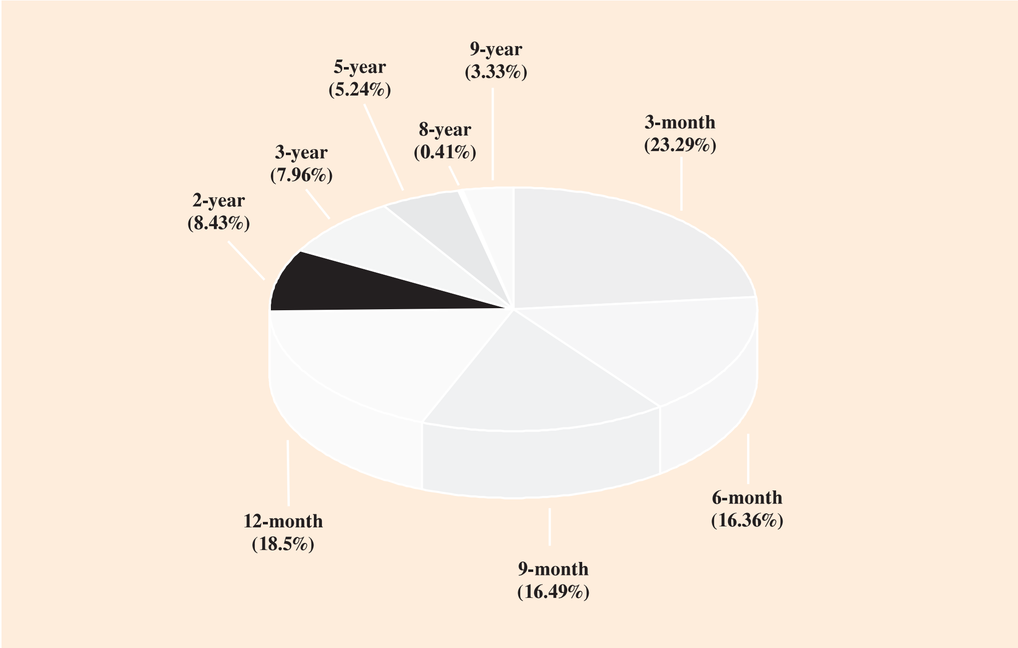
**STRUCTURE OF DOMESTIC GOVERNMENT DEBT**

(billion BGL)




Source: BNB.

**OUTSTANDING GOVERNMENT SECURITIES ISSUED FOR BUDGET DEFICIT FINANCING AS OF 31 DECEMBER 1996**




Source: BNB.

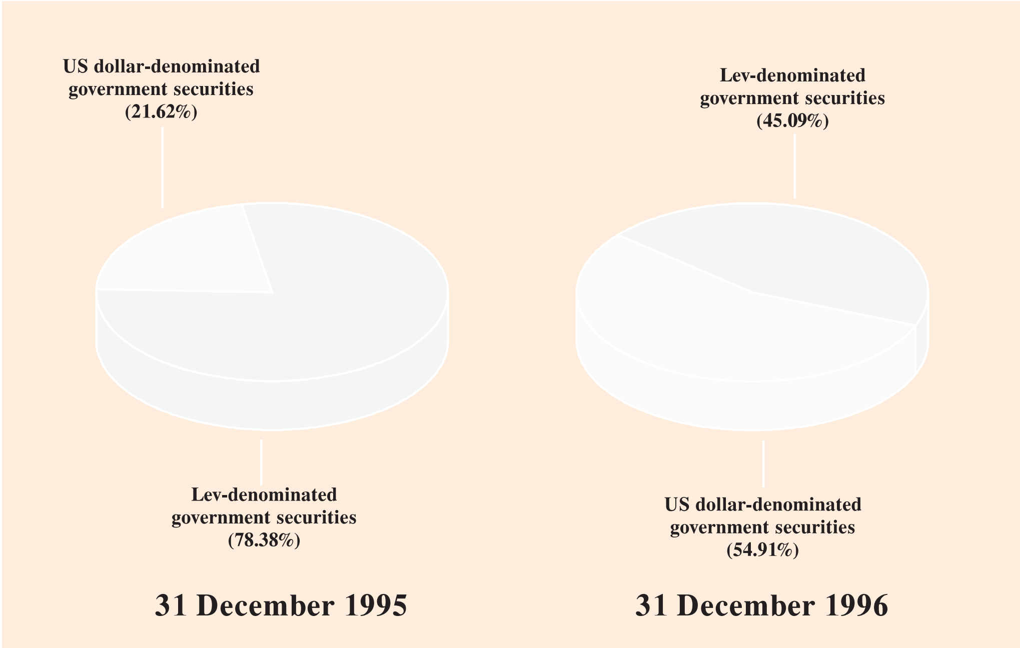
Domestic government debt in 1996 tripled, rising from BGL 345,395.2 million at the end of 1995 to BGL 1,052,867.9 million by the end of 1996, comprising 59.8% of GDP. Expenditures for government debt service through the year totaled BGL 555,979.5 million (principal and interest), or 31.6% of GDP.

Debt on government securities issued for budget deficit financing (a basic component of domestic debt), reached BGL 301,117.6 million, including target issues and index-linked bills earmarked for sale to individuals and companies. Compared with 1995, this debt has risen 1.9 times. In terms of debt structure, the share of the debt on government securities issued for budget deficit financing accounted for 28.6% of the total debt, against 44.8% in 1995. The tendency, typical of previous years, to issue predominantly short-term government securities (with maturity up to one year) for budget deficit financing, a result of the volatility in the debt instruments market, and investors' interest in this type of government securities, continued in 1996. This reflected on the term structure of outstanding government securities issued under Regulations No. 5: those with maturity of up to one year prevailed, totaling BGL 224,734.5 million, or 74.7%; those with maturity of up to five years totaled BGL 65,123.6 million, or 21.6%; those with maturity of up to nine years (securitized direct debt) totaled BGL 11,259.5 million, or 3.7%. The high share of short-term government securities issued in 1996 combined with the worsened maturity structure of government securities issued in previous years are the factors behind the large redemptions (of principal and interest) during particular periods. This made domestic debt service management much more difficult throughout the reporting period.

Direct debt to the BNB rose from BGL 26,051.5 million at the beginning of 1996 to BGL 138,060.8 million by year-end, or 5.3 times. The debt was regularly serviced. Principal repayments totaled BGL 2,990.7 million and interest repayments BGL 48,603 million. Considerably increased government general borrowing requirements and the lack of alternative sources for budget deficit financing at 1996 year-end entailed a parliament-approved decision for the extension of a direct credit to the MF by the BNB, totaling BGL 115,000 million, with a 15-year redemption term and a five-year grace period.

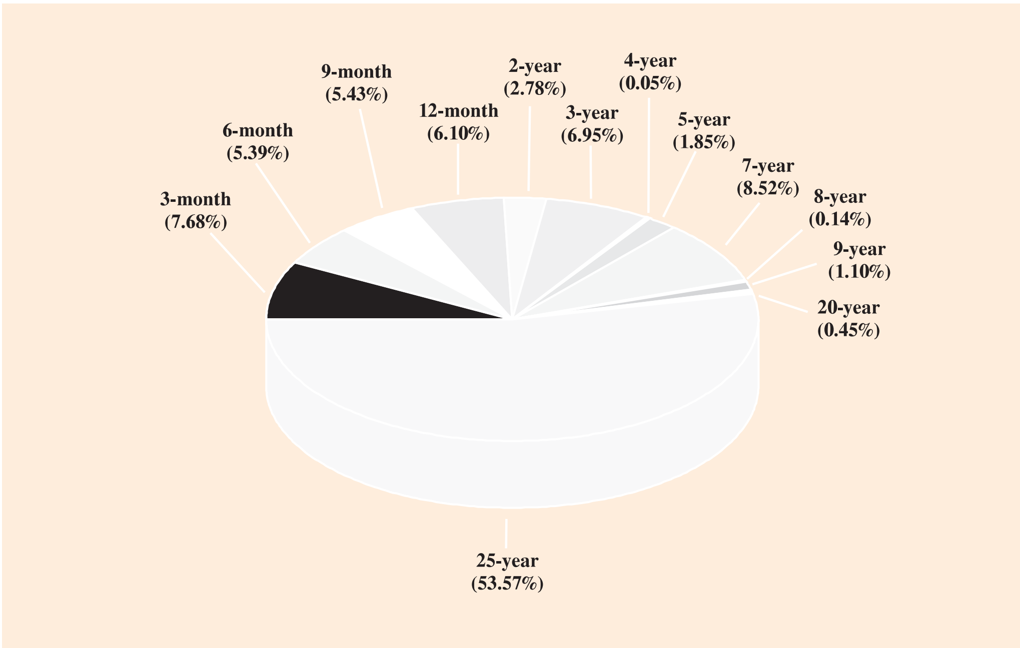
Direct debt to the SSB fell from BGL 1,517.9 million at the beginning of 1996 to BGL 1,264.9 million by year-end, 16.7%. Principal and interest repayments on this debt accounted for BGL 253 million and BGL 1,580 million respectively. Principal and interest repayments on debt to the State Insurance Institute totaled BGL 220 million and BGL 83.1 million respectively. By 31 December 1996, the debt to this financial institution was completely repaid. Principal and interest payments to both institutions were made in accordance with contractual terms.

**STRUCTURE OF GOVERNMENT SECURITIES DENOMINATED IN LEVS AND US DOLLARS**




Source: BNB.

**MATURITY STRUCTURE OF OUTSTANDING GOVERNMENT SECURITIES AS OF 31 DECEMBER 1996**




Source: BNB.

As a result of these operations direct debt to financial institutions rose considerably, from BGL 27,789.4 million by the end of 1995 to BGL 139,325.8 million by the end of 1996: a fivefold increase. In structural terms, debt to financial institutions comprised 13.2% of the total debt, against 8.1% in 1995.

Debt on long-term government bonds issued to convert the nonperforming debts of state-owned companies to banks into government debt, outstanding debt from municipalities on SSB house-building loans, and outstanding debt under the Law on State Protection of Deposits (government securities for the structural reform) rose from BGL 162,843.8 million at the beginning of 1996 to BGL 612,424.6 million by year-end, or 3.8 times. This type of government securities accounted for the largest share, 58.2%, of total domestic debt, against 47.1% in 1995. This increase is primarily attributable to both the forex component and the newly issued long-term government bonds worth BGL 58,033.8 million under the Law on State Protection of Deposits, including six issues of seven-year government guaranty bonds in favor of the SSB, totaling BGL 19,481.9 million, and three issues of three-year government guaranty bonds of USD 79.1 million. As a result of these government securities' use in privatization deals, and for payment to the budget of nonperforming state-owned enterprises' obligations converted into government debt, they decreased by BGL 2,869. 7 million through the year.

Significant changes occurred in 1996 in the proportion of debt on government securities denominated in levs and US dollars. As a result of the increased exchange rate, the share of dollar-denominated government securities reached some 55% of total outstanding government securities, against 22% at the end of 1995.

This brought about changes in the term structure of debt on government securities in circulation at 31 December 1996. Long-term government bonds with a term to maturity of up to 25 years, issued under Articles 4 and 5 of the 1993 LSNC, CM Decree No. 234 of 1992 and CM Decree No. 3 of 1994 held the largest share (53.6%), against 30.8% at the end of 1995. The rest of government securities with terms of three months to 20 years accounted for 46.4% of the total amount, against 69.2% in 1995.