

BULGARIAN NATIONAL BANK

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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 53 of this Law, I have the honor to submit the semiannual report of the Bulgarian National Bank for the period ending 30 June 1995.

A black and white image of a handwritten signature in white ink on a dark background. The signature is cursive and appears to read 'Todor Vulchev'.

**Prof. Dr. Todor Vulchev
Governor of the Bulgarian
National Bank**

Abbreviations

BGL (Lev)	<i>National Currency of the Republic of Bulgaria</i>
BISERA	<i>Banking Integrated System for Electronic Transfer</i>
BNB	<i>Bulgarian National Bank</i>
BORICA	<i>Banking Organization for Payments Initiated by Cards</i>
BUS	<i>Banking Unified Standard</i>
CGB	<i>Central Government Budget</i>
CM	<i>Council of Ministers</i>
COMECON	<i>Council for Mutual Economic Assistance</i>
CUBS	<i>Commission on Unified Banking Standards</i>
EBRD	<i>European Bank for Reconstruction and Development</i>
ECU	<i>European Currency Unit</i>
EFTA	<i>European Free Trade Association</i>
EIB	<i>European Investment Bank</i>
EU	<i>European Union</i>
GDP	<i>Gross Domestic Product</i>
IMF	<i>International Monetary Fund</i>
LBCA	<i>Law on Banks and Credit Activity</i>
LGB	<i>Long-term Government Bonds</i>
LSNC	<i>Law on Settlement of Nonperforming Credits Negotiated prior to 31 December 1990</i>
MF	<i>Ministry of Finance</i>
MLSS	<i>Ministry of Labor and Social Security</i>
MTIEC	<i>Ministry of Trade and International Economic Cooperation</i>
NSI	<i>National Statistical Institute</i>
OECD	<i>Organization for Economic Cooperation and Development</i>
SBL	<i>State Budget Law</i>
SDR	<i>Special Drawing Rights</i>
SII	<i>State Insurance Institute</i>
SSB	<i>State Savings Bank</i>

Contents

I.	Major Trends in the Development of the World Economy	7
II.	General Characteristics of the Economy	
1.	Output	9
2.	Employment	11
3.	Income and Consumption	14
4.	Prices	16
5.	Foreign Trade	19
6.	Balance of Payments	23
III.	Fiscal Policy	
1.	Consolidated State Budget	25
2.	Budget Deficit and Budget Deficit Financing	26
IV.	Monetary Policy	
1.	Money Supply	30
2.	Reserve money and Money Multiplier	33
3.	Domestic Credit	35
4.	Monetary Instruments and the Money Market	37
5.	Interest Rates on Commercial Bank Operations	42
6.	Issuing Activities	43
7.	Foreign Exchange Policy	46
V.	Bank Supervision	53
VI.	Financial Results of BNB Activities	60
VII.	Development of the Banking and Settlement System	
1.	State of the Settlement System	62
2.	Legal Regulation of Bank Activities	63
3.	Relations with International Financial Institutions	63
VIII.	Major Trends in Monetary Policy through Year-end	65
	Appendix	67

I. Major Trends in the Development of the World Economy

Favorable trends developing in the world economy since mid-1994, which became firmly established by 1994 year-end, were sustained in the middle of 1995, though showing signs of weakening in certain regions. With the exception of a few countries, economic conditions in most countries have improved, sometimes even reaching levels not seen since the 60's. Due to these favorable developments in the global economy, growth in gross world output and world trade are projected to remain unchanged from their 1994 level. In 1995, *world output* is likely to exceed slightly the 3% growth attained in the past year, while *world trade* may exhibit a partial return to more normal developments following an unusually high growth of 9% in the past year.

With the exception of Japan, the *developed countries* are recovering from the recession of the early 90's and have restored their typical rates of economic growth (2 – 3%). General outlook for the group of developing countries during the current and following years is optimistic, despite some differences in their economies' growth.

In late 1994 the US economy caused concern over expected acceleration of inflation consistent with output growth exceeding productivity potential. In the first half of 1995 this was brought under control. The slower pace of GDP growth in the first, and particularly in the second quarter of 1995 did much to overwhelm fears of inflation and prepared the ground for easing of monetary policy in the middle of 1995.

Western Europe is witnessing a period of recovery but this would hardly have proinflationary effects, as maximum productivity has not been reached in most countries. Nevertheless, significant differences appeared between individual countries. The macroeconomic situation in *Germany* seems most promising. Despite past years' enormous spending intended to support the country's unification of its eastern and western provinces, Germany succeeded in maintaining balance in all major economic indicators. *France* faced persistently high unemployment, despite high growth and record low inflation (typical for Europe as a whole) since the 60's. As in 1994, *Italy's* growth was relatively high (due to depreciation of the lire and higher competitiveness of exports reflecting improved foreign demand in Europe), although the unusually low inflation in 1994 (below 4%) began to accelerate and again threatens to evolve into a serious problem, along with chronic budget deficits and growing government debt. Divergent macroeconomic indicators were present in the *United Kingdom*, but are not cause for serious concern.

The recovery and growth of most developed countries was in stark contrast with stagnation in *Japan*. This is expected to continue in 1995.

Deep structural recession consistent with the transition to a market economy in the *former centrally planned economies* has been gradually halted. The list of countries with restored economic growth increased. Following a positive GDP growth in 1994, in 1995 the drop in all *eastern and central European countries* ceased and growth occurred even in the *former Soviet republics*. Signs of normalization emerged in the *Russian* economy in the first half of 1995. The drop in output is expected to be further reduced, inflation may be brought down to a two-digit figure, and actual industrial privatization has been already carried out. However, success was coupled with a plethora of problems which might have serious economic implications since they have the potential to slow or even reverse the general trend of economic processes.

Based on the analysis of major trends in the development of the world economy in the first half of 1995, prospects for *Bulgaria* seem optimistic. For the first time since the collapse of the centrally planned economy in the late 80's, the external economic environment may have a beneficial effect on Bulgaria's economy. The transition from recovery to growth in western Europe and from post-totalitar-

ian recession to recovery in the eastern part of the continent, including Russia, reflect growing foreign demand which Bulgarian exporters could exploit to establish themselves in western markets as well as regain their competitive positions in eastern markets. Pursuit of a policy toward elimination of barriers to international exchange of goods, services, assets and factors of production, consistent with the results achieved within the European integration, will also have positive effect on the Bulgarian economy, paving the way for greater efficiency and competitiveness in the long run. As export-led growth has no alternative in Bulgaria, buoyant foreign demand and better access to major markets may provide stimuli to boost production, investment and long-run economic development. In the short run, however, the potential threat of foreign demand triggering a proinflationary effect should not be underestimated. Avoiding such a scenario will involve a consistent and coordinated national economic policy, combined with the resolve to pursue it.

II. General Characteristics of the Economy

1. Output

The recovery which began in mid-1994 continued in the first half of 1995. In the six-month period, output produced in the state, cooperative and private sectors totaled approximately BGL 500 billion. Compared with last year (at constant prices), output rose by more than 5%.¹ Private-sector expansion continued, accounting for 25% of total output in the first half of 1995. Compared with last year, it rose by 10 percentage points.

Growth in output was consistent with companies' enhanced utilization of production capacity. In the first six months of 1995, companies from the state and cooperative sector employed already over 60% of their production capacities, and private companies more than 71%. Orders for these companies' output increased from a year ago.

No serious changes occurred in the structure of output by sector since early 1995. Industry retained its key role in the Bulgarian economy, providing approximately 64% of total output. Private industrial companies provided more than 10% of total output in this sector. Their share in trade, construction and transport (approximately 75% and 50%) was most evident.

Real growth in output occurred in all private sector industries, but the prime reason behind the return to growth was the enhanced activity of state-owned and cooperative companies. In the first half of 1995, output in the state and cooperative enterprises totaled BGL 374 billion, and receipts from sale of goods and services BGL 412 billion. Compared with the same period last year (at constant prices), output increased by 1%, but receipts from sale of goods and services declined by more than 2%. Monthly output at constant prices for all months in 1995, with the exception of March, is higher than that produced in the corresponding 1994 months, while monthly receipts from sales remained below last year's monthly levels in the same period. This is indicative of state and cooperative companies' serious difficulties in selling their products.

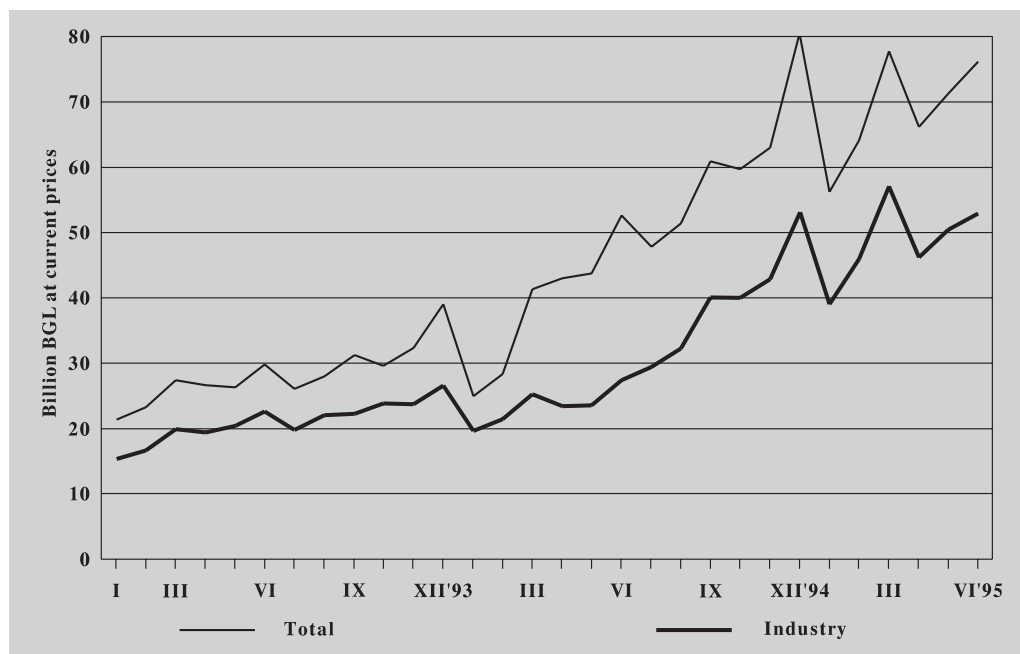
In 1995, industrial output and receipts from the sale of industrial goods contributed significantly to improvement in state-owned and cooperative enterprises. Between January and June 1995, industrial output produced by state-owned and cooperative companies totaled BGL 308 billion, a 1.1% increase compared with last year (at constant prices). Receipts from the sale of output in the first half of 1995 totaled BGL 298 billion, a 1.9% increase from a year ago (at constant prices). Ferrous metallurgy and the chemical and oil processing industries marked the highest growth in industrial output and receipts from sale in the 1995 six-month period.

Cessation of the drop in output was derived from slightly increased foreign demand, higher government purchases and investment in inventories.² Between January and June 1995, retail turnover in the state, cooperative, and private sectors totaled BGL 155 billion, a 2.8% decline over last year's level. This is alarming, since it points to a further decline in final consumption of households after the real drop in output was temporarily halted in 1994.

¹ As per National Statistical Institute (NSI) data on the current economic situation (excluding agriculture).

² Since the NSI has not yet released GDP data for the first half of 1995, estimates of the final demand components are imprecise.

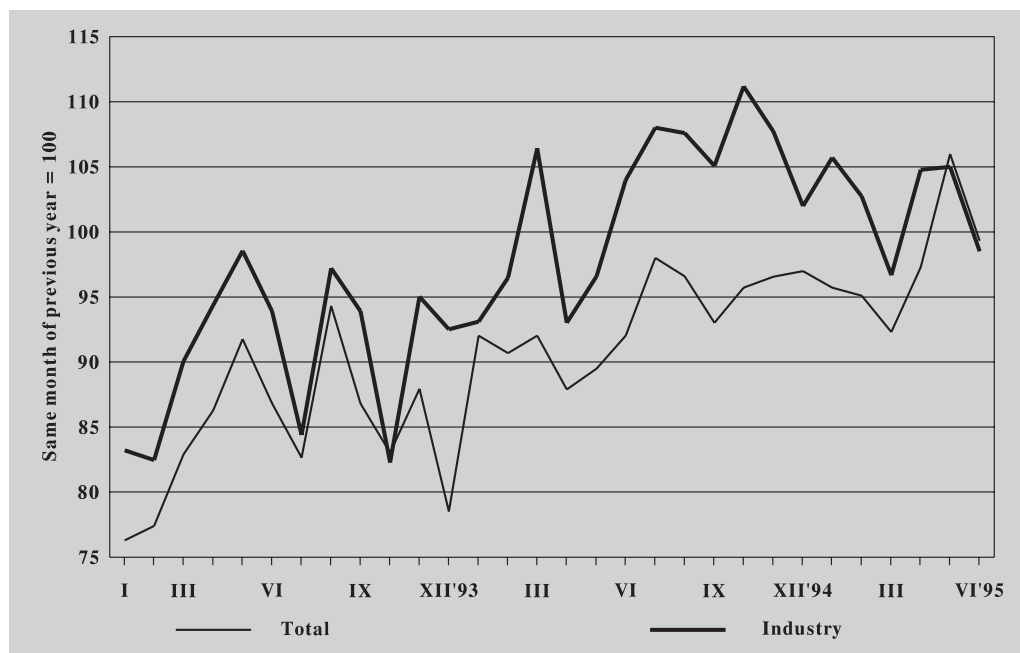
RECEIPTS FROM SALES OF OUTPUT IN THE STATE AND COOPERATIVE SECTOR



Source: NSI, BNB.

RATE OF RECEIPTS FROM SALES OF OUTPUT IN THE STATE AND COOPERATIVE SECTOR

(%)



Source: NSI, BNB.

2. Employment

Overall Decline

Despite indications of the beginning of stabilization and modest economic growth, employment in the public sector continued to contract. In the first half of 1995, per the NSI data, the number of persons employed in the public sector³ was 1,851,000 persons⁴, or 7.2% less than in the same period last year. Unfavorable developments in the labor market were prompted by continuous contraction of the state sector of the economy, despite prevailing estimates about cessation of recession and boom in the private sector. Preliminary data suggests that more than 1,100,000 persons are employed in the private sector. In contrast to public-sector employment, private-sector work is predominantly part-time.

Changes occurring in the sectoral structure of employment were dependent upon the specific way in which each branch adjusted to the new market-driven conditions. Employment in the mining and industrial branches declined faster than employment in the services sector during the reporting period.

Industry

Compared with the same period last year, payroll in industry in the first half of 1995 declined by approximately 50,000 persons, or 34.5% of total decline in employment in the public sector. Improved economic performance of industrial enterprises and companies during the most recent twelve months resulted in certain branches and businesses maintaining or increasing last year's levels of employment. At the same time, there are branches where employment has been increasingly diminishing.

In the first half of 1995, the machine building and metal processing industry, the electrical and electronic industry, and the food industry experienced the fastest decline in employment (by approximately 11%, 10.8% and 11.8% respectively). Loss of markets in the former Soviet republics and lack of innovations in production were the prime reasons behind the nearly double decline in employment in these branches since initiation of the economic reforms.

At the same time, the improved economy in the first half of 1995 resulted in constant employment levels in most industrial branches, and even increases. Positive developments in employment across different companies was broadly consistent with their capability to find their place in the extremely volatile economic environment in the previous period. Compared with the first half of 1994, employment in the cellulose and paper, glass and earthenware, and the oil and gas extracting industries increased most significantly (6.9%, 4.2% and 3.9% respectively).

Agriculture and Forestry

Between January and June 1995, the most sizable contraction in employment occurred in agriculture. Compared with the same period last year, the share of persons employed in agriculture declined by 24.7% and employment in forestry was also significantly reduced (11.9%). The prime reason behind reduced employment in agriculture and forestry was mainly agricultural reform, now in its fourth year. On the other hand, a large number of workers passed into the private sector.

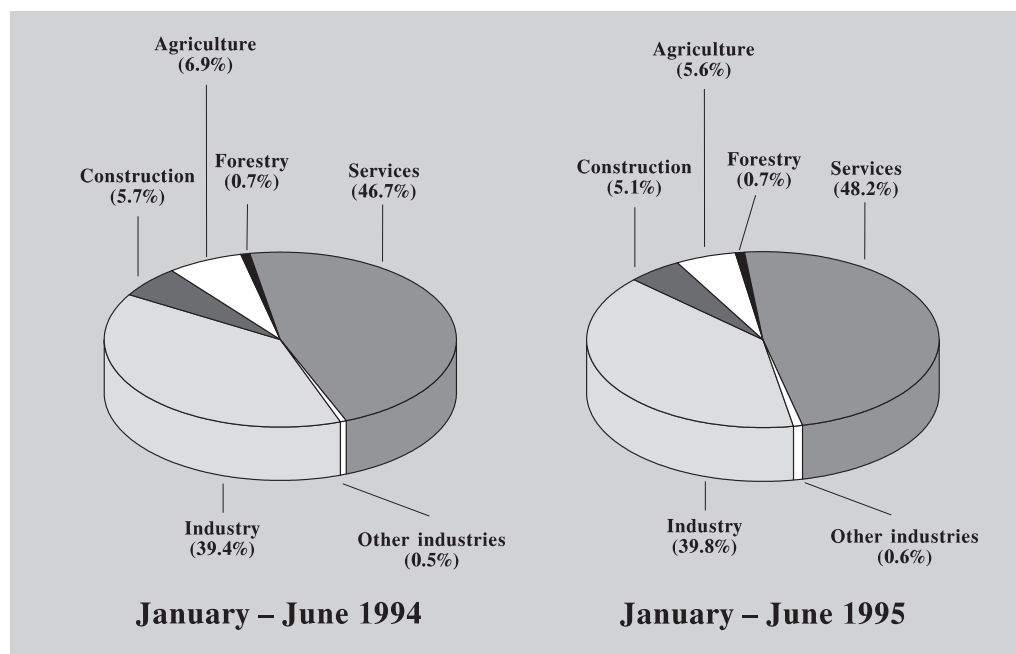
Construction

Lack of new investments and slow structural changes led to higher unemployment in construction. In the first half of 1995, a further 16.5% decline in employment occurred in construction from one year ago. At the same time, there is ground to assume that a substantial portion of laid off workers have found jobs in the fast growing private sector.

³ For the fifth year since initiation of economic reform, there is no available data about sectoral structure of private-sector unemployment, so analyses and conclusions are limited and refer only to the public (state and cooperative) sector of the economy.

⁴ Data does not include women on maternity leave.

STRUCTURE OF EMPLOYMENT IN THE PUBLIC SECTOR



Source: NSI, BNB.

Transport

Employment in transport was proportionate to that in construction. In the first half of 1995, the number of persons employed in transport declined by 8.2% (approximately 14,000 persons) from one year ago. Poor performance in this sector may be ascribed to ongoing economic depression coupled with the UN trade embargo on former Yugoslavia. The automobile transport formed a substantial private sector in terms of size, large enough to provide jobs for most of those dismissed from state automobile companies.

Trade

Employment in the state and cooperative trade sector continued to decline most dramatically. Between January and June 1995, employment in this sector declined by more than 18,000 persons from one year ago. At the same time, private trade was the fastest developing segment of the national economy. There is ground to assume that this sector generated jobs not only for those laid off from state-owned trade companies, but for unemployed with other professional qualifications.

Other Services

Compared with the January – June 1994 period, payroll in services declined by 9,400 persons, or by a mere 1.5%.⁵ Substantial differences across specific service sectors occurred in line with new social priorities, suggesting reduced government capability to finance certain social activities.

In the first half of 1995, employment in housing and public utilities, and management rose by 6% and 5.1% respectively. Simultaneously, heavy budget constraints on the financing of science and scientific research accounted for the significant reduction in employment within this sector (13.8%). Employment in education, culture and health care continued to decline, although at a slower pace.

⁵ Actually the contraction in real terms is less sizable due to the methodological transformation of approximately 5,400 employees from the Bulgarian Red Cross into the private sector and financial institutions with joint ventures and foreign stake.

Unemployment

Compared with the first half of 1994, the decline in unemployment, which started in early 1994, continued in the first half of 1995. The number of unemployed persons in the country fell by over 1,000 persons, reaching 408,500 persons by the end of June 1995, thus matching the November 1991 level. Nevertheless, the unemployment rate in the country's labor force continued to be substantial (10.5% in June 1995). The prime reason behind reduced unemployment was the short term of unemployment benefits. After expiry of the term unemployed workers did not re-enter labor-office registration lists. By the end of June 1995, a mere 26.8% of total unemployed received indemnifications or benefits. Low provision of new jobs in the official labor exchange contributed additionally to this.

Major Trends

Since early 1995, the decline in unemployment encompassed all age and professional groups. In structural terms, the following trends developed:

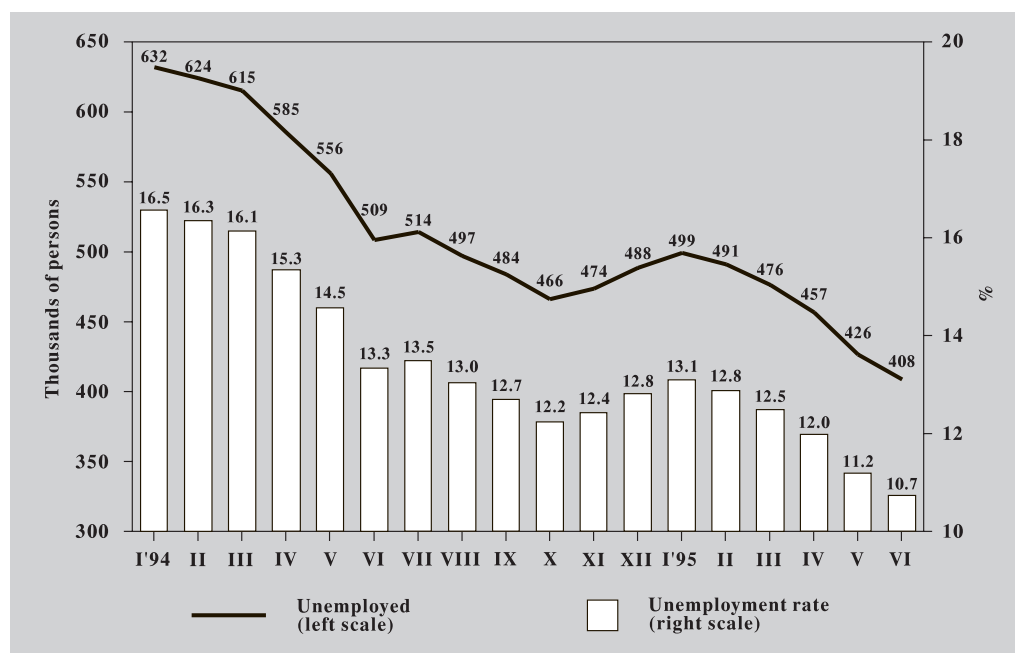
- the decline in unemployment among those aged 30 and under continued to be the largest (34%), while the smallest decline in unemployment occurred among those over 50 (3.5%);
- people with no professional qualifications remained unemployed for a longer term. The share of unqualified unemployed registered a smaller decline (14.8%), against a faster decline in unemployed specialists (294.1%);
- unemployed university graduates were in the most favorable position to find a job, whereby the share of unemployed specialist contracted by more than 30% over one year.

NUMBER OF UNEMPLOYED AND COMPENSATION, BENEFIT AND RETRAINING EXPENDITURE

Indicators	June 1994	June 1995
Unemployed (thousands of persons)	508.6	408.5
Unemployed receiving compensation (thousands of persons)	165.8	109.5
Share of unemployed receiving compensation (%)	32.6	26.8
Average amount of compensation per one unemployed (BGL)	1262	2399
Retraining expenditure per one unemployed (BGL)	9.9	24.0

Source: Ministry of Labor and Social Security (MLSS), BNB.

UNEMPLOYMENT

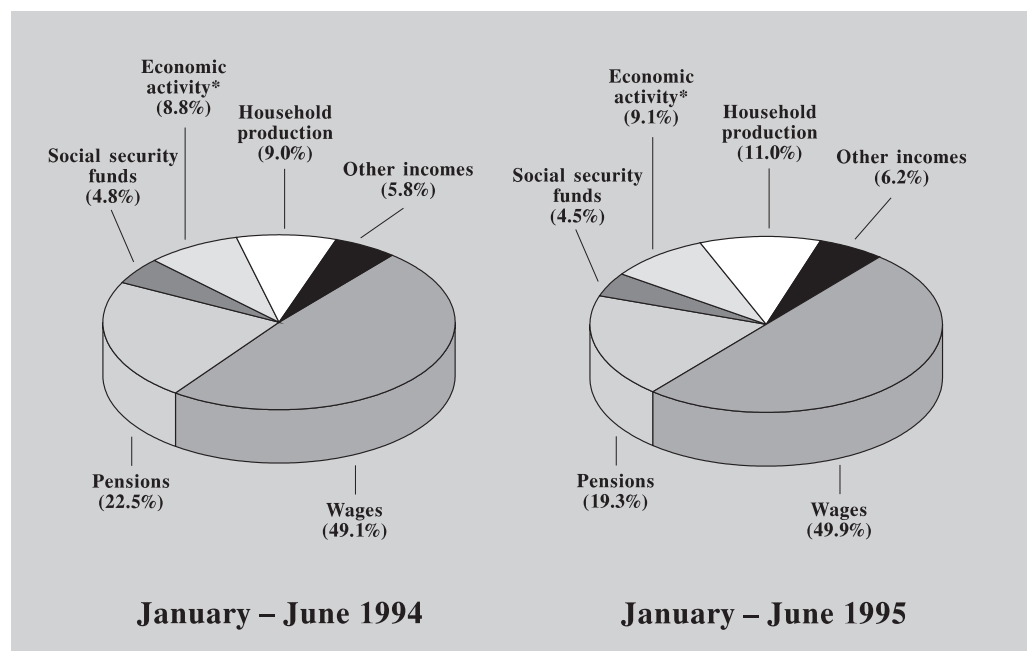


Source: MLSS

3. Income and Consumption

In the first half of 1995, gross income of the population⁶ (monetary and natural) grew significantly in nominal terms (47.3%) from a year earlier. However, real income declined substantially (21.9%), due to a steep price rise over the one-year period. In structural terms, the share of social payments in income during the first six months of 1995 was 23.4%, a decline from the 27.3% share during the same period of 1994. Heavy constraints on the budget financing of pensions kept low the nominal level of pensions, unemployment and social benefits. At the same time, household production rose significantly, especially the share of natural incomes. The share of wages in income was due primarily to extra incomes from part-time jobs. Income from entrepreneurship remained small. On the one hand, this reflected inadequate tax culture and loose discipline, but also gives reason to assume that the statistical sample did not cover high-income groups of the population.

STRUCTURE OF GROSS INCOME OF THE POPULATION



* This group includes income from entrepreneurship, rent and dividend, and income from sale of property.

Source: NSI, BNB.

Wages

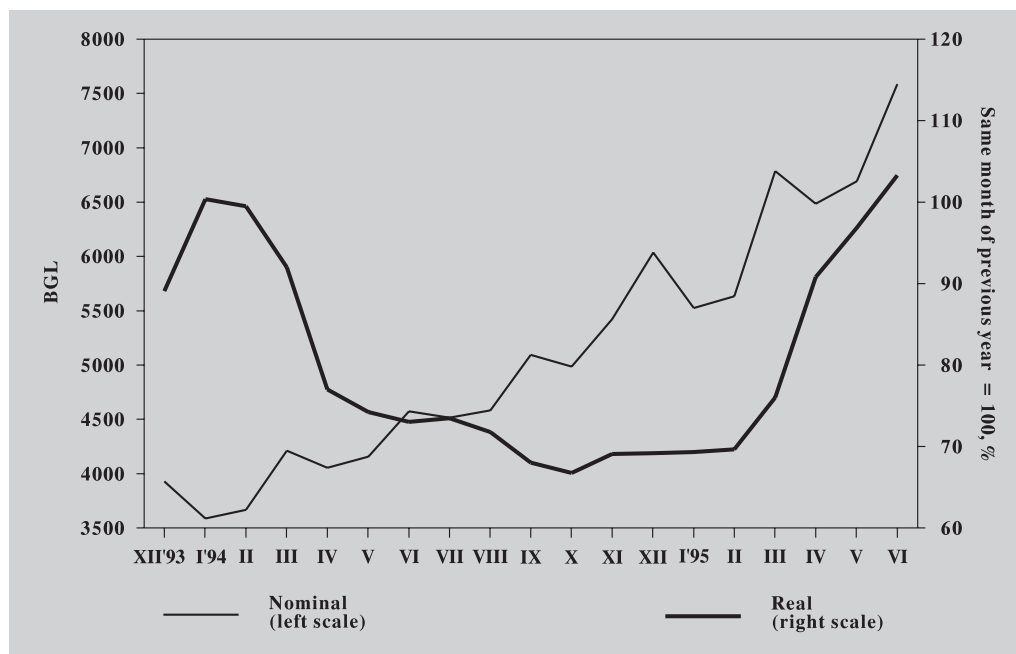
During the first half of 1995, the average monthly wage in the public (state and cooperative) sector⁷ increased by 61.4% compared with the same period a year ago, reaching BGL 6,659 per month⁸. Despite the noticeable increase in nominal terms, real wages dropped further by 14.4%. Even though some industries and businesses witnessed initial recovery, the high inflation rate and government's policy of restricting incomes in the companies with majority state holding, now in its fifth year, continued to put downward pressure on wages.

⁶ Data is obtained from the NSI monthly survey of household incomes.

⁷ Since data about wages in the private sector is not available, the analyses and conclusions refer to public sector wages only.

⁸ Women on maternity leave excluded.

AVERAGE WAGE IN THE PUBLIC SECTOR



Source: NSI, BNB.

In sectoral terms, wages depended significantly on the extent to which economic decline in the specific branch was halted as well as on its capacity to rapidly improve financial performance in the new market conditions. During the first six months of 1995, wages in most branches rose within 55 – 65% in nominal terms from one year earlier. The cellulose and paper industry and the sewing industry were the only exceptions (the former grew by 86.6% and the latter by 80.5%). At the same time, the nominal average wage in the different sectors remained strongly dependent on the structure existing since the 1991 – 1993 period. The wages of workers employed in the energy sector, coal mining, metallurgy, chemical and oil processing industries continued to be between 74.2% and 51.2% higher than the average wage in the country. Staff employed in finance, credit and insurance continued to receive nearly twofold higher wages than the average one. Despite the higher growth rate in wages between January and June 1995, below average wages were paid in the sewing industry (29.1%), textile and clothing industry (25.1%), agriculture (30.3%) and forestry (39.9%). Wages in health care, education and culture continued to be low-paying.

Pensions

During the first six months of 1995, BGL 31.6 billion was disbursed in pensions. By the end of June 1995 (over one year), pensioners totaled 2,416,000, decreasing by approximately 13,000 persons. However, the number of pensioners considerably exceeded the number of employed, which put the latter under upward pressure on contribution to security funds. The average monthly pension increased in nominal terms by 31.3% during the first half-year, reaching BGL 2,135. In real terms, the high inflation rate considerably eroded the average pension and it lost 30.4% of its purchasing power.

Consumption

The NSI survey of household incomes during the first half of 1995 indicated that the structure of gross expenditures on consumption is deteriorating. Compared with the first six months of 1994, the traditionally high expenses on food increased further by 5.5 percentage points, reaching 46.1% of total expenditures. Other groups' expenses declined further from their low levels – with the exception of expenditures on personal hygiene and health care (due to increases in pharmaceutical prices).

STRUCTURE OF GROSS HOUSEHOLD EXPENDITURE

(%)

Indicators	January – June 1994	January – June 1995
Total expenditure	100	100
Food	40.6	46.1
Drink	1.6	1.3
Tobacco products	2.6	2.2
Housing	4.4	3.1
Electricity for households	4.9	4.9
Home furniture	4.6	3.8
Clothing, footwear and haberdashery	7.5	7.3
Personal hygiene and health care	3.3	4.0
Education and leisure	3.0	2.7
Transport and communications	8.9	7.3
Household production	5.3	5.2
Other expenditure	13.1	12.1

Source: NSI.

4. Prices

In contrast to the previous years of reform, no essential changes occurred in price developments during January – June 1995. This is attributable primarily to slow results of monetary constraints imposed in the second half of 1994, as well as to the lack of significant changes in the fixed prices of electricity and thermal power, coal, international and domestic communication services, and fuels. A number of other factors also contributed: relative political stability following end-1994 elections, lack of external shocks and sustainable recovery in the real sector. As a result, inflationary expectations in the economy subsided and the monthly inflation rate declined to 1 – 2% in the second quarter of 1995.

Consumer Prices⁹

Inflation rates decreased during the first half of 1995. In June, the consumer price index, the foremost formal measure of inflation, increased by 15.2% compared with December 1994, the smallest-ever increase in consumer prices since the start of 1991 economic reform. During the first six months of 1995, the inflation rate declined by 44.2 percentage points from a year earlier. The lack of dramatic price jumps over the reporting period precipitated a smoother monthly price movement in the general consumer price index. Monthly consumer price increases reached a high of 3.9% in January and a low of 0.5% in June. These developments diverged from the previous five years of reform and cannot be attributed to seasonal factors.

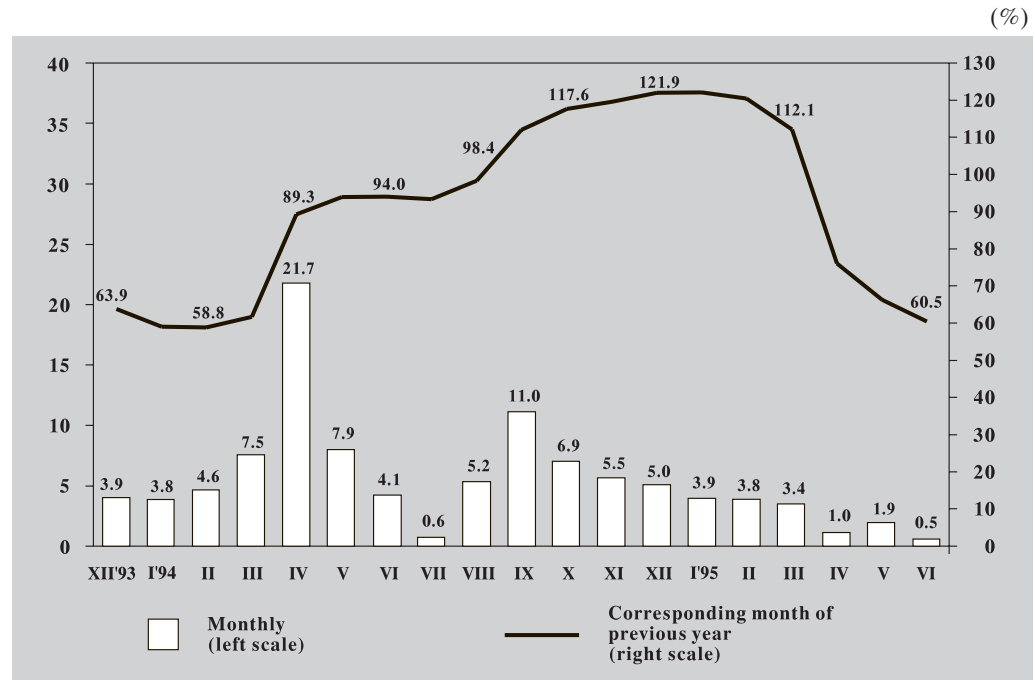
Over the first half of 1995, adjustment of relative prices of consumer goods and services (after the 1994 price jumps) continued. Compared with end-1994, food prices rose by 7.2%, nonfood prices by 18.5%, and services prices by 34.7%. In contrast to 1994, prices of services grew in comparison to the general consumer price index. This was typical for the years when fixed and limit prices were gradually liberalized to compensate for their lag in the general price index, accumulated from previous periods when fixed and limit prices had been used as a price policy instrument to curb inflation. In March, the government raised the price of electricity, thermal power and coal, and in June raised the price of fuels¹⁰.

The relatively lower consumer price index pertains primarily to the developments in food price index. This is entirely attributable to the insignificant movements in food prices and relatively big share of food expenditures, both used as weights in the consumer basket. Smooth food price movements refer basically to a reduced solvent consumer demand as well as to an increased output of some agricultural products, particularly by households.

⁹ In 1995, the NSI continued to calculate the consumer price index using the methods adopted in early 1993. In January – June 1995, no changes were made in the structure of the consumer basket.

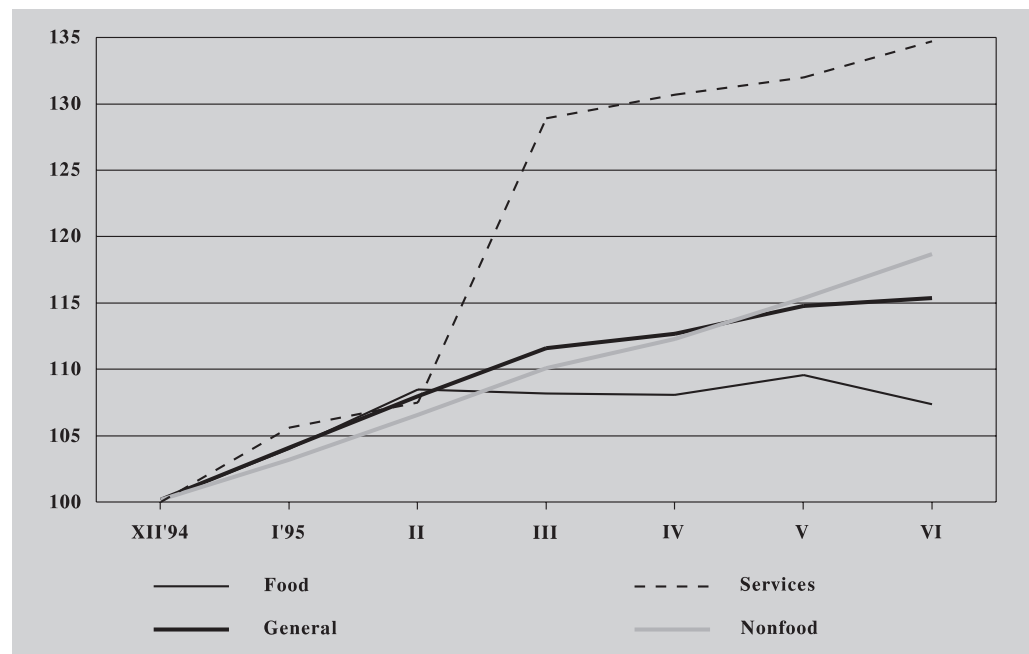
¹⁰ CM Decree No. 42 of 22 February 1995 set fixed prices on electricity, thermal power, coal and compressed slack produced in the country, and CM Decree No. 104 of 23 May 1995 amending CM Decree No. 24 of 14 October 1994 set limit prices on liquid fuels, natural gas.

CONSUMER PRICE GROWTH



Source: NSI, BNB.

CONSUMER PRICE INDICES (December 1994 = 100)



Source: NSI, BNB.

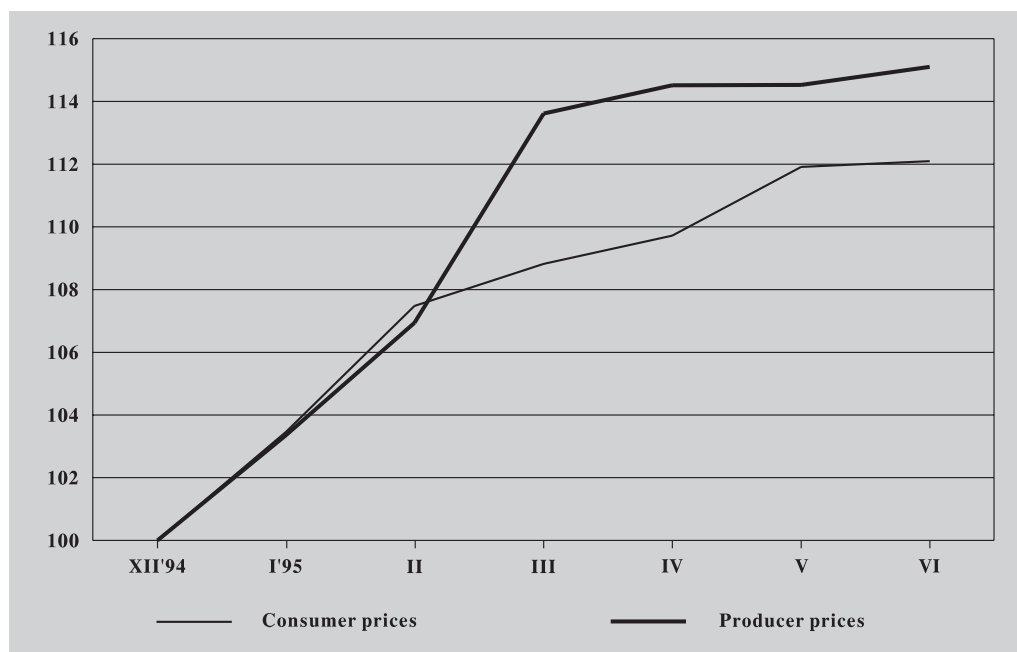
Developments in the nonfood price index almost match those in the general consumer price index. Since nonfood prices are extremely sensitive to changes in the exchange rate, this pertains mainly to the stable exchange rate over the reporting period¹¹.

¹¹ The reason is that the number of the so-called "tradable goods" and imported goods in nonfoodstuffs was the largest relative to the other groups in the consumer basket.

Producer Price Index

During the first half of 1995, monthly industrial producer price indices almost approached the level of consumer price indices¹². However, after February (for the first time since the start of economic reform) industrial producer price indices grew faster than consumer price indices. Since early 1995, producer prices of industrial output have increased by 15.1%, i.e. a mere 0.1 percentage point less than consumer prices but approximately 3 percentage points more than the consumer price index.

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



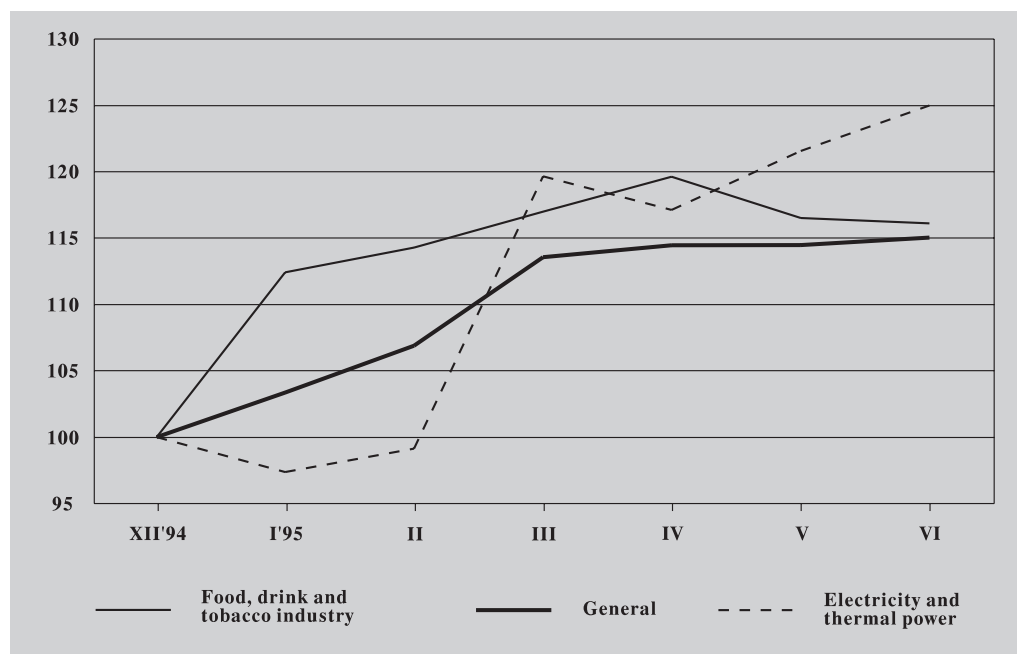
Source: NSI, BNB.

During the period under review, more significant movements were registered in monthly industrial producer price indices. This stemmed primarily from the February changes in fixed prices of electricity and thermal power and the slow reaction by industrial sectors to these changes. Various producer price indices moved within ranges smaller than the average monthly indices compared with one year ago. The primary reason for the smaller shifts in various industrial producer price indices around the general monthly industrial producer price index is the stable exchange rate in 1995, which helped curb fluctuations in equivalent lev prices of exported industrial goods.

Since January 1995, producer prices for the following industries have increased faster than the general industrial producer price index: printing and publishing industry (approximately 40 percentage points); cellulose and paper (approximately 5 percentage points); timber and wood processing industry (approximately 12 percentage points). During the period under review, producer prices of the sectors subject to government regulation (electricity and thermal power generation, coal mining) grew about 9 percentage points faster than the general industrial producer price index. In the first half of 1995, producer prices in nonferrous metallurgy fell.

¹² Comparing consumer price indices with commodity industrial producer price indices is more relevant than comparing general indices, since the sample used for industrial output price indices does not include services.

INDICES OF INDUSTRIAL OUTPUT PRODUCER PRICES



Source: NSI, BNB.

5. Foreign Trade

Recovery in the level of foreign trade, which started in the first 1995 quarter after the dramatic drop in exports and imports in the first half of 1994, was sustained in the second quarter of 1995.

This pertains primarily to two groups of factors which emerged in 1994 and continued in 1995. The first group of external factors refers to Bulgaria's increased access to EU markets, along with the recovery of western European economies. The second group includes internal factors relating to the economic recovery of the country following a five-year decrease in output.

Developments in Exports and Imports

Increases in exports and imports noted in the first quarter of 1995 were sustained throughout the first half of 1995, though at a slower pace. According to NSI preliminary data, Bulgaria's foreign trade volume in the first half of 1995 totaled BGL 216.9 billion (at FOB prices in exports and CIF prices in imports), or USD 3.3 billion (calculated according to the dollar average central exchange rate for the first half of 1995). Compared with the first half of 1994, foreign trade volume increased by 52.4% in nominal terms (based on lev values), and approximately 9.6% in real terms (if it is assumed that dollar values are reliable indicators of Bulgaria's foreign trade developments). Given the dramatic real drop in the 1994 first half-year, the growth in real foreign trade flows is insufficient to reach the 1993 dollar volume (USD 4.3 billion).

Foreign trade growth is attributable to the nominal and real increase both in exports and imports. According to NSI data, the volume of exports totaled BGL 114.1 billion, or over USD 1.7 billion (based on the average exchange rate) in the first half-year of 1995. On a year-earlier level, this data indicates an increase of 51.6% in nominal terms and approximately 9% in real terms. Despite the reported growth, exports did not match the dollar volume registered in the first half of 1993 (USD 1.9 billion). According to NSI estimates, the volume of imports amounted to BGL 102.7 billion at CIF prices, or over USD 1.5 billion (based on the average exchange rate), and USD 98.3 billion at FOB prices during the first six months of 1995. The reported growth accounted for 53.4% in nominal terms (at CIF prices)

Commodity Structure of Exports and Imports

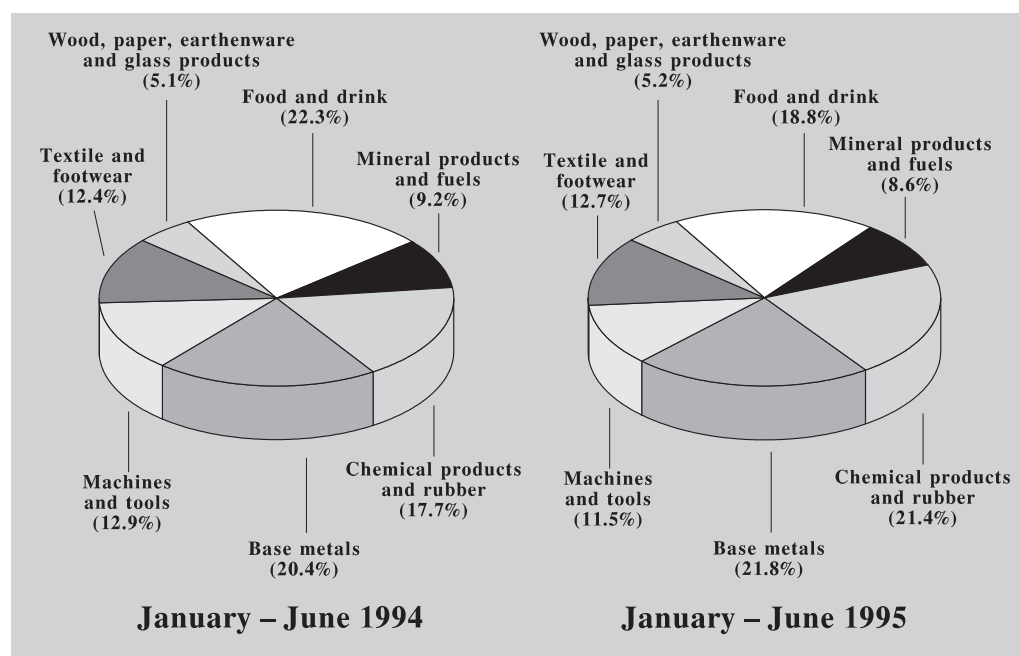
and approximately 9.6% of 1994's results in real terms. However, imports denominated in US dollars did not reach the volume of the first half of 1992 (USD 1.9 billion) and 1993 (USD 2.4 billion). As in the first half of 1994, the foreign trade balance registered a surplus. If CIF prices in imports are used, the surplus totals BGL 11.4 billion, or USD 172.5 million (based on the average central exchange rate) versus USD 174.5 million a year ago. At FOB prices, the surplus in imports rose by BGL 15.8 billion, or USD 239.3 million.

Analysis of foreign trade developments suggests that the high growth rate in dollar exports (based on the quarterly average exchange rate) in the first quarter (22.7%) slowed over the first half of 1995. At the same time, slower growth in dollar imports in the first quarter (7.9%) was sustained over the entire six-month period.

The trend of further restructuring in exports and imports by commodity group, evolving in recent quarters, was sustained in the first quarter of 1995 and in the first half-year¹³.

Exports. Food and drink, traditionally first in Bulgaria's exports, moved to the third position in the first quarter of 1995, accounting for 18.8% during the first six-month period of 1995. Base metals (21.8%) and chemicals (21.4%) retained their leading positions although changing their places in the second quarter of 1995. The share of machines and equipment continued to drop, reaching an atypical low of 11.5%.

COMMODITY STRUCTURE OF EXPORTS



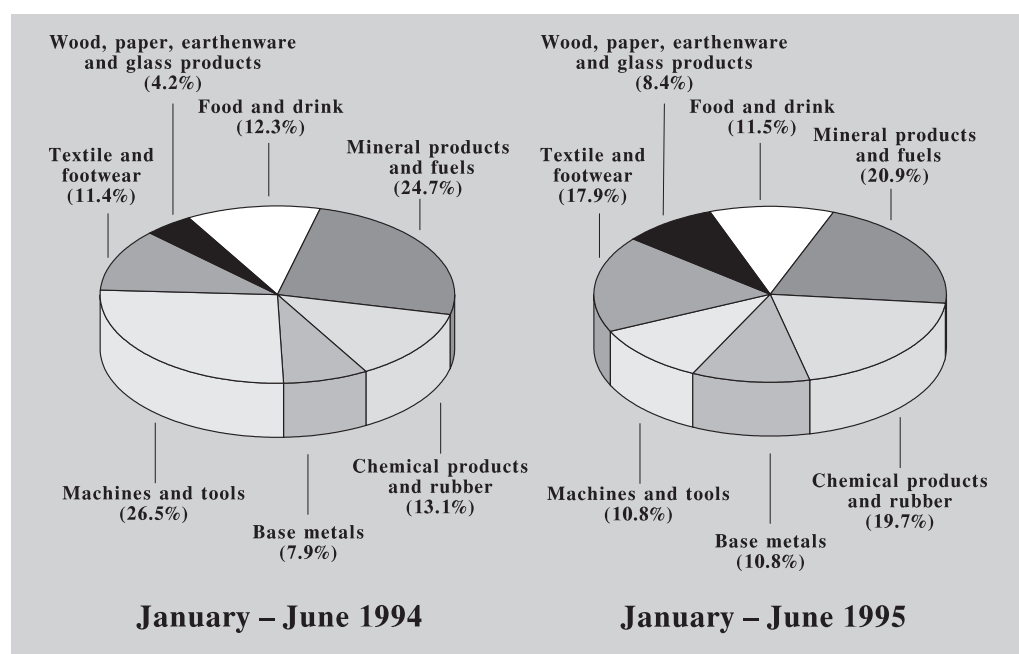
Source: NSI, BNB; Ministry of Trade, International and Economic Cooperation (MTIEC), BNB.

Imports. Changes in the shares of major commodity groups in imports are indicative of further restructuring in imports. Over the second 1995 quarter, the share of machines and equipment dramatically fell by nearly 15 percentage points, compared to the first quarter of 1995 and the first half of 1994. This group, recently ranking first in Bulgaria's imports, lost its position and ranked among the three groups with the smallest shares in imports. The decline in the share of machines and equipment to the unusual low of 10.8% is indicative of sluggish investments by Bul-

¹³ In analysis of the commodity structure of exports and imports, the BNB employs the classification, according to which the harmonized system of foreign trade classification (introduced by the NSI in 1992), including 21 sections, is enlarged to 7 commodity groups.

garian companies, which may adversely affect Bulgaria's economic growth in the long run. The share of minerals and fuels, a group of key significance in Bulgaria's imports, continued to decline, comprising slightly over one fifth (20.9%) of Bulgaria's total imports in the first half of 1995. Despite the decline, this group ranked first in imports, followed by the group of chemicals, whose share increased by 6.5 percentage points from one year ago. Textile and footwear dramatically increased its share relative to the first six months of 1994, is third by significance in Bulgaria's imports. As a result, the structure of imports by commodity group has become more balanced, with the shares of the 7 commodity groups falling within 12.5 percentage points.

COMMODITY STRUCTURE OF IMPORTS



Source: NSI, BNB; MTIEC, BNB.

Geographic Structure of Exports and Imports

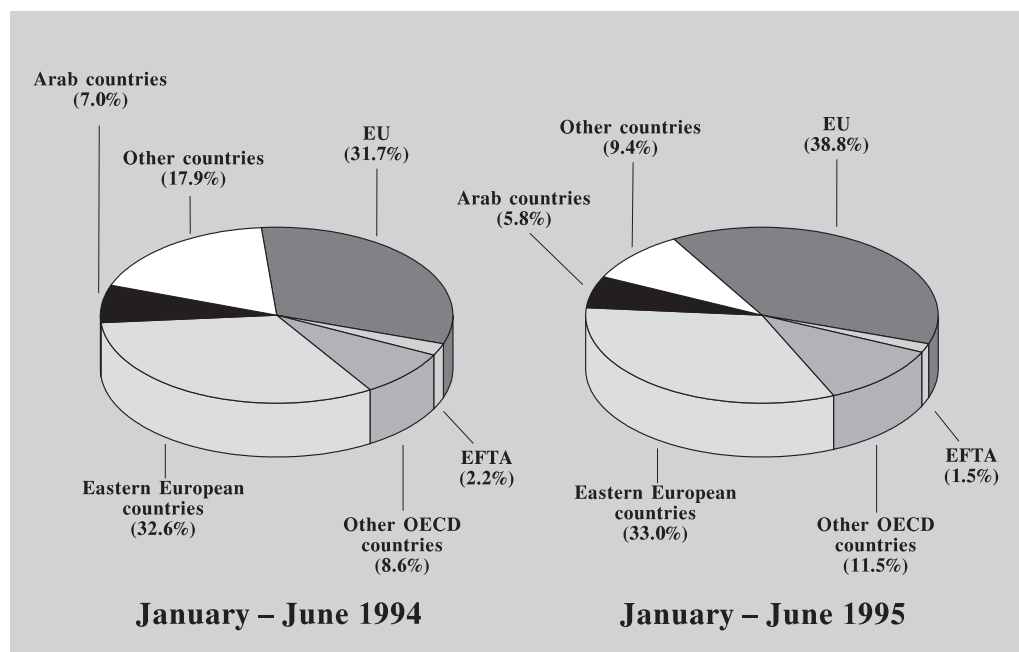
Certain changes occurred in the geographic structure of Bulgaria's exports and imports. However, these changes are not so clearly pronounced as in the commodity structure.

Exports. The trend of a gradually increasing share of Bulgaria's exports to OECD countries after COMECON disruption and the start of market-driven economic reform was sustained over the January – June period of 1995. The share of Bulgaria's exports to OECD countries was more than half of Bulgaria's total exports (51.8%). The significant growth from one year ago was attributable to an increase of over 7 percentage points in the share of the EU, a result primarily of the intensified integration and association of Austria, Norway and Finland with the EU in early 1995. Increased exports (approximately 3 percentage points) to the countries which are not members of the EU and EFTA, a region which has lost its significance in the geographic structure of Bulgaria's exports, also contributed to this effect. The increased share of OECD countries was matched by a decline in the share of developing countries (Arab and other countries). At the same time, the share of central and eastern European countries and the former Soviet republics in total Bulgaria's exports remained almost unchanged from one year ago.

Imports. The OECD countries, the most important region in the geographic structure of imports, increased slightly (less than 1 percentage point) compared with the first half of 1994. This increase pertains mainly to a 7.1 percentage point growth in the share of the EU. More significant growth (7.1 percentage points) was registered in the share of eastern European countries (including former Soviet republics), which signals a certain recovery in imports from Bulgaria's biggest traditional

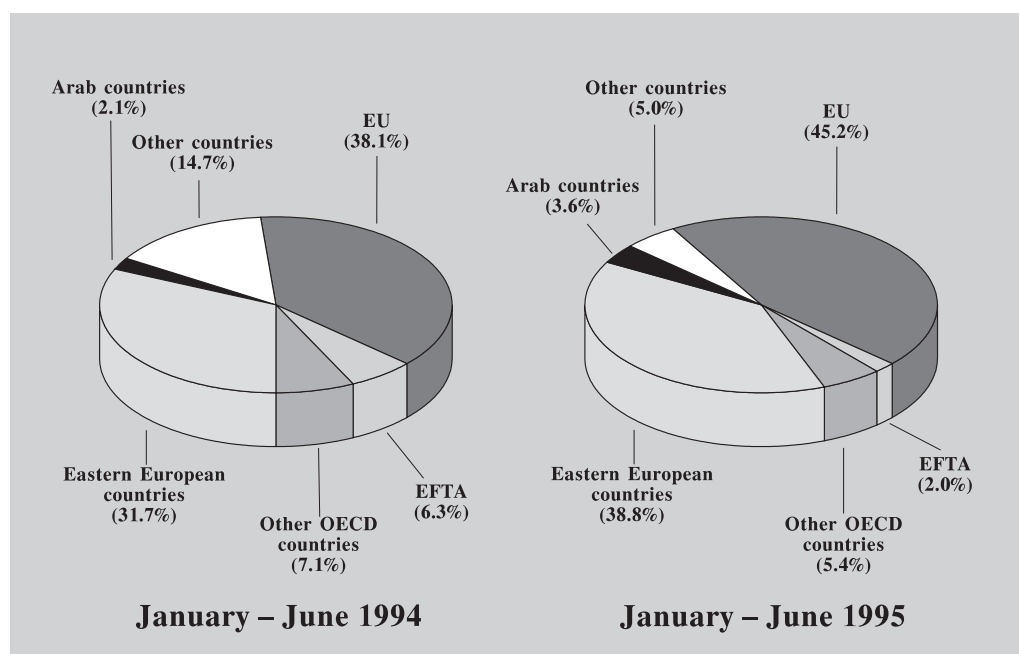
trade partners (Russia, Ukraine), consistent with the normalization of the internal economic situation in the region. The increased share of imports from eastern European countries was matched by an almost 50% decline in the share of developing countries (Arab and other countries).

GEOGRAPHIC STRUCTURE OF EXPORTS



Source: NSI, BNB; MTIEC, BNB.

GEOGRAPHIC STRUCTURE OF IMPORTS



Source: NSI, BNB; MTIEC, BNB.

The geographic structure of Bulgaria's exports and imports was characterized by increased significance of two regions making up approximately 85% of exports and over 90% of imports. These are the OECD countries and the EU, with a combined share of over 50% both in exports and imports, and the eastern European

countries, with shares of approximately 1/3 of exports and imports respectively. Given the geographic, cultural and historical closeness of these regions and the historical trade relationships, combined with the high competitiveness of the western markets and increasing competitiveness of the eastern markets, the intensive trade operations both in exports and imports favor the export/import structure and production.

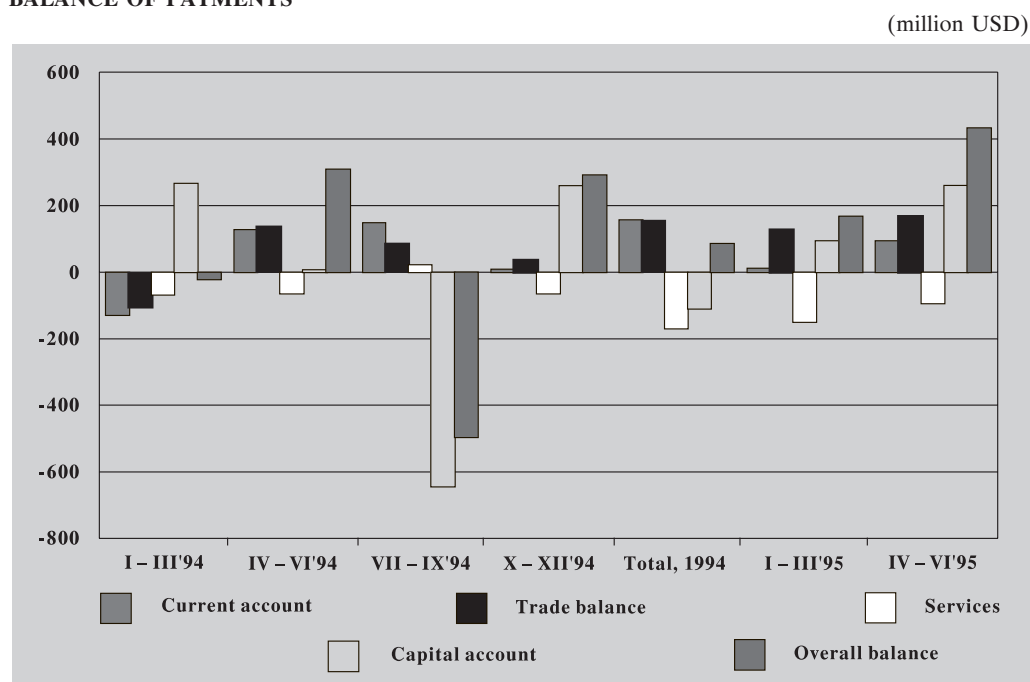
6. Balance of Payments

Current Account

In January – June 1995, the balance of payments current account amounted to USD 106.2 million, an increase of USD 106.7 million. The surplus registered in this first half-year was mainly attributable to the foreign trade surplus of USD 294.8 million, which increased by USD 262.3 million from a year ago. The stable USD exchange rate and relatively moderate inflation rate over the six-month period favored economic growth. Obviously, the faster inflation rate relative to the lev depreciation against major convertible currencies did not affect adversely exports.

Net value of services over January – June 1995 dropped to USD -242.6 million, thus deteriorating the balance of payments current account. Transport ran a persistent deficit. Over the first six months of 1995, transport accounted for USD 34 million compared to USD 38.5 million a year ago. Given the favorable geographic situation of Bulgaria, the deficit (net) on transport is primarily due to the UN trade sanctions against Yugoslavia.

BALANCE OF PAYMENTS



Source: BNB.

The balance on interest payments (net) reported a deficit of USD 215.4 million, an increase of USD 124.3 million from one year ago. This was due to the payment of USD 128 million to the London Club creditors.

The surplus on travel in the January – June period is USD 30.9 million. Compared with a year earlier, net earnings from travel have grown by USD 25.3 million, a result of the faster growth of revenue over expenditure.

**Capital
Account**

The balance of payments capital account ran a surplus of USD 355.7 million, an increase of USD 83.2 million over a year earlier. Despite the double increase in direct foreign investments compared with the first half-year of 1994, these investments' share in total capital inflow remained small. Bulgaria's low credit rating and the general instability of the Balkan peninsula impede foreign investment, despite the relatively favorable conditions provided by Bulgarian legislation.

The inflow of medium- and long-term credits declined from USD 100.7 million in the first half of 1994 to USD 52.3 million over January – June 1995. This was a result of reduced financing from international financial institutions. Interest repayments over the six-month period totaled USD 146.5 million, including USD 103.1 million to the IMF.

Compared with the first half of 1994, a growth of USD 92.6 million was registered due to the increased payments of USD 89.4 million to the IMF.

Interest repayments on credits extended by Bulgaria total USD 135.9 million, a decrease of USD 38.8 million compared with the same period of 1994. Repayments in natural gas under the Yamburg pipeline agreement, totaling USD 133.5 million in the first half of 1995 (a decrease of USD 32 million from year ago) comprised the largest share and continued to be an essential factor for the capital account surplus.

In the January – June 1995 period, commercial banks' deposits abroad fell by USD 163.5 million from one year ago, while in the same period of 1994 they increased by USD 220 million due to the March forex crisis. Foreign capital inflows of uncertain origin added significantly to the capital account surplus. According to BNB estimates, these inflows amounted to USD 340 million, which has made BNB forex reserves strongly dependent on them.

**Overall
Balance**

In January – June 1995, the overall balance reported a surplus of USD 600.8 million, an increase of USD 311 million from one year ago. As a result, BNB net foreign exchange reserves have increased by USD 600.8 million and gross foreign exchange reserves by USD 497.7 million.

III. Fiscal Policy

Over the first half of 1995, a number of macroeconomic indicators improved in relative terms, consistent with certain changes in economic policy. Although the National Assembly has adopted a relatively restrictive budget, signs of relaxation were evident. Against the background of a relatively stable macroeconomic situation in the country, the revenue side of the cash basis reporting of the state budget over the first half of 1995 is broadly in variance with the 1995 State Budget Law (SBL) projections and the cash deficit has grown alarmingly.

1. Consolidated State Budget

The consolidated state budget of the Republic of Bulgaria includes the government budget,¹⁴ local budgets, the social security budget, some extrabudgetary accounts, and several special funds¹⁵. The 1995 SBL adopted portions of the consolidated budget, including the central government budget (CGB); transfers to cover the deficits of other budgets; the social security budget; and the legal system budget.

Over the six months of 1995, net revenue on the consolidated state budget, obtained after deducting intrabudgetary transfers and funds for budget deficit financing, accounted for BGL 141,471.8 million, or 16.9% of GDP projected¹⁶. Net expenditure on the consolidated state budget totaled BGL 165,481.1 million, or 19.8% of GDP projections. Compared with 1994's corresponding levels, revenue and expenditure in reported GDP¹⁷ were 16.6% and 18.6% respectively. Revenue and expenditure in the government budget made up the largest shares in the consolidated state budget – 58.2% and 57.6% respectively. Compared with the same period a year ago, revenue accounted for 58% and expenditure considerably less, at 49.7%. The structure and amount of revenues and expenditures in the consolidated state budget reflect directly the changes occurring in central government expenditure and revenue. As of 30 June 1995, revenue in the central government budget totaled BGL 82,288 million, or 38.2% of SBL projections, and 9.8% of GDP projections. By way of comparison, between January and June 1994 revenue was 52% of SBL and 9.6% of reported GDP. The 1995 SBL set the VAT as the major revenue provider, with a 45.1% share of projected tax revenue. However, over the first six months of 1995, it showed the worst performance relative to SBL projections (32.2%).

As of 30 June 1995, expenditure on the central government budget totaled BGL 113,810.1 million, or 43.1% of SBL projections. In structural terms, current expenditure has accounted for the largest share (56%) in contrast to the previous year where transfers granted by the central government to other budgets composed the largest share (50.9%). Structural changes in central government budget expenditure pertain to increased spending on government debt service. During the first half of 1994, interest paid on domestic debt totaled BGL 23,690.4 million, or 4.4% of reported GDP, while over the same period in 1995 it almost doubled – to BGL 46,116.9 million, or 5.5% of projected GDP. The SBL projection of central government transfers to other budgets totals BGL 123,719.4 million. Only 40.2% of this is projected for the 1995 half-year.

¹⁴ The government budget includes central government budget, budgets of ministries and agencies, and regional municipal budgets.

¹⁵ Extrabudgetary accounts and funds included in the consolidated state budget are the following: "Professional Qualification and Unemployment Fund," and "Land Tenure and Improvement Fund" and the extrabudgetary accounts opened as per CM Decree No. 27 of 1992 and the Law on Protection of Arable Land and Pastures.

¹⁶ GDP was estimated to reach BGL 836 billion.

¹⁷ The GDP reported at the end of 1994 accounted for BGL 543 billion.

2. Budget Deficit and Budget Deficit Financing

The SBL established that the cash deficit be concentrated solely in the central government budget. During the reporting period, owing to balances on accounts of ministries, agencies and regional administration, a certain difference between the cash deficit of the CGB and the government budget appeared.

Between January and June 1995, a primary surplus on the CGB of BGL 25,788.4 million was registered, or only 39.8% of SBL projections, which reflected slower receipt of tax revenue on the CGB than projected in the SBL. Compared with the same period a year ago, the CGB primary surplus accounted for BGL 13,521 million, or 149.2% of SBL projections, which reflected a restrictive fiscal policy and high inflation.

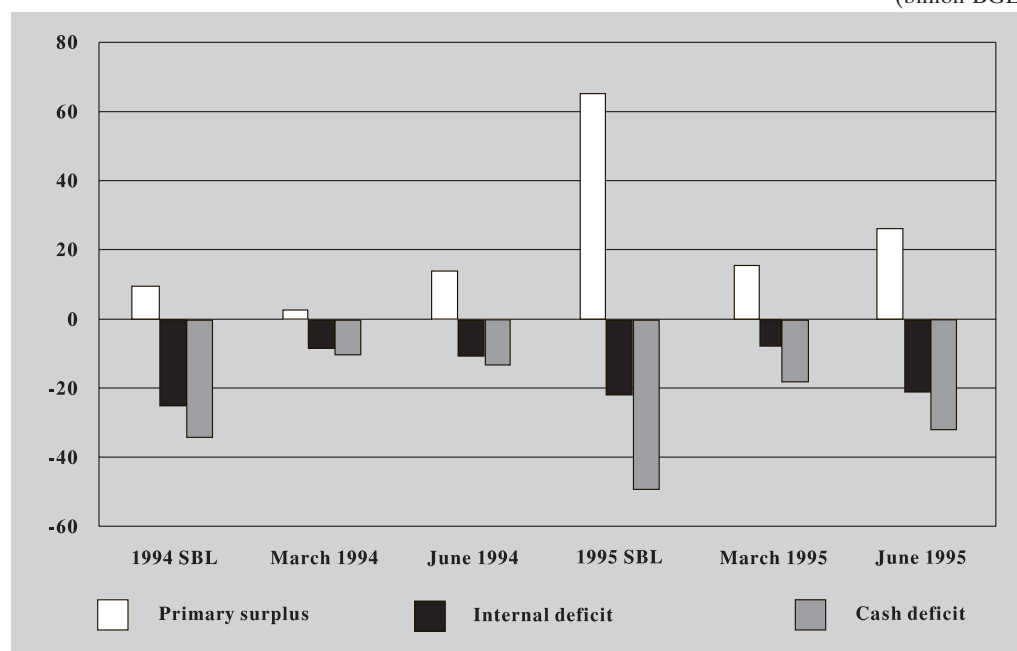
As of 30 June 1995, the primary surplus in the CGB proved insufficient to cover domestic debt service expenses. After relationships between the budget and domestic creditors are taken into account, an internal deficit of BGL 20,328.5 million was chalked up by end-June, or 95% of SBL projections and 2.4% of projected GDP. Compared with the 1994 level, internal deficit rose by 49.9%, as a result of considerably higher expenses on interest repayment of domestic debt.

As of 30 June 1995, the cash deficit of the CGB had reached BGL 31,522.2 million, or 64.7% of SBL projections and 3.8% of GDP projections. By way of comparison, the reported cash deficit from a year ago was significantly less than the 1995 level (BGL 12,519.5 million), or 37.2% of SBL projections and 2.5% of reported GDP.

Increased government borrowing from domestic creditors and withholding of large budget deposits on accounts led to enhanced overall demand for credit resources¹⁸. As of 30 June 1995, demand totaled BGL 87,623.4 million, a 42.2% increase on a year-earlier level. In structural terms, domestic government debt service expenses had the largest share, 50.9%. Retention of the trend toward a considerable increase in the overall budget demand for credit resources is alarming because it may make it difficult in the following years to maintain an adequate level of budget deficit.

DEFICIT OF THE CENTRAL GOVERNMENT BUDGET

(billion BGL)

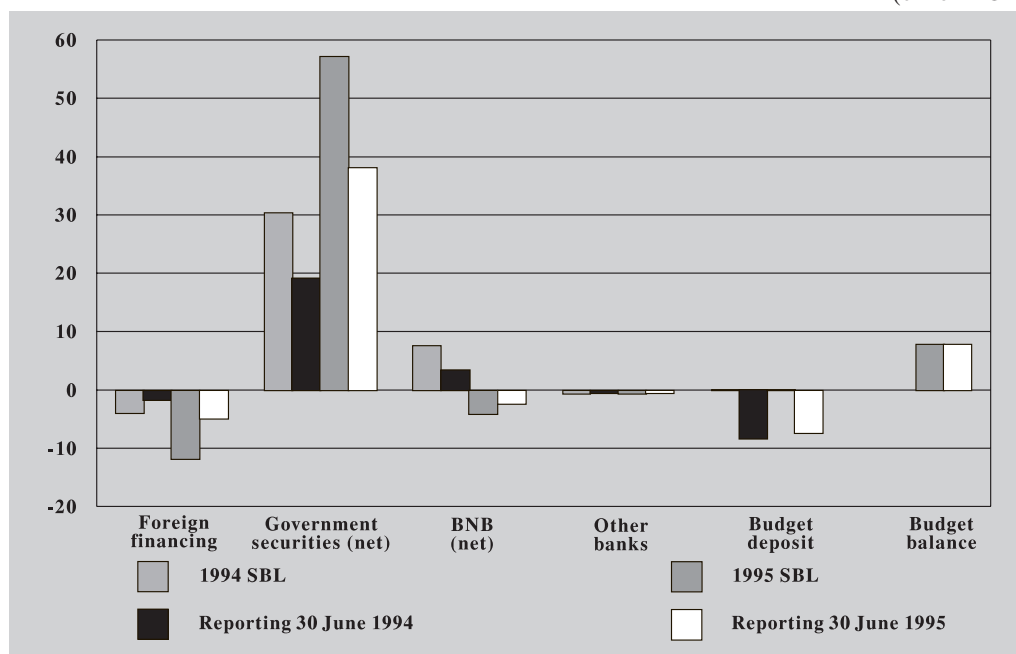


Source: BNB.

¹⁸ Overall budget demand for credit resources includes cash deficit plus decline in liabilities to domestic and foreign creditors.

CASH DEFICIT FINANCING OF THE CENTRAL GOVERNMENT BUDGET

(billion BGL)

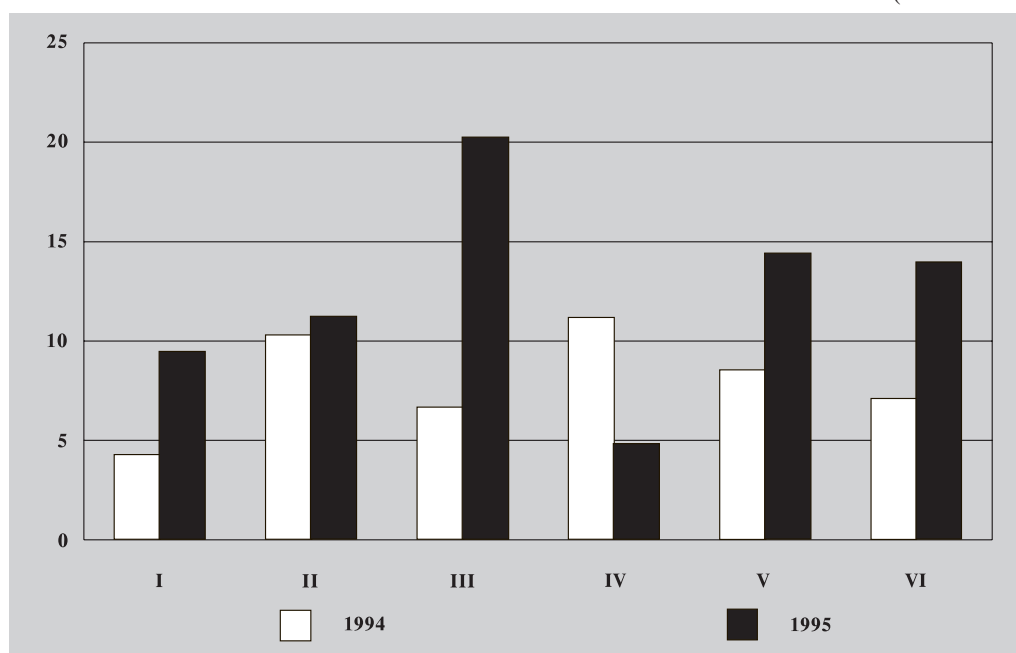


Source: BNB.

By the end of the 1995 half-year, negative foreign financing (net) had been reported, totaling BGL 4,778 million, or 41.1% of SBL estimates. Of this, repayments of overdue interest on external loans came closest to SBL projections (90.9%), while over the first half of 1994 it totaled BGL -1,482.3 million, or 39.4%.

MONTHLY SALES OF GOVERNMENT SECURITIES

(billion BGL)



Source: BNB.

As of 30 June 1995, domestic financing (net) of the CGB totaled BGL 36,300.2 million, including BGL 38,073.4 million in government securities operations (net), or 66.7% of SBL, which consists of bank and nonbank budget deficit financing

through government securities. Direct bank financing (net) of the state budget accounted for BGL -2,345.4 million, or 52.3% of SBL projections. The 1994 CGB showed a surplus of BGL 7,745.8 million, which made up a portion of net domestic financing of the budget. Throughout the reporting period, the budget deposit was relatively large, and by end-June it accounted for BGL 7,203.5 million (including government time deposit of BGL 500 million).

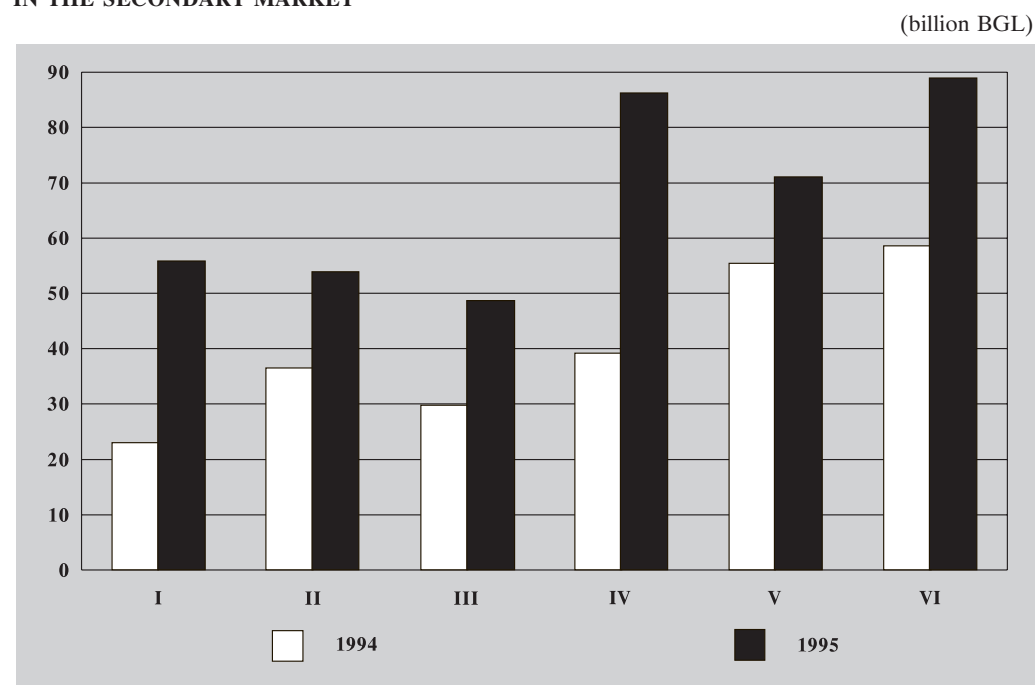
Between January and June 1995, 68 issues of book-entry government securities with a total nominal value of BGL 137,499.13 million were sold through the BNB, including 5 issues of discount treasury bills, 39 issues of interest-bearing treasury bills, and 24 issues of treasury bonds. As of 30 June 1995, 116 issues were in circulation (51 of treasury bills and 65 of treasury bonds) with a total nominal value of BGL 173,586.1 million.

Government securities sold during the first six months of 1995 brought BGL 73,844.6 million in the state coffers, 1.6 times more than a year ago. Maturing government securities of BGL 35,771.2 million were redeemed, including government securities issued in previous years and redeemed in the present year in the amount of BGL 30,619.6 million. Both the greater sale of government securities issues and the higher basic interest rate resulted in enhanced spending on interest and government securities discounts totaling BGL 24,688.3 million, a 2.9-fold increase from a year ago.

The aggregate nominal value of government securities offered by the MF over the first half-year was BGL 149,180.9 million; for two of the issues no amount was set.

Financial institutions' auction bids netted a total of BGL 155,196.6 million. No auction bids were received for the five-year treasury bonds (No. 56) and the MF did not approve any of the bid prices set for the three-year treasury bonds, issue No. 9; as a result the two issues remained unsold. As the MF did not announce in advance minimum acceptable prices for participation, financial institutions' bids were approved upon attainment of a minimum price set by the MF on the auction day. The only exception were several issues sold at a discount from their nominal value and the issues sold under the terms of Article 3, para. 4 of Regulations No. 5 of 1993 of the BNB.

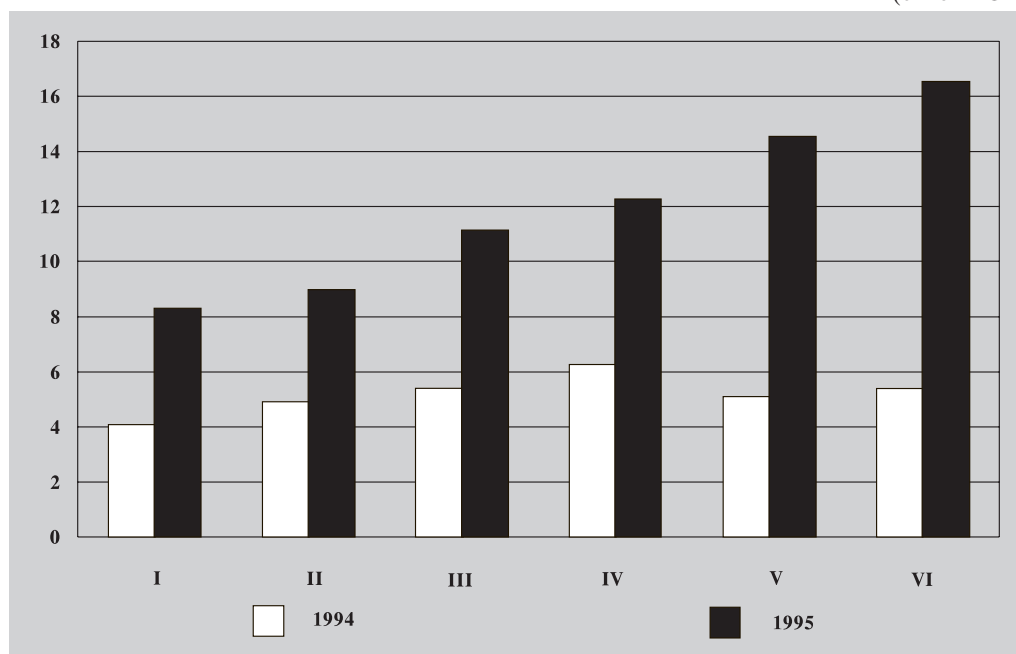
MONTHLY TRANSACTIONS IN GOVERNMENT SECURITIES IN THE SECONDARY MARKET



Source: BNB.

NONBANK FINANCING OF THE BUDGET DEFICIT

(billion BGL)



Source: BNB.

The trend toward greater interest in treasury bill investments by commercial banks continued, while the SSB proved to be a major investor in treasury bonds. Overall, SSB and SII's government securities portfolios significantly decreased, while those of BNB and commercial banks increased.

During the 1995 first half-year, the average annual yield of most government securities was higher than, or equal to, the basic interest rate which prevailed in the January – June 1995 period, except for four issues of treasury bills sold at a discount of their nominal value and issue No. 26 of six-month treasury bills sold for the first time at a fixed interest rate.

Over the January – June 1995 period, government securities transactions in the secondary interbank market doubled compared with the same 1994 period. Government securities transactions numbered 4,085, totaling BGL 403,678.5 million nominal value. The BNB continued to be the main participant in secondary market operations (effecting 3,457 transactions of BGL 372,793.7 million), although the relative share of secondary market transactions effected without its participation increased 3.3-fold.

Regular sale of government securities targeted at individuals and companies continued along with the latter's participation with noncompetitive bids at the auctions. Over the first 1995 half-year, government securities of BGL 3,237.4 million with a total nominal value of BGL 3,488.3 million were purchased by individuals and companies under these terms. Government securities bought with noncompetitive bids at the auctions totaled BGL 63.1 million. The remaining amount was bought by individuals and companies directly from commercial banks and the BNB. Nonbank financing of the budget deficit through government securities operations totaled BGL 16,517 million (aggregate nominal value), versus BGL 5,362 million in the January – June 1994 period.