Bulgarian National Bank

REPORT - January - June 2014





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

Under the provisions of Article 1, paragraph 2 and Article 50 of the Law on the Bulgarian National Bank, I have the honour of presenting the Bank's Semi-annual Report for the period ending 30 June 2014.

Ivan Iskrov

Governor

of the Bulgarian National Bank



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

Governing Council

Ivan Iskrov

Governor

Dimitar Kostov

Deputy Governor Banking Department

Kalin Hristov

Deputy Governor Issue Department

Tsvetan Gunev

Deputy Governor Banking Supervision Department

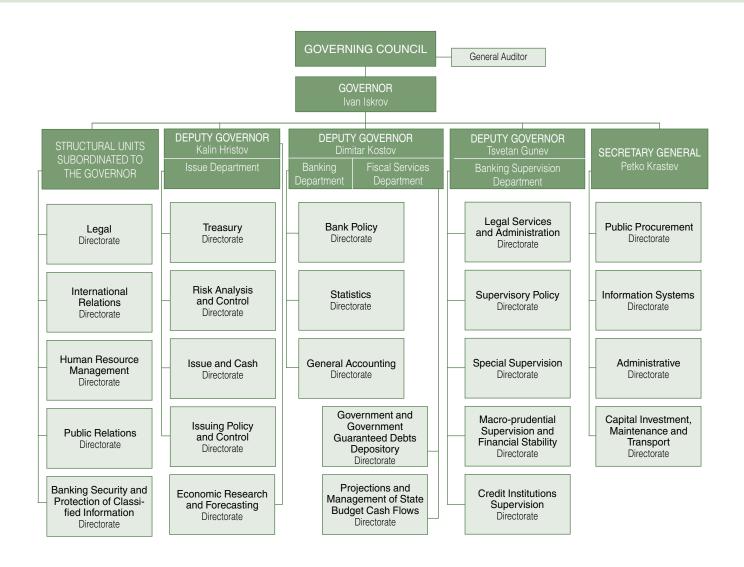
Boryana Pencheva

Lena Roussenova*

Statty Stattev

^{*} Lena Roussenova became a Member of the BNB Governing Council on 13 June 2014. Until 12 June 2014, Penka Kratunova was a Member of the BNB Governing Council.

Organisational Structure of the BNB





In 2014 the Bulgarian National Bank marked the 135th anniversary of its establishment with a number of events and initiatives to acquaint the public in more detail with the Bank's past role and functions, its current activities and duties, and its responsibilities as Bulgaria's central bank and member of the European System of Central Banks.

The main jubilee celebrations were on 6 June.* They included an international conference on Central Banks and the Overhaul of Banking Regulation and the 31st session of the Central Banks Governors' Club of Central Asia, Black Sea Region and Balkan Countries.

Marking its jubilee, the Bank posted on its website more complete catalogues of commemorative coin and banknote samples and published a new brochure of exhibits in its Museum Collection. The BNB website now also carries declassified BNB Reports for the 1980–1990 period which are a valuable source of information on Bulgaria's economic history during that decade. The illustrated two volume work *Mihail Tenev:* Life and Works, including the memoirs of this eminent Bulgarian financier and Bank Governor at the close of the 19th Century, amplified the BNB publications series A History of Finance and Banking: the Heritage.

The joint hosting by the BNB and ECB of European Cultural Days, this year devoted to Bulgaria, formed part of the jubilee celebrations. The Frankfurt events included a series of events and performances by Bulgarians representing national history and culture. Evoking great interest in Bulgaria, these initiatives enjoyed great success.

^{*} A Deed of Association established the Bulgarian National Bank on 25 January 1879. Appointment of the first Governor was on 4 April that year. The Bank formally opened its doors on 23 May. BNB anniversaries are traditionally marked on 6 June, the day of the first banking operation.

Contents

Sumr	nary11
l.	Economic Development in the First Half of 2014
II.	Gross International Reserves 28
11.	The Amount and Structure of Gross International Reserves
III.	Payment Systems 36
IV.	Bank Reserves at the BNB 40
V.	Currency in Circulation 42
VI.	Maintaining Banking System Stability and Protecting Depositor Interests 46 1. The Banking System 46 2. Assessment of the Financial Performance of Financial Institutions
	Registered under Article 3a of the Law on Credit Institutions 53 3. Banking Supervision 56
VII.	The Central Credit Register 59
VIII.	The Fiscal Agent and State Depository Function 61
IX.	Participation in the ESCB and in the Activities of EU Institutions 66
Χ.	International Relations 68
XI.	Statistics 69
XII.	Research 71
XIII.	Information Systems 72
XIV.	Human Resource Management 73
XV.	Facilities Management 75
XVI.	BNB Internal Audit 76
XVII.	BNB Budget Implementation in the First Half of 2014 78 1. Operating Expenditure 78 2. The Investment Programme 79
XVIII	Bulgarian National Bank Consolidated Financial Statements as of 30 June 2014 (unaudited)
Majo	Resolutions of the BNB Governing Council in the First Half of 2014 113
Appe	ndix (CD)

Abbreviations

Base interest rate

BIR

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

Summary

In the first half of 2014 global economic growth fell slightly to 2.6 per cent on December (2.0 per cent in the first half of 2013). Trends differed across regions. Real growth in the USA and China slowed marginally, while Japan recorded a significant economic activity slowdown over the second quarter. Euro area growth was low but positive. Ireland, Latvia, and Slovenia grew faster, unlike Cyprus, Greece, and Italy which continued to report negative growth rates in real terms. In June EU and euro area indicators dipped with rising tension between Russia and Ukraine and further EU sanctions on Russia.

Continuing major world commodity price falls depressed global annual inflation to 2.4 per cent by end-June from 2.5 per cent six months earlier. Brent oil rose slightly by 0.8 per cent in US dollars, falling 3.4 per cent in euro. Food, cereals, and metals continued dropping by 0.9, 23.2, and 10.9 per cent on an annual basis. Euro area annual inflation was 0.5 per cent from 0.9 per cent at the end of 2013. US annual inflation rose to 2.1 per cent from 1.5 per cent at the end of 2013.

Divergent euro area and US growth and inflation prompted divergent ECB and Federal Reserve reactions. In June the ECB cut main refinancing operation and marginal lending facility interest and set negative deposit facility interest. Additional measures were introduced to provide liquidity for euro area banks and encourage lending. The Federal Reserve kept interest unchanged and cut asset purchases further. Government bond yields declined globally, euro area periphery spreads narrowing.

Gradual external environment improvement stimulated the Bulgarian economy. Real GDP growth rose to 1.8 per cent from 0.3 per cent in the first half of 2013, underpinned by final consumption and fixed capital investment reflecting government investment growth. The labour market improved slightly, employees rising by 0.3 per cent annually. Unemployment fell to 12.2 per cent from 13.4 per cent in the first half of 2013. Productivity rose 1.4 per cent from 0.8 per cent in 2013. Total economy nominal average wage grew 2.4 per cent from 7.7 per cent in the first half of 2013, or 4.2 per cent from 6.0 per cent in real terms.

Strengthened domestic demand boosted imports, resulting in a negative contribution of exports to economic growth. Trade deficit grew to EUR 1608.2 million and the current and capital account surplus fell to EUR 260.4 million. The balance of payments financial account was in surplus by EUR 176.1 million.

The annual inflation rate was negative (-1.8 per cent compared with -0.9 per cent by end-2013) impacted by lower international food, fuel and commodity prices and the decreased regulated price of electricity for households from late June. GDP deflator was -1.7 per cent. By component of final use, goods and service import and export deflators and household final consumption expenditure and fixed capital investment deflators also recorded negative values, while government consumption remained the sole positive deflator.

Credit demand rose with economic activity. The annual growth of claims on the non-government sector began rising to reach 2.4 per cent in June (0.3 per cent by end-2013), largely as loans to non-financial corporations rose 3.3 per cent annually from 0.3 last year. Signs of revival emerged in household lending (up 0.3 per cent in June), overdrafts (0.8 per cent), consumer loans (0.9 per cent) and housing loans (0.4 per cent), while other household loans declined by 6.3 per cent on an annual basis.

Liquidity pressure on banks in late June impacted monetary aggregates. Depositors withdrew some time deposits and transformed others into overnight deposits, boosting currency in circulation. This increased annual growth of money outside MFIs and overnight deposits to 12.5 and 18.4 per cent in June from 6.8 and 23.8 per cent six months earlier and 9.8 and 15.1 per cent in May 2014. Quasi-money growth slowed to 1.5 per cent from 4 per cent by end-2013 and 5.7 per cent in May 2014. Broad money growth decreased to 7.4 per cent on an annual basis from 8.9 per cent in late 2013.

The consolidated fiscal programme accrued a BGN 996.4 million deficit, up BGN 990.2 million on the same period last year. This reflected a BGN 440 million negative balance on EU programmes, mainly through suspended payments to the Operational Programme Environment and two axes of the Operational Programme Regional Development. Budget revenue stabilised at last year's level, expenditure growing 7.0 per cent. BGN 1786 million of net government domestic market debt issues financed the budget. In late June Bulgaria issued EUR 1493 million of new ten-year benchmark Eurobonds with a 2.95 per cent interest coupon.

BNB policy follows global and national economic developments. In compliance with the Law on the Bulgarian National Bank and using effectively its potential and capabilities, the BNB pursues its primary goal: maintaining price stability through ensuring the stability of the national currency. The Bank invests Bulgaria's gross international reserves in line with prudent investment principles and practice. It regulates and supervises Bulgarian banks to maintain their stability and protect depositors. The Bank helps launch, operate, and oversee efficient payment systems by regulating and supervising their operators and payment and electronic money institutions. As issuing bank, the BNB prints banknotes, mints coins, and scraps uncirculated or unfit cash. The Bank is government fiscal agent and depository. It is part of the European System of Central Banks (ESCB) and other EU institutions.

By end-June gross international reserves had a market value of EUR 14,323 million, EUR 103 million less on the end of 2013. The Bank continued managing risk conservatively in investing the reserve. Net earnings from gross international reserve management include the following components: income from investment of BNB international reserves in the amount of EUR 62.14 million; the positive net result of exchange rate movements and price revaluations on assets and liabilities' open foreign currency positions of the Issue Department balance sheet amounting to EUR 122.54 million almost entirely due to the increase in the monetary gold price; zero interest on Issue Department balance sheet liabilities. As a result, net income from BNB international reserve management was positive at EUR 184.68 million: 1.44 per cent net yield.

Amendments to the national supervision framework transposed the EU directive and regulation to strengthen banks' capital position. In March amendments to the Law on Credit Institutions and BNB ordinances were made, including revocation of old and adoption of new ordinances. The new framework entailed also a change in the BNB supervisory approach: the minimum capital adequacy ratio was cut from 12 to 8 per cent and the specific provisions regime was removed. To preserve accumulated banking system capital buffers, the Bank set the capital conservation buffer at 2.5 per cent from May and the systemic risk capital buffer at 3 per cent for domestic credit institutions.

News reports casting doubt on the quality of the KTB (Corporate Commercial Bank) and subsidiary CB Victoria banks' credit portfolios caused runs on them in late June. Significant liquidity depletion led to conservatorship over the two banks on 20 and 22 June. By the end of June runs hit other banks, ending in early July thanks to significant system liquidity buffers, BNB and government measures, and rapid European Commission offers of liquidity support. The EC allows state aid only to solvent and

economically viable banks. These measures revived confidence in banks and deposits recovered to surpass the May level compared to September. The banking system managed to improve liquidity indicators, maintain capital buffers and continued to play its financial intermediary role. Economic agents appreciated banking system resilience and the continuation of financial intermediacy as normal.

The liquid assets ratio dipped to 25.83 per sent before ending the half year at 26.8 per cent. Banking capital adequacy rose from 16.96 to 19.96 per cent in a year. The share of exposures past due over 90 days in net loans (excluding those to credit institutions) fell from 10.73 to 9.57 per cent in a year. Mid year banking system profits were BGN 332 million, return on assets 0.77 per cent, and return on equity 6.30 per cent.

The BNB oversees payment system effectiveness and payment flow continuity. The Bank's RINGS real time gross settlement system processed 84.2 per cent of Bulgarian payments or 489,910 instances worth BGN 335.8 billion. Payment numbers through the Trans-European Automated Real-time Gross settlement Express Transfer system for the euro national system component TARGET2-BNB rose 21.4 per cent. Alongside operating these two major Bulgarian payment systems, the Bank supervises all payment systems in Bulgaria with a view to limiting system risks and improving reliability and efficiency.

BNB issue and cash operations include: banknote printing and coin minting; accepting, delivering, repaying, processing, authenticity and fitness checking of Bulgarian banknotes and coins, and foreign currency; exchanging damaged cash; and destroying unfit Bulgarian banknotes and coins. By the close of June, 364.2 million banknotes worth BGN 10,314.0 million circulated, the average banknote worth BGN 28.32. Some 1684.5 million coins worth BGN 212.0 million circulated, the average one worth BGN 0.13. The share of retained non-genuine Bulgarian banknotes was 0.000565 per cent of those in circulation, while that of retained non-genuine Bulgarian coins was 0.000019 per cent. Ensuring cash circulation integrity and security, the BNB performed three full and 15 topical checks at credit institutions and service providers to ensure compliance with the regulatory framework requirements for cash handling and banknote recycling.

Under market contracts with the Ministry of Finance, the Bank submits statements of budget entities' domestic bank accounts to the Ministry and acts as government debt agent. By June, it produced 317 statistical reporting forms to the budget through the IOBFR system for budget and fiscal reserve information servicing, including 155 for the fiscal reserve, up 8 per cent in a year. There were 16 government bond auctions through the GSAS system. ESROT registered BGN 17,713.4 million of government bond transactions, down 7.0 per cent in a year.

An agreement was reached within the EU on important elements of the banking union agenda, the Single Supervisory Mechanism (SSM) and the operational framework for direct recapitalisation of banks by the European Stability Mechanism. The adoption of legislation concerning the recovery and resolution of credit institutions and investment firms, deposit guarantee schemes and credit agreements for consumers relating to residential immovable property was an essential step to enhance financial sector security and transparency.

The BNB representatives helped voice Bulgarian positions on key economic governance areas and the financial sector at the ESCB and before the European Commission, the EU Council, the European Systemic Risk Board, the European Banking Authority, and the national Council for European Affairs. The Bank supported in principle EU and euro area regulatory and institutional amendments, seeing macroeconomic and financial stability as of prime importance across the EU.

The BNB continued supporting Western Balkan central banks' preparations for EU accession. It also participates in the Central Banks Governors' Club of Central Asia, Black Sea Region and Balkan Countries, in June hosting its 31st meeting which changed the Statute and welcomed Slovenia and Croatia as members.

Economic Development in the First Half of 2014

1. The External Environment

In the first half of 2014 annual world growth was 2.6 per cent: close to the second half of 2013 from 2.0 per cent in the first half of 2013. Diverse developments were observed across regions. Real growth slowed slightly in the USA and China and more markedly in Japan. Euro area real GDP posted low positive growth on an annual basis. In June EU and euro area economic indicators started to worsen due largely to the rising tensions between Russia and Ukraine and further EU sanctions against Russia.

Global industrial output rose 3.4 per cent annually, most in emerging Asian economies, Japan, Central and Eastern Europe, and the USA.² World trade grew 2.7 per cent, most in emerging African economies, the Middle East, and Latin America.³ Japanese and US trade continued growing faster than other developed economies.

Major Macroeconomic Indicators

(per cent)

		Average annual real GDP growth*			Inflation (end of year)			Unemployment rate (average annual)				
	2012	2013	20	14	2012	2012 2013	2014		0010	2012	20	014
	2012	2013	3	II			- 1	II	2012	2013	1	II
EU	-0.4	0.1	1.5	1.3	2.3	1.0	0.6	0.7	10.4	10.8	11.0	10.2
Euro area	-0.7	-0.4	0.9	0.5	2.2	0.9	0.5	0.5	11.3	12.0	12.3	11.4
New EU Member States	1.0	1.0	3.3	1.1	2.9	0.7	0.4	0.2	9.5	9.8	9.8	8.8
EU-3	0.3	1.6	3.1	4.4	2.5	1.7	1.3	1.6	7.9	7.5	7.0	6.5
United States	2.3	2.2	1.9	2.6	1.7	1.5	1.5	2.1	8.1	7.4	6.9	6.1
Japan	1.5	1.5	3.0	-0.1	-0.1	1.6	1.6	3.6	4.3	4.0	3.7	3.7
China	7.7	7.7	7.4	7.5	2.5	2.5	2.4	2.3	4.1	4.1	4.1	4.1

Notes: The new EU Member States are countries joining since 2004 less those now in the euro area. The EU-3 are the United Kingdom, Sweden, and Denmark. The indicators of new EU Member States and EU-3 are calculated by weighing time series by country weights in group GDP for growth, in group labour force for unemployment, and the weights of the EU-27 in HICP calculated by Eurostat for inflation. Non-seasonally adjusted data on real GDP growth on an annual basis. Non-seasonally adjusted data on unemployment. Excluding Croatia from economic growth of new EU Member States for the second quarter of 2014 due to lack of data.

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

The euro area economy continued a gradual recovery started in the second half of 2013. Stronger gross fixed capital formation and consumer demand contributed most to first quarter growth, net exports contributing close to zero.⁴ The second quarter mostly matched the first, its annual growth slowing mainly through poor net export growth. Individual economies differed. Ireland, Latvia and Slovenia recorded high growth unlike Cyprus, Greece and Italy posting negative real growth. Average unemployment fell to 11.9 per cent from 12.2 per cent a year earlier, with 27.3 and 25.2 per cent peaks in Greece and Spain and 5.3 and 5.4 per cent troughs in Germany and Austria.

Bad weather hit US first quarter annual growth, consumer demand and gross capital formation contributing less alongside a negative net export contribution. Growth strengthened in the second quarter, gross capital formation and consumer demand recovering. Unemployment continued falling to 6.5 per cent on average from 7.8 per cent in the same period of 2013.

^{*} Data based on ESA 95.

¹ Based on World Bank seasonally adjusted quarterly data of 29 September 2014.

² CPB Netherlands Bureau for Economic Policy Analysis data of 25 September 2014.

³ Ibid.

Seasonally adjusted data.

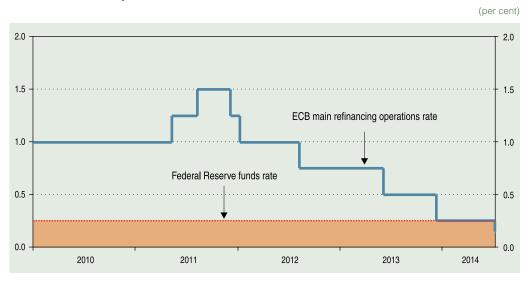
Global inflation dropped insignificantly to 2.4 per cent from 2.5 per cent at the end of 2013.⁵ In developed countries, it fell to 0.9 from 1.3 per cent at the end of 2013, remaining unchanged at 3.7 per cent in developing economies.⁶ Annual euro area inflation⁷ was running at 0.5 per cent at the end of June from 0.9 per cent six months earlier. Core inflation (excluding food, energy, alcohol, and tobacco) rose slightly from 0.7 to 0.8 per cent. Austria and Luxembourg led at 1.7 and 1.2 per cent, Greece and Portugal trailing at -1.5 and -0.2 per cent.

US inflation rose to 2.1 per cent from 1.5 per cent six months earlier.⁸ Inflation measured by the private consumption expenditure deflator rose to 1.4 from 1.1 per cent at the close of 2013.

Most commodity and raw material prices continued falling in the first half of 2014. On an annual basis, Brent oil price rose 0.8 per cent in US dollars, falling 3.4 per cent in euro. The dollar increase reflected mainly delivery threats resulting from geopolitical tensions in Ukraine, Iraq, and Libya, offset by the slowdown in Chinese economic activity. Food prices fell 0.9 per cent on an annual basis, with divergent developments by group; cereals dropped significantly by 23.2 per cent after good harvests and increased global supply. Metals fell 10.9 per cent on the first half of 2013, reflecting lower demand by leading consumer China, high inventories, and new production capacities. Iron fell most at 18.5 per cent, followed by aluminium and copper at 8.5 and 8.3 per cent.

Low economic activity and falling inflation drove ECB and Federal Reserve monetary policies. On 5 June the ECB Governing Council cut reference rates, approved an additional stimulus package, and extended the unlimited distribution of liquidity on main and three-month refinancing operations until at least December 2016.9 The Federal Reserve kept its reference rate unchanged. It continued to reinvest earnings from maturing US government bonds into new US government bonds and those from government sponsored agency unsecured and mortgage bonds into new mortgage bonds. The 17 and 18 June Federal Reserve Open Market Committee meeting decided to cut asset purchase volumes.

Federal Reserve System and ECB Interest Rates



Sources: ECB, Federal Reserve System.

⁵ Based on seasonally adjusted World Bank data of 29 September 2014.

⁶ See footnote 5.

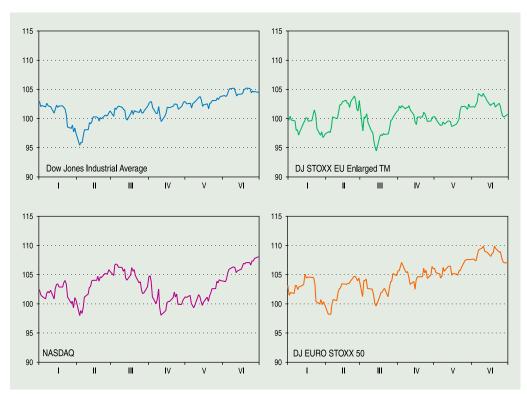
⁷ Measured by the Harmonised Index of Consumer Prices (HICP).

⁸ Measured by the CPI.

⁹ For details on the ECB and US Federal Reserve monetary policy, see Chapter II.

Despite the decline in early 2014 as a result of unfavourable weather conditions, US stock market indices posted an increase on end-2013, driven mainly by improved expectations of economic growth recovery following the temporary drop in the first quarter. By June, the Dow Jones and NASDAQ rose 4.6 and 6.2 per cent on December 2013. The European EURO STOXX 50 rose 8.5 per cent, while EURO STOXX EU Enlarged TM increased 2.4 per cent.¹⁰

Major Stock Market Indices in the First Half of 2014



Note: US dollars, December 2013 = 100.

2. The Bulgarian Economy

In the first half year real GDP grew 1.8 per cent on an annual basis, up on the first half of 2013. 11 Consumer confidence increased and the labour market improved slightly. Private consumption made the largest positive contribution to real GDP growth. Investment into fixed assets, mostly by government, and government consumption also rose, boosting domestic demand's GDP contribution to 2.6 percentage points. Growing domestic demand pushed goods and service imports to exceed exports. Real terms goods and service exports fell significantly, driven by specific mineral product and fuel dynamics. 12 Net exports thus cut -1.3 percentage points from GDP growth. Increased construction and industrial inventories contributed little to economic activity growth.

¹⁰ See Chapter II for details on government bond markets.

¹¹ Based on ESA 95 data.

¹² Renovated and new oil production capacities were major drivers of falling mineral product and fuel exports.

Real GDP Growth Rate and Contribution by Component of Final Use

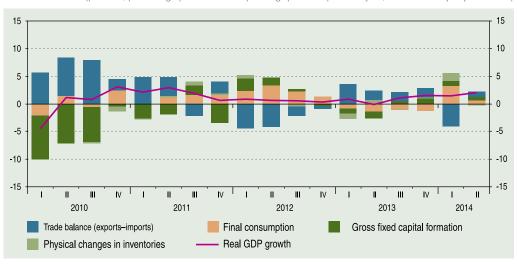
(on the corresponding period of previous year, non-seasonally adjusted data)

		20	13		20)14
	Januar	y – June	July – D	ecember	January – June	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
GDP	0.3	-	1.3	-	1.8	-
Final consumption	-1.4	-1.1	-1.3	-1.1	2.1	1.8
Household consumption	-2.7	-1.8	-1.9	-1.2	1.9	1.2
NPISH consumption	4.7	0.0	-7.3	0.0	0.2	0.0
Final consumption expenditure of the general government sector	4.6	0.4	-0.1	0.0	4.2	0.4
Collective consumption	3.7	0.3	2.3	0.2	1.6	0.2
Gross fixed capital formation	-4.9	-1.0	3.4	0.7	3.9	0.8
Physical changes in inventories	-	0.0	-	0.1	-	0.5
Exports (goods and services), net	-	2.5	-	1.6	-	-1.3
Exports (goods and services)	7.9	5.4	9.8	6.4	1.9	1.3
Imports (goods and services)	3.7	-2.9	7.5	-4.8	3.6	-2.6

Sources: NSI, BNB.

Real GDP Growth Rate and Contribution by Component of Final Use

(per cent, percentage points on corresponding quarter of previous year, non-seasonally adjusted data)



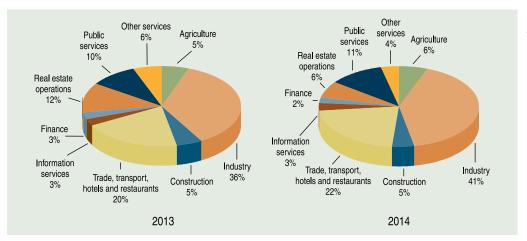
Sources: NSI, BNB.

Decreased unemployment and low employment growth in the first half year had a positive effect on household consumption. Though household saving remained high, confidence improved significantly and household final consumption expenditure grew 1.9 per cent in real terms.

Real terms government consumption grew 2.9 per cent and had a low positive contribution to the economic growth. It reflected increased wage and healthcare spending, while operating expenditure fell on the same period last year.

Real fixed capital investment rose 3.9 per cent. This reflected government capital spending and, to a lesser extent, improved corporate expectations. Despite rising output and capacity utilisation, business remained cautious about investing. Preliminary NSI data show that nominal expenditure on acquiring fixed assets for the total economy rose by 7.8 per cent on an annual basis. Investment posted an increase in industry, trade, transport, hotels and restaurants, public services, information services, agriculture. All other sectors experienced declines.

Structure of Fixed Asset Expenditure by Sector in the First Half of 2014



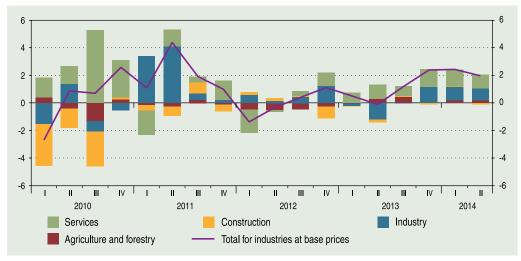
Note: Preliminary data for 2014.

Sources: NSI, BNB.

Gross value added growth rose to 2.2 per cent from 0.2 per cent in the first half of 2013. Industry contributed most, its value added rising 3.2 per cent to offset a slight drop in construction. Higher demand in trade, cars and motorcycles repair, transport, storage and mail services, hotels and restaurants pushed up value added growth in the services sector.

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

(per cent, percentage points on corresponding period of previous year, non-seasonally adjusted data)



Sources: NSI, BNB.

Gross Value Added Change in Real Terms and Contribution by Industry

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

		201	2014				
	Janu	ary – June	July -	– December	January – June		
	Change (per cent)	,		Contribution, percentage points	Change (per cent)	Contribution, percentage points	
Gross Value Added	0.2	-	1.8	-	2.2	-	
Agriculture and forestry	6.1	0.1	2.0	0.2	1.2	0.2	
Industry*	-2.6	-0.9	2.0	0.6	2.7	0.9	
Services	1.4	0.9	1.6	1.0	1.8	1.1	

^{*} Industry and construction.

Sources: NSI, BNB.

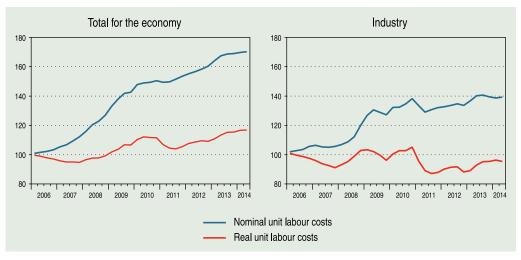
The labour market situation improved slightly. Following the insignificant employment decline in 2013, the number of employees in the economy rose 0.3 per cent on an annual basis. Services sub-sectors contributing most included trade, cars and motorcycles repair, transport, storage and mail services, hotels and restaurants, creation and dissemination of information and author products, telecommunications and general government, education, human health and social work activities, as well as the sector of agriculture, forestry and fishery. Industry and some services sub-sectors (professional, scientific and technical activities, and administrative and support activities) contributed negatively. ¹³

The labour force survey shows unemployment falling to 12.2 per cent from 13.4 on average in the first half of 2013. The unemployment rate, estimated by Employment Agency registrations, remained close to that of last year at 11.7 per cent. The economic activity rate of 15 to 64 age group rose to 68.9 per cent from 68.2 per cent this time last year. The number of discouraged persons fell on an annual basis to 201,000 from 227,000 in the first half of 2013. The survey shows short-term unemployment (up to 12 months) declining more than long-term, the share of long-term unemployed people rising slightly to 58.5 per cent of all unemployed.

Annual overall labour productivity rose insignificantly by 1.4 per cent from 0.8 per cent in the same period of 2013. It rose more in industry, professional activities and scientific research, and administrative and ancillary activities. There were lower increases in agriculture, forestry and fishery, construction, finance and insurance, and real estate operations.

Overall average wage grew less than in the first half of 2013. Nominal pay rose 2.4 per cent on an annual basis from 7.7 per cent in the first half of 2013. National account data show higher average wage growth in construction, finance and insurance, and professional activities and scientific research. Wages in trade, cars and motorcycles repair, transport, storage and mail services, hotels and restaurants and real estate operations declined on the same period of 2013. In real terms, ¹⁴ average wage posted a higher growth rate (4.2 per cent) than nominal wage, though moderating on the first half of 2013 (6.0 per cent). Similar sector developments occurred in compensation *per* employee.

Unit Labour Costs (moving average, 2005 = 100)



Sources: NSI, BNB.

Wage and productivity movements pushed down nominal unit labour cost growth to 1.1 per cent after 7.8 and 2.9 per cent rises in the first and second halves of 2013.

¹³ Including industry and construction.

¹⁴ HICP deflated.

Overall annual gross operating surplus fell to 2.8 per cent from 4.7 and 3.1 in the first and second halves of 2013. Agriculture, forestry and fishery, and to a lesser extent professional activities and scientific research and public services contributed most to the drop.

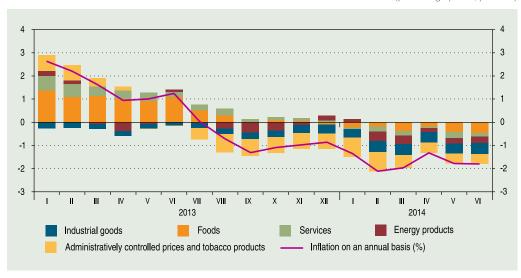
Domestic goods and service prices continued falling, their annual GDP deflator reaching -1.7 per cent. By component of final consumption, goods and service import and export deflators and household final consumption expenditure and fixed capital investment deflators had negative values, the government consumption deflator remaining positive.

In the first half of 2014 annual deflation rose, HICP changing -1.8 per cent by June from -0.9 per cent at the end of 2013. Lower overall prices reflected continuing imported goods price falls, lower production costs from cheaper industrial electricity since the second half of 2013, service price falls, and a relatively weak household consumption recovery. Lower inflation in individual goods and service groups mainly reflected lower energy prices, food deflation, and growing core deflation. Since early 2013, falling world food, oil and other commodity prices in euro continued depressing Bulgarian food and fuel prices. Food deflation in 2014 reflected falling producer food prices since late 2013, good harvests in Bulgaria and the region, and falling agricultural production costs.

Core inflation (excluding food and energy, administered prices and tobacco) curbed overall inflation most, falling from -0.7 per cent in late 2013 to -1.4 per cent in June 2014. Services recorded deflation since early 2014. Non-food price declines accelerated. Lower service prices resulted from higher annual telecommunications price declines, lower general practitioner fees, and transport services deflation due to lower fuel prices. Public catering prices retained their mid-2013 deceleration trend in growth rates in line with falling food prices. Other services sub-groups stabilised or fell slightly as business curbed labour costs and consumer demand remained weak. Non-food deflation (excluding fuel) continued as it has in the past four years, reinforced by the euro rises on the dollar for most of the period. Annual drops in durable goods prices continued driving non-food prices amid a relative stabilisation of non-durable goods prices at levels close to a year earlier.

Annual Inflation and Contributions by Major Goods and Services

(percentage points, per cent)



Sources: NSI, BNB.

¹⁵ The analysis employs HICP data.

¹⁶ General practitioner, consultant and dentist fees were cut by 28.6 per cent from 1 January.

HICP Inflation Accumulated since the Year's Start and Contributions of Major Goods and Services Groups to It

	January-	June 2013	January–June 2014		
Inflation (per cent)	-C	1.8	-1.7		
	Rate of inflation by group (per cent)	Contribution, percentage points	Rate of inflation by group (per cent)	Contribution, percentage points	
Food	0.4	0.11	-1.1	-0.28	
Processed food	0.1	0.02	-1.1	-0.19	
Unprocessed food	1.0	0.09	-0.9	-0.09	
Services	-0.7	-0.18	-1.7	-0.43	
Catering	1.3	0.07	0.4	0.02	
Transportation	-1.3	-0.04	-4.6	-0.16	
Telecommunications	-0.6	-0.03	-2.8	-0.14	
Other services	-1.6	-0.17	-1.4	-0.15	
Energy products	-1.0	-0.09	-6.0	-0.55	
Transport fuels	-0.8	-0.07	-6.3	-0.54	
Industrial goods	-0.9	-0.17	-1.3	-0.26	
Administratively controlled prices	-2.6	-0.47	-1.4	-0.24	
Tobacco products	0.2	0.01	0.4	0.02	

Note: This structure corresponds to the Eurostat classification; tobacco products and goods and services with administratively controlled prices are presented separately. The index of goods and services with administratively controlled prices is calculated through the elementary aggregates level in the consumer basket.

Sources: NSI, BNB

In the first half of 2014 the overall current and capital account surplus fell to EUR 260.4 million (1.4 per cent of GDP) from EUR 345.6 million in the same period of 2013. This reflects primarily the worsened trade balance and lower positive balance of net current transfers. The decreased deficit on the income account and higher capital account balance pushed down the overall current and capital account surplus.

Trade deficit grew to EUR 1608.2 million from EUR 1266 million a year earlier, resulting mainly from a 3.3 per cent annual export drop. This reflects lower international commodity prices and lower mineral product and fuel exports. Commodity groups contributing negatively to nominal export growth include mineral products and fuels, animal and plant products, and base metals and their products, while machines and vehicles made the greatest positive contribution.

World prices also subdued nominal goods imports over the first half year. Imports remained broadly unchanged as price declines offset increased physical volumes reflecting rising domestic demand. Machines and vehicles contributed most to import dynamics, mineral products and fuels detracting most.

The services balance surplus rose EUR 110 million on annual basis to EUR 704.7 million due mainly to higher transport service exports. Increased nominal imports of other services (excluding transport and travel) subdued service surplus growth. The income account deficit shrank by EUR 197.2 million to EUR 426.0 million through smaller investment income outflows, mainly from the direct investment sub-item (interest paid to foreign investors). Current transfers fell EUR 235.7 million to EUR 1263.4 million driven by lower transfers to the general government sector, other than EU grants. Remaining items under net current transfers stayed close to the same period of 2013. Capital account surplus picked up due to larger EU payments to the general government sector.

Preliminary balance of payments data show EUR 751.3 million (4.1 per cent of GDP) of foreign direct investment inflows, down EUR 73 million on the first half of 2013. This was due to lower equity inflows and one-off effects like non-resident equity transfers to local economic agents. Sectorally, manufacturing (EUR 295.1 million) and real estate operations, leasing, and business services (EUR 194.5 million) had largest net receipts. FDI was lower in production and distribution of electricity and heating, gase-

ous fuels and water (EUR 50.3 million) and trade, repair of motor vehicles and motor-cycles, personal belongings and household goods (EUR 34.1 million).

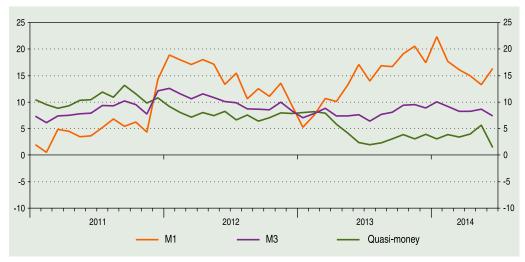
Unlike in early 2013, the financial account lacked significant external government debt operations. In June banks repatriated EUR 831.3 million of foreign assets. The balance of payments financial account ended the half year in surplus by EUR 176.1 million from a EUR 941.8 million deficit a year earlier.

Gross external debt fell EUR 291.6 million on December 2013 to EUR 37.0 billion. This decrease reflects the fall in other sectors' debt¹⁷ (by EUR 705.0 million). Growing debt in terms of attracted FDI (intercompany loans) impeded the decrease in overall debt. Other sectors, mainly transport, storage and communications and excluding trade and bond liabilities, cut gross external debt by EUR 550.5 million on December 2013. Intercompany loans of the non-bank sector rose EUR 400.0 million in six months to EUR 15.8 billion, mainly through funds attracted into manufacturing. Public and publicly guaranteed debt fell slightly by EUR 41.3 million to EUR 4.0 billion in six months. Loan repayments and deposits were EUR 2388.1 million (including EUR 1050 million intercompany loans, EUR 579.4 million in the bank sector, and EUR 572.9 million in other sectors), and principal obligations serviced were EUR 2034.7 million.

All external current, capital, and financial transactions pushed down BNB international reserves by EUR 225.8 million, excluding valuation adjustments and price revaluations. International reserves on the BNB Issue Department balance sheet, including valuation adjustments and price revaluations, fell by EUR 103.3 million.

Monetary Aggregates (annual change)

(per cent)



Source: BNB.

In the first half of 2014 annual broad money growth tended to decrease, reaching 7.4 per cent in June. Until May, M3 movements reflected a significant slowdown in the narrow aggregate M1, and mainly the slower growth of overnight deposits. Developments reflected the reducing effect of time deposit interest tax introduced in early 2013 which encouraged deposits with non-taxable interest and the transformation of time into demand deposits. From the beginning of 2014 deposit interest tax fell from 10 to 8 per cent, contributing to lower overnight deposit growth. Trends reversed in June when banks experienced liquidity pressure resulting in conservatorship on KTB

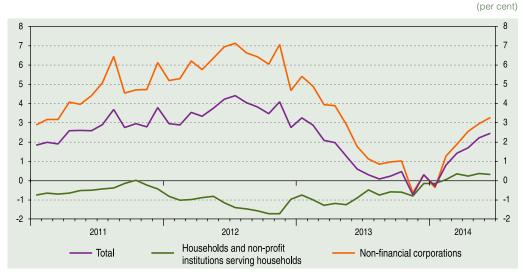
¹⁷ Data from public and private corporations, including government guaranteed loans. Intercompany loans not included. Data cover only loans registered by the BNB and those on which information is available.

¹⁸ Excluding trade and bond loan liabilities from the sectoral breakdown.

¹⁹ Revolving and trade loans excluded.

and its subsidiary CB Victoria.²⁰ ²¹ Some time deposits were withdrawn from banks, boosting currency in circulation, while others were transformed into overnight deposits. This cut quasi money growth significantly to 1.5 per cent from 4 per cent six months earlier and 5.7 per cent in May 2014. In addition, annual growth of money outside MFIs and overnight deposits rose to 12.5 and 18.4 per cent from 6.8 and 23.8 per cent six months earlier and 9.8 and 15.1 per cent in May 2014.

Claims on the Non-government Sector (annual change)



Source: BNB.

After trending downward throughout 2013, the claims on the non-government sector began rising in February 2014 to reach 2.4 per cent by mid-year from 0.3 per cent six months earlier. Along with the nominal GDP decline, this increase boosted claims on the non-government sector to GDP ratio to 72.6 per cent, up 2 percentage points on June 2013. This was largely due to corporate lending (3.3 per cent from 0.3 six months earlier). Real estate operations, manufacturing and trade had a strong positive contribution to the overall annual growth of loans to non-financial corporations. Professional activities and scientific research, other activities, creation and dissemination of information, construction, hotels and restaurants contributed most negatively. After three annual declines, household lending began recovering slightly in early 2014, with 0.3 per cent annual growth in the first half year. Overdrafts, consumer lending, and hausing loans also grew at 0.8, 0.9, and 0.4 per cent, other loans to households declining 6.3 per cent on an annual basis.

The BNB quarterly lending survey showed a first quarter fall in corporate and consumer credit demand followed by an increase. Banks link corporate lending growth with the need to replace inventories, boost working capital, and invest. In the first half year they eased household lending criteria and left them unchanged for corporations. Competition among banks and cheaper and more plentiful attracted resource were the main factors behind credit easing.

Banks continued financing credit by resident household and corporate deposits, the former contributing more. In the first five months household deposits rose by BGN 1363 million and total resident deposits by BGN 1247 million. As KTB and Victoria went under conservatorship in June, households, non-financial and financial corporations withdrew BGN 1044 million from banks: a sum offset by government depos-

²⁰ See Chapter VI.

²¹ KTB is Bulgaria's fourth largest bank by assets.

its.²² Half year funds attracted from residents grew BGN 1158 million, retaining ample bank liquidity and boosting the liquid assets ratio to 26.8 per cent in June.

Between January and May banks spent significant liquidity on foreign assets, Bulgarian government securities, claims on the non-government sector, and some repayment of foreign liabilities. Their net foreign assets reached BGN 3056 million in May, falling by BGN 1477 million in June as government securities increased in bank portfolios.

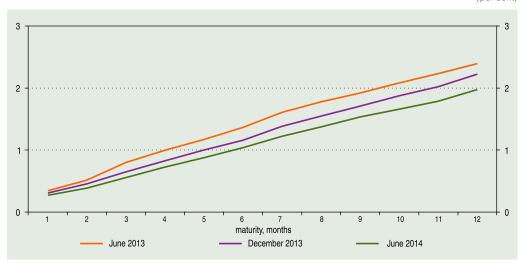
Banks managed lev liquidity mainly through foreign currency trading with the BNB, taking advantage of the currency board's main function: buying and selling levs against euro at the exchange rate fixed under the Law on the Bulgarian National Bank.²³ Foreign currency market turnover was EUR 209.4 billion, down 25.3 per cent on the same period of 2013.²⁴ This drop occupied the largest segment, transactions between the BNB and banks, while interbank trading (excluding the BNB) and with final customers posted an increase.

In interbank foreign currency trading, the share of USD transactions rose mostly at the expense of EUR. Thus, 78.7 per cent of transactions between banks were in euro and 21 per cent in US dollars. Final customer trading concurred broadly, with euro operations comprising 90 per cent.

Ample banking liquidity continued affecting interbank money trading, the downward yield curve trend continuing, especially in long-term maturities.

Interbank Money Market Yield Curve

(per cent)



Note: Average SOFIBOR/SOFIBID Index.

Source: BNB.

Reflecting EONIA movements, average interbank deposit and repo interest rose to 0.07 per cent from 0.04 in 2013. The negative LEONIA/EONIA spread expanded by 8 basis points on 2013 to 15 basis points on average. This reflected faster EONIA than LEONIA growth at 10 *versus* 2 basis points in the half year. Over the first five months strong euro area liquidity surplus movements moved EONIA overnight interest within a broad interval of 0.10 to 0.69 per cent. The ECB main refinancing rate cut in early June halted EONIA and LEONIA declines, the spread shrinking to 4 percentage points as EONIA fell more significantly.

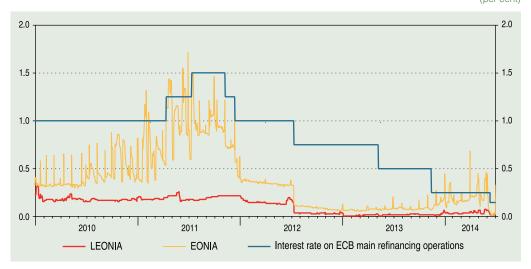
²² On 30 June the Ministry of Finance sold BGN 1.23 billion of five-month government securities at an extraordinary auction, with proceeds supporting a bank's liquidity.

²³ See Chapter II.

²⁴ This comprises transactions by banks and the BNB in foreign currency against levs with a spot value date of up to two business days and includes the double volume of trade between the BNB and banks and interbank trading.

Interbank Money Market Interest Rates

(per cent)



Sources: BNB, ECB.

The interbank money market transaction total of BGN 24.3 billion rose 5.1 per cent on the same period of 2013. Deposits comprised 72.3 per cent and government securities repos 27.7 per cent. Overnight transactions dominated deposits at 85.8 per cent.

The consolidated fiscal programme cash balance ended with a BGN 996.4 million deficit (deterioration of BGN 990.2 million on the same period of prior year). This reflected a BGN 440 million negative balance on EU programmes, mainly due to suspended EC payments for Operational Programme Environment and two axes of Operational Programme Regional Development.

Government revenue and grants remained unchanged from the same period of 2013. Non-tax revenue made the largest negative contribution at -2.6 percentage points, tax revenue and grants contributing positively by 2.1 and 0.6 percentage points. Annual tax revenue growth (2.7 per cent) was mainly due to personal income tax and social security contributions rising 17.4 and 4.5 per cent. VAT revenue (down 3.4 per cent in June) had the major negative contribution, reflecting the negative growth of VAT receipts from domestic and intra-Community transactions (net) and VAT on imports.

Non-tax revenue fell 16.8 per cent because of new dividend payment dates and the base effects of BGN 148.1 million one-off Government Consolidation Company revenue and a BGN 303 million arbitration award for government in early 2013.²⁵

Budget revenue retention at the previous year's level was not compensated by reduced government expenditure, its growth reaching 7.0 per cent in June. Social and capital spending contributed most at 3.2 and 2.8 percentage points to consolidated fiscal programme spending growth. Social payments grew 7.2 per cent mainly through the base effect of the April 2013 pension rise, February's repayment of old hospitals debts, and April's pension and heating supplements. Capital expenditure rose mainly through 66.4 per cent higher annual investment of EU funds, while national budget spending fell 18.6 per cent. At -1.0 percentage point, interest expenditure helped curb budget spending growth most.

A BGN 1786.0 million positive net government bond issue on the domestic market provided the main budget finance.²⁸ New government bonds totalled BGN 2975.2 million, including BGN 2428.6 million discount bills maturing in 2014. Net external financ-

²⁵ In 2014 dividend payment deadlines to government extended to 16 June or 15 July for companies presenting consolidated financial statements. The 2014 State Budget cut the rate of deductions from profits from 80 to 70 per cent.

 $^{^{\}rm 26}$ Including government reserve growth.

²⁷ Monthly Ministry of Finance consolidated fiscal programme data.

²⁸ See Chapter VIII for more on the government securities primary and secondary markets.

ing was negative at BGN -22.0 million. Government negotiated BGN 94.2 million of new investment loans and took no external loans.

The Public Finance Law in force since early 2014 included funds on deposits and total receivables from EU funds for certified expenses and advance payments into the fiscal reserve. By June the fiscal reserve was BGN 6599.8 million, with BGN 5854.5 million in deposits. The latter sum rose BGN 1173.9 million. BGN 113.4 million went into the State Fund for Guaranteeing the Stability of the State Pension System (the Silver Fund), which is part of the fiscal reserve, boosting it to BGN 2445.4 million.

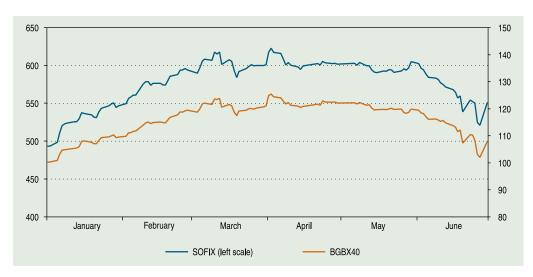
On 26 June Bulgaria issued EUR 1493 million of new ten-year benchmark Eurobonds at 2.95 per cent interest, maturing 3 September 2024. Issue proceeds were reported in early July and had no bearing on first half year budget financing.

By the end of June USD-denominated global bonds maturing in 2015 were quoted on the secondary market at 103.6 (1.4 per cent yield) from 107.5 (0.8 per cent yield) in early 2014. Bulgarian Eurobonds maturing in 2017 were quoted at 107.7 (1.6 per cent yield) from 108.2 (1.8 per cent yield) six months earlier. USD-denominated ZUNK bonds hovered around nominal.

The leading Bulgarian Stock Exchange SOFIX and BGBX40 indices followed broadly upward trends in the beginning and middle of the half year, dipping from late May.²⁹ In June the SOFIX average dropped 15.3 per cent on December 2013, while the BG40 rose 12.7 per cent.

Secondary market share trading dropped 42 per cent to BGN 421 million. *Bourse* bond turnover dropped 30 per cent to BGN 90.5 million. Over-the-counter equity deals came to BGN 227.8 million and those in bonds to BGN 24 million.³⁰ Market capitalisation of the Bulgarian Stock Exchange, Sofia, was BGN 10.5 billion or 13.5 per cent of GDP, from 12.8 per cent at the close of 2013.

Bulgarian Stock Exchange Indices in the First Half of 2014



Sources: BNB, Bulgarian Stock Exchange

²⁹ From 1 January 2014 the old BG40 index was replaced by the new BGBX40 covering 40 issues of common shares of the companies with the most transactions and the highest median daily turnover in the last six months.

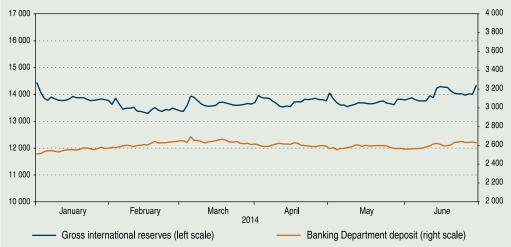
Major exchange traded deals involved Petrol AD (over BGN 140 million), Agro Finance REIT, BULSTRAD Vienna Insurance Group – Sofia, and Varna-Plod AD. Major OTC equity deals included Delta Credit REIT, Chimsnab Bulgaria AD, Sintetica AD, and Rodna Zemya Holding AD.

Gross International Reserves

The BNB manages its gross international reserves in line with the Law on the Bulgarian National Bank, investment constraints, business procedures and methodologies, and opportunities offered by international financial markets. The Bank's gross international reserves comprise the Issue Department balance sheet assets, and their role is to provide complete coverage for monetary liabilities at the fixed BGN/EUR exchange rate. The excess of gross international reserves over monetary liabilities forms the Banking Department deposit item or the net value of the Issue Department's balance sheet. Banking Department deposit item or the net value of the Issue Department's balance sheet.

Gross International Reserves and Banking Department Deposit





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

Source: BNB.

The Amount and Structure of Gross International Reserves

At the end of June 2014 the market value of gross international reserves was EUR 14,323 million: a EUR 103 million fall on the end of 2013.³³ The 0.72 per cent relative terms decline was mainly due to BNB selling reserve currency to banks for levs.

³¹ The Law on the BNB Article 28, paragraph 2 defines the Bank's monetary obligations as all circulating banknotes and coins issued by the BNB, and all balances of other persons' BNB accounts, except the IMF. Article 28, paragraph 3 defines what assets may comprise gross international reserves: monetary gold; Special Drawing Rights; banknotes and coins in freely convertible foreign currency; funds in freely convertible foreign currency held by the BNB on accounts with foreign central banks or other financial institutions or international financial organisations with one of the two highest ratings by two internationally recognised credit rating agencies; securities issued by foreign countries, central banks, other foreign financial institutions, or international financial organisations assigned one of the two highest ratings by two internationally recognised credit rating agencies; the balance on accounts receivable and payable on BNB forward or repo agreements with (or guaranteed by) foreign central banks, public international financial organisations or other foreign financial institutions with one of the two highest ratings from two internationally recognised credit agencies; and BNB futures and options which bind non-residents and which are payable in freely convertible foreign currency. The Law on the BNB stipulates that these assets be estimated at market value

³² The Law on the BNB Article 28, paragraph 1 provides that 'the aggregate amount of the monetary liabilities of the BNB shall not exceed the lev equivalent of gross international reserves,' the equivalent based on the fixed exchange rate.

³³ The two tranches totalling SDR 611 million received by the BNB in August and September 2009 upon general SDR allocation by the IMF with the total income on them are not included in further analyses of changes in BNB gross international reserves. For details, see BNB Annual Report, 2009, p. 25.

External Cash Flows in Foreign Currency

(EUR million))

	January – June 2013	January – June 2014
I. Euro purchases and sales		
At tills	-13	-14
With banks	-820	-923
Purchases from banks	16 721	14 346
Sales to banks	-17 541	-15 268
Subtotal I	-833	-937
II. Currency flows with banks, the MF, etc.		
Minimum required reserves	-11	-113
Government and other depositors (total)	262	748
Subtotal II	251	635
Total I+II	-581	-301

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

Source: BNB.

Receipts of EUR 748 million into government and other depositors' foreign currency accounts (mostly the MF and the European Commission's foreign currency account) contributed most to external foreign currency inflows. Net sales of reserve currency to commercial banks resulted in an outflow of EUR 923 million. This mirrored the first half of 2013 when the BNB sold EUR 820 million. In the context of minimum reserve maintenance, BNB net refunds to banks were EUR 113 million on EUR 11 million in the same period of 2013.

The currency structure of BNB gross international reserves changed marginally from 2013 averages.

Gross International Reserves Currency Structure

(per cent)

Currency	Issue Departm	ent balance sheet
Currency	2013	January – June 2014
EUR	89.04	90.14
USD	0.04	0.04
XAU	10.61	9.51
XDR	0.30	0.30
CHF	0.01	0.01

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

Source: BNB.

The structure of assets by financial instrument experienced no significant change on 2013 averages.

Gross International Reserves by Financial Instrument

(per cent)

Financial instruments	2013	January – June 2014
Vault cash*	4.76	4.46
Deposits**	18.66	18.04
Securities**	76.58	77.50

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

* Account balances, payments, and monetary gold. **Including instruments in foreign currency and gold.

Source: BNB.

In residual terms to maturity, assets with up to a year (current accounts, short-term foreign currency and gold deposits and short-term securities) and three to five years rose at the expense of ones with one to three years.

Gross International Reserves by Residual Term to Maturity

(per cent)

Maturity sectors	2013	January – June 2014
Up to a year	59.85	62.32
One to three years	36.88	31.27
Three to five years	2.45	5.69
Five to ten years	0.81	0.72
Over ten years	0.01	0.00

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

Source: BNB.

2. Gross International Reserve Risk and Yield

The Market Environment

Euro area and US economic activity data, leading central banks' monetary policies, and rising geopolitical tension reflecting events in Ukraine and the Middle East drove financial markets in the first half of 2014.

Euro area and US government bond prices posted an increase, with the global risk stemming from geopolitical tensions in some regions driving their developments. Euro area rises were much greater than US ones, reflecting Federal Reserve and ECB monetary policy and growth divergences.

Moderately improving euro area periphery economic and fiscal indicators boosted several countries' credit ratings, reducing their bond spreads against benchmark German ones. Portugal's EU/IMF bailout exit and successful Portuguese, Irish, and Spanish medium/long-term issues helped market confidence and cut bond spreads. Rising investor risk appetite and growing capital inflows into the euro area boosted euro area government bond prices. The ECB's June reference interest rate cut and move to longer-term refinancing operations further cut spreads.

Central Bank Policy

Significant energy and food price falls further cut euro area inflation and medium-term inflation expectations. Euro appreciation from rising euro area capital inflows also depressed inflation. The euro area bank credit portfolio continued contracting and EONIA overnight interest rose.

On 5 June inflation, lending, and interest trends prompted the ECB to cut main refinancing operation, marginal lending facility, and deposit facility interest 10, 35, and 10 basis points to 0.15, 0.4, and -0.1 per cent. Negative deposit facility interest also applies to: (i) banks' average reserve holdings in excess of the minimum reserve requirements; (ii) government deposits held with the Eurosystem that exceed certain thresholds; (iii) Eurosystem reserve management services accounts if not currently remunerated; (iv) participants' account balances in TARGET2; (v) non-Eurosystem NCB balances (overnight deposits) held in TARGET2; and (vi) other accounts held by third parties with Eurosystem central banks when stipulated that they are not currently remunerated or are remunerated at the deposit facility rate. The ECB stated it would maintain current interest rates for an extended period of time and where necessary, to take additional measures.

The same ECB meeting extended additional monetary stimuli. To support bank lending to euro area non-financial private sector (except loans to households for house purchase), the ECB planned targeted longer-term refinancing operations (TLTROs) and intensified preparations to buy simple and transparent asset backed securities (ABS) whose underlying assets are claims against euro area non-financial private sector. In addition, the ECB will continue distributing unlimited liquidity on main and three-month refinancing operations until at least December 2016 and accepting eligi-

ble assets as security in refinancing operations (credit claims) until at least September 2018. To ease euro money market liquidity and cut undue EONIA fluctuations, the ECB halted weekly liquidity absorbing operations to sterilise additional liquidity under the Securities Markets Programme until the first TLTRO in September. It also halted one-month refinancing operations (STRO).

EONIA overnight interest moved within the broad range of 0.1 to 0.69 per cent as liquidity surplus moved between EUR 70 billion and 179 billion. The index was 0.21 on average from 0.1 per cent in the second half of 2013. After the 5 June ECB meeting, it gradually fell to 0.03 per cent.

EURIBOR interest on interbank market deposits rose until mid-May before one, six and 12-month rates fell to 0.1, 03 and 0.49 per cent by the end of June (-12, -9 and -7 basis points from the end of 2013).

The US Federal Reserve System kept federal funds reference interest unchanged within 0–0.25 per cent and continued reinvesting earnings from maturing US government securities on its balance sheet into new US government bonds, and earnings from government debt and mortgage backed securities into new mortgage bonds. The Federal Open Market Committee March meeting revised monetary policy guidance. Nominal 6.5 and 2.5 per cent unemployment and inflation expectation thresholds introduced in December 2012 to assess low target effectiveness gave way to broader expert estimates of progress on employment and 2 per cent inflation. The Committee anticipated that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run. The 17–18 June meeting decided to cut QE3 programme asset purchase volumes by another USD 10 billion to USD 35 billion *per* month, effective from 1 July.

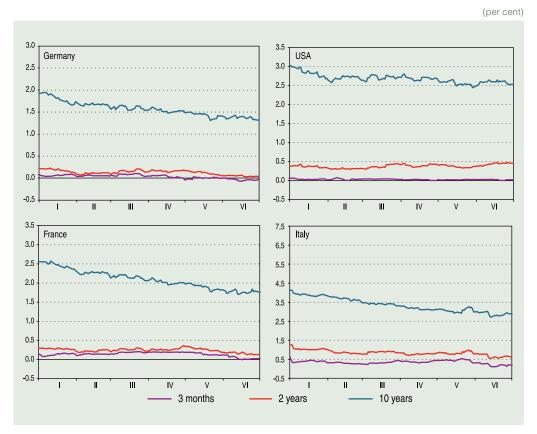
The Government Securities Yield Curve

German government bond yields fell significantly in the first half of 2014. The two and ten-year maturity sectors fell 19 and 68 basis points to -0.03 and 1.25 per cent. Early months' yield declines reflected investor expectations that the ECB would counteract low euro area inflation. Events in Ukraine also depressed yields as uncertainty prompted demand for low risk assets. In the second quarter lower than expected euro area GDP for the first quarter exerted additional pressure as did the ECB's June measures.

Euro area periphery government securities yield spreads narrowed in the first half of 2014. In the two-year maturity sector, Portugal, Spain, and Ireland led declines at 224, 86, and 52 basis points to 87, 43, and 21 basis points. In the ten-year sector, Portuguese, Spanish, and Italian spreads fell 180, 81, and 60 basis points to 240, 142, and 160 basis points. A syndicate successfully placed five-year Greek and Cypriot bonds at under 5 per cent annual yield (4.95 and 4.82 per cent).

US bond yields moved within wide bands, their dynamics most pronounced in maturities over five years. Two-year bond yields moved between 0.29 and 0.48 per cent, while ten-year bonds fluctuated between 2.44 and 3.03 per cent. Global geopolitical risk, leading central banks' monetary policies and US economic performance drove spread movements. In early 2014 yields declined due to the significant investment outflow from developing countries and a temporary first quarter moderation of US economic activity because of bad weather. Robust second quarter GDP growth and the FOMC decisions then boosted yields by the end of June. At the close of the first half ten-year yields were 2.53 per cent, down 50 basis points on the end of 2013. Two-year yields rose 8 basis points, flattening the yield curve.

Government Bond Yields in the First Half of 2014

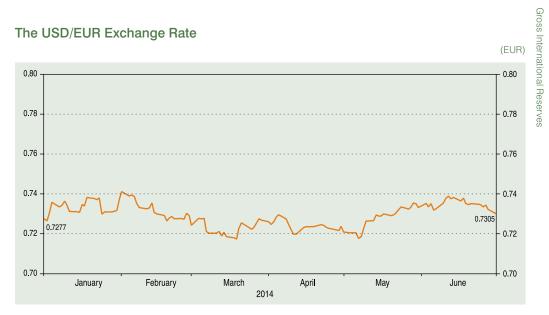


Gold and Exchange Rates

In the first half of 2014 world gold prices moved between USD 1202 and 1383 *per* troy ounce. They rose 10.46 per cent in US dollars and 10.68 per cent in euro to USD 1327 and EUR 969 *per* troy ounce. The major reason was investor demand induced by Ukraine and Middle East events. Lower demand for gold as a hedge against inflation limited the rise. At the end of the half year gold prices rose after the ECB decision to cut key interest and launch new longer-term refinancing operations.

In the first half of 2014 the US dollar appreciated cumulatively 0.38 per cent against the single European currency, the increase more pronounced in the second quarter. The rate moved within a narrow range of 0.72 to 0.74 with slight fluctuations. Early in 2014 euro appreciation on the dollar reflected data on a gradual euro area recovery, prospects of improving credit ratings for some euro area countries, and significant euro area periphery bond spread narrowing. In the second quarter the euro began depreciating as the ECB signalled it would provide additional monetary stimulus and the Federal Reserve stated that slower US growth reflected mainly temporary factors. The ECB's June decisions to launch stimulus measures confirmed market expectations and contributed to the euro falling against the dollar.

The USD/EUR Exchange Rate



Troy Ounce Gold Price in US Dollars

(USD) 1600 1600 1500 1500 1400 1400 1327.00 1300 1300 1200 1200 1201.64 1100 -1100 January February March April May 2014

Troy Ounce Gold Price in Euro



Major Risk Types

BNB gross international reserves were invested in line with the risk tolerance set by the BNB Governing Council as regards the net value in the Issue Department balance sheet.³⁴ The Bank's strategic risk budget depends on value-at-risk (VaR) and maximum loss thresholds set by reference to the net value of the Issue Department balance sheet.³⁵

On an annual basis, net value volatility for the half year was 7.32 per cent.³⁶ Currency risk contributed most at some 94 per cent due to the open foreign currency position in gold.

In the first six months of 2014 international reserve interest rate risk measured by reserves' average modified duration was 0.98 years. Maintained duration was slightly higher than the average one for 2013 at 0.91 years.

The provision that the sum of the absolute values of open foreign currency positions in currencies other than SDR and monetary gold should not exceed 2 per cent of the market value of monetary liabilities in these currencies constrained international reserve currency risk.³⁷ There were minimal open positions in currencies over the reporting period, the open position in monetary gold in the Issue Department balance sheet posing the main currency risk to the BNB.

In the first six months of 2014 **credit risk** remained a major factor influencing euro area government and government guaranteed securities markets. Financial market tensions decreased and market environment improved somewhat. There were no significant changes in credit risk management. The Bank continued controlling credit risk in government and government guaranteed debt investment and constraints on sovereign issuers which are conditionally divided into three inherent risk groups. The minimum 35 per cent share of the least risky Group I changed to 30 per cent. To achieve its main objectives by ensuring high security and liquidity of international reserves, the BNB continued to invest the main part of assets into German and French government securities with up to three year residual maturities, German and French government guaranteed debt, and short-term deposits.

At the end of the half year, some 64 per cent of the international reserves were invested into assets with the highest AAA long-term credit rating, their value averaging 63 per cent.

Operational risk was managed through strict monitoring and control of investment restrictions and business procedures for gross international reserve management.

Profitability and Efficiency

Net income from assets in euro comprises three components: i. income from investment of gross international reserves in original currency; ii. currency imbalance income;³⁸ iii. expenditure on liabilities. BNB income from international reserve investment was positive at EUR 62.14 million or 0.49 per cent cumulative yield. The currency imbalance yield was entirely due to the essential change in the EUR price of monetary gold over the review period and amounted to EUR 122.54 million (see the charts on p 33). There was no interest paid on Issue Department balance sheet liabilities.³⁹ These three components brought net return from international reserve management to EUR 184.68 million or 1.44 per cent net rate of return.

 $^{^{34}\,\}mathrm{Net}$ value means the Banking Department Deposit item in the Issue Department balance sheet.

³⁵ Net value risk measured by VaR=-X% (X>0) at 95 per cent confidence level and allowing for normal yield allocation means that 95 per cent of the time maximum net value loss would not exceed X per cent. Maximum loss threshold is the highest loss in case adverse scenarios have materialised in the past.

³⁶ Standard deviation of net value yield.

³⁷ An open foreign currency position is the difference between the value of assets and liabilities in any currency other than the euro.

³⁸ Currency imbalance income is the result of exchange rate movements on assets and liabilities' open foreign currency positions.

³⁹ Data on the Issue Department liabilities do not go directly into the international reserve management information system, but via the accounting system interface.

International Reserves Income and Profitability* in the First Half of 2014

Net income Net	Net (, , , , , , ,		Profitability (per cent)	Expenditure (EUR million)	Profitability (per cent)				
Period	(EUR million)	(per cent)	on assets**		on currency revaluation of assets and liabilities		on liabilities		
	(1)+(2)+(3)	(1	(1)		(2)		(3)	
First quarter	102.59	0.80	27.71	0.22	74.88	0.58	0.00	0.00	
Second quarter	82.09	0.63	34.43	0.27	47.66	0.37	0.00	0.00	
Total	184.68	1.44	62.14	0.49	122.54	0.95	0.00	0.00	

^{*} Profitability in the table is for the first six months of 2014; annual earnings will almost double the six-month profitability.

*** Profitability in the first quarter was 0.22 per cent and income EUR 27.71 million. Profitability in the second quarter was 0.27 per cent and income EUR 34.43 million. As a result, profitability for the first half approximately equals the sum of profitabilities in the first two quarters, namely 0.49 per cent, and income is EUR 62.14 million.

Source: BNB.

For operational management purposes, international reserves are split into portfolios by currency and investment goal, each with a benchmark, investment goals, and investment limits. The table below shows major BNB portfolios and the results from their management.

Profitability and Risk of Portfolios in the First Half of 2014

Portfolio and type of asset	Profitability		Volatility (risk)		Information
	Absolute (per cent)	Relative ¹ (basis points)	Absolute (basis points)	Relative ² (basis points)	ratio ³
Investment 1, EUR	0.52	10	25	9	2.41
Investment 2, EUR	0.57	15	30	7	4.74
Investment 3, EUR	4.80	-	247	-	-
External manager A, EUR	0.48	5	35	3	2.97
External manager B, EUR	0.45	3	38	7	0.79
Liquidity, EUR	0.07	5	1	1	-
Liquidity, gold	0.13	5	2	2	-
Liquidity, USD	0.02	2	0	0	-

¹ A portfolio's positive relative yield is profit attained against benchmark yield. Where the relative yield is negative, it is interpreted as opportunity cost in portfolio management.

Relative volatility (relative risk) against benchmark indicates the degree of deviation of portfolio risk characteristics from

Source: BNB.

To diversify management styles and reduce operational risk, most euro denominated assets continued being distributed into two investment portfolios with identical benchmarks and investment limits, managed by different BNB teams. Investment 3 Portfolio securities are less liquid as they are intended to be held to maturity. On 30 June 2014 external managers at international financial institutions managed some 6 per cent of gross international reserves. Beside additional diversification, using external managers helped exchange international market investment expertise. Liquid portfolios mainly assist immediate payment needs.

benchmark through active portfolio management. Risk is calculated on an annual basis.

Information ratio is the ratio between portfolio relative yield and relative risk (on an annual basis). The item is calculated only for actively managed portfolios.

Payment Systems

Organising, supporting, and developing national payment systems by implementing and overseeing efficient payment mechanisms is a Bank duty under the Law on the Bulgarian National Bank. The Bank's major goals are curbing systemic risk and integrating Bulgarian payment systems into the European payment infrastructure.

Lev settlement systems are:

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

Euro settlement systems in Bulgaria include:

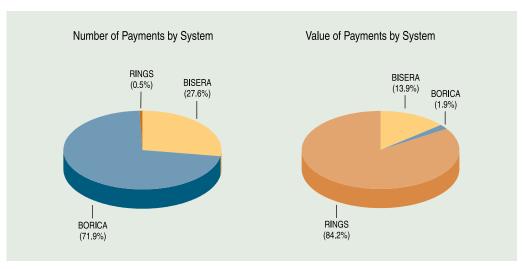
- The TARGET2 national system component, TARGET2-BNB, run by the BNB;
- The TARGET2-BNB ancillary system: BISERA7-EUR, a system for servicing customer transfers to be settled at a designated time, operated by BORICA– Bankservice AD;

Securities settlement systems are:

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

Lev Settlement Systems and Securities Settlement Systems In the half year RINGS processed 84.2 per cent of the value of lev payments in Bulgaria. ⁴⁰ This cut payment system risks: a major central bank goal. RINGS processed 0.5 per cent of the total number of lev non-cash payments in Bulgaria.

Lev Payments in Bulgaria by Payment System in the First Half of 2014



Source: BNB.

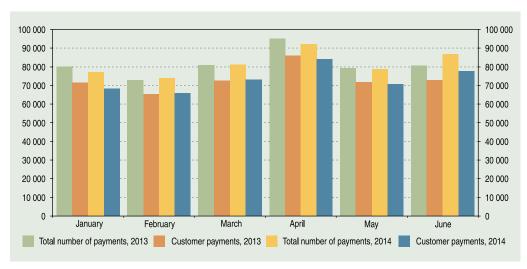
 $^{^{}m 40}$ Values around 80 per cent are deemed optimal for real-time gross settlement systems.

BORICA transactions rose 7.2 per cent in number and 11.8 per cent in value on the first half of 2013. ATM cash withdrawal value and number rose 3.3 and 9.1 per cent. BORICA authorised POS terminal transactions rose 5.2 per cent in number and 5 per cent in value. BISERA payments grew 12.4 per cent in number and 8 per cent in value.

Central Depository transaction value fell 19.4 per cent on the first half of 2013, the number rising 71.4 per cent.

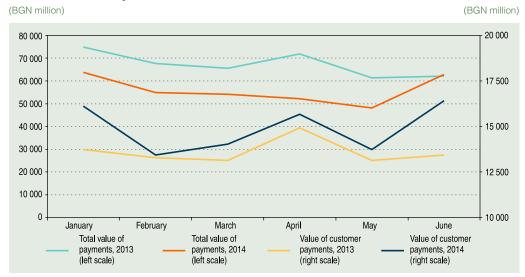
The RINGS real-time gross settlement system is Bulgaria's most important payment system operator. On 30 June 2014, 30 banks participated in RINGS. The 489,910 payment transactions for BGN 335,795 million rose 0.2 per cent in number and fell 16.7 per cent in value on the first half of 2013. Customer payments numbered 439,535 or 89.7 per cent of all, for BGN 89,596 million or 26.7 per cent of value. There were 3983 average daily payments for BGN 2730 million on average. Over the period 64.1 per cent of payments were processed by noon and 85.1 per cent by 2:30 pm. As regards traffic, 82.8 per cent of the number of RINGS payments went through by 2:30 pm. RINGS offered 99.97 per cent availability.⁴¹

Number of RINGS Payments in the First Halves of 2013 and 2014



Source: BNB.

Value of RINGS Payments in the First Halves of 2013 and 2014



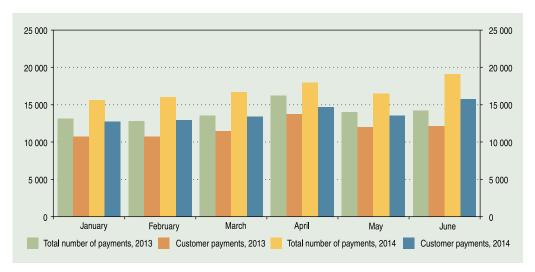
Source: BNB.

⁴¹ The ratio of operational to scheduled operating time.

Euro Settlement System

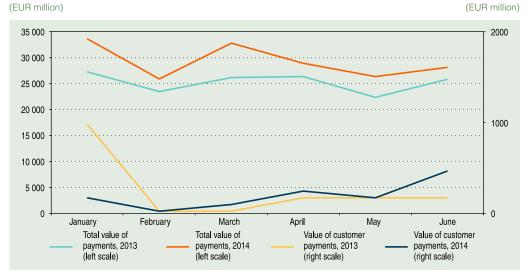
The BNB runs the TARGET2-BNB national system component and is responsible for the business relations of its participants and coordination with the European Central Bank and participating central banks. ⁴² On 30 June 2014 the TARGET2-BNB national system component included the BNB, 23 direct participant banks, three addressable BIC holders, and two ancillary systems: BISERA7-EUR for settling customer transfers in euro at a designated time and BNBGSSS for government securities settlement. ⁴³

Number of TARGET2-BNB Payments in the First Halves of 2013 and 2014



Source: BNB

Value of TARGET2-BNB Payments in the First Halves of 2013 and 2014



Source: BNB.

In the first half of 2014 TARGET2-BNB processed 101,923 payments for EUR 175,802 million, including 83,165 customer payments for EUR 3552 million. Transaction number rose 21.4 per cent and value 16.1 per cent on the first half of 2013. Payments by other system components to banks were 88 per cent of the number and 91.2 per cent of the value of all TARGET2-BNB payments. The daily average number of system payments was 815, their value reaching EUR 1406 million. Daily numbers peaked at 1333 and value at EUR 2919 million.

⁴² TARGET2 settles gross euro payments in real time with central bank money. It is a Single Shared Platform (SSP) system, each participating and connected central bank responsible for its system component. On 30 June 2014 it connected the ECB and 23 EU central banks.

⁴³ A current list of TARGET2 participants through TARGET2-BNB is at www.bnb.bg/PaymentSystem/PSTARGET2/PSTAR-GETList/index.htm. On 30 June 2014 the BISERA7-EUR ancillary system included 15 of 23 direct participant banks in TARGET2-BNB.

The BISERA7-EUR ancillary system processes customer transfers in euro at a designated time. The BISERA7-EUR ancillary system processed 14,962 payments for EUR 156 million, up 25.6 per cent in number and 21.7 per cent in value on the prior year.

BISERA7-EUR operated by BORICA–Bankservice AD processes only SEPA credit transfers and direct debits. To ensure bank reachability in SEPA payments to and from foreign banks, BISERA7-EUR connected with SEPA Clearer and Equens in December 2010 and December 2011.⁴⁴ This allowed SEPA credit transfers between bank communities in Bulgaria and other EU countries, mainly Germany, Greece, Italy, the Netherlands, Poland, and Switzerland. A link with Poland's EuroELIXIR expanded Bulgarian banks' SEPA reachability from 1 January 2014. By the end of June 2014 almost all banks and foreign bank branches in Bulgaria handled SEPA credit transfers. Their share was 52.8 per cent of all customer euro payments under Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro.

Bulgarian Payment and Settlement System Development

By 30 June 2014, 86.7 per cent of Bulgarian cards, including 85.5 per cent of debit and 98.7 per cent of credit cards had migrated to the EMV standard. Card payments infrastructure EMV migration involved all ATMs and 99.7 per cent of POS terminals.

In February Regulation (EU) No 248/2014 of the European Parliament and of the Council amending Regulation (EU) No 260/2012 as regards the migration to Union-wide credit transfers and direct debits extended the migration deadline until 1 August.

Payment System Oversight

Payment systems overseers sought to limit system risk and improve payment systems' reliability and efficiency. They monitored observance of standards and recommendations by the Bank for International Settlements, the International Organization of Securities Commissions, the European Central Bank, and the European System of Central Banks.

On 6 February the BNB Governing Council reviewed SEP Bulgaria AD's notice of closing its settlement finality payment system under Article 102, paragraph 1 in connection with Article 101, paragraph 1, item 7 of the Law on Payment Services and Payment Systems. Finding that Article 102 of the Law was satisfied, the BNB Governing Council revoked SEP Bulgaria AD's licence under Article 101, paragraph 1, item 7.

In the half year the Bank inspected three payment service providers to check compliance with the Law on Payment Services and Payment Systems and its statutory instruments.

The following entries and deletions were made to relevant BNB registers:

- 102 agents listed and 32 agents delisted onto/from the public register of licensed payment institutions and their branches and agents under Article 17 of the Law;
- 13 agents listed on the public register of licensed electronic money institutions and their branches and agents under Article 17 of the Law;
- 21 payment institutions from other EU countries operating in Bulgaria listed onto the public register under Article 7 of BNB Ordinance No 16 of 16 July 2009; twenty-two agents of payment service providers from other EU countries were also listed;
- six electronic money institutions licensed elsewhere in the EU and issuing, distributing, and redeeming electronic money in Bulgaria listed onto the register under Article 39 of the same Ordinance.

The review period saw enquiries into 90 complaints submitted to the BNB by payment service users.

 $^{^{44}}$ Reachability means that SEPA payments may be effected from and to each bank account in SEPA participating countries.

⁴⁵ EMV is a global smart or chip credit and debit card standard developed by Europay, Mastercard and Visa to boost card payment security and limit abuse and misuse.

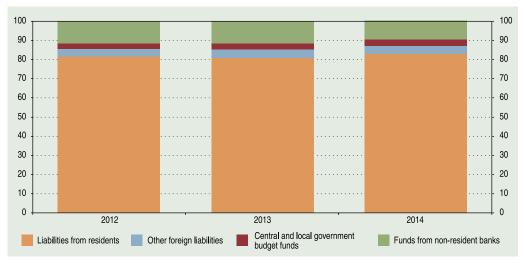
IV.

Bank Reserves at the BNB

In the first half of 2014 the average daily value of bank funds designated as minimum required reserves (excluding central government and local budget funds) rose 5.9 per cent on the same period of 2013. This reflected a 10.9 per cent lev and 1.3 per cent foreign currency liability rise. The average daily value of funds attracted from residents (excluding central government and local budget funds) rose 9.6 per cent, and from non-residents 12.0 per cent. Bank central and local government budget liabilities grew 9.2 per cent. The change in the structure of attracted funds boosted the effective implicit ratio of minimum required reserves 0.01 percentage points to 9.0 per cent on average in the half year.⁴⁶

Structure of Attracted Funds in the Banking System*





* Average daily value for reserve calculation purposes. Source: BNB.

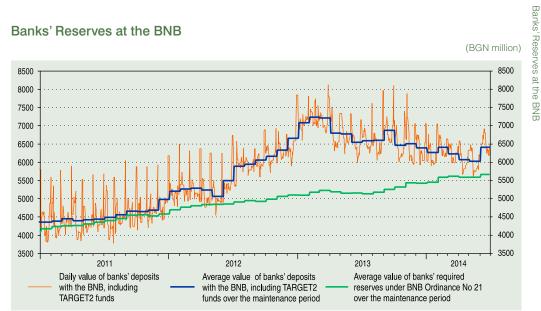
Reserve assets covering this ratio include funds in banks' BNB accounts under Ordinance No 21 (7.9 percentage points) and half of cash balances designated as reserves (1.1 percentage points). Between January and June the average daily value of lev assets rose 11.8 per cent on the first half of 2013, euro assets rising 1.2 per cent. This changed the currency structure of banks' reserves, the euro share falling to 33.4 per cent on average from 35.6 per cent in 2013.

Banks' excess reserves fell further, funds in banks' accounts under BNB Ordinance No 21 exceeding minima by 3.8 per cent against 7.2 per cent in 2013. In addition to funds in minimum required reserve accounts and excess reserves, banks maintained funds in TARGET2-BNB national system component accounts, sustaining a downward trend since March 2013.⁴⁷ Decreased excess reserves and TARGET2-BNB balances show improving asset management and release of more funds for lending or investing into Bulgarian government securities.

⁴⁶ BNB Ordinance No 21 sets banks' minimum reserves at 10 per cent of their domestic and 5 per cent of their foreign deposit base. Government and local government funds are zero rated.

⁴⁷ The Issue Department Balance Sheet shows banks' funds in the TARGET2-BNB national system as liabilities to banks.

Banks' Reserves at the BNB



Source: BNB.

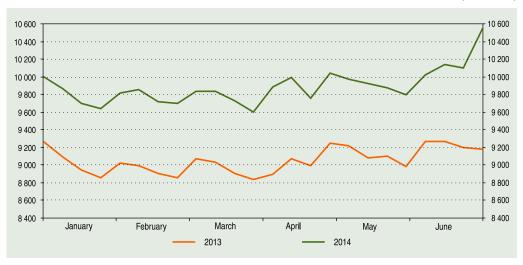
V. Currency in Circulation

The Bulgarian National Bank holds the Bulgarian currency monopoly.⁴⁸ Banknotes and coins issued by the Bank are legal tender mandatorily acceptable in payments at face value without restriction. The Bank prints banknotes, mints coins, stores, and scraps uncirculated or withdrawn currency.

Banknotes and Coins in Circulation (Outside BNB Vaults) On 30 June 2014, BGN 10,532.4 million of currency circulated outside BNB vaults: up BGN 278.7 million or 2.72 per cent on the end of 2013 and BGN 1362.2 million or 14.86 per cent on end-June 2013.⁴⁹

Circulating Banknotes and Coins (Outside BNB Vaults)

(BGN million)



Source: BNB.

Circulating cash has increased steadily since January 2013. Bank, corporate, and consumer demand peaked in April and June.

Circulating banknotes numbered 364.2 million worth BGN 10,314.0 million on 30 June. Their number rose 5.0 million or 1.39 per cent and value BGN 272.6 million or 2.71 per cent on the end of 2013 and 37.7 million or 11.53 per cent or BGN 1343.0 million or 14.97 per cent in a year. Banknotes comprised 97.93 per cent of circulating cash value, as of the end of 2013.

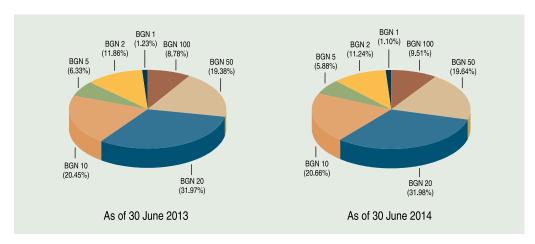
Since early 2014 the numbers of BGN 2, 5, 20, 50, and 100 banknotes rose 2.03, 1.62, 0.43, 2.25, and 5.52 per cent, while that of BGN 10 banknotes fell 0.07 per cent.

BGN 50s and 100s continued rising fastest by 8.2 million (13 per cent) and 6 million (20.86 per cent) on June 2013. Given the enhanced demand in June, BGN 10 and 20 numbers grew significantly by 12.69 and 11.55 per cent in a year from 1.45 and 4.02 per cent in the prior year. Their shares in circulating banknotes reached 20.66 and 31.98 per cent. BGN 10s numbered 75.2 million and BGN 20s 116.5 million. The shares of BGN 2 and 5 banknotes fell 0.62 and 0.45 percentage points.

⁴⁸ Article 2 paragraph 5 and Article 25 of the Law on the BNB.

⁴⁹ Banknotes and circulating and commemorative coins issued after 5 July 1999.

Denomination Shares in Circulating Banknote Numbers



Source: BNB.

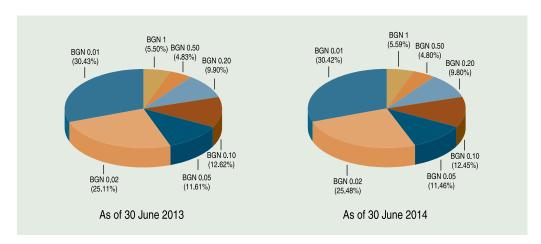
The BGN 50 banknote had the largest value share. The 71.5 million BGN 50s circulating at the end of June were worth BGN 3575.9 million (34.67 per cent) of the value of circulating banknotes, followed by BGN 100s and 20s at 33.58 and 22.58 per cent.

A stronger increase of BGN 100 numbers changed the denomination composition of banknotes by value. The BGN 100 was the only banknote whose value share rose from 31.94 to 33.58 per cent (1.64 percentage points) in the year to June 2014.

The average banknote circulating at the end of June 2014 was worth BGN 28.32. This rose BGN 0.37 on December 2013 and BGN 0.85 (3.08 per cent) on June 2013.

By the end of June 2014, 1684.5 million coins circulated, worth BGN 212 million. This rose 57.8 million (3.55 per cent) in number and BGN 6.1 million (2.93 per cent) in value in the half year. In a year coins grew by 146.3 million (10.13 per cent) in number and BGN 19 million (9.86 per cent) in value. By 30 June 2014 the share of circulating coins was 2.01 per cent of circulating cash.

Denomination Shares in Circulating Coin Numbers



Source: BNB.

The steady annual growth of circulating coins continued, smaller coin numbers growing faster. BGN 0.01 and 0.02 numbers rose 44.3 (9.46 per cent) and 43 million (11.14 per cent) in a year. BGN 1s continued rising fast at 11.41 per cent in a year.

The share of BGN 0.02s grew 0.5 percentage points (from 4.00 per cent to 4.05 per cent) in value and that of BGN 1s by 0.61 percentage points (from 43.84 per cent to 44.45 per cent). Other coins' shares fell: BGN 0.01s 0.01 percentage points, BGN 0.05s 0.08 percentage points, BGN 0.10s 0.17 percentage points, and BGN 0.20s and 0.50s 0.20 percentage points. At the end of June the average circulating coin was worth BGN 0.13, as in late 2013.

Commemorative coins outside BNB vaults were worth BGN 6.4 million nominal value at the end of June 2014. Their value share in circulating currency was 0.06 per cent, a 0.01 percentage point annual fall.

Non-genuine Banknotes and Coins

In the first half of 2014 the BNB retained 2058 non-genuine Bulgarian banknotes, of which 2010 had been circulated. The share of retained non-genuine banknotes remained very low at 0.000565 per cent of banknotes circulating in the half year.

BGN 10 and 20 banknotes had the largest 41.93 per cent share of non-genuine banknotes in the half year. This represented 0.001147 and 0.000741 per cent of circulating BGN 10 and 20 banknotes. Non-genuine BGN 50 banknotes comprised 12.29 per cent and non-genuine BGN 2 banknotes 3.01 per cent. Non-genuine BGN 5 and BGN 100 banknotes numbered 17 or 0.83 per cent of non-genuine banknotes retained in the six months.

Non-genuine Bulgarian coins numbered 313: 295 BGN 0.50s, 16 1s and two 0.20s. The numerical share of retained non-genuine Bulgarian coins in circulating coins was 0.00019 per cent.

As regards foreign banknotes and coins retained within Bulgaria, in the first half of 2014 the Bank's National Analysis Centre retained 1080 euro banknotes, 5175 US dollar banknotes and 1666 assorted foreign non-genuine banknotes.

BNB Issue and Cash Activities

BNB issue and cash operations include minting and printing cash; accepting, delivering, repaying, processing, and authenticating and fitness checking of Bulgarian and foreign currency; exchanging damaged Bulgarian banknotes and coins; destroying unfit Bulgarian banknotes and coins.

By June 2014, 76.0 million new coins worth BGN 13.2 million nominal value were supplied under contracts with producers. The Bank launched a commemorative coin issue planned in its 2014 minting programme under Article 25, paragraph 1 of the Law on the BNB.⁵⁰

Banknote and coin deposits and withdrawals from the BNB totalled BGN 15,251.9 million between January and June 2014. Banknotes and circulating coins deposited with the BNB totalled BGN 7486.4 million, up BGN 245.4 million or 3.39 per cent compared with the corresponding period of 2013. Banknotes and coins withdrawn from the BNB in the first six months of 2014 totalled BGN 7765.4 million, up BGN 904.6 million or 13.18 per cent on the same period of 2013.

Between January and June 2014 BNB and Cash Services Company⁵¹ sorting machines processed 423.3 million banknotes and 82.3 million coins. Banknotes rose 6.63 per cent and coins fell 6.91 per cent on the same period of 2013. BGN 10 and BGN 20 banknotes and BGN 0.20 and BGN 1 coins were processed most often.

Unfit banknotes numbered 36.5 million, down 3.9 million (9.60 per cent) on the same period of 2013. BGN 2s, 10s and 20s had the largest shares at 22.26, 27.37, and

 $^{^{50}}$ See the BNB website for news on banknote and circulating and commemorative coin issues.

⁵¹ Cash Services Company is a joint-stock company for handling cash and a service supplier within the meaning of BNB Ordinance No 18, whose shareholders are the BNB and four commercial banks.

27.56 per cent of unfit banknotes. Unfit coins numbered 591.600, up 182.900 (44.75 per cent) on the first half of 2013.

The half year's reserve currency purchases were EUR 0.16 million: EUR 0.1 million from budget organisations and EUR 0.06 million from individuals. Reserve currency sales were EUR 14.2 million: EUR 3.6 million to budget organisations and EUR 10.6 million to individuals.

The BNB conducted three full and 15 spot on-site checks into credit institution and service provider compliance with Ordinance No 18 on the Control over Quality of Banknotes and Coins in Currency Circulation and the instructions on its implementation. Inspections included reviewing the cash operations statutory framework, testing ATM banknote quality, and checking sorting and customer-operated machines.

VI.

Maintaining Banking System Stability and Protecting Depositor Interests

1. The Banking System

In the first half of 2014 the banking system continued to operate in the context of low economic activity and limited household consumption. Despite some signs of recovery, lending remained subdued. The deposit base rose further amid high savings rates. Decreased funds attracted from credit institutions were fully offset by increased domestic financing. Free resources were primarily invested in Bulgarian government securities.

News reports casting doubt on the quality of the KTB and subsidiary CB Victoria banks' credit portfolios caused runs on them in late June. Significant liquidity depletion led to conservatorship over the two banks on 20 and 22 June. By the end of June runs hit other banks, ending in early July thanks to significant system liquidity buffers, BNB and government measures, and rapid European Commission offers of liquidity support. The EC allows state aid only to solvent and economically viable banks. These measures revived confidence in banks and the inflow of deposits recovered to surpass May by September. The banking system managed to improve liquidity and maintain capital buffers. Economic agents appreciated banking resilience and the role of financial intermediary as normal.

Credit risk management was the major priority in bank managements' actions and the level of loans past due over 90 days remained within the limits recorded in an annual horizon. The capital base of the banking system was preserved and thereby its capacity to absorb risks related to credit institutions' operations.

As of 30 June 2014 bank assets totalled BGN 87.2 billion, up BGN 1.6 billion (1.9 per cent) on end-2013. In a one-year horizon, the sector's assets rose by BGN 4 billion (4.8 per cent) against an increase of 4.7 per cent reported for the banking system in the June 2012–June 2013 period.

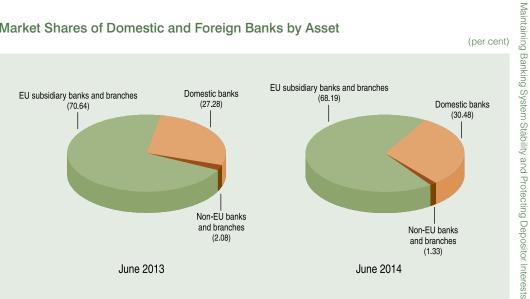
By the end of June 2014 the share of the five largest banks in the banking balance sheet accounted for 51.2 per cent. The market position of Bulgarian-owned banks⁵⁴ reached 30.5 per cent. Market shares of EU bank subsidiaries and branches fell to 68.2 and that of non-EU banks and branches to 1.3 per cent.

At the request of the KTB and CB Victoria managements, the two banks were placed under conservatorship in the second half of June. Under the Law on Credit Institution conservatorship requirements, the BNB appointed conservators, discontinued the operations of the two banks for a period of three months, dismissed from office all members of the management bodies and revoked the voting rights of the shareholders holding more than 10 per cent of shares. With the follow-up decisions of the BNB Governing Council, the measure under Article 116, paragraph 2, item 1 of the Law on Credit Institutions was imposed, with the interest rates on bank's liabilities being reduced to the market average. Three audit firms (Deloitte Audit Bulgaria OOD, Ernst & Young OOD, and AFA OOD), which have not audited the two banks in recent years, were selected to start a comprehensive assessment of assets, intended to assess their actual state and any possible capital requirements for rescuing the two banks. Developments of the KTB and CB Victoria issue were regularly made publicly available *via* press releases and statements published on the BNB website. A comprehensive analysis and assessment will be made in the BNB Annual Report.

 ⁵³ See the BNB monthly press release entitled *The State of the Banking System in the Second Quarter of 2014*.
 54 As of 30 June the group of domestic banks included 10 banks. In June 2014 KTB acquired Credit Agricole, Bulgaria EAD and its name was changed to Commercial Bank Victoria on 8 August 2014. Under Article 11 of the agreement between the BNB and First Investment Bank (concluded on 28 February 2014) the takeover of MKB Unionbank by First Investment Bank was recorded in the Commercial Register on 4 March 2014.

Market Shares of Domestic and Foreign Banks by Asset

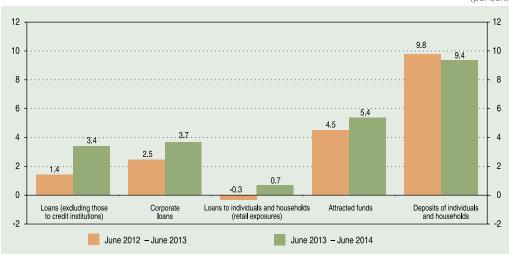
(per cent)



Source: BNB.

Dynamics of Selected Balance Sheet Indicators (annual change)

(per cent)



Source: BNB.

Between January and June 2014 the structure of the banking sector balance sheet experienced certain changes. Securities portfolios rose by about 1.4 billion and their share in banks' assets reached 13.5 per cent at the end of June. Investment in Bulgarian government securities increased by BGN 1.7 billion (acquired mainly in June as assets available for sale), while debt instruments of non-resident issuers exhibited a decline. Claims on credit institutions decreased on end-2013 and their share in banks' assets also went down (10.1 per cent). Despite the decline in cash, its share remained high (9.8 per cent in the system's balance sheet). Household deposits continued to grow, indicating an increase by 3.3 per cent on end-2013. Banks continued to repay their obligations to non-residents (mostly to entities of the group). As a result, the share of attracted funds from resident sources increased (84.1 per cent). The share of attracted funds in levs reached 49.9 per cent.

Despite some signs of recovery, lending remained subdued. Between January and June 2014 gross loans (excluding loans to credit institutions) went up BGN 1.1 billion (1.9 per cent). Growth was entirely due to corporate loans (BGN 1125 million, 2.9 per cent), with KTB contributing most significantly to growth in this segment.

Retail exposures remained almost unchanged on June 2013 due to divergent developments in the two types of household deposits: housing mortgage loans rose by BGN 67 million (0.7 per cent) and consumer loans decreased by BGN 66 million (0.7 per cent). Bank loans extended to non-credit institutions and central governments indicated a certain fall on the end of 2013. Claims on credit institutions recorded a stronger decrease (by 8.5 per cent) on the end of 2013 as a result of rechanelled investment into debt instruments. By end-June the share of positions in levs accounted for 36.2 per cent, in euro 58.7 per cent and in US dollars 5.1 per cent.

Structure of Attracted Funds

(per cent) 29 25 100 100 11.2 13.9 80 31.2 32.3 60 40 40 54.0 52.1 20 20 0 n June 2013 June 2014 Individuals and Institutions other Credit Subordinated term debt and institutions households than credit debt-equity instruments

Source: BNB.

By end-June funds attracted in the banking system totalled BGN 75.1 billion, up BGN 1.2 billion (1.6 per cent) on end-2013. Growth was entirely due to internal sources. Deposits of individuals and households rose by BGN 1.3 per cent (3.3 per cent) on end-2013. On an annual basis (against June 2013) they grew 9.4 per cent (against 9.8 per cent between June 2012 and June 2013). For a year, the share of household resources increased by about 2 percentage points and by 30 June 2014 these funds accounted for 54 per cent in the structure of banking system financing. Funds attracted from institutions other than credit increased by BGN 603 million (2.6 per cent) on the end of 2013. Annual growth of 9.1 per cent was reported and the share of funds from institutions other than credit in total financing rose to 32.3 per cent. Attracted funds from credit institutions in the banking system decreased by BGN 719 million and debt/equity (hybrid) instruments by BGN 36 million on end-2013. Concurrently, subordinated term debt went up BGN 29 million. The lev component (49.9 per cent by the end of June) remained dominant in the currency breakdown of attracted funds, followed by the share of funds in euro (43.4 per cent) and that of other currencies (6.7 per cent),

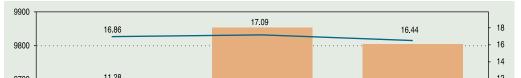
At the end of June 2014 the banking system balance sheet equity exceeded BGN 11 billion: up 0.4 per cent (BGN 48 million) on end-2013. The item was impacted by the decrease in issued capital (due to the merger of Unionbank into First Investment Bank) and in revaluation reserves. The increase in reserves (including retained earnings) helped offset this effect.

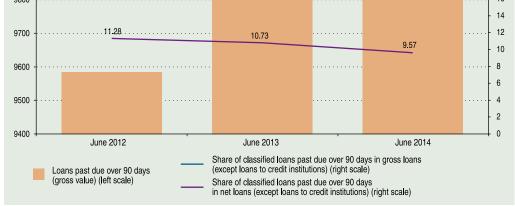
(per cent)

In managing risks in the first half of 2014, most credit institutions preserved the amount and quality of capital and liquidity buffers held over years. Liquidity risk and banks' ability to cope with a significant outflow of deposits were highlighted as important issues. The instability in political and economic environment was challenging for credit institutions in improving the business model, focusing mainly on liquidity management and provision of additional liquidity buffers, including the involvement of shareholders.

Credit risk remained the major risk. The quality of assets outside the credit portfolio remained good. Credit institutions maintained their capital positions in line with their risk profiles. The impairment of credit portfolios, lower income from assets and growth of attracted funds continued to exert a downward pressure on banks' other costs, particularly on interest expenditure.

Loans Past Due over 90 Days





Source: BNB

(BGN million)

Between January and June loans past due over 90 days (including those past due over 180 days) reported a decline. As of 30 June loans classified as other than standard⁵⁵ totalled BGN 13.7 billion, up 1 per cent on December 2013. As a result of BNB recommendations for credit risk management in banks, in the first half of 2014 loans past due over 90 days (including those past due over 180 days) decreased by BGN 75 million (0.8 per cent) to BGN 9.8 billion and their share in banks' gross loans (excluding those to credit institutions) accounted for 16.44 per cent. The share of net (balance sheet) loans past due over 90 days⁵⁶ in net loans (excluding those to credit institutions) remained within the levels observed in the last 12 months and by the end of June accounted for 9.57 per cent (10.73 per cent at the end of June 2013).

The review of credit institutions' credit portfolio across segments suggests that servicing of corporate loans again cause the most serious problems. As of 30 June the share of corporate loans past due over 90 days (including also loans past due over 180 days) accounted for 18.5 per cent. The share of corresponding retail exposures was 13.4 per cent. The classified portion of housing mortgage loans accounted for 17.0 per cent, while the level of past due consumer loans (9.6 per cent) remained more favourable.

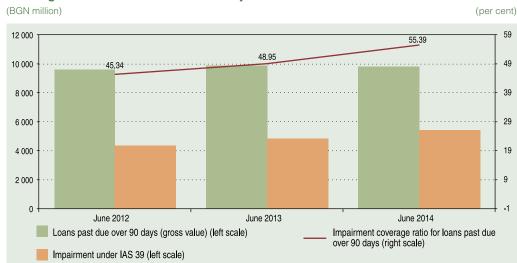
The impairment coverage ratio for loans past due over 90 days (including also loans past due over 180 days) accounted for 55.4 per cent at the end of June 2014 (until

 $^{^{55}}$ Specified as classified exposures in repealed Ordinance No 9 of the BNB.

⁵⁶ The amount of net loans past due over 90 days is calculated by subtracting impairment costs from their gross value.

the end of 2013 the coverage ratio included the effect of specific provisions for credit risk removed with the repealed Ordinance No 9 of the BNB).

Coverage of Loans Past Due over 90 Days

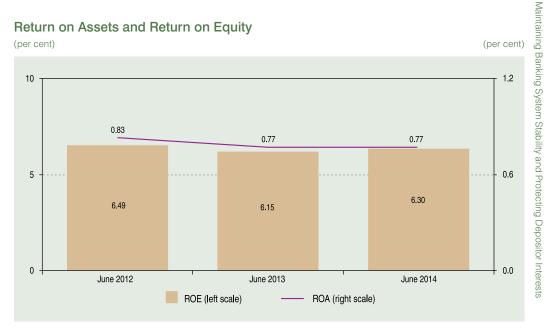


Source: BNB.

Other balance sheet items (other than loans) preserved their good quality and liquidity but their profitability was insufficiently high. Within the structure of credit institutions' securities portfolio, Bulgarian government bonds accounted for 61.7 per cent at the expense of the decreased share of securities issued by foreign issuers. The share of capital instruments remained insignificant (3 per cent). Investment in banks also reported low growth due to the high share of investment in entities of the group (70.1 per cent of total placements).

Between January and June 2014 the profitability of credit institutions remained impacted by limited business opportunities and continuous impairment of assets. Changes in banks' price levels on attracted funds ensured for the banking system a decline of BGN 127 million (11.9 per cent) in interest expenditure compared with the first half of 2013. Market developments and decreasing profitability of invested resources led to a fall in interest income by BGN 40 million (1.8 per cent), formed mostly by loans and receivables and financial assets held for trading. Compared with June 2013, the net interest income went up and the net interest margin rose to 3.31 per cent against 3.29 per cent a year earlier. Net fee and commission income remained almost unchanged on the first half of 2013 (BGN 404 million as of 30 June 2014). Over the review period higher gains from financial assets and liabilities (as compared with the previous year) had a favourable effect. Concurrently, higher impairment was accrued. The lower amount of other operating revenue and net valuation adjustments, as well as the higher administrative costs exerted an additional downward pressure on the profit.

Return on Assets and Return on Equity



Source: BNB.

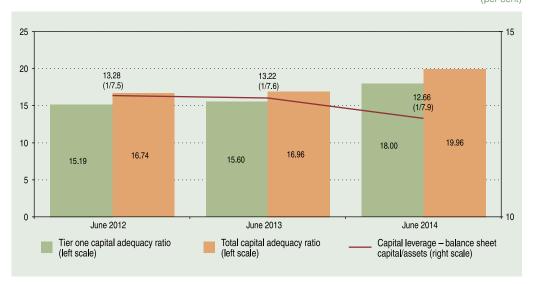
Between January and June 2014 the banking sector profit was BGN 332 million, ensuring 0.77 per cent return on assets (ROA). The return on balance sheet equity and reserves (ROE) improved to 6.30 per cent. Banks' efforts to reduce their operating costs (excluding those on impairment) resulted in an improvement of the efficiency ratio to 51.5 per cent.

The amount and quality of regulatory capital remained high, with the banking system capital buffer increasing significantly in the first half of 2014. This reflects both the removed requirement for reporting specific provisions for credit risk (reported until 2013 as a discount of own funds, equally split between primary and supplementary capital)57 and BNB supervisory recommendations regarding banks' capital positions. The capital base increased by 22.2 per cent (approximately BGN 2.1 billion) to BGN 11.5 billion, and the two major indicators improved. As of 30 June 2014 the banking system total capital adequacy ratio increased from 16.96 per cent at end-June 2013 to 19.96 per cent, and the tier one capital adequacy ratio reached 18.00 per cent (15.6 per cent at end-June 2013). The excess (the capital buffer) over the regulatory level of 12 per cent was BGN 4.6 billion. Over the review period tier one capital (after the statutory discounts) increased by BGN 1.5 billion and supplementary capital by BGN 596 million. Tier one capital accounted for 90.2 per cent in the structure of own funds. The leverage ratio (balance sheet equity/assets) based on statistical reporting accounted for 12.66 per cent at the end of June 2014 (ratio 1/7.9) and remained at more favourable levels than the average ratios in the EU Member State banking systems.

⁵⁷ To bring the Bulgarian legislation in compliance with the new EU legal framework on credit institutions' activity (Directive and Regulation on capital requirements, the so-called CDR IV/CRR package) the Governing Council made amendments to ordinances, in force until 1 January 2014, repealed ordinances effective until 1 January 2014 and adopted new ordinances. BNB Ordinance No 8 on the Capital Adequacy of Credit Institutions and Ordinance No 9 of the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk were repealed. With the repeal of the regime of specific provisions for credit risk, one of the main factors influencing the dynamics in composing the tier one capital, supplementary capital and, hence own funds as a whole, was removed. The BNB published capital adequacy ratios based on parallel reporting for statistical purposes. This was intended to provide information in due time on trends in the capital positions in a period shorter than those adopted in the EU. Due to ongoing implementation of reporting under the new Regulation (EU) No 575/2013 and verification of received data, the analysis in this section refers to both the statistical reporting and data under Regulation (EU) No 575/2013 to ensure greater reliability.

Selected Capital Indicators

(per cent)



Note: Data are according to statistical reporting under Ordinance No 8 of the BNB, in force until the end of 2013. Source: BNB.

Under Regulation (EC) No 575/2013, since early 2014 the new reporting framework on the capital adequacy and components unified for EU banks has been applied. The dynamics of major bank indicators reported under the Regulation was similar to that reported under the statistical reporting in compliance with Ordinance No 8. Differences in reporting risk weighted exposures under repealed Ordinance No 8 of the BNB and the Regulation were ascribable to the different risk weights and treatments, some of which having more favourable effects on banks and other leading to higher capital requirements. According to the reporting under Regulation (EU) No 575/2013, at the end of June the total capital adequacy ratio and tier one capital adequacy ratio accounted for 21.26 and 18.79 per cent, respectively. Equity amounted to BGN 11.8 billion. Common equity tier one capital accounted for 97.7 per cent in the structure of tier one capital. Equity of five banks was entirely consisted of tier one capital. The banking system leverage ratio, using the fully implemented tier one capital definition under the Regulation, was 11.80 per cent (1/8.5 as a ratio).

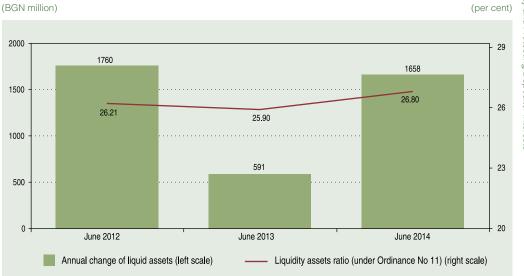
Liquidity buffers held by banks and deliberately required by the BNB allowed to preserve banking stability and, correspondingly the stability of the entire financial system. Banks overcame the liquidity shock they faced in the second half of June. KTB and CB Victoria suffered a strong deposit outflow which entailed the placement of the banks under coservatorship. In June the liquidity of other credit institutions was strengthened as a response to uncertainty. Increasing funds of households and corporations in the context of still slow lending activity also contributed to liquidity buffer growth. Between January and June banking liquid assets rose by BGN 135 million (0.7 per cent) and by the end of June 2014 they amounted to BGN 20.2 billion. Marketable debt securities issued by central governments or central banks increased most substantially: by BGN 1.3 billion. Cash decreased by BGN 374 million. As a result of rechannelled investment, cash on current accounts with other banks and interbank deposits of up to seven days went down by BGN 644 million.

At the end of June cash retained its largest share in the structure of liquid assets (42.2 per cent) followed by funds on current accounts with other banks and interbank deposits of up to seven days (33.7 per cent), and marketable securities issued by central governments or central banks (19.9 per cent). The share of Bulgarian government securities (other than those for trading) accounted for 3.8 per cent.

 $oldsymbol{\gamma}$ \mid Maintaining Banking System Stability and Protecting Depositor Interests

Between January and June 2014 banks adhered to the supervisory recommendation for a 20 per cent coverage of attracted funds of individuals and institutions other than credit institutions by liquid assets. The lowest liquid assets ratio of the banking system (the liquid assets/liabilities ratio) was 25.83 per cent and at the end of June 2014 it reached 26.80 per cent. The implementation of macro-prudential requirements was among the factors allowing banks to overcome the pressure of the liquidity shock.

Selected Liquidity Indicators



Source: BNB

Assessment of the Financial Performance of Financial Institutions Registered under Article 3a of the Law on Credit Institutions

The amendments to the Law on Credit Institutions and Ordinance No 26 of the BNB establish requirements for a registration and equity not less than BGN 1 million which shall be raised by own funds. Financial institutions were obliged to announce the actual owners, and as to the managers acting by virtue of authorisation qualification, professional experience and reputation criteria are introduced.

By the end of the first half of 2014 the total number of registered financial institutions decreased to 287, with companies extending loans (130) and financial leasing (65) prevailing among them.

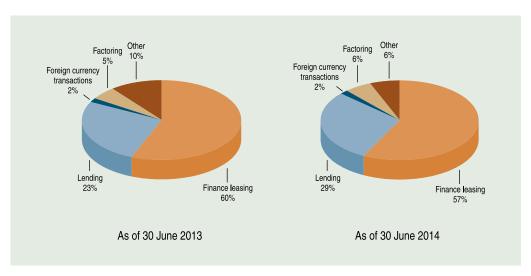
As of 30 June 2014 assets totalled BGN 6.1 billion⁵⁸ posting a decline by 8.4 per cent on June 2013. At the end of the half-year period, the share of sector's assets went down to 7.0 per cent of banking system assets. The assets of the 20 largest financial institutions accounted for 70 per cent of the sector's balance sheet. Developments in assets reflected the contracted leasing portfolio and started voluntary termination of operations as a financial institution. Operations of lending companies posted a positive dynamics resulting in an increase in their market share.

Distribution of market shares of financial institutions specialised in respective activities remained almost unchanged over the review period. Leasing companies again

⁵⁸ The balance sheet includes financial reports for supervisory purposes of 255 financial institutions. Mutual credit cooperatives of private farmers under §12 of the Law on Credit Institutions were not included in the balance sheet.

retained their dominant share (57 per cent) followed by lending companies (29 per cent) and factoring services companies (6 per cent).

Structure of Assets by Group of Financial Institutions



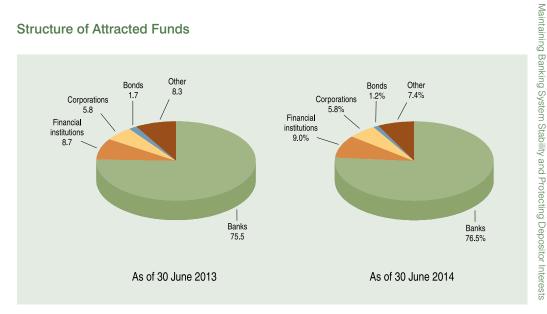
Source: BNB.

Loans and receivables (including financial leasing) retained their dominant share of 76 per cent (BGN 4.6 billion) in the structure of assets. Concurrently, for a year the share of cash remained unchanged (11.0 per cent) despite the decrease of funds on an annual basis by 12 per cent and almost double fall in funds denominated in euro. Growth of consumer loans and the decrease in the leasing portfolio gradually changed the currency structure of the sector portfolio in favour of receivables in levs. Receivables denominated in euro were mostly from financial leasing, indicating a fall by 2 per cent on an annual basis. Within the currency structure of loans and receivables, the share of lev items increased to 48 per cent and the share of euro items declined to 52 per cent.

At the end of June 2014 the quality of loans (including financial leasing) remained deteriorated, with gross impaired loans slightly contracting to reach BGN 2.6 billion or 49.9 per cent of the gross credit portfolio. Loans past due over 90 days accounted for 23 per cent of gross impaired loans (against 25.3 per cent by the end of June 2013) and loans past due for other reasons 18 per cent (against 15.2 per cent as of June 2013). Assets impairment charges increased by 6.1 per cent on an annual basis and reached BGN 990 million.

Attracted funds decreased by 8.4 per cent on June 2013, reaching BGN 4.6 billion. Bank resources (BGN 3.5 billion) remained the major source of financing for the sector, its share reaching 76.5 per cent of total attracted funds at the end of the first half of the year (against 75.5 per cent in June 2013). More than half of attracted funds were concentrated in leasing companies (64 per cent), followed by lending companies (23 per cent). Funds in foreign currency retained their strong share of 72 per cent in total financial liabilities. These resources accounted for 77 per cent in the corresponding period of 2013. Total financing in euro continued to decrease in the recent two years to reach 71.4 per cent in June 2014.

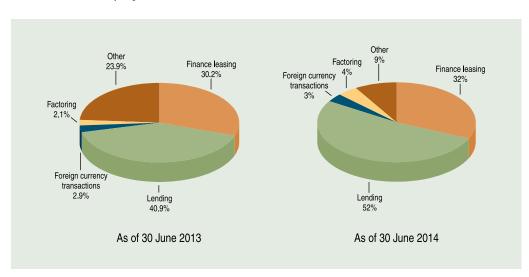
Structure of Attracted Funds



Source: BNB.

By the end of June financial institutions' equity amounted to BGN 1.1 billion, reporting a decrease by 18 per cent on June 2013. The capital position of the sector matched the levels of the corresponding period of 2012 due to continuous depreciation of leasing companies' assets. The compensating effect of the profit and equity of lending companies helped avoid a strong capital decline in the sector.

Distribution of Equity



Source: BNB.

By the end of June 2014 financial institutions reported a profit amounting to BGN 87 million, with lending companies contributing most significantly (78 per cent) followed by financial institutions conducting factor transactions (16 per cent). Compared with June 2013, net interest income of financial institutions (BGN 246 million) increased by 6.1 per cent attributable mainly to lower interest expenditure.

The sector current liquidity⁵⁹ posted a slight decrease over the review period (15 per cent) compared with June 2013 (15.7 per cent).

⁵⁹ Measured by comparing current assets with current liabilities.

3. Banking Supervision

In March 2014 amendments to the Law on Credit Institutions were adopted to meet the requirements of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. These amendments and the enforcement of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (the so-called CRD IV/CRR package), in substance, introduce the European version of rules of the new Basel capital agreement, Basel III. The new framework also entailed changes to the BNB supervisory approach aimed at preserving the buffers accumulated in the banking system over years.

In April the BNB Governing Council approved amendments to several major BNB ordinances on the banking supervision and adopted new ordinances on capital buffers and risk management in banks. The amendments helped align Bulgarian legislation with the new EU legal framework on credit institutions' activity established with the adoption of the CRD IV/CRR package, and with amendments made to the Law on Credit Institutions published in the Darjaven Vestnik, issue 27 of 2014.⁶⁰

The new Ordinance No 7 of the BNB on Organisation and Risk Management of Banks provides for requirements on the organisation and risk management of banks, establishment of a risk committee and expansion of the existing requirements and criteria concerning the treatment of different risk categories. The new Ordinance No 8 on Banks' Capital Buffers provides for statutory requirements for establishing a methodology of maintaining a capital conservation buffer, a bank-specific countercyclical capital buffer, a buffer for global systemically important institutions (G-SIIs), a buffer for other systemically important institutions (O-SIIs) and a systemic risk buffer.⁶¹ The BNB set the capital conservation buffer at 2.5 per cent (effective as of May 2014) and the capital buffer for systemic risk at 3 per cent (effective as of October 2014) for all domestic credit institutions.

With the implementation of the CRD IV/CRR package, the simulation exercise with banks, intended to analyse the effect of the new regulatory framework, continued in the first half of 2014. Banks reported in parallel forecast data under CRD IV/CRR and under former regulatory framework. Data allowed the BNB to identify an approach of smooth implementation of the new requirements used for calibration of some discretionary elements in applying the framework.

From 2014 a standardised supervisory reporting framework covering the entire reporting of banks under the CRD IV/CRR package was launched in the EU. To facilitate the implementation of the new requirements under Regulation (EU) No 575/2013, communication with banks was intensified and best efforts were made to provide unified practices of treatment of key issues in implementing the framework.

In compliance with the amendments to the Law on Credit Institutions, the BNB is the competent authority exercising macro-prudential supervision. To further strengthen the BNB macro-pudential mandate in respect of the banking system, a structural change was initiated in the second quarter of 2014: the financial stability analysis function was moved to the activity of the Banking Supervision Department. This change was intended to respond to dynamic changes in international regulatory en-

⁶⁰ To this end, amendments were made to Ordinance No 2 of the BNB on the Licenses, Approvals and Permissions Granted by the Bulgarian National Bank according to the Law on Credit Institutions, Ordinance No 4 of the BNB on the Requirements for Remunerations in Banks, Ordinance No 11 of the BNB on Bank Liquidity Management and Supervision and Ordinance No 20 of the BNB on the Issuance of Approvals under Article 11, paragraph 3 of the Law on Credit Institutions.

⁶¹ With the approval of these amendments and adoption of new ordinances, the currently effective ordinances were repealed: Ordinance No 7 of the BNB on Large Exposures of Banks; Ordinance No 8 of the BNB on the Capital Adequacy of Credit Institutions, Ordinance No 9 of the BNB on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk, BNB Ordinance No 12 of the BNB on the Supervision on a Consolidated Basis and Ordinance No 17 of the BNB on Establishing the Amount of Bank Investment under Article 47 of the Law on Credit Institutions.

vironment, including the implementation of the macro-prudential framework in the EU, and to ensure synergy of competences and building of current expertise in the macro-prudential supervision area. The major task of macro-prudential supervision and financial stability was the continuous monitoring, analysis and assessment of the dynamics of risks in the Bulgaria's banking system as a whole.

Over the review period the scope of analyses on macroeconomic conditions for operation of the banking system was expanded. The analysis focused on major factors influencing the economic activity and financial performance of corporations and households in terms of their creditworthiness and the ensuing risks for the banking system. Major exposures among institutional sectors and potential risks for banks ensuing from financial corporations behaviour were analysed. With regard to supervisory measures to be initiated and recommendations to be given, the sensitivity of the banking sector and individual credit institutions to various real and hypothetical effects was regularly examined (test of stability under credit and liquidity pressure). The results were used in determining the recommended levels of liquidity buffers and taken into account in establishing maximum levels of the capital conservation buffer and systemic risk buffer under Ordinance No 8 on Banks' Capital Buffers.

As a result of the changes to the regulatory framework and supervisory and financial reporting, the current supervisory reporting and analytical instruments employed were adjusted. For the purposes of analysis, comparable data were provided and reporting forms with additional information were prepared. The new supervisory framework and the follow-up Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 impose new reporting requirements for credit institutions: new templates, scope and frequency. In parallel to the work on the Single Data Depository, a mechanism for accepting and verifying new reports, and for XBRL output generation, required for presenting to the European Banking Authority, was provided.

Supervisory reviews and assessments of individual credit institutions carried out through off-site monitoring and on-site inspections remained a priority in the banking supervision activity in the first half of 2014. Special attention was paid to basic bank operational risk and the efficiency of new regulatory reporting on the capital requirements under Regulation (EU) No 575/2013. The current monitoring of banks' financial performance continued over the review period. The results were reported in quarterly supervisory analyses reflecting the degree and developments of bank risks and CAEL ratings which determined the risk profiles of individual banks. The on-site supervision programme entailed eight supervisory inspections. Analysis and assessment of institutions' risk profile, adequacy of the systems of monitoring and control over assumed risks, capital sufficiency, profitability, liquidity and compliance with the regulatory framework were the starting points of on-site inspections. Inspections of two credit institutions were carried out to assess their preparedness for applying advanced approaches (internal models) for measuring credit risk.

Inspectors found 29 formal violations to the banking statutory framework and 102 recommendations were made to banks' managements for improving various bank operations. The bulk of found breaches reflected the incorrect identification and measurement of the risk degree in individual risk exposures and their impairment, and non-compliance with the supervisory regulations. To improve their preparedness, recommendations for adopting action plans for removing the weaknesses in designing and validating the models were provided to the banks requesting permission to apply internal models for computing capital requirements. Provided the results of the initiated measures are acceptable and following a supervisory assessment, the BNB will decide whether there is a ground to permit the banks to apply advanced approaches.

In the first six months of 2014 tasks reflected also the EC commitments for implementing a modern legal framework and a smoothly functioning system for timely identification of suspicious transactions associated with money laundering and financing

of terrorism. The regular inspections found that banks applied effective policies and procedures for minimising risk of transferring funds of unclear and criminal origin. The information exchange with banks on the EU restrictive measures imposed against jurisdictions, bodies, organisations and persons threatening the territorial integrity, sovereignty and independence of a third country intensified. To this end, the cooperation with the Ministry of Internal Affairs strengthened. Working meetings were organised to coordinate actions of competent institutions. Regular contacts with bodies involved in fighting financial fraud and cross-border crimes continued. At the training organised by BNB experts for bankers, new standards and techniques applied in the context of free movement of capital, through which undesirable or illegal transactions can be effectively identified, were presented.

Assessments of credit institutions as custodians were also subject to supervisory attention. Trust organisation and procedures applied by credit institutions were evaluated jointly with the Financial Supervision Commission. The collaboration between the BNB and the Deposit Insurance Fund continued with the assistance provided by the BNB in developing instructions for implementing regular tests of the deposit insurance system. The inspections carried out in banks for compliance with the provisions of the Law on Bank Deposit Guaranty assessed the quality of applied procedures and recommended corrective actions.

No new procedures for licensing credit institutions were opened in the first half of 2014 but the shareholder structure of several banks experienced serious changes. Shareholders with qualifying holdings in the First Investment Bank acquired in concerted action a common equity interest exceeding 50 per cent of voting shares, thereby exercising control over the bank. Based on an issued approval, Corporate Commercial Bank acquired all shares of Credit Agricole, Bulgaria, and later its name was changed to Commercial Bank Victoria as marked in the licence. Following a participation in the capital increase of D Commerce Bank, Fortera EAD Company acquired an equity interest exceeding 33 per cent of the capital of this bank.

Over the review period three banks, CIBANK, ProCredit Bank and First Investment Bank, repaid in advance their obligations on tier two capital instruments and Corporate Commercial Bank included subordinated term debt in its tier two capital.

In the first half of 2014 no essential changes occurred in management bodies of credit institutions. Three new members were elected in the Management Board of Texim Bank, two members in the Management Board of Municipal Bank and and two members in the Supervisory Board of Allianz Bank Bulgaria. Minor changes were made in the management bodies of other six banks.

The supervisory bodies of eight EU Member State credit institutions notified the BNB of their intent to provide cross-border services in Bulgaria. The number of these institutions reached 238. No new foreign bank branches from EU Member States were opened in Bulgaria.

Based on results of supervisory inspections, three domestic banks were provided with prescriptions and were recommended to improve risk management, as well as to prepare plans and commitments to address the weaknesses.

Over the first half of 2014 the BNB continued to receive claims from bank customers and financial institutions. The resolution of claims concern the competence of the Commission on Consumer Protection. The BNB initiated the relevant actions to inform the Commission and resolve in due time the problems specified in the claims.

The Central Credit Register

The Bulgarian National Bank maintains an information system on customer debt to Bulgarian banks, other financial institutions, and payment and electronic money institutions. BNB Ordinance No 22 on the Central Credit Register of 16 July 2009 regulates CCR terms, procedure, and information flows. The Register provides centralised borrowing information to banks, financial, payment, and electronic money institutions, and to the BNB.

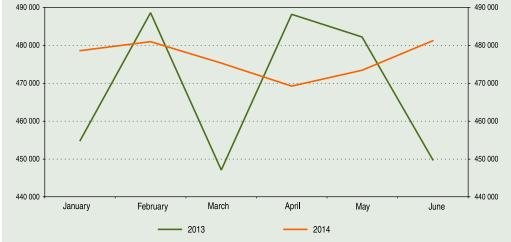
By 30 June the CCR had 217 participants: 29 banks, 187 financial institutions, and one payment institution. Ten new financial institutions listed and five financial institutions and a bank delisted under Ordinance No 22 Articles 8 and 9 due to termination of operations and deletion from the Banking Supervision Department public register.

By 30 June the CCR listed 4,080,000 loans (4,053,000 a year earlier) with a balance sheet exposure rising to BGN 64,316 million on BGN 62,460 million a year earlier. It listed 2,135,000 borrowers: 2,031,000 natural persons, 93,000 legal entities, 7000 self employed people, and 4000 foreign entities.

In the half year Register participants conducted 2,859,000 digital certificate searches on 2,236,000 natural persons and 623,000 legal entities: 48,000 more than in the same period of 2013 (2,811,000 searches). There were some 476,000 monthly searches on average.

CCR Searches in the First Halves of 2013 and 2014

(number)

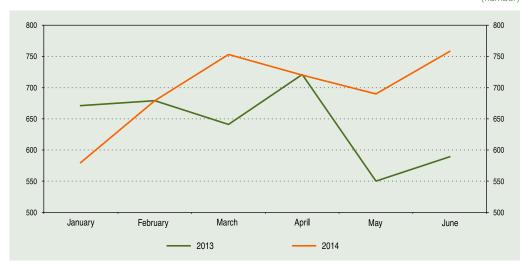


Source: BNB.

Ordinance No 22 Articles 21 and 22 govern individual and legal entity information disclosure. Access involves applying and remitting a published fee according to a BNB tariff. In the first half year there were 4180 statement applications: 4072 by individuals and 108 by legal entities, on 3851 in the same period of 2013.

CCR Statement Applications in the First Halves of 2013 and 2014

(number)



Source: BNB.

Based on system data analyses, the BNB made amendments to the CCR functionalities and statement types. In addition, new logic control procedures were developed to boost the quality of CCR data maintenance.

Amendments to the Law on Credit Institutions Article 56 (*Darjaven Vestnik*, issue 27 of 15 May 2014) expanded the scope of CCR participants to financial institutions providing guarantee transactions, acquiring credit claims, and offering factoring, forfaiting and other finance. These are specific areas requiring investigating international practice and analysing data to improve CCR operation. Amendments to CCR regulations will focus on credit requisites in the guidelines to the Ordinance and on data submission and reporting by new participants.

LCI amendments and Regulation No 575/2013 of the European Parliament and of the Council of 26 June 2013 call for amending Ordinance No 22. In the context of the Bulgarian Credit Register's participation in an international working group of central banks' credit registers within the European Union, information is exchanged to facilitate the application of higher requirements for the CCR operation. The application of Commission Implementing Regulation (EU) No 680/2014 laying down implementing technical standards under Regulation (EU) No 575/2013 with regard to supervisory reporting of institutions and of ECB Recommendation of 25 February 2014 on the organisation of preparatory measures for the collection of granular credit data by the European System of Central Banks (ECB/2014/7) is now under way. The Recommendation is addressed to non-euro area national central banks wishing to participate in the long-term framework for the collection of granular credit data within the ESCB.

VIII. The Fiscal Agent and State Depository Function

The Law on the Bulgarian National Bank designates the Bank state fiscal agent and official depository. Under market conditions and price contracts with the Ministry of Finance (MF), the BNB submits statements of budget entities' accounts with domestic banks to the MF and acts as government debt agent.

These duties call for continual improvement of the GSAS system for conducting government securities auctions, the ESROT electronic system for registering and servicing government securities trading, the GSSS government securities settlement system, the Register of Special Pledges, the AS ROAD automated system for registering and servicing external debt and the IOBFR system for budget and fiscal reserve information servicing.

The BNB earned BGN 1,503,300 from its agency functions in the first half of 2014: an increase of 28.4 per cent on the same period of 2013. This was mainly due to 41.5 per cent higher revenue from greater bond supply, primary market auctions, registration and settlement, and issue maturity paperwork. Fees paid by the MF under Article 43, paragraph 1 of the Law on the BNB (up 5.6 per cent) added further to this growth.

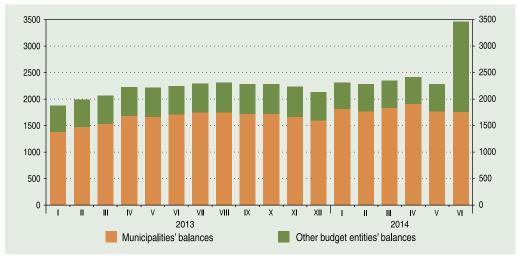
Information Service

Servicing state budget information to the MF contract involved submitting daily and periodical statements on budget entities' (municipalities included) budget, extra budgetary, deposit, foreign currency, and letter of credit lev and foreign currency accounts at the BNB and other Bulgarian banks *via* IOBFR. The Bank also monitored security pledged by banks under the State Budget Law and the Public Finance Law on a daily basis, tallying it with reported balances.

On 30 June 2014, 23 banks including the BNB serviced budget funds with access to the IOBFR. The overall balance of budget entities' accounts (including the central budget) was BGN 7623.0 million, 62 down BGN 92.2 million on 30 June 2013. BGN 4157.2 million or some 55 per cent was in BNB accounts and the rest with domestic banks.

Budget Entities' Account Balances with Domestic Banks





Source: BNB.

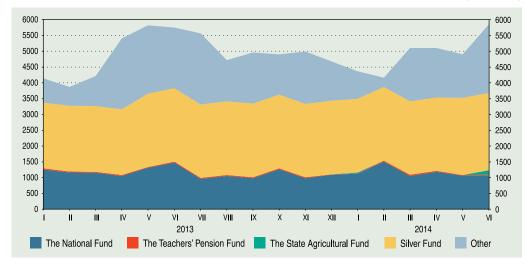
⁶² Foreign currency account balances are shown in levs at the 30 June 2014 BNB rate

Account balances of budget entities⁶³ outside the central bank rose 54 per cent on June 2013. As in prior years, five banks held over 73 per cent of them.

Some 77 per cent of budget funds at the BNB and other domestic banks formed the fiscal reserve's liquid part⁶⁴: BGN 5854.5 million on 30 June. Of this, BGN 3673.1 million was in dedicated Silver Fund (State Fund for Guaranteeing the Stability of the State Pension System), MF National Fund, Agricultural State Fund Paying Agency, and Teachers' Pension Fund accounts.

Fiscal Reserve Bank Account Structure

(BGN million)



Source: BNB.

BNB duties to the MF and standing joint instructions by the Minister of Finance and the BNB Governor⁶⁵ involved preparing 317 statistical budget reporting forms, including 155 for fiscal reserve account balances, up 8 per cent on the same period of 2013. The rise reflected MF needs for daily statements of budget entity BNB accounts.

The AS ROAD system tracks government foreign financial obligations for which the BNB is calculating and paying agent. There were 17 regular payments of EUR 69.8 million⁶⁶ under the agency contract with the MF, comprising EUR 28.9 million principal and EUR 40.9 million interest payments. On 30 June obligations in AS ROAD came to EUR 3010.2 million⁶⁷ from EUR 2704.2 million a year earlier. Debt in euro continued dominating at 73.2 per cent, followed by US dollars and yen at 26.4 and 0.4 per cent.

Servicing Government Securities Trading

In the first half of 2014, as in the same period of 2013, the MF⁶⁸ held its 15 scheduled government securities auctions plus an extraordinary one. They offered four short-term, two medium-term and two long-term issues. Average-weighted term to maturity of sold issues was 18 months. Nominal offered value was BGN 3296.7 million.

Almost 74 per cent or BGN 3990.0 million of bids were by banks, with BGN 1413.1 million by non-bank institutions. Private pension funds were among the most active investors with 10.51 per cent of bids, followed by the Bulgarian Deposit Insurance Fund with 9.07 per cent, insurance companies with 1.8 per cent, and the National

⁶³ Including central budget account balances.

⁶⁴ According to § 1, item 41 of the Additional Provisions of the Law on Public Finance, fiscal reserve includes balances on all bank accounts of budget entities, excluding municipalities and their budget spending units, plus other assets and EU fund receipts.

⁶⁵ Under Article 96 of the 2014 State Budget Law, new joint instructions by the Minister of Finance and the BNB Governor require banks to present daily statements on budget entities' accounts and security on them.

 $^{^{66}}$ The payments total is shown in euro at the 30 June 2014 BNB rate.

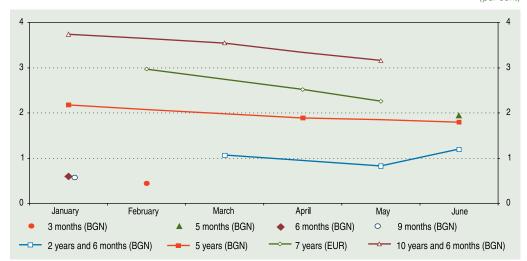
 $^{^{67}}$ The debt total is shown in euro at the 30 June 2014 BNB rate.

⁶⁸ The issuer changed its June schedule with an extraordinary auction for sale of five-month government securities.

Insurance Institute Employee Pay Guarantee Fund with 1.30 per cent. BGN 2975.2 million or 90.25 per cent⁶⁹ of offered volume was sold, including the lev equivalent of EUR 75.0 million. Almost three quarters of sold bonds went to primary⁷⁰ and non-primary dealer banks. Average annual yields of lev-denominated three, five, six and nine-month, 2.5, five and 10.5-year issues were 0.45, 1.95, 0.6, 0.58, 0.95, 1.96 and 3.48 per cent, euro-denominated seven-year issues reaching 2.58 per cent.

Average Annual Yield Attained at Domestic Government Securities Auctions in the First Half of 2014

(per cent)



Note: Average annual yield is shown for the 2.5 year bond auction of 23 June 2014 at which the MF rejected all bids.

ESROT registered BGN 1313.8 million⁷¹ of corporate event payments on behalf and on the account of the issuer, up BGN 1038.2 million on the same period last year. Reflecting positive net government bond financing of BGN 1779.6 million, the nominal volume of ESROT registered government securities transactions was BGN 8076 million, up 28.7 per cent on June 2013. In the currency structure, BGN-denominated issues redeemable in levs continued occupying the largest share at 76.1 per cent, followed by euro-denominated issues redeemable in euro at 22.1 per cent, and euro and US dollar-denominated issues redeemable in levs at 1.8 per cent. In the maturity structure, medium and long-term issues fell from 87.3 per cent on 30 June 2013 to 71.2 per cent in favour of up to one year issues.

The total nominal volume of ESROT transactions was BGN 17,713.4 million, down 7 per cent on the same period of 2013. Repo transactions had the largest share at 75.6 per cent, followed by operations between participants and customers or between ESROT participants' customers (15.1 per cent), and sales and purchases (9.3 per cent). One-day repos dominated at 48.9 per cent, those denominated in levs leading. Overall, the average-weighted yield of repo agreements posted a year-on-year increase, moving between 0.04 and 0.09 per cent. Four to seven-day transaction yields fluctuated more significantly.

Bond sales and purchases between ESROT participants dropped 15 per cent to BGN 1648.1 million. Securities were traded across the entire yield curve, BGN and EUR-denominated bonds with a residual term to maturity of about five years being most liquid. The average annual yield of the long term benchmark issue (10.5 years) fell gradually from 3.56 in January to 3.11 per cent in June, unlike the previous year

⁶⁹ The MF rejected all bids for a June auction and decreased the initial volume at another auction.

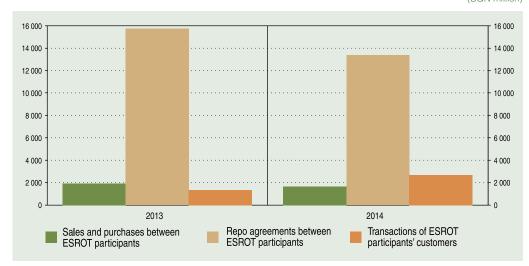
 $^{^{70}}$ There were 13 primary dealers selected under Ordinance No 15 of the MF and the BNB.

⁷¹ The lev equivalent of payments on foreign currency denominated government securities issues is shown at BNB rates on payment days.

when it rose from 3.27 to 3.4 per cent. Operations between participants and customers or between ESROT participants' customers doubled to BGN 2677.3 million. The secondary government securities market liquidity ratio⁷² was 2.19 from 3.03 in the first half of 2013.

Volume of Transactions in Tradable Government Securities

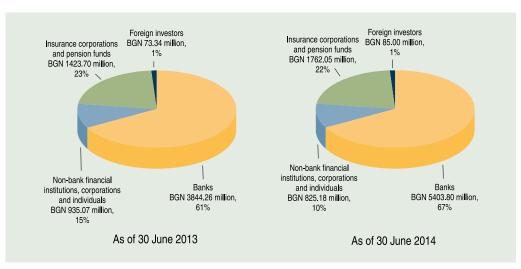
(BGN million)



Source: BNB.

Blocking and unblocking operations in domestic government securities registered in ESROT and related to securing funds in budget entities' bank accounts and on pledges registered under the Law on Special Pledges totalled BGN 11 366.1 million from BGN 9989.6 million in the same period of 2013.

Holders of Government Securities Issued on the Domestic Market



Source: BNB.

Government securities in bank portfolios rose greatly by BGN 1559.5 million on June 2013. Investment by insurance corporations and pension funds rose BGN 338.4 million, 90 per cent into long-term instruments. This changed the structure of government securities to 67 per cent with banks, 22 per cent with insurance corporations and pension funds, 10 per cent with non-bank financial institutions, corporations and

⁷² The ratio between the volume of secondary market government bond transactions in a year and the volume of government securities circulating by the year's end.

individuals, and 1 per cent with foreign investors, from 61, 23, 15, and 1 per cent on 30 June 2013.

In the half year ESROT offered 99.9 per cent availability,⁷³ with no call for contingency rules for interaction between BNB systems. There were 29 system participants: 26 banks, of which 23 government securities sub-depositories, an international central securities depository (Clearstream Banking, Luxembourg), the Reserve Collateral Pool, and the MF.

On 30 June 2014 there were 1356 accounts in the government securities settlement system under BNB Ordinance No 31 on Government Securities Settlement. Of them, 30 were for government securities of the issuer (the MF), 557 for participants' government securities, 402 for participants' customers, and 367 for encumbered bonds. Account nominals tallied with the amount of outstanding issues at BGN 8076 million.

System Development

Government securities registration and settlement system began changing in line with Regulation (EU) No 909/2014 of the European Parliament and the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories (CSDR). The Regulation will have a fundamental effect on all European depository systems, including the T2S project.

New GSAS business requirements matched MF government debt management and operational risk optimisation needs. They include system upgrades and functionality expansion in line with issuer's requirements and GSAS participants' needs.

 $^{^{73}}$ The ratio of time when the system is operational to scheduled operating time.

Participation in the ESCB and in the Activities of EU Institutions

In the first half year EU efforts focused on economic growth recovery and further rebuilding of confidence in the financial system. Following the late 2013 entry into force of the regulation conferring specific credit institution prudential supervision tasks on the European Central Bank, there was agreement on the other elements of banking union: the Single Supervisory Mechanism (SSM) and the European Stability Mechanism's operational framework for direct bank recapitalisation. The adoption of legislation concerning the recovery and resolution of credit institutions and investment firms, deposit guarantee schemes and credit agreements for consumers relating to residential immovable property was an important move to enhance financial sector security and transparency.

European System of Central Banks

The BNB Governor sits on the ECB General Council with EU central bank governors and the ECB President and Vice President. In the first half of 2014 three General Council sessions debated the ECB Convergence Report, economic development and the EU financial sector, and the final report of the ESCB supervisory macroeconomic research network.

BNB representatives sit on 12 ESCB committees⁷⁴ and 32 working groups, and the Human Resources Conference. Through ESCB representatives, the Bank helps elaborate ECB legal instruments on monetary and banking policy, payment and settlement systems, statistical reporting and research, and other central banking issues. The Bank also helped prepare ECB opinions as part of written consultations between Member States and the ECB on relevant bills. The BNB consulted the ECB on a Bill concerning non-bank financial institution lending to consumers.

European Systemic Risk Board, European Banking Authority, Colleges of Supervisors The BNB Governor is a member of the European Systemic Risk Board (ESRB) General Council. The three General Council sessions debated the procedure for ESRB opinions and recommendations under the directive and regulation on credit institutions capital requirements (the CRD IV/CRR package), possible systemic risks posed by large bank groups, and European Banking Authority and stress test scenarios launched by the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority for banks and insurance corporations. BNB representatives on the General Council and sub-structures consistently backed Bank positions. To bolster banks against stressful episode losses, the ESRB recommended guidelines on countercyclical capital buffers. Consistent with Directive 2013/36/EU, they enable a common supervisory approach to assessing countercyclical buffer adequacy. The Bank shares the opinion that the recommendation is of great significance for implementation of the EU macro-prudential framework, providing flexibility to national authorities to set levels of the buffer consistent with the specificity of the domestic financial system.

⁷⁴ The Accounting and Monetary Income Committee (AMICO), the Financial Stability Committee (FSC), the Banknotes Committee (BANCO), the Eurosystem/ESCB Communications Committee (ECCO), the Information Technology Committee (ITC), the Internal Auditors Committee (IAC), the International Relations Committee (IRC), the Legal Committee (LEGCO), the Market Operations Committee (MOC), the Monetary Policy Committee (MPC), the Payment and Settlement Systems Committee (PSSC), the Statistics Committee (STC).

⁷⁵ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

⁷⁶ The Bank is represented on the ESRB General Council, Advisory Technical Committee, three working groups, and target groups.

Experts took active part in all EBA committees and most working groups, developing instructions and technical standards on the Directive and Regulation on credit institution capital requirements and the new Directive establishing a framework for the recovery and resolution of credit institutions and investment firms.

European
Council,
Ecofin
Council and
Economic
and Financial
Committee

In early 2014 Ecofin accepted European Parliament proposals on the directive on credit agreements for customers relating to residential immovable property, ultimately adopting it. It creates an effective and competitive single market for mortgage loans and protects consumers. The BNB was active in the debate and helped draft bills transposing it into national law.

Following the successful negotiations between the Council and the European Parliament, in June the directive on recovery and resolution of credit institutions and investment firms and the new Directive 2014/49/EU on deposit guarantee schemes became essential elements of financial system reform.

The resolution Directive creates a framework for dealing effectively with unsound or failing institutions so that they could be restructured to avoid a significant adverse effect on the rest of the financial system. It introduces possible resolution tools used in individual stages of this process: preparatory work and precautionary measures, early intervention phase and resolution process. Member States establish a resolution financing arrangement based on advance bank contributions. Member States must apply the national measures transposing this Directive from 1 January 2015, except for the provisions on shareholders and creditors bearing an appropriate share of the losses, to be implemented from January 2016.

The new deposit guarantee scheme Directive harmonises EU depositor protection. It improves depositor access to guarantee schemes greatly by expanding and clarifying their scope, cuts payout periods, and introduces more comprehensive information and more stringent financing rules. This enhances confidence in financial stability across the internal market. Member States transpose the Directive from 3 July 2015.

The BNB launched required interinstitutional organisation to develop national legislation introducing the requirements of both Directives within the set deadlines.

Preparations continued on the single resolution mechanism (SRM): the other element of euro area banking union. Euro area members agreed to stage formation of a single resolution fund and transfer national contributions to it. Countries outside the euro area could participate in negotiations leading to this and BNB and Government representatives took part to prepare joining the SSM and SRM later. All EU members save Sweden and the UK signed the agreement in May, adopting the final SRM regulation in July. Mandatory for euro area members, SSM and SRM membership is open to non-members. SRM provisions on preparing resolution plans, collecting information, and cooperating with national resolution authorities apply from 1 January 2015. Those on resolution planning, early intervention, resolution actions and instruments, and loss bearing by shareholders and creditors apply from 1 January 2016 provided the conditions for transfers of contributions to the single resolution fund are met. The agreement enters into force upon ratification by 90 per cent of the weighted vote of SSM and SRM participant states.

The BNB contributed actively to Economic and Financial Committee work. Debate centred on banking union elements, progress to SSM operational structuring, and promoting long-term financing of the European economy. The Committee focused on EU financial stability assessments, national fiscal and macroeconomic policy surveillance in the context of the fourth European semester, and EU positions on G20, IMF, and Financial Stability Board issues. The June meeting discussed European Commission and European Central Bank regular convergence reports on the past two years' progress by EU members outside the euro area.

X.

International Relations

International Financial Institutions

The Law of the Bulgarian National Bank entitles the Bank to participate in international organisations furthering currency, monetary, and credit policy cooperation. The Bank is Bulgaria's official fiscal agent and depository in international financial institutions.

The BNB holds equity in the Bank for International Settlements (BIS). The BNB Governor sat on BIS central bank governors' bimonthly meetings: a major forum for cooperation and debate on world economic development and prospects, and international financial markets. In late June the Annual General Shareholder Meeting allocated the Bank a EUR 1.9 million dividend.

The Governor represents Bulgaria as member on the IMF Board of Governors. The Bank attended the regular IMF and World Bank meeting at the Hague in May. Debate addressed monetary policy challenges, economic growth, employment, and energy. Bulgaria announced its intent to host the meeting in 2015.

In January the BNB paid its annual contribution of USD 8500 to the International Accounting Standards Committee Foundation and USD 10,000 to the Group of Thirty.

Cooperation and Technical Assistance with Central Banks

The BNB continued stepping up cooperation with Western Balkan central banks and backing their EU accession preparations. It participates in a EU financed ECB managed technical cooperation programme with the Western Balkan central banks and assists the Bank of Albania on financial stability. In May representatives of the Kosovo Central Bank and Ministry of Finance studied Association Agreement experience at the BNB. The visit was organised with United Nations Development Programme help through the Ministry of Finance.

Helping step up regional cooperation, the Bank also participates in the Central Banks Governors' Club of Central Asia, Black Sea Region and Balkan Countries. In June the BNB hosted the 31st meeting of the Club which changed the Statute and welcomed new members Slovenia and Croatia.

XI. Statistics

The BNB collects, compiles, and publishes statistical information under Article 42 of the Law of the Bulgarian National Bank and Article 5 of the Statute of the ESCB and the ECB. Alongside implementing the 2009 amendments to Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the ECB, the Bank provides statistics to the European Systemic Risk Board. As a member of the ESCB, the BNB continued to provide reliable and sound statistical information.

In monetary and interest rate statistics, the Bank continued to regularly collect and disseminate MFI balance sheet data and information on interest rates applied by MFIs to deposits and loans *vis-à-vis* households and non-financial corporations and on the long-term interest rate for assessing the degree of convergence.

Preparations began on extended methodological guidelines and reporting forms for monetary and interest statistics, and the statistics of financial vehicle corporation transaction securitisation. Work relates to new statistical information user requirements and the new Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (ESA 2010). The guidelines are governed by Regulation (EC) No 1071/2013 of 24 September 2013 concerning the balance sheet of the monetary financial institutions sector (ECB/2013/33), Regulation (EU) No 1072/2013 of 24 September 2013 concerning statistics on interest rates applied by monetary financial institutions (ECB/2013/34) and Regulation (EU) 1075/2013 of 18 October 2013 concerning the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2013/40).

The BNB continued gathering and publishing statistics on non-bank financial institutions. As ESCB member, it helped draft a new ECB regulation on the statistics of insurance corporations.

BNB continued providing data to the ECB project to extend Register of Institutions and Affiliates Database information and to analyse and change it.

Preparations to apply the sixth Balance of Payments and International Investment Position Manual (IMF, 2009) continued. Complexity stems from the need to harmonise changes in the methodology of external sector statistics with changes to ESA 2010 and the fourth edition of the OECD's Benchmark Definition of Foreign Direct Investment (2008). The sixth edition significantly changes definitions and presentations of balance sheet and international investment position items.

Governing Council adoption of new Ordinance No 27 on the Balance of Payments Statistics, International Investment Position and Securities Statistics on 13 March 2014 brought external sector statistics legislation into line with the latest international statistical standards and EU regulations. Due to the importance of information on securities and its quality, BNB Ordinance No 27 includes also securities statistics. The Ordinance establishes the requirements to reporting agents as to the scope, type of information and time limits for providing the information to the BNB.

Work continued on the ESCB Centralised Securities Database project and a Bulgarian securities database. As ESCB member, the Bank continued active participation in the Securities Holdings Statistics project, important for other statistics and financial stability analyses.

Ordinance No 27 cuts the reporting burden on legal entities and sole proprietors. From 1 April 2014 only loans equal or above BGN 500,000 are subject to quarterly reporting (there was no such a threshold until end-March 2014). Those between BGN 50,000 and 500,000 are reported annually. Receivables and trade credit obligations and other transaction reporting thresholds changed, only those equal or above BGN 200,000 subject to quarterly reporting (until end-March this threshold was BGN 50,000).

The Ordinance allows electronic reporting *via* the Integrated Statistical Information System (ISIS) opened from 23 June. Reporting form and declaration submissions began on 1 July 2014. ISIS development boosts reliability and quality through automated control, processing, and dissemination of statistical information.

The BNB continued compiling data on quarterly General Government financial accounts under Regulation (EC) No 501/2004 of the European Parliament and of the Council of 10 March 2004 and reporting government finance statistics in compliance with Guideline ECB/2009/20. The Bank submitted data on all institutional sectors' quarterly accounts under Guideline of the ECB/2002/7 (recast) on the statistical reporting requirements of the European Central Bank in the field of quarterly financial accounts.

Work on implementing EAS 2010 continued with the National Statistical Institute. Joint working groups finished analysing and listing holding corporations and head offices for reclassification in line with ESA 2010 methodological requirements. Elaborating and aligning quarterly and annual financial account methodology continues.

At Bank suggestion, the NSI launched a new quarterly survey of non-financial corporation financial indicators. The BNB needs this for quarterly accounts, financial stability analyses, and European Systemic Risk Board commitments.

The BNB together with the NSI and MF updated and certified metadata under the Special Data Dissemination Standard to IMF requirements and schedules.

The Bank provided statistical information to the IMF and the Bank for International Settlements.

Implementation of the new SDMX-ML statistical representation standard continued with testing of format and method changes in data transmission to the ECB.

XII. Research

Economic research, Bulgarian economic analyses, and macroeconomic forecasts prepared by BNB experts support the Bank's management in making decisions and formulating economic policy. In the first half of 2014 research focused on global crisis effects on the Bulgarian economy in terms of output, prices, the housing market, foreign trade, fiscal policy, the labour market, the banking system, economic debt, and macroeconomic forecasting models.

Specialised research under the 2013 to 2014 BNB Research Plan supported the Bank's operations by analysing individual economic processes and issues and improving forecasting and modelling tools. Work addressed the effects of the global crisis on Bulgaria in terms of output, prices, the housing market, foreign trade, fiscal policy, the labour market, the banking system, economic debt. Testing and honing the basic model for BNB macroeconometric forecasting continued. Research results featured in technical reports and seminars held by the Bank for experts from relevant bodies, academia, and non-governmental organisations.

The Guest Researcher Programme supports BNB research and helps establish fruitful cooperation with experts from Bulgaria and abroad on subjects of interest to the Bank. In the first half year one guest researcher participated in the programme.

Through its Discussion Papers research series, the BNB continued to encourage the research potential of Bulgarian economic science and practice in macroeconomics and finance. The Discussion Papers Editorial Board reviewed five submissions, approving two for publication.

The quarterly Economic Review presents information and short-term projections of Bulgaria's economic development, analyses of the balance of payments flows, monetary aggregates, and their effect on the real economy and price stability. It also analysed external developments directly affecting the Bulgarian economy. The Review contains quantitative assessments of short-term developments in major macroeconomic indicators like inflation, economic growth, exports, imports, trade balance, and the balance of payments current account.

XIII. Information Systems

In the first half of 2014 BNB information system work involved:

- maintaining information systems integrity and prevention of downtime in users' work caused by suspension or problems in the systems;
- developing applications;
- updating and maintaining the Bank's communication and information infrastructure;
- implementing ECB/ESCB projects;
- developing information security policy and procedures.

The BNB IT centre serviced Bank employees, the banking and financial community, and ESCB projects by handling incident reports rapidly and working to prevent recurrences.

BNB applications' scope and functionality expand continually. An Integrated Automated Statistical Information System update improved input data control, maintained classification, nomenclatures and metadata, and allowed online data submission by reporting agents. A new version of the Single Data Depository was launched. Core banking information system functionality continued expanding with particular emphasis on system security. Preparations began for new SOFI hardware. An additional functionality to SOFI now services first class systems in SEBRA payments.

SOFI and the Budget Entity Internet Banking System now allow first level and subordinate budget spending entities to report account balances in line with item 71 of the MF and BNB Guidance No 5 of 28 March 2014.

RINGS, servicing lev payments in Bulgaria and the Bulgarian component of TARGET2, TARGET2-BNB for payments in euro and related Swift Alliance services and products functioned smoothly. Besides the current work on system administering and monitoring, control over the smooth RINGS operation was improved. New statements for RINGS and TARGET2-BNB were developed and the application for statements and statistical reports of TARGET2-BNB operation was updated to match the new TARGET2 version.

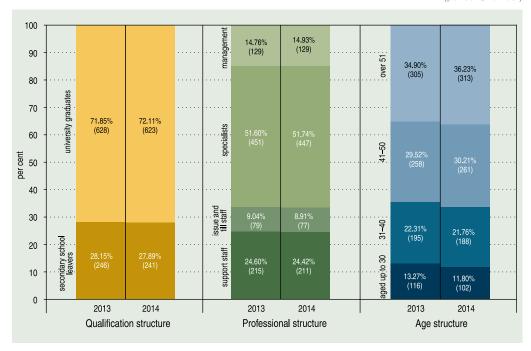
XIV. Human Resource Management

Human Resource Managemen

BNB human resource management priorities are boosting staff performance through training and career development, maintaining analytical and administrative capacity, applying performance related pay, ensuring a sociable environment, and promoting health and safety at work.

Staff Structure

(per cent, number)



Source: BNB.

No significant changes occurred in the number of staff. At the end of June the BNB had 864 employees from 874 a year earlier. Twenty-eight joined the Bank compared to 14 in the same period of 2013. Recruitment sought highly qualified employees to match job requirements and descriptions. Thirty-six left compared to 18 a year earlier. No employees retired in the first half of 2013 but 13 (most leaving staff) retired in this half year.

The staff education and qualification structure changed little. Graduates made up 72 per cent of staff, with 19 reading for doctorates, as in 2013. Staff categories remained unchanged. Specialists held the largest share at 51.74 per cent, followed by support staff and management.

The share of employees aged up to 30 continued falling, by 1.5 percentage points on the same period of 2013. The proportions of the 31 to 40 and 41 to 50 age groups stayed almost unchanged. Employees aged over 51 increased by 1.3 percentage points on the first half of 2013.

Staff structure by gender remained unchanged, women accounting for 64 per cent of total number and men 36 per cent.

The Bank promoted different forms of mobility to boost skills and professional qualifications and promote exchange of experience across different business areas. Thirteen employees moved between units from eight in the first half of 2013. Four went on short-term ECB, ESCB, and EU national central bank assignments.

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

Employees enjoyed plentiful opportunities to improve professional qualifications. An annual schedule enabled them to take a variety of national and international training and qualification improvement programmes, distant learning, professional courses and seminars in Bulgaria and abroad, language and information technology courses, and vocational training.

Induction training developed new means for familiarising new employees with the Bank's corporate culture, topical tasks, internal rules, and general administrative procedures. Two induction sessions involved 22 new employees in the half year.

Over the review period 17 employees, of whom six reading for doctors', four for masters', and seven for bachelors' degrees, boosted their educational attainments without discontinuing work. Strong interest continued in various distant training programmes, 13 employees taking part in three reserve management and internal audit programmes.

Employees attended specialised courses on, *inter alia*, changes in banking and financial legislation, administrative procedure, labour and social security legislation, European social security systems, health and safety at work, public tendering, auditing, and staff recruitment.

The BNB continued working with the central banks of a number of European countries and international institutions offering specialised professional training relevant to central banks and supervisory institutions. Employees participated in seminars, training courses, and workshops on ESCB committees and working groups and European supervisory authorities. More than 118 staff attended courses, seminars, and conferences abroad.

Thirty-seven employees attended English, French and German courses, attaining levels of proficiency appropriate to job descriptions and acquiring specialist vocabulary and improved oral skills. Courses in English drew most interest.

Information technology training focused on new and improved specialised software skills. Training addressed Oracle innovations and key IT competences.

There was also training in operating, servicing, and maintaining equipment requiring national or internal competence certificates.

As a responsible institution with a positive attitude to youth education and professional development, the Bank continued providing career opportunities and encouraging research and sound academic knowledge. The annual scholarship programme continued to enjoy great interest. In early 2014 the BNB awarded two masters' and one doctor's degree scholarships. In the beginning of June the internship programme started with 14 students participating in the first month.

XV. Facilities Management

Facilities Management

The BNB operates from owned premises and properties. This provides the degree of independence, security and protection required of an institution of national importance. Property management expenditure was in line with the BNB budget for 2014. It included construction, refurbishment and modernisation, deliveries and equipment, maintenance (transformers, power supply, distribution boards, diesel generators, backup power supply, plant rooms, pressure boilers, lifts, HVAC installations and heaters), vehicles, supplying assets and cash processing consumables, and optimising power, heating, and water use.

There was no acquisition or disposal of BNB property in the first half of 2014.

XVI. BNB Internal Audit

There were seven audits under the BNB Internal Audit annual programme between January and June 2014. Five were scheduled by Internal Audit and two by the ESCB Internal Auditor Committee.

They addressed major and auxiliary Bank functions based on the risk evaluation:

- in the area of the bank services provided to the government and public organisations, there was one audit.
 - Servicing budget organisations and the single account system.

The main objectives included assessing the effective performance of the tasks; providing reasonable assurance regarding the adequacy and efficiency of the control, corporate governance and risk management; assessing reliability and integrity of significant information, legal compliance and the internal framework; evaluating the workflow and planning efficiency.

- two audits were launched under the internal services function:
 - construction, repair and maintenance of buildings and equipment.

The audit aimed at providing reasonable assurance regarding the effective governance and control.

· Record-keeping office and archives. The MIKSI system. Public vault.

The audit was intended to review the work organisation and to provide reasonable assurance on the effectiveness of the risk control and management system.

- An audit of information and communication technologies addressed:
 - System administration, maintenance and functioning of shared services: Microsoft Active Directory, e-mail and Novell e-Directory.

The main purpose was to assess the extent to which these activities ensured reliable control of accessibility and normal operation of BNB IT services.

In accordance with the Internal Audit annual programme, the implementation of the recommendations from previous audits of BNB structural units was examined. The audit addressed the status of recommendations and the assessment of adequacy, effectiveness, and timeliness of the measures undertaken by the managers of respective units.

The audits under the annual programme approved by the BNB Governing Council are shown in the table on the next page.

BNB Internal Audit Programme Audits

Functions	Audits
Services to government and public organisations	Servicing budget entities and the single account system
Internal services	Construction, repair and maintenance of buildings and equipment
Internal services	Records office and archives. The MIKSI system. Public vaults
Information and communication technologies	System administration, maintenance and functioning of shared services: Microsoft Active Directory, e-mail and Novell e-Directory
BNB Internal Audit	Implementation of recommendations from previous audits

Source: BNB

There were two audits under the ESCB Internal Auditors Committee Programme for 2014 and the Internal Audit Programme approved by the BNB Governing Council.

In the area of statistics, the audit addressed:

• Monetary and financial statistics.

Its main purpose was to provide reasonable assurance regarding the adequacy and efficiency of risk management, control and management processes in preparing interest rate statistics of MFIs.

The audit followed up implementation of recommendations from earlier ESCB Internal Auditor Committee programme audits at BNB structural units. It addressed the status of recommendations and the assessment of adequacy, effectiveness, and timeliness of the measures undertaken by the managers of respective units.

The following table displays the audits under the ESCB Internal Auditors Committee Programme and the Internal Audit Programme approved by the BNB Governing Council:

ESCB Internal Auditors Committee Programme Audits

Functions	Audits
Statistics	Monetary and financial statistics
BNB Internal Audit	Implementation of recommendations from previous ESCB Internal Auditors Committee audits.

Source: BNB

The Chief Auditor organised and coordinated Internal Audit Unit work with external auditors KPMG Bulgaria.

Internal auditors also continued giving opinions on draft internal rules and reviewed operational risk assessment to synchronise horizontal and business risk assessments (horizontal risks typically cause business risks). There was risk management training at Bank units. Operational risk management software commissioning continued over the rewiew period.

XVII. BNB Budget Implementation in the First Half of 2014

The Governing Council adopted the BNB budget by Resolution No 96 of 14 November 2013. Under the Internal Rules on Drafting, Implementing, and Reporting the BNB Budget, this report is divided into Operating Expenditure and Investment Programme sections.

1. Operating Expenditure

In the half year the BNB spent BGN 37,201,000/43.4 per cent of its annual budget.

Currency circulation cost BGN 4,058,000/26.7 per cent of annual budget and 10.9 per cent of operating expenditure over the first half year. There was no expenditure on new banknotes, their production postponed to the second half of 2014. New coins cost BGN 3,843,000, including BGN 3,794,000 for circulating coins. Commemorative coin expenditure was in line with the BNB Governing Council programme at BGN 49,000. Designing new banknotes and coins cost BGN 14,000, including design award competitions. Cash servicing machines cost BGN 57,000 and consumables for banknote and coin processing BGN 62,000. Renting premises at the Cash Services Company and the State Mint cost BGN 81,000.

Materials, services, and depreciation cost BGN 16,485,000/41.4 per cent of annual budget and 44.3 per cent of operating expenditure. Materials cost BGN 483,000/1.3 per cent of operating expenditure. Vehicle fleet fuel and spares (BGN 209,000) and inventories (BGN 92,000) occupied the largest share in this group. The Bank spent BGN 88,000 on office consumables.

External services cost BGN 8,350,000/22.4 per cent of operating expenditure. Significant items were software maintenance subscriptions at BGN 1,873,000, Bloomberg, Reuters, internet and other systems at BGN 530,000, mandatory TARGET2 modules at BGN 443,000, and BORICA–Bankservice subscriptions at BGN 285,000/37.5 per cent of external service expenses. Equipment maintenance was BGN 531,000. Property and refuse collection levies were BGN 858,000. Mail and telephone expenditure was BGN 375,000, in line with the trend to optimising BNB voice services. Electric bills were BGN 396,000 and heating and water BGN 131,000. Property insurance cost BGN 113,000. The Bank spent BGN 1,108,000 on security and fire protection. Major buildings maintenance cost BGN 1,274,000. Consultancy services for BGN 103,000 included, *inter alia*, IT training, implementing European Commission technical standards, media and social media monitoring, legal services, and running the Banking and Financial History Research and Publications Programme Council.

Depreciation was BGN 7,652,000/20.6 per cent of operating expenditure.

Payroll, social, and healthcare spending was BGN 13,185,000/57.1 of budget and 35.4 per cent of operating expenditure. The Bank had BGN 1,344,000 of current retirement obligations and unused paid leave under IAS 19, Income of Hired Persons.

Social expenditure was BGN 1,541,000/68.4 per cent of budget and 4.1 per cent of operating expenditure.

Other administrative costs were BGN 743,000/32.5 per cent of budget and 2.0 per cent of operating expenditure. Inland travel worth BGN 30,000 involved mainly regional cash centre logistics and checks. Foreign travel unrelated to the ESCB and other EU bodies cost BGN 125,000.

The annual BNB Staff Education and Professional Training Programme cost BGN 266,000. BNB employees took part in distance learning and courses and seminars held by EU central banks and international financial institutions. BNB representatives actively participated in expert training in the ESCB, European Commission and EU bodies.

Representative and protocol expenses were BGN 319,000, the major part spent to celebrate the Bank's 135th Anniversary. Expenditure related to ESCB memberschip was BGN 1,189,000/36.9 per cent of annual budget under this item or 3.2 per cent of operating expenditure. Staff travel to ESCB committees and working groups and other EU bodies cost BGN 390,000 and training BGN 25,000. The annual European Banking Authority membership fee was BGN 726,000.

2. The Investment Programme

In the first half of 2014 the BNB spent BGN 1,201,000/6.2 per cent of annual budget on its Investment Programme.

This involved public tendering, contractor selection and project implementation. In the first half year some procurement procedures were not finalised, while others were completed by the end of the review period but their implementation has not yet started. Projects postponed to the second half year contributed to lower investment programme spending.

The Bank spent no monies under the construction, refurbishment and modernisation item.

Machine and equipment, vehicle, and other equipment investment came to BGN 390,000/12.5 per cent of approved funds and 32.5 per cent of investment for the period. Vehicles cost BGN 251,000 and equipment for the central building, recreation homes and cash centres BGN 139,000.

Information system investment was BGN 811,000/5.3 per cent of projected funds and 67.5 per cent of all investment for the half year. Funds went mostly into keeping the information and communication technology infrastructure modern.

Hardware cost BGN 769,000, mainly for computer and communications equipment. Software licences cost BGN 42,000.

BNB Budget Implementation as of 30 June 2014

Indicator	Report 30 June 2014 (BGN'000)	Budget 2014 (BGN'000)	Implementation (per cent)
Section I. Operating expenditure	37 201	85 811	43.4
Currency circulation	4 058	15 185	26.7
Materials, services, and depreciation expenditure	16 485	39 788	41.4
Staff expenditure	13 185	23 078	57.1
Social expenditure	1 541	2 254	68.4
Other administrative expenditure	743	2 283	32.5
ESCB membership	1 189	3 223	36.9
Section II. Investment Programme	1 201	19 385	6.2
Construction, refurbishment, and modernisation	0	730	0.0
Machines, vehicles, and other equipment	390	3 115	12.5
Information technology	811	15 344	5.3
ESCB membership	0	196	0.0

Source: BNB

XVIII. Bulgarian National Bank Consolidated Financial Statements as of 30 June 2014 (unaudited)

Statement of Responsibilities of the Governing Council of the Bulgarian National Bank	_82
Consolidated Statement of Comprehensive Income for the Period Ended 30 June 2014 (unaudited)	_83
Consolidated Statement of Financial Position as of 30 June 2014 (unaudited)	_84
Consolidated Statement of Cash Flows for the Period Ended 30 June 2014 (unaudited)	_85
Consolidated Statement of Changes in Equity for the Period Ended 30 June 2014 (unaudited)	_86
Notes to the Consolidated Financial Statements	87

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

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

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

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

Ivan Iskrov

Governor of the BNB

Consolidated Statement of Comprehensive Income for the Period Ended 30 June 2014 (unaudited)

(BGN'000)

	Note	30 June 2014	30 June 2013
Interest income	7	199,338	212,650
Interest expenses	7	(889)	(622)
Net interest income		198,449	212,028
Fee and commission income		5,235	4,819
Fee and commission expenses		(2,014)	(2,030)
Net fee and commission income		3,221	2,789
Net gains/(losses) from financial assets and liabilities at	0	1.47.000	(1.074.500)
fair value through profit or loss	8	147,333	(1,074,583)
Other operating income	9	24,956	27,458
Total income from banking operations		373,959	(832,308)
Administrative expenses	10	(51,158)	(54,467)
Profit for the period		322,801	(886,775)
Other comprehensive income			
Other comprehensive income		(41)	(17)
Other comprehensive income, total		(41)	(17)
Total comprehensive income for the period		322,760	(886,792)
Profit attributable to:			
Equity holder of the Bank		322,697	(886,807)
Non-controlling interest		104	32
Profit for the period		322,801	(886,775)
Total comprehensive income attributable to:			
Equity holder of the Bank		322,656	(886,824)
Non-controlling interest		104	32
Total comprehensive income for the period		322,760	(886,792)

Consolidated Statement of Financial Position as of 30 June 2014 (unaudited)

(BGN'000)

	Note	30 June 2014	31 December 2013
ASSETS			
Cash and deposits in foreign currencies	11	5,913,296	6,318,854
Gold, instruments in gold and other precious metals	12	2,454,948	2,228,481
Financial assets at fair value through profit or loss	13	19,602,909	19,623,926
Financial assets available for sale	14	1,472,323	1,454,171
Tangible assets	15	182,895	190,068
Intangible assets	16	3,562	4,729
Other assets	17	101,134	87,048
Total assets		29,731,067	29,907,277
LIABILITIES			
Banknotes and coins in circulation	18	10,532,411	10,253,722
Due to banks and other financial institutions	19	7,250,033	7,063,410
Liabilities to government institutions and other liabilities	20	5,035,644	5,905,707
Borrowings against Bulgaria's participation in international			
financial institutions	21	2,694,283	2,659,865
Other liabilities	22	76,932	143,270
Total liabilities		25,589,303	26,025,974
EQUITY			
Capital	23	20,000	20,000
Reserves	23	4,117,420	3,857,063
Non-controlling interest	24	4,344	4,240
Total equity		4,141,764	3,881,303
Total liabilities and equity		29,731,067	29,907,277

Consolidated Statement of Cash Flows for the Period Ended 30 June 2014 (unaudited)

(BGN'000)

	Note	30 June 2014	30 June 2013
OPERATING ACTIVITIES			
Net profit/ (loss)		322,801	(886,775)
Adjustments:			
Dividend income		(6,994)	(8,796)
Depreciation and amortisation	15, 16	9,617	11,592
Loss on disposal of tangible assets		44	249
(Profit)/loss on financial assets and liabilities arising from market movements		(275,727)	922,696
(Profit) of associates		-	-
Other adjustments		(15)	(17)
Net cash flow from operating activities before changes in operating assets and liabilities		49,726	38,949
Change in operating assets			
(Increase) in gold, instruments in gold and other precious metals		(2,430)	(2,057)
Decrease/(increase) in financial assets at fair value through profit or loss		88,930	(2,050,783)
(Increase) in other assets		(10,913)	(2,128)
Change in operating liabilities			
Increase/(decrease) in currency in circulation		278,689	(379,828)
Increase /(decrease) in due to banks and other financial institutions		186,623	(220,605)
(Decrease) in due to government institutions and other liabilities		(870,063)	(272,895)
Increase in borrowings from IMF of total allocation of SDR		-	
(Decrease) in other liabilities		(66,338)	(10,341)
Net cash flow (used in)/from operating activities		(345,776)	(2,899,688)
INVESTING ACTIVITIES			
Acquisition of tangible and intangible assets		(1,346)	(3,959)
Dividends received		6,994	8,796
Other investments		43	<u> </u>
Net cash flow (used in) investing activities FINANCING ACTIVITIES		5,691	4,837
Payments to the Government		(62,300)	(105,834)
Net cash flow (used in) financing activities		(62,300)	(105,834)
Net (decrease)/ increase in cash and cash			
equivalents		(402,385)	(3,000,685)
Cash and cash equivalents at beginning of period	44.49	6,368,240	9,417,131
Cash and cash equivalents at end of period	11, 17	5,965,855	6,416,446

Consolidated Statement of Changes in Equity for the Period Ended 30 June 2014 (unaudited)

(BGN'000)

						(BGN 000)
Source of changes in equity	Capital	Revaluation of non- monetary assets	Special and other reserves	Total capital and reserves	Non- controlling interest	Total equity
Balance as of 1 January 2013	20,000	138,538	4,806,427	4,964,965	4,197	4,969,162
Profit for the period	-	-	(886,807)	(886,807)	32	(886,775)
Other comprehensive income:						
other income	-	(11)	(6)	(17)	-	(17)
Other comprehensive income, total	-	(11)	(6)	(17)	-	(17)
Total comprehensive income for the period	-	(11)	(886,813)	(886,824)	32	(886,792)
Other movements	-	-	-	-	-	
Contributions by and distributions to owners:	-	-	-	-	-	
contribution to the budget of the Republic of						
Bulgaria	-	-	(105,834)	(105,834)	-	(105,834)
Transactions with owners, total	-	-	(105,834)	(105,834)	-	(105,834)
Balance as of 30 June 2013	20,000	138,527	3,813,780	3,972,307	4,229	3,976,536
Balance as of 1 January 2014	20,000	133,609	3,723,454	3,877,063	4,240	3,881,303
5 (0.4 0.1 0.1 0.1 0.1 0.1 0.1 0.1 0.1 0.1 0.1						
Profit for the period	-	-	322,697	322,697	104	322,801
Other comprehensive income:	-	- (40)	-	-	-	-
other income	-	(40)	-	(40)	-	(40)
Other comprehensive income, total	-	(40)	-	(40)	-	(40)
Total comprehensive income for the period	-	(40)	322,697	322,657	104	322,761
Other movements	-	-	-	-	-	-
Contributions by and distributions to owners:	-	-	-	-	-	-
contribution to the budget of the Republic of Bulgaria		-	(62,300)	(62,300)	-	(62,300)
Transactions with owners, total	-		(62,300)	(62,300)	-	(62,300)
Balance as of 30 June 2014	20,000	133,569	3,983,851	4,137,420	4,344	4,141,764

Notes to the Consolidated Financial Statements

1. Statute and Principal Activities

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

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

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

The Governing Council of the BNB approved the Consolidated Financial Statements, set out on pages 81 to 112, on 27 November 2014.

2. Applicable Standards

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

3. Basis of Preparation

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

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

The Bank has adopted the following new standards and amendments to standards, including all resulting amendments to other standards, with a date of initial application 1 January 2014:

- IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 Separate Financial Statements (2012) and IAS 28 Investments in Associates and Joint Ventures (2012), (see 1);
- Amendments to IFRS 10, IFRS 12 and IFRS 27 (see 2);
- Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities (see 3);
- Amendments to IAS 36 Recoverable Amount Disclosures for Non-Financial Assets (see 4):
- Amendments to IAS 39 Financial Instruments: Recognition and Measurement, titled Novation of Derivatives and Continuation of Hedge Accounting (see 5).

1) A new set of consolidation standards

As a result of adopting these standards, the Bank has changed its accounting policy for determining availability of control over the entities in which investments were made and their consolidation respectively, as well as its policy regarding its interests in joint arrangements. These changes have not led to a change in the conclusion as to whether the Bank has control and respectively consolidates the entities where investments were made; therefore, this is not expected to have any impact on the Bank's Consolidated Financial Statements.

Adopting IAS 27 (2012) has no material impact on the Separate Financial Statements as it has not brought about any changes to the Bank's accounting policy for reporting investments in subsidiaries and joint arrangements.

2) Amendments to IFRS 10, IFRS 12 and IAS 27

These amendments have no impact on the Financial Statements since the Bank does not fit the definition of investment entity.

3) Offsetting Financial Assets and Financial Liabilities

These amendments have no impact on the Financial Statements since the Bank does not apply offsetting of its financial assets and financial liabilities and has no global activities to offset.

4) Amendments to IAS 36

These amendments have no impact on the degree of disclosure in the Financial Statements.

5) Amendments to IAS 39

These amendments have no impact on the Financial Statements as the Bank does not novate derivatives designated as hedging instruments to central counterparties as a consequence of laws and regulations.

4. Basis of Consolidation

Subsidiaries

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

Associated companies

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

5. Significant Accounting Policies

(a) Income recognition

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

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

Interest income and expenses presented in the profit or loss include:

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

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

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

(b) Financial instruments

(i) Classification

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

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

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

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

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

(ii) Recognition

The Bank recognises trading financial assets and investments, the Bank's loans and receivables, and financial liabilities at amortised cost on the date at which they are originated. All other financial assets and financial liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument. From that moment on, any changes in their fair value are recognised by the Bank as income or expense.

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

(iii) Amortised cost measurement

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

(iv) Fair value measurement and disclosure principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market and, if no such market is available, then in the most advantageous and accessible market on the measurement date. The fair value of a liability reflects the effect of non-performance risk.

Whenever possible, the Bank measures the fair value of an instrument using quoted prices in an active market of that instrument. A market is considered to be active if asset or liability transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

If no quoted price in an active market is available, the Bank uses the most relevant observable inputs and makes minimum use of unobservable data. The aim of using a valuation technique is to estimate the price that would be obtained in an orderly transaction between market participants. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in determining a price, and is consistent with accepted economic methods of financial instruments pricing.

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

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, *i.e.*, the fair value of the consideration given or received. When the Bank finds a difference between the fair value at initial recognition and the transaction price, and the fair value is neither evidenced by quoted price in an active market for identical assets or liabilities, nor based on a valuation technique relying only on data from observable markets, then the financial instrument is initially recognised at fair value adjusted with the difference between the fair value at initial recognition and the transaction price. This difference is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

The Bank recognises assets and long positions at a bid price and liabilities and short positions at an ask price when assets or liabilities measured at fair value have a bid and an ask price.

When the Bank has positions in the group of financial assets and financial liabilities, it is exposed to market risks and credit risk. On the basis of its net exposure to such risks, the Bank measures them at fair price on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. In such cases, the Bank allocates the portfolio-level adjustments to the individual assets and liabilities, which form the group of financial assets and financial liabilities, on the basis of the relative risk of each of the individual instruments in the group.

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

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change occurred.

(v) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to the receipt of the contractual cash flows from the financial asset in the transaction in which substantially all risks and rewards of ownership of the financial asset are transferred. Any holding in transferred financial assets, which has been originated or kept by the Bank, is recognised as a separate asset or liability.

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

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

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

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

(vi) Offsetting

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

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

(vii) Impairment of assets

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

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

The Bank considers the need of impairment of loans or investments held to maturity at both individual and group level. All individually significant loans and investments held to maturity are evaluated for specific impairment. All individually significant loans and investments held to maturity on which no specific impairment losses have been charged are evaluated on a portfolio basis. Loans and held-to-maturity investments that are not individually significant are collectively assessed for impairment by grouping together loans and held-to-maturity investment securities with similar risk characteristics.

In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses from assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted by the original effective interest rate of the asset. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired asset continues to be

recognised through unwinding of the discount. When a subsequent event reduces impairment loss, the reduction in the impairment loss is reversed through profit and loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss.

If, in a subsequent period, the fair value of an impaired debt security available for sale increases and the increase can be objectively linked to an event that occurred after the impairment loss had been recognised in profit and loss, then the impairment loss is reversed and the reversed amount is recognised in profit and loss. However, any subsequent recovery in the fair value of an impaired equity instrument available for sale is directly recognised in other comprehensive income.

(viii) Financial assets/liabilities held for trading

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

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

(ix) Investments

1) Held-to-maturity investments

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

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

2) Financial assets available for sale

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

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

(c) Gold and other precious metals

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

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

(d) Equity investments

For the purposes of measuring the equity investments subsequent to initial recognition, they are classified as available-for-sale financial assets and are measured at fair value. Details of investments held by the Bank are set out in note 14.

(e) Property, plant, equipment and intangible assets

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

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

1) Subsequent expenditure

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

2) Depreciation

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

(per cent

Buildings	2–4
Plant & equipment	3–15
Computers	30-33.3
Fixtures and fittings	15–20
Motor vehicles	8–25
Intangible fixed assets	20–25

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

3) Calculation of recoverable amount of assets

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

4) Reversals of impairment

In respect of property, plant and equipment, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only up to the amount of the asset's carrying amount before recognising impairment loss.

(f) Foreign exchange

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

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

The exchange rates of the major foreign currencies as of 30 June 2014 and 31 December 2013 are as follows:

Currency	30 June 2014	31 December 2013
US dollars	1 : BGN 1.43200	1 : BGN 1.41902
Euro	1 : BGN 1.95583	1 : BGN 1.95583
Special Drawing Rights	1 : BGN 2.21371	1 : BGN 2.18529
Gold	1 troy ounce : BGN 1880.77	1 troy ounce : BGN 1708.92

(g) Taxation

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

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

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the unused tax losses or tax credit can be utilised. The deferred tax assets are reduced to the extent to which it is no longer likely that the related tax benefits will be realised.

(h) Profit distribution policy of the Bank

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

(i) Cash in hand and deposits in foreign currency

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

(j) Employee benefits

The Bank has the obligation to pay certain amounts to each employee who retires in accordance with the requirements of Article 222, § 3 of the Labour Code in Bulgaria. According to these Labour Code requirements, on termination of the employment con-

tract of an employee who has become entitled to retirement, the employer is obliged to pay him/her compensation amounting to twice his/her gross monthly salary. If, at the date of retirement, the employee has been employed by the Bank for ten or more years, the amount of the compensation is six gross monthly salaries. As at the date of the statement of financial position, the Bank's Management estimates the approximate amount of the potential expenditures for every employee based on an actuarial report using the projected unit credit method. The estimated amount of the obligation and the main assumptions, on the basis of which the estimation of the obligation has been made, is disclosed to the Financial Statements in note 10.

Termination benefits

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

Short-term employee benefits

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

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

A number of new standards, amendments to standards and interpretations endorsed for adoption by the European Commission may be adopted earlier – for the period ending 30 June 2014. These amendments to IFRS were not adopted when preparing these Consolidated Financial Statements and the Bank does not intend to apply them earlier.

Standards, interpretations and amendments to standards that have not been early endorsed by the EC:

• IFRIC 21 Levies is to be adopted no later than the start date of the first financial year beginning on or after 17 June 2014. Earlier adoption is permitted and is to be applied retrospectively. It is expected that when applied initially, the interpretation will not have any significant impact on the financial statements as it will not lead to any changes in the Bank's accounting policy in terms of state imposed levies.

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

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

- IFRS 9 Financial Instruments (issued on 24 July 2014);
- IFRS 14 Regulatory Deferral Accounts (issued on 30 January 2014);
- IFRS 15 Revenue from Contracts with Customers (issued on 28 May 2014):
- Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture (issued on 11 September 2014);
- Amendments to IFRS 27 Equity Method in Separate Financial Statements (issued on 12 August 2014);

- Amendments to IAS 16 and IAS 38 Clarification of Accepted Methods of Depreciation and Amortisation (issued on 12 May 2014);
- Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations (issued on 6 May 2014);
- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions (issued on 21 November 2013);
- Annual Improvements to IFRS 2010–2012 Cycle (issued on 12 December 2013);
- Annual Improvements to IFRS 2011–2013 Cycle (issued on 2 December 2013);
- Annual Improvements to IFRS 2012–2014 Cycle (issued on 25 September 2014).

6. Financial Risk Management Policy Disclosure

(a) Introduction and overview

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

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

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

General provisions of risk management

In the process of management of the gross international reserves, the Bank aims to achieve high security and liquidity of the assets, first, and then to maximising returns in the situation of the current global financial markets. Its investment strategy depends mainly on the specific function of a central bank operating under currency board arrangement and in full compliance with the requirements of the Law on the BNB.

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

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

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

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

(b) Credit risk

The BNB is exposed to credit risk through its trading operations and investment activities and in cases where it acts as an intermediary on behalf of the government or other public institutions. The Bank assumes credit risk also in operations of purchases and sales of foreign currency with banks. In general, this credit risk is associated with the probability of insolvency of a BNB's counterparty or the insolvency of an issuer, in

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

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

- Investment programmes with central banks;
- Automatic borrowings/lending of securities with the main depository;
- Deposits in foreign currency (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- Deposits in gold (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- Commercial securities (of up to 1 year term to maturity), issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks, and other financial institutions – issuers of European covered bonds;
- Bonds issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks and other financial institutions – issuers of covered bonds. All bonds must be with a one-off payment of their face value on the maturity date and without any embedded option;
- Purchases and sales of foreign currency with a value date of up to 2 business days.

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

(c) Liquidity risk

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

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

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

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

(BGN'000)

						(BGN'000)
	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Undefined maturity	Total
As of 30 June 2014							
Financial assets							
Cash and deposits in foreign currencies	4,525,791	459,393	928,112	-	-		5,913,296
Gold, instruments in gold, and other precious metals	989,987	465,719				999,242	2,454,948
Financial assets at fair value through profit or loss	1,026,383	789,373	9,154,510	8,453,838	178,805		19,602,909
Financial assets available for sale	75,490	-	-	-	-	1,396,833	1,472,323
Other assets	21,106	11,500	19,926	-	-		52,532
Total financial assets	6,638,757	1,725,985	10,102,548	8,453,838	178,805	2,396,075	29,496,008
Financial liabilities							
Banknotes and coins in circulation	-	-	•	•	-	10,532,411	10,532,411
Due to banks and other financial institutions	7,250,033	-	-		-		7,250,033
Liabilities to government institutions and other borrowings	5,014,130		21,514				5,035,644
Borrowings against Bulgaria's participation in international financial institutions	-		-			2,694,283	2,694,283
Total financial liabilities	12,264,163		21,514			13,226,694	25,512,371
Asset-liability maturity mismatch	(5,625,406)	1,725,985	10,081,034	8,453,838	178,805	(10,830,619)	3,983,637
A (04 B 1 0040							
As of 31 December 2013							
Financial assets							
Cash and deposits in foreign currencies Gold, instruments in gold, and other precious metals	5,985,684	185,958	147,212	•		007.000	6,318,854
Financial assets at fair value through profit or loss	1,320,493	0.001.710	E 610 760	10 000 065	225,346	907,988	2,228,481
Financial assets available for sale	1,611,734 74,521	2,081,718	5,612,763	10,092,365	225,540	1,379,650	1,454,171
Other assets	17,902	9,000	22,484			1,379,030	49,386
Total financial assets	9,010,334	2,276,676	5,782,459	10,092,365	225,346	2,287,638	29,674,818
Total illiancial assets	3,010,004	2,210,010	3,702,433	10,032,003	223,040	2,201,000	23,074,010
Financial liabilities							
Banknotes and coins in circulation				-		10,253,722	10,253,722
Due to banks and other financial institutions	7,063,410						7,063,410
institutions Liabilities to government institutions and other borrowings	7,063,410 5,884,193	21,514					7,063,410 5,905,707
institutions Liabilities to government institutions and		- 21,514 -				2,659,865	
institutions Liabilities to government institutions and other borrowings Borrowings against Bulgaria's participation in international financial		21,514	- - -		-	2,659,865 12,913,587	5,905,707

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

(BGN'000

	Book value	Gross nominal outgoing cash flow	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years
As of 30 June 2014							
Banknotes and coins in circulation	10,532,411	10,532,411					10,532,411
Due to banks and other financial institutions	7,250,033	7,250,033	7,250,033				
Liabilities to government institutions and other borrowings	5,035,644	5,035,644	5,014,130		21,514	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,694,283	2,694,283					2,694,283
	25,512,371	25,512,371	12,264,163		21,514	-	13,226,694
As of 31 December 2013							
Banknotes and coins in circulation	10,253,722	10,253,722			-	-	10,253,722
Due to banks and other financial institutions	7,063,410	7,063,410	7,063,410				
Liabilities to government institutions and other borrowings	5,905,707	5,905,707	5,884,193	21,514			
Borrowings against Bulgaria's participation in international financial							
institutions	2,659,865	2,659,865	-	-		-	2,659,865

(d) Market risk

Market risk

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

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

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

(BGN'000)

				(DGI1000
	As of 30 June 2014	Average	Maximum	Minimum
Currency risk	(8,505)	(23,474)	(38,416)	(8,193)
Interest rate risk	(1,401)	(3,162)	(8,419)	(1,286)
Correlation (per cent)	0.30	0.20	0.46	(0.14)
Overall risk	(9,906)	(23,719)	(36,505)	(9,542)
	As of 31 December 2013	Average	Maximum	Minimum
Currency risk	(50,188)	(48,700)	(107,536)	(11,312)
Interest rate risk	(5,723)	(5,351)	(11,587)	(702)
Correlation (per cent)	0.19	0.14	0.60	(0.41)
Overall risk	(52,305)	(50,104)	(105,977)	(9,121)

Interest rate risk

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

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

(BGN'000)

		FI "	Fixe	d rate instrun	nents
	Total	Floating rate instru- ments	Up to 1 month	From 1 month to 3 months	Over 3 months
As of 30 June 2014					
Interest-earning assets					
Cash and deposits in foreign currencies	5,755,761	1,990,242	2,378,395	459,229	927,895
Gold, instruments in gold and other precious metals	1,455,667	-	989,963	465,704	-
Financial assets at fair value through profit or loss	19,660,234	428,852	1,015,599	787,841	17,427,942
Financial assets available for sale	75,490	-	75,490	-	-
Other interest-earning assets	52,532	7,486	13,620	11,500	19,926
Total	26,999,684	2,426,580	4,473,067	1,724,274	18,375,763
Interest-bearing liabilities					
Due to banks and other financial institutions	7,250,033	-	7,250,033	-	-
Liabilities to government institutions and other borrowings	2,992,592	-	2,971,078	-	21,514
Borrowings against Bulgaria's participation in international					
financial institutions	1,352,302	1,352,302	-		-
Total	11,594,927	1,352,302	10,221,111	· · · · ·	21,514
Interest-bearing assets/liability gap	15,404,757	1,074,278	(5,748,044)	1,724,274	18,354,249
As of 31 December 2013					
Interest-earning assets					
Cash and deposits in foreign currencies	6,298,511	1,951,740	4,013,791	185,804	147,176
Gold, instruments in gold and other precious metals	1,320,448	-	1,320,448	-	-
Financial assets at fair value through profit or loss	19,632,459	575,065	1,507,000	2,029,141	15,521,253
Financial assets available for sale	74,521	-	74,521	-	-
Other interest-earning assets	49,368	8,423	9,461	9,000	22,484
Total	27,375,307	2,535,228	6,925,221	2,223,945	15,690,913
Interest-bearing liabilities					
Due to banks and other financial institutions	7,063,410	-	7,063,410	-	-
Liabilities to government institutions and other borrowings	3,401,011	-	3,379,497	21,514	-
Borrowings against Bulgaria's participation in international financial institutions	1,334,940	1,334,940	-	-	
Total	11,799,361	1,334,940	10,442,907	21,514	
Interest-bearing assets/liability gap	15,575,946	1,200,288	(3,517,686)	2,202,431	15,690,913

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

The standard scenarios include the following changes in yield curves: 1) 100 basis points instant and parallel increase; 2) 100 basis points instant and parallel decrease; 3) 50 basis points parallel increase in the yield curves for a period of 12 months, and 4) 50 basis points parallel decrease in the yield curves also for a period of 12 months.

The second two scenarios assume that the change in yields takes place at the beginning of the period and over the one-year period the yield curve remains unchanged.

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

(BGN'000)

	100 basis points instant and parallel increase	100 basis points instant and parallel decrease	50 basis points parallel increase in the beginning of the period	50 basis points parallel decrease in the beginning of the period
As of 30 June 2014	(246,954)	246,954	23,412	44,294
As of 31 December 2013	(228,912)	228,912	64,204	53,969

Currency risk

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

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

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

(BGN'000)

	30 June 2014	31 December 2013
Assets		
Bulgarian lev and euro	24,507,747	24,941,471
US dollar	6,234	7,468
Japanese yen	31	36
Pound sterling	154	267
SDR	2,793,173	2,757,605
Gold	2,420,622	2,197,242
Other	3,106	3,188
	29,731,067	29,907,277
Liabilities, capital and reserves		
Bulgarian lev and euro	27,025,918	27,235,293
US dollar	6,363	7,671
Japanese yen	-	-
Pound sterling	-	16
SDR	2,695,646	2,661,050
Other	3,140	3,247
	29,731,067	29,907,277
Net position		
Bulgarian lev and euro	(2,518,171)	(2,293,822)
US dollar	(129)	(203)
Japanese yen	31	36
Pound sterling	154	251
SDR	97,527	96,555
Gold	2,420,622	2,197,242
Other	(34)	(59)

(e) Using accounting judgements and assumptions

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

These disclosures supplement the notes to the financial risk management.

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

Major sources of uncertainty for evaluation

(i) Determination of fair values

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

(ii) Valuation of financial instruments

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

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

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

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

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

(BGN'000)

	Level 1 Market quotes in active markets	Level 2 Valuation techniques using market data	Total
30 June 2014			
Cash and deposits in foreign currency Gold, instruments in gold and other	5,913,926	-	5,913,926
precious metals Financial assets at fair value through	2,454,948	•	2,454,948
profit or loss	18,176,165	1,426,744	19,602,909
Total	26,545,039	1,426,744	27,971,783
31 December 2013			
Cash and deposits in foreign currency Gold, instruments in gold and other	6,318,854	-	6,318,854
precious metals Financial assets at fair value through	2,228,481	-	2,228,481
profit or loss	19,164,306	459,620	19,623,926
Total	27,711,641	459,620	28,171,261

Financial instruments not measured at fair value, but by applying a level of the fair value hierarchy where a fair value measurement is categorised, are analysed in the table below:

(BGN'000)

	Level 1 Market quotes in active markets	Level 2 Observable inputs other than quoted prices	Total
30 June 2014			
Due to banks and other financial institutions	-	7,250,033	7,250,033
Liabilities to government institutions and other borrowings	-	5,035,644	5,035,644
Borrowings against Bulgaria's participation in international financial institutions	-	2,694,283	2,694,283
Total	-	14,979,960	14,979,960
31 December 2013			
Due to banks and other financial institutions		7,063,410	7,063,410
Liabilities to government institutions and other borrowings	-	5,905,707	5,905,707
Borrowings against Bulgaria's participation in international financial			
institutions	-	2,659,865	2,659,865
Total	-	15,628,982	15,628,982

The fair value of due to banks and other financial institutions and of liabilities to government institutions is approximately equal to the reporting value as they are short-term.

The fair value of the liabilities for participation in international financial institutions is approximately equal to their reporting value as they are interest-free and of no definite maturity.

7. Interest Income and Expenses

(BGN'000)

	30 June 2014	30 June 2013
Interest income		
- securities	193,761	209,722
- deposits	5,574	2,927
- other	3	1
	199,338	212,650
Interest expenses		
– deposits	889	622
– other	-	-
	889	622
	889	622

As of 30 June 2014, there is no interest paid by the Bank on BGN or foreign currency deposits of government or other organisations.

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

(BGN'000)

	30 June 2014	30 June 2013
Net (losses) from operations in securities	(138,548)	(174,006)
Net gains from operations in foreign currency	122	198
Net revaluation (losses)/gains on futures	(261)	48
Net revaluation gains/(losses) on securities	61,046	(39,665)
Net revaluation gains/(losses) on foreign currency assets and liabilities	937	(1,062)
Net revaluation gains/(losses) on gold	224,037	(860,096)
	147,333	(1,074,583)

Net gains from financial assets and liabilities carried at fair value through profit or loss as of 30 June 2014 are largely attributable to gold revaluation of BGN 224,037 thousand resulting from the increase in the price of gold. The market price of gold determined on the basis of the London Bullion Market fixing in euro picked up by 10.6 per cent from BGN 1708.92 *per* troy ounce as of 31 December 2013 to BGN 1880.77 as of 30 June 2014.

The primary factor behind the net losses from securities transactions of BGN 138,548 thousand is the lower market yield compared to the coupon yield on the securities, as a result of which they are sold at a premium above their par value. During the reporting period the market yield on the securities, in which the BNB invests, declined between 10 and 60 basis points across sectors and issuers, leading to an increase in their prices and to their positive revaluation of BGN 61,046 thousand.

9. Other Operating Income

(BGN'000)

	30 June 2014	30 June 2013
Income from subsidiaries	17,013	17,634
Income from associated companies	-	-
Income from sale of coins	321	486
Dividend income	6,994	8,796
Other income, net	628	542
	24,956	27,458

Dividend income includes dividends from BNB's participation in BIS Basle amounting to BGN 3806 thousand and from BNB's participation in BORICA-Bankservice of BGN 3188 thousand.

10. Total Administrative Expenses

(BGN'000)

	30 June 2014	30 June 2013
Personnel costs	18,245	16,540
Administrative expenses	20,712	23,797
Depreciation	9,617	11,592
Other expenses	2,584	2,538
	51,158	54,467

Personnel costs include salaries, social and health insurance costs charged under the local legislation provisions as of 30 June 2014, and social activities costs, respectively for the BNB: BGN 14,726 thousand, for the Printing Works of the BNB Corp.: BGN 1970 thousand, and for the Bulgarian Mint EAD BGN 1549 thousand. The number of employees of the Bank and its subsidiaries is 1167 as of 30 June 2014 (30 June 2013: 1244), including the BNB staff of 864 as of 30 June 2014 (30 June 2013: 874).

Based on actuarial calculations, the Bank has accrued compensation liabilities for personnel on retirement and for unused paid annual leave at BGN 1344 thousand (30 June 2013: BGN 1371 thousand). The retirement and unused paid annual leave compensation for the Bank's subsidiaries as of 30 June 2014 are BGN 65 thousand (30 June 2013: BGN 13 thousand).

Administrative expenses include the BNB's currency circulation expenses of BGN 4058 thousand as of 30 June 2014 (30 June 2013: BGN 6959 thousand).

11. Cash and Deposits in Foreign Currencies

(BGN'000)

	30 June 2014	31 December 2013
Cash in foreign currencies	156,790	19,363
Current accounts in other banks	1,989,474	1,945,825
Deposits in foreign currencies	3,767,032	4,353,666
	5,913,296	6,318,854

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

(BGN'000)

	30 June 2014	31 December 2013
Euro area residents		
In EUR	1,436,831	2,717,094
In other currencies	1	1
	1,436,832	2,717,095
Non-euro area residents		
In EUR	3,112,940	2,254,172
In other currencies	1,363,524	1,347,587
	4,476,464	3,601,759
	5,913,296	6,318,854

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

	30 June 2014		31 December 2013	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	964,916	513	876,749
Gold deposits in standard form	774	1,455,706	773	1,320,493
Gold in other form	16	30,316	16	27,563
Other precious metals		4,010	_	3,676
		2,454,948		2,228,481

Gold in standard form includes gold held for safekeeping with a depository and deposits. Deposits in gold are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognised rating agencies and bear interest between 0.13 per cent and 0.30 per cent annually.

Gold in other form includes commemorative gold coins of BGN 25,597 thousand.

Other precious metals include silver commemorative coins of BGN 601 thousand and platinum commemorative coins of BGN 3409 thousand.

13. Financial Assets at Fair Value through Profit or Loss

(BGN'000)

Securities at fair value through profit or loss	30 June 2014	31 December 2013
Foreign treasury bills, notes and bonds	19,602,909	19,623,926
	19,602,909	19,623,926

Securities comprise both coupon and discount securities denominated in euro. The maximum coupon interest of the EUR-denominated securities was 2.21 per cent as of 30 June 2014 (31 December 2013: 2.41 per cent).

As of 30 June 2014 there were no securities pledged as collateral on futures transactions

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

(BGN'000)

	Issuer's credit rating	30 June 2014	31 December 2013
Investment graded securities by the issue/	AAA	12,723,895	14,491,901
issuer credit rating	AA+	1,265,833	1,506,276
	AA	88,110	229,419
	AA-	3,597,297	2,627,478
	A+	1,614,697	587,776
	Α	313,077	181,076
		19,602,909	19,623,926

14. Financial Assets Available for Sale

(BGN'000)

	30 June 2014	31 December 2013
Republic of Bulgaria's quota in the IMF Equity investments in international financial institutions Investments in associates	1,417,217 28,709 26,397 1,472,323	1,399,023 28,751 26,397 1,454,171

The Republic of Bulgaria's quota in the IMF is SDR 640,200 thousand. BGN 75,491 thousand of the Republic of Bulgaria's quota in the IMF represents the reserve tranche held with the IMF. The IMF pays remuneration (interest) to those members who have a remunerated reserve tranche position, at an average rate of 0.11 per cent.

Equity investments in international financial institutions include the equity investment in the Bank for International Settlements (BIS), Basle, and 25 per cent of the equity investment in BIS Basle is paid up. As of 30 June 2014 the current value of 10,000 thousand shares in SDR amounts to BGN 21,853 thousand, while as of 31 December 2013 it was BGN 21,853 thousand (ref. note 28). The capital subscribed, but not paid-in has an option to be paid-in within three months upon a decision of the BIS Board of Governors. Equity investments in international financial institutions do not exceed 10 per cent of the subscribed share capital of the respective institution. Investments in international financial institutions also include BNB's equity investment in the ECB. BNB is a member of the ESCB. In accordance with the 2010 amendments to the regulatory frameworks of the national central banks of the countries which have not adopted the euro, these pay effectively 3.75 per cent of the subscribed equity investment. The BNB's capital contribution in the ECB is EUR 3487 thousand or BGN 6820 thousand.

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

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

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

15. Tangible Assets

(BGN'000)

	Land and buildings	Plant and equipment	IT equip- ment	Office equipment	Other equip- ment (includ- ing motor vehicles)	Tangible assets in progress	Total
As of 1 January 2014	181,113	86,134	41,609	9,758	6,678	2,265	327,557
Additions	-	91	8	24	15	1,166	1,304
Disposals	-	(680)	(597)	(122)	(0)	(68)	(1,467)
Transfers	-	69	871	87	251	(1,278)	-
As of 30 June 2014	181,113	85,614	41,891	9,747	6,944	2,085	327,394
Depreciation and impairment loss							
As of 1 January 2014	(33,645)	(57,994)	(33,193)	(6,843)	(5,814)	-	(137,489)
Charge for the period	(2,803)	(2,744)	(2,312)	(417)	(132)		(8,408)
On disposals	-	680	596	122	-	-	1,398
As of 30 June 2014	(36,448)	(60,058)	(34,909)	(7,138)	(5,946)	-	(144,499)
Net book value							
as of 30 June 2014	144,665	25,556	6,982	2,609	998	2,085	182,895
Net book value as of 31 December 2013	147,468	28,140	8,416	2,915	864	2,265	190,068

When revaluating tangible fixed assets, the Bank derecognises the accrued depreciation at the expense of the gross book value of the assets, and their net value is recalculated against the revalued amount.

(BGN'000)

							Dai (000)
	Land and buildings	Plant and equipment	IT equip- ment	Office equipment	Other equip- ment (includ- ing motor vehicles)	Tangible assets in progress	Total
As of 1 January 2013	184,256	113,635	37,397	9,538	6,695	13,059	364,580
Additions	1,375	11,835	19	29	8	5,517	18,783
Disposals	(4,601)	(39,801)	(399)	(49)	(25)	(10,931)	(55,806)
Transfers	83	465	4,592	240	-	(5,380)	-
As of 31 December 2013	181,113	86,134	41,609	9,758	6,678	2,265	327,557
Depreciation and impairment loss							
As of 1 January 2013	(28,677)	(71,917)	(28,901)	(6,014)	(5,513)	-	(141,022)
Charge for the period	(5,729)	(8,051)	(4,691)	(877)	(325)	-	(19,673)
On disposals	761	21,974	399	48	24	-	23,206
As of 31 December 2013	(33,645)	(57,994)	(33,193)	(6,843)	(5,814)	-	(137,489)
Net book value							
as of 30 June 2013	147,468	28,140	8,416	2,915	864	2,265	190,068
Net book value as of 31 December 2012	155,579	41,718	8,496	3,524	1,182	13,059	223,558

In applying IAS 16 *Property, Plant and Equipment* and BNB's *Internal Rules for Financial Statements and Accounting Policy*, as of December 2013 a review was made of the book value of tangible fixed assets stated in the Bank's balance sheet. The fair value of land and buildings was determined by an external, independent and licensed assessor of recognised professional qualification and experience in assessing property of location and category similar to the assessed ones. As of 31 December 2013, the fair value of land and buildings did not differ materially from their book value as at the same date; therefore, it is considered that the present book value of land and buildings on the Bank's balance sheet fairly reflects their market value. The fair value of land and buildings is categorised as Level-3 fair value based on the input data for the given assessment technique. For the remaining asset classes, Plant and Machinery, Equipment, Vehicles, Fixtures and Fittings, the fair value is considered to be their present value on the Bank's balance sheet as most of them were bought in the last four years and their book value is close to their fair value.

When revaluating tangible fixed assets, the Bank derecognises the accrued depreciation at the expense of the gross book value of the assets and their net value is recalculated against the revalued amount.

16. Intangible Assets

(BGN'000)

	Software	Other intangible assets	Development costs	Total
As of 1 January 2014	45,606	161	133	45,900
Additions	-	-	42	42
Disposals	(139)	-	-	(139)
Transfers	173	-	(173)	-
As of 30 June 2014	45,640	161	2	45,803
Depreciation and impairment loss	((100)		,,,,=,\
As of 1 January 2014	(41,043)	(128)	-	(41,171)
Charge for the period	(1,195)	(14)	-	(1,209)
On disposals	139	<u>-</u>	-	139
As of 30 June 2014	(42,099)	(142)	-	(42,241)
Net book value as of 30 June 2014	3,541	19	2	3,562
Net book value as of 31 December 2013	4,563	33	133	4,729

Software includes, as of 30 June 2014, licenses purchased by the BNB to the total amount of BGN 42 thousand (31 December 2013: BGN 1017 thousand).

	Software	Other intangible assets	Development costs	Total
As of 1 January 2013	44,265	152	-	44,417
Additions	-	8	1,508	1,516
Disposals	(33)	-	-	(33)
Transfers	1,374	1	(1,375)	-
As of 30 December 2013	45,606	161	133	45,900
Depreciation and impairment loss				
As of 1 January 2013	(37,948)	(101)	-	(38,049)
Charge for the period	(3,128)	(27)	-	(3,155)
On disposals	33	-	-	33
As of 30 December 2013	(41,043)	(128)	-	(41,171)
Net book value as of 31 December 2013	4,563	33	133	4,729
Net book value as of 31 December 2012	6,317	51	•	6,368

Software includes, as of 31 December 2013, licenses acquired by the BNB to the total amount of BGN 1017 thousand (31 December 2012: BGN 995 thousand), and software products to the amount of BGN 473 thousand (31 December 2012: BGN 1823 thousand).

17. Other Assets

(BGN'000)

30 June 2014	31 December 2013
52,559	49,386
19,034	19,034
343	359
16,728	14,143
3,976	2,091
714	1,235
7,780	800
101,134	87,048
	52,559 19,034 343 16,728 3,976 714 7,780

Cash held by subsidiaries with local banks comprise BGN 45,058 thousand of Printing Works of the BNB Corp. and BGN 7501 thousand of Bulgarian Mint EAD.

18. Banknotes and Coins in Circulation

(BGN'000)

	30 June 2014	31 December 2013
Banknotes in circulation	10,313,918	10,041,360
Coins in circulation	218,493	212,362
	10,532,411	10,253,722

19. Due to Banks and Other Financial Institutions

(BGN'000)

	30 June 2014	31 December 2013
Demand deposits from banks and other financial institutions		
- in BGN	5,249,721	4,868,900
- in foreign currency	2,000,312	2,194,510
	7,250,033	7,063,410

The Bank does not pay interest on demand deposits from banks and other financial institutions. Demand deposits include BGN 5,681,419 thousand representing the required reserves, which all local banks are required to maintain on accounts with the BNB (31 December 2013: BGN 5,329,979 thousand).

20. Liabilities to Government Institutions and Other Liabilities

(BGN'000)

	30 June 2014	31 December 2013
Current accounts:		
- in BGN	1,420,219	1,043,314
- in foreign currency	622,833	1,461,382
Time deposit accounts:		
- in BGN	2,576,000	2,983,000
- in foreign currency	416,592	418,011
	5,035,644	5,905,707

The government's deposits and current accounts with the Bank comprise funds held on behalf of state budget and other government organisations. No interest is payable on the current accounts. The government deposits in euro and in BGN bear 0.00 per cent interest.

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

The borrowings against Bulgaria's participation in the IMF as of 30 June 2014 amount to BGN 1,338,184 thousand or SDR 604,475 thousand (as of 31 December 2013: BGN 1,321,004 thousand or SDR 604,475 thousand).

Borrowings from the IMF are denominated in SDRs. Borrowings related to Bulgaria's quota in the IMF are non-interest bearing with no stated maturity. This note includes account No 1 and account No 2 of the IMF for administrative expenses in levs amounting to BGN 3576 thousand (as of 31 December 2013: BGN 3,689 thousand).

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

22. Other Liabilities

(BGN'000)

	30 June 2014	31 December 2013
Funds of EU institutions and bodies	51,954	84,300
Salaries and social security payable	4,478	3,262
Deferred income	554	1,474
Other liabilities	19,946	54,234
	76,932	143,270

'Funds of EU institutions and bodies' include European Commission's funds and European Investment Bank's funds. Pursuant to Article 9 of Council Regulation No 1150 of 2000 and Bulgaria's participation in the funding of the EU budget, the Bank opened accounts of the European Commission. As of 30 June 2014 the funds on these accounts were BGN 51,944 thousand. In 2011 the Bank opened accounts with the European Investment Bank (EIB) for the purposes of a financial arrangement between the Government of the Republic of Bulgaria and the EIB with the funds on these accounts amounting to BGN 10 thousand as of 30 June 2014.

23. Capital and Reserves

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

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

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

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

As of 30 June 2014 profit distribution in accordance with the profit distribution policy disclosed in note 5 (h) is as follows:

(BGN'000)

	30 June 2014	30 June 2013
Profit for the period	322,801	(886,775)
Allocation to special reserve under Article 36 of the Law on the BNB:		
Unrealised loss/(gains) from gold revaluation	(224,037)	860,096
Unrealised loss/(gains) from revaluation of financial assets at fair value through profit or loss	(67,913)	80,639
Unrealised foreign currency valuation loss/(gains)	(937)	1,062
Result after allocation to special reserve	29,914	55,022

24. Non-controlling Interest

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

25. Monetary Liabilities and Gross International Reserves

(BGN'000)

	30 June 2014	31 December 2013
Gross international reserves		
Cash and deposits in foreign currencies	5,913,296	6,318,854
Monetary gold and other instruments in gold	2,420,622	2,197,242
Security investments	19,602,909	19,623,926
Equity investments and quota in the IMF	75,491	74,521
	28,012,318	28,214,543
Monetary liabilities		
Currency in circulation	10,532,411	10,253,722
Due to banks and other financial institutions	6,495,264	7,063,308
Liabilities to government institutions	4,157,224	4,418,743
Other liabilities	1,685,143	1,571,366
	22,870,042	23,307,139
Surplus of gross international reserves over monetary liabilities	5,142,276	4,907,404

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

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

26. Related Party Transactions

Bulgarian Government

International Monetary Fund

As of 30 June 2014, the Republic of Bulgaria has not received funds under IMF agreements.

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

Government bank accounts

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

Fiduciary activities

In accordance with the Law on the BNB and under the terms agreed upon with the Minister of Finance, the BNB acts as an agent in government or government-guaranteed debts. With regard to this role, BNB performs agent and central depository services related to the administration and management of government securities issued by the Ministry of Finance. The Bank receives commission for providing these services. These government securities are not assets or liabilities of the BNB and are not recognised in its consolidated statement of financial position. The Bank is not exposed to any credit risk relating to government securities as it does not guarantee them. As of 30 June 2014, the par value of the government securities held in custody was BGN 8,076,028 thousand (31 December 2013: BGN 6,289,649 thousand).

27. Subsidiaries

(per cent)

Ownership interest	30 June 2014	31 December 2013
Bulgarian Mint EAD	100	100
Printing Works of the BNB Corp (ref. note 24)	95.6	95.6

The net income from subsidiaries for the period comprises net profit of BGN 568 thousand from the Bulgarian Mint EAD (30 June 2013: BGN 114 thousand) and BGN 2366 thousand from the Printing Works of the BNB Corp (30 June 2013: BGN 719 thousand).

28. Commitments and Contingencies

(i) Participation in the Bank for International Settlements

The Bank holds 8000 shares of the capital of BIS, Basle, each amounting to SDR 5000. Twenty-five per cent of the equity investment in BIS, Basle is paid up. The capital subscribed but not paid in is with an option to be paid in within three months following a decision of the BIS Board of Governors. The contingent amount as of 30 June 2014 is BGN 65,559 thousand (31 December 2013: BGN 65,559 thousand).

(ii) IMF quota

The IMF quota is secured by promissory notes jointly signed by the Bank and the Government of the Republic of Bulgaria amounting to BGN 1,322,831 thousand.

(iii) Capital commitments

As of 30 June 2014 the Bank has committed to BGN 214 thousand to purchase non-current assets (31 December 2013: BGN 465 thousand).

(iv) Other commitments and liabilities

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

29. Events Occurred after the Reporting Date

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

Major Resolutions of the BNB Governing Council in the First Half of 2014

6 February

The BNB Governing Council considered the application from the 'System for Electronic Payments' AD, in which the company informed the BNB about its intention to terminate its activities as an operator of a payment system with settlement finality.

The Chairperson of the Conciliation Commission for Payment Disputes, Prof. Kamelia Kassabova, Ph.D., presented to the Governing Council of the Bulgarian National Bank the annual report on the Commission's activities in 2013.

13 March

Report on BNB Budget Implementation as of 31 December 2013 was approved.

The BNB Governing Council considered the application and refused to issue a payment institution license to Bulgarian Posts EAD, submitted to the BNB under Article 10, paragraph 1 of the Law on Payment Services and Payment Systems.

Ordinance on Amendment of BNB Ordinance No 16 of 2009 on Payment Institutions and Payment System Operators Licensing was adopted.

New BNB Ordinance No 27 on the Balance of Payments Statistics, International Investment Position and Securities Statistics was adopted.

24 April

The BNB Annual Report for 2013 was approved.

Ordinance No 7 of 2006 on Large Exposures of Banks was repealed.

Ordinance No 8 of 2006 on the Capital Adequacy of Credit Institutions was repealed.

Ordinance No 9 of 2008 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk was repealed.

Ordinance No 12 of 2007 on the Supervision on a Consolidated Basis was repealed.

Ordinance No 17 of 2001 on Establishing the Amount of Bank Investment under Article 47 of the Law on Credit Institutions was repealed.

Ordinance on Amendment of BNB Ordinance No 2 of 2006 on the Licenses, Approvals and Permissions Granted by the Bulgarian National Bank According to the Law on Credit Institutions was adopted.

Ordinance on Amendment of BNB Ordinance No 20 of 2009 on the Issuance of Approvals under Article 11, Paragraph 3 of the Law on Credit Institutions was adopted.

Ordinance on Amendment of BNB Ordinance No 11 of 2007 on Bank Liquidity Management and Supervision was adopted.

Ordinance on Amendment of BNB Ordinance No 4 of 2010 on the Requirements for Remunerations in Banks was adopted.

Ordinance No 7 on Organisation and Management of Risks in Banks was adopted.

Ordinance No 8 on Banks' Capital Buffers was adopted.

As of 19 May 2014 the Bulgarian National Bank will put into circulation a silver commemorative coin 'Troyan Monastery' of the 'Bulgarian Churches and Monasteries' series with a nominal value of BGN 10, issue 2014.

The BNB Governing Council approved the 2013 Budget Performance 13 May Report on the Administrative Expenses of the Bulgarian Deposit Insurance Fund. Ordinance on Amendment of BNB Ordinance No 26 of 23 April 2009 on Financial Institutions was adopted. 29 May The BNB Governing Council decided to set a systemic risk buffer at 3 per cent of risk-weighted exposures formed by banks under § 8 of the Transitional and Final Provisions in connection with Article 12 of the BNB Ordinance No 8 on the Banks' Capital Buffers, confirming the requirement for maintaining a capital conservation buffer of 2.5 per cent under Article 3, paragraph 1 of the BNB Ordinance No 8 of 24 April 2014 on Banks' Capital Buffers. The capital conservation buffer will be applicable after the entry into force of this Ordinance on 24 April 2014. The system risk buffer will come into effect on 1 October 2014 and will apply to all banks in Bulgaria. 19 June As of 14 July 2014 the Bulgarian National Bank will put into circulation a gold commemorative coin 'St. Prophet Elijah' of the 'Bulgarian Iconography' series with a nominal value of BGN 100, issue 2014. The BNB Governing Council accepts by its decision that 'indicators published by the Bulgarian National Bank' within the meaning of the Law on Consumer Credit shall be the interest rate statistics data compiled by the Bulgarian National Bank under the Law on the BNB and the applicable European directives and regulations. 20 June Corporate Commercial Bank AD was placed under three-month conservatorship. 22 June CB Victoria EAD was placed under three-month conservatorship. 30 June The BNB made a decision to reduce the interest rates on deposits held with Corporate Commercial Bank AD and CB Victoria EAD down to the average market rate for the banking system by type, maturity and currency. In the cases where these rates are lower than the average market rate in May 2014, they will remain unchanged.

Ordinance on Amendment of BNB Ordinance No 6 on Extending Col-

lateralised Lev Loans to Banks was adopted.