

Economic Review

3/2015



BULGARIAN
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BANK

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The BNB quarterly *Economic Review* presents information and analysis of balance of payments dynamics, monetary and credit aggregates, their link with the development of the real economy, and their bearing on price stability. Processes and trends in the external environment are also analysed since the Bulgarian economy is directly influenced by them. This publication contains also quantitative assessments of the development in major macroeconomic indicators in the short run: inflation, economic growth, exports, imports, trade balance and BoP current account, foreign direct investment, monetary and credit aggregate dynamics.

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Abbreviations

ABSPP	Asset-Backed Securities Purchase Programme
APP	Asset Purchase Programme
APRC	Annual percentage rate of charge
BIR	Base interest rate
BOP	Balance of Payments
BTC	Bulgarian Telecommunications Company
b.p.	basis points
CBPP3	Covered Bond Purchase Programme
CEECs	Central and East European countries
CEFTA	Central European Free Trade Association
CFP	Consolidated Fiscal Programme
CIF	Cost, insurance, freight
CNY	Chinese Yuan
CPI	Consumer Price Index
DXY	an index measuring the exchange rate of the US dollar against the basket of six major currencies
EA	Employment Agency
EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
EMBI	Emerging Markets Bond Index
EONIA	Euro OverNight Index Average
EU	European Union
EURIBOR	Euro Interbank Offered Rate
EWRC	Energy and Water Regulatory Commission
FDI	Foreign Direct Investment
FOB	Free on Board
FRS	Federal Reserve System
GDP	Gross Domestic Product
GFMS	Gold Fields Mineral Services
HICP	Harmonized Index of Consumer Prices
HRW	Hard Red Wheat
HUF	Hungarian forint
IEA	International Energy Agency
IMF	International Monetary Fund
ISM	Institute for Supply Management
LEONIA	LEv OverNight Index Average
LIBOR	London Interbank Offered Rate
M1	narrow money
M2	M1 and quasi-money
M3	broad money
MF	Ministry of Finance
MFIs	Monetary Financial Institutions
mt	metric tons
NPISHs	Non-profit institutions serving households
NSI	National Statistical Institute
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
OTC	over-the-counter
PBoC	People's Bank of China
PMI	Purchasing Managers' Index
p.p.	percentage points
PPP	Purchasing Power Parity
PSPP	Public Sector Purchase Programme
RON	Romanian new leu
SITC	Standard International Trade Classification
WTI	West Texas Intermediate

Summary

In the third quarter of 2015 the global business indicator declined, reflecting the ongoing downward trend in the manufacturing index. The global indicator drop across regions was mainly due to deterioration in the economic activity expectations in the developing economies. Weaker growth in both global economy and world trade along with worsening global economic indicators, especially in developing countries, gave grounds for several international institutions, including the ECB and the IMF, to revise downwards their projections of the global economic growth in 2015 and 2016. The stabilisation of international financial markets since September contributed to the improvement in business expectations, and in October the quarterly global economic indicator increased on a quarterly basis.

Dynamics of leading economic indicators in the euro area creates expectations about a slight moderation of the economic growth in the third quarter of 2015. In September the ECB revised downwards its euro area GDP growth projection from 1.5 to 1.4 per cent for 2015 and from 1.9 to 1.7 per cent for 2016, reflecting mainly the weaker external demand as a result of lower economic growth in developing economies.

The first estimate of the US GDP change in the third quarter shows a slowdown in economic growth to 2.0 per cent on an annual basis and to 0.4 per cent on a quarterly basis. Economic data received at the beginning of the fourth quarter show signals of acceleration in real US GDP growth over the fourth quarter of 2015.

Global inflation continued declining mainly due to the fall in developed economies' price indices affected by the continuous decrease in international commodity prices: the international price of Brent crude oil fluctuated within the range of USD 40 to 60 *per* barrel in the first ten months of 2015, falling 50 per cent below its average level in 2014, and the prices of other major raw material and commodity groups retained their downward trends. The decline in international oil prices was among the main reasons for the ECB to revise downwards its euro area average annual inflation projection in September from 0.3 to 0.1 per cent for 2015 and from 1.5 to 1.3 per cent for 2016. In the fourth quarter of 2015 and first quarter of 2016 inflation in the USA is expected to rise, but to remain below 2.0 per cent on an annual basis.

The expected lower growth in global economic activity and world trade in 2015 against 2014 is likely to result in slower annual growth of external demand for Bulgarian goods and services in the fourth quarter of 2015 and first quarter of 2016. Based on the expectations of major raw material and food price dynamics, it may be concluded that the terms of trade for Bulgaria will worsen until the end of the year and in the beginning of 2016 from the first half of 2015.

Irrespective of the slowdown in global economic growth and declines in international commodity prices, nominal imports and exports of goods grew on an annual basis, according to the balance of payments data. Between January and August 2015 total nominal exports of goods rose by 9.1 per cent on an annual basis, while nominal imports of goods increased by 3.7 per cent. This resulted in a decrease of the trade balance deficit. The overall surplus of the BOP current and capital account increased significantly between January and August 2015 on the same period of 2014. This reflected mainly the decline in the trade deficit and the capital account surplus growth. In the fourth quarter of 2015 and first quarter of 2016 the current and capital account surplus, as a share of GDP, is expected to shrink on an annual basis due to the decreased capital account surplus and increased deficit on the primary income account.

As of September 2015 deposits attracted from residents in the banking system went up by BGN 2.5 billion against end-2014, while the low credit demand and investment profitability outside Bulgaria contributed to maintaining the high level of liquidity in the system. In the fourth quarter of 2015 and first quarter of 2016 declining interest rates on deposits are not expected to have a negative impact on the household savings rate, and attracted funds in the banking system are expected to continue to grow. Growth of loans to the non-government sector is projected to remain low, and it is expected to be around zero by end-2015 and slowly to increase from the beginning of 2016. Interest rates on bank deposits and loans continued to follow a downward trend, which is expected to be retained until the end of 2015 and in early 2016.

In the second quarter of 2015 quarterly growth of real GDP decelerated on the previous quarter, accounting for 0.5 per cent.¹ Over the same quarter government consumption and gross fixed capital formation posted the highest growth. The change in inventories also contributed positively to the growth. Private consumption retained its previous quarter's level. Net exports contributed negatively to the growth as the quarterly decrease in goods and services exports outstripped that in goods and services imports.

Short-term economic indicators over the third quarter of 2015 give mixed signs about economic developments. If the household sentiments remain positive and the labour market continues to recover, private consumption may be expected to grow on a quarterly basis in the fourth quarter of 2015 and first quarter of 2016. Positive sentiment and business expectations would result in an increase in private investments. Government consumption is expected to rise at slow rates over the same period. Goods and services imports are expected to increase at slightly higher rates than exports of goods and services. The above mentioned component dynamics shows that in the fourth quarter of 2015 and first quarter of 2016 quarterly GDP growth is expected to remain close to that in the first half of 2015.

In September 2015 the annual inflation was negative at -0.9 per cent, with the fall in transport fuel prices contributing most to this, driven by falling international oil prices. Administrative prices of goods and services had a positive contribution to the overall inflation in early 2015, mostly due to the increase in prices of electricity for households at the end of 2014.

Deflation is expected to deepen temporarily in the fourth quarter of 2015, reflecting the lower oil prices over the third quarter. However, the annual rate of decline of consumer prices is projected to start decreasing in the first quarter of 2016. This will reflect mainly the declines in international oil prices in euro over the third quarter of 2015 and the expected stabilisation afterwards.

¹ The analysis employs GDP data published by the NSI on 4 September 2015. Since 30 September 2015, the NSI has initiated phased-in publication of revised GDP data for the period between the beginning of 1999 and the second quarter of 2015. On 12 October 2015 Eurostat published revised Bulgaria's GDP data for the same period.

1. External Environment

In the third quarter of 2015 the global business indicator declined, reflecting the ongoing downward trend in the manufacturing index. The global indicator drop across regions was mainly due to deterioration in the economic activity expectations in the developing economies. Weaker growth in both global economy and world trade along with worsening global economic indicators, especially in developing countries, gave grounds for several international institutions, including the ECB and the IMF, to revise downwards their projections of the global economic growth in 2015 and 2016. The stabilisation of international financial markets since September contributed to the improvement in business expectations, and in October the global economic indicator increased on a quarterly basis. Global inflation continued declining mainly due to the fall in developed economies' price indices affected by the continuous decrease in international commodity prices.

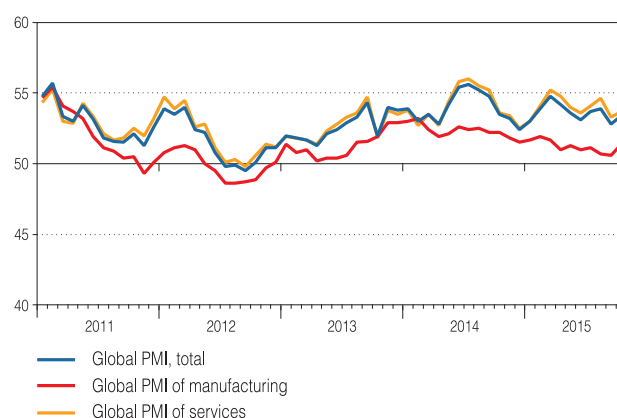
The expected lower growth in global economic activity and world trade in 2015 against 2014 is likely to result in slower annual growth of external demand for Bulgarian goods and services in the fourth quarter of 2015 and first quarter of 2016. Based on the expectations of major raw material and food price dynamics, it may be concluded that the terms of trade for Bulgaria will worsen until the end of the year and in the beginning of 2016 from the first half of 2015.

Current Business Situation

In the third quarter of 2015 the global economic indicator (global PMI) declined compared to the previous quarter's average level, reflecting largely the ongoing sustainable downward trend in the manufacturing index. Developments diverged across regions and the quarterly decline in the global economic indicator was mainly driven by the lower activity in developing economies, where the index fell below the limit of 50 at the end of the quarter. Heightened uncertainty in financial and commodity markets contributed to this dynamics. Concurrently, the index in developed countries remained above the level of 50, which is indicative of strengthening economic activity. In the beginning of the fourth quarter positive signals for global economic activity were observed and PMI indices grew on a quarterly basis both in the manufacturing and services sector. This was partly linked to the lowered uncertainty in financial markets after the end of the third quarter.

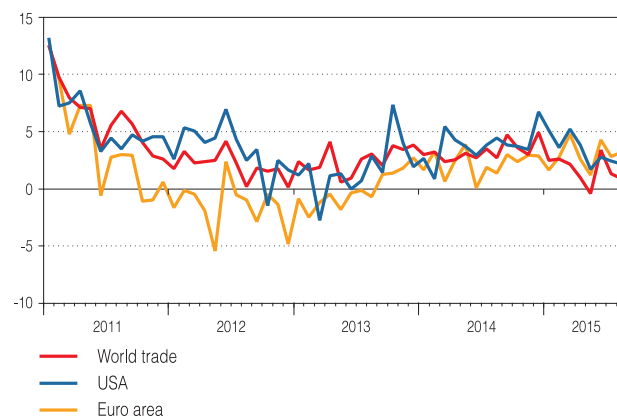
Worsening economic indicators in the third quarter and weaker-than-expected growth in the global economy and world trade in early 2015, especially in developing countries, gave grounds for several international institutions, including the

Global PMI



World Trade

(annual rate of growth, per cent)



ECB² and the IMF³, to revise downwards their projections of the global economic growth for 2015 and 2016. Despite the downward revision in the projections, economic growth in developed countries like the USA and the euro area is expected to accelerate in 2015 and 2016.

Divergent trends in economic activity in developed and developing economies had an effect on world trade growth as well. In the first eight months of the year the world trade grew slightly on an annual basis, with developed economic regions like the USA and the EU having the main contribution, while the trade volume in developing economies remained almost unchanged.

Annual global inflation decreased to reach 1.5 per cent in September, reflecting the fall in international commodity prices, especially oil prices. By regions, the annual decline in global inflation over the first nine months of the year was driven mainly by the lower price indices in developed economies and, to a lesser extent, by the slowdown in inflation rate in developing economies.

The expected lower growth in global economic activity and world trade in 2015 against 2014 is likely to result in slower annual growth of external demand for Bulgarian goods and services in the fourth quarter of 2015 and first quarter of 2016.

Euro Area

Over the second quarter of 2015 euro area real GDP increased by 1.5 per cent on an annual basis against 1.2 per cent growth in the previous quarter. Economic growth accelerated in the four largest economies in the region: in Germany it reached 1.6 per cent, in France 1.1 per cent, in Italy 0.6 per cent, and in Spain 3.1 per cent.

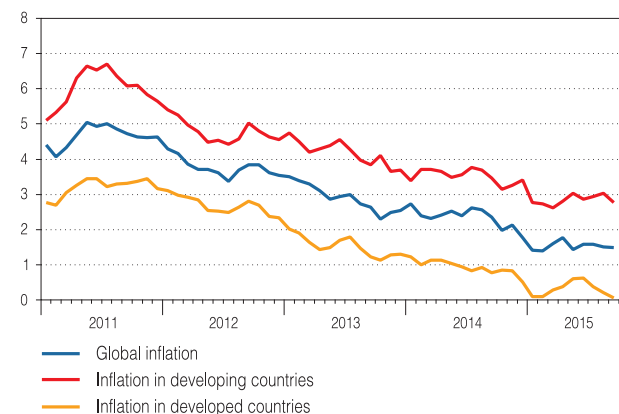
On a quarterly basis, euro area real GDP growth decreased to 0.4 per cent from 0.5 per cent in the prior quarter. This decrease was almost entirely due to the decline of the economic growth in France (to 0 per cent), which was partially offset by accelerated quarterly growth in Germany and Spain to 0.4 per cent and 1.0 per

² ECB Staff Macroeconomic Projections for the euro area, September 2015: www.ecb.europa.eu/pub/pdf/other/ecbstaff-projections201509.en.pdf.

³ IMF World Economic Outlook, October 2015: Adjusting to Lower Commodity Prices: www.imf.org/external/pubs/cat/longres.aspx?sk=43229.0

Inflation Measured through CPI

(per cent, annual rate of change, seasonally adjusted data)

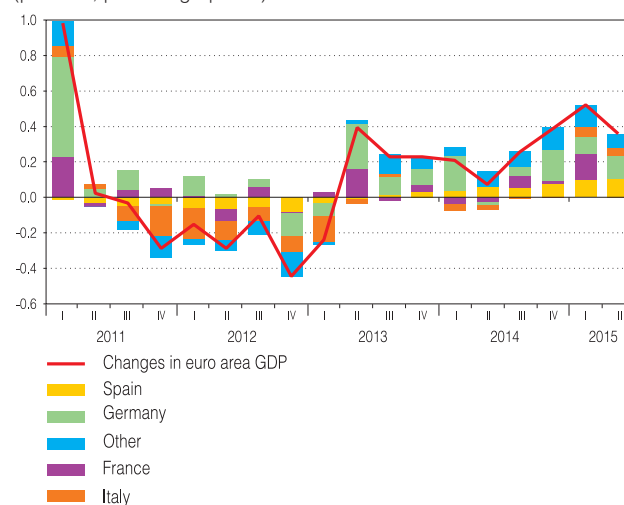


Note: The World Bank measures the change of CPI in individual groups as a weighted average of CPI changes in the countries of the group. For calculating the weights of the countries, real GDP based on purchasing power parity is used. Groups include only World Bank Member States classified by the World Bank as developing and developed countries.

Source: World Bank.

Contribution to Real GDP Growth in the Euro Area by Country (Quarterly)

(per cent; percentage points)



Source: Eurostat and BNB calculations.

cent, respectively. GDP growth in Italy came to 0.3 per cent, with the positive contribution of changes in inventories comprising a significant portion of it (0.4 percentage points). By country, Germany (0.12 percentage points), Spain (0.11 percentage points) and Italy (0.05 percentage points) had the main contribution to GDP growth in the euro area, while France had no contribution to the economic activity growth over the reviewed period.

Net exports (0.3 percentage points) had a major contribution to euro area GDP growth. The higher contribution of net exports was offset by the lower contribution of household consumption (0.2 percentage points) and government consumption (0.05 percentage points), as well as by the negative contribution of changes in inventories (-0.13 percentage points) and investment (-0.09 percentage points).

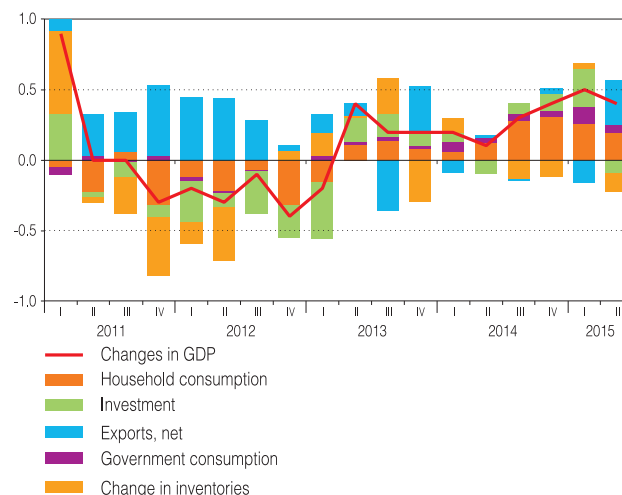
The dynamics of euro area leading economic indicators shows that GDP growth rate is likely to slightly slow down in the third quarter on the previous quarter. The EC economic sentiment index rose to 105.9 in October against 103.5 in June 2015, while the consumer confidence index decreased to -7.7 in October against -5.6 in June. The EC business climate index in the euro area, which is an indicator for the regional investment activity, grew in October to reach 0.44 from 0.25 in June. Between July and October euro area PMIs displayed volatile and slight changes. In October the composite PMI was 53.9 against 54.2 in June and manufacturing and services PMIs declined to 52.3 and 54.1, respectively (against 52.5 and 54.4 in June 2015).

In September the ECB revised downwards its euro area GDP growth projections for 2015 and 2016 to 1.4 per cent and 1.7 per cent and in the beginning of November the EC revised its GDP growth projection in 2015 and 2016 to 1.6 per cent (+0.1 percentage point) and 1.8 per cent (-0.1 percentage point), respectively. The main reason behind the revision by both institutions was the weaker external demand as a result of the lower economic growth in developing economies.

Since June a decrease was observed in the Harmonised Index of Consumer Prices in the euro area, with preliminary data in October showing a 0.0 per cent change on an annual basis. The

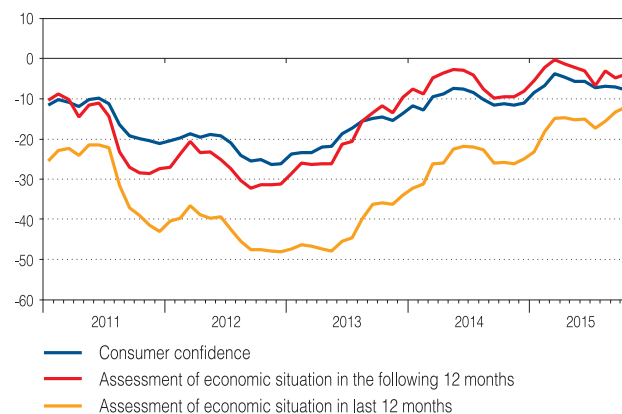
Contribution to Real GDP Growth in the Euro Area by Component (Quarterly)

(per cent; percentage points)



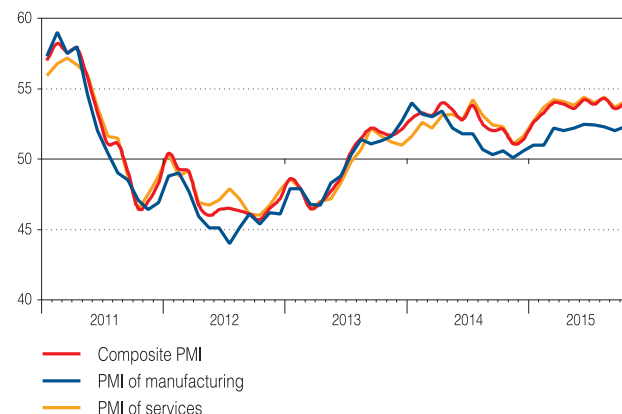
Source: Eurostat.

Euro Area Consumer Confidence Indices



Source: European Commission.

Manufacturing and Services PMIs



Source: Markit.

inflation decline continued to be driven largely by the energy price falls. According to Eurostat final data, in September the consumer prices fell mostly in Cyprus (-1.9 per cent), Spain (-1.1 per cent) and Slovenia (-1.0 per cent), and the highest inflation was in Malta (1.6 per cent), Portugal (0.9 per cent) and Belgium (0.9 per cent).

The decline in international oil prices was among the main reasons for the ECB to revise downwards in September its euro area average annual inflation projection for 2015. Risks to the inflation outlook were considered to lie on the downside.

Euro area unemployment continued to decline slowly to 10.8 per cent in September, down by 0.2 percentage points on the end of the second quarter. Greece (unchanged 25.0 per cent) and Spain (down to 21.6 per cent) still reported the highest unemployment rate over the last few months. An increase in annual unemployment was observed in Finland, Belgium, and France, where the indicator rose between 0.1 and 0.6 percentage points in September 2015. Germany and Malta still reported the lowest unemployment levels at 4.5 per cent and 5.1 per cent, respectively. The indicator of the expected unemployment over the next twelve months, included in the EC consumer confidence index, shows worsening consumer expectations concerning labour market developments. In the July to October 2015 period the average value of this sub-index went up to 15.8 points from 9.8 points in the second quarter.

On the basis of persistently low inflation in the euro area, at its monetary policy meeting of 3 September, the ECB Governing Council emphasised its willingness to use all available instruments within the limits of its mandate to achieve a continuous upward trend of the indicator to nearly 2 per cent. The ECB stated that the asset-purchase programme provides sufficient flexibility in terms of adjusting the size, composition and duration of the programme. At the same meeting, the ECB increased the PSPP issue share limit from 25 per cent to 33 per cent, subject to verification on a case-by-case basis that this would not create a situation in which the Eurosystem would have blocking minority power, where this limit would remain at 25 per cent. The decision on the limit increase was taken in order to ensure the smooth implementation of the programme in the future.

Projections of the Annual Rate of Change of Euro Area Real GDP

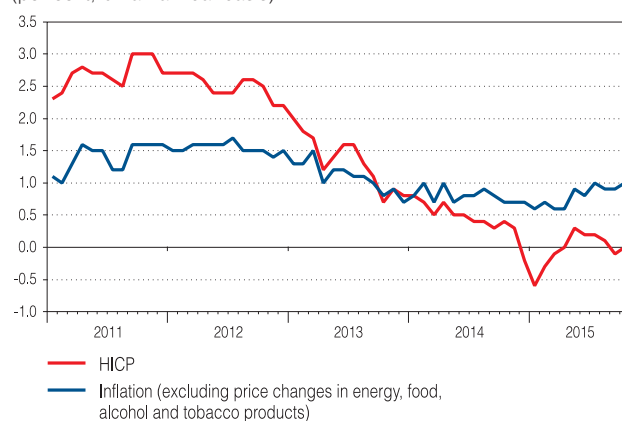
(per cent)

Institution	Publishing date	2015		2016	
		last	previous	last	previous
EC	November 2015	1.6	1.5	1.8	1.9
ECB	September 2015	1.4	1.5	1.7	1.9

Sources: EC, ECB.

Euro Area Inflation Rate

(per cent, on an annual basis)



Note: Preliminary data for October 2015.

Source: Eurostat.

Projections of Euro Area Annual Inflation Rate

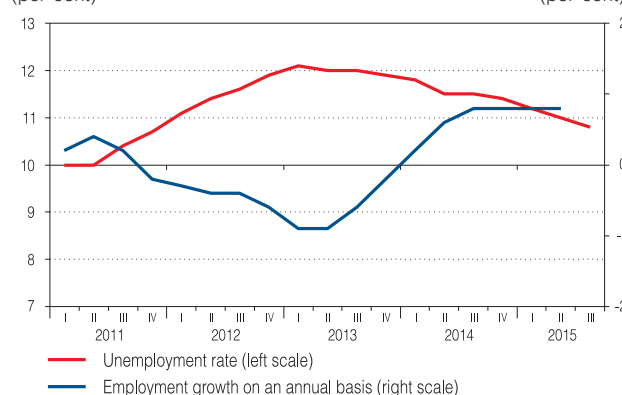
(per cent)

Institution	Publishing date	2015		2016	
		last	previous	last	previous
EC	November 2015	0.1	0.1	1.0	1.5
ECB	September 2015	0.1	0.3	1.1	1.5

Sources: EC, ECB.

Euro Area Unemployment Rate and Employment Growth

(per cent)



Source: Eurostat.

In the period up to the ECB next meeting held on 22 October, euro area inflation went down to negative values. For this reason, the ECB Governing Council announced that at the next meeting (3 December) when the updated euro area economic growth and inflation forecast will be presented, members will assess the need to take additional monetary policy measures. To that end, the relevant ECB committees would be mandated to conduct a technical analysis and propose various monetary policy instruments which might be used.

The monthly volume of purchases under the expanded APP of the ECB in July, August, September and October accounted for EUR 61.3 billion, EUR 51.6 billion, EUR 60.6 billion⁴ and EUR 63.7 billion, which was in line with the ECB's intention to temporarily frontload purchases before the beginning of August and the beginning of December, months over which financial market activity is typically lower. On 30 October cumulative amount of purchases under the PSPP, CBPP3 and ABSPP programmes came to EUR 393.6 billion, EUR 131.1 billion and EUR 14.6 billion, respectively.

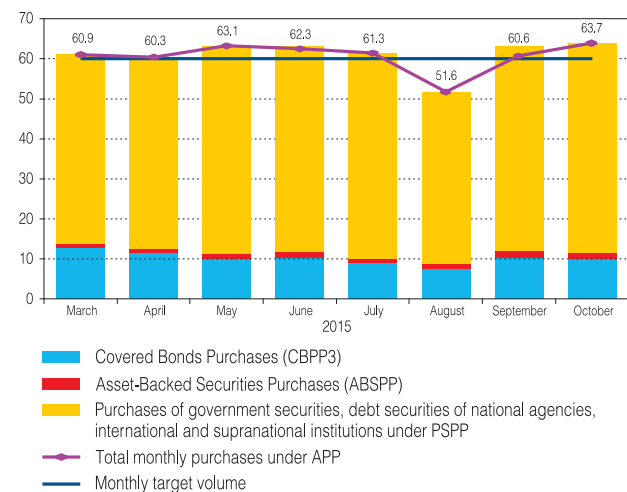
In its fifth Targeted Longer-Term Refinancing Operation (TLTRO) conducted on 24 September, EUR 15.6 billion was allotted to 88 banks which participated in the operation (against previously allotted EUR 73.8 billion among 128 banks). The lower interest in the operation was likely to reflect both the higher amount of allotted funds in the previous targeted operations and the relatively weaker demand for loans by the real sector.

As a result of ECB operations and programmes, on 6 November 2015 the amount of excess liquidity in the euro area banking system grew to EUR 564.6 billion (against EUR 396.3 billion by end-June 2015). On 6 November the ECB balance sheet figure increased by 5.1 per cent compared with end-June 2015 and reached EUR 2.669 trillion.

Due to the increase in the excess liquidity, between 1 July and 6 November 2015 the average value of the EONIA continued to fall to -0.13 per cent (against -0.10 per cent in the second quarter of 2015). Concurrently, the volume of overnight deposits in euro area's interbank market

Monthly Securities Purchases under the Expanded APP of the ECB

(billion EUR)

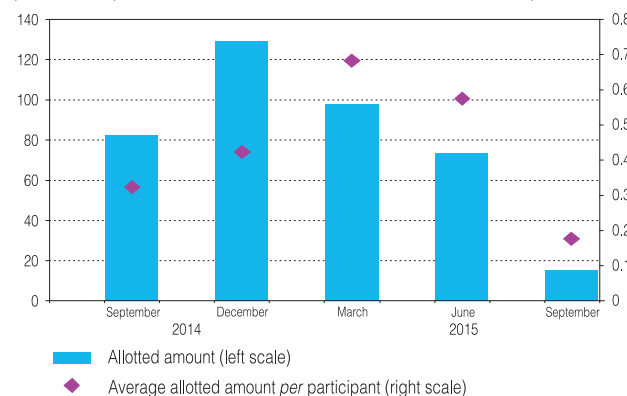


Source: ECB.

Allocation of Funds on ECB Targeted Longer-term Refinancing Operations (TLTRO)

(billion EUR)

(billion EUR)

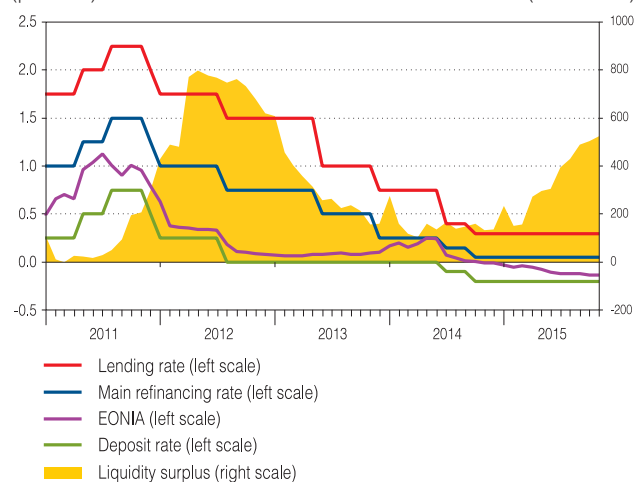


Source: ECB.

ECB Interest Rates, EONIA and Excess Liquidity in the Euro Area

(per cent)

(billion EUR)



Note: EONIA monthly averages.

Source: ECB.

⁴ The values by end-September 2015 are after amortisation.

trade continued decreasing as their daily average value between 1 July and 6 November was EUR 15.7 billion (against EUR 20.6 billion in the second quarter of 2015).

EURIBOR interest rates on interbank market deposits continued to follow a downward trend. On 6 November one-month interest rates reached -0.12 per cent (-6 basis points on end-June), and those with maturities of six and 12 months fell to 0.0 per cent (-5 basis points on end-June) and 0.10 per cent (-7 basis points on end-June). Given the expectations for further rises in excess liquidity in the banking system and the possible decrease in the ECB deposit facility interest rate, the downward trend in money market interest rates is expected to be sustained.

The United States

In the second quarter of 2015 US real GDP growth moderated to 2.7 per cent on an annual basis from 2.9 per cent in the previous quarter. Over the same period the US GDP quarterly increase was 1.0 per cent against 0.2 per cent in the first quarter of the year. Acceleration of quarter-on-quarter growth in the second quarter was largely due to the net exports recovery following the significant decrease in the first quarter and accelerating household consumption growth.

The first estimate of the US GDP change in the third quarter shows a slowdown in economic growth to 2.0 per cent on an annual basis and to 0.4 per cent on a quarterly basis.

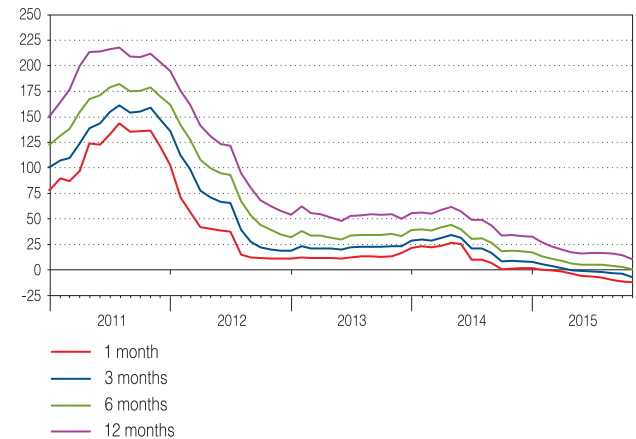
In the third quarter of 2015 US leading economic activity indicators exhibited volatile and diverse dynamics.

Consumer confidence indicators underwent divergent changes over the third quarter, though remaining at comparatively high levels. Manufacturing and services ISM-PMIs also reported divergent developments. Over the reviewed period the ISM for services sector rose, while the negative trend in the analogous indicator for manufacturing sector was sustained. Positive dynamics was observed in consumer expenditure and retail sales. The National Association of Home Builders (NAHB) index also grew, indicating an acceleration in housing sector recovery.

Economic data received at the beginning of the fourth quarter show signals of acceleration in US GDP growth. On 4 November the forecasting model of the Federal Reserve Bank of Atlanta

EURIBOR Dynamics

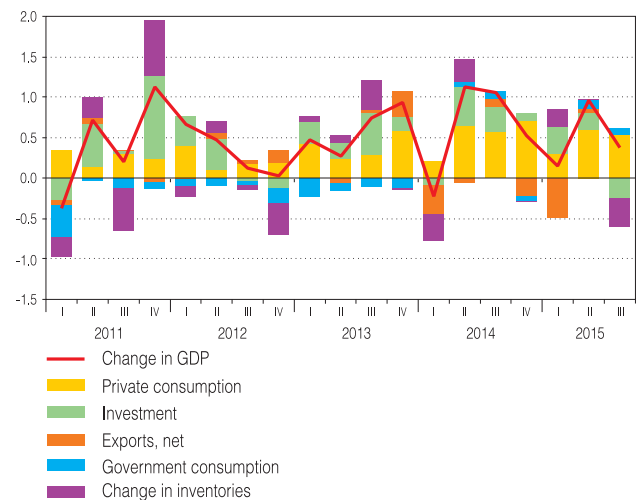
(basis points)



Source: ECB.

Contribution to US GDP Growth by Component (Quarterly)

(per cent; percentage points)



Source: Bureau of Economic Analysis.

US Consumer Confidence Indices

(2000 = 100)



Source: The Conference Board.

for economic growth over the current quarter (GDPNow) points to a 2.3 per cent change in GDP on a quarterly annualised basis in the fourth quarter of 2015 which corresponds to an increase of 0.6 per cent on a quarterly basis.

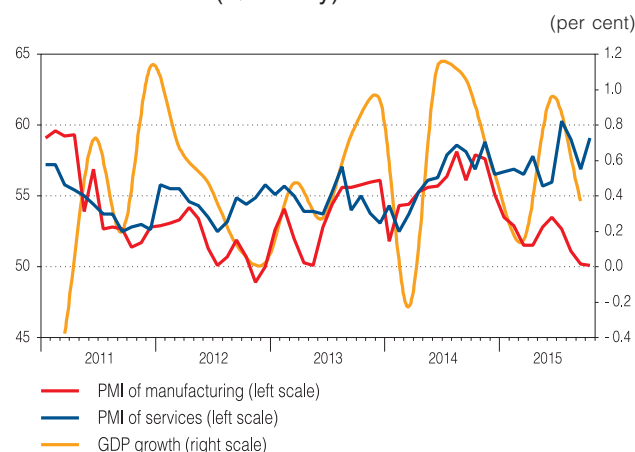
In the third quarter inflation indicators in the USA increased slightly. In September the annual inflation rate measured by the personal consumption expenditure (PCE) deflator decreased to 0.2 per cent after staying at the level of 0.3 per cent in the previous four months, while the annual growth rate of core inflation (excluding food and fuel prices) remained unchanged at 1.3 per cent for a second consecutive month. Over the same period the annual growth rate of consumer price index, the other measure of the US inflation, decreased to 0.0 per cent from a 0.2 per cent growth in the previous two months. Among this indicator's components, energy and particularly fuels continued to report the largest annual fall. The annual growth rate of core inflation rose by 0.1 percentage point to 1.9 per cent in September.

In the third quarter of 2015 the expectations of consumer price developments in the period of one to five years, a component of the University of Michigan consumer confidence index, remained relatively stable. In September 2015 inflation expectations in the period of up to one year stayed at 2.8 per cent for a third consecutive month and inflation expectations in the period up to five years went up to 2.7 per cent for a second consecutive month. In the fourth quarter of 2015 and first quarter of 2016 US inflation is expected to rise, but to remain below 2.0 per cent on an annual basis.

In October unemployment reached 5.0 per cent, the lowest level of this indicator since March 2008. At the same time, new jobs created in the non-agricultural sector reached in October the highest level since the year start (271,000), and the average monthly level of employment in the non-agricultural sector reached 206,000 persons.

At its meeting of 16 and 17 September, the US Federal Open Market Committee (FOMC) decided to keep the target range for the federal funds rate unchanged within a 0.00 to 0.25 per cent band, emphasising the role of the external environment for the members to take this decision. A new element in the Committee communication was the inclusion of the comments in the press release on potential negative effects of global

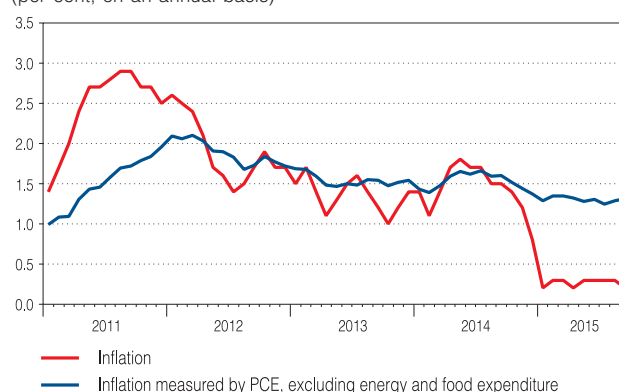
US Manufacturing and Services ISM-PMIs and GDP Growth (Quarterly)



Source: Institute for Supply Management.

US Inflation Rate

(per cent, on an annual basis)



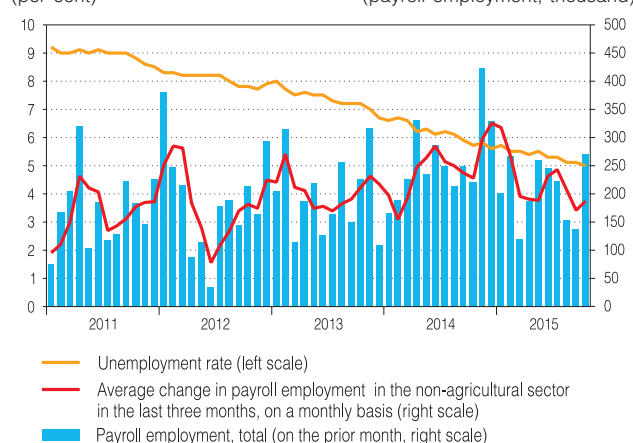
Note: Inflation is measured by the personal consumption expenditure deflator.

Source: Bureau of Labor Statistics.

US Unemployment Rate and Number of New Employees in the US Non-Agricultural Sector

(per cent)

(payroll employment, thousand)



Source: Bureau of Labor Statistics.

economic and financial developments on the economy and US medium-term inflation rates.

Individual forecasts of the Committee members for the appropriate level of the main rate at the end of 2015, 2016, 2017 and 2018 were revised once again downwards, reflecting their expectations for an even smoother interest rate increase as a result of slower than projected growth rates of the US economy and inflation in June 2015. However, projections showed once again that most meeting participants anticipated that it would be appropriate to begin raising the federal funds rate as early as in 2015.

At its meeting of 27 and 28 October, the FOMC expressed again its intention to start raising Federal Reserve rates before the end of 2015, and a possible decision thereof is likely to be taken in December. After the release of the 6 November data on employment in the non-agricultural sector for October, the probability of federal funds rates to increase in December 2015 was 68 per cent, based on exchange-traded futures contracts.

China

By end-September the People's Bank of China confirmed its GDP growth projection of 7.0 per cent for 2015. The IMF did not change its expectations for China's economic growth and in early October it retained its April projection for GDP growth of 6.8 per cent in 2015 and 6.3 per cent in 2016.

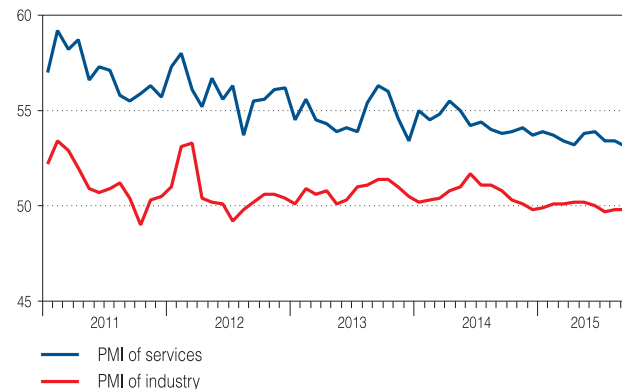
Based on data of the National Bureau of Statistics of China, China's real GDP grew by 6.9 per cent on an annual basis over the third quarter of 2015 against 7.0 per cent in the previous two quarters. Quarter-on-quarter economic growth came to 1.8 per cent, with services contributing most to this, while industry and investment moderated.

In the third quarter services and manufacturing PMIs reported slight and divergent developments. The downward trend in manufacturing PMI in China was reversed, though remaining below the 50 point threshold, while services PMIs continued to indicate a rise in the economic activity.

In September the annual growth of industrial output slowed down to 5.7 per cent against 6.8 per cent at the end of the second quarter. The 0.5 per cent contraction in car produc-

Manufacturing and Services PMIs in China

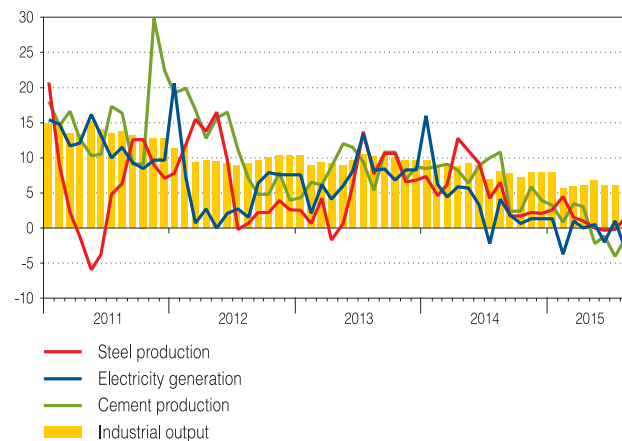
(per cent, on an annual basis)



Source: China Federation of Logistics and Purchasing.

Industrial Output and Output in Selected Sub-sectors in China

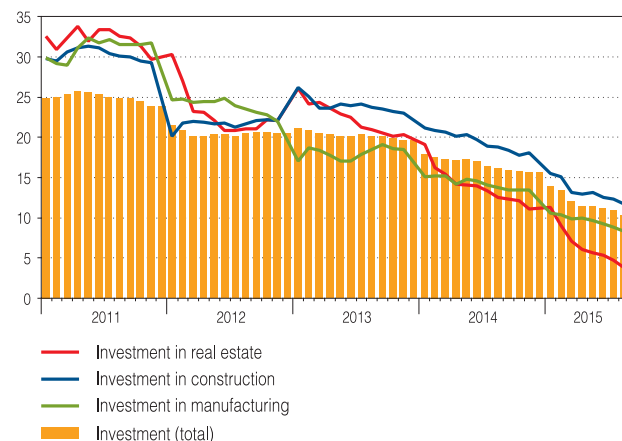
(per cent, on an annual basis)



Source: National Bureau of Statistics of China.

Total Investment in Fixed Capital and in Selected Sectors in China's Economy

(per cent, on an annual basis)



Source: National Bureau of Statistics of China.

tion on an annual basis was among the factors behind the slower growth. Subsequently, the Chinese authorities launched a tax relief for this sector, reducing by half the sales tax on some cars.

Over the third quarter the trend to a gradual slowdown in the growth rate of investment was sustained, with its annual growth rate coming to 10.3 per cent in September. The main factor behind the growth moderation continued to be the lower growth rate of investment in real estate and industrial output.

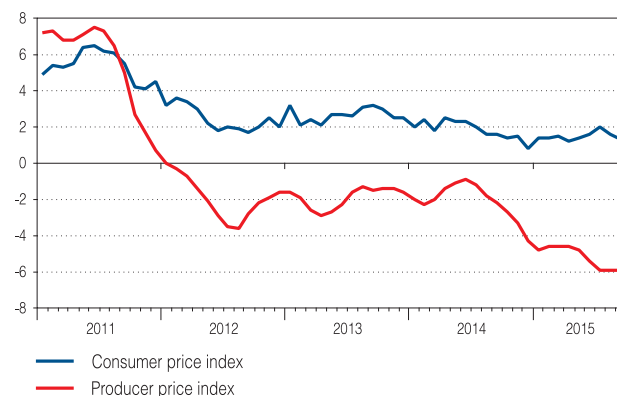
In October the annual rate of change in consumer prices slowed down to 1.3 per cent, following a slight acceleration in consumer inflation to 1.6 per cent in the third quarter against 1.4 per cent in June. Real estate prices also began to rise. The increase was observed mainly in the four largest Chinese cities, where supply decreased and absorption of unsold land accelerated. However, producer prices continued to follow their downward trend which started in mid-2014, with a decrease reaching -5.9 per cent in October 2015.

In late June a sharp and continuous adjustment in Chinese stock market triggered concerns about a further slowdown in economic activity. To mitigate the potential negative effects on the economy, the authorities of China initiated a series of administrative, monetary and fiscal measures, including such intended to stimulate investments in shares, infrastructure and bank lending operations. After their introduction, the major stock market indices in China stabilised.

In August and October 2015 the People's Bank of China lowered twice one-year bank lending and deposit interest rates by 25 basis points to 4.35 per cent and 1.50 per cent, respectively. An additional measure to boost lending activity was the reduction of the banks' reserve requirements ratio by 50 basis points in August and October to 17.5 per cent. The estimated effect of the two measures is assessed at CNY 1400 billion (USD 212 billion) of available funds in the banking system for new lending. In addition, the central bank changed minimum reserve requirements and the amount of banks' funds on minimum reserve requirements with the central bank will be calculated on an average monthly basis, instead of daily. These changes

Inflation Indices in China

(per cent, on an annual basis)

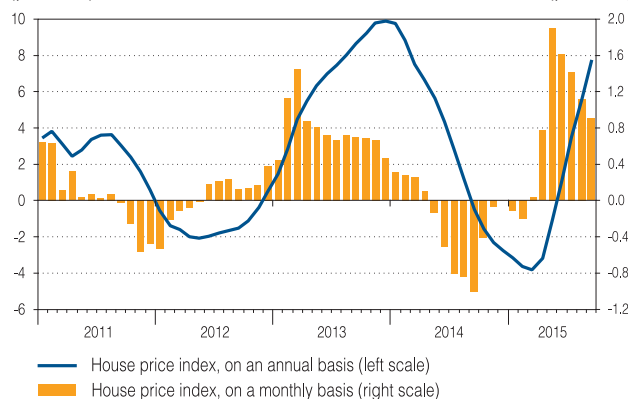


Source: National Bureau of Statistics of China.

Housing Prices (rate of change)

(per cent)

(per cent)

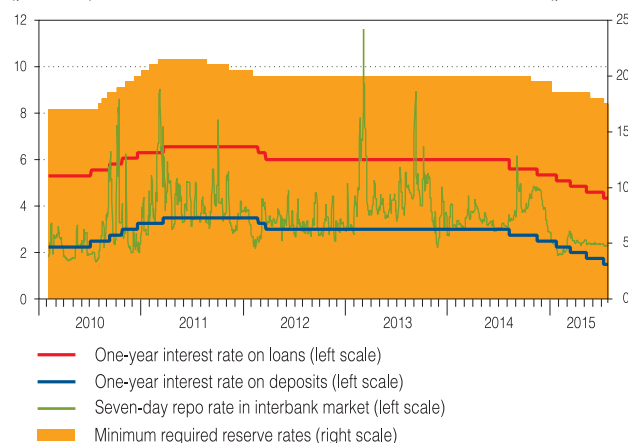


Source: National Bureau of Statistics of China.

Bank Market Interest Rates and Minimum Required Reserve Rates in China

(per cent)

(per cent)



Source: People's Bank of China.

aimed at reducing the risks related to the possible deterioration of liquidity in the interbank market, resulting in a decreased volatility of the interest rate on seven-day repo transactions in the interbank market.

As a result of the measures undertaken by the central bank in August and September, the annual growth of new loans was over 15 per cent, with the annual growth rate of monetary aggregate M2 accelerating over 13 per cent.

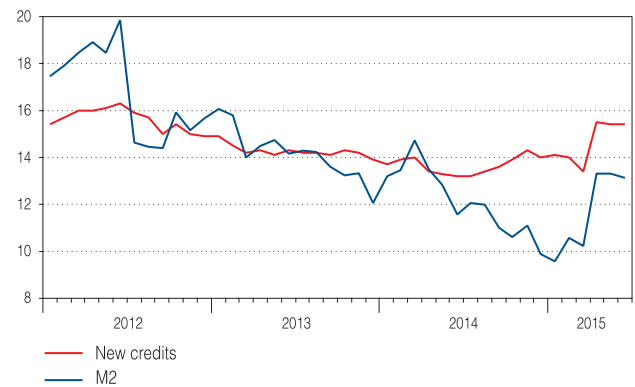
On 11 August the People's Bank of China changed the methodology of determining the CNY/USD daily central exchange rate. After the change the Yuan depreciated by around 4.0 per cent against the US dollar on the spot market in the period to the end of the third quarter. According to the new methodology, the higher number of quotations will be used for calculating the CNY/USD central exchange rate by the primary dealers in China (onshore), thus its value will approach the spot market exchange rate in the over-the-counter market. The central bank stated that this change was a one-off adjustment and in the future, the central exchange rate set on a daily basis would follow more closely the market rate at the end of prior day's trading session.

In October the People's Bank of China announced that it would abandon the restrictions which the banks had to respect until now in determining the interest rate on retail deposits. This change is an important part of the financial sector reform in China. The removal of the restriction is assumed to push up competition between credit institutions, which would help to allocate resources more effectively in the economy.

In the third quarter the downward trend in China's foreign exchange reserves deepened, and they fell by USD 180 billion over the period. Most likely, more serious decreases in international reserves were driven by the central bank interventions in the foreign exchange market in order to limit the further depreciation of the local currency against the US dollar after capital outflows from China. In October this trend was reversed as China's foreign exchange reserves went up USD 11.4 billion to reach USD 3.526 trillion, according to the People's Bank of China data.

Lending and Money Supply in China

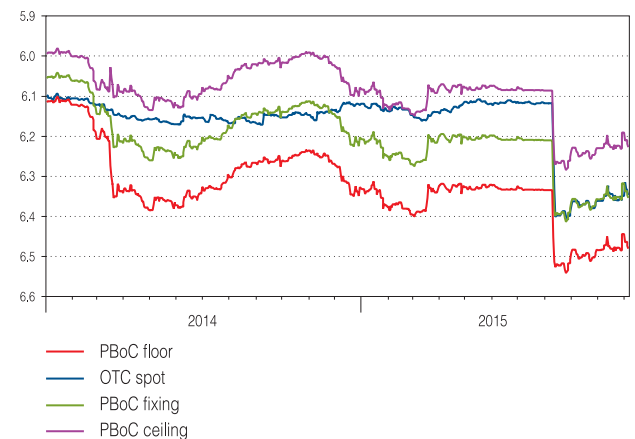
(per cent, on an annual basis)



Source: People's Bank of China

CNY/USD Exchange Rate and Trading Band Set by the People's Bank of China

(CNY/USD)



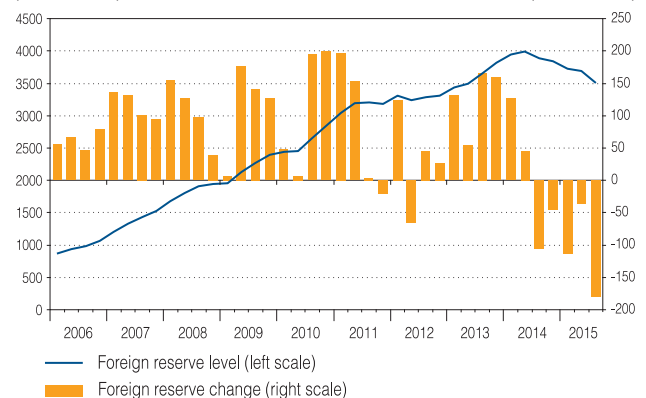
Note: Inverted left-hand scale.

Source: People's Bank of China.

China's Foreign Reserves

(billion USD)

(billion USD)



Source: People's Bank of China.

International Commodity Prices

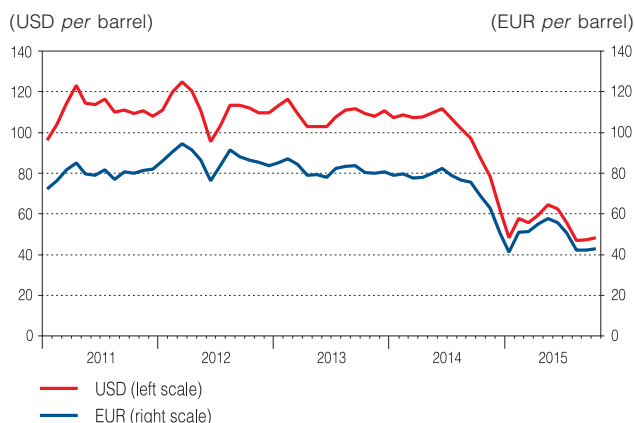
Crude Oil

In the second quarter of 2015 the crude oil price increased on a quarterly basis reflecting mainly the expectations for increased global demand. In the third quarter, however, it fell following changed expectations due to concerns about the slowdown in economic growth of China, the world's second largest oil consumer. The oil supply continued to exceed global demand, with higher oil production from OPEC countries and Russia and the high level of world oil inventories also contributing to oil price falls in the reviewed period. Over the third quarter of 2015 Brent crude oil was traded at USD 50.0 *per barrel* (USD 45.0 *per barrel*) on average, down 19.4 per cent on a quarterly basis compared with the average value in US dollars for the second quarter and 51 per cent on the corresponding period of 2014. In the beginning of the fourth quarter of 2015 the petroleum price rose slightly on a quarterly basis due to the growing concerns about US production decreases and increased tensions in the Middle East.

According to the International Energy Agency (IEA), demand for petroleum products will increase further in 2016, albeit at a lower rate than in 2015. Concurrently, the first sign of more pronounced moderation in non-OPEC countries' production and of a decline in investment in the oil sector appeared over the review period. Growing demand and slowing supply gave grounds to expect a trend to oil price rises from the current levels.

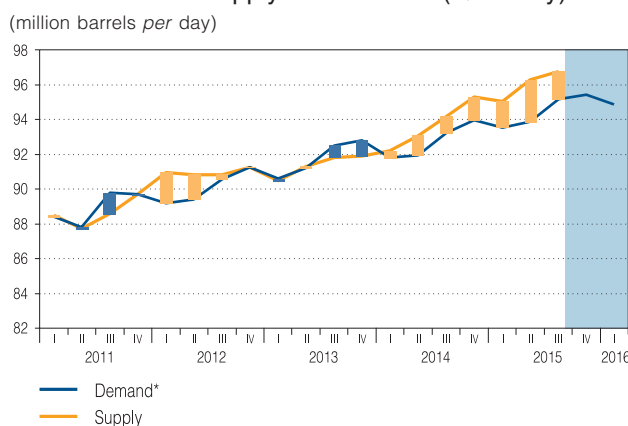
Expectations based on crude oil futures prices in September tended to move upward, which is confirmed by the IEA projection, although the rebalancing of demand and supply in global oil markets will probably take place gradually. Oil prices are expected to move within the range of USD 50–60 *per barrel* in the fourth quarter of 2015 and first quarter of 2016.

Brent Crude Oil Prices



Source: World Bank.

World Crude Oil Supply and Demand (Quarterly)

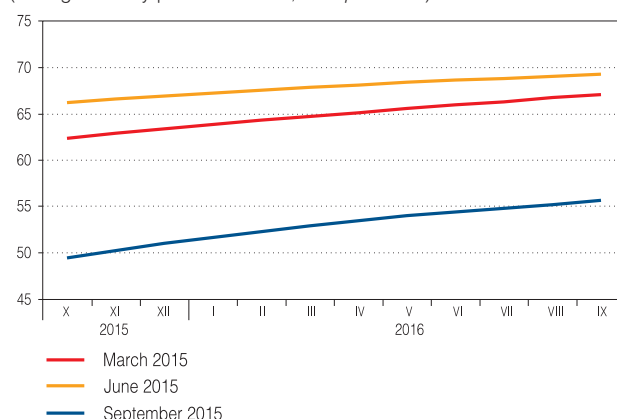


* Including the October 2015 IAE latest available data about crude oil demand.

Source: IEA.

Brent Crude Oil Futures Prices

(average monthly price of contract, USD per barrel)



Source: JP Morgan.

Major Raw Material and Food Prices

In the third quarter of 2015 international prices in US dollars of major commodity groups continued to decline on both annual and quarterly basis. Concurrently, reflecting the 16.1 per cent year-on-year depreciation of the euro against the US dollar, in the third quarter of 2015 certain price indices, such as the composite food index, posted divergent dynamics in euro and US dollars.

The metals price index published by the ECB decreased by 16.9 per cent on an annual basis (a decrease of 30.3 per cent in US dollar) in the third quarter of 2015 and by 11 per cent on a quarterly basis compared to the average value in the second quarter of 2015. At the end of the period the ECB index of metals moved close to the values of the global financial crisis in early 2009. This significant decline was primarily driven by the concerns about a slowdown in economic activity of China, which is a large metal consumer. Additional factors having a downward effect on metal prices were enhanced global supply and inventories. The international copper price in euro, which is a main sub-component of Bulgaria's exports, also went down significantly on both quarterly and annual basis in the third quarter of 2015, reflecting again concerns over decreased demand from China.

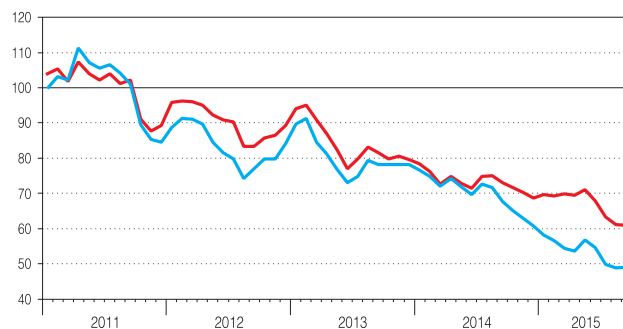
Expectations for prices of industrial metals (ferrous and non-ferrous, excluding precious metals) in euro point to a slowing quarterly decline in the fourth quarter of 2015 and price stabilisation on a quarterly basis in the first quarter of 2016.

In the third quarter of 2015 the food price index in US dollars decreased by 10.7 per cent on the corresponding period of 2014. At the same time, reflecting the depreciation of the euro against the US dollar, the price of food in euro posted an increase of 6.5 per cent. On a quarterly basis, the average food price in the third quarter of 2015 declined on the second quarter of 2015 both in euro and in US dollars. Over the period under review, prices of all index sub-components in US dollars went down on an annual basis due to several factors, as increased global supply, falling energy prices and concerns that the moderation in economic activity in the developing countries will have an adverse effect on consumption of this group's commodities. In

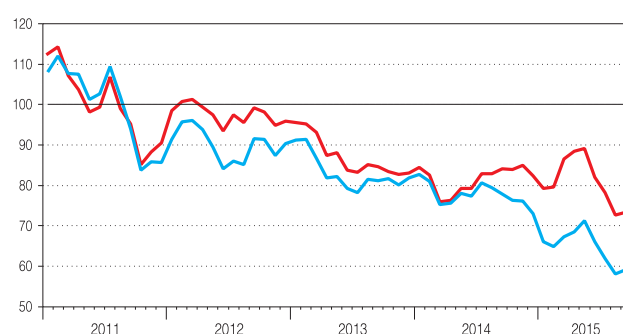
Price Indices of Major Raw Materials and Commodity Groups

(2011 = 100)

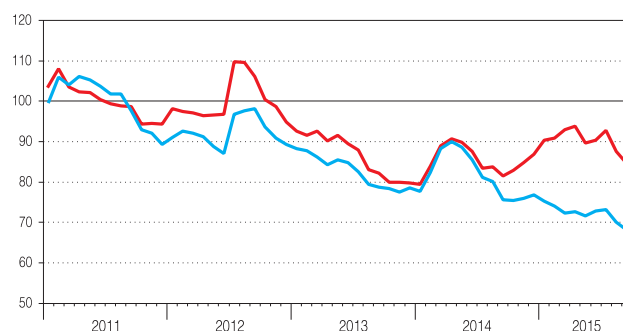
Metals



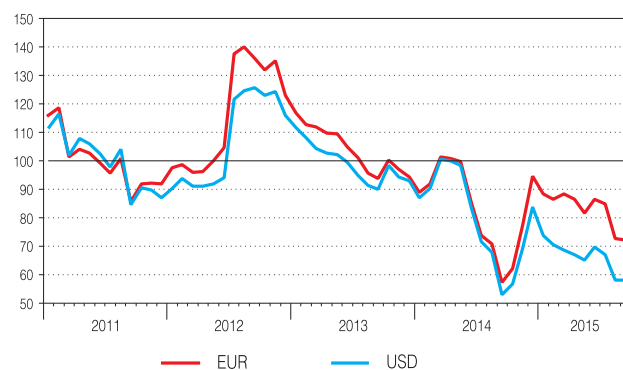
Copper



Food



Wheat



Sources: ECB and BNB calculations.

the third quarter of 2015 the wheat price in euro, which is of main importance for Bulgarian exports, rose by 13.9 per cent on an annual basis mainly due to depreciation of the euro against the US dollar. Over the same period the wheat price in US dollar dropped by 4.7 per cent on an annual basis, reflecting the abundant harvests in the northern hemisphere.

International food prices in euro are expected to continue moderating quarter on quarter in the fourth quarter of 2015 and to stabilise in the first quarter of 2016.

Based on the expected dynamics of major raw material and food prices, the estimation for the projection horizon shows that the terms of trade in Bulgaria will worsen compared to the first half of 2015.

2. Financial Flows, Money and Credit

The overall surplus of the BOP current and capital account increased significantly between January and August 2015 on the same period of 2014. This reflected mainly the decline in the trade deficit and the capital account surplus growth. In the fourth quarter of 2015 and first quarter of 2016 the current and capital account surplus, as a share of GDP, is expected to shrink on an annual basis due to the decreased capital account surplus and increased deficit on the primary income account.

As of September 2015 deposits attracted from residents in the banking system went up to BGN 2.5 billion against end-2014, while the low credit demand and investment profitability outside Bulgaria contributed to maintaining the high level of liquidity in the system. In the fourth quarter of 2015 and first quarter of 2016 declining interest rates on deposits are not expected to have a negative impact on the household savings rate, and attracted funds in the banking system are expected to continue to grow. Growth of loans to the non-government sector is projected to remain low, and it is expected to be around zero by end-2015 and slowly to increase in the beginning of 2016. Interest rates on bank deposits and loans continued to follow a downward trend, which is expected to be retained until the end of 2015 and in early 2016.

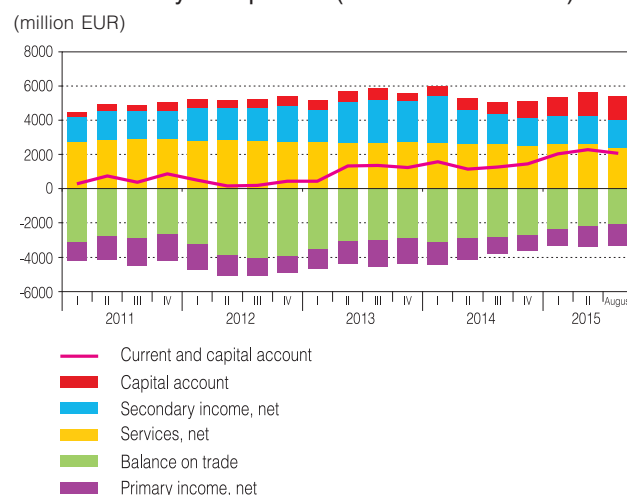
External Financial Flows

The overall surplus of the BOP current and capital account increased significantly between January and August 2015 on the same period of 2014.⁵ This was mainly due to both declines in the trade balance deficit and increases in funds received under EU programmes, especially in March and April, contributing to the capital account surplus growth. The annual fall of the trade balance deficit was determined by the stronger growth of exports (9.1 per cent) compared to that of imports (3.7 per cent), reflecting the favourable terms of trade between January and August 2015 and the exhausted effect of one-off factors that limited real growth rate of exported goods over the same period of 2014. In the first eight months of the year the surplus in services trade balance shrank on an annual basis due to a slight decline in exports of services and growth in imports.⁶

⁵ The analysis in this section is based on statistical data in accordance with the balance of payments analytical reporting, compiled as of 17 April 2015 under the sixth edition of the IMF Balance of Payments and International Investment Position Manual (BPM6).

⁶ For a more detailed analysis of exports and imports of goods and services, see Chapter 3.

Current and Capital Account Dynamics and Contribution by Component (on an Annual Basis)



Source: BNB.

Flows on Balance of Payments Accounts

(million EUR)

	2013	2014	January – August 2015
Current account	765.2	495.2	1 172.9
Trade balance	-2 890.7	-2 734.6	-1 090.7
Services, net	2 735.1	2 530.0	1 876.6
Primary income, net	-1 474.9	-915.7	-987.6
Secondary income, net	2 395.6	1 615.6	1 374.6
Capital account	469.3	959.6	883.7
Financial account	1 421.6	-1 627.3	-357.9
Changes in reserves	-531.8	1 810.4	3 400.8

Source: BNB.

Between January and August 2015 the primary income deficit rose on the corresponding period of 2014. In the second quarter of 2015 outflows from dividends and distributed profit were considerably higher compared to the same period of the previous year, partly reflecting the gross operating surplus growth.

Over the review period the secondary income surplus rose, resulting from the higher inflows to the general government sector linked to the significant growth in grants received under the EU programmes.

In the fourth quarter of 2015 and first quarter of 2016 the balance of payments current and capital account surplus, as a share of GDP, is expected to shrink from the first half of 2015. This decline will be mainly driven by a decrease in the capital account surplus due to the expected lower receipts under the EU programmes and the increased deficit of primary income account due to payments on the investment income item.

Between January and August 2015 the financial account balance was negative. Stronger declines in assets than the reported decrease in liabilities were observed over the same period. Dynamics of financial account assets and liabilities was mainly determined by banks' operations, decreasing both their foreign assets (in the form of currency, deposits and debt securities) and foreign liabilities.⁷

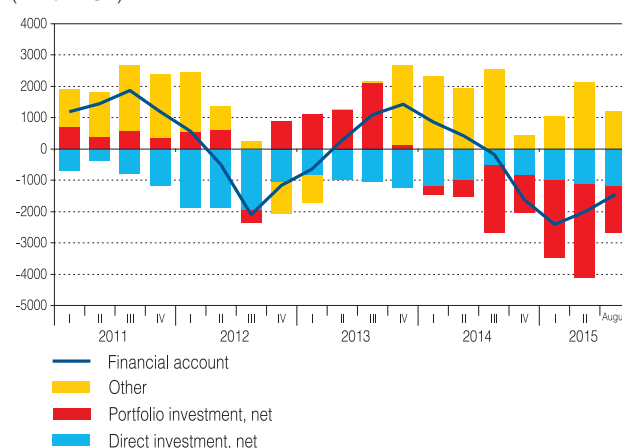
Despite the new Eurobonds issued by the Bulgarian government in March, overall liabilities of the general government sector declined between January and August 2015. This reflected repayments made on government bonds, issued in international capital markets, and on a bridge bank loan disbursed at the end of 2014.

Direct investment liabilities are an important item in the balance of payments financial account as they reflect the foreign direct investment in Bulgaria. Between January and August direct investment liabilities came to EUR 965.4 million,

⁷ A more detailed analysis of banks' behaviour is presented in the Monetary and Credit Aggregates Section of Chapter 2.

Financial Account Dynamics and Contribution by Component (on an Annual Basis)

(million EUR)



Note: The Other item includes Other Investments, net, and Financial Derivatives (Other than Reserves) and Employee Stock Options, net.

Source: BNB.

Banks' Flows on Balance of Payments Financial Account

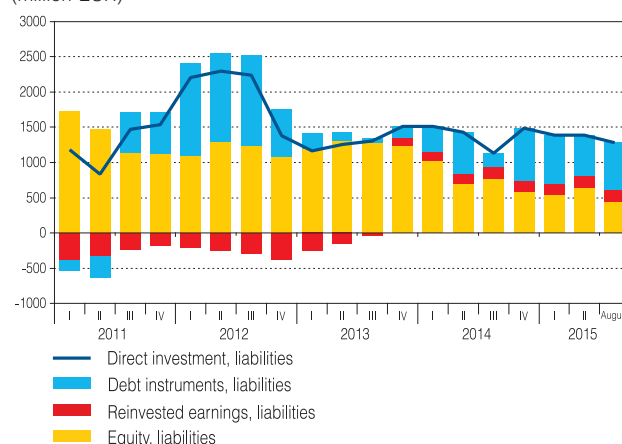
(million EUR)

	2013	2014	January – August 2015
Direct investment			
assets	18.1	35.0	-1.5
liabilities	109.1	106.1	122.3
Portfolio investment			
assets	292.3	-309.4	-878.9
liabilities	67.0	-50.6	1.9
Other investment			
assets	2 007.5	1 238.2	-1 142.0
liabilities	-811.7	-295.6	-1 395.6
Assets, total	2 318.0	963.8	-2 022.4
Liabilities, total	-635.6	-240.1	-1 271.4
Assets, net	2 953.6	1 203.9	-751.0

Source: BNB.

Direct Investment Liabilities by Type of Investment (on an Annual Basis)

(million EUR)



Source: BNB.

with more substantial inflows observed in the sub-item of debt instruments of the non-financial sector.

In August 2015 BOP data⁸ showed that financial inflow and outflow dynamics boosted international reserves to EUR 3400.8 million on an annual basis. The international reserve coverage of the average nominal imports of goods and non-factor services over the last 12 months increased to 8.4 months (7.1 months by end-2014).

In August Bulgaria's gross external debt posted a decline from December 2014. Decreased inter-company loans had the major contribution to this fall, reflecting the unilateral write-off of a claim by a foreign creditor⁹ and lower bank debt. The share of the long-term debt in total gross external debt expanded from the end of 2014 mainly due to the new government debt issued in international financial markets in March.

In the context of declining international market interest rates, both access to new external financing and resident debt service improved between January and July 2015. Over the review period an annual increase was reported in financial credit transactions declared by non-residents along with a decrease in external debt service costs paid by residents.

Monetary and Credit Aggregates

Monetary and credit aggregate developments in the first nine months were driven by the retained high savings rate of households and increased resident deposits in the banking system, comparatively weak demand for bank loans and lack of investment alternatives outside Bulgaria amid declining euro area yields.

At the end of September the broad monetary aggregate M3 rose by BGN 3.4 billion from the end of 2014. The analysis of individual com-

⁸ Valuation adjustments and price revaluation excluded.

⁹ See *Gross External Debt, August 2015* publication on the BNB website: http://bnb.bg/Statistics/StExternalSector/StGrossExternalDebt/index.htm?toLang=_EN

Gross External Debt in August 2015

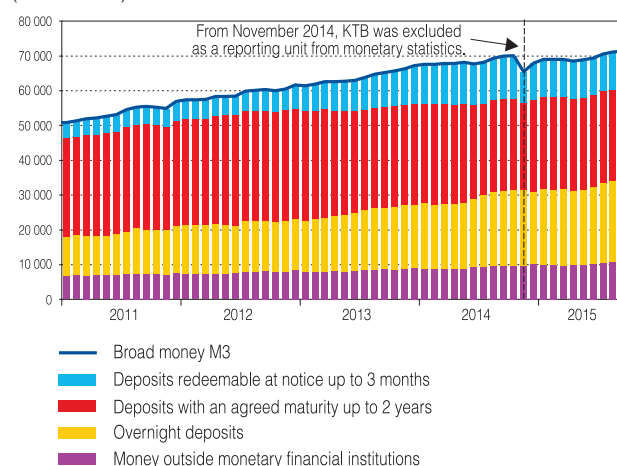
(million EUR)

	Amount	Change	
		Since December 2014	For the last 12 months
General government	5 909.8	-116.7	1 151.0
Central bank	0.0	0.0	0.0
Banks	4 185.8	-1 281.4	-1 377.1
Other sectors	11 717.5	-267.4	-250.6
FDI: inter-company loans	13 577.5	-2 300.3	-2 698.1
Total	35 390.7	-3 965.7	-3 174.7

Source: BNB.

M3 and Contribution of Individual Components

(million BGN)

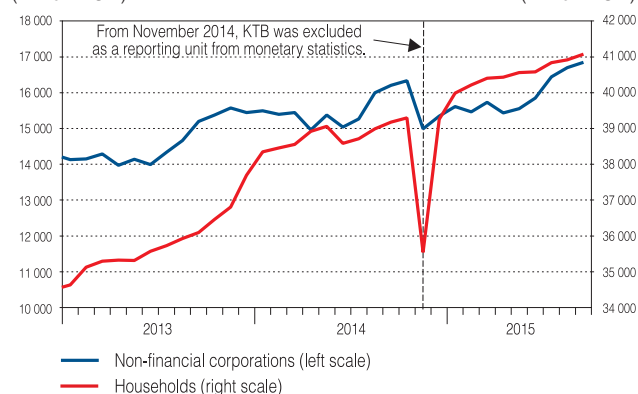


Note: The contribution of marketable instruments is not shown on the chart due to their insignificant contribution to broad money growth.

Source: BNB.

Deposits of Non-financial Corporations and Households

(million BGN)



Source: BNB.

ponents shows that increases were observed mainly in overnight deposits and, to a lesser degree, in money outside MFIs, while quasi-money posted only slight growth.

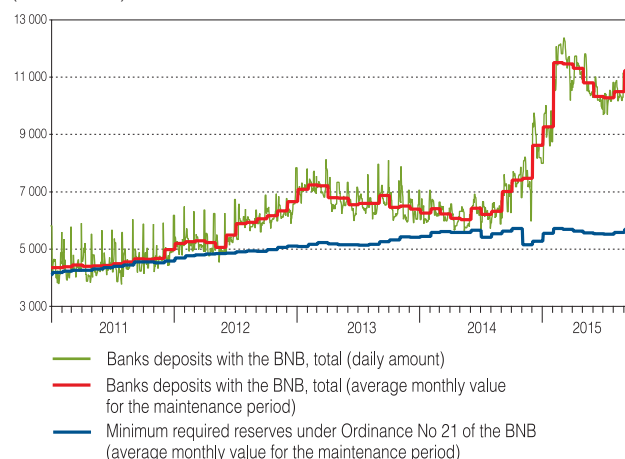
The structure of household deposits was influenced by interest rate developments and the expanded scope of deposit interest tax since early 2015. Households deposited their savings primarily into time deposits. On the background of the overall downward trend in deposit rates, more significant declines were observed in the rates on deposits redeemable at notice compared to other deposit rates, an incentive for households to shift their savings increasingly into longer-term deposits. Another depositing option involved high-liquid overnight deposits. As regards the currency structure of household deposits, lev-denominated deposits contributed most strongly to the overall growth.

Non-financial corporations, unlike households, continued to direct their free funds mainly in overnight deposits, while deposits with an agreed maturity recorded a fall for the first nine months of the year. The currency structure of deposits of firms shows that lev-denominated deposits had the major contribution to their overall growth.

The effective implicit rate of minimum required reserves reached 9.21 per cent in September,¹⁰ with bank reserves with the BNB comprising 8.05 percentage points, and the remaining 1.16 percentage points being formed by cash holdings and funds on banks' settlement accounts in the TARGET2-BNB system.¹¹ The liquid asset ratio¹² of the banking system rose to 34.02 per cent, from 30.12 per cent at the end of 2014. In September excess reserves on banks' minimum reserve accounts with the BNB over the required minimum under Ordinance

Bank Deposits with the BNB

(million BGN)

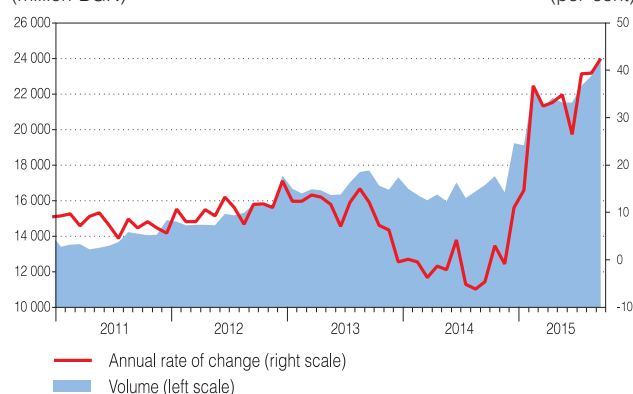


Source: BNB.

Reserve Money

(million BGN)

(per cent)

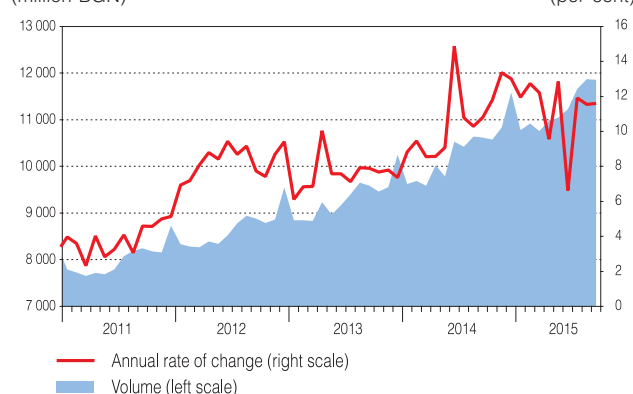


Source: BNB (monetary statistics).

Currency in Circulation

(million BGN)

(per cent)



Source: BNB.

¹⁰ According to Article 3, paragraph 1 of BNB Ordinance No 21, the rate of minimum required reserves for funds attracted from residents is 10 per cent of the deposit base, from non-residents 5 per cent and from the state and local government budgets 0 per cent.

¹¹ See Article 4 of Ordinance No 21 of the BNB.

¹² See Ordinance No 11 of the BNB.

No 21 came to 96.7 per cent on an average daily basis (56.5 per cent in December 2014).

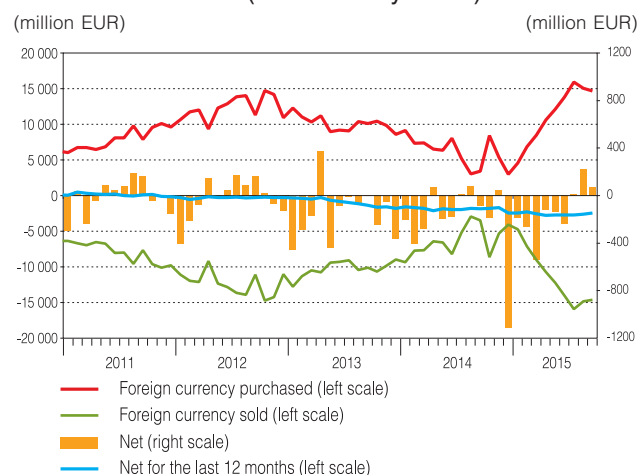
Over the first nine months reserve money posted high growth, its rate of increase reaching 25.0 per cent in September *vis-à-vis* end-2014. Bank excess reserve growth and increased banknotes and coins in circulation had the major contribution to money supply dynamics. In September the growth rate of currency in circulation was 2.3 per cent from end-2014.

Another instrument for banks to manage their liquidity was foreign currency trading with the BNB. Over the third quarter bank sales exceeded purchases of foreign currency. As of September net purchases of banks from the BNB were EUR 2.5 billion for the last twelve months.

Demand for loans by corporations and households remained weak despite the continued decline in interest rates on bank loans. At the same time, banks were cautious about their lending policy and retained the high level of some lending standards. In the first nine months claims on the non-government sector declined by 0.2 per cent from end-2014, reflecting mainly the decreased credit to non-financial corporations and, to a lesser degree, lower household loans. Net sales of loans by banks also pushed down claims on the non-government sector.

Over the first nine months of 2015 the volume of new loans to NFCs was lower than a year earlier, though remaining at levels above BGN 1 billion on average for the last twelve months. As regards the currency structure of new corporate loans, the upward trend in lev-denominated new loans was sustained at the expense of those denominated in euro and US dollars. For the last twelve months as of September, the share of new lev-denominated corporate loans went up to 43.2 per cent of total new loans extended to non-financial corporations. Concurrently, the share of loans denominated in euro fell to 54.2 per cent of all new loans, whereas that of US dollar-denominated loans was 2.6 per cent.

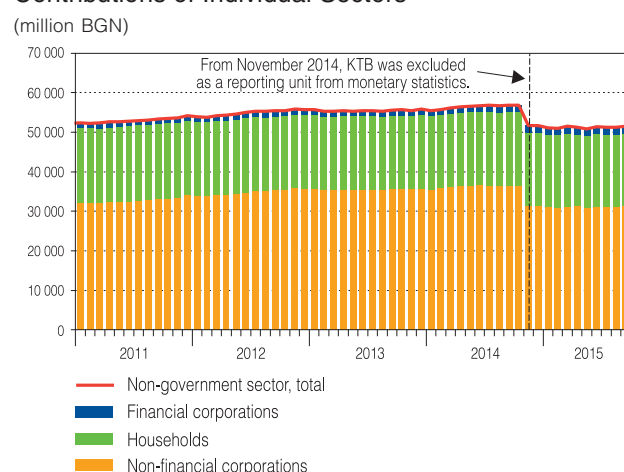
Foreign Currency Purchases and Sales between the BNB and Banks (on a Monthly Basis)



Note: Net means currency bought by the BNB less currency sold by the BNB. Data refer to all bank transactions in foreign currency, including liquidity management operations related to the transfer of own funds from lev accounts with the BNB to own accounts with the BNB in euro and *vice versa*.

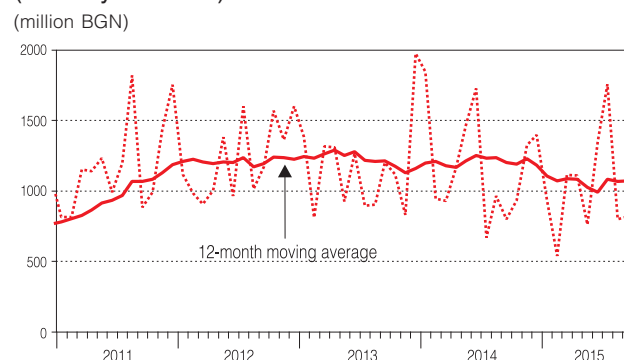
Source: BNB.

Receivables from the Non-government Sector and Contributions of Individual Sectors



Source: BNB.

New Loans to Non-financial Corporations* (Monthly Volumes)



* For data characterised by significant fluctuations, additional moving averages computed for suitably selected periods are provided in order to smooth the fluctuations in corresponding time series and present the trends in their development.

Source: BNB.

In September the pace of change in lending to households came to -0.2 per cent on end-2014, though from March a low growth rate was observed on a monthly basis. Lending to households in September dropped by 1.4 per cent on an annual basis, this decline affecting all categories, except for consumer loans which has been recovering since March. In September the strongest annual fall was recorded in other loans and significantly lower declines in overdrafts and housing loans. New loans to households showed an increase in volumes over the first nine months, driven mainly by the upward trend in housing loans followed by consumer credit, to a lesser extent. Volumes in other loans, however, remained broadly unchanged from the end of 2014.

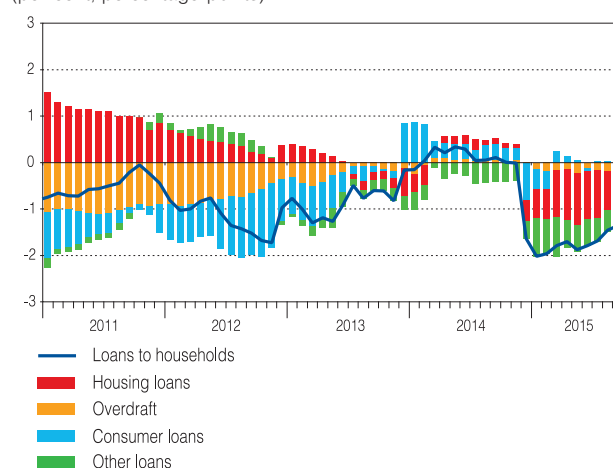
According to BNB quarterly lending survey results, over the second quarter of 2015 banks reported an increase in demand for loans by corporations to meet the needs for working capital and inventories, and greater demand by households for consumer rather than housing loans. Bank expectations for July–September show that demand for corporate, consumer and housing loans will increase.

Over the second quarter banks eased their corporate lending policy with regard to interest rates and fees and commissions, while tightening standards for the maximum credit amount and risk premiums. As for housing loans, their standards were eased, while bank policies in the area of consumer loans remained unchanged from the first quarter. Lower costs of attracted resources and their increased amount, enhanced competition from other banks and lack of high-yield alternative investment were the main factors contributing to easing the credit standards, according to the survey. Concurrently, the uncertain macroeconomic environment, credit and collateral risks also called for tightening. In the third quarter banks expect their credit policy toward corporations and households to be eased.

Over the fourth quarter of 2015 and first quarter of 2016 funds attracted by residents are expected to continue growing and liquidity to

Annual Growth of Loans to Households and Contribution by Type of Loans

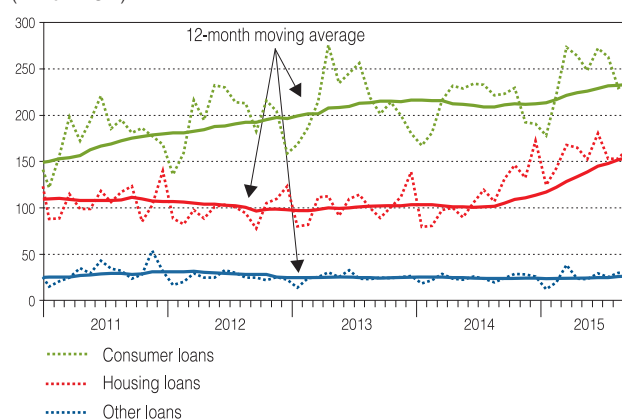
(per cent; percentage points)



Source: BNB.

New Loans to Households (Monthly Volumes)

(million BGN)



Source: BNB.

remain high. In the context of negative short-term interest rates in the euro area and lack of investment alternatives, banks are expected to continue maintaining high excess reserves on their accounts with the BNB. Until the end of the year, no significant change in lending to the non-government sector is anticipated, and its annual growth rate may be around zero by the end of 2015. From the first quarter of 2016, expectations are for a slow increase in lending to the private sector in line with the projected gradual recovery of economic activity and positive effects of relatively low lending interest rates.

Interest Rates

In the first nine months, amid low credit demand and limited alternatives for high-yield investment in international markets, the continuous increase in funds attracted from residents contributed to the growth in banking system liquidity and declines in money market rates. Interbank money market interest rates decreased from December 2014 across all maturities, with longer-term maturities posting stronger declines.

From the year start EONIA continued to follow a downward trend with deepening negative values, unlike LEONIA which retained its close to zero levels. As a result of developments in both indices, the positive spread between them formed in August 2014 continued to widen, reaching in September 15 basis points on average.

Over the first nine months interbank three-month deposit rates in the euro area and Bulgaria continued to decline, turning negative in the euro area since May.¹³ Over the review period the average three-month SOFIBOR and SOFIBID, and EURIBOR indices decreased at an even rate, thereby retaining the spread between them. Downward developments were also observed in longer-term interest rates in the interbank money market. Six-month and

¹³ The analysis is based on the average value between the quotations of SOFIBOR and SOFIBID of unsecured three-month deposits in levs.

Changes in Credit Standards

a) Applied to Corporate Loans

(balance of opinions)



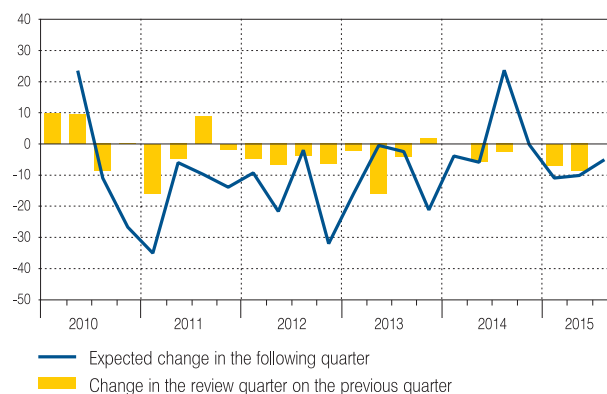
b) Applied to Consumer Loans

(balance of opinions)



c) Applied to Housing Loans

(balance of opinions)



Note: The charts present banks' balance of opinions defined as a difference in percentage points between the percentage of banks responding 'tightened considerably' and 'tightened somewhat' and the percentage of banks responding 'eased considerably' and 'eased somewhat'. All responses are weighted according to banks' market share in the respective credit segment. The expectations are shown in the charts by shifting the data a quarter forward.

Source: BNB.

12-month deposit rates between December 2014 and September 2015 declined by 17 and 30 basis points, respectively.

Interest rate dynamics in new deposits to households and non-financial corporations remained on the downside. Compared to December 2014, the cost of attracted funds posted a decline in both sectors, with household deposit rates falling more significantly. In September 2015 the average weighted interest rate on new time deposits of non-financial corporations and households accounted for 1.2 per cent (2.1 per cent in December 2014).

Interest rates on new time deposits by type of currency continued to follow a downward tendency in all currencies: in September more significant falls were recorded in lev and euro-denominated deposits and lower in US dollar-denominated deposits. The share non-financial corporations and households' deposits on balances in foreign currency, the bulk of which in euro, remained unchanged from end-2014, reaching 42.7 per cent in September.

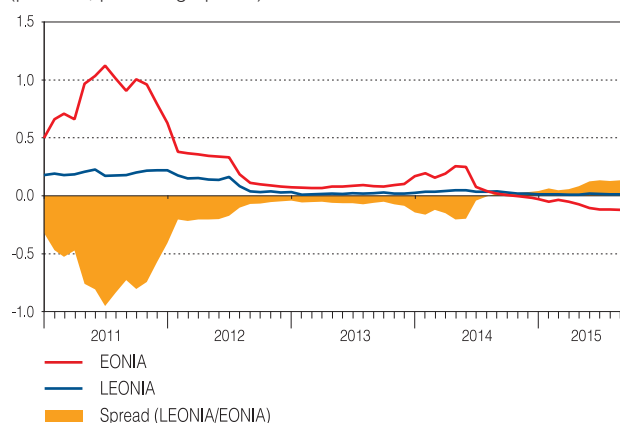
The distribution of interest rates on new time lev deposits across banks shows that the average rate was below 3 per cent. The number of banks concluding new deposit agreements at a rate within the 2 to 3 per cent band decreased at the expense of the increased number of banks offering rates of up to 1 per cent and within the 1 to 2 per cent band. Between May and September the average interest rate level dropped by 13 basis points to 1.54 per cent and the standard deviation contracted by 14 basis points to 0.72 per cent.

The continuous weak credit activity in the context of rising liquidity of the banking system was the major factor behind progressively falling interest rates on new loans. The downward dynamics in interest rates on new loans to households and non-financial corporations was consistent with the assumption of credit standard easing for interest rates, as shown in the bank lending survey of the BNB. At the same time, lending interest rate declines tended to be lower than deposit rate falls. Compared with

Interbank Money Market Interest Rates

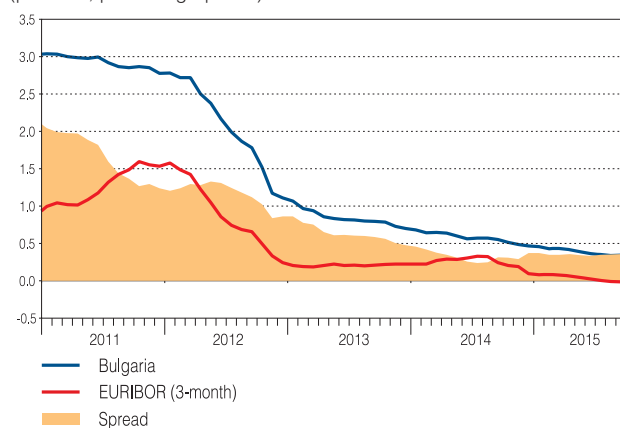
a) Overnight Deposits

(per cent; percentage points)



b) Deposits with a Maturity of Three Months

(per cent; percentage points)

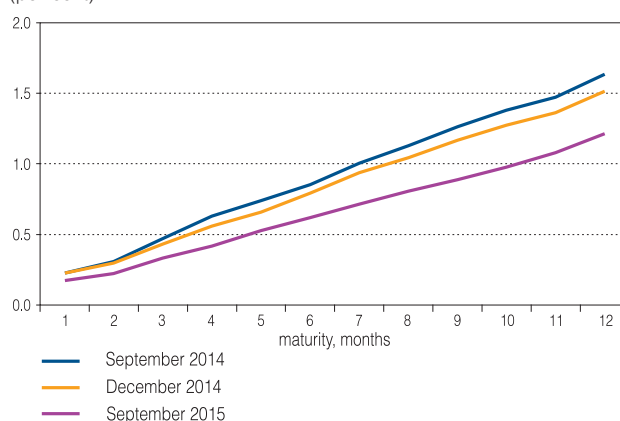


Note: The values for Bulgaria reflect the average value of SOFIBOR and SOFIBID of unsecured three-month deposits in levs.

Source: BNB, ECB.

Interbank Money Market Yield Curve

(per cent)



Note: The values reflect the average value of SOFIBOR and SOFIBID of unsecured deposits in levs.

Source: BNB.

the end of 2014, rates on loans to non-financial corporations went down in the three major currencies: lev, euro and US dollars. In September interest rates on new lev and euro original currency loans were 6.9 and 6.6 per cent,¹⁴ while those on dollar-denominated loans came to 7.8 per cent.

Over the first nine months the downward trend in the annual percentage rate of charge (APRC) on new household loans was retained in both consumer and housing lending. From the year start both interest and non-interest charges on these loans decreased, with interest rate declines contributing stronger to the APRC drop. In September APRC on consumer loans was 11.6 per cent and on housing loans 6.7 per cent.¹⁵ Between January and September the decline in interest rates on consumer and housing loans was 56 basis points and that in the implicit rate of non-interest service charges, 18 and 16 basis points, respectively.

The breakdown of interest rates on newly extended housing loans in euro shows that the average interest rate did not exceed 8 per cent in September. Compared to May, the number of banks offering loans at a rate of 6 per cent increased at the expense of the decreased number of banks crediting at interest rates within the 7–8 and 8–9 per cent band. Over the same period, the average interest rate level fell by 45 basis points to 5.84 per cent, and the standard deviation remained unchanged.

In the last quarter of 2015, as in the first three months of 2016, the downward trend in interest rates is expected to continue.

In the context of relatively low supply of primary government bond market over the third quarter, yields on three and five-year government secu-

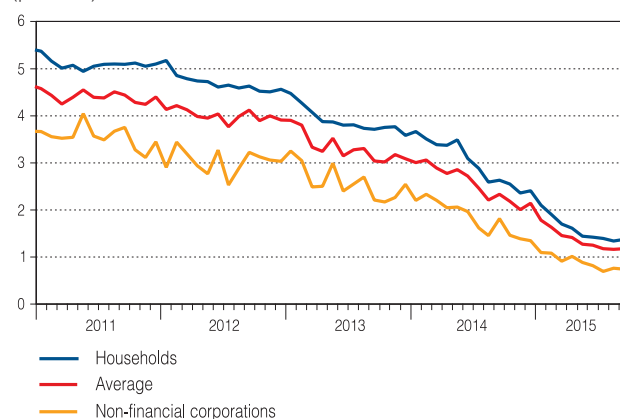
¹⁴ The above values are weighted averages of the interest rates on loans to non-financial corporations on a 12-month basis.

¹⁵ Values indicating APRC and interest rates are weighted averages of the interest rates on household consumer and housing loans on a 12-month basis.

Interest Rates on New Time Deposits

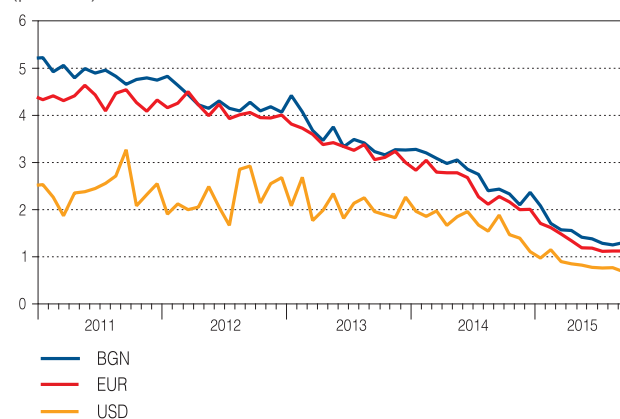
a) By sector

(per cent)



b) By currency

(per cent)

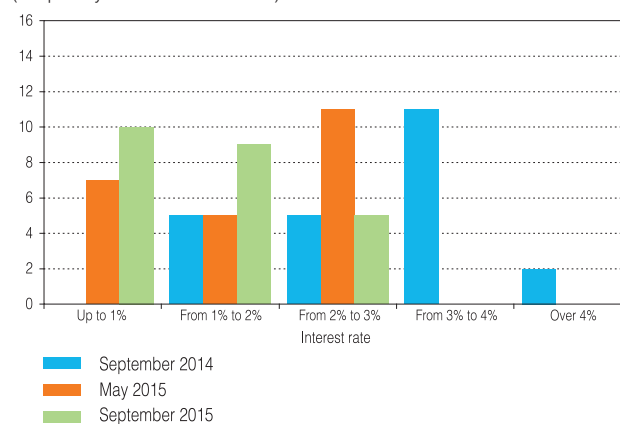


Notes: The average interest rate is calculated for all sectors, maturities and currencies weighted by the relevant volumes of new deposits.

Source: BNB.

Distribution of Interest Rates on New Household Time Lev Deposits

(frequency – number of banks)



Source: BNB.

rities declined from 0.68 and 1.28 per cent in May to 0.49 and 0.94 per cent in September.¹⁶

By end-October the long-term interest rate in the secondary government securities market remained unchanged at 2.36 per cent. Between April and October no transactions in the benchmark issue were concluded in the secondary market due to the insignificant issued volume in circulation and investor preferences in euro-denominated government bond trading.

In line with EU yield government bond developments, all Bulgarian Eurobond yields increased in most of the second quarter. Since mid-July, however, this trend has reversed toward a moderate decline and stabilisation.¹⁷

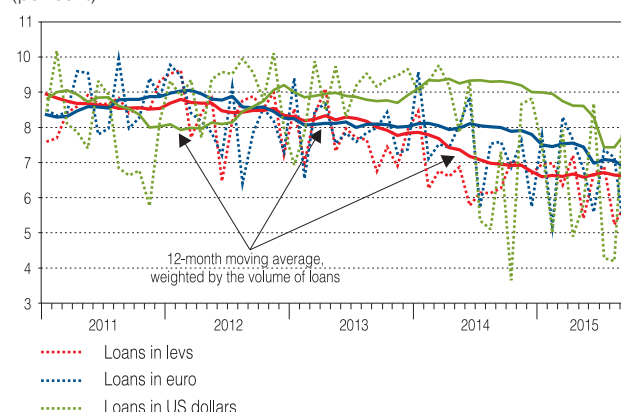
At the end of 2015 and early 2016 a slight yield decline in the short end of the maturity curve is expected along with stable yields of medium and longer-term securities. Given the significant volumes of maturing government securities in December 2015 (BGN 782.4 million), January 2016 (BGN 460.8 million) and March 2016 (BGN 417.6 million), demand for government securities in both primary and secondary markets is likely to increase.

¹⁶ In the third quarter the MF organised three auctions (in September) and did not approve the bids received for one auction. As a result, the net issue was negative and corresponded to the full budget financing after issuing large volumes of new Eurobonds in international capital markets in March and given the expected accumulation of a budget surplus for the first nine months.

¹⁷ Solely yields of securities maturing in 2017 posted a stable downward trend since the year start which may be explained by the low residual maturity of the issue.

Interest Rates on New Loans to Non-financial Corporations by Currency

(per cent)



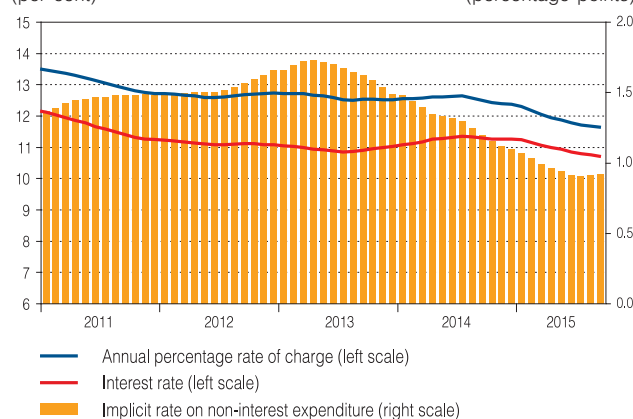
Source: BNB.

Interest Rates and Annual Percentage Rate of Charges on New Household Loans

a) Consumer Loans

(per cent)

(percentage points)

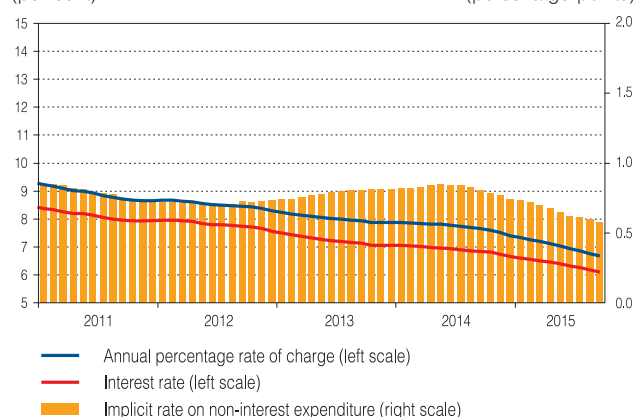


Source: BNB.

b) Housing Loans

(per cent)

(percentage points)



Notes: Interest rates in all maturities and currencies are weighted by the relevant volumes of new loans for a 12-month period. The implicit rate is the difference between the APRC and the relevant interest rates and reflects the approximate rate of all non-interest service charges on loans (including fees and commissions).

Source: BNB.

Financial Flows between the General Government and the Other Sectors of the Economy

Government revenue and expenditure policy and budget financing operations affect the allocation of liquidity among economic sectors.¹⁸

In the second quarter inflows from the external sector to the budget were 5.8 per cent of GDP and included grants under EU programmes (BGN 1194.1 million), which exceeded significantly the negative external debt financing (BGN 43.6 million) and the EU budget contribution (BGN 203.4 million) for the quarter. The banking sector (excluding the BNB) again was a net source of liquidity to the budget amounting to 2.3 per cent of GDP over the quarter, reflecting mainly the positive net issue of government securities (BGN 150 million) for the April to June period.¹⁹

Financial flows attracted from the external and financial sector (excluding the BNB) were primarily used to increase the government deposit with the BNB (by BGN 1061.2 million for the quarter). In April the excess of revenue over expenditure of the BNB deposited in favour of the budget was BGN 48.6 million, boosting the net inflow of liquidity from the budget to the BNB to BGN 1012.6 million.

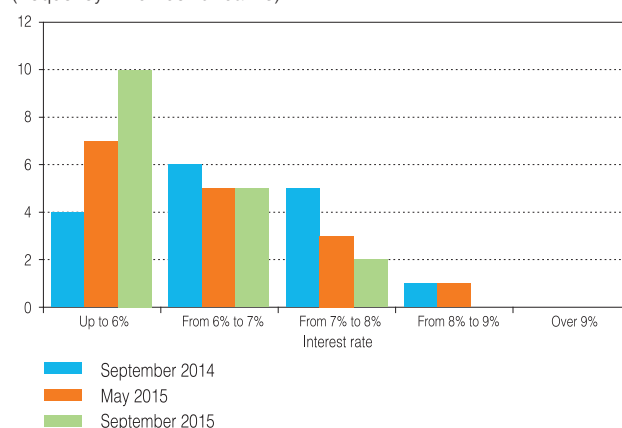
Preliminary monthly data as of the beginning of October 2015 indicate that in the third quarter the government deposit with the BNB (down BGN 806.4 million between July and September) was the main source of liquidity for the budget. Net flows from the external sector will continue to be positive, though limited in amount, and funds received on EU programmes should exceed the period's contribution to the EU budget for the quarter and interest payments to non-residents, the bulk of which paid on benchmark bonds maturing in 2024. As a

¹⁸ For more details on financial flows between the budget and other sectors, see *Economic Review*, May 2004, p. 28. The sign '+' of the respective financial flow indicates that as a result of its operations, the budget provided net funds to the respective sector, while the sign '-' means that the budget withdrew net funds from the respective sector.

¹⁹ During the review period, no payments were made on maturing government securities.

Distribution of Interest Rates on New Housing Loans in Euro

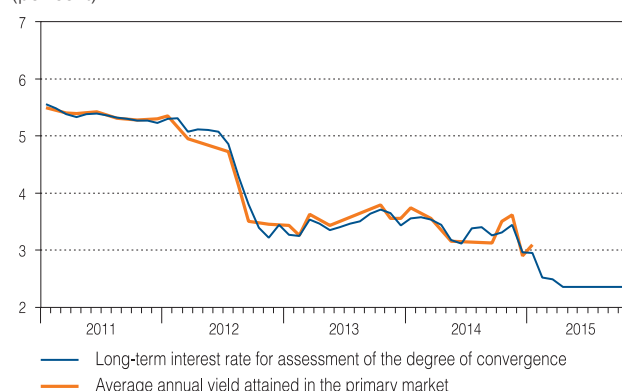
(frequency – number of banks)



Source: BNB.

Interest Rates on Ten-Year-and-Six-Month Government Bonds in the Primary and Secondary Markets

(per cent)



Source: BNB.

result mainly of the negative net issue of government securities in the domestic market, the banking sector (excluding the BNB) is expected to be a net beneficiary of liquid funds from the budget. The main portion of the funds coming from both the decreased government deposit and the external sector is expected to be redirected to the non-government non-bank sector.

Developments in financial flows generated in the process of interaction between external and internal economic factors contributed to the growth in international foreign exchange reserves. By end-September the market value of international reserves²⁰ (assets on the Issue Department balance sheet) rose by EUR 4569.3 million to EUR 20.1 billion (BGN 39.4 billion). According to the currency board principles, the increase in international reserves corresponded to the increase in the Issue Department balance sheet liabilities.²¹ Liabilities to banks and to the government and other budget organisations contributed most significantly to the growth in the Issue Department balance sheet, while currency in circulation had a lower contribution.

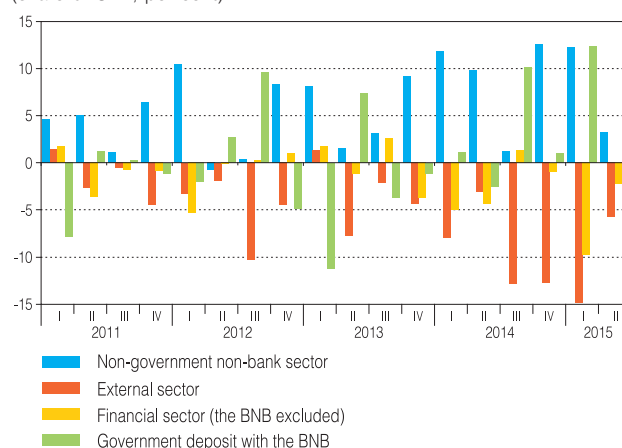
In the fourth quarter of 2015 and first quarter of 2016 international reserve developments will be driven by the fall in the government deposit resulting from expected end-year budget deficit financing. Bank deposits with the BNB will retain their comparatively high levels due to the limited investment alternatives in Bulgaria and abroad. Currency in circulation is projected to post comparatively high growth with a tendency toward a gradual slowdown.

²⁰ The market value of international reserves includes changes stemming from transactions, valuation adjustments and price revaluation.

²¹ According to Article 28, paragraph 1 of the Law on the BNB, 'the aggregate amount of monetary liabilities of the BNB shall not exceed the lev equivalent of gross international reserves,' with the lev equivalent calculated on the basis of the fixed exchange rate.

The Effect of Consolidated Budget on Other Sectors' Liquidity (Quarterly)

(share of GDP, per cent)



Sources: MF, BNB.

3. Economic Activity

In the second quarter of 2015 quarterly growth of real GDP decelerated on the previous quarter, accounting for 0.5 per cent.²² Over the same quarter government consumption and gross fixed capital formation posted the highest growth. The change in inventories also contributed positively to the growth. Private consumption retained its previous quarter's level. Net exports contributed negatively to the growth as the quarterly decrease in goods and services exports outstripped that in goods and services imports.

Short-term economic indicators over the third quarter of 2015 give mixed signs about economic developments. If the household sentiments remain positive and the labour market continues to recover, private consumption may be expected to grow on a quarterly basis in the fourth quarter of 2015 and first quarter of 2016. Positive sentiment and business expectations would result in an increase in private investments. Government consumption is expected to rise at slow rates over the same period. Goods and services imports are expected to increase at slightly higher rates than exports of goods and services. The above mentioned component dynamics shows that in the fourth quarter of 2015 and first quarter of 2016 quarterly GDP growth is expected to remain close to that in the first half of 2015.

Current Economic Environment

In the second quarter of 2015 quarterly growth of real GDP decelerated on the previous quarter to 0.5 per cent, according to seasonally adjusted NSI data.²³ Among GDP sub-components, government consumption experienced the strongest growth. Gross fixed capital formation also went up quarter on quarter, driven by the significant growth rate of government investment. Changes in inventories also contributed positively to the growth. Private consumption retained its previous quarter's level. Net exports contributed negatively to the growth as the quarterly decrease in goods and services exports outstripped that in goods and services imports.

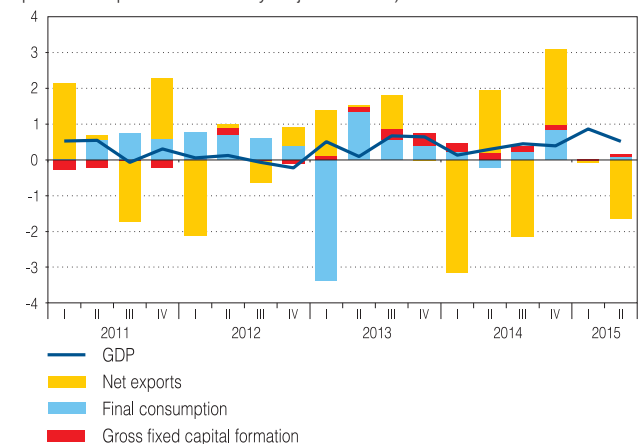
Short-term economic indicators over the third quarter of 2015 give mixed signs about economic developments. On the one hand, retail trade volumes posted quarter-on-quarter declines in both second and third quarters. On the other hand, there are preconditions to expect an increase in household consumption over the coming quarters: the indicator of household confidence was retained at a

²² See Note 1.

²³ The quarter-on-quarter analysis in this section employs seasonally adjusted data, unless otherwise indicated. The seasonal adjustment of indicators, on which the NSI or Eurostat do not officially publish seasonally adjusted data, was made via the TRAMO SEATS or OxMetrics programmes by using automated set up for diagnostics and optimisation of adjustment parameters.

Contribution to GDP Growth by Final Use Component

(per cent, percentage points, quarter-on-quarter seasonally adjusted data)



Note: Non-additive data due to direct chain-linked and seasonal adjustment of GDP and its components; the contribution of the change in inventories has not been included.

Sources: NSI, BNB calculations.

comparatively high level, growth in compensation *per* employee accelerated and the unemployment rate continued to decline. Based on these assumptions, in the fourth quarter of 2015 and first quarter of 2016 private consumption is expected to rise on a quarterly basis.

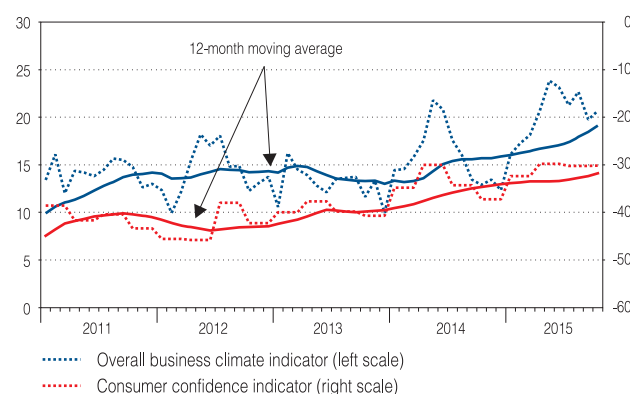
The business climate indicator tracking business sentiment went down in the third quarter of 2015, though remaining at comparatively high levels. In October this indicator increased, with improvements observed in all sectors, except for services. Positive sentiment and expectations of firms amid retained high production capacity utilisation give grounds to expect firms to gradually recover their investment activity. The uncertain economic environment continued to be a limiting factor for the firms in all sectors which is likely to increase the uncertainty about their plans to hire personnel and invest in the future. Private investment is projected to recover in the context of positive business sentiment and expectations, as well as in a continuous period of high production capacity utilisation in industry.

Government consumption is expected to rise at low rates until the end of 2015 and in early 2016.

Goods and services imports are projected to increase at slightly higher rates than exports of goods and services.

Based on the above component dynamics, in the fourth quarter of 2015 and first quarter of 2016 quarterly GDP growth is expected to

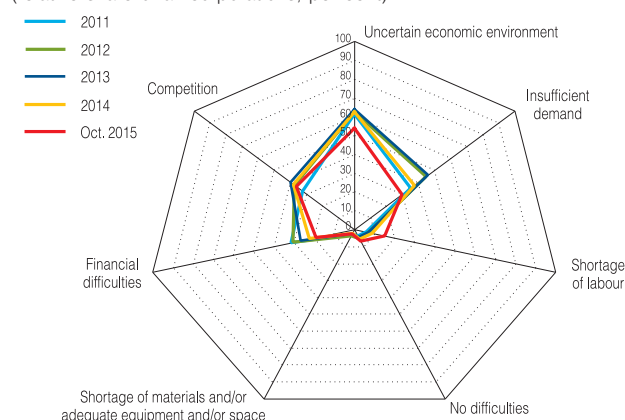
Business Climate and Consumer Confidence



Sources: NSI, BNB calculations.

Factors Limiting Economic Activity of Corporations

(relative share of all corporations, per cent)



Note: Data for 2011–2014 are average for the period and sector-weighted (industry, construction, trade and services).

Sources: NSI, BNB calculations.

Real GDP Growth by Component of Final Use

(per cent on the previous quarter; real rate, seasonally adjusted data)

	2012				2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Consumption	1.0	0.9	0.7	0.5	-4.1	1.7	0.7	0.5	0.3	-0.3	0.3	1.1	0.0	0.1
incl.														
Household consumption	2.0	0.6	0.1	-0.4	-2.2	0.7	-0.3	0.4	1.3	-0.4	0.4	0.9	0.2	0.0
Final government consumption expenditure	4.7	-6.2	0.8	-0.2	-0.3	4.9	-3.4	-2.5	7.5	1.9	-2.1	1.5	-3.1	6.1
Collective consumption	-0.6	0.7	0.5	1.6	1.2	0.8	0.9	-0.1	0.5	0.4	0.2	0.5	-0.4	0.0
Gross fixed capital formation	0.0	1.0	-0.2	-0.4	0.5	0.7	1.4	1.6	1.1	0.9	0.7	0.6	-0.1	0.4
Exports of goods and non-factor services	-5.9	6.6	-1.4	0.8	5.8	1.3	3.3	-0.1	-2.2	2.2	-2.6	8.3	4.8	-3.9
Imports of goods and non-factor services	-2.3	6.1	-0.4	-0.1	3.5	1.2	1.8	-0.1	2.6	-0.5	0.7	4.6	4.7	-1.6
Real GDP growth	0.1	0.1	-0.1	-0.2	0.5	0.1	0.7	0.6	0.1	0.3	0.4	0.4	0.9	0.5

Source: NSI.

remain close to that in the first two quarters of 2015.

Based on quarterly developments, over the fourth quarter of 2015 real annual growth is projected to stay close to that in the second quarter and to slightly moderate in the first quarter of 2016. Net exports are expected to have the largest positive contribution to the growth followed by private consumption and gross fixed capital formation.

The external environment remains a source of uncertainty for the projection. Slower than expected growth rates in Bulgaria's major trading partners would contribute to lower domestic growth, while longer than expected retention of international oil prices at low levels may have a positive contribution, thereby boosting consumption and decreasing production costs of corporations. If firms continue to invest cautiously and the expected recovery of private investment is postponed, that will result in lower than expected economic growth.

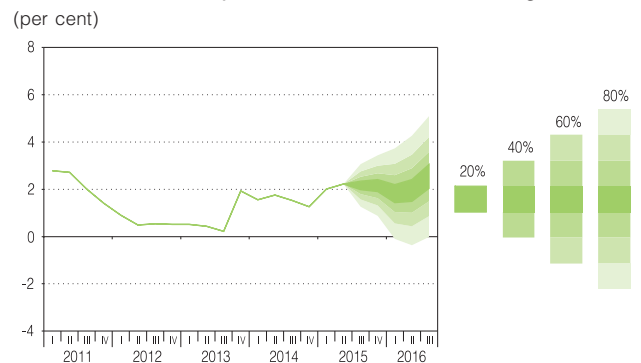
Household Behaviour

In the second quarter of 2015 household consumption remained weak, the household savings rate was retained relatively high and labour supply decreased slightly. The gradual unemployment drop and accelerating labour income growth are expected to affect favourably household consumption.

Employment remained at comparatively low levels over the second quarter of 2015. The growth rate of household income from remuneration increased further (on an annual basis according to non-seasonally adjusted data of the wage bill and average wage *per* employee and on a quarterly basis according to seasonally adjusted national account data).²⁴ Corporations' expectations about the number of personnel suggest a continuous recovery in labour demand by corporations. However, in a period of declining energy prices there are prerequisites for increasing labour costs without distorting competitive positions of the firms. These factors are likely to contribute to boosting households'

²⁴ Quarter-on-quarter rates of change in seasonally adjusted data indicate recent developments in indicators that are not subject to base effects in the corresponding period of prior year.

Fan Chart of the Expected Annual Rate of Change of GDP

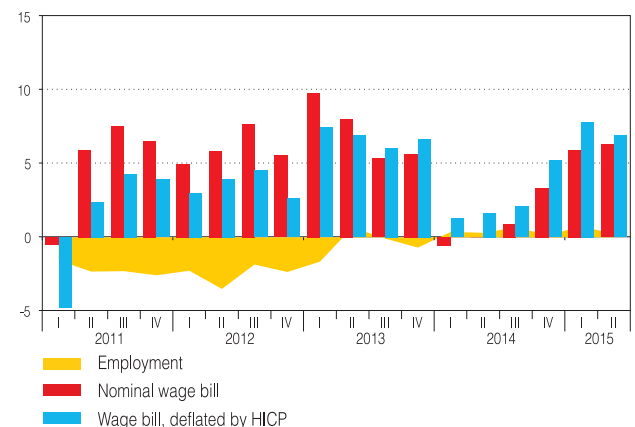


Note: The fan chart shows the expert views of the forecasters on the uncertainty around the projected value based on probability distribution. The reporting period includes revised GDP growth estimates. The middle band of the chart, depicted in the darkest colour, includes the central projection and the probability distribution shows 20 per cent probability for the actual value to fall in this band in each of the quarters. If neighbouring bands (in the same brighter colour) are added to the middle band, there would be 40 per cent coverage of the probability mass. Thus, by adding each same colour couple of bands, the probability for the value to fall there would be increased by 20 percentage points to reach 80 per cent. The probability for the value to remain outside the coloured part of the chart is 20 per cent based on the distribution chosen.

Source: BNB.

Employment and Nominal Wage Bill

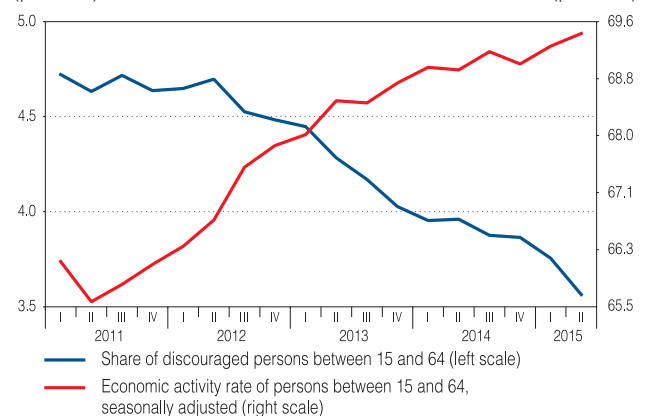
(annual change, per cent)



Sources: NSI – SNA, BNB calculations.

Economic Activity Rate and Share of Discouraged Persons

(per cent)



Sources: NSI Labour Force Survey, BNB calculations.

labour income over a short-term horizon, affecting consumption positively.

Household labour supply (as measured by the quarterly changes of seasonally adjusted data on labour force)²⁵ continued to decrease in the second quarter of 2015, according to the NSI Labour Force Survey. The increase in the economic activity rate,²⁶ as in most of 2014, was mainly driven by the fall of working-age persons rather than labour force growth. The Labour Force Survey shows that in the second quarter of 2015 the seasonally adjusted unemployment rate²⁷ continued its downward trend, reaching 10 per cent (according to non-seasonally adjusted data: 9.9 per cent).

The seasonally adjusted unemployment rate²⁸ calculated using the Employment Agency data also continued to decrease in the second and third quarters of 2015, reaching 9.8 per cent in September (9.2 per cent according to non-seasonally adjusted data). Decreases were recorded in short-term unemployed persons (up to one year), while the number of long-term unemployed persons (those jobless for more than a year) went up. According to the NSI Labour Force Survey, in the second quarter of 2015 the share of long-term unemployment did not change significantly, remaining at 6.3 per cent.

Seasonally adjusted national account data show that household consumption in the second quarter of 2015 was sustained on a quarterly basis. In the second quarter retail trade turnover declined compared to the first quarter, due to decreases in the groups of food, drinks, computer and communication equipment, automobile fuels and lubricants, according to seasonally adjusted data.

Retail trade turnover data for the third quarter of 2015 suggest that consumption will remain

²⁵ The labour force (currently economically active population) comprises persons aged 15 and older who provide the supply of labour for the production of goods or services. The labour force includes both employed and unemployed persons.

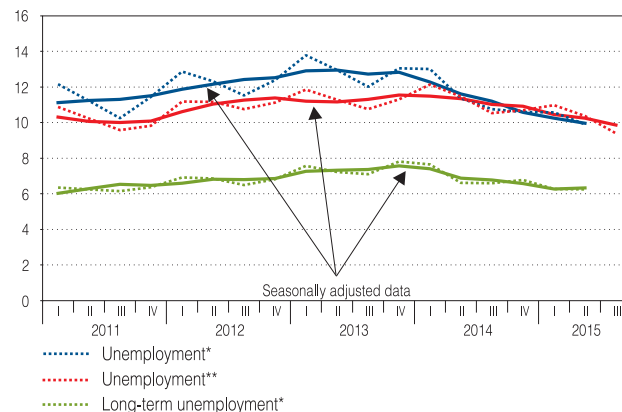
²⁶ The labour force participation rate is the proportion between economically active persons (labour force) and the population of the same age.

²⁷ Unemployment rate is the proportion between the number of unemployed and the labour force based on Labour Force Survey data.

²⁸ The definition of unemployment rate according to Employment Agency data corresponds to that referred to in note 27, but using a constant rate of labour force comprising the number of persons in the respective age group since the last census of the population.

Unemployment Rate

(per cent of labour force)



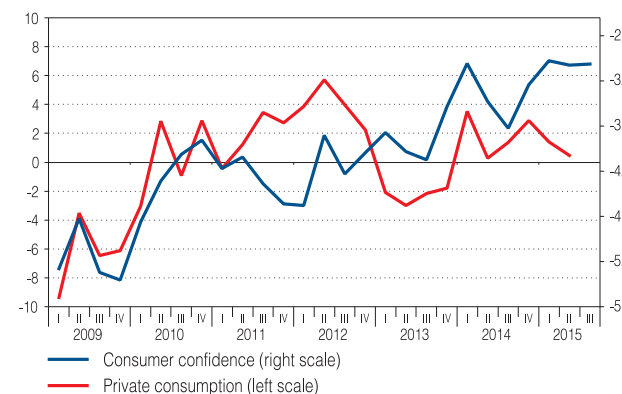
* NSI data.

** Employment Agency data.

Sources: NSI Labour Force Survey, Employment Agency, BNB calculations.

Private Consumption and Consumer Confidence

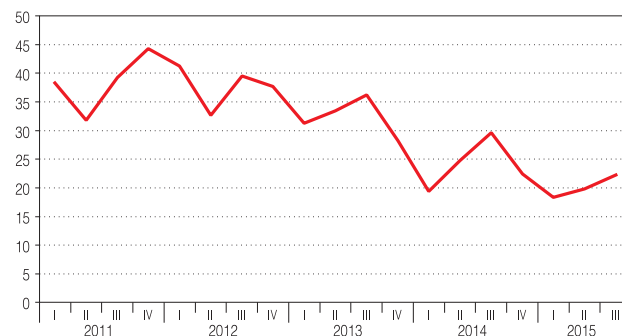
(annual change, per cent)



Sources: NSI Consumer Survey and BNB calculations.

Unemployment Expectations in the Following 12 Months

(balance of opinions; per cent)



Source: NSI Consumer Survey.

Employment and Income Dynamics

	2012				2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
(per cent, on the previous quarter, seasonally adjusted data)														
Employed	-0.7	-1.0	0.1	-0.2	-0.2	0.4	-0.2	-0.1	0.2	0.0	0.2	0.0	0.3	-0.1
Nominal wage per employee*	1.7	2.1	2.3	1.5	3.5	0.5	0.7	0.5	-1.2	1.0	1.1	1.6	1.4	1.4
Real wage per employee**	2.1	1.7	1.9	1.7	2.7	1.1	1.3	0.3	0.5	0.9	1.1	2.8	0.8	1.9
Wage bill, nominal terms	1.0	1.6	2.2	0.8	3.4	0.5	0.5	0.3	-1.3	1.2	1.0	1.5	1.7	1.5
Wage bill, real terms**	1.4	1.1	1.8	1.0	2.6	1.1	1.0	0.1	0.4	1.1	1.1	2.6	1.2	1.9
(per cent, on the corresponding period of the previous year, non-seasonally adjusted data)														
Employed	-2.3	-3.5	-1.9	-2.3	-1.7	0.7	-0.1	-0.7	0.3	0.3	0.7	0.1	0.8	0.2
Nominal wage per employee*	7.1	7.9	8.5	8.3	12.3	8.6	6.2	6.6	0.0	-0.2	0.9	3.7	5.1	5.7
Real wage per employee**	5.2	6.0	5.4	5.3	9.9	7.4	6.9	7.7	1.9	1.5	2.1	5.6	6.9	6.4
Wage bill, nominal terms	4.9	5.8	7.6	5.5	9.8	8.0	5.3	5.6	-0.6	0.0	0.9	3.3	5.9	6.3
Wage bill, real terms**	3.0	3.9	4.5	2.6	7.4	6.9	6.0	6.7	1.3	1.6	2.1	5.2	7.8	6.9

* The wage is calculated on the basis of NSI (SNA) data by subtracting employers' social contributions from the compensation of employees and the difference is divided by the number of employees.

** Data deflated by HICP.

Sources: NSI – SNA, BNB calculations, Eurostat.

Retail Trade Turnover

(per cent, on the previous quarter; seasonally adjusted data at constant prices)

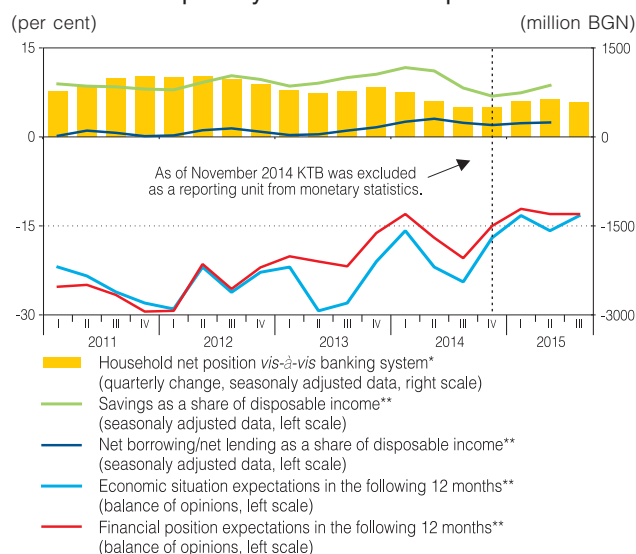
	2012				2013				2014				2015		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Retail trade turnover, excluding cars and motorcycles incl.	5.9	-1.0	-0.5	-0.5	1.0	3.1	1.4	1.4	1.0	-0.1	1.9	0.9	0.0	-0.7	-1.3
Food, drinks and tobacco	1.5	0.9	0.0	1.5	-4.6	3.6	3.9	0.2	0.8	0.7	0.9	0.8	-1.7	-1.3	-1.3
Textile, clothing, footwear and leather	8.2	-4.8	2.3	3.5	2.2	4.6	6.3	-3.4	-3.6	1.8	3.1	-0.1	-5.2	0.1	-5.7
Household goods and home appliances	8.4	0.5	-2.4	-0.8	1.4	2.7	2.4	2.4	0.0	0.6	1.5	2.5	1.2	1.0	1.1
Computers and communication equipment, etc.	-3.3	1.4	0.0	-8.1	5.1	5.6	1.5	5.5	4.2	-2.5	1.1	0.7	-0.9	-0.1	-2.0
Pharmaceutical and medical goods, cosmetics and toiletries	2.6	0.8	1.2	-4.6	7.2	5.3	4.3	1.7	-1.2	0.0	1.8	3.9	0.7	1.6	3.3
Non-specialised stores with different kinds of goods	8.6	-1.4	-1.3	1.2	0.5	11.7	-4.6	-1.2	-1.2	0.4	-0.3	0.1	0.0	-0.8	3.1
Automobile fuels and lubricants	5.1	0.2	1.3	0.9	-3.6	4.6	-5.4	-0.8	1.3	-0.9	6.8	-1.1	6.2	-5.9	-3.6

Source: NSI Short-term Business Statistics.

weak. Over the same quarter, the retail trade volumes at constant prices (seasonally adjusted data) continue to decline against their average level in the second quarter of 2015. This decline is expected to be temporary, given the maintained higher value of the consumer confidence indicator due to prevailing better expectations of households for the economic situation, their financial position and unemployment reported in the NSI Consumer Survey²⁹ conducted in October 2015.

²⁹ Final results of the Consumer Survey represent balances of opinions calculated as a difference between the relative shares of positive and negative opinions on raised issues. The composite consumer confidence indicator is calculated as the arithmetic mean of expectation balances in the following 12 months for the development of: financial position and savings of households, the overall economic situation in Bulgaria and unemployment (the latter with the sign reversed).

Household Propensity to Save and Expectations



* BNB data.

** NSI data.

Sources: NSI Household Budget Survey, NSI Consumer Survey; BNB.

The household savings rate remained comparatively high in the second quarter of 2015. The NSI Household Budget Survey data show that the share of savings in household disposable income retained its comparatively high levels. A high share was also reported by households which intend to increase their savings in the following 12 months (according to the Consumer Survey of October 2015). Households' net assets measured by their net position *vis-à-vis* the banking system (BNB monetary statistics) continued to increase in the second and third quarters of 2015.

Consumer demand is expected to increase at comparatively low rates, the household savings rate to remain high and labour supply relatively low in the fourth quarter of 2015 and first quarter of 2016. Balanced risks to this projection relate mainly to factors which would affect consumer confidence, as employment and labour income.

Fiscal Policy Effects on the Economy

The consolidated state budget surplus amounted to BGN 621 million as a result of the significant tax revenue overperformance due to the improved collectability.

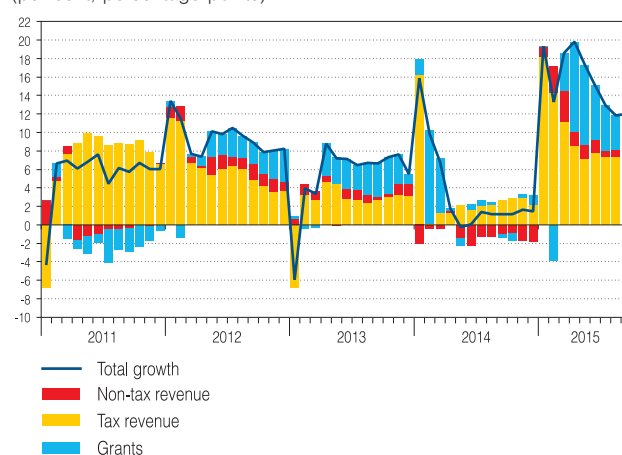
In September 2015 total revenue growth (12 per cent) moderated compared to the first quarter reflecting the weaker tax revenue increase. Indirect taxes continued to have a major contribution to the tax revenue rise. Their performance continued to be significantly higher than in the previous year, with slower VAT revenue growth largely offset by the accelerated rise in excise revenue. Given the relatively low growth rates of nominal household consumption in the first half of the year, the improved collectability continued to be the driving factor for the favourable dynamics of indirect taxes.

Between January and September 2015 social and health insurance had a relatively high positive contribution to the tax revenue dynamics. This resulted from amendments to the 2015 State Budget Law³⁰ of end-2014 and the improved collectability. In addition, the accelerating growth in compensation *per* employee in the economy also added to higher social and health insurance

³⁰ For further details, see *Basic Parameters of the 2015 Law on the State Budget of the Republic of Bulgaria and the Updated Medium-term Budget Forecast for the Period 2015–2017*, Economic Review, 4/2014.

Contribution of Major Groups of Revenue to Growth in Total Revenue and Grants, Cumulatively (on an Annual Basis)

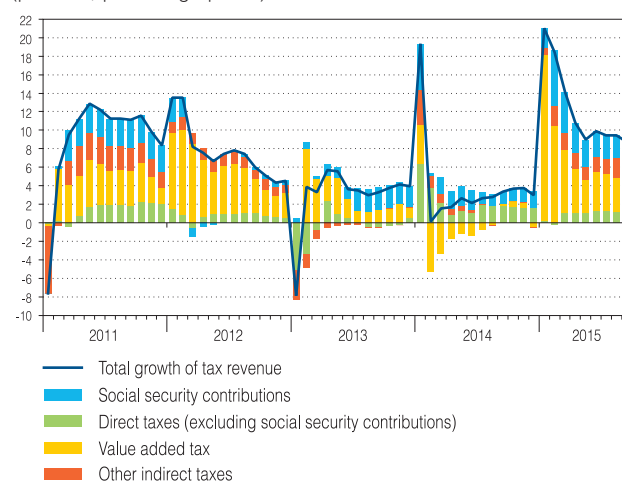
(per cent, percentage points)



Sources: MF, BNB calculations.

Contribution of Major Tax Groups to Tax Revenue Growth, Cumulatively (on an Annual Basis)

(per cent, percentage points)



Sources: MF, BNB calculations.

contributions. EU grants also made a sizeable contribution to the increase in total revenue.

In September 2015 total expenditure on consolidated fiscal programme posted comparatively low growth on an annual basis (2.1 per cent) on the corresponding period of the previous year (6.3 per cent). The downward trend in current operating expenditure, subsidies and the EU budget contribution remained unchanged, while the capital expenditures and social payments continued to have a leading role for total expenditure growth. Social payments rose by 2.3 per cent in September 2015. In end-September government capital expenditure growth was completely driven by higher investments costs related to the implementation of programmes financed by the EU. The strengthened utilisation of EU funds since 2014 continued in 2015, whereby the level of these payments broadly approached the average EU level.³¹

In the second quarter of 2015 government consumption had a positive contribution to real GDP, with the effect of increased health insurance payments between April and June outstripping the effect of decreased operating expenditure and compensation of employees.

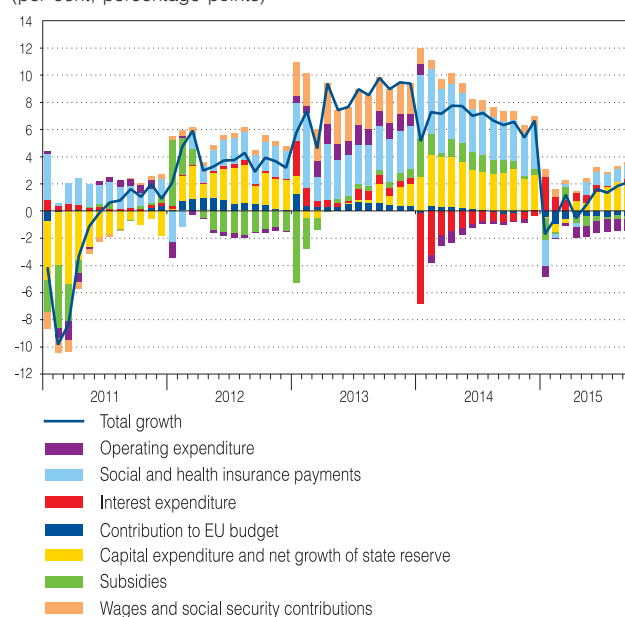
In the fourth quarter of 2015 and first quarter of 2016 the tax revenue growth is expected to slow down due to lower effects of increased collectability. Provided that the current expenditure dynamics is determined by the 2015 State Budget Law parameters, the contribution of government consumption to real GDP growth is expected to be close to zero in the fourth quarter of 2015. Similar growth in the government consumption contribution is also expected for the first quarter of 2016.

Finalisation of the programmes under the EU Cohesion Policy for 2007–2013 co-financed by the EU Structural and Cohesion Funds with an expenditure deadline by the end of 2015 will continue to be a major factor for increasing general government investment until the end of the current year. As a result, public investment is anticipated to retain its decisive contribution to the growth of total investment in the economy. In the first quarter of 2016 government investments will probably have a lower positive contribution to

³¹ The level of tranches received for Bulgaria was 80.6 per cent, and the average level for EU was 87.0 per cent, based on EC data as of September 2015.

Contribution of Major Groups of Expenditure to Total Budget Expenditure Growth, Cumulatively (on an Annual Basis)

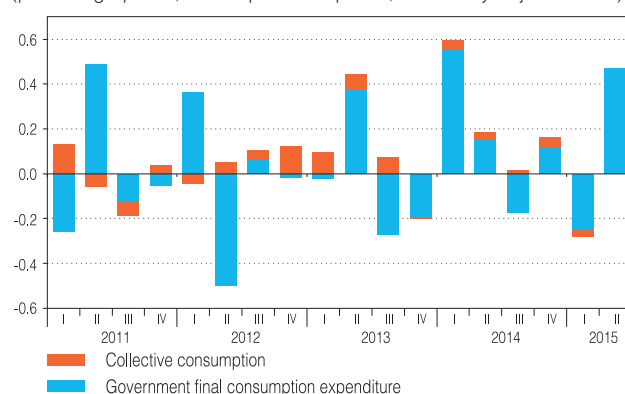
(per cent, percentage points)



Sources: MF, BNB calculations.

Contribution of Government Consumption to Real GDP Growth

(percentage points, on the previous quarter, seasonally adjusted data)



Sources: NSI, BNB calculations.

Revenue, Expenditure and Budget Balance on Consolidated Fiscal Programme for 2014–2015

Consolidated Fiscal Programme	2014										2015				2014		2015	
	Q1		Q2		Q3		Q4		Total		Q1		Q2		January – September ¹		January – September ¹	
	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²	million BGN	per cent ²
Total revenue and grants	6 576	6.8	7 595	-5.2	7 386	3.4	7 853	2.4	29 409	1.5	7 795	18.5	8 508	12.0	21 556	1.2	24 149	12.0
Tax revenue	5 200	1.6	5 980	3.7	5 895	4.6	5 953	1.8	23 028	2.9	5 937	14.2	6 349	6.2	17 075	3.3	18 569	8.7
Corporate tax	453	-2.4	496	10.2	219	13.9	511	14.6	1 679	8.1	464	2.4	545	9.8	1 168	5.6	1 239	6.1
Personal income tax	623	21.6	678	13.8	645	2.6	652	6.4	2 597	10.6	621	-0.2	735	8.4	1 935	12.5	2 017	4.3
Value added tax	1 617	-10.3	1 869	3.5	2 029	8.4	1 749	-7.2	7 264	-1.4	1 969	21.8	1 977	5.8	5 515	0.6	6 083	10.3
Excise	855	6.1	980	-2.1	1 152	-2.7	1 052	-1.2	4 039	-0.4	950	11.1	1 057	7.9	2 987	-0.1	3 333	11.6
Customs duties	35	9.6	35	2.1	42	-5.4	41	15.6	153	4.8	39	12.5	36	2.8	112	1.3	113	1.3
Social and health insurance contributions	1 396	5.8	1 641	3.4	1 644	6.0	1 768	10.2	6 449	6.4	1 625	16.4	1 727	5.2	4 681	4.8	5 081	8.5
Other taxes	221	21.6	281	-4.5	165	-0.3	180	-9.5	847	0.8	269	21.7	272	-3.0	677	4.3	703	3.9
Non-tax revenue	859	-3.1	966	-26.0	874	20.2	762	-26.1	3 460	-12.4	1 080	25.8	939	-2.7	2 698	-7.6	2 838	5.2
Grants	518	238.0	649	-30.6	616	-20.7	1 138	43.8	2 921	10.0	778	50.3	1 221	87.9	1 783	-4.4	2 742	53.8
Total expenditure (incl. the contribution to EU budget)	7 450	7.1	7 717	6.9	7 868	5.0	9 447	8.0	32 482	6.8	7 539	1.2	7 875	2.1	23 039	6.3	23 528	2.1
Wages and social security contributions	1 396	3.7	1 492	3.2	1 471	3.3	1 659	3.3	6 020	3.4	1 415	1.4	1 519	1.8	4 359	3.4	4 392	0.8
Operating expenditure	1 016	-5.7	1 145	2.9	1 023	-0.3	1 541	4.1	4 725	0.6	1 005	-1.1	1 022	-10.8	3 190	-1.0	2 988	-6.3
Interest	199	-37.4	41	-33.4	271	-1.6	69	103.8	580	-15.8	263	31.8	47	15.2	511	-22.0	630	23.4
Social security, assistance and social care	3 375	10.8	3 364	3.8	3 388	5.8	3 582	10.0	13 709	7.5	3 388	0.4	3 504	4.2	10 127	6.7	10 364	2.3
Subsidies	329	5.7	510	50.2	291	4.6	421	-13.6	1 551	9.5	401	21.9	378	-25.8	1 130	21.9	1 067	-5.6
Capital expenditure and state reserve growth	786	49.5	951	17.3	1 285	19.3	1 920	13.1	4 942	20.2	765	-2.6	1 202	26.3	3 021	25.4	3 462	14.6
Contribution to EU budget	349	6.4	213	3.6	139	-35.1	255	36.1	955	2.2	302	-13.4	203	-4.5	700	-6.3	624	-10.8
	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)	million BGN	differ- ence ³ (million BGN)
Budget balance on a cash basis	-874.7	-77.0	-121.7	-913.2	-482.6	-127.2	-1 593.9	-514.6	-3 072.9	-1 632.0	255.9	1 130.6	633.6	755.3	-1 483.2	-1 122.7	621.5	2 104.6

Note: The difference between the sum of individual components and total sum is due to rounding.

¹ Based on monthly reports on cash budget implementation and EU fund accounts of first-level budget spending entities.

² Annual rate of change on the same period of previous year.

³ Budget balance changes on the same period of previous year.

Source: MF.

the gross fixed capital formation due to the early stage of the new programming period.

Behaviour of Firms and Competitiveness

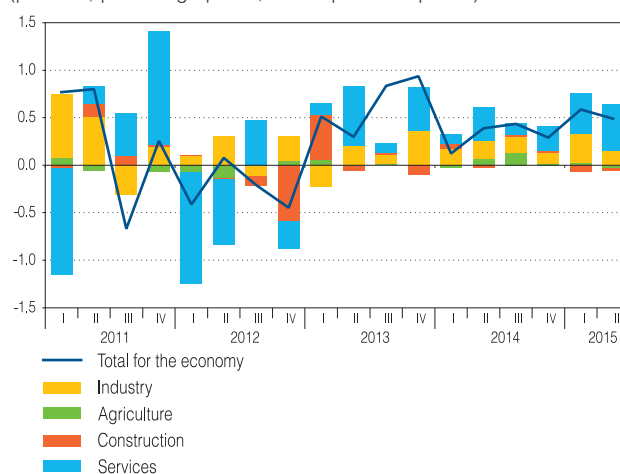
In the second quarter of 2015 real value added for the total economy moderated slightly to 0.5 per cent on a quarterly basis from 0.6 per cent in the previous quarter. The services and industrial sectors had the major contribution to the growth.

In the second quarter of 2015 the gross value added in industry rose by 0.6 per cent, accompanied by an increase of the real industrial turnover component in the external market.

Over the second quarter value added in construction dropped by 0.4 per cent on a quarterly basis, with an observed decline in both

Value Added Growth and Contribution by Sector

(per cent, percentage points, on the previous quarter)



Note: Non-additive data on contributions due to direct seasonal adjustment of value added and its components.

Sources: NSI, BNB calculations.

building and civil construction according to the construction production index (at constant prices).

In the services sector, value added growth accelerated in the second quarter of 2015 on the previous quarter. Real estate operations sub-sector contributed mostly to the growth, while professional and scientific activities³² and trade, transport, hotels and restaurants³³ had a less significant contribution.

NSI data on short-term business statistics (turnover in industry, construction and trade) for the third quarter of 2015 gave rather negative signs for the change in gross value added over the same period. In the third quarter of 2015 nominal industrial turnover fell compared to the second quarter. This was due to both the price and the real component. Retail trade volumes at constant prices also declined compared to the second quarter of 2015. In the third quarter of 2015 the construction production index remained almost unchanged, despite the observed increase in civil construction on the second quarter.

The business climate indicator that measures expectations and perceptions of corporations sustained its relatively high level, decreasing slightly in the third quarter and October 2015. Expectations of the future economic activity for the total economy kept their comparatively constant level in the July–October 2015 period. Over the same period, most of the sectors continued to report higher expectations about the number of personnel in the following three months and increased staff shortage. This gives indications that employment will continue recovering gradually.

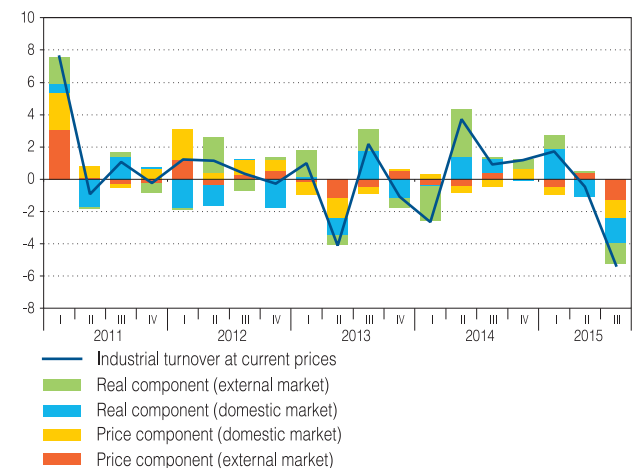
Investment activity of the private sector remained subdued. According to national account data, in the second quarter of 2015 total investment in fixed capital posted a quarterly rise of 0.4 per cent in real terms, driven mainly by government investment developments.

³² The sub-sector of *professional and scientific activities, administrative and ancillary activities* according to A10 breakdown of economic activities.

³³ The sub-sector of *trade, repair of motor vehicles and motorcycles, transport, storage and mail services, hotels and restaurants* according to A10 breakdown of economic activities.

Industrial Turnover Dynamics

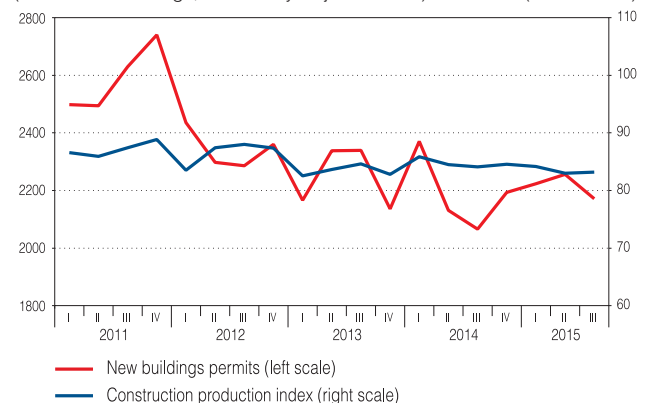
(per cent, percentage points, on the previous quarter, seasonally adjusted data)



Sources: NSI, BNB calculations.

Construction Production Dynamics and New Buildings Permits Issued

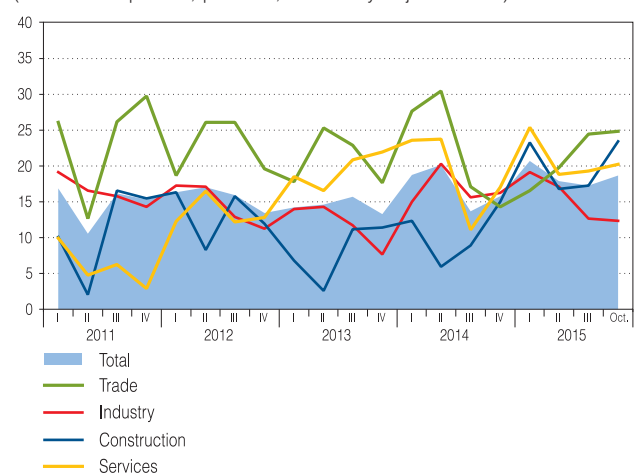
(number of buildings; seasonally adjusted data) (2010 = 100)



Sources: NSI, BNB calculations.

Expectations about Future Economic Activity

(balance of opinions, per cent; seasonally adjusted data)



Sources: NSI, BNB calculations.

After its significant decline in the first quarter of 2015, gross operating surplus increased in the second quarter on both quarterly and annual basis. The rise was mainly due to value added growth and to a lesser extent to increasing profit margins. Services and industry had the major positive contribution to gross operating surplus growth, while construction and agriculture contributed negatively.

Divergent dynamics was observed in the firm's financing sources other than gross operating surplus. In the industry sector, a decline in bank loans and a rise in external obligations other than intercompany loans were observed. In services, however, increases were reported in both bank loans and external obligations other than intercompany loans.

Employment for the total economy (seasonally adjusted national account quarterly changes) went down slightly in the second quarter of 2015. A decline was recorded in services and agriculture, while industry and construction increased slightly. Given the gradual recovery of economic activity and retained business indicators of firms' sentiment about the number of personnel and business environment at a comparatively high level, the slight decline in the second quarter of 2015 may be seen as a one-off effect and the employment is expected to continue recovering in the fourth quarter of 2015 and first quarter of 2016.

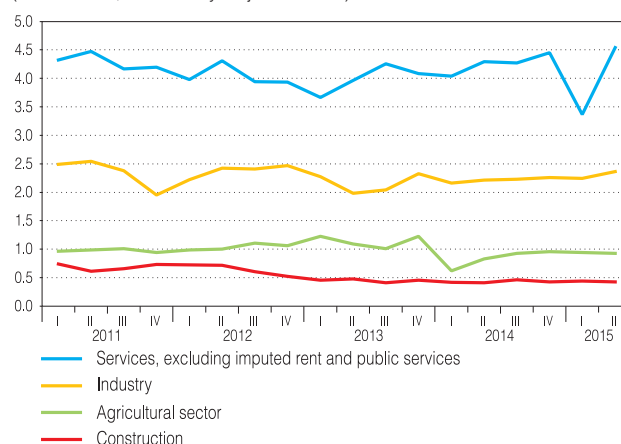
Labour productivity in both industry and services (excluding imputed rent) kept increasing gradually in the second quarter of 2015. The quarter-on-quarter negative change of labour productivity in construction was a result of a decrease in gross value added and lower increase in sector's employment from the previous quarter.

In the second quarter of 2015 compensation *per employee* in nominal terms continued to pick up on a quarterly basis and slightly accelerated its growth rate on an annual basis as in the previous quarter. A rise in compensation *per employee* was recorded in all economic sub-sectors. The financial and insurance activities and culture, sports and entertainment sub-sectors³⁴ posted the strongest changes.

³⁴ The sub-sector of culture, sport and entertainment; other activity; activities of households as employers; non-identified activities of households producing goods and services for own use; activities of extraterritorial organisations and bodies according to A10 breakdown of economic activities.

Gross Operating Surplus at Current Prices

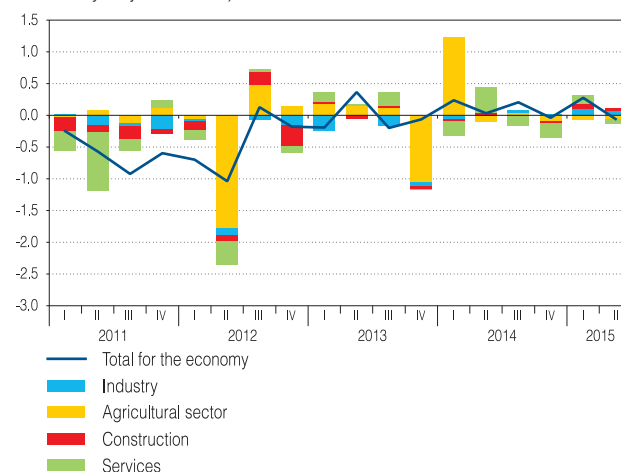
(billion BGN, seasonally adjusted data)



Sources: NSI, BNB calculations.

Contribution to Changes in the Number of Employed by Economic Sector

(per cent, percentage points, on the previous quarter, seasonally adjusted data)

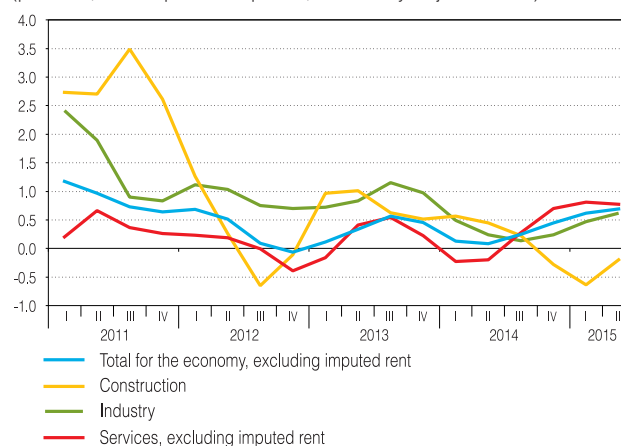


Note: Non-additive data on contributions due to direct seasonal adjustment of the total amount and its components.

Sources: NSI, BNB calculations.

Labour Productivity Developments (Value Added per Employee)

(per cent, on the previous quarter; seasonally adjusted data)



Sources: NSI, BNB calculations.

Gross Value Added Growth

(per cent; on the previous quarter; real growth, seasonally adjusted data)

	2012				2013				2014				2015	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Agriculture and forestry, hunting and fishing	-1.4	-2.8	-0.3	1.0	1.2	-0.1	0.4	0.1	-0.7	1.5	2.7	0.3	0.5	-0.8
Mining and quarrying, manufacturing, production and distribution of electricity, gas and water	0.5	1.4	-0.5	1.1	-1.0	0.9	0.4	1.6	0.8	0.8	0.7	0.5	1.3	0.6
Construction	0.1	-0.3	-1.5	-8.7	7.6	-0.8	0.3	-1.6	0.7	-0.5	0.4	0.5	-1.1	-0.4
Trade, cars and motorcycles repair; transport, storage and mail services; hotels and restaurants	0.4	0.4	0.6	0.6	0.5	0.4	0.8	0.5	0.1	0.8	0.3	0.3	0.4	0.3
Creation and dissemination of information and author products; telecommunications	-2.1	0.2	0.2	0.4	0.5	0.0	1.2	0.4	0.1	0.1	0.2	-0.4	0.4	0.4
Finance and insurance activities	-2.6	-7.9	3.1	-5.3	0.6	3.5	-3.4	-1.8	2.2	1.3	-1.7	0.6	0.3	0.9
Real estate activities	-3.9	1.8	-0.5	0.1	0.6	-0.1	0.9	0.1	-0.1	0.3	1.2	1.1	1.8	1.9
Professional activities and scientific research; administrative and ancillary activities	-10.3	-3.0	5.4	2.8	-3.0	4.0	-3.9	4.3	1.7	0.3	1.3	0.9	1.5	1.5
General government; education; healthcare and social services	0.9	-0.3	-0.7	1.0	-0.4	0.4	1.3	0.8	0.0	0.2	-0.2	0.0	0.0	0.3
Culture, sport and entertainment; other activity; activities of households as employers; non-identified activities of households producing goods and services for own use; activities of extraterritorial organisations and bodies	0.9	-4.3	-0.6	-11.5	3.5	0.3	3.4	5.6	-6.8	0.0	0.1	-0.6	0.7	-0.1
Gross value added, total for the economy	-0.4	0.1	-0.2	-0.4	0.5	0.3	0.8	0.9	0.1	0.4	0.4	0.3	0.6	0.5

Source: NSI.

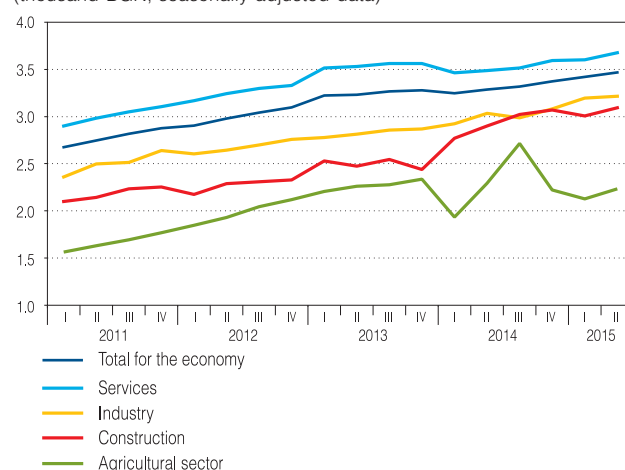
Reflecting the stronger growth of compensation *per* employee than labour productivity, over the second quarter nominal unit labour costs in the total economy continued their upward trend, slightly accelerating their growth rate. This indicator fell in real terms in both industry and total for the economy on a quarterly basis.

Decomposition of real GDP growth by production factor suggests that the high capital contribution was sustained in the second quarter of 2015, due to high capacity utilisation. Given the slow employment and labour productivity dynamics, labour and total factor productivity had almost a zero contribution to the economic growth.

In the second quarter of 2015 the operating surplus recovery and lower production costs of firms for energy products are prerequisites for employment to continue recovering and labour costs to increase. In the context of relatively positive sentiment and expectations of corporations and the high capacity utilisation, a longer real growth trend is expected to stimulate investment activity in the fourth quarter of 2015 and first quarter of 2016.

Compensation per Employee at Current Prices

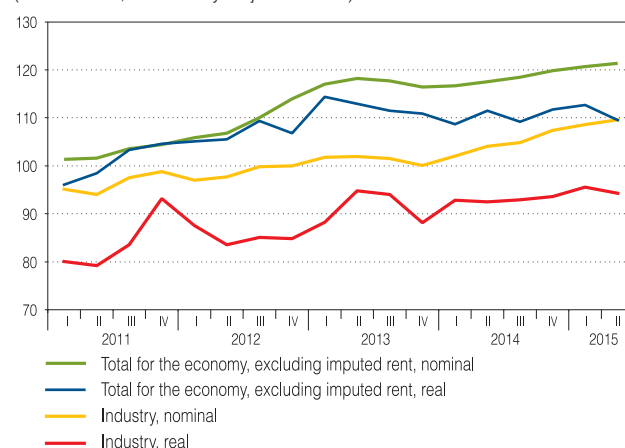
(thousand BGN; seasonally adjusted data)



Sources: NSI, BNB calculations.

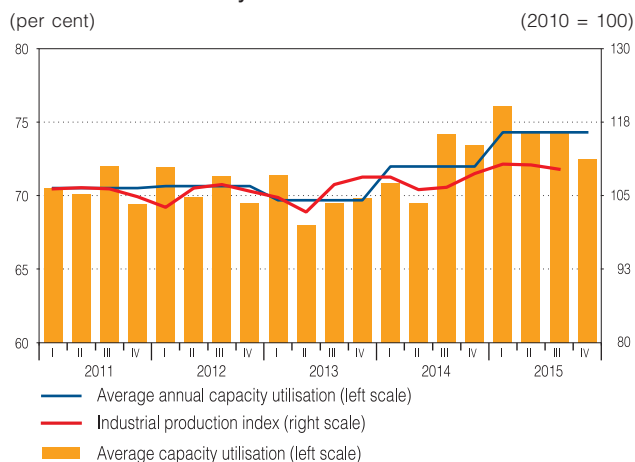
Unit Labour Costs

(2010 = 100; seasonally adjusted data)



Sources: NSI, BNB calculations.

Industrial Production Index and Production Capacity Utilisation in Industry



Sources: NSI, BNB calculations.

Exports and Imports of Goods and Services

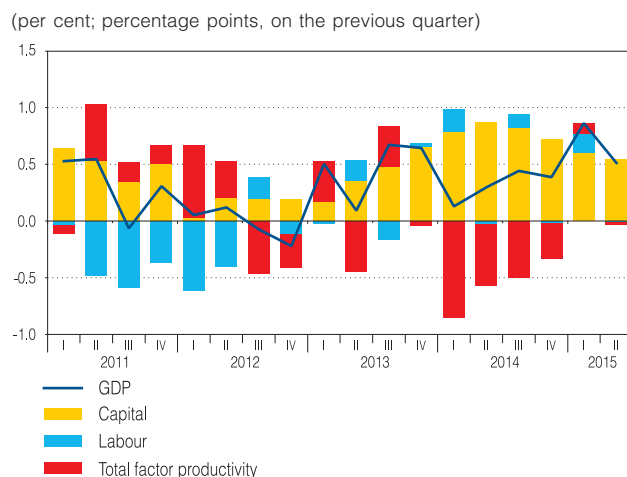
In the second and the beginning of the third quarter of 2015 nominal exports and imports of goods kept their year-on-year upward trend from the beginning of the year, with nominal exports of goods rising between January and July 2015 by 9.4 per cent on an annual basis, and nominal imports of goods, by 5.4 per cent.³⁵ According to non-seasonally adjusted GDP data, real annual growth in exports of goods came to 11.8 per cent in the first half of 2015, while real imports of goods increased by 5.3 per cent. Cross-checking the changes in exports and imports of goods in nominal and real terms showed that the dynamics in global prices curbed nominal growth of international trade flows in the first half of 2015.

In the fourth quarter of 2015 and first quarter of 2016 real exports and imports of goods are expected to continue rising on an annual basis, with growth rates reflecting external and domestic demand dynamics. Annual growth of goods exports is anticipated to continue to outpace that of imports. The further annual decline of international prices of major commodity groups will limit the nominal growth of exports and imports, expecting trade balance deficit to shrink as a share of GDP against the first half of 2015.

According to balance of payments data, between January and August 2015 exports of services decreased and imports of services grew

³⁵ Foreign trade data.

Contribution of Changes in Production Factors to GDP Growth



Sources: NSI, BNB calculations.

Net Exports of Commodity Groups By Use, January–July 2015

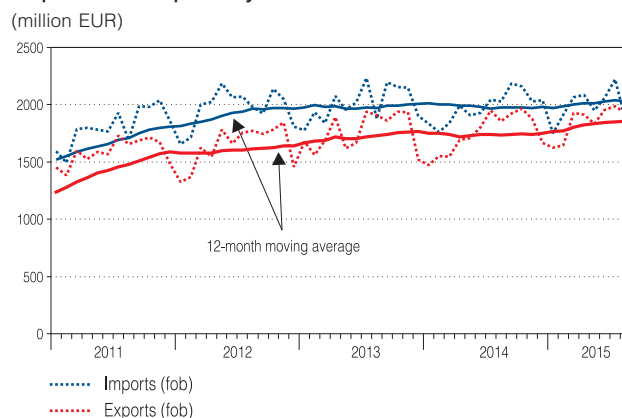
	Balance, million EUR	Change*, million EUR	Export growth** (per cent)	Import growth** (per cent)
Consumer goods	353.0	-35.1	6.2	8.2
Raw materials	-244.6	49.7	12.7	11.1
Investment goods	-947.3	24.3	16.3	11.0
Energy resources	-1018.3	342.2	-4.7	-14.1
Total	-1905.6	384.4	9.4	5.4

* The change in balance on the same period of previous year.

** Growth of exports and imports for the period (on an annual basis).

Source: BNB.

Export and Import Dynamics



Source: BNB.

on the corresponding period of 2014. In the first half year national accounts data show that exports and imports of services in real term rose on an annual basis, with services import and export prices increasing from the corresponding period of 2014.

Our expectations for the fourth quarter of 2015 and first quarter of 2016 point to a year-on-year decrease in real exports of services, reflecting partly the decline of tourists from Greece and Russia. Concurrently, at the end of 2015 the annual growth rate of services imports is anticipated to moderate against the first half of 2015 and likely to decline on an annual basis in the first quarter of 2016 because of the high level since early 2015.

In the first seven months of 2015 exports to EU Member States increased by 10.1 per cent on an annual basis in line with the improvement of EU economic activity. Exports of machines³⁶ and base metals had the most significant contribution to the nominal exports of goods to the EU, with exports to Germany and Romania registering the biggest increase by geographical breakdown. Between January and July 2015 exports to non-EU countries rose by 8.3 per cent on an annual basis, mainly due to the larger exports to Turkey. By commodity group, machines and animal and plant products³⁷ contributed mostly to the growth of exports to non-EU countries. The share of goods exports to EU Member States increased at the expense of that to non-EU countries.

In the January–July 2015 period nominal exports of all commodity groups grew year on year, with exports of machines having the most significant positive contribution.

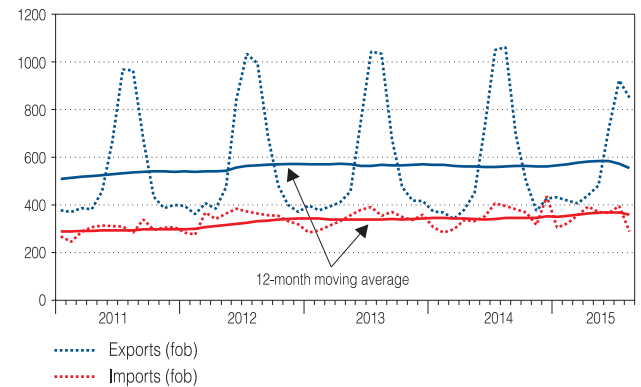
The observed growth rate of exported machines in the last years continued in the first seven months of 2015. Over the review period machines exports had the largest positive contribution to the nominal growth of goods exports to both EU countries and the rest of the world. The group dynamics over the period was determined by the increase in both the exported

³⁶ In this chapter it should read the *machines, vehicles, appliances, instruments and weapons* group under the Combined Nomenclature.

³⁷ In this chapter it should read the *animal and plant products, food, drinks and tobacco* group under the Combined Nomenclature.

Export and Import Dynamics in Services

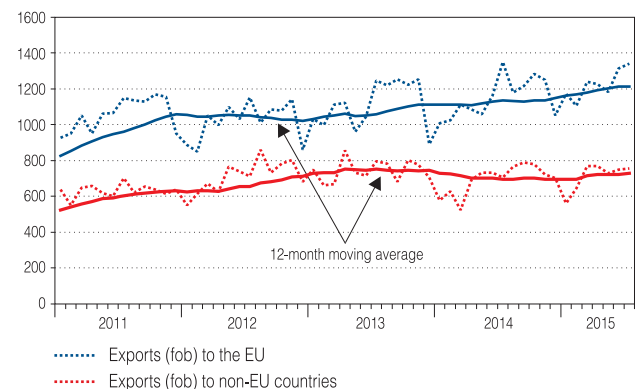
(million EUR)



Source: BNB.

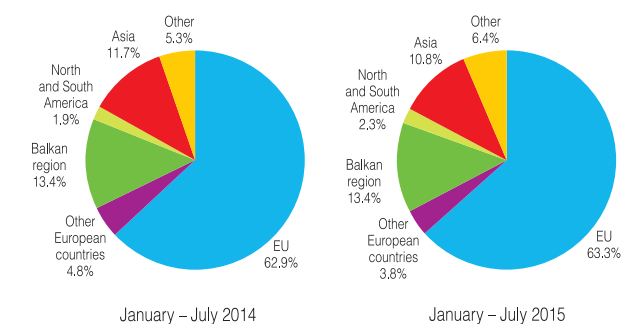
Dynamics of Exports to the EU and non-EU Countries

(million EUR)



Source: BNB.

Geographical Distribution of Exports



Source: BNB.

quantities and in prices.³⁸ In the fourth quarter of 2015 and first quarter of 2016 exports in the group are expected to continue to rise on an annual basis due to growing external demand, and to be a main driving factor for total growth of goods exports over the projected horizon.

Despite the year-on-year fall of international energy prices observed since the second half of 2014, nominal exports of energy products³⁹ recorded a slight annual increase between January and July 2015, thanks to the rise of exported physical volumes.⁴⁰ In the fourth quarter of 2015 and first quarter of 2016 the nominal export growth rate in this group is expected to be depressed by the slump of international oil prices in euro and US dollars on an annual basis.

In the first seven months of 2015 exports of base metals⁴¹ increased on an annual basis, ascribable to the increased exports to EU countries. The nominal growth of copper exports grew compared to the same period of 2014, with both prices of exported metals and larger physical volumes of exports in the group⁴² having a positive contribution. In the fourth quarter of 2015 and first quarter of 2016 nominal exports in the group are expected to grow year on year mainly due to the increased export quantities. At the same time metals prices in EUR are expected to decrease on an annual basis, limiting nominal growth of exports in the group and probably leading to its slowdown on the first half of 2015.

Exports of animal and plant products exhibited an annual increase in the January–July 2015 period which was attributable to the larger exports of cereals and oil seeds mainly to non-EU countries. In the first seven months of 2015 nominal growth of exports in the group was

³⁸ The quarterly export deflators for the *machines, equipment and vehicles* group under SITC were used to estimate the price effect in the first and second quarters of 2015.

³⁹ In this chapter it should read the *mineral products and fuels* group under the Combined Nomenclature.

⁴⁰ According to the Balance of Payments, October 2015, p. 52, and using the quarterly export deflators of the *mineral fuels, oils and related products* group under the SITC in the first and second quarters of 2015.

⁴¹ In this chapter it should read the *base metals and their products* group under the Combined Nomenclature.

⁴² According to the Balance of Payments, October 2015, p. 52, for the *non-ferrous metals* sub-group, and using the quarterly export deflators for the *precious metals and other non-ferrous metals* group under the SITC in the first and second quarters of 2015.

Exports by Commodity Group, January–July 2015

	million EUR	Change* (million EUR)	Growth** (per cent)	Contribution** (percentage points)
Wood products, paper, ceramics and glass	711.5	52.3	7.9	0.4
Machines, vehicles, appliances, instruments and weapons	3 265.0	487.2	17.5	3.9
Mineral products and fuels	1 891.0	3.0	0.2	0.0
Base metals and related products	2 323.9	179.3	8.4	1.4
Animal and plant products, food, drinks and tobacco	1 970.7	219.4	12.5	1.8
Textiles, leather, clothing, footwear and other consumer goods	1 767.3	33.1	1.9	0.3
Chemical products, plastics and rubber	1 617.2	195.1	13.7	1.6
Total exports	13 546.7	1 169.4	9.4	

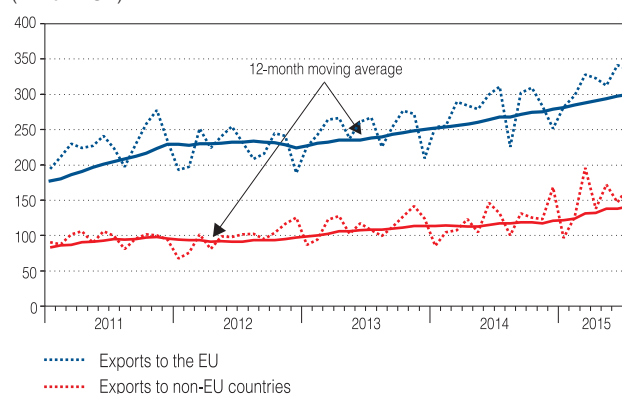
* Change on corresponding period of previous year.

** Growth/contribution to total export growth over the period on an annual basis.

Source: BNB.

Exports of Machines, Vehicles, Appliances, Instruments and Weapons

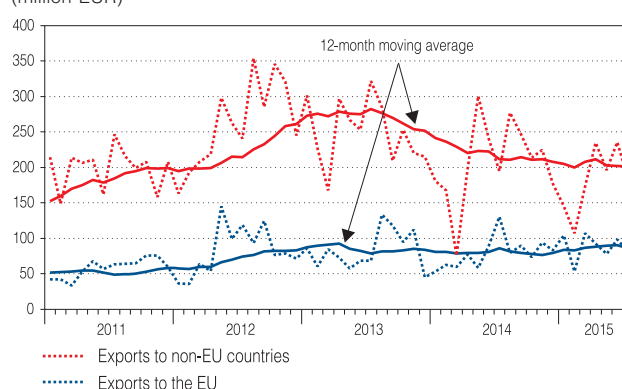
(million EUR)



Source: BNB.

Exports of Mineral Products and Fuels

(million EUR)



Source: BNB.

driven by the higher volumes, while the falling international goods prices of this group limited the nominal growth of exports in the group.⁴³ In the fourth quarter of 2015 and first quarter of 2016 group's exports attributable to physical volumes are not expected to increase significantly on an annual basis, which will reduce the increase of nominal exports in the group. Concurrently, deflationary trends in international food prices will further limit nominal growth of group's exports.

Between January and July 2015 exports of chemicals⁴⁴ increased to both EU countries and the rest of the world on an annual basis. Exports of fertilisers and plastic products had the most significant contribution in this group. Over the same period physical volumes rose, while prices remained almost unchanged.⁴⁵ Over the projected horizon the group's exports are expected to continue increasing at rates close to the current ones, driven by the growing external demand.

According to balance of payments data, for the January–August 2015 period exports of services dropped by 1.7 per cent year on year, with a decrease in most services groups. Over the same period tourism earnings decreased by 4.4 per cent on an annual basis, with NSI data showing a fall of nearly 8.7 per cent in foreigners travelling for tourism compared to the corresponding period of 2014. The fall was mainly due to a decrease in the visits from Greece, Romania and Russia.

In the January–July 2015 period nominal imports of goods (cif) registered a 5.4 per cent increase on the corresponding period of the previous year. Based on a comparison between real and nominal annual growth of goods imports in the first half of 2015, non-seasonally adjusted GDP data show that nominal growth was attributable to the increase of imported physical volumes. Raw materials contributed most significantly and investment goods, to a

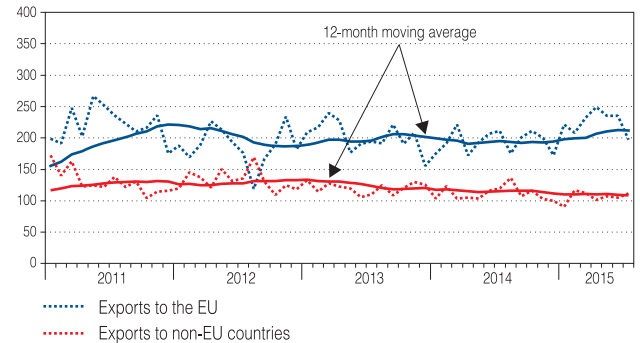
⁴³ The quarterly export deflators for the *cereals and mill products* and *oil seeds and fruit* sub-groups under the SITC were used to estimate the price effect in the first and second quarters of 2015.

⁴⁴ *Chemical products, plastics and rubber* group under the Combined Nomenclature.

⁴⁵ The quarterly export deflators for the *chemicals and chemical products* group under the SITC were used to estimate the price effect in the first and second quarters of 2015.

Exports of Base Metals and Related Products

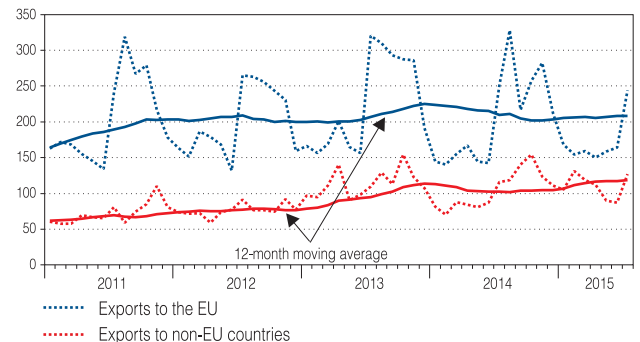
(million EUR)



Source: BNB.

Exports of Animal and Plant Products, Food, Drinks and Tobacco

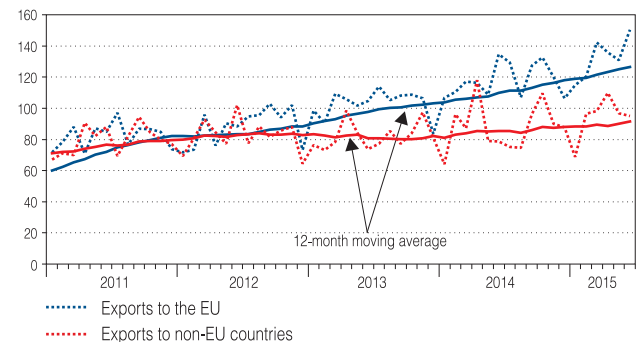
(million EUR)



Source: BNB.

Exports of Chemical Products, Plastics and Rubber

(million EUR)



Source: BNB.

lesser extent, to nominal growth of goods imports by use. In the first seven months of 2015 the increased imports of these goods may be explained by the annual growth in private consumption and gross capital formation during the period considered.

Between January and July 2015 imports of goods from EU Member States increased by 7.8 per cent year on year, with imports from Germany contributing most positively. Non-EU countries imports grew by 2.8 per cent on an annual basis over the same period, with most considerable increase in imports from China, while imports from Russia fell significantly. Over the review period the share of imports from EU reached 52 per cent.

Nominal imports in the energy resources continued declining in the first seven months of 2015. Over the review period the annual decline was driven by both year-on-year falling international prices of energy resources⁴⁶ and lower imported physical volumes. Our expectations for the fourth quarter of 2015 and first quarter of 2016 point to an annual fall of oil prices in US dollars and in euro, which will continue to dampen the nominal change in imports of the group.

In the January–July 2015 period imports of raw materials group increased on an annual basis. The assessment of price changes suggests that growth in nominal imports of the group is due to higher imported quantities, while the decrease in international prices of most goods in the group limited nominal growth of the group.⁴⁷ Imports of ores had the most positive contribution for the period. Over the projected horizon the growth rate of the group is expected to narrow due to expected annual deceleration in private investment in the fourth quarter of 2015 and their gradual recovery in early 2016.

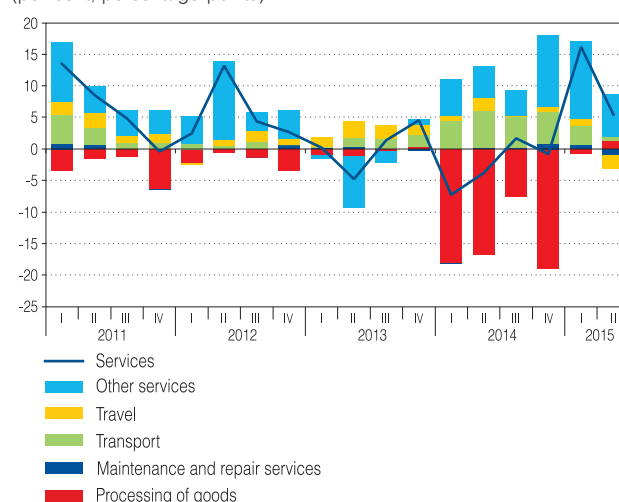
In the first seven months of 2015 imports of consumer goods rose year on year, with food, drinks and tobacco, and pharmaceuticals and

⁴⁶ According to the Balance of Payments, October 2015, p. 52, and using the quarterly import deflators of the *mineral fuels, oils and related products* group under the SITC in the first and second quarters of 2015.

⁴⁷ According to the Balance of Payments, September 2015, p. 56, and the quarterly import deflators of the groups of *food and live animals, inedible (crude) materials* (excluding fuels); *chemicals and chemical products* and *manufactured goods classified chiefly by materials* under the SITC in the first and second quarters of 2015.

Annual Changes in Services Exports and Contributions by Sub-component

(per cent; percentage points)



Source: BNB.

Imports of Commodity Groups By Use, January–July 2015

	million EUR	Change* (million EUR)	Growth** (per cent)	Contribution** (percentage points)
Consumer goods	3 119.8	237.2	8.2	1.6
Raw materials	5 880.0	585.2	11.1	4.0
Investment goods	3 828.6	379.4	11.0	2.6
Energy resources	2 551.4	-418.1	-14.1	-2.9
Imports, total (cif)	15 452.3	784.9	5.4	

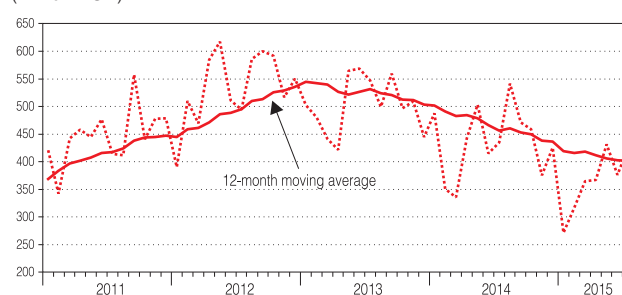
* Change on corresponding period of previous year.

** Growth/contribution to total import growth over the period on an annual basis.

Source: BNB.

Imports of Energy Resources

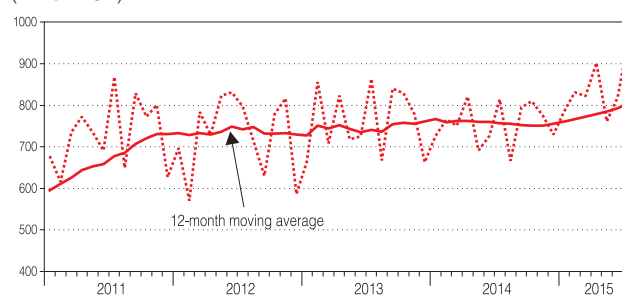
(million EUR)



Source: BNB.

Imports of Raw Materials

(million EUR)



Source: BNB.

cosmetics groups having the largest contribution. In the first half of 2015 imports dynamics of consumer goods corresponded to higher year-on-year private consumption in Bulgaria. In the fourth quarter of 2015 and first quarter of 2016 imports of the group are expected to grow at similar rates on an annual basis, impacted by private consumption dynamics, which are projected to remain close to the observed in the first half of 2015.

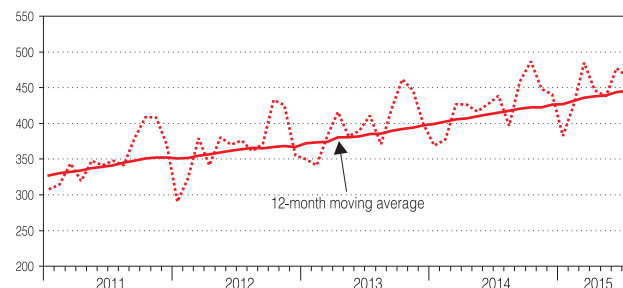
In the January–July 2015 period nominal imports of investment goods grew year on year and had a significant positive contribution to total imports growth. This increase was related to both the higher imported physical volumes and the annual price rise.⁴⁸ Expectations for imports in this commodity group incorporate a slight moderation in the fourth quarter of 2015 and first quarter of 2016 due to the projected annual deceleration in private investment in the fourth quarter of 2015 and its gradual recovery in early 2016.

According to balance of payments data, for the January–August 2015 period imports of services went up by 3.1 per cent year on year. Traveling expenditure of Bulgarians increased most considerably. According to NSI data, in the first eight months of 2015 Bulgarians' visits abroad increased on an annual basis, with the most significant increase in the number of visits to Greece and Turkey.

⁴⁸ The quarterly import deflators for the *machines, equipment and vehicles* group under SITC were used to estimate the price effect in the first and second quarters of 2015.

Imports of Consumer Goods

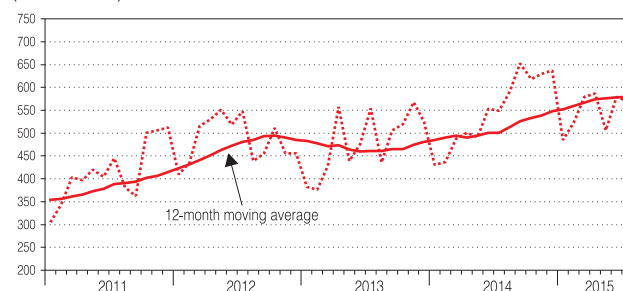
(million EUR)



Source: BNB.

Imports of Investment Goods

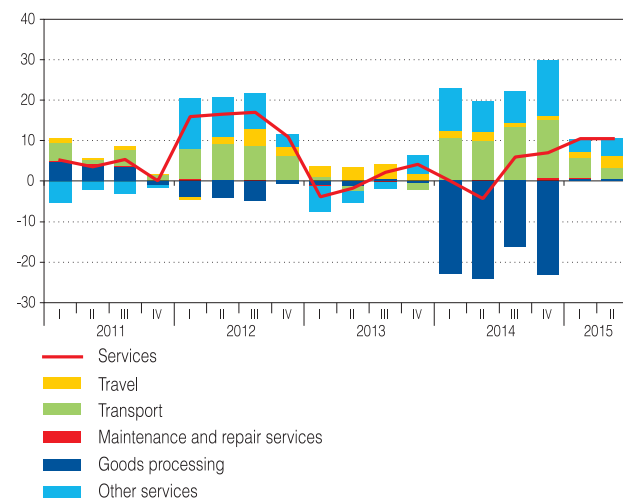
(million EUR)



Source: BNB.

Annual Changes in Imports of Services and Contributions by Sub-component

(per cent; percentage points)



Source: BNB.

4. Inflation

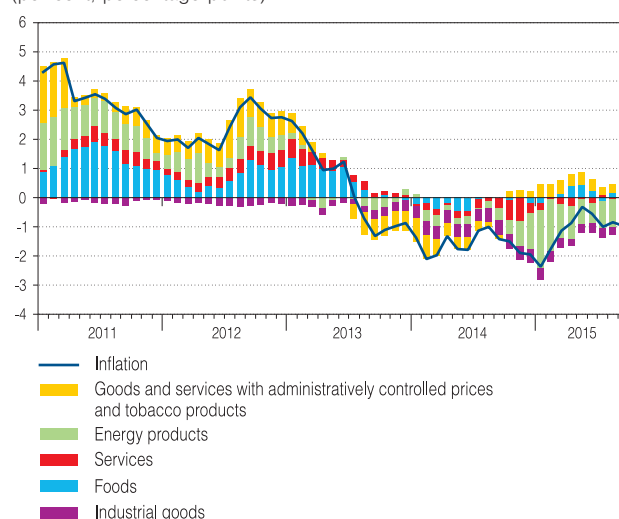
In September 2015 the annual inflation was negative at -0.9 per cent, with the fall in transport fuel prices contributing most to this, driven by falling international oil prices. Administrative prices of goods and services had a positive contribution to the overall inflation in early 2015, mostly due to the increase in prices of electricity for households at the end of 2014.

Deflation is expected to deepen temporarily in the fourth quarter of 2015, reflecting the lower oil prices over the third quarter. However, the annual rate of decline of consumer prices is projected to start decreasing in the first quarter of 2016. This will reflect mainly the declines in international oil prices in euro over the third quarter of 2015 and the expected stabilisation afterwards.

The annual inflation, which has been negative since mid-2013, came to -0.9 per cent in September 2015 (on -2.0 per cent in December 2014).⁴⁹ Since early 2015 the downward dynamics in international prices of major raw materials and fuels was the major source of a deflationary effect. Foreign trade data suggest that the fall in import prices was mainly driven by food and mineral fuels groups,⁵⁰ while finished industrial products reported higher import prices. Between January and September 2015 transport fuels had the largest negative contribution to overall inflation matching the reported average fall of 36.7 per cent in the petroleum price (in euro) over the review period (in US dollars the petroleum price decline was 48.1 per cent). Euro depreciation (the reported decline over the first nine months was 17.8 per cent on average against the US dollar)⁵¹ is a prerequisite for limiting the downward trend in prices of durable goods in Bulgaria.

In September 2015 administratively controlled prices contributed positively to the overall inflation rate due to the increased regulated price of electricity for households by 10.1 per cent since October 2014.

Annual Inflation and Contribution of Major Commodity and Services Groups to It
(per cent, percentage points)



Notes: 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 calculations.

⁴⁹ The analysis in this Section employs NSI data on HICP.

⁵⁰ Import data under the SITC. In the second quarter of 2015 year-on-year import prices in the *food and live animals, soft and alcohol drinks and tobacco, mineral fuels, oils and related products, and chemicals and chemical products* groups reported a decline.

⁵¹ For further details, see the research topic *Potential Effects of the USD/EUR Exchange Rate Change on the Bulgarian Economy*, Economic Review, 2/2015.

Between January and September 2015 the diffusion index, showing the share of declining HICP sub-indices on an annual basis, went down to 31.2 per cent against 40.9 per cent at the end of 2014. This reflected mainly the lower share of industrial goods, food and services with declining prices and suggested that since early 2015 deflation in Bulgaria tended to be driven, to a larger degree, by products with a relatively high weight in the consumer basket, as fuels. Possible indirect effects, a result of lower prices of energy products, are a prerequisite for the diffusion index to remain at a relatively high level in the following months. Between January and September 2015 the number of goods and services with increasing prices continued to grow. Given the comparatively low price rise (mostly up to 1 per cent) and the small weights of these goods in the consumer basket, the price rise could not offset the negative contribution of deflated goods and services.

The effect of international prices and the degree of their spillover along the supply chain on end-use consumer prices may be seen through producer price developments. Over the first nine months of 2015 domestic producer prices continued to decrease on an annual basis. In September 2015 the total producer price index (PPI) reported a year-on-year decline of 2.1 per cent (against 0.9 per cent at the end of 2014) reflecting the negative contribution of prices charged in the manufacturing which continued to be driven mainly by lower production prices of refined oil products.⁵² Concurrently, the sub-sector related to production of electricity⁵³ had a positive contribution to the annual rate of change in producer prices as of September 2015, which reflected administratively increased electricity prices at the end of 2014.

By commodity group,⁵⁴ a decrease in prices of energy products was reported between January and September 2015, with a year-on-year price fall reported also in intermediate consumption goods in September. These products form a portion of firms' production costs which signal that the downward dynamics of international prices of

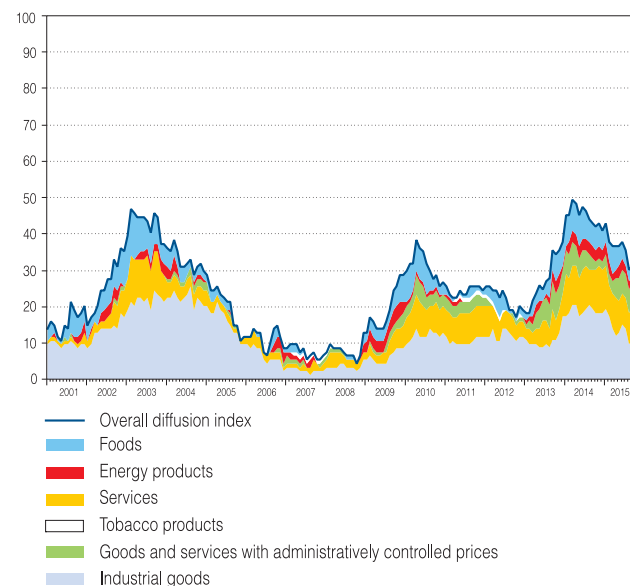
⁵² Production of coke and refined petroleum products.

⁵³ Production and distribution of electricity, heating and gas.

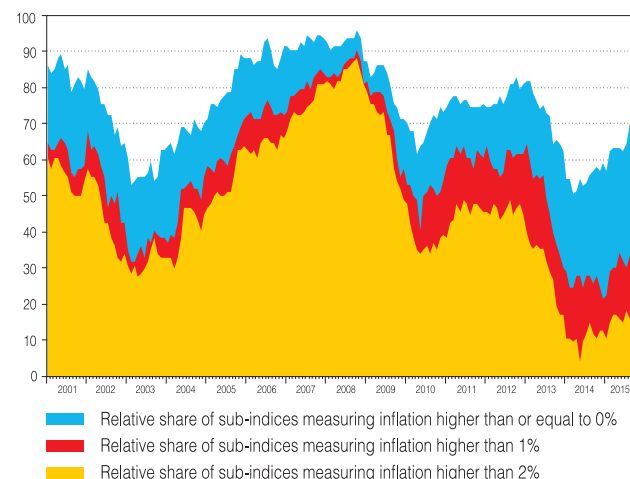
⁵⁴ These are intermediate consumption goods, energy products, investment products, durable consumer goods and non-durable consumer goods.

Diffusion Indices for Major Goods and Services Groups

(per cent, relative shares of declining HICP sub-indices on an annual basis)



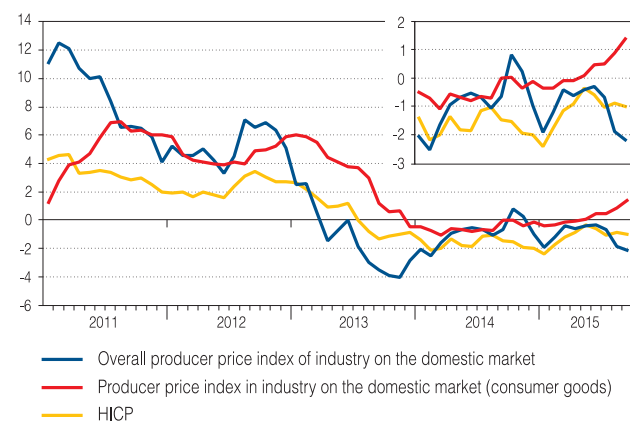
(per cent, relative shares of increasing HICP sub-indices on an annual basis)



Sources: NSI, BNB calculations.

Rate of Change in Manufacturing PPI and HICP

(per cent, on an annual basis)



Source: NSI.

petroleum and major raw materials will remain a prerequisite for a decline in end-use consumer prices in the following months. Gross operating surplus growth reported in the second quarter of 2015 suggested that the decrease in prices of energy products was sufficient to offset higher unit labour costs over the period.⁵⁵ Consequently, no strong upward pressure on end-use consumer prices may be expected in the following months.

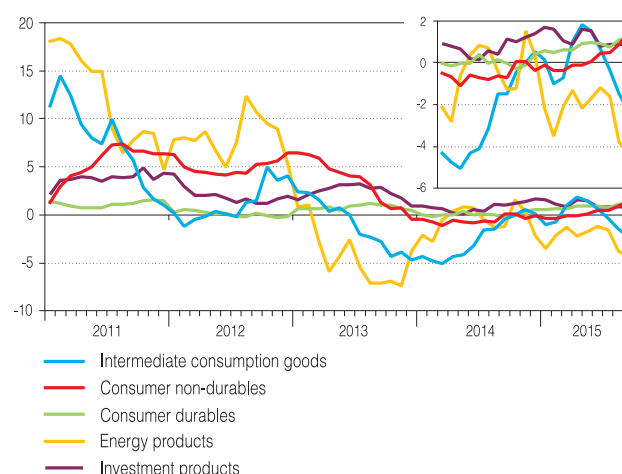
Household consumer demand is another factor influencing firms' pricing decisions. Since mid-2014 NSI business surveys have reported a lower number of firms pointing to insufficient demand as a factor limiting their activity. However, this trend was more strongly pronounced for firms which stayed relatively farther from end users in the supply chain. The slowdown in retail trade volumes annual growth reported since early 2015 and the projected slight consumer demand improvement in the following months give no ground to expect an upward pressure on end-user prices. Most managers in industry, services and retail trade expect that selling prices in the following three months will be close to their current levels. This policy probably reflects the sustained uncertainty of firms about the economic environment, competition and insufficient demand despite the reported business climate improvement in all sectors since early-2015.

In September 2015 core inflation accounted for -0.2 per cent against -1.6 per cent by the end of 2014, with the price dynamics of both non-food goods and services groups contributing to its lower negative rate.

Between January and September 2015 non-food inflation was negative and reached -1.2 per cent in September (against -2.2 per cent at the end of 2014) driven by lower prices of durable goods. The devaluation of the euro against the US dollar was a factor for a deflation decrease in this group. In September automobile, computer and television equipment prices continued to have the largest negative contribution. Since early 2015 non-durable prices tended to increase on an annual basis reflecting the recovering consumer demand and increasing import prices of these goods.

Annual Rate of Change in Producer Prices on the Domestic Market by Major Industrial Groupings

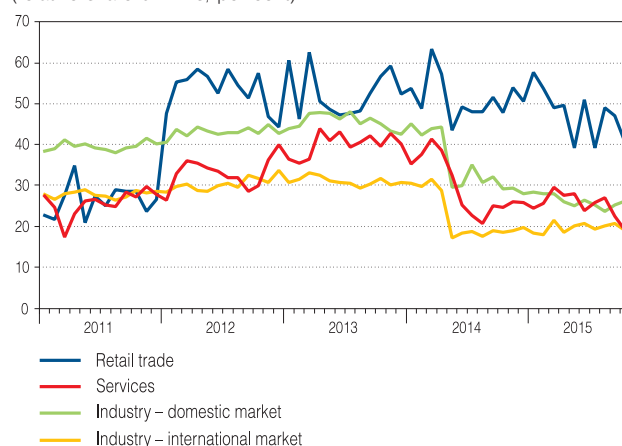
(per cent)



Source: NSI.

Share of Firms Pointing to Insufficient Demand as a Factor Limiting Their Activity

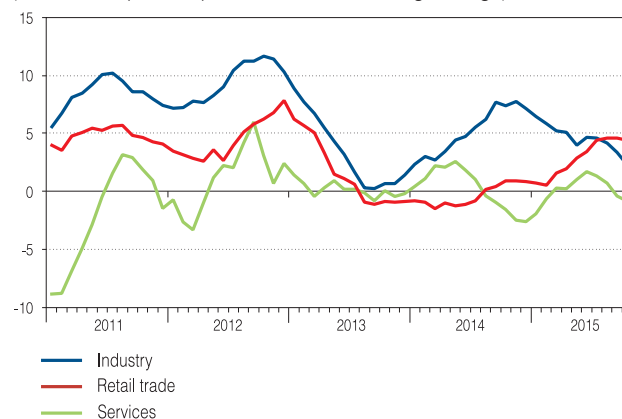
(relative share of firms, per cent)



Sources: NSI, BNB calculations.

Selling Prices Expectations in Industry, Retail Trade and Services in the Following Three Months

(balance of opinions, per cent, 6-month moving average)



Source: NSI.

⁵⁵ See Chapter 3.

As of September 2015 inflation in services (excluding administratively controlled prices) accounted for 0.5 per cent. Consequently, the downward trend in the prices of this group (-1.2 per cent at the end of 2014), which started in early 2014, was reversed. This reflected both the base effects of one-off price declines in 2014 in medical, dental⁵⁶ and telecommunication services, and the appreciation of catering, package holidays, cultural recreation services and accommodation. In the March–September 2015 period transport services had a negative contribution to overall inflation due mainly to lower air transport prices, while indirect effects of lower fuel prices on other types of transport remained limited.

Since early 2015 inflation of energy products was strongly negative impacted by the international oil price declines started in the second half of 2014.⁵⁷ As of September 2015 transport fuel prices decreased by 17.8 per cent on an annual basis and had the largest negative contribution to overall inflation (-1.46 percentage points).

In the first nine months of 2015 inflation in administratively controlled prices remained positive accounting for 1.6 per cent in September. The increase in regulated price of electricity for households by 10.1 per cent from October 2014 was the major factor behind the positive contribution of this group. In 2015 the price of the natural gas bought by Bulgargas went down, reflecting the lower prices of alternatives to natural gas in international markets. This allowed for the Energy and Water Regulatory Commission (EWRC) to decrease the regulated heating and natural gas prices in April and July 2015 but their contribution to overall price dynamics was relatively small. Medicals and other pharmaceutical products were another group following a downward trend in prices since early 2015.

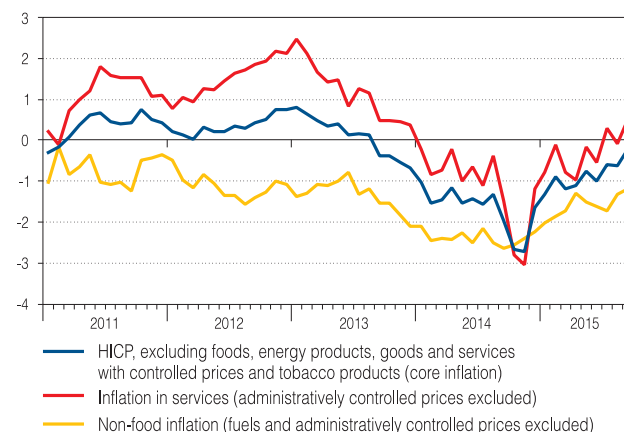
In September 2015 inflation in the group of food accounted for 1.2 per cent (-0.7 per cent at the end of 2014), reflecting higher prices

⁵⁶ From January 2014 fees paid to GPs, specialists and dentists having concluded contracts with the National Health Insurance were administratively reduced to 28.6 per cent.

⁵⁷ In the group of energy products (excluding the administratively controlled prices of energy, heating and central gas supply) transport fuels occupy the largest relative share; hence, their price developments determine the price dynamics of energy products in general.

Core inflation

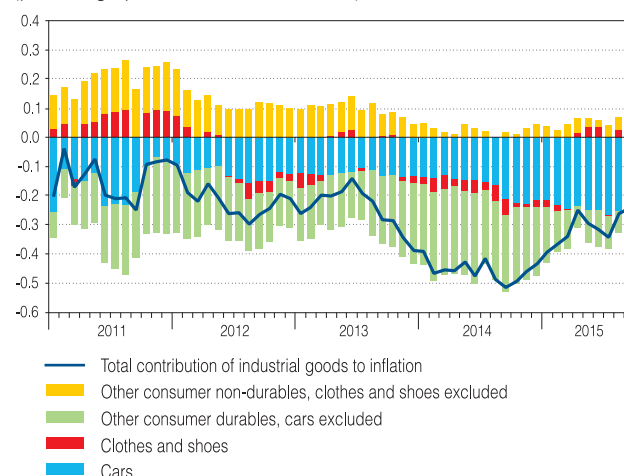
(per cent, on an annual basis)



Sources: NSI, BNB calculations.

Contribution of Non-food Goods (Excluding Energy Products) and Major Goods Sub-groups Inflation to Overall Inflation

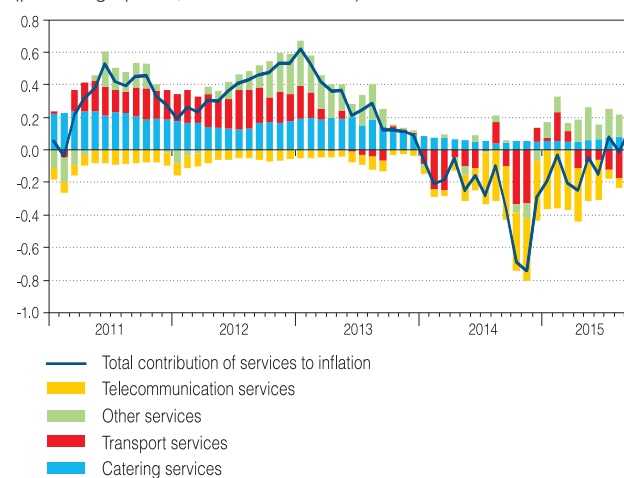
(percentage points, on an annual basis)



Sources: NSI, BNB calculations.

Contribution of Services and Major Sub-groups of Services to Overall Inflation

(percentage points, on an annual basis)



Sources: NSI, BNB calculations.

of processed and unprocessed food. Since the second quarter the positive contribution of processed food reflected mainly price rises in the sugar and sugar confectionery⁵⁸ and animal and vegetable fats and oils groups. This was a result of a turnaround of the downward trend in the wholesale sugar price and increased import prices of animal and vegetable fats and oils. As of September 2015 unprocessed food posted a slight rise on an annual basis reflecting the positive contribution of the fruit and vegetables groups. The continuous price decline since mid-2014 in the meat and meat products group had a dampening effect on the price rise of unprocessed goods.

Inflation expectations for the fourth quarter of 2015 and first quarter of 2016 and uncertainty related to the projection are presented in the fan chart on the annual rate of change in the HICP.⁵⁹ The projection is based on the assumption for a fall in international food prices (in euro) in the fourth quarter of 2015 and their stabilisation in 2016. Following the quarter-on-quarter decline in petroleum prices (in euro) by 19.9 per cent reported in the third quarter of 2015, the Brent crude oil price is expected to stabilise in the fourth quarter tending to gradually appreciate in 2016.

In the fourth quarter of 2015 inflation is expected to range between -1.7 per cent and -0.8 per cent and in the first quarter of 2016 between -0.9 per cent and 0.3 per cent.⁶⁰ The slowdown in the annual rate of decline in the consumer price index in the beginning of 2016 will be determined mainly by the projected decrease in the negative contribution of fuels amid a slight quarter-on-quarter increase in petroleum prices (in euro).

Major risks to the outlook relate mainly to the possible further decline in petroleum prices, thereby the inflation rate will be lower than the projected one. Further depreciation in some goods and services may be expected as a

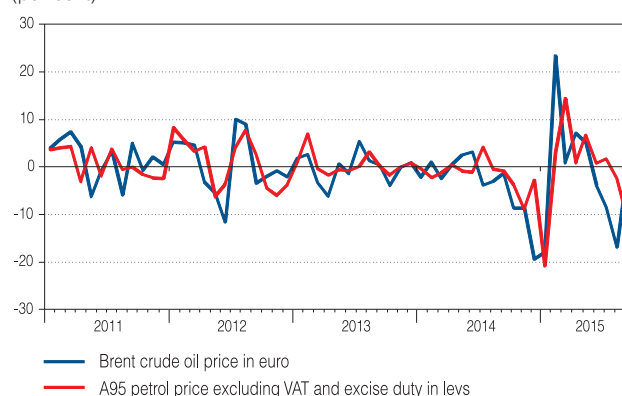
⁵⁸ The full name of the group is: sugar, jams, honey, chocolate and confectionery.

⁵⁹ For further details, see *Measurement and Presentation of Uncertainty in Forecasting Economic Indicators*, Economic Review, 1/2012.

⁶⁰ Thus presented ranges of the expected annual rate of inflation correspond to 40 per cent probability distribution according to our expert forecast of the probability distribution for the relevant quarter.

Monthly Rate of Change in the Prices of Brent Crude Oil and A95 Petrol

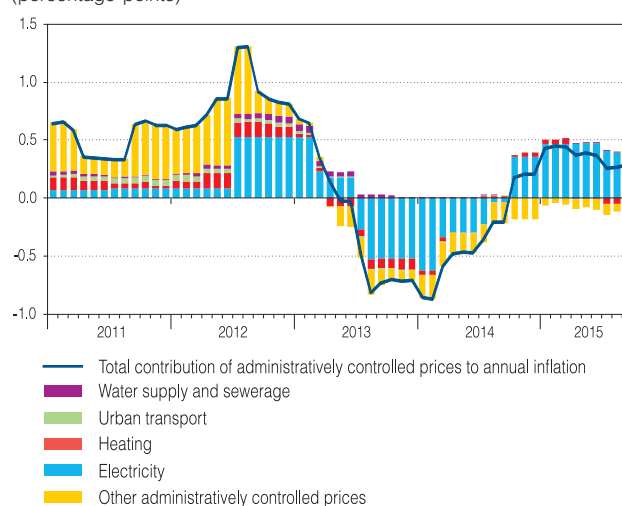
(per cent)



Sources: ECB, NSI, BNB calculations.

Contribution of Major Sub-groups of Administratively Controlled Prices to Overall Inflation

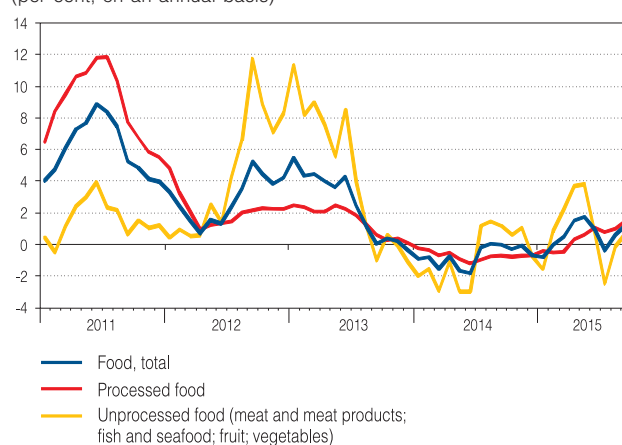
(percentage points)



Sources: NSI, BNB calculations.

Rate of Change of Food Price Index

(per cent, on an annual basis)



Sources: NSI, BNB calculations.

Rate of Change in Major Goods and Services Groups Prices and Their Contribution to Inflation

	Inflation accumulated as of September 2014 (December 2013 = 100)		Inflation accumulated as of September 2015 (December 2014 = 100)		Annual inflation rate as of September 2015 (September 2014 = 100)	
Inflation (per cent)	-1.9		-0.9		-0.9	
	Inflation rate by group, per cent	Contribution, percentage points	Inflation rate by group, per cent	Contribution, percentage points	Inflation rate by group, per cent	Contribution, percentage points
Food	-0.4	-0.09	1.6	0.41	1.2	0.31
Processed food	-1.0	-0.17	1.2	0.20	1.5	0.25
Unprocessed food	0.8	0.08	2.3	0.21	0.7	0.06
Services	-2.7	-0.66	-1.0	-0.25	0.5	0.12
Catering services	0.4	0.02	1.0	0.06	1.5	0.09
Transport services	-3.0	-0.11	-7.1	-0.26	-1.9	-0.07
Telecommunication services	-7.1	-0.34	-0.6	-0.03	-1.2	-0.05
Other services	-2.1	-0.23	-0.2	-0.02	1.4	0.15
Energy products	-4.2	-0.39	-7.2	-0.56	-16.6	-1.46
Transport fuels	-4.4	-0.38	-7.8	-0.55	-17.8	-1.46
Industrial goods	-2.8	-0.55	-1.8	-0.36	-1.2	-0.24
Goods and services with administratively controlled prices*	-1.3	-0.21	-0.8	-0.13	1.7	0.29
Tobacco products	0.7	0.03	0.5	0.02	0.7	0.03

* The index of goods and services with administratively controlled prices is calculated through weighting the relevant elementary aggregates in the consumer basket.

Sources: NSI, BNB calculations.

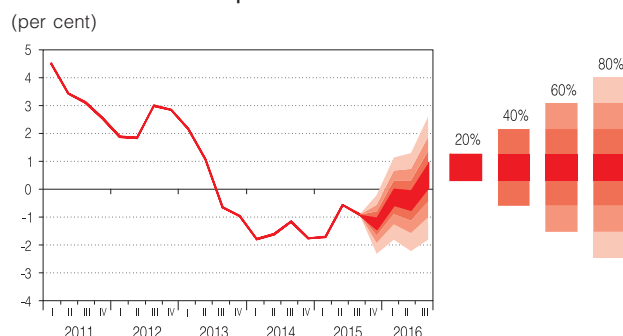
result of the decrease in the price of the natural gas by the EWRC in the fourth quarter of 2015.⁶¹ Corporate managers' steady expectations of new energy products price declines is a prerequisite for stronger indirect effects on other commodity and service groups in the following months. Concurrently, as of August 2015 the EWRC announced a change in energy pricing for corporate customers resulting in an increase of the energy price⁶² which is a prerequisite to anticipate lower than expected deflation in the following months. This effect will be alleviated by the price decrease in the energy for non-household customers by 2.5 per cent on average as from 1 November, reflecting the lowered price of natural gas in the fourth quarter of 2015.⁶³

⁶¹ The Energy and Water Regulatory Commission (EWRC) decreased natural gas and heating prices starting from October 2015.

⁶² From August 2015, the amount of the public service obligations levy on electricity bills for households and industry will be equal. For further details, see the EWRC press release: <http://www.dker.bg/newsbg.php?n=2672>

⁶³ For further details, see the EWRC press release: <http://www.dker.bg/newsbg.php?n=2694>

Fan Chart of the Expected Annual Inflation Rate



Note: The fan chart shows the expert views of the forecasters on the uncertainty around the projected value based on probability distribution. The middle band of the chart, depicted in the darkest colour, includes the central projection and the probability distribution shows 20 per cent probability for the actual value to fall in this band in each of the quarters. If neighbouring bands (in the same brighter colour) are added to the middle band, there would be 40 per cent coverage of the probability mass. Thus, by adding each same colour couple of bands, the probability for the value to fall there would be increased by 20 percentage points to reach 80 per cent. The probability for the value to remain outside the coloured part of the chart is 20 per cent based on the distribution chosen.

Source: BNB.