BULGARIAN NATIONAL BANK

ANNUAL REPORT · 2017

Bulgarian National Bank

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Honourable Madam National Assembly Chair;
Honourable People's Representatives:

I have the pleasure of forwarding to your attention this, the Bank's 2017 Annual Report, in discharge of the duty bestowed upon me by the Law on the Bulgarian National Bank Article 1 paragraph 2 and also by Articles 50 and 51 therein.

The Report comprises an overview of economic developments, detailed information on the Bank's functions and the performance of duties bestowed upon the Bank by the Law on the Bulgarian National Bank, and also of other Bank actions during the year. It further contains a report on the Bank budget and consolidated financial statements (audited) by 31 December 2017, accompanied by an opinion of the international auditors and information on major BNB Governing Council resolutions under Article 17, paragraph 5 of the Law on the Bulgarian National Bank.

In 2017 the Bank continued to seek price stability as its primary duty: a duty discharged by safeguarding national currency stability and by prosecuting a monetary policy as provided for by the Law on the Bulgarian National Bank.

The Bank also performed other functions and discharged other duties as mandated in Law: managing gross international reserves; operating and overseeing payment systems; monitoring banks' reserves deposited with the BNB; managing currency circulation; maintaining banking system stability and protecting depositor interests; resolving credit institutions; participating in the European System of Central Banks and other EU bodies; acting as fiscal agent and official depository; and providing statistics.

Further Bulgarian National Bank duties included running the Central Credit Register and the Bank Account and Safe Deposit Box Register, conducting research, managing human resources, and internal auditing.

Over the course of 2017 the Bank devoted especial attention to the following four areas within its overall purview:

- Optimising overall governance. Law on the Bulgarian National Bank amendments assigned to the Governing Council powers, which had previously resided with the Banking and Banking Supervision Deputy Governors, relating to supervision, early intervention, approvals, authorisations, and consent. Governance and management decision making functions are now cognisant of this optimisation at the operational level.

- Extending banking supervision reform and development. We adopted the Bank Supervisory Process Manual; proposed new statutory moves on lending to internally related parties, most of them enacted in amendments to the Law on Credit Institutions; we assessed banks' ability to implement the new IFRS 9 Financial Instruments standard; we continued harmonising supervision with wider European Union practice by introducing European Banking Authority guidelines.
- Development of the activities related to the recovery and resolution of banks: new rules and methods for practical resolutions of credit institutions were developed, including methodology for determining individual annual contributions of banks and branches from third countries to the Bank Resolution Fund.
- Evolving the statutory framework of payment services, systems, and oversight. Transposing the Payment Services Directive II, we paid especial attention to the new Law on Payment Services and Payment Systems, in force from 6 March 2018; we also continued harmonising payment supervision with wider European Union practice by implementing European Banking Authority guidelines.

In conclusion, I take this opportunity of advising you of the banking sector's favourable state this last year. Capital adequacy and liquidity ratios exceeded EU averages, lending continued growing, non-performing loans declined, profits approached historic highs, and equity consolidation continued.

Dimitar Radev
Governor
of the Bulgarian National Bank

BNB Governing Council

Dimitar Radev
Governor

Kalin Hristov
Deputy Governor
Issue Department

Nina Stoyanova
Deputy Governor
Banking Department

Dimitar Kostov
Deputy Governor
Banking Supervision Department

Boryana Pencheva

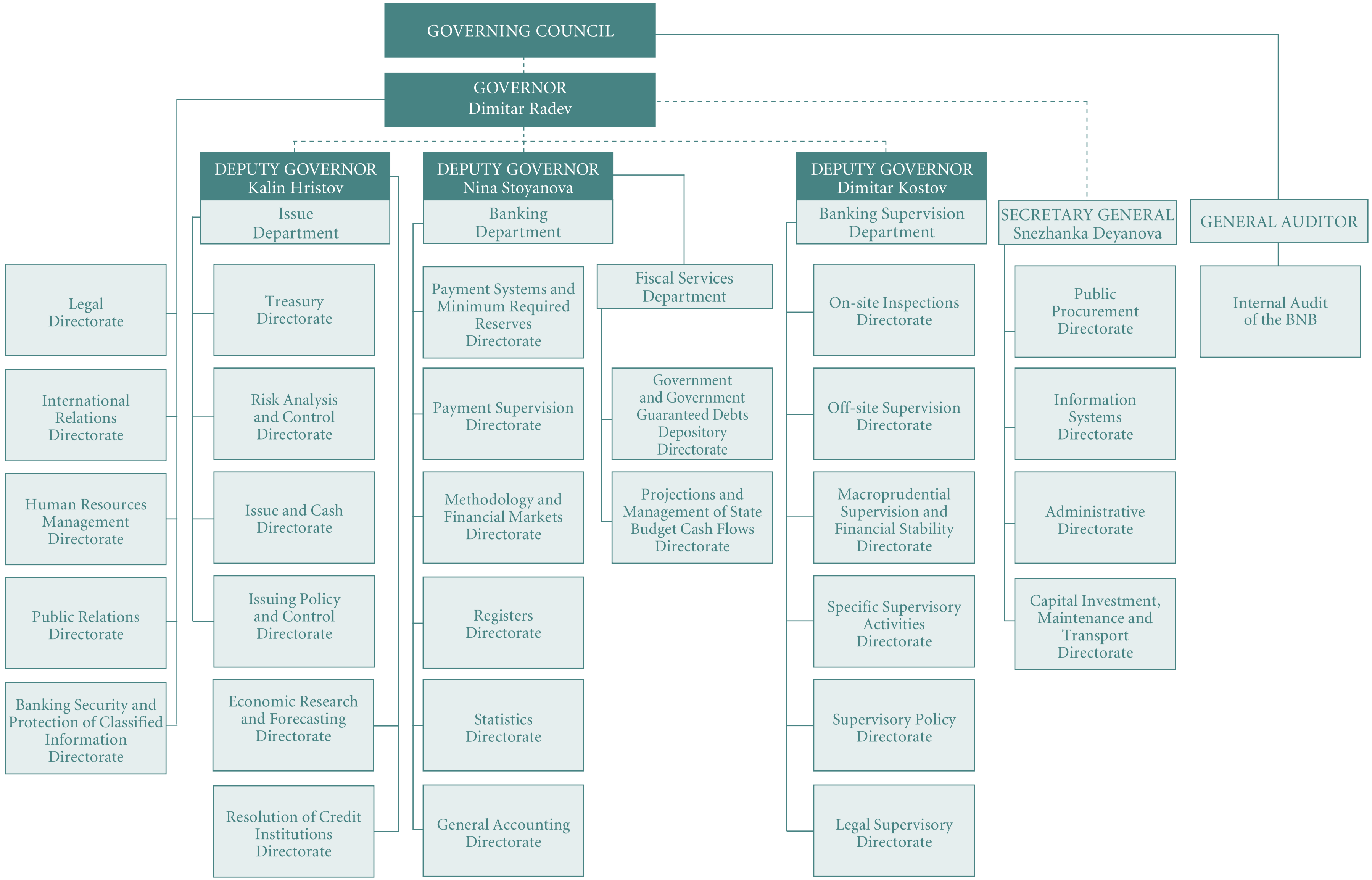
Lena Roussenova

Elitsa Nikolova

BNB Governing Council

Sitting from left to right: Boryana Pencheva, Nina Stoyanova, Lena Roussenova, Elitsa Nikolova.
Standing from left to right: Dimitar Kostov, Dimitar Radev, Kalin Hristov.

Organisational Structure of the BNB
(as of March 2018)



Abbreviations

ABSPP	ECB Asset-backed Securities Purchase Programme
APP	ECB Asset Purchase Programme
AQR	Asset Quality Review
AS ROAD	Automated System for Registration and Servicing of External Debt
ATM	Automated Teller Machine
BIS	Bank for International Settlements
BISERA	Bank Integrated System for Electronic Payments
BNB	Bulgarian National Bank
BOP	balance of payments
BORICA	Bank Organisation for Payments Initiated by Cards
BRF	Bank Resolution Fund
CBPP3	ECB's Third Covered Bond Purchase Programme
CCR	Central Credit Register
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
Ecofin	Economic and Financial Affairs Council of the European Union
EDIS	European Deposit Insurance Scheme
EONIA	Euro OverNight Index Average (registered trademark of the European Money Market Institute, EMMI)
ESA 2010	European System of National and Regional Accounts
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
ESROT	Electronic System for Registering and Servicing Government Securities Trading
EU	European Union
EUR	euro
EURIBOR	Euro InterBank Offered Rate (EURIBOR, registered trademark of the European Money Market Institute, EMMI)
GDP	Gross Domestic Product
GSAS	System for Government Securities Sale and Repurchase Auctions
HICP	Harmonized Index of Consumer Prices
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOBFR	System for Budget and Fiscal Reserve Information Servicing
LBDG	Law on Bank Deposit Guarantee
LBNB	Law on the Bulgarian National Bank
LCI	Law on Credit Institutions
LEONIA	an interest rate on real transactions in unsecured overnight deposits in BGN offered at the interbank market
LPSPS	Law on Payment Services and Payment Systems
LRRCIIF	Law on the Recovery and Resolution of Credit Institutions and Investment Firms
LTROs	Longer-term refinancing operations
MF	Ministry of Finance
MFI	Monetary Financial Institutions
NPISH	Non-profit institutions serving households
NSI	National Statistical Institute
OPEC	Organization of Petroleum Exporting Countries
POS	Point of sale/point of service: a retail trade terminal for credit and debit card transactions
PSPP	Public Sector Purchase Programme
RINGS	Real-time gross settlement system
ROA	Return on Assets
ROE	Return on Equity
SDR	Special Drawing Rights
SEPA	Single Euro Payments Area
SITC	Standard International Trade Classification
SOFIBID	(Sofia Interbank Bid Rate) is an index calculated as the average of the bid quotes for unsecured BGN deposits
SOFIBOR	(Sofia Interbank Offered Rate) is a fixing of the quotes for unsecured BGN deposits offered in the Bulgarian interbank market
TARGET2	Trans-European Automated Real-time Gross Settlement Express Transfer System for the Euro
TARGET2-BNB	Bulgarian system component of TARGET 2
VaR	Value-at-Risk
VAT	value added tax
WB	World Bank
XAU	troy ounce gold
ZUNK	Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990

Contents

Summary

Global economic activity continued improving in 2017, real world economic growth reaching 3.7 per cent from 3.2 a year earlier. Advanced economies grew faster, though both emerging and developing economies continued recovering. International commodity prices rose due to lower excess supply, and food prices declined slightly. Global inflation rose insignificantly to 2.1 per cent at the end of 2017 from 2.0 per cent in 2016. Developed world inflation accelerated to 1.6 per cent from 1.1 per cent, while developing countries saw 3.3 per cent from 3.2 per cent in December 2016.

Euro area growth accelerated to 2.4 per cent from 1.8 per cent in 2016, with private consumption and investment in fixed capital contributing most, followed by net exports. Euro area inflation rose to 1.4 per cent annually from 1.1 per cent in 2016, core inflation (excluding food, energy, alcohol and tobacco) remaining at 0.9 per cent. ECB monetary policy continued pursuing favourable financing conditions to meet the euro area medium term inflation target. ECB main refinancing operation, marginal lending, and deposit facility interest rates stayed unchanged at 0.00, 0.25 and -0.40 per cent. ECB extended Asset Purchase Programme securities purchase volumes remained EUR 80 billion a month to the end of March, falling to EUR 60 billion after.

The US economy grew 2.3 per cent: faster than 2016's 1.5 per cent, private investment contributing greatly. US Consumer Price Index inflation stayed steady at 2.1 per cent at the end of 2017. Unemployment was 4.1 per cent. Continuously improving US economic data prompted the Federal Reserve to raise federal funds rate target interest range by 25 basis points in each of three steps to 1.25–1.50 per cent by the year's end. In October the Federal Reserve began gradually curbing the reinvested portion of the funds from the maturing government securities and mortgage bonds of its portfolio.

In a favourable environment, international financial markets saw steady prices of developed country shares and bonds. Markets mostly sensed uncertainty on US tax reform scope and likelihood, political uncertainty on the French presidential elections and US/North Korean tensions. By the end of 2017 all German government bonds with under six-year maturities traded at negative yields on euro area financial markets. Spreads between yields on euro area periphery government bonds and German benchmark bonds decreased significantly in 2017.

In 2017 Bulgaria's real GDP was 3.6 per cent from 3.9 per cent in 2016. Private consumption contributed most to growth whereas the contribution of net exports was negative. An important factor behind the strong real growth of consumption was the increase in household disposable income in the context of increasing employment and wages, and decreasing unemployment rate. The negative contribution of net exports of goods and services to growth reflected the stronger growth rate of imports (by 7.2 per cent) driven by significantly increased domestic demand. Exports nevertheless rose 4.0 per cent in real terms. Real fixed capital investment grew 3.8 per cent, entirely due to private investment, public investment continuing to fall.

Annual inflation was 1.8 per cent in December 2017 from -0.5 per cent in 2016, driven by foreign and domestic factors: dearer world oil and commodities, food imports, administratively controlled prices of some goods and services, and higher tobacco excise.

Monetary aggregates continued to reflect the sustained significant inflow of funds attracted from residents in the banking system. The broad monetary aggregate M3 grew relatively fast at 7.7 per cent annually from 7.6 per cent at the end of 2016. In December 2017 non-government sector deposits in the banking system totalled BGN 72.4 billion, up 6.1 per cent from 7.0 per cent a year earlier. Bank lending to the non-government sector grew 4.7 per cent annually amid favourable macroeconomic environment, gradual lending rate declines, and increased absorption of funds under the National Multi-Family Residential Building Energy Efficiency Programme.

LEONIA/LEONIA Plus index, reporting real transactions in the lev unsecured deposits in interbank overnight market was volatile due to a small number and low volume of transactions. The fourth quarter of 2017 saw a stronger decline in LEONIA Plus index and increase in the volume of transactions due to BNB's lower interest rate on banks' excess reserves, effective as of October 2017.

The consolidated fiscal programme surplus was BGN 845.6 million (0.9 per cent of GDP). The budget balance significantly exceeded the government's programme target of a BGN 1330 million deficit, mainly thanks to higher tax revenue and lower capital expenditure. In 2017 the government followed a policy on reducing government debt with a the government debt/GDP ratio declining to 25.4 per cent at the end of 2017 from 29.0 per cent at the end of 2016.

The Bulgarian National Bank conducts its policy taking into account the international situation and developments in the domestic economy. The BNB pursues its primary objective of price stability through maintaining national currency stability by adhering to the Law on the Bulgarian National Bank and applying its potential and capabilities effectively. Amendments to the Law on the BNB, the Law on Credit Institutions, and the Law on Payment Services and Payment Systems (Darjaven Vestnik Issue 97 of 5 December 2017) assigned the Governing Council bank and payment supervision supervisory, early intervention, approval, authorisation, and consent powers which had previously resided with individual Deputy Governors.

This report covers activities relating to BNB statutory duties and functions and other activities in support of these functions and duties. The report also covers the 2017 BNB budget, consolidated financial statements by 31 December 2017 (audited), and information on major 2017 BNB Governing Council resolutions as set out in the Law on the BNB Article 17 paragraph 5.

In 2017 the BNB continued its conservative policy in gross international reserve management. New constraints on maximum individual exposure to BNB counterparty banks came into force in early 2017, cutting permissible exposure by 1 per cent of international reserve market value for each of the five relevant risk bank groups. To achieve the main international reserves management objectives of security and liquidity, the Bank continued investing most assets into core euro area government bonds and government guaranteed debt. Investment credit quality remained high and by the close of the year AAA long term credit rated assets represented 67 per cent of international reserves. All assets met strict liquidity requirements, the share of most liquid financial instruments at 48 per cent.

Gross international reserve market value was EUR 22,708 million, down EUR 167 million or 1 per cent on end-2016. The main factors governing market value of assets were management, foreign currency revaluation gains, and the effect of external cash flows. International reserve management net income was EUR -73.02 million or -0.33 per cent 2017 total profitability. Broken by component, net income comprised: earnings from international reserve investment in the original currency, which was negative, worth EUR -74.16 million, reflecting mainly negative interest rates and higher yields of euro-denominated government bonds, which in turn contributed to lower securities prices of the BNB portfolio; earnings from currency imbalance

(EUR -16.90 million) almost entirely reflected changes in the euro price of monetary gold; and the net financial result of liabilities, which was positive (EUR 18.04 million), reflecting the early January 2016 new interest rate policy on bank excess reserves and negative market rates on other customers' account balances.

The Law on the Bulgarian National Bank tasks the Bank with payment system organisation, support, and development by assisting the implementation, operation, and oversight of efficient payment mechanisms. In 2017 BNB participated in drafting the new Law on Payment Services and Payment Systems, transposing into Bulgarian legislation the requirements in Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 (the Payment Services Directive II) on payment services in the internal market to update payment services legal framework.

The BNB operated two major payment systems: Real-time Gross Settlement System (RINGS) which in 2017 processed 81.9 per cent of the payments effected in Bulgaria and 0.5 per cent of total lev payments, and the national system component of the Trans-European Automated Real-time Gross settlement Express Transfer system for the euro (TARGET2-BNB), with the payments made *via* the system increasing by 6.8 per cent in number and 1.4 per cent in value from 2016.

In line with the Law on the BNB and the Law on Payment Services and Payment Systems, the BNB regulates and oversees payment system operators, payment service providers and electronic money institutions in Bulgaria. In 2017 the BNB licensed one electronic money institution, refused three applications for licences to conduct bank transactions as a payment institution, and terminated an electronic money institution licensing procedure at the applicant's request. In 2017 the Bank inspected four payment service providers to check adherence to the Law on Payment Services and Payment Systems and its statutory instruments.

In the first nine months of 2017 banks continued to maintain high excess reserves on their accounts with the BNB, the excess funds on banks' minimum reserve accounts with the BNB over the required minimum under Ordinance No 21 comprising 112.3 per cent of minimum required reserves on average. According to the changed methodology of setting interest rates to be applied on accounts with the BNB, effective as of 4 October 2017, the BNB applies on banks' excess reserves an interest rate equal to the lower of the two figures: 0 per cent and ECB deposit facility rate reduced by 20 basis points. This change resulted in cutting interest on bank excess reserves with the BNB to -0.60 per cent. In the fourth quarter banks' excess reserves decreased by BGN 4.6 billion on average from the end of September, and banks' excess funds with the BNB over the required minimum of reserve assets decreased to 47.4 per cent of minimum required reserves. At the end of 2017 banks' reserves posted an annual drop of 3.8 per cent, down 2.2 per cent from December 2016.

BNB issue and cash operations include: banknote printing, coin minting, accepting, delivering, repaying, processing, authenticity and fitness checking of Bulgarian banknotes and coins and foreign currency, exchanging damaged Bulgarian banknotes and coins, and scrapping unfit Bulgarian banknotes and coins.

In 2017 producers supplied 66.2 million new banknotes and 179.9 million new coins worth BGN 2779.4 million nominal value. The Bank issued the five commemorative coins scheduled in its 2017 Minting Programme. By the close of 2017 circulating banknotes numbered 452.9 million, worth BGN 15,333.2 million nominal value. Their number rose 27.1 million or 6.37 per cent and their value BGN 1494.2 million or 10.80 per cent. In late 2017, 2289.4 million coins, worth BGN 362.4 million circulated. Year on year, the total number of circulating coins rose 8.26 per cent (174.8 million), and their value 18.18 per cent (BGN 55.7 million) across all denominations, reflecting the distribution of BGN 2 coin. Discharging its control duties the Bank conducted four full credit institution and service provider inspections to check observance of banknote and coin quality standards, and topical onsite checks at twenty credit institutions and five service providers.

Banking Supervision analysed and assessed banking system and individual banks to identify potential risks in a timely manner and initiate remedial measures. One of the priorities of the off-site supervision in the supervisory review and evaluation process related to the preparation of periodic assessment of the adequacy of own funds, liquidity, and credit institutions' risk profiles and recovery plans. Credit institutions implementation of supervisory inspection recommendations was subject to monitoring. Alongside ongoing supervision, supervisory inspections of banks focused on set risk management processes and systems, and internal capital needs identification, organisation, rules and methodology in credit institution internal capital adequacy analysis. Supervisors assessed previous inspection report measures and recommendation implementation. Inspections resulted in supervisory measures and recommendations. Macroprudential supervision focused on the inherent risks affecting banking system stability. The year saw a review of the systemic risk buffer and the other systemically important institution buffer. The countercyclical capital buffer continued being assessed and analysed every quarter.

Entry into force of the IFRS 9 Financial Instruments standard on 1 January 2018 prompted the Bank to run two surveys on anticipated effects.

In 2017 banks maintained adequate liquidity and capital positions. Banking system assets rose by BGN 5.7 billion (6.2 per cent) to BGN 97.8 billion. Banking system balance sheet posted an increase in attracted deposits, loans and advances, and securities holdings. Banks reported BGN 1150 million of profits, ROA and ROE slightly down on 2016 at 1.18 and 9.15 per cent. The common equity tier one, tier one capital, and total capital adequacy ratios were 20.41, 20.86 and 22.08 per cent. The liquid assets ratio calculated under the BNB Ordinance No 11 reached 38.97 per cent (against 38.24 per cent at the end of 2016). The trend to asset quality improvement continued. Net non-performing loans and advances representing potential credit risk in bank balance sheets remained entirely covered by capital exceeding the 8 per cent regulatory minimum.

In 2017 the BNB adopted internal rules establishing the procedures for preparation and decision making, and powers related to their implementation with a view to discharge its duties as a resolution authority of credit institutions under the Law on Recovery and Resolution of Credit Institutions and Investment Firms (LRRCIIF).

Work continued on methods and procedures for uniform approaches to recovery plan assessment and analysis and on other Bank duties according to the LRRCIIF. The BNB participated in international colleges for resolution of cross-border banking groups from the EU. In March the Bank set 2017 banking system dues to the Bank Resolution Fund (BRF) at BGN 111,274,000. All banks remitted their dues on time.

Participating in ESCB, European Commission, EU Council, European Systemic Risk Board (ESRB), European Banking Authority (EBA), and national Council for European Affairs committees and working parties, the BNB contributed to formulating Bulgarian standpoints on key economic governance areas and the financial sector. BNB representatives helped elaborate ECB legal instruments and took part in negotiating EC legislative proposals under the competence of central banks. In 2017 interaction and cooperation with the supervisory colleges, and international colleges for resolution continued.

The BNB gathers and disseminates data on monetary and interest rate statistics and the long term interest rate for assessing the degree of convergence, publishes statistical data on non-bank financial institutions, the balance of payments, the international investment position, gross external debt, and the reserve and foreign currency liquidity template. The Bank also compiles data on the quarterly financial accounts of the general government sector, government finance statistics, and all institutional sectors' quarterly financial accounts.

The BNB maintains the Central Credit Register (CCR) on customer debt to Bulgarian banks, other financial institutions, and payment and electronic money institutions extending loans under Article 19 of the Law on Payment Services and Payment Systems. New information from reporting units on co-borrowers, guarantors, or loan avalists is now being incorporated into the CCR to improve the quality of Register information. In 2017 CCR conducted 7,258,000 electronic searches: monthly average of 605,000, of which 68.3 per cent by banks and 31.7 per cent by other participants.

On 3 January 2017 the BNB opened a Register of Bank Accounts and Safe Deposit Boxes. It keeps information from banks and foreign bank branches operating in Bulgaria on bank account numbers, holders and attorneys, and deposit box holders and their attorneys. It listed 2.98 million extant and 3.45 million closed accounts. Bodies and institutions entitled to Register access conducted searches on 508,066 individuals.

Acting as fiscal agent and official depository the BNB maintains, develops and improves electronic systems for budget and fiscal reserve information servicing, auctions, settlement and securities trade servicing, the Register of Pledges, and external debt transactions. Late September saw a direct link from the BNB Government Securities Depository to the Bulgarian Stock Exchange – Sofia AD system allowing government securities trading on the Exchange, trade starting on 1 November.

Economic research and projections support the Bank's management in making decisions and forming economic policy standpoints. The 2017 Research Plan covered analysis of labour cost setting in non-financial corporations, the effects of non-financial corporations' debt on the economy, factors driving investment, the transmission mechanism, relations between the financial and business cycles, and the potential mismatch between labour demand and supply. In 2017 the BNB continued to encourage the research potential of Bulgarian economic science and practice in the area of macroeconomics and finance through its Discussion Papers research series. The year saw eleven new submissions reviewed by the BNB's Publications Council, of which six were published.

Developing and maintaining a competitive human resource management system is ever important. Priorities included providing favourable working and social environment to attract and keep qualified employees and attractive career development. The year saw continued optimisation of employee assessment and adequate remuneration systems tailored to performance, results, and statutory requirements. An annual training schedule offered employees plentiful opportunities to take a variety of training and qualification boosting programmes.

BNB internal audit conforms to the International Standards for the Professional Practice of Internal Auditing, the Code of Ethics of Internal Auditors, ESCB Internal Auditor Committee Rules and Internal Auditor Rules approved by the BNB Governing Council. There were eleven audits, of which eight under the annual Governing Council Internal Audit Unit Programme and three under the ESCB Internal Auditors Committee Programme. Audits sought assurance of risk management, control and management of relevant areas.

The BNB budget underpins Bank performance. In 2017 the BNB spent BGN 78,511,000 or 83.6 per cent of the adopted budget, including cash circulation at BGN 19,666,000, materials, services, and depreciation at BGN 26,541,000, and staff at BGN 26,943,000. The Bank's 2017 investment programme cost BGN 2,558,000 or 17.5 per cent of the budget.

Consolidated financial statements present the Bank's financial position as of 31 December 2017.

I. Economic Development in 2017

The External Environment

Preliminary estimates show that in 2017 real global economic growth accelerated to 3.7 per cent from 3.2 in 2016.[1] Developed economies including the USA, the euro area, Japan and Canada enjoyed stronger growth. The United Kingdom reported a slowdown in economic activity. Activity recovered in emerging and developing economies, Russia and Brazil reporting an annual decline and China preserving a sustainable growth rate.

In 2017 global industrial production grew 3.5 per cent, a significant acceleration from 1.8 per cent a year ago.[2] Developing economies also reported a faster increase than in 2016. By country, output growth slowed only in Africa and Middle East. World goods and services trade growth also accelerated to 4.7 per cent in 2017 from 2.5 per cent in 2016 with developed, emerging, and developing economies contributing alike.[3]

Major Macroeconomic Indicators

(per cent)

	Average annual real GDP growth			Inflation (end of year)			Unemployment rate (average annual)		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
EU	2.3	2.0	2.4	0.2	1.2	1.7	9.4	8.6	7.6
Euro Area	2.1	1.8	2.3	0.2	1.1	1.4	10.9	10.0	9.1
New non-euro area Member States	4.0	3.1	4.7	-0.3	0.9	2.0	7.5	6.1	5.0
EU-3	2 6	2.1	1.9	0.3	1.5	2.7	5.7	5.2	4.8
United States	2.9	1.5	2.3	0.7	2.1	2.1	5.3	4.9	4.4
Japan	1.4	0.9	1.7	0.2	0.3	1.0	3.4	3.1	2.8
China	6.9	6.7	6.8	1.6	2.1	2.3	4.1	4.0	4.0

Notes: New non-euro area Member States are countries joining since 2004 less those now in the euro area. The EU3 are the United Kingdom, Sweden, and Denmark. New non-euro area Member States and EU3 indicators are calculated by weighing time series by country weights in group GDP for growth, in group labour force for unemployment, and the weights of the EU countries in HICP calculated by Eurostat for inflation. The GDP growth estimate for the euro area in 2017 is preliminary; data on Luxembourg real GDP are not published.

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

The euro area reported a sustainable economic activity rise underpinned by the ECB's monetary policy measures and higher global economic growth. Euro area real GDP growth accelerated to 2.3 per cent from 1.8 per cent last year, led by private consumption and fixed capital investment, followed by net exports. Economic activity accelerated in all euro area countries, except Spain.[4] Ireland, Malta, and Slovenia reported highest economic growth at 7.7, 6.6, and 5.0 per cent respectively, while Greece, Italy and Belgium reported the weakest economic growth at 1.4, 1.5, and 1.7 per cent. Unemployment rate fell to 9.1 per cent on average from 10.0 per cent in the previous year, with Greece and Spain still recording the highest values at 21.6 and 17.3 per cent. In 2017 as in 2016 Germany remained the country with the lowest unemployment rate of 3.8 per cent, followed by Malta 4.0 per cent.

[1] IMF data: World Economic Outlook Update, January 2018.

[2] CPB data: Netherlands Bureau for Economic Policy Analysis, 22 February 2018.

[3] IMF data: World Economic Outlook Update, January 2018.

[4] Luxembourg published no data on real GDP growth in 2017.

Real US economic growth was 2.3 per cent, accelerating considerably on 2016's 1.5 per cent. Private investment led higher 2017 growth followed, to a much lesser extent, by a reduced detraction by net exports. Unemployment continued falling to reach 4.4 per cent on average for the year from 4.9 per cent in 2016.

International commodity prices (excluding food) in both US dollars[5] and euro increased on 2016 as a result of the decline reported in global excess supply. The price of Brent crude oil rose in US dollars 23.5 per cent and in euro 21.0 per cent on average on an annual basis. The agreement to extend oil output cuts between OPEC and other major oil producers until the end of 2018 and the increased oil demand were the main factors behind this increase. Oil production disruptions after US hurricanes and North Sea and Libya pipeline breaches also hiked prices temporarily. Food prices fell 1.6 per cent on an annual basis in US dollars and -3.3 per cent in euro. There were differences between food price index sub-components, wheat rising 6.1 per cent annually in euro as global stocks fell. Metals prices rose 20.7 per cent in USD (18.1 per cent in EUR) as increasing output boosted demand while China curbed supply to cut pollution. Copper increased most as major copper mines suffered disruptions.

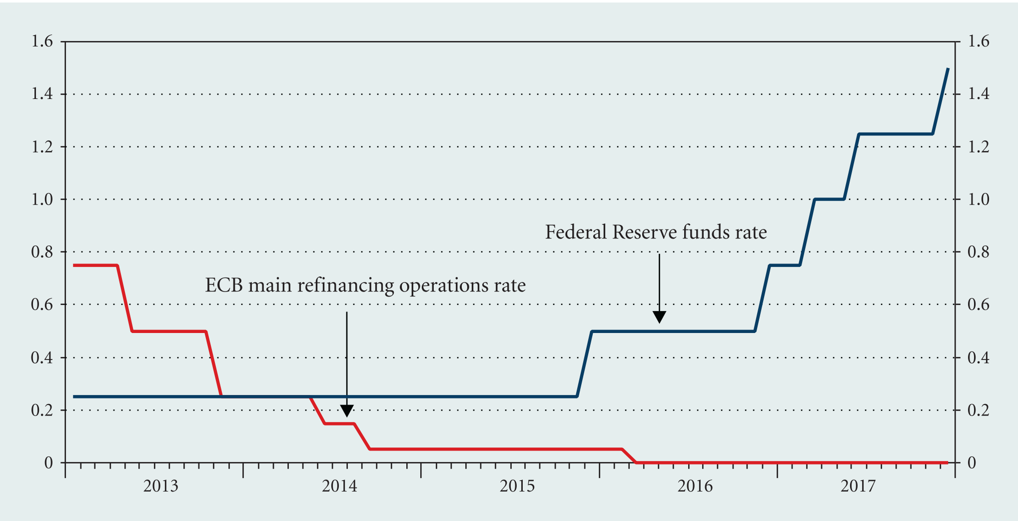
Global annual inflation went up from 2.0 to 2.1 per cent[6]: from 1.1 to 1.6 per cent in developed countries and from 3.2 to 3.3 per cent in developing ones.[7]

Euro area annual inflation[8] rose from 1.1 to 1.4 per cent, core inflation (excluding food, energy, alcohol and tobacco) staying at 0.9 per cent for a third year. Estonia, Lithuania, and Austria led annual inflation at 3.8, 3.8, and 2.3 per cent, while Cyprus, Ireland, and Finland trailed at -0.4, 0.5, and 0.5 per cent.

US inflation measured by the Consumer Price Index (CPI)[9] remained at 2.1 per cent at the end of 2017. Annual inflation measured by the personal consumption expenditure price index was slightly up on the 1.6 per cent in 2016 at 1.7 per cent, but below the Federal Open Market Committee (FOMC) target.

Federal Reserve System and ECB Interest Rates

(per cent)



Sources: the ECB; the Federal Reserve System.

[5] Referred to as the US dollar below.

[6] Based on World Bank data, Global Economic Monitor Database. The World Bank measures CPI change in country groupings as a weighted average of CPI changes in group countries. Real GDP based on purchasing power parity is used to calculate country weights. Groups include only World Bank Member States.

[7] Based on World Bank data, Global Economic Monitor Database.

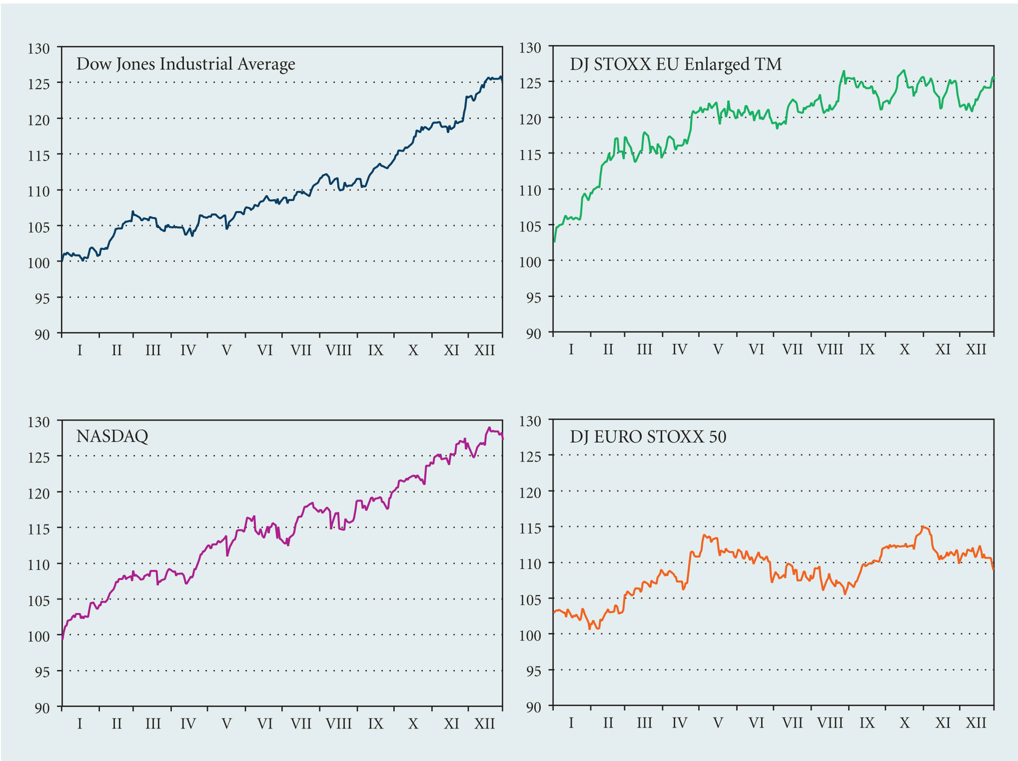
[8] Measured by the HICP.

[9] Non-seasonally adjusted data.

ECB[10] monetary policy continued to aim at favourable financing conditions to achieve medium-term inflation target. Interest rates on main refinancing operations, marginal lending facility and deposit facility remained unchanged in 2017 at nil, 0.25 and -0.40 per cent. Net monthly ECB Asset Purchase Programme (APP) volumes stayed EUR 80 billion to the end of March, then dropping to 60 billion. In June forward guidance on key interest rates changed to keep rates at their current levels for an extended period after asset purchasing ends. The guidance excluded interest rate cuts as it deemed euro area deflation risks spent. In October 2017 the ECB extended the APP, cutting January to September 2018 monthly volumes to EUR 30 billion and leaving the possibility of volume and/or duration rises open in response to inflation target deviations. December 2017 saw greater confidence that euro area inflation would meet ECB targets.

Improving 2017 US economic data allowed the FOMC to fulfil its 2016 intentions of raising the federal funds rate target range three times in 2017. Unemployment dropping to 4.1 per cent at the end of 2017 (below FOMC long term-equilibrium value assessments) was a key factor in ongoing US monetary normalisation. In the USA the 2017 inflation rate measured by the price index of personal consumption expenditure was below target, which the FOMC ascribed to one-off factors. At its March, June and December 2017 meetings FOMC decided to raise the federal funds rate target range by 25 basis points reaching 1.25–1.50 per cent. In June the FOMC announced it would cut Federal Reserve balance sheet assets by directing a rising share of proceeds from maturing government securities and Federal Reserve portfolio mortgage bonds away from new instruments from October.

Main Stock Exchange Indices in 2017



Note: US dollars, December 2016 = 100.

[10] For details on ECB and US Federal Reserve monetary policies, see Chapter II.

Burgeoning global economic activity and anticipated Federal Reserve and ECB moves were the main drivers of international financial market prices. The French presidential elections were among temporary factors affecting international financial markets in the first half. Rising tension between the USA and North Korea and US tax reform had a temporary effect on international financial market prices in the second half. The EURO STOXX 50 and STOXX EU Enlarged European stock indices and the US Dow Jones and NASDAQ increased on 2016 as investor risk appetite grew.[11]

The Bulgarian Economy

Real Bulgarian GDP rose 3.6 per cent (3.9 per cent in 2016). Economic activity grew most from private consumption and less from fixed capital investment, government consumption, and inventories changes. In a good international environment rising Bulgarian competitiveness[12] continued boosting goods and services exports by 4.0 per cent in real terms. Net exports detracted from growth as imports grew more at 7.2 per cent. Private investment drove gross fixed capital formation growth, government investment continuing to drop, though less than in 2016.[13] Improving economic indicators underpinned private consumption and investment, suggesting that households and businesses continue to be more optimistic on the Bulgarian economy.

The number of employed people grew, unemployment fell continuously and real wage rose. Annual private consumption grew 4.8 from 3.6 per cent driven by the above factors and consumer confidence.

Real government consumption grew 3.2 per cent, wage rises leading, followed by operating expenditure and health insurance contributions.

Fixed capital investment increased 3.8 per cent in real terms because of private investment as business optimism and capacity utilisation rose. Government investment continued to decline as a result of low national investment throughout the year.

GDP Change in Real Terms and Contribution by Component of Final Use

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

	2016		2017	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
GDP	**3.9**	-	**3.6**	-
Final consumption	3.3	2.6	4.5	3.4
Household consumption	3.5	2.2	4.8	2.9
NPISH consumption	8.7	0.1	6.7	0.0
Final consumption expenditures by general government	1.8	0.1	2.5	0.2
Collective consumption	2.6	0.2	4.0	0.3
Gross fixed capital formation	-6.6	-1.4	3.8	0.7
Physical changes in inventories	-	0.4	-	1.1
Exports (goods and services), net	-	2.3	-	-1.7
Exports (goods and services)	8.1	5.2	4.0	2.6
Imports (goods and services)	4.5	-2.9	7.2	-4.3

Sources: the NSI, BNB calculations.

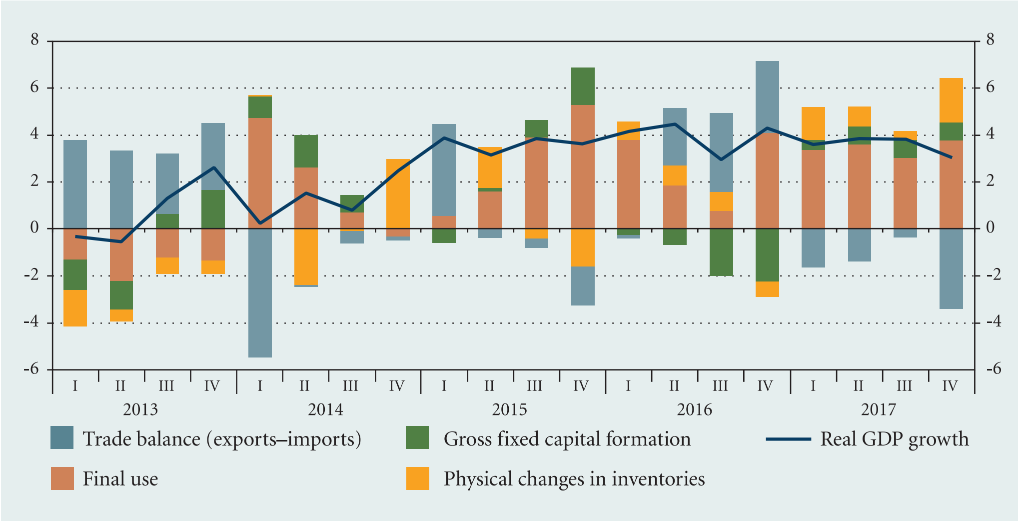
[11] For more information on government bond markets, see Chapter II.

[12] Bulgarian exports' share of world markets grew steadily, indicating increasing Bulgarian competitiveness. In 2017 this indicator rose by 5.8 per cent.

[13] Private and government investment is assessed by available national accounts data on overall investment in the economy, quarterly non-financial accounts data on the general government sector, and NSI reports on consolidated fiscal programme implementation.

GDP Rate of Change in Real Terms and Contribution by Component of Final Use

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



Sources: the NSI, BNB calculations.

Real gross value added growth in the economy rose to 3.7 on 3.4 per cent. Almost all sectors’ gross value added increased, services and industry contributing 2.8 and 1.0 percentage points, and agriculture[14] neutral. Among services, real estate activities, wholesale and retail trade[15] and public services[16] grew, only information and communication[17] gross added value contracting. Construction marked a more significant 5.9 per cent rise in industry. Industry value added[18] rose 3.0 per cent, retaining its greater contribution to gross value added growth.

Gross Value Added Rate of Change in Real Terms and Contribution by Industry

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

	2016		2017	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
Gross value added	**3 4**	-	**3.7**	-
Agriculture and forestry	5.3	0.3	-0.1	0.0
Industry*	4.0	1.1	3.4	1.0
Services	3.1	2.1	4.2	2.8

* Industry and construction.

Sources: the NSI, BNB calculations.

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14 Agriculture, forestry, and fishing sector by economic activity groupings (A 10).

15 Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities by economic activity groupings (A 10).

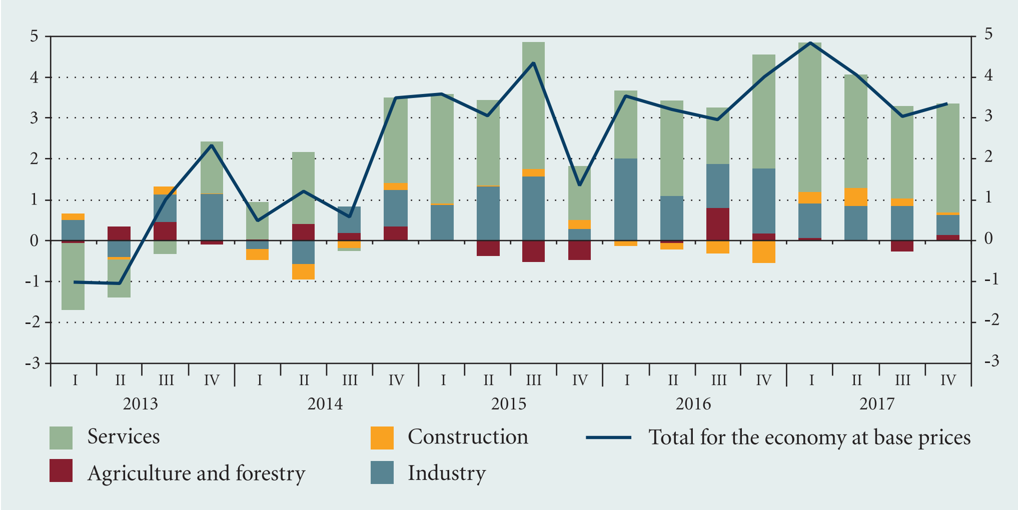
16 General government, education, and human health and social work activities by economic activity groupings (A 10).

17 Information and communication by economic activity groupings (A 10).

18 Mining and quarrying; manufacturing; electricity, gas, steam and air conditioning supply; water supply; sewerage, waste management and remediation by economic activity groupings (A 10).

Gross Value Added Rate of Change in Real Terms and Contribution by Industry

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



Sources: the NSI, BNB calculations.

The labour market continued improving. The number of employed people rose 1.8 per cent on 0.5 per cent in 2016. Employment grew in all economic sectors, agriculture leading at 1.2 percentage points, with a significant rise in self-employment, mainly as a result of one-off factor effect in 2016, leading to a significant decline in self-employment in this sector.

NSI Labour Force Survey data show unemployment continuing to fall to 6.2 per cent on average from 7.6 per cent in 2016. Employment Agency data also demonstrate that unemployment continued dropping to 7.2 per cent on average from 8.8 per cent in 2016. Long term (over a year) unemployment fell more than short-term (up to a year). Long term unemployment accounted for 54.8 per cent: lower than 2016's 59.7 per cent. The labour force participation rate of 15–64 year olds rose greatly to 71.3 per cent from 68.7 per cent on average in 2016 as new entrants joined. The number of discouraged persons continued falling to 115,000 from 165,000 in 2016.

Labour demand amid buoyant economic activity, minimum wage and insurance threshold rises, changes in pension contributions and education wage rises drove labour costs. Nominal compensation *per* employee in the total economy rose 7.9 per cent, from 7.7 per cent in 2016. Compensation *per* employee increased 7.5 per cent from 5.8 per cent in 2016, industry and public services contributing most. Nominal wage *per* employee in the total economy rose 6.6 per cent from 6.2 per cent in 2016, industry sub-sectors helping most at 11.4 per cent in industry and 31.4 per cent in construction. Real annual wage[19] growth fell to 5.3 per cent from 7.6 per cent in 2016.

Total economy labour productivity[20] growth slowed to 1.7 per cent from 3.4 per cent in 2016. Information and communications services and agriculture, forestry and fishing detracted from productivity growth.

Faster compensation per employee than labour productivity rises pushed nominal unit labour costs up 5.7 per cent from 2.3 per cent in 2016. Services sub-sectors real estate activities, information and communication, and financial and insurance activities saw declines in this indicator on an annual basis. Real unit labour costs in

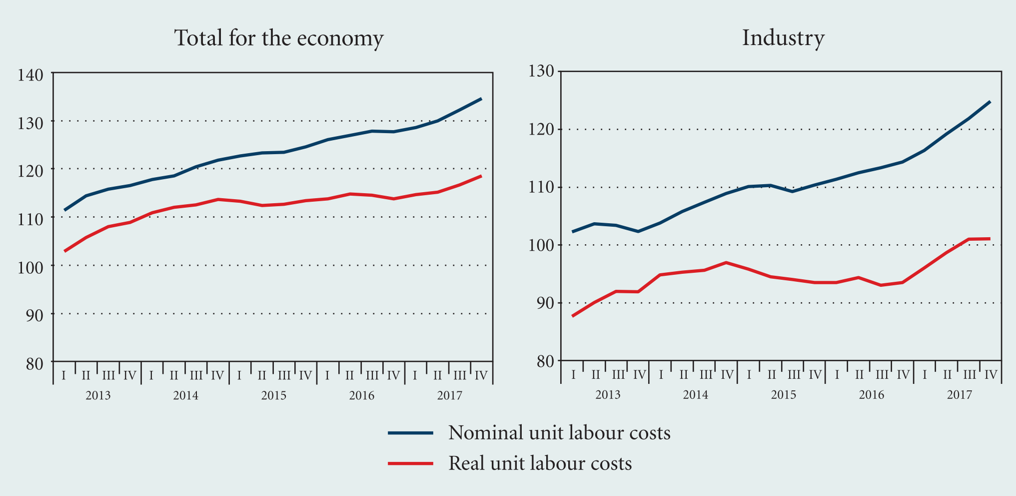
[19] HICP deflated.

[20] Real GDP measures labour productivity in the overall economy. Sector labour productivity is calculated based on sector value added in real terms.

the total economy rose 4.5 per cent from 0.1 per cent in 2016, rising 8.2 per cent from 0 per cent in exporting industries.

Unit Labour Costs

(moving average, 2010 = 100)



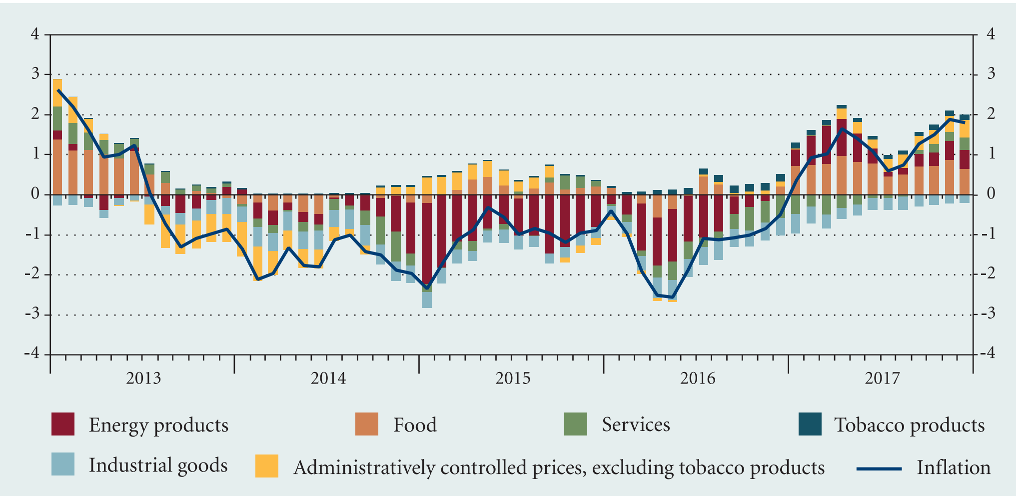
Sources: the NSI, the BNB.

Gross operating surplus growth in the total economy decelerated to 0.7 per cent from 5.6 per cent in 2016. Agriculture, forestry and fishing and industry sub-sectors detracted most from growth, services' contribution rising as their gross operating surplus growth accelerated.

The 2017 GDP deflator was 1.2 per cent from 2.2 per cent in 2016. By final use component, the gross fixed capital formation deflator was 4.4 per cent, government consumption 3.9 per cent, private consumption 1.1 per cent, goods and services exports 4.4 per cent, and goods and services imports 6.2 per cent. By economic sector, the industry deflator was 1.7 per cent, services 1.5 per cent, with agriculture negative at -3.1 per cent.

Annual Inflation and Contributions by Major Group of Goods and Services

(per cent, percentage points)



Sources: the NSI, the BNB.

At the end of 2017 annual inflation was 1.8 per cent from -0.5 per cent in 2016.[21] Most major goods and services sub-groups pushed end-user consumer prices up reflecting external and internal factors impact. External factors included oil and commodities price rises on international markets. Food led inflation, both processed and unprocessed food prices rising under pressure from imports[22] and higher agriculture costs.[23] Transport fuels also contributed to inflation, mainly through higher oil prices. Some goods' and services' administratively set prices and tobacco excise were the main internal inflationary factors.[24] Administratively set prices reflected mainly Energy and Water Regulatory Commission (EWRC) price rises for natural gas in January, April, and July and heating and electricity from April and July: all prices indirectly affected by international oil prices.

HICP Inflation Accumulated since the Year's Start and Contributions by Major Goods and Services Groups

	2016		2017	
Inflation (per cent)	-0 5		1.8	
	Rate of inflation by group (per cent)	Contribution, percentage points	Rate of inflation by group (per cent)	Contribution, percentage points
Food	**0.9**	**0.23**	**2.7**	**0.65**
Processed food	0.5	0.09	2.5	0.40
Unprocessed food	1.9	0.14	3.0	0.24
Services	**-2.1**	**-0.57**	**1.2**	**0.31**
Catering	2.0	0 11	3.0	0.18
Transport services	-8.4	-0.32	-0.6	-0.02
Telecommunication services	-6.1	-0.33	-2.0	-0.10
Other services	-0.3	-0.03	2.2	0.25
Energy products	**-0.2**	**-0.01**	**6.9**	**0.47**
Transport fuels	-0.4	-0.02	6.7	0.41
Industrial goods	**-1.9**	**-0.44**	**-0.9**	**-0.20**
Goods and services with administratively controlled prices	**0.6**	**0.10**	**2.6**	**0.43**
Tobacco products	**3.8**	**0.19**	**2.7**	**0.13**

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

Sources: the NSI, the BNB.

The year saw a gradual reversal of the core deflationary trend obtained since the second half of 2013 (excluding food, energy, administratively set prices and tobacco). By December core inflation was 0.3 per cent from -2.1 per cent a year earlier, driven by dearer services and lower detraction by non-food. Services inflation reflected gradual rises in catering and other service prices (excluding telecommunications and transport). Telecommunications and transport prices continued falling, though less fast. Intensified competition in telecommunications and transport and the introduction of low cost airlines to Bulgaria in recent years were the main reasons for the downward

[21] The analysis employs HICP data.

[22] Standard International Trade Classification (SITC) imports data are used.

[23] NSI data on price indices of goods and services intended for current consumption in agriculture are used in the analysis.

[24] From the beginning of 2017, the *ad-volarem* excise duty on tobacco products rose from 25 to 27 per cent along with minimum overall excise duty (specific and *ad-volarem*) from BGN 161 to 168 *per* 1000 cigarettes.

price trend through the year.[25] The long-term downward trend in non-food prices continued in 2017, driven mainly by lower car prices and also by price cuts in other durable goods. Consumer durables' prices reflected euro appreciation and price cuts in some imported goods.[26] Last year's fall in non-durables' prices reversed, this group making a small contribution to overall inflation.

Preliminary balance of payments data show that in 2017 the overall balance on the current and capital accounts was in a EUR 2794.7 million surplus, up EUR 633.5 million in a year. The current account surplus rose EUR 1177.7 million due to lower deficit on the net primary income item and the positive balance on net trade in services. The higher trade balance deficit offset this partially. The capital account surplus remained below its 2016 level as a result of lower transfers from EU.

Lower outflows under the reinvested profit item and lower dividends and distributed profit to non-residents, possibly owing to slower gross operating surplus growth in the economy, cut the net primary income deficit.

The positive services trade balance increased slightly, mostly because of 9.3 per cent higher tourism revenue on 2016. NSI data show foreign visitor numbers rising 9.4 per cent, Romania and Turkey leading. Bulgarians' foreign travel spend rose 21.8 per cent and, coupled with their foreign transport services spend, had the main contribution to overall service imports growth in 2017.

Worsened trading terms and real imports growth outstripping real exports[27] added greatly to the trade deficit.

Foreign trade statistics[28] show nominal goods exports rising 10.7 per cent, led by base metals and their products, alongside machines, vehicles, appliances, instruments, and weapons. Nominal goods' imports rose 15.5 per cent on 2016. By use, raw materials and energy commodities played an essential role.

The balance of payments financial account was positive because of foreign assets rising more than foreign liabilities. The foreign assets rise was mainly because other sectors [29] boosted their foreign assets through direct and portfolio investment. Increased bank foreign assets helped. Direct investment attracted from other sectors increased foreign liabilities substantially. Preliminary balance of payments data put direct investment liabilities in the economy (direct investment into Bulgaria) at EUR 1446.8 million. The general government sector partly offset rising financial account foreign liabilities following a repayment of Eurobonds maturing in July 2017 and resident purchases of Bulgarian government securities on international capital markets.

Net current, capital, and financial account flows cut BNB international reserves by EUR 98.9 million according to the balance of payments data (valuation adjustments and revaluations excluded). When changes in international foreign reserves on the BNB Issue Department balance sheet are taken into account, including valuation adjustments and revaluations, international reserves fell by some EUR 236.4 million.

Gross external debt fell EUR 1481.6 million to EUR 32.6 billion or 64.3 per cent of GDP. External debt fell in all sectors except banks. General government led in cutting gross external debt, mainly due to resident purchasing Bulgarian government securities

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[25] The European Commission's moves against roaming charges also depressed telecommunications prices.

[26] Standard International Trade Classification (SITC) import data.

[27] According to GDP data.

[28] The analysis employs balance of payments data to the sixth edition of the IMF Balance of Payments and International Investment Position Manual (IMF, 2008): BPM6. BPM6 introduced major methodological changes in reporting goods and services trade, leading to a mismatch between data on them and those on international trade in goods compiled by the NSI.

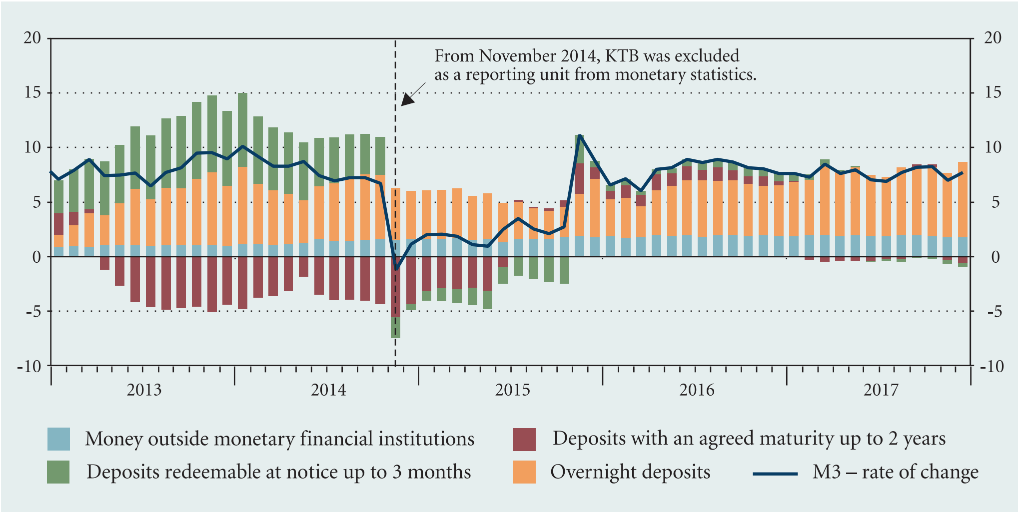
[29] Sectors other than central banks, other monetary financial institutions and general government.

issued on international markets from non-residents, repayment of Eurobonds maturing in July, and less to foreign obligation repayments. Reduced intercompany debt and lower other sectors' external debt added to the fall.

Monetary aggregates continued to reflect the sustained significant inflow of residents' funds into the banking system. The broad monetary aggregate M3 continued growing relatively fast, ending the year 7.7 per cent higher from 7.6 per cent a year ago. Increased overnight deposits led broad money, while money outside monetary financial institutions (MFI) was steady and quasi-money detracting. Amid low interest rates both households and corporations preferred to save mainly in overnight deposits. Lev deposits led.

Annual Rate of Change in M3 and Contribution by Component

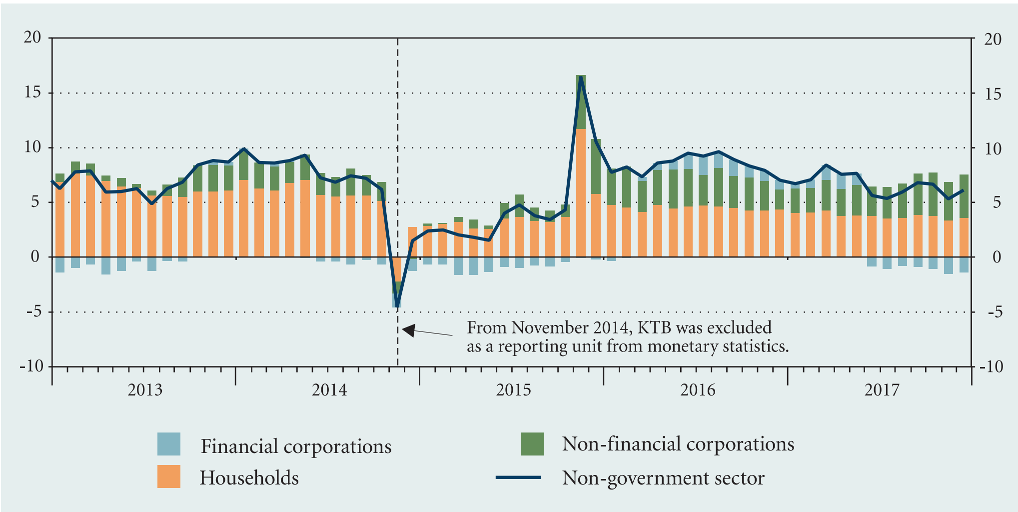
(per cent, percentage points)



Source: the BNB.

Annual Growth of Non-government Sector Deposits and Contribution by Sector

(per cent, percentage points)



Source: the BNB.

Overall non-government bank deposits reached BGN 72.4 billion, growing 6.1 per cent from 7.0 per cent a year ago. This was driven by non-financial corporation deposits, household deposits helping. Deposits of non-financial corporations grew

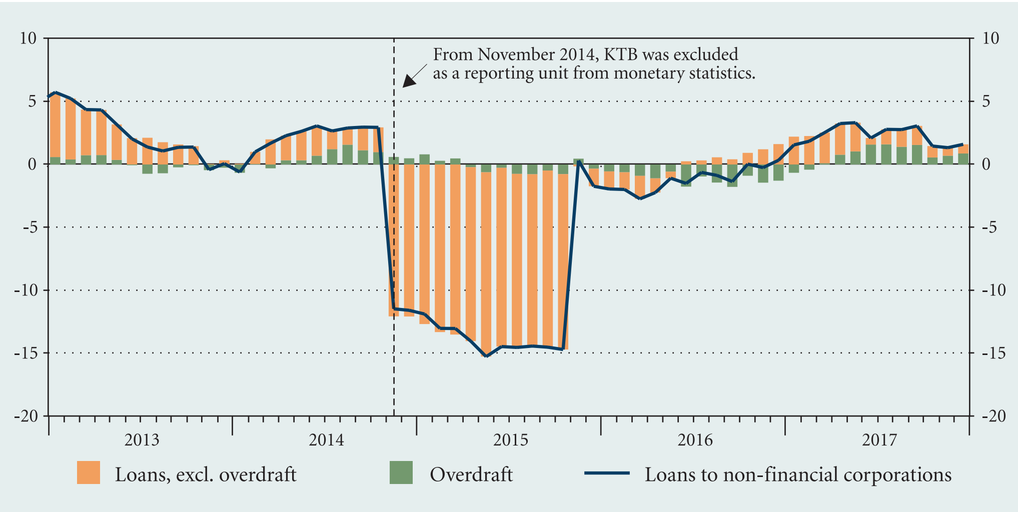
13.8 per cent from 6.3 per cent a year earlier, to BGN 22.0 billion. Household deposit growth slowed to 5.4 per cent from 6.6 per cent in a year to BGN 47.8 billion. Financial corporation deposits fell 26.9 per cent from 18.1 per cent in a year, detracting greatly from the overall growth of non-government deposits.

Bank lending to the non-government sector, growing 4.7 per cent, reflected good macroeconomics, a gradual lending rate drop and absorption of funds under the National Programme for Energy Efficiency of Multi-Family Residential Buildings (the Energy Efficiency Programme). After accelerating in the first nine months of 2017, credit to non-financial corporations moderated, annual growth reaching 1.6 per cent from 0.3 per cent a year ago. Banks wrote off and sold loans, affecting corporate lending dynamics.[30] In 2017 household lending accelerated gradually to annual rise of 6.0 per cent from 2.0 per cent a year ago. The upward trend in loans to households reflected mainly the contributions of housing and consumer loans as well as other loans, while overdrafts detracted throughout the year. Energy Efficiency Programme lending continued boosting other household lending. Payment of Programme loans, which the government started in July, helped cut the contribution of other lending to overall household credit growth. New lending to non-financial corporations slowed from the end of 2016, while that to households grew led by housing and consumer credit.

BNB quarterly lending survey data show rising credit demand by households and corporations. Stronger corporate credit demand reflected investment needs and low interest rates. Demand for funds to finance working capital and inventories, including refinancing, restructuring or renegotiating debt, helped. Low interest rates, macroeconomic confidence and demand for durable goods drove consumer credit demand. Housing credit demand reflected residential property market confidence and rising house prices.

Annual Growth of Loans to Non-financial Corporations and Contributions by Loan Type

(per cent, percentage points)

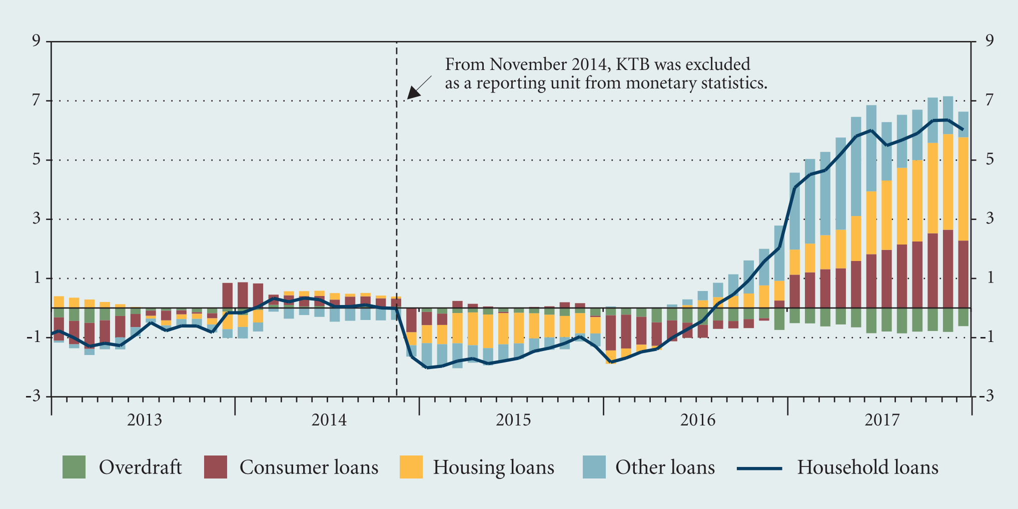


Source: the BNB.

[30] For more information, see Chapter VI.

Annual Growth of Loans to Households and Contributions by Loan Type

(per cent, percentage points)



Source: the BNB.

On the supply side, banks eased net standards for household lending, while retained corporate standards mainly unchanged. Intensifying bank competition and lower risk expectations led behind to ease lending. Lower risk expectations reflect macroeconomic improvement, better borrower solvency, and favourable housing market outlook. Competition, liquidity, rising attracted funds and falling costs also led to some easing of corporate lending. Nevertheless, banks' lower lending risk appetite militated in favour of tighter corporate lending.

Retention of the high savings rate in the economy helped banking keep liquidity position strong. At the end of December the liquid asset ratio calculated under BNB Ordinance No 11 rose to 38.97 per cent from 38.24 per cent a year ago. Managing assets over the year, banks' claims on the non-government sector and their foreign assets increased more significantly, while foreign liabilities dropped somewhat. The foreign assets rise was more marked in the fourth quarter due to lower interest rates on banks' excess reserves with the BNB[31]. Increased foreign assets and slightly smaller foreign liabilities boosted banks' net foreign assets by BGN 2.2 billion to BGN 7.0 billion.

Reserve currency (euro) transactions with the BNB is banks' main lev liquidity management instrument. This takes advantage of the main currency board function: buying and selling levs for euro at the fixed exchange rate set by the Law on the Bulgarian National Bank[32]. Throughout the year the BNB purchased EUR 0.8 billion net from commercial banks (EUR 1.1 billion in 2016).

Volumes on the lev interbank market rose, deposit transactions and repos coming to BGN 95 million on an average daily basis from 59 million in June 2016. The fourth quarter saw greater intensification, transactions value reaching BGN 163 million on an average daily basis from BGN 72 million over the first nine months as a result of the BNB cutting interest on banks' excess reserves from -0.40 to -0.60 per cent[33]. Interbank money market transactions came to BGN 23.5 billion, rising 57.6 per cent

[31] The BNB changed the interest methodology for accounts with itself. Since the change came into force on 4 October the Bank applies on bank excess reserves whichever is the lower of: 0 per cent or the ECB deposit facility rate reduced by 20 basis points. The change cut interest on bank excess reserves with the BNB to -0.60 per cent. See Chapter IV.

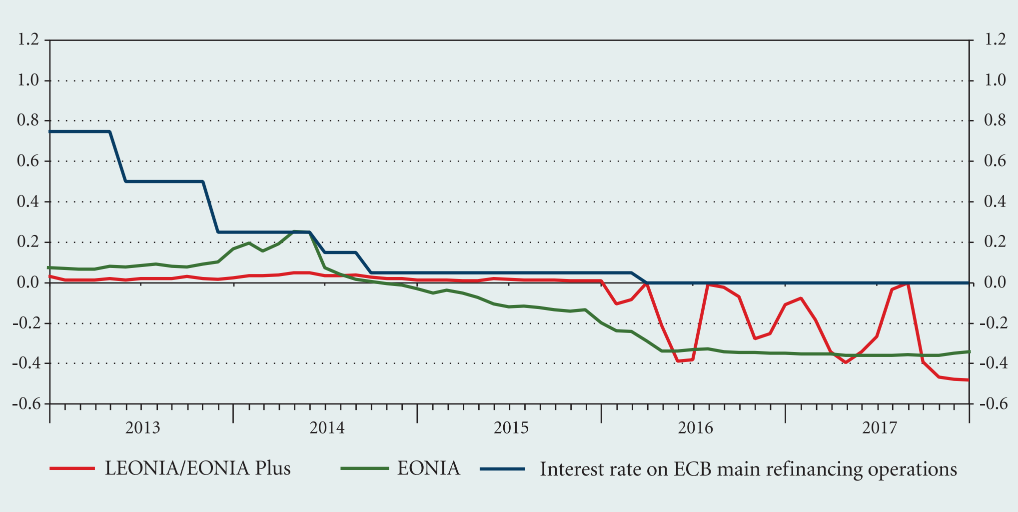
[32] See Chapter II.

[33] See Chapter IV.

on 2016. Deposits comprised 71 per cent of turnover and repos in government securities 29 per cent. Overnight transactions dominated deposits between banks at 89 per cent.

Interbank Money Market Interest Rate

(per cent)

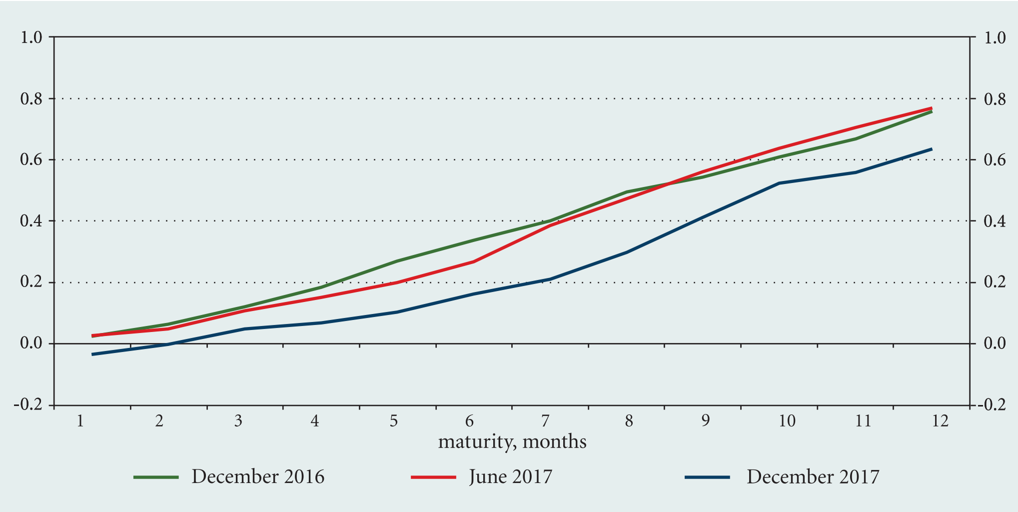


Note: LEONIA Plus replaced LEONIA on 1 July 2017. LEONIA Plus monthly values are calculated as an arithmetic average for those days when overnight unsecured lending transactions are concluded in the interbank market in levs.

Sources: the BNB, the ECB.

SOFIBOR Yield Curve

(per cent)



Note: The average monthly SOFIBOR rate for the relevant maturity.

Source: the BNB.

Average interest rate on interbank deposits and repurchase agreements was -0.30 per cent, down 20 basis points in a year. The LEONIA/LEONIA Plus index[34], reporting real transactions in unsecured lev deposits on the overnight interbank market, was volatile due to the small number and low volume of transactions. The fourth quarter

[34] On 1 July 2017 the BNB stopped calculating the LEONIA reference rate and adopted a Methodology for Calculating the LEONIA Plus Reference Rate of Interbank Bulgarian Lev Overnight Deposits, replacing LEONIA (for details, see http://www.bnb.bg/PressOffice/POPressReleases/POPRDate/PR_20170316_EN).

of 2017 saw a greater dip in LEONIA Plus and a transaction volume rise due to the BNB cutting interest on banks' excess reserves. EONIA remained at its low 2016 levels to reach December at -0.34 per cent. Marked LEONIA/LEONIA Plus volatility over the year made the EONIA spread move within the wide range of 0.36 per cent in August to -0.14 per cent in December.

Indicative interbank money market rates based on SOFIBOR, with no real transactions concluded, declined across all maturities. The dip was sharper in the fourth quarter, with negative interest rates on instruments with maturities of up to two months by the close of the year.

In 2017 the surplus on the consolidated fiscal programme amounted to BGN 845.6 million (0.9 per cent of GDP). Better tax revenue and lower capital expenditure helped the budget balance significantly exceed the BGN -1330 million deficit target set in the government programme. The consolidated fiscal programme budget balance was BGN 619.5 million lower than at the end of 2016, mainly through the base effect of higher revenue under 2016 EU programmes.[35]

Consolidated fiscal programme revenue and grants grew 4.0 per cent, 10.0 per cent higher annual tax revenue, offsetting 47.7 per cent lower grants. Tax revenue reflected growing domestic demand, higher employment, changes to tax and social security policy, and improved tax collectibility. Social and health contributions up 14.3 per cent and indirect taxes up 7.2 per cent led tax revenue growth. There was a particularly pronounced 11.2 per cent and 42.7 per cent increase in corporate and personal income tax revenue. Non-tax revenue grew 1.6 per cent.

Total consolidated fiscal programme expenditure increased 6.1 per cent largely due to staff costs (2.4 percentage points), social expenditure (2.1 percentage points) and subsidies (1.1 percentage points). Current non-interest government expenditure rose because of social security legislation amendments, minimum wage, pension, and education wage rises. Capital expenditure[36] dropped 3.1 per cent, the rise in EU programmes' capital expenditure through faster 2014–2020 Operational Programme funds absorption failing to offset national budget capital expenditure drops.

The government cut debt with a ratio between government debt to GDP declining to 25.4 per cent from 29.0 per cent at the end of 2016. Over the year there were no government securities issued on the international capital market and net external financing under the consolidated fiscal programme was negative by BGN 2174.1 million after a EUR 950 million repayment on Eurobonds maturing in July. At BGN 789.5 million the amount of domestic government securities was similar to payments on matured bonds, resulting in a positive though minimal net issue of BGN 4.4 million.[37]

Accumulated fiscal reserve funds from a 2016 Eurobond issue and the consolidated fiscal programme annual surplus cut government debt, greatly reducing the need for accumulated liquidity buffers. By the end of 2017 government fiscal deposit funds declined by BGN 1325.0 million to BGN 9782.9 million on the beginning of the year. The total fiscal reserve, including certified expenditure claims on EU funds, advances, and other payments, was BGN 10,289.0 million.

The downward trend in Bulgarian Eurobond yields continued with a substantial narrowing of spreads between Bulgarian and German government bonds across yield curve maturity segments. Strong demand for government securities by resident

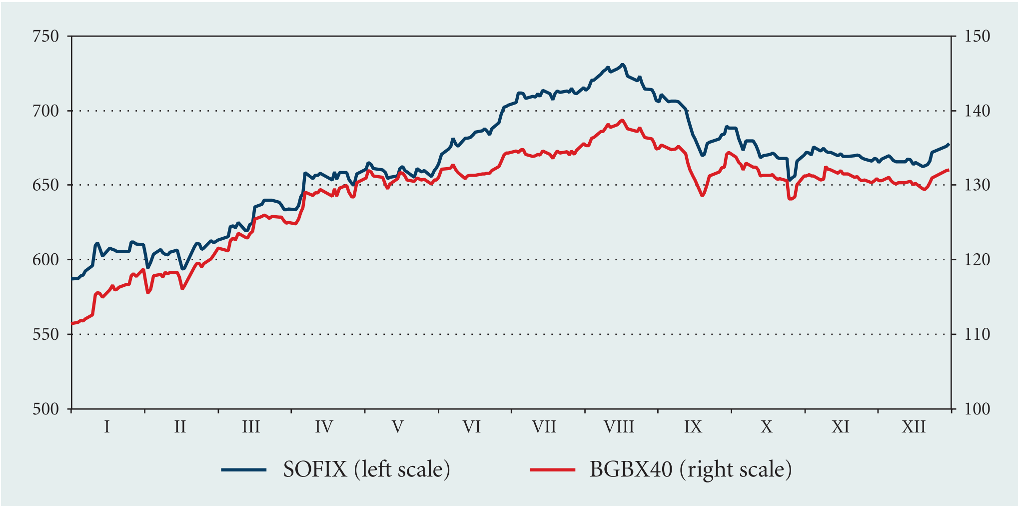
[35] In 2016 the EC reinstated payments for 2007–2013 programming period spend concentrated in late 2015.

[36] Including government reserve growth.

[37] For more information on government securities primary and secondary markets see Chapter XII.

financial institutions, an improving fiscal position auguring fewer issues, and Bulgaria's December 2017 credit rating upgrade cut spreads.

Bulgarian Stock Exchange Indices in 2017



Sources: the BNB, the Bulgarian Stock Exchange.

The leading Bulgarian Stock Exchange SOFIX and BGBX40 indices followed clear upward trends. The September to December period saw a slight downward adjustment, both indices remaining close to their 2016 levels at the end of the year. In December the SOFIX and BGBX40 were 15.5 and 18.6 per cent higher than a year earlier.

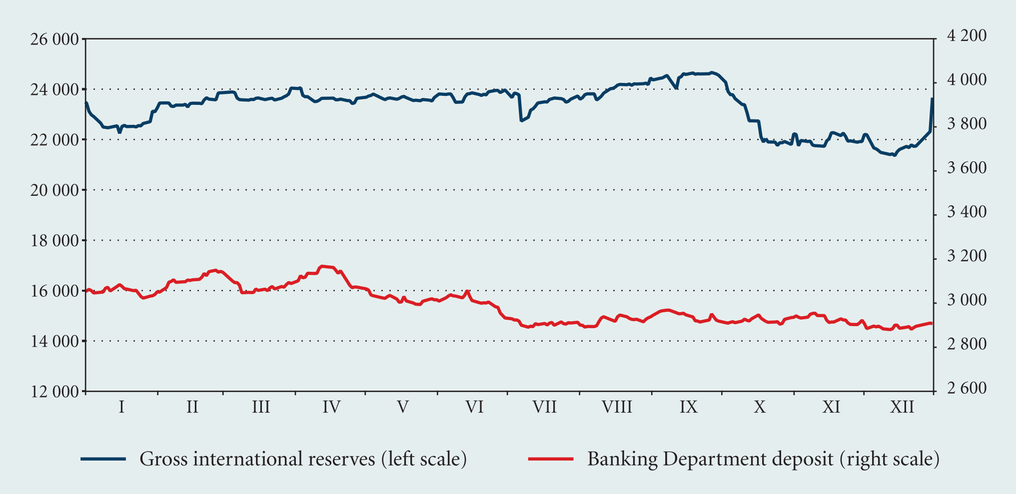
Secondary market stock trading rose 78.7 per cent to BGN 617.8 million and bourse bond turnover increased 59.6 per cent to BGN 78.2 million. Over-the-counter equity deals were BGN 1.2 billion and bond deals BGN 24.4 million. In December Bulgarian Stock Exchange market capitalisation was BGN 23.6 billion or 3.9 per cent of GDP, from 10.3 per cent at the close of 2016.

II. Gross International Reserves

The BNB manages its gross international reserves in line with the Law on the Bulgarian National Bank[38], investment constraints, business procedures and methodologies, and international financial market opportunities. Gross international reserves comprise the assets in the Issue Department balance sheet. Their role is to provide complete cover for monetary liabilities under the fixed exchange rate of the lev to the euro provided for by the Law on the Bulgarian National Bank[39]. The excess of gross international reserves over monetary liabilities forms the Banking Department deposit item or the net value in the Issue Department balance sheet[40].

Gross International Reserves and Banking Department Deposit in 2017

(EUR million) (EUR million)



Note: The chart shows daily movements of the Issue Department balance sheet figure and the Banking Department deposit in the Issue Department balance sheet.

Source: the BNB.

[38] There were no Law on the BNB amendments concerning the regulatory framework for gross international reserve management.

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

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

The Amount and Structure of Gross International Reserves

The market value of gross international reserves was EUR 22,708 million, down EUR 167 million on the end of 2017.[41] Income from asset management and foreign currency revaluation, and external cash flow effects were the main factors affecting the market value of the assets. EUR -74 million income from asset management and EUR -71 million outgoing external cash flows had an almost equal effect on foreign exchange reserves in 2017.

External Cash Flows in Foreign Currency

(EUR million)

	2016	2017
I. Euro bought and sold		
at tills	-61	-43
with banks	-159	-312
bought from banks	99 944	61 216
sold to banks	-100 103	-61 529
Sub-total I	**-220**	**-355**
II Currency flows with banks, the MF, *etc.*		
Bank reserves (including minimum required reserves)	397	534
Government and other depositors	3 034	-250
Sub-total II	**3 432**	**284**
Total I+II	**3 212**	**-71**

Source: the BNB.

The slight external flow drop reflected mainly principal and interest paid by the MF on EUR denominated bonds issued on international markets in early July and totalling some EUR 1044 million. This cut government foreign exchange accounts by about EUR 250 million (net). The BNB sold EUR 742 million to commercial banks in the fourth quarter, with EUR 312 million net for the whole year. The EUR 534 million additional reserves in banks' BNB accounts could not offset the foreign currency outflows. By contrast, 2016 saw significant foreign currency inflows into government BNB accounts: the main reason for external flows contributing to assets then.

Currency Structure of Gross International Reserves

(per cent)

Currency	Issue Department balance sheet assets	
	2016	2017
EUR	91.96	92.79
USD	0.48	0.20
XAU	7.02	6.46
SDR	0.53	0.54
CHF	0.00	0.00

Note: Average values calculated on a daily basis for the period.

Source: the BNB.

[41] Balances in banks' TARGET2 national system component accounts (worth EUR 233.4 million at the end of 2017), and the two tranches of SDR 611 million the IMF disbursed in August and September 2009 upon general SDR allocation are omitted from the analysis below. For further details see BNB Annual Report, 2009, p. 26.

The share of gold in gross international reserves fell to 6.46 per cent from 7.02 per cent in 2016. This was mainly due to the 0.74 per cent gold price fall over the year. This boosted the weight of euro assets despite external cash outflows in euro. The average share of EUR denominated assets was 92.79 per cent.

The share of deposits in the structure of assets by financial instrument rose at the expense of securities investment. At 57.05 per cent most assets continued to be invested into securities.

Gross International Reserves by Financial Instrument

(per cent)

Financial instruments	2016	2017
Vault cash*	3.91	3.47
Deposits**	27.32	39.48
Securities**	68.78	57.05

Note: Average values calculated on a daily basis for the period.
* Account balances, payments, and monetary gold.
** Including instruments in foreign currency and gold.

Source: the BNB.

By residual term to maturity, some 62.10 per cent of international reserve assets continued to be invested in the up to a year maturity sector: current accounts, short-term deposits in foreign currency and gold, and short-term securities. Investment in up to three year maturity sector rose at the expense of the three to five and five to ten year ones.

Gross International Reserves by Residual Term to Maturity

(per cent)

Maturity sectors	2016	2017
Up to a year	57.41	62.10
One to three years	23.10	29.05
Three to five years	11.81	8.43
Five to ten years	7.50	0.41
Over ten years	0.17	0.01

Note: Average values calculated on a daily basis for the period.

Source: the BNB.

Gross International Reserves Risk and Return

The Market Environment

In 2017 international financial markets saw little share and bond price volatility. Financial asset prices reflected better global economic prospects whetting investor risk appetite and changing anticipated monetary moves by large central banks. Uncertainty about the scope and likelihood of US tax reform, the French presidential elections [42], and US-North Korean tension also influenced markets, though mostly temporarily.

In the first quarter global financial markets reflected the Federal Reserve's March decision to raise federal funds interest rates, better-than-expected euro area economic data, and related expectations of an earlier ECB interest rate rise. By the end of the

[42] Dutch and German general elections affected international financial markets moderately.

quarter demand for low-risk and liquid assets grew, reflecting increased euro area political risk linked to the French presidential elections.

Following the elections investor risk appetite grew until the end of the second quarter, depreciating German securities, narrowing government bond yield spreads in other euro area countries, and launching a steady euro appreciation on the US dollar. Positive euro area data intensified these trends. The ECB President's 27 June statement on overcoming the threat of deflation markedly boosted euro area government bond yields and euro exchange rates. The Federal Reserve's June federal funds rate rise had a moderate market effect, being widely expected by most of market participants.

In the third quarter rising tension between the USA and North Korea and uncertainty about US tax reform promoted safe assets and lowered US inflation expectations. This cut US and German government bond yields, mostly in medium and long-term maturity sectors.

By the year's end US and German government bond yields started climbing again as Eurosystem securities purchases were expected to end and US tax reform went through.

ECB and Federal Reserve Policies

The ECB kept reference interest rates unchanged but amended its non-standard monetary measures.

The 19 January monetary policy meeting applied the changed extended Asset Purchase Programme (APP) rule on securities with yields below deposit facility rate only to the Public Sector Purchase Programme (PSPP), prioritising securities with yields above that rate. Only securities with yields higher than the ECB deposit facility rate of -040 per cent were to be purchased under the other programmes: the Covered Bond Purchase Programme (CBPP3), the Asset-Backed Securities Purchase Programme (ABSPP) and the Corporate Sector Purchase Programme (CSPP).

The ECB Governing Council 8 June monetary policy meeting changed the forward guidance on interest rates, proposing to retain rates for an extended period after the APP ends. The Council also dismissed the option of setting lower than forward guidance interest rate as it deemed there was no risk of euro area deflation. The forward guidance on the implementation of the extended asset purchase programme remained unchanged as it provided for an opportunity to increase the size and/or the duration of the programme in the future if necessary.

Indeed, on 26 October the ECB extended APP duration, halving January to September 2018 net purchases to BGN 30 billion a month, subject to scope or duration variations prompted by inflation target performance. The ECB also decided that the Eurosystem would continue reinvesting principal repayments from maturing APP securities for as long as necessary after net asset purchases end. The ECB would continue main and three-month longer-term refinancing operations in the form of fixed rate tenders with full allotment at least until the end of the last reserve maintenance period in 2019.

The 14 December 2017 ECB monetary policy meeting expressed greater confidence in keeping euro area inflation to target and stressed that the euro area economy was entering an upturn.

The Eurosystem 2017 balance sheet figure rose 22.1 per cent to EUR 4472 billion on the end of 2016. This increase was mainly due to early 2017 purchases of EUR 634.1 billion of PSPP public assets, EUR 80.5 billion of CSPP corporate bonds, EUR 37.2 billion of CBPP3 collateral securities, EUR 2.2 billion of ABSPP asset-backed securities, and the funds allotted in the last targeted longer-term refinancing operations (TLTRO II) on 23 March, when 474 banks got EUR 233.5 billion. The net effect of this operation on euro area banking liquidity was EUR 216.7 billion, as banks repaid EUR 16.7 billion of their TLTRO I participation ahead of schedule.

Excess euro area banking liquidity rose to EUR 1779 billion from EUR 1207 billion a year earlier. Average EONIA overnight deposit effective interest rate fell to -0.35 per cent from -0.32 per cent in 2016. EURIBOR interbank market longer-term deposit interest rates also dropped. At the end of the year the one month rate was unchanged from the end of 2016 at -0.37 per cent. Six and twelve month deposit rates fell by -5 basis points to -0.27 per cent and -10 basis points to -0.19 per cent on the end of 2016.

US 2017 economic data largely matched FOMC expectations. Unemployment fell to 4.1 per cent: significantly lower than the 4.6 per cent FOMC consensus forecast of the long-term equilibrium value of this indicator at that time (4.6 per cent). This allowed the FOMC to go with its late 2016 intention of raising the federal funds rate target range in three 25 basis points steps. The decisions were at the March, June, and December meetings. The federal funds target rate corridor ranged between 1.25 and 1.50 per cent at the end of the year. US inflation alone was lower than FOMC forecast in most months of 2017. Annual personal consumption expenditure price index growth stayed under the 2 per cent target throughout the year. Failure to meet the inflation target did not prevent the target rate rise, most FOMC members believing that lower 2017 inflation reflected one-off factors.

In June the FOMC announced a plan to cut the Federal Reserve balance sheet to levels just adequate for conducting the monetary policy. Implementation was expected by the year's end. A set, gradually rising, amount of funds from maturing treasury securities and mortgage-backed securities in the Federal Reserve portfolio would not be reinvested into new instruments of the same type. Implementation started in October. FOMC intentions are for the Federal Reserve balance sheet to decline automatically and be withdrawn from active monetary policy before all other instruments are exhausted.

Euro Area and US Government Bond Yields

German government bond yield rose across maturities sectors. Yield in the two and ten year maturity sectors rose 14 and 22 basis points to -0.63 and 0.43 per cent on 2016. By the end of the year all German government bonds with under six year maturities traded at negative annual yields.

Core euro area government bond yield spread developments diverged. Political uncertainty before the French presidential elections boosted volatility and widened French and other euro area yield spreads. The March Dutch general elections also temporarily widened Dutch yield spreads. The French elections' outcome boosted investor risk appetite, narrowing euro area bond yield spreads. Over 2017 yield spreads of French, Belgian, Austrian and Dutch ten year government bonds narrowed against German ones. In the two year maturity segment, the yield spread of Dutch government bonds narrowed 7 basis points to -0.04 per cent, two year Dutch yield ending the year lower than two year German yield. The spread of comparable Finnish bonds also narrowed, those of French, Austrian and Belgian government bonds widened.

Spreads between euro area periphery and German benchmark bond yields dropped significantly in 2017. Portuguese spreads contracted most: at -28 basis points in the two year and -204 basis points in the ten year maturity sector, reflecting significantly improved Portuguese economic and fiscal indicators. Moody's accordingly improved

Portuguese credit rating outlook, S&P and Fitch raising it in September and December. Narrowing Irish government bond spreads reflected steadily improving economic activity, particularly better external demand prospects, allowing Moody's and Fitch to raise Irish credit rating in September and December. Lower Italian spreads reflected S&P's October Italian credit rating increase and reduced political instability. Events in Catalonia and general uncertainty in Spain had a comparatively limited effect on Spanish government bonds prices, yield spread in the two and ten year maturity sectors narrowing 21 and 4 basis points.

Over 2017 the US government bond yield curve decreased significantly (by 73 basis points), reflecting a great short term yield rise (69 basis points to 1.88 per cent for two year sector) and an insignificant long term drop (4 basis points to 2.41 per cent for ten year sector). Higher short term maturity sector yield reflected FOMC increasing the federal funds target rate in March, June and December, and changed market expectations about the rate of monetary policy normalisation. Lower medium and long term yield reflected many factors, most related to continuing euro area and Japan accommodative monetary policy and lower than expected US inflation. Political instability in the euro area prior to the French presidential elections and German general elections, August and September's disastrous US southeastern coast hurricanes, US tax reform expectations, and North Korea tensions also affected US long term government bond prices.

Government Bond Yields in 2017

(per cent)

Gold and Exchange Rates

The US dollar gold price rose 13.5 per cent and fell 0.7 per cent in euro, ranging between USD 1148 and 1347 and EUR 1057 and 1212 *per* troy ounce. In the first half year gold fluctuated relatively little, driven mostly by demand for safe assets and US dollar depreciation. Gold was a safe asset amid political uncertainty about the future US administration and the Dutch and French elections. In the second half year gold appreciated alongside geopolitical tension between the USA and North Korea and US dollar depreciation.

The US dollar depreciated 14.1 per cent on the euro, mostly in the second and third quarters of the year and the USD/EUR exchange rate ranging from USD 1.04 to USD 1.20 *per* EUR 1 (from EUR 0.83 to EUR 0.96 per USD 1). The depreciation started early in the year due to poor market expectations of the scope and likelihood of expansionary fiscal measures promised by the US administration. Political uncertainty in Europe and geopolitical tension elsewhere had relatively limited effects on the EUR/USD exchange rate in the first quarter. In the second and third quarters the US dollar continued depreciating on the euro due to unfavourable data on inflation and to hourly pay growth in the US non-agricultural sector raising market doubts on the rates of Federal Reserve target rate increase. The euro appreciation on the US dollar was due to euro area economic data mostly better than analysts' expectations, and significantly lowered European political uncertainty after the French presidential and general elections. In the fourth quarter US dollar depreciation on the euro was mainly because of the changed market participant expectations of an ECB main interest rates rises by the year's end.

The USD/EUR Exchange Rate in 2017

(EUR)

Troy Ounce Gold Price in US Dollars in 2017

(USD)

Troy Ounce Gold Price in Euro in 2017

(EUR)

Major Types of Risk

In 2017 net value risk in the Issue Department balance sheet measured by value-at-risk (VaR) was 8.61 per cent on an annual basis.[43]

International reserve **interest rate risk** measured by reserves' average modified duration was 0.99 years in 2017. The 2017 duration was 0.62 years shorter than the average for 2016 largely due to the early 2017 decision to curb international reserve interest rate risk. The limit for maximum deviation in the modified duration of investment portfolios from benchmark ranged from -0.20 to 0.20 years in the first three quarters. From the beginning of the fourth quarter the relative interest risk limit of investment portfolios was set on the basis of not more than 0.25 per cent relative yield volatility.

Gross international reserve **currency risk** was constrained by the Law on the BNB stipulation that the sum of the absolute values of open foreign currency positions [44] in

[43] *VaR* = -*X*% (*X*>0), at 95 per cent confidence level and allowing for normal yield allocation means that 95 per cent of the time maximum net value loss would not exceed *X* per cent.

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

currencies other than euro, SDR, and monetary gold, should not exceed 2 per cent of the market value of monetary liabilities in these currencies. There were minimal open positions in foreign currencies in the reporting period, the open position in monetary gold posing the main currency risk to the BNB.

The BNB continued managing gross international reserve investment credit risk conservatively. Early 2017 saw new constraints on maximum individual exposures to BNB counterparty banks, permissible exposure reduced by 1 per cent of the market value of international reserves for each of the five risk BNB counterparty bank groups.

To achieve its main international reserves management objectives of high international reserve security and liquidity, the BNB continued investing most assets into core euro area government securities and government guaranteed debt.

In 2017 the credit quality of investment was traditionally high and by the close of the year assets with the AAA long term credit rating accounted for 67 per cent of international reserves.

All assets met strictly defined liquidity requirements and by the close of 2017 the share of financial instruments with the highest liquidity accounted for 48 per cent.

Operational risk continued adhering strictly to investment constraints and relevant business procedures for international reserve management.

Return and Efficiency

Net income from international reserves in euro is the sum of three components: 1. income from assets in the original currency; 2. income from currency imbalance[45]; and 3. expenditure and/or income from liabilities. Income from assets in 2017 was negative at EUR -74.16 million: -0.33 per cent yield. This reflected mainly the negative interest rates and higher euro-denominated government bond yields, which boosted the price of government bonds in the BNB portfolio. Currency imbalance income of EUR -16.90 million was almost entirely due to the change in the monetary gold price in euro. The January 2016 BNB interest rate policy made the financial result from liabilities positive at 0.06 per cent for the year, corresponding to a EUR 18.04 million income. These three components brought net earnings from BNB international reserve management to EUR -73.02 million: -0.33 per cent of total 2017 return.

International Reserves Income and Return[1] in 2017

Period	Net income (EUR million)	Net return (per cent)	Income (EUR million)	Return (per cent)	Income (EUR million)	Return (per cent)	Expenditure (EUR million)	Return (per cent)
			on assets		on currency revaluation of assets and liabilities		on liabilities	
	(1)+(2)+(3)		(1)		(2)		(3)	
First quarter	85.30	0.38	-24.51	-0.11	105.76	0.47	4.05	0.02
Second quarter	-142.91	-0.63	-30.35	-0.13	-117.49	-0.51	4.93	0.02
Third quarter	-4.51	-0.02	-3.09	-0.01	-6.69	-0.02	5.27	0.02
Fourth quarter	-10.91	-0.07	-16.21	-0.08	1.51	0.00	3.79	0.01
Total	**-73.02**	**-0.33**	**-74.16**	**-0.33**	**-16.90**	**-0.06**	**18.04**	**0.06**

[1] Return between time T_0 and T_N is calculated by chain linked returns for this period. The formula is: $R(T_0,T_N) = (1+r_1)(1+r_2)\ldots(1+r_N)-1$. This formula complies with Global Investment Performance Standards (GIPS).

Source: the BNB.

[45] Currency imbalance income is the result of the effects of exchange rate movements on asset and liability open foreign currency positions.

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

To diversify management styles and cut operational risk, most euro denominated assets continued being split into two investment portfolios with identical benchmarks and investment limits, managed by different BNB teams. By the end of 2017 international financial institution external managers managed some 4 per cent of gross international reserves. Beside additional diversification, using external managers helped exchange expertise in international market investment management. Liquid portfolios mainly assisted immediate BNB foreign currency payment needs.

Portfolio Return and Risk in 2017

Portfolio	Return		Volatility (risk)		Information ratio[3]
	Absolute (per cent)	Relative[1] (basis points)	Absolute (basis points)	Relative[2] (basis points)	
Investment 1, EUR	-0.37	17	17	9	1.83
Investment 2, EUR	-0.35	19	16	8	2.30
External manager A, EUR	-0.71	19	80	13	1.52
External manager B, EUR	-0.82	8	77	13	0.65
Liquid, EUR	-0.35	21	1	1	-
Liquid, XAU	0.23	-	6	-	-
Liquid, USD	1.29	38	12	12	-

[1] A portfolio's positive relative return is attained profit against benchmark return. Relative returns with a negative sign are interpreted as opportunity cost in portfolio management.
[2] Relative volatility (relative risk) against benchmark indicates the degree of deviation of portfolio risk characteristics from benchmark through active portfolio management. The risk is on an annual basis.
[3] Information ratio is the ratio between relative portfolio return and relative portfolio risk on an annual basis.

Source: the BNB.

III. Payment Systems and Payment Oversight

The Law on the Bulgarian National Bank tasks the Bank with payment system organisation, support, and development by assisting the implementation, operation, and oversight of efficient payment mechanisms. The Bank's major goals are curbing systemic risk and integrating Bulgarian payment systems into the European payment infrastructure.

Bulgaria's lev payment systems are:

- RINGS, a real-time gross settlement system operated by the BNB;
- RINGS has these transaction settlement ancillary systems:
  - BISERA, for settling customer transfers at a designated time, operated by BORICA AD;
  - BORICA, for servicing bank card payments in Bulgaria, operated by BORICA AD.

Bulgaria's euro payment systems are:

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

Bulgaria's securities settlement systems are:

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

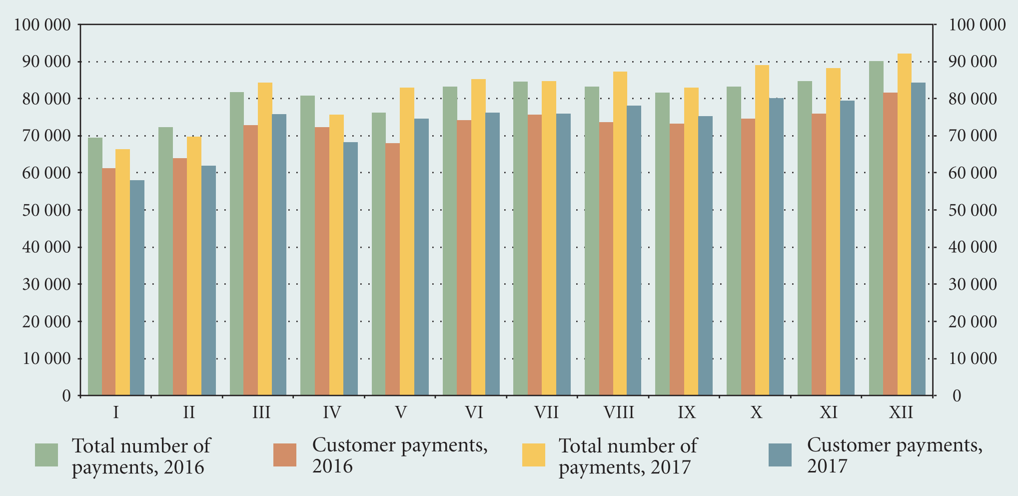
Lev Payment Systems

In 2017 the RINGS real-time gross settlement system processed most lev payments in Bulgaria. This helped mitigate risks to the payment system: one of the major goals of a central bank. On 31 December 2017 the BNB and 27 banks participated in RINGS.

In 2017 RINGS processed payments worth BGN 702,615 million, down 9.9 per cent on 2016, their number reaching 988,333 or 1.8 per cent higher than in 2016. Customer payments numbered 887,915 (89.8 per cent of the total) for BGN 207,755 million (29.5 per cent of the total). The daily average value of payments *via* the system was BGN 2833 million and their daily average number was 3985. In 2017, 66 per cent of payments were processed by noon and 86 per cent by 2:30 pm. The balance of 14 per cent went through by 5:30 pm. As regards system traffic, 82.3 per cent of the number of system payments were effected by 2:30 pm. RINGS offered 100 per cent availability[46] in the period under review.

[46] The ratio of time when the system is operational to scheduled operating time.

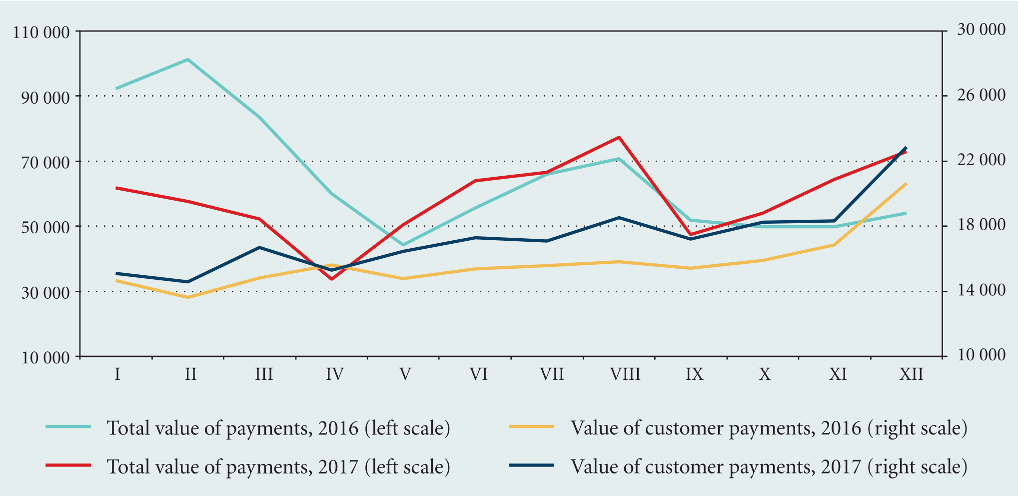
RINGS Payment Number in 2016 and 2017



Source: the BNB.

RINGS Payment Value in 2016 and 2017

(BGN million) (BGN million)



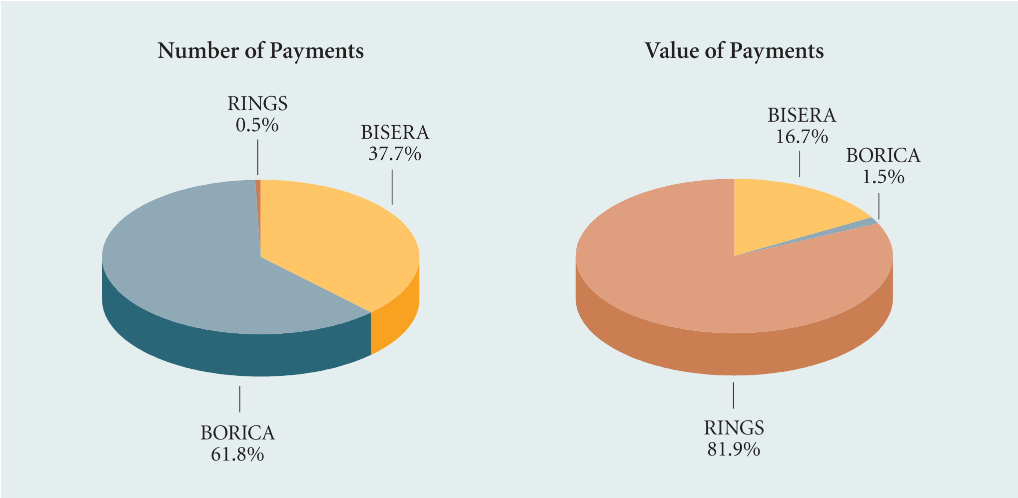
Source: the BNB.

Distribution of lev payments in Bulgaria by payment system remained unchanged from 2016. RINGS processed 81.9 per cent of the payments effected in Bulgaria. Values around 80 per cent are deemed optimal for the operation of real-time gross settlement systems. RINGS also processed 0.5 per cent of the total number of lev non-cash payments in Bulgaria.

In 2017 BORICA processed 122.7 million of payments totalling BGN 12,622.1 million: a rise of 14.5 per cent in number and 13 per cent in value on 2016. ATM cash withdrawal value and number increased by 2.4 and 8.7 per cent. BORICA processed card payments rose 24.4 and 23.5 per cent in number and value.

BISERA processed 74.9 million of payments for BGN 143,110.5 million: up 8.2 per cent in number and 8.8 per cent in value on 2016.

Distribution of Lev Payments in Bulgaria by Payment System in 2017

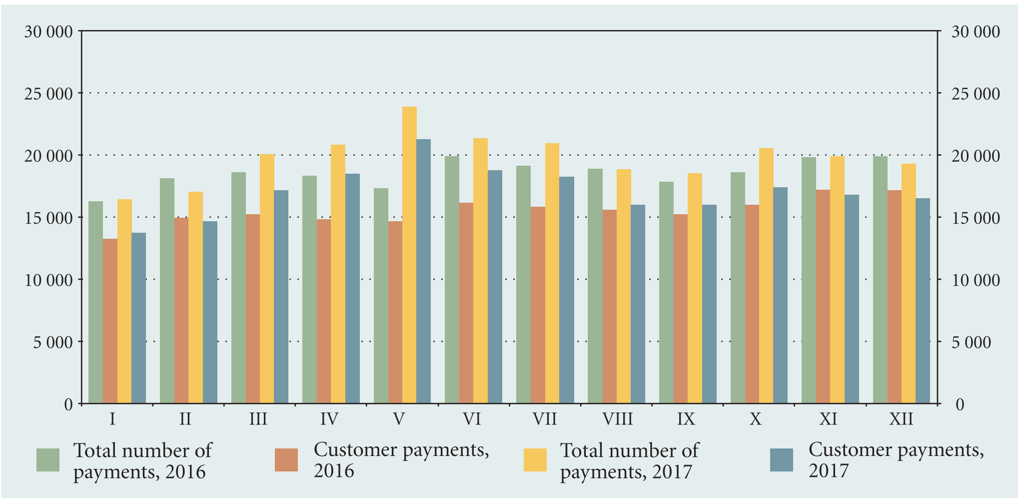


Source: the BNB.

Euro Payment Systems

TARGET2 settles gross euro payments in real time with central bank money. It is a Single Shared Platform (SSP) system, each participating and connected central bank responsible for its system component. From 1 February 2010, the BNB operates the TARGET2-BNB national system component and is responsible for the business relations of its participants and coordination with the European Central Bank and participant central banks.

TARGET2-BNB Payment Number in 2016 and 2017



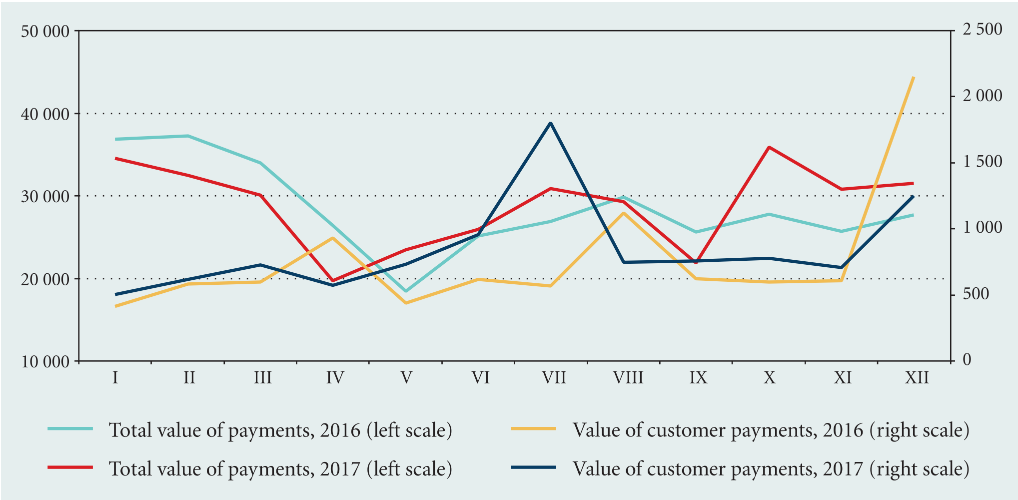
Source: the BNB.

On 31 December 2017 the system included the BNB, 21 direct participant banks, three addressable BIC holders, and two ancillary systems: the BISERA7-EUR for settling customer transfers in euro at a designated time and the BNBGSSS for government securities settlement at the BNB.

In 2017 TARGET2-BNB processed 237,654 of payments worth EUR 346,434 million. Customer payments numbered 205,074 (86.3 per cent of the total) accounting for EUR 10,144 million (2.9 per cent of the total). Processed payment number grew 6.8 per cent and value 1.4 per cent on 2016.

TARGET2-BNB Payment Value in 2016 and 2017

(EUR million) (EUR million)



Source: the BNB.

TARGET2 payments by other system components to banks were 92.4 per cent of the number and 75.6 per cent of the value of all national component payments. The daily average number of ordered TARGET2-BNB payments was 936, the average daily value of processed payments reaching EUR 1360 million. The daily number peak of payments ordered by TARGET2-BNB participants was 1551, with a daily transaction value peak of EUR 4117 million.

The BISERA7-EUR ancillary system processes designated time customer euro transfers. On 31 December 2017 16 banks participated in BISERA7-EUR. The system processed 61,167 payments for EUR 481 million, up 47.7 per cent in number and 20.6 per cent in value from 2016.

The Bulgarian National Bank and all banks and foreign bank branches in Bulgaria process SEPA credit transfers and participate in the Pan European Credit Transfer Scheme, having ensured adherence to Regulation (EU) No 260/2012.[47] BISERA7-EUR payment system for small payments in euro, operated by BORICA AD, processes SEPA payments and ensures interoperability with SEPA Clearer, Equens and EuroELIXIR systems, thus allowing SEPA credit transfers between banks in Bulgaria and other EU Member States.

[47] Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009.

Bulgarian Payment and Settlement System Development

To reconcile the Central Depository with Regulation (EU) No 909/2014[48] of the European Securities and Markets Authority (ESMA) regulatory technical standards, European Commission internationally promoted market standards, corporate actions processing, and to expand Central Depository services, in 2017 the BNB as operator of the RINGS and TARGET2-BNB systems:

– changed the RINGS system day schedule to allow for a third settlement request in the Central Depository securities settlement system in line with Regulation (EU) No 909/2014 on improving securities settlement and regulatory technical standards of the European Securities and Markets Authority (ESMA). These changes became effective on 18 September 2017;
– launched the project of incorporating the Central Depository as ancillary system into TARGET2 through the TARGET2-BNB national system component. This will allow for the euro settlement of the cash leg of ancillary system transactions to be effected through central bank accounts under Article 40, paragraph 1 of Regulation (EU) No 909/2014. This is also a condition for bilateral connections between the Central Depository and other European depository institutions and other institutions with cash settlement in euro in TARGET2 and for implementing the project of Central Depository participation in ESROT to ensure cash settlement of government securities transactions in euro;
– launched a project to allow corporate event payments in RINGS and TARGET2. Its implementation will guarantee quick, safe and effective payments, including dividend payments on shares in book-entry form, principal and/or interest payments on book-entry bonds, principal and/or interest payments on government securities and other payments related to changes in circumstances with regard to registered book-entry financial instruments under item 2(b) of Section B in the Annex to Regulation (EU) No 909/2014 on processing of corporate actions as ancillary services to boost safety, efficiency and transparency of securities markets.

As of 31 December 2017, 99.4 per cent of Bulgarian cards, including 99.4 per cent of debit and 99.9 per cent of credit cards had migrated to the EMV standard.[49] EMV implementation into the card payments infrastructure was almost complete, with 100 per cent of ATMs and 99.9 per cent of POS terminals migrated to EMV by the end of 2017.

The BNB amended Ordinance No 3 of 16 July 2009 on the Terms and Procedure for the Execution of Payment Transactions and Use of Payment Instruments.[50] Amendments mainly involve requirements on basic feature payment account and the presentation of payment transaction charges on payment service provider tariffs.

In 2017 the BNB participated in drafting a Payment Services and Payment Systems Bill[51] transposing Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market to update payment services legal framework. As before, the Bill also transposes

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[48] Regulation (EU) 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

[49] The EMV is a global standard for credit and debit cards based on microprocessor technology (smart or chip cards). It was developed by Europay, Mastercard, and Visa to boost card payment security and limit abuse and misuse.

[50] Published in the Darjaven Vestnik, issue 30 of 11 April 2017.

[51] Published in the Darjaven Vestnik, issue 20 of 6 March 2018.

Directives 98/26/EC, 2009/44/EC, 2009/110/EC, 2010/78/EU and 2014/92/EU into Bulgarian Law. The Second Payment Services Directive transposed by the Bill: extends the negative scope; introduces new payment services and new payment service provider regulations; introduces additional payment institution and electronic money institution licensing requirements; calls for registration of the new category of account information service providers; sets precise requirements for payment institution and electronic money institution equity holding; sets out detailed procedures for exercising the right of establishment and freedom to provide services and for cooperation between supervisory authorities; changes information requirements and payment provider rights and duties in relevant services extensions; sets out new security requirements for off-site or on-line payments; details internal complaints procedures. The Bill also introduces European and international provisions like CPSS-IOSCO principles for financial market infrastructures and Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

Payment Systems Oversight

In line with the law on the BNB and the Law on Payment Services and Payment Systems (LPSPS), the Bank regulates and oversees payment system operators, payment service providers and electronic money institutions in Bulgaria. The BNB oversees compliance with national and European statutory requirements and relevant international principles, standards and recommendations. At the end of 2017 the National Assembly amended the Law on the BNB and the LPSPS (Darjaven Vestnik, issue 97 of 5 December 2017) to enable the BNB Governing Council to enact individual banking supervision administrative deeds further to proposals specifically by the Banking Department Deputy Governor rather than any Deputy Governor[52] as before.

In 2017 the Bank inspected four payment service providers to check whether they complied with the Law on Payment Services and Payment Systems and its statutory instruments. The main breaches were of Article 21 of the LPSPS safeguards, prior information to payment service users, and notification of individual payment transactions using agents, and online payments, and issuing electronic money. Three payment service providers inspected in 2017 were asked to remove breaches within set deadlines.

Two payment service providers inspected in 2016 were also asked to remove breaches within set deadlines. A company was served an administrative infringement notice for providing unlicensed payment services.

The BNB granted five licenses under the Law on Payment Services and Payment Systems. The Governing Council licenced BORICA AD to provide payment services under Article 4, item 5, sentence two of the LPSPS. It declined to licence Smart Pay Bulgaria OOD, Best Pay OOD, and Prima Latius EOOD as payment institutions. Electronic money licensing proceedings for Fintex Services EAD (formerly Cash Credit EAD) ended at the applicant's request.

The BNB withdrew licences from Small World Financial Services Bulgaria EOOD (formerly Choice Money Transfer Bulgaria EOOD and Master Envios Bulgaria EOOD) and Change Centre – Bulgaria EOOD at their requests.

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[52] Except individual administrative deeds for entering, refusal to enter, and deletion of payment and electronic money institutions' agents in the BNB register, which remains in the competence of the Banking Department Deputy Governor.

At the end of 2017 there were ten payment institutions licensed by the BNB, three of them also licensed to operate as electronic money institutions.

The year saw these entries and deletions in/from registers under the Law on Payment Services and Payment Systems and BNB Ordinance No 16:

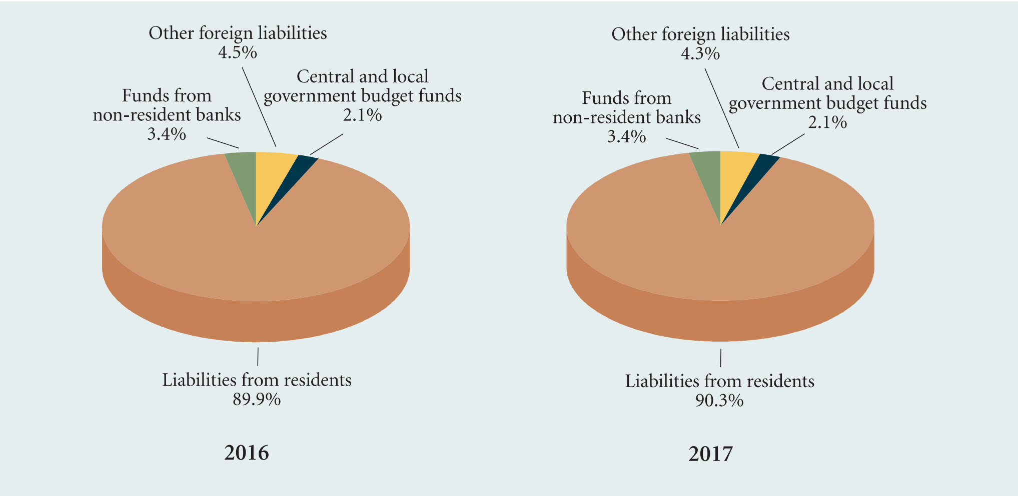
- 205 agents were listed and 96 agents delisted in the public register of licensed payment institutions and electronic money institutions in Bulgaria;
- 100 payment institutions and electronic money institutions licensed elsewhere in the EU and eligible to operate in Bulgaria were listed and 19 delisted.
- 186 agents of payment service providers licensed elsewhere in the EU and eligible to operate in Bulgaria were listed and 158 delisted.

The BNB enquired into 251 complaints submitted by members of the public and corporate payment service users. In 14 of them, the Bank issued mandatory instructions and implementation deadlines. The other cases involved no breaches of the Law on Payment Services and Payment Systems and its statutory instruments, or were resolved in favour of payment service users through correspondence.

IV. Banks' Reserves at the BNB

The average daily value of banks' attracted funds on which minimum required reserves accrued (excluding central and local government budget fund accounts) rose 6.6 per cent on 2016. This was due to an 11.0 per cent rise in lev denominated liabilities and a 1.4 per cent increase in foreign currency liabilities. The average daily value of residents' funds (excluding funds in central and local government budget accounts) rose 6.9 per cent, and non-residents' ones 2.8 per cent, funds attracted from non-resident banks rising 5.4 per cent. Banks' central and local government attracted funds rose 2.8 per cent. The effective implicit ratio of minimum required reserves remained unchanged at 9.4 per cent.[53] Reserve assets covering this ratio include funds in banks' BNB accounts (8.3 per cent) and half the cash balances designated as reserve assets (1.1 per cent).

Structure of Attracted Funds in the Banking System*



* Average daily value for reserve calculation purposes.

Note: The sum total may differ from 100 per cent due to rounding.

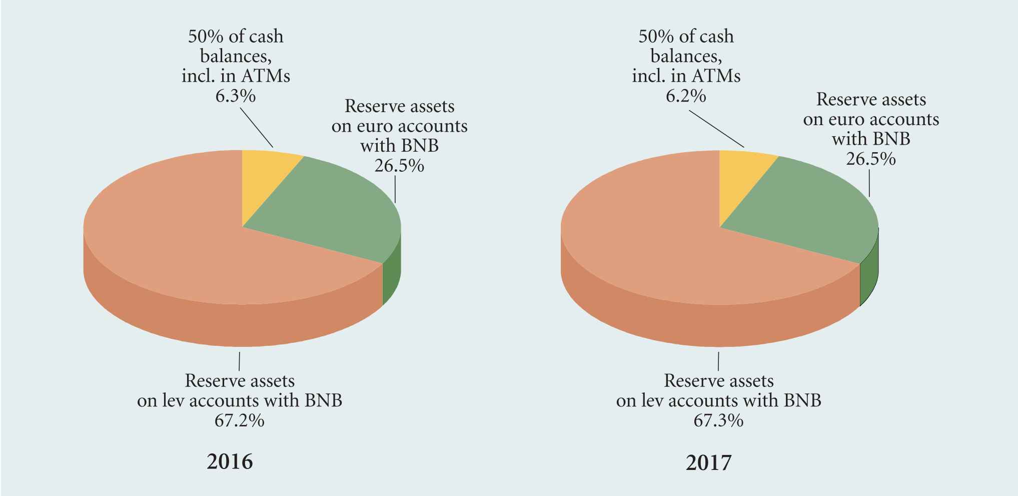
Source: the BNB.

Banks keep reserves in own assets in BNB lev and euro accounts and half their cash balances, including in ATMs, is deemed part of them.[54] In 2017 the share of lev denominated reserve assets was 67.3 per cent on an average day, from 67.2 per cent a year earlier, the share of euro reserve assets forming 26.5 per cent on an average day as a year earlier.

[53] BNB Ordinance No 21 on the Minimum Required Reserves Maintained with the BNB by Banks, effective as of 4 January 2016, sets the minimum required reserves rate on funds attracted from residents at 10 per cent of the reserve base, those from non-residents at 5 per cent, and those from central and local government budgets at nil.

[54] BNB Ordinance 21 Article 4.

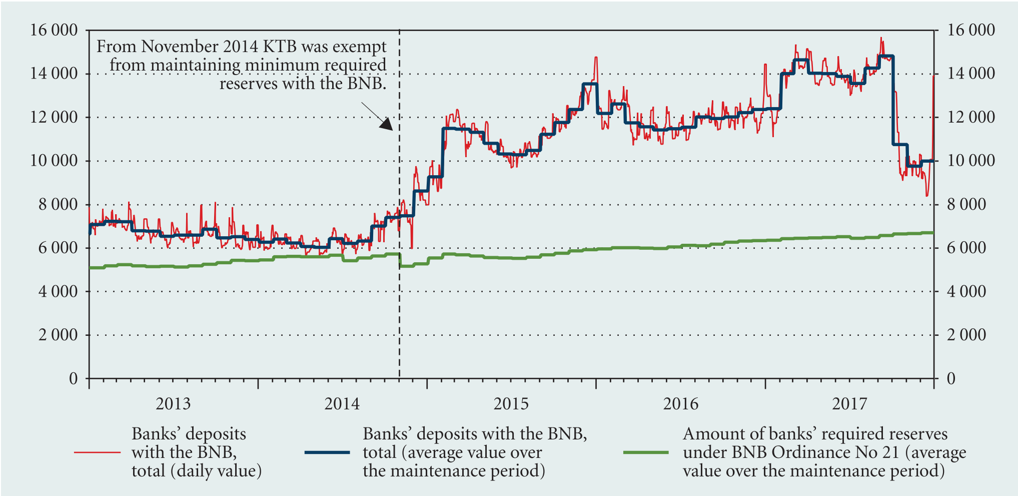
Banks' Ordinance 21 Article 4 Reserve Asset Structure



Source: the BNB.

Banks' Reserves at the BNB

(BGN million)



Source: the BNB.

Between January and September 2017 banks continued to maintain excess reserves high. Banks' excess funds with the BNB over the required minimum of reserve assets under Ordinance No 21 averaged 112.3 per cent of minimum required reserves. On 4 October 2017 the BNB changed its interest methodology to pay the lower of two interest values: nil per cent or the ECB deposit facility rate less 20 basis points. This cut excess reserve interest rate to -0.60 per cent.[55] In the fourth quarter banks' excess reserves decreased by BGN 4.6 billion on average from the end of September, and banks' excess funds with the BNB over the required minimum of reserve assets decreased to 47.4 per cent of minimum required reserves. By the year's end reserves fell 3.8 per cent against a fall of 2.2 per cent a year earlier. Funds in banks' BNB Ordinance No 21 accounts exceeded minima by 96.1 per cent on an average daily basis, from 92.0 per cent in 2016.

[55] From 16 March 2016 the ECB deposit facility rate was -0.40 per cent.

V. Currency in Circulation

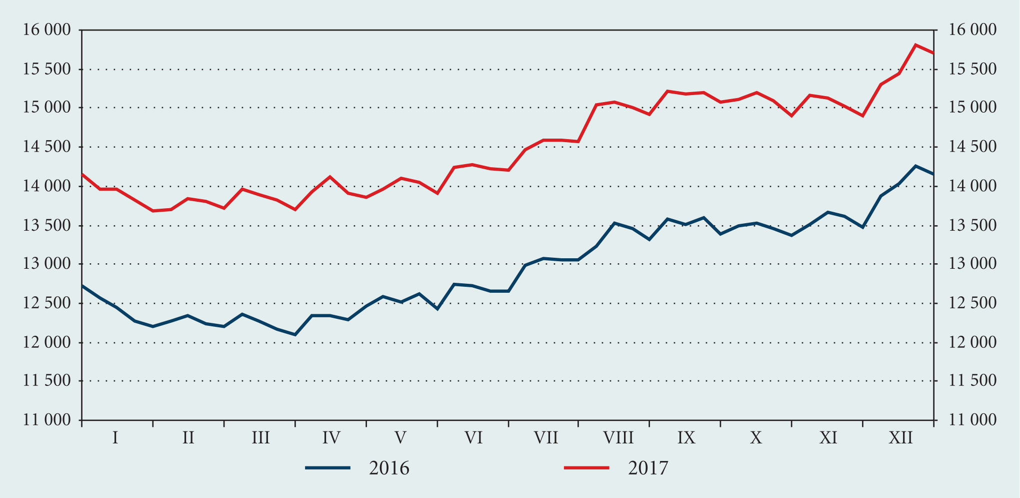
The Bulgarian National Bank has a monopoly on banknote and coin issue in Bulgaria.[56] Its currency is mandatorily acceptable as legal tender at face value without restriction. The Bank prints and mints banknotes and coins, and keeps and scraps uncirculated or withdrawn currency.

Banknotes and Coins in Circulation (Outside BNB Vaults)

At the end of 2017 circulating currency[57] reached BGN 15,703.2 million, up BGN 1550.3 million or 10.95 per cent on 2016. The share of banknotes was 97.64 per cent, that of coins 2.31 per cent, and that of commemorative coins 0.05 per cent.

Banknotes and Coins in Circulation (Outside BNB Vaults)

(BGN million)



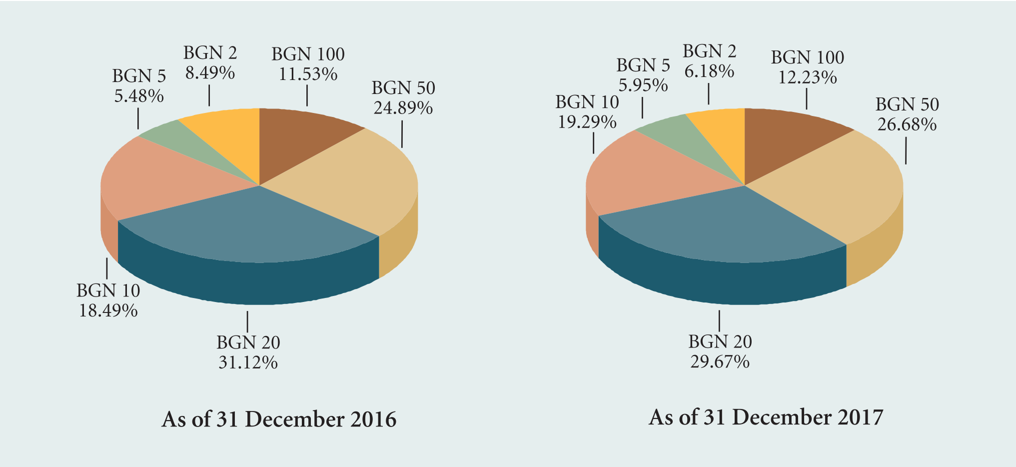
Source: the BNB.

By the close of 2017 circulating banknotes numbered 425.8 million, worth BGN 15,333.2 million. In a year, their number rose 6.37 per cent (27.1 million), and their value 10.80 per cent (BGN 1494.2 million). The BGN 10, 50 and 100 banknotes contributed most to the annual rise in the number of circulating banknotes. On an annual basis, the number of BGN 50 banknotes increased by 14.9 million or 14.02 per cent. BGN 10s and 100s rose 8.7 million and 6.3 million (10.99 and 12.74 per cent).

[56] Law on the BNB Article 2, paragraph 5 and Article 25.

[57] Legal tender banknotes, circulating, and commemorative coins issued after 5 July 1999, including those withdrawn from circulation with no time restriction on exchange.

Individual Banknote Denomination Shares in the Total Number of Circulating Coins

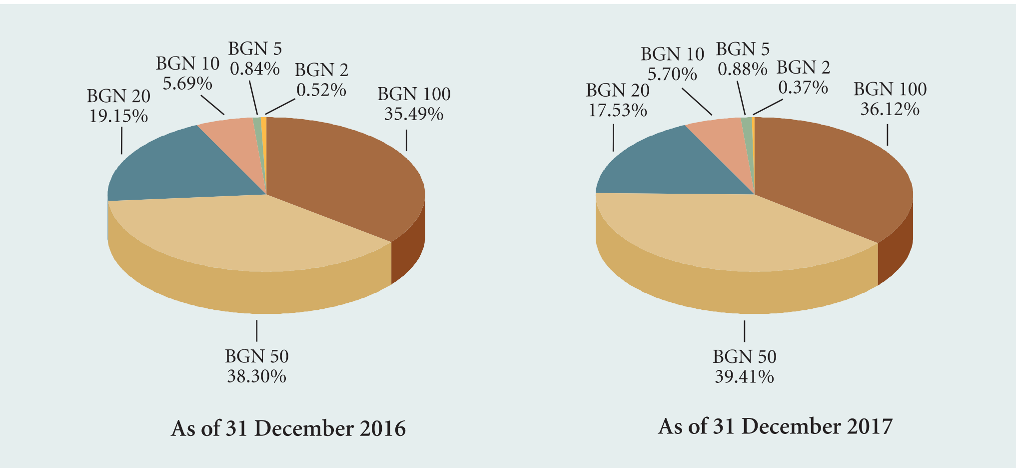


Source: the BNB.

The BGN 20 led banknote numbers at 134.4 million or 29.67 per cent, down 1.45 percentage points on 2016. The BGN 2 comprised 6.18 per cent of banknotes: a 2.31 percentage point annual drop. BGN 50 and 100 shares continued rising, by 1.79 and 0.70 percentage points. BGN 5 and 10 shares rose 0.47 and 0.80 percentage points.

The BGN 50 held the largest value share at 39.41 per cent, followed by the BGN 100 and 20 at 36.12 and 17.53 per cent.

Individual Banknote Denomination Shares in the Total Value of Circulating Banknotes



Source: the BNB.

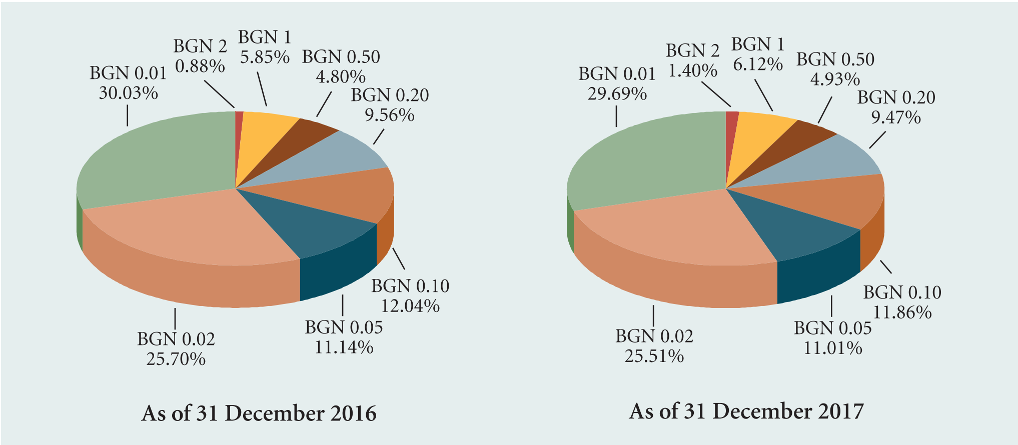
The average circulating banknote was worth BGN 33.85 at the close of 2017, up BGN 1.35 or 4.17 per cent, reflecting BGN 50 and 100 growth and the BGN 2 banknote's rollover with a coin.

In late 2017, 2289.4 million coins worth BGN 362.4 million circulated. Year on year, the number of circulating coins rose 8.26 per cent (174.8 million), and their value 18.18 per cent (BGN 55.7 million) across all denominations. On an annual basis the share of BGN 1 coins in the currency in circulation increased by 13.35 per cent (16.5 million), which was the highest growth in coins in 2017 (excluding the new

BGN 2 coin). Over the year the number of BGN 2 coins increased by 13.4 million or 71.75 per cent reaching 32.1 million at the end of December 2017.

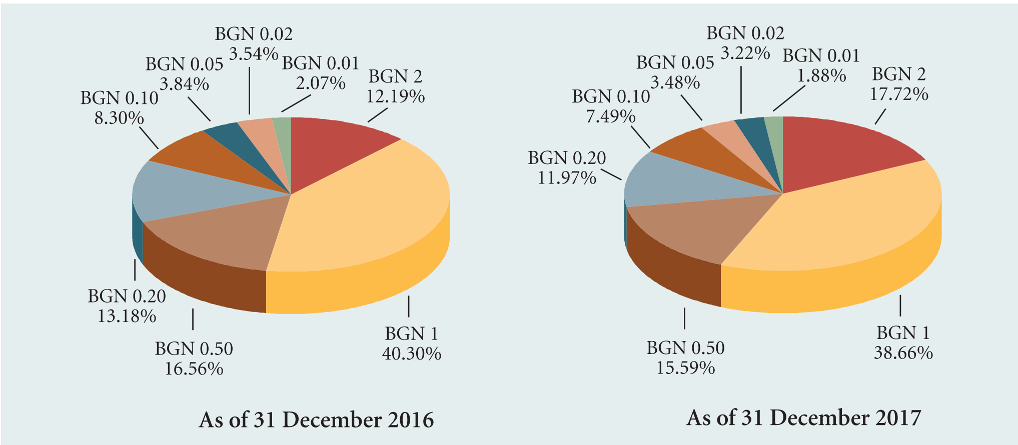
The BGN 0.01 coin had the largest share at 29.69 per cent, falling 0.34 percentage points in a year. The share of BGN 0.50 coins was higher compared to the end of 2016. The faster rise of BGN 1 and the new BGN 2 coins cut the shares of BGN 0.01, 0.02, 0.05, 0.10, 0.20 and 0.50 coins.

Individual Nominal Value Shares in the Total Number of Circulating Coins



Source: the BNB.

Individual Nominal Value Shares in the Total Value of Circulating Coins



Source: the BNB.

The average coin circulating at the end of 2017 was worth BGN 0.16: up BGN 0.01 in a year as a result of the new BGN 2 coin.

The share of commemorative coins in circulation stayed unchanged at 0.05 per cent.

Non-genuine Banknotes and Circulating Coins

In 2017 the BNB National Analysis Centre retained 919 non-genuine Bulgarian banknotes, 202 fewer than last year. The share of retained non-genuine banknotes remained very low at 0.000203 per cent of circulating banknotes, from 0.000263 per cent last year.

The BGN 20 banknote was most popular among retained non-genuine Bulgarian banknotes at 58.22 per cent, followed by the BGN 50 and 10 at 20.78 and 18.93 per cent. The 19 non-genuine BGN 2, 5, and 100 banknotes comprised 2.07 per cent of all retained non-genuine banknotes.

There were 766 non-genuine retained coins: 22 BGN 2s, 246 BGN 1s, 475 BGN 0.50s and 23 BGN 0.20s. Their share was also very low at 0.000033 per cent.

On evaluating suspect foreign banknotes and coins, in 2017 the National Analysis Centre retained 7645 euro banknotes, 445 US dollar banknotes, and 177 other banknotes.

BNB Issue and Cash Operations

BNB issue and cash operations include: banknote printing, coin minting, accepting, delivering, repaying, processing, authenticity and fitness checking of Bulgarian banknotes and coins and foreign currency, exchanging damaged Bulgarian banknotes and coins, and scrapping unfit Bulgarian banknotes and coins.

In 2017 contractors supplied 66.2 million banknotes and 179.9 million coins, worth BGN 2779.4 million. The BNB launched five commemorative coins as provisioned in the Law on the BNB Article 25 paragraph 1 and the 2017 Minting Programme.[58]

Banks deposited BGN 16,186.8 million of circulating banknotes and coins, down BGN 259.0 million or 1.57 per cent on 2016. Over the same period Bulgarian banknotes and coins, worth BGN 17,737.5 million were withdrawn from the BNB: down BGN 137.7 million or 0.77 per cent on the prior year.

In 2017 banknotes recirculated through BNB tills an average of 2.1 times. Lowest and highest value banknotes returned less often, from 0.3 to 1.3 times; while BGN 10 and BGN 20 banknotes returned more often at 4.3 and 3.0 times.

Banknote processing machines tested 845.9 million banknotes and 122.1 million coins. The number of processed banknotes and coins fell 6.40 and 25.53 per cent on this time last year. BGN 10s and 20s and BGN 0.20s, BGN 0.50s and BGN 1s had the largest nominal value shares at 36.58, 43.36, 15.99, 15.67, and 19.34 per cent.

Currency quality and integrity checks identified some 58.0 million banknotes as unfit for circulation, down 17.7 million (23.37 per cent) on 2016. BGN 10 and BGN 20 banknotes had the largest shares of unfit banknotes at 30.21 and 28.39 per cent. The share of processed unfit banknotes was 6.85 per cent. There were 1.1 million unfit coins, down 21.81 per cent in a year. Their share was 0.88 per cent.

In 2017 the BNB bought EUR 1.4 million of reserve currency, including EUR 1.4 million from budget organisations and EUR 0.04 million from individuals. The Bank sold EUR 44.5 million of reserve currency: EUR 10.0 million to budget organisations and EUR 34.5 million to individuals.

The Bank conducted four full checks into credit institutions and a service provider to ensure observance of Ordinance No 18 of the BNB on the Control over Quality of Banknotes and Coins in Currency Circulation and its enabling instruments. The BNB conducted spot on-site checks into twenty credit institutions and five service providers under Ordinance No 18 for authorising and testing 215 sorting machines and customer operated machines in line with identification and fitness standards.

[58] Check the BNB website for new banknotes, circulating, and commemorative coins.

VI. Maintaining Banking System Stability and Protecting Depositor Interests

Assessment of the State of the Banking System[59]

Banking activities in 2017 were conducted while observing adequate levels of credit institutions' liquidity and capital position. Actions to improve asset quality led to retention of the downward trend in the credit risk. The volume and share of non-performing loans declined alongside residual (potential) credit risk in bank balance sheets.

The structure of credit institutions' liquid assets changed somewhat, with almost half of banks' liquidity remaining in the form of cash and cash balances with the BNB. All credit institutions observed the supervisory recommendation of 20 per cent or more liquid asset cover for household and legal entity deposits.

Consolidation of banks continued, a leading European banking group acquiring a large credit institution.

As of 31 December 2017 the banking system reported a BGN 1150 million profit, providing acceptable return on assets and equity.

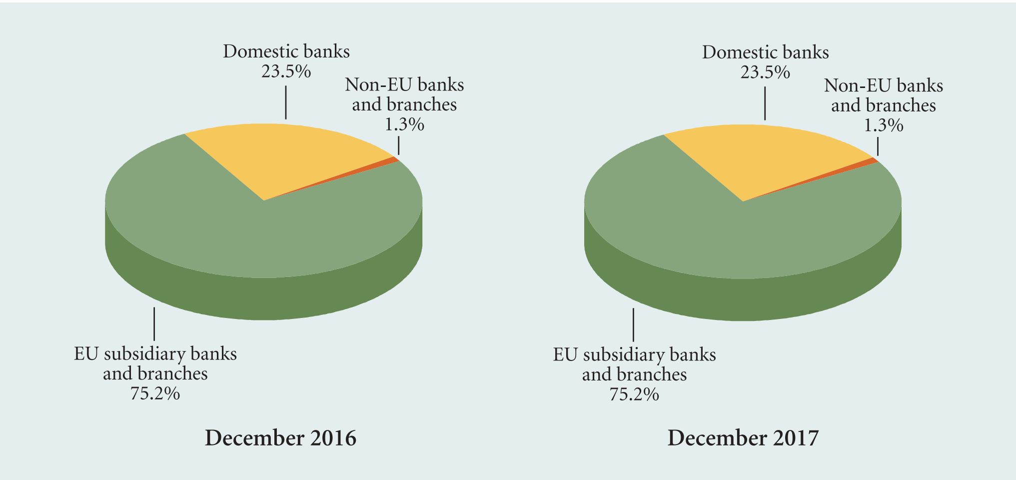
Banking system assets rose BGN 5.7 billion (6.2 per cent) to BGN 97.8 billion. The system's balance sheet showed rising deposits, loans and advances, and securities holdings.

The market shares of banks with predominantly Bulgarian equity, EU bank subsidiaries and branches, and non-EU banks and branches remained unchanged at 23.5, 75.2, and 1.3 per cent.

By end-2017 the big five banks' assets comprised 55.9 per cent of the system's balance sheet.

Gross loans and advances[60] totalled BGN 81.5 billion. The share of resident claims fell to 86.0 per cent in favour of non-resident ones rising to 14.0 per cent.

Domestic and Foreign Bank Market Shares by Asset



Source: the BNB.

[59] Based on individual supervisory statements as of end-December 2016 and 2017, submitted by 24 February 2017 and 26 February 2018.

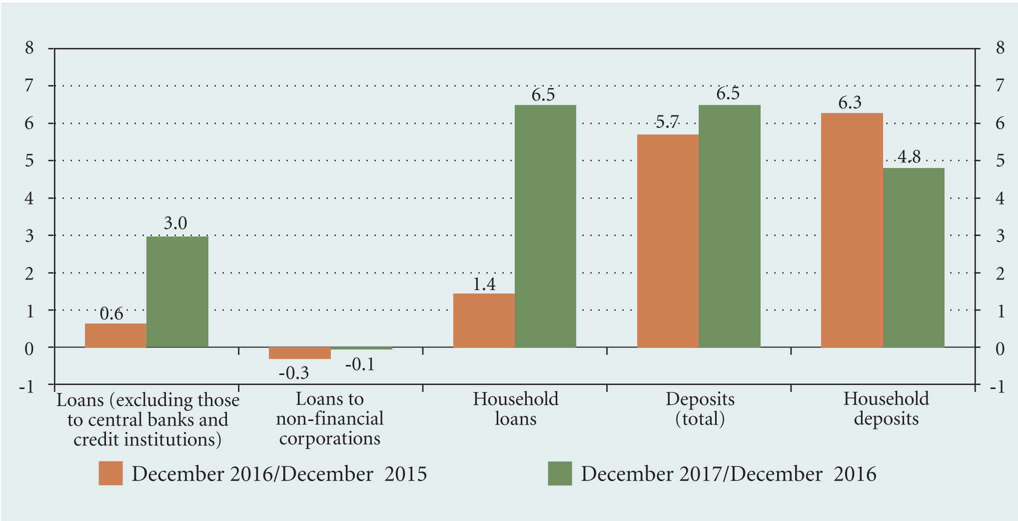
[60] Source: the BNB (Macroprudential Form 1 – MPF1).

The gross credit portfolio (except loans and advances to credit institutions and central banks) rose to BGN 56.1 billion. A slight decrease of loans to non-financial corporations (BGN 20 million, 0.1 per cent) cut their portfolio share which still led at 59.1 per cent. Loans to households rose BGN 1.2 billion (6.5 per cent), their share rising to 35.3 per cent. Loans to other financial corporations also rose BGN 0.5 billion (25.0 per cent), their share reaching 4.5 per cent. Claims on the general government sector fell BGN 82 million(11.9 per cent) their share declining to 1.1 per cent. The gross credit portfolio foreign currency structure shows lev-denominated items rising from 54.5 to 60.9 per cent, the euro share falling from 43.1 to 37.5 per cent.

Dynamics of Selected Balance Sheet Indicators

(annual change)

(per cent)

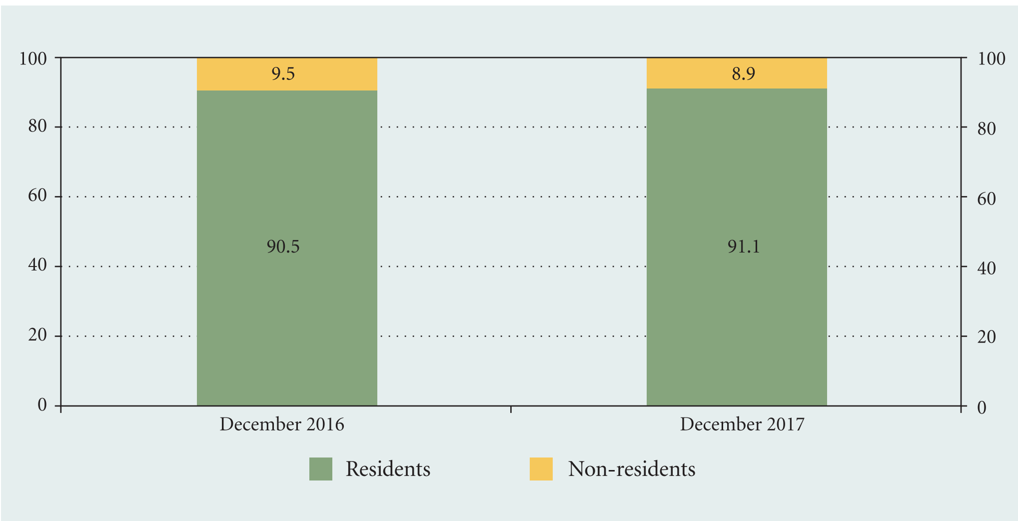


Source: the BNB.

Banking system deposits rose BGN 5.1 billion (6.5 per cent) to BGN 83.7 billion. Volumes grew across institutional sectors except other financial corporations. Corporations' deposits rose most significantly in absolute terms by BGN 2.8 billion on an annual basis.

Banking System Deposit Structure by Source

(per cent)



Source: the BNB.

Household deposits' share continued leading at 59.1 per cent, followed by non-financial corporations at 28.9 per cent. The credit institutions and general government shares rose to 6.3 and 2.4 per cent, other financial corporations dropping to 3.3 per cent. The share of domestic deposits rose to 91.1 per cent at the expense of non-residents. By currency, the lev share rose from 55.7 to 57.3 per cent, the euro deposits falling from 35.4 to 34.4 per cent.

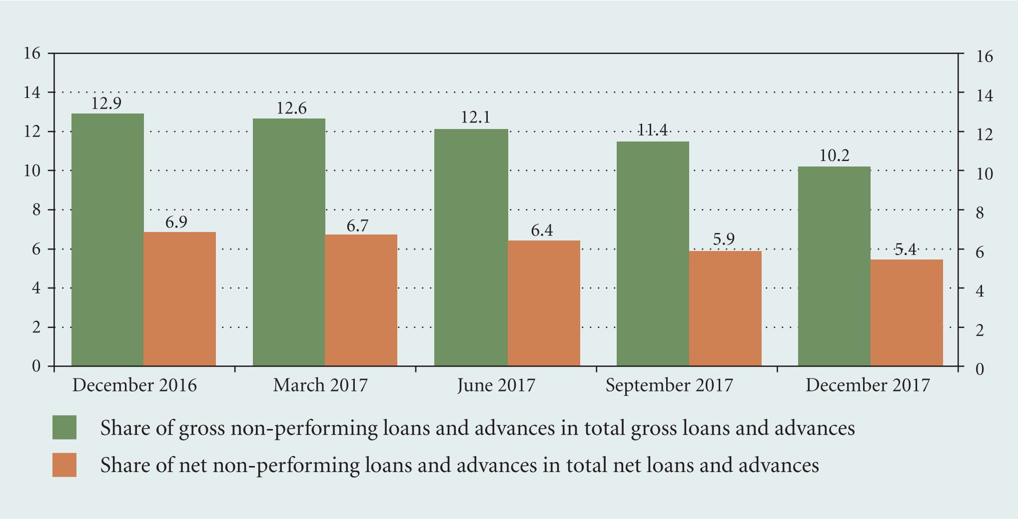
Balance sheet equity rose 3.6 per cent to BGN 12.6 billion. Accumulated other comprehensive income from available-for-sale financial assets contributed greatly.

Asset quality continued improving. By end-December 2017 gross non-performing exposures were BGN 8.3 billion, comprising mainly loans and advances. Non-performing securities were BGN 38 million. The non-performing exposure ratio, according to the broadest European Banking Authority (EBA) definition, improved to 8.9 per cent at the end of the year.

Gross non-performing loans and advances declined by some BGN 1.7 billion (16.7 per cent), while total gross loans and advances rose BGN 4.0 billion (5.2 per cent). The non-performing loan and advance share contracted 2.7 percentage points and its ratio fell to 10.2 per cent. The gross amount of non-performing loans and advances past due over a year fell by BGN 1.0 billion on an annual basis or 17.7 per cent.

Shares of Gross and Net Non-performing Loans and Advances

(per cent)



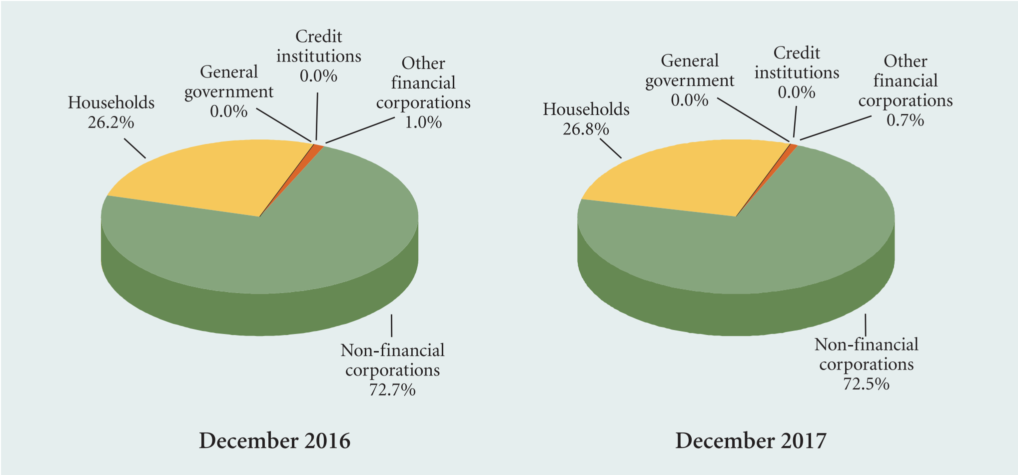
Source: the BNB.

Gross non-performing loans and advances coverage ratio was 49.4 per cent with inherent impairment. Net non-performing loans and advances, representing potential credit risk in bank balance sheets,[61] fell to BGN 4.2 billion and remained entirely covered by a BGN 7.3 billion capital excess over the 8 per cent regulatory minimum.

The structure of non-performing loans and advances did not change much, non-financial corporation debt dominating at 72.5 per cent by end-2017. Instruments banks used to curb credit risk included writing off irrecoverable claims at the expense of provisions, selling loans, and collateral repossession.

[61] Net non-performing loans and advances are calculated as the gross figure of non-performing loans and advances less the inherent accumulated impairment.

Non-performing Loans and Advances by Sector



Source: the BNB.

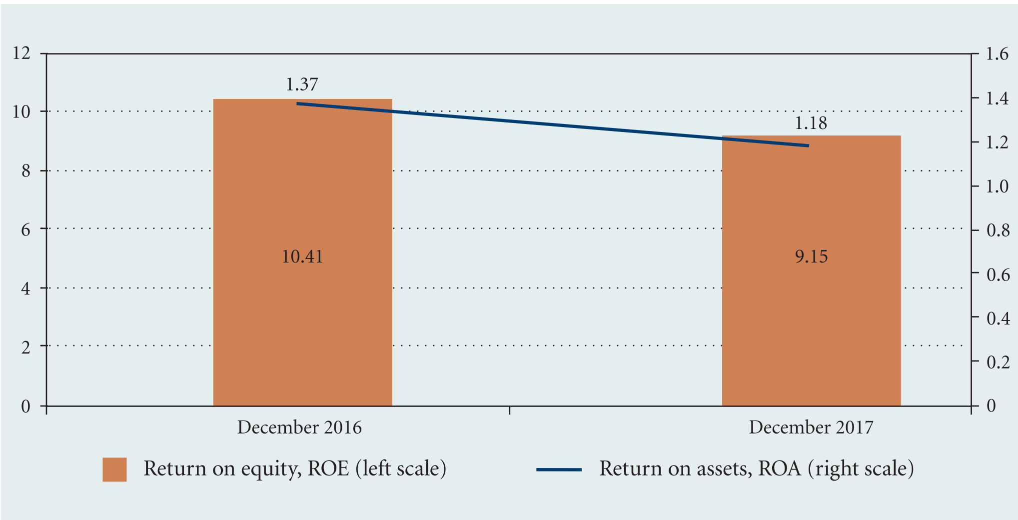
Balance sheet assets other than loans retained their good quality with a high share of liquid assets. Securities on the assets side carried no high risk or impairment since most were issued by the general government sector. The increase in bonds mainly during the last quarter boosted the share of securities to 14.2 per cent of assets. The share of claims on credit institutions continued rising, largely through placements with non-resident banks, mainly parent companies.

In 2017 impairment costs on loans and receivables were BGN 755 million, down BGN 50 million or 6.2 per cent on 2016.

The main banking system profitability indicators remained acceptable by end-2017. ROA and ROE declined slightly on 2016, to 1.18 and 9.15 per cent respectively at the end of the year.

Return on Assets and Return on Equity

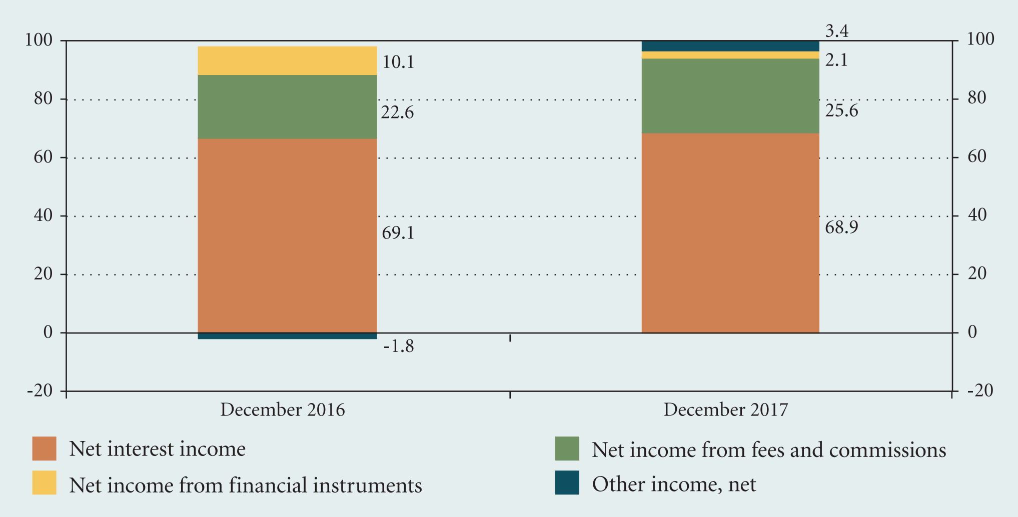
(per cent)



Source: the BNB.

Net Operating Income Structure

(per cent)



Source: the BNB.

Net total operating income fell annually 4.7 per cent to BGN 3.9 billion. The main changes in its structure were a fall in net income from financial instruments and a rise in other net income. The share of net interest income fell to 68.9 per cent and that of net income from charges and commissions rose to 25.6 per cent.

Net interest income was BGN 2.7 billion, down BGN 142 million, or 5.0 per cent compared with the previous year. Interest income fell BGN 272 million or 8.2 per cent. Interest expenditure declined BGN 130 million or 26.1 per cent on end 2016, its drop outpacing that of interest income.

The cost to income ratio rose to 46.1 per cent on 43.1 in 2016. By end-2017 the impairment loss to net total operating income ratio fell slightly to 19.8 from 19.9 by end-2016.

At the close of 2017 banking capital ratios moved little from a year earlier. Credit institutions adhered to capital buffer requirements (2.5 per cent capital conservation buffer, 3 per cent systemic risk buffer[62], and 0 per cent countercyclical capital buffer).

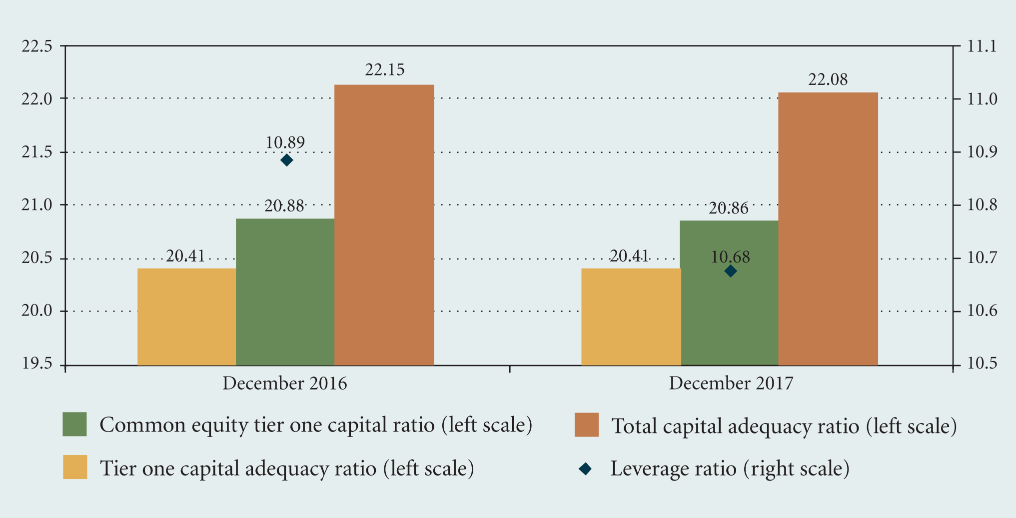
The increase in the common equity tier one capital boosted tier one capital and banking system equity. Regulatory own funds rose BGN 415 million or 3.7 per cent to BGN 11.5 billion. The increase was due to other growing accumulated comprehensive income and other reserves.

Total risk exposures, mainly weighted credit risk exposures, rose on an annual basis but did not result in a substantial change in the credit risk structure.

[62] The systemic risk buffer is cumulative with the other systemically important institution (O-SII) buffer set for systemically important banks. For more information on capital buffers, see the BNB website: http://www.bnb.bg/BankSupervision/BSCapitalBuffers/index.htm

Selected Capital Indicators under Regulation (EU) No 575/2013 on Capital Requirements

(per cent) (per cent)



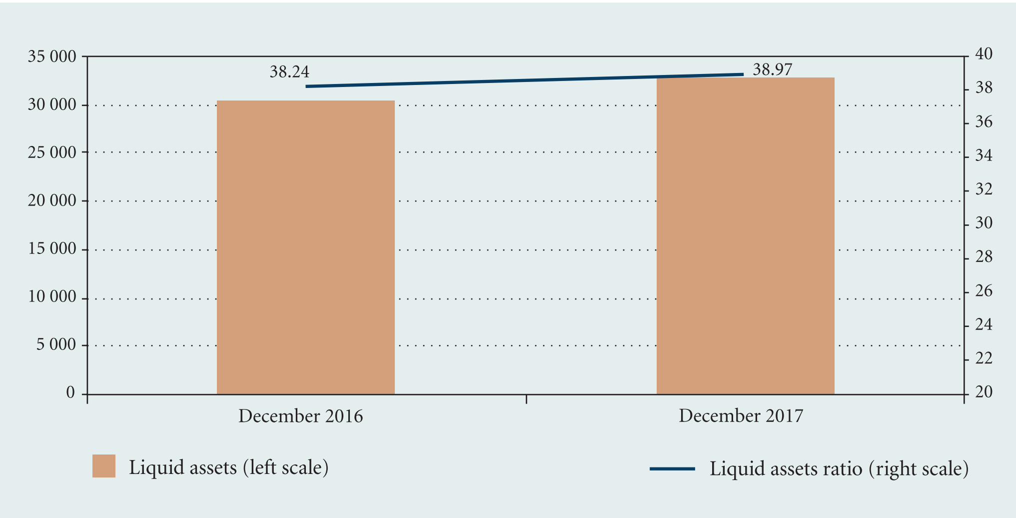
Source: the BNB.

The common equity tier one, tier one capital and total capital adequacy ratios ended the year at 20.41, 20.86 and 22.08 per cent. The capital excess over the 8 per cent regulatory minimum increased to BGN 7.3 billion at the end of 2017.

By end-2017 leverage ratio (10.68 per cent) continued to reflect low banking system debt.[63]

Selected Liquidity Indicators under Ordinance No 11 of the BNB

(BGN million) (per cent)



Source: the BNB.

In 2017 the liquidity position[64] of the banking system enhanced further in the context of increased deposits of non-financial corporations and households. The credit portfolio increased faster than in 2016.

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[63] A mandatory leverage requirement is expected in 2019.

[64] Regulation (EU) No 575/2013 and Delegated Regulation (EU) 2015/61 of the Commission introduce new liquidity reporting requirements in early 2018. This harmonises EU liquid asset and cash inflow and outflow reporting.

The liquid assets ratio calculated under the BNB Ordinance No 11 reached 38.97 per cent from 38.24.

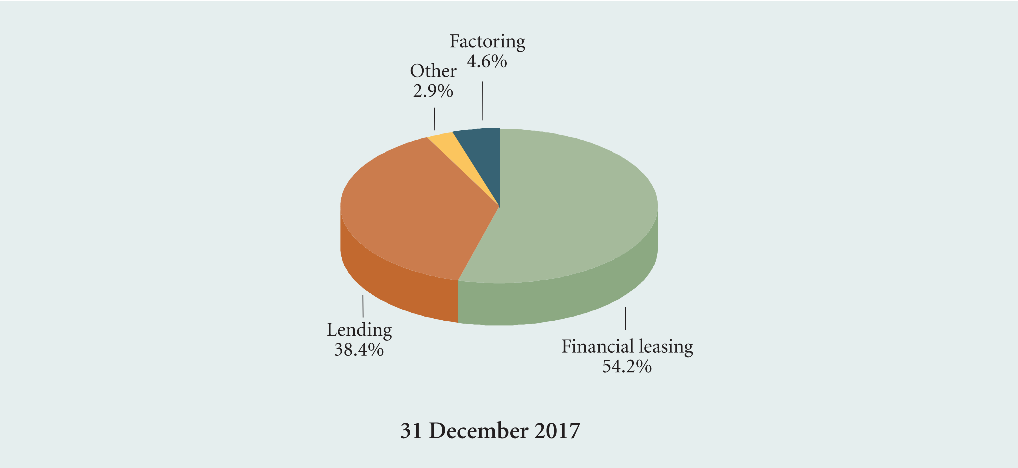
At the end of December the loan to deposit ratio (LTD)[65] was 71.5 per cent (73.5 for the prior year). The improvement was due to the faster growth rate in deposits (except credit institution ones) compared to that in banking credit portfolio.

Financial Institutions Recorded in the BNB Register[66]

In 2017 14 new companies were listed into the Register of Financial Institutions and three were deleted due to termination of trading or winding up. Three financial institutions provided single European passport mutual recognition services, their supervisory bodies notifying the BNB. At the end of the period, there were 187 listed financial institutions. Their assets were BGN 7.7 billion or 7.9 per cent of credit institutions' assets, from 7.5 per cent in 2016.

Asset breakdown by type of business remained unchanged, leasing companies leading at 46, followed by lending institutions at 123, loan claims acquirers at 11, and institutions acquiring holdings in credit or financial institutions or conducting guarantee transactions at 7.

Breakdown of Financial Institutions' Assets by Type of Business



Source: the BNB.

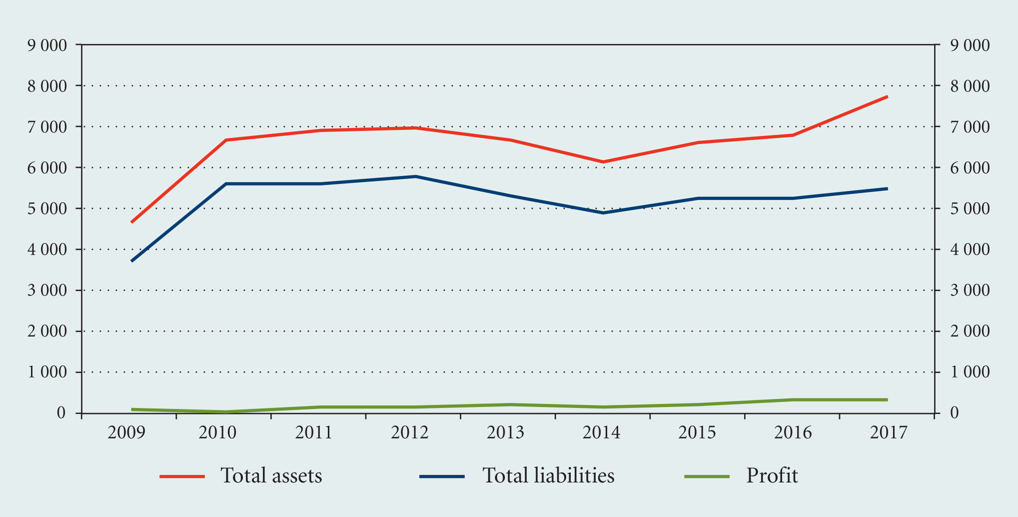
At the end of 2017 lease receivables led unimpaired assets at 51.6 per cent, followed by consumer loans at 35.2. Receivables under lease agreements led impaired assets at 53 per cent, followed by other loans related to business at 31.5 and consumer credit at 15.4 per cent.

[65] The LTD indicator uses data from the MPF1 reporting template with gross loan portfolio as denominator and deposits as denominator (except central bank and bank figures).

[66] The BNB Public Register under Article 3a, paragraph 1 of the Law on Credit Institutions.

Dynamics of Balance Sheet Indicators by Year

(BGN million)

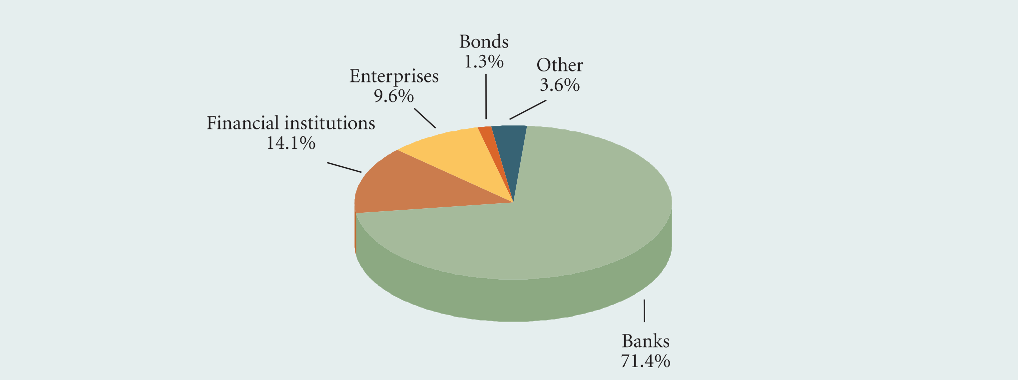


Source: the BNB.

The 20 financial institutions with the largest share of total gross loan portfolio assets (including financial leases) held 80.6 per cent from 81.1 in 2016, claim quality remaining good.

In the structure of total attracted resources (BGN 5.4 billion) the funds breakdown by source remained unchanged following the general trend over the years.

Breakdown of Attracted Funds



31 December 2017

Source: the BNB.

In 2017 annual profits were slightly up on the prior year, mostly down to the lending companies.

Return on assets (4 per cent) and return on equity (16.6 per cent) declined due to the significant growth of balance sheet figure compared to the marginal profit rise. Sector indebtedness stayed at 14 per cent.

Financial institutions' equity rose 20.4 per cent to BGN 1.8 billion, distribution by business remaining 57.5 per cent at lending companies and 31.2 per cent at leasing companies. The marginal profit rise left reserves as the main internal source of growth, including unallocated past years' profit.

Banking Supervision

At the end of 2017 the BNB adopted amendments to the Law on the BNB and the Law on Credit institutions (Darjaven Vestnik, issue 97 of 5 December 2017) whereby individual banking supervision administrative acts are placed in the purview of the Governing Council at the proposal of the Deputy Governor heading the Banking Supervision Department, not any Deputy Governor[67] as before.

Off-site Supervision

In 2017 off-site supervision worked to identify problems and potential risks which might have an adverse effect on credit institutions' ability to absorb shocks and on their risk profile assessment. This relied on continuous monitoring of banks' financial status and in-depth analyses of asset quality trends and institutions' capacity to meet liquidity pressure. Risks to profitability amid low deposit and lending rates also merited significant attention.

Periodic capital adequacy and liquidity assessments, including day-to-day liquidity position monitoring, looked into observance of BNB recommendations on attracted fund coverage: an off-site supervision priority in the supervisory review and evaluation process (SREP). A comprehensive assessment of credit institutions' financial performance and risk profile emerged from the review and assessment of banks' reports on the internal capital adequacy assessment process (ICCAP) and internal liquidity adequacy assessment process (ILAAP), and funding plans. Supervisors identified potential unacceptable risks at individual credit institutions and launched alleviation measures.

Monitoring of supervisory measures implementation continued in 2017. Supervisors reviewed five banks' moves to bring operations into line with regulatory requirements. Regular reports established that the institutions had taken appropriate remedial measures to improve their operations and functions of specific units and committees with regard to assessing, monitoring, controlling, and managing risks, and improving supervisory reports and internal capital adequacy analyses.

Participating in supervisory colleges which is another priority, helped boost supervision effectiveness at European bank group subsidiaries licensed in Bulgaria.

Pursuant to the Law on the Recovery and Resolution of Credit Institutions and Investment Firms (LRRCIIF), the Bank revised and assessed the updated and revised 2016 recovery plans of domestic banks which are not part of groups subject to consolidated supervision under Article 6, paragraph 1 of the LRRCIIF. This review involved checking if credit institutions applied integrity, quality, and overall plausibility criteria consistent with their specific circumstances and the nature, scope, and complexity of their business. In addition, the Bank monitored whether credit institutions addressed weaknesses and deficiencies identified by the 2016 recovery plan review. The review identified that recovery plans and their drafting and coordination improved significantly, though some still needed revisions. Supervisory colleges reviewed and assessed the recovery plans of EU parent companies' subsidiaries.

The BNB reviewed all banks' funding plans in line with EBA Guidelines on harmonised definitions and templates for funding plans of credit institutions[68] and European Systemic Risk Board Recommendation.[69]

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[67] Except individual administrative acts for listing, declining to list, and deletion into and from the Register under Article 3a of the Law on Credit Institutions which remain with the Banking Supervision Department Deputy Governor, and for listing and delisting into and from the Central Credit Register and the Register of Bank Accounts and Safe Deposit Boxes, which remain with the Banking Department Deputy Governor.

[68] EBA/GL/2014/04.

[69] Recommendation A4 of the ESRB Recommendation on funding of credit institutions (ESRB/2012/2).

On-site Inspections

In 2017 the BNB continued conducting supervisory inspections alongside day-to-day supervision. There were 14 inspections over the year. On-site inspections focused mainly on existing processes and systems for managing specific risks. Close attention was paid to the organisation, rules and methodology credit institutions use to identify their internal capital needs in analysing capital adequacy. Inspections covered implementation of measures and recommendations from the 2016 asset quality review. The objective was to assess the impact of these recommendations on the risk management and control framework and on the capital position of the inspected credit institutions.

Implementation of supervisory recommendations contained in previous inspection reports addressing shortcomings in institutions' control mechanisms was thoroughly assessed. Recommendations concerned improvements in internal rules and procedures, corporate culture, risk management policy, and internal audit. Some institutions improved internal risk management and tightened internal controls which had failed supervisory assessment. Recommendations on operational risk management, IT security, reserve information centres, business continuity, recurrent budgeting weaknesses, and internal audit frequency were implemented partially.

Some banks have yet to improve their overall approach to internal risk and internal capital adequacy assessments. Others failed to fully implement supervisory prescriptions on a methodology to prepare documentation on ICAAP and approaches to internal assessment of bank stability under stress, incorporating all significant risks into internal risk management and evaluation systems to be reflected in capital adequacy and planning.

Findings resulted in supervisory measures and prescriptions to banks' managements to change internal lending rules, improving borrower creditworthiness analyses and loan security valuations, and adopting realistic implementation terms. Other recommendations concerned incorporating internal capital assessment process and ICAAP into the risk management framework to integrate them in all bank operations and develop reliable assessments of inherent risks and their capital coverage. Continual credit risk monitoring brought recommendations to some banks to update early warning systems by tightly defining quantitative and qualitative criteria for identifying nascent credit exposure problems to be monitored and analysed periodically in order to take timely actions aimed at mitigating credit and concentration risks.

Operational risk reviews and assessments resulted in asking some banks to improve operational risk management by updating the applied stress test methodologies and related operational risk exposure scenarios, introducing a periodic stress test requirement and controlling the registration of all operational events and deadlines in preparing the relevant reports.

Macroprudential Supervision

Macroprudential supervision in 2017 focused on developments in inherent risks affecting banking system stability. A thorough analysis of financial intermediation and risk profile developments sought to identify vulnerabilities through an extensive set of indicators, thematic studies, and improved comparative assessments. The Annual Banking Business Aspects Survey augmented macroprudential analyses of key risk areas like non-performing loans and indebtedness. All credit institutions' liquidity positions continued to be monitored daily.

A capital stress test under Article 80b of the Law on Credit Institutions formed part of macroprudential monitoring of risks to banking system stability. It used the top-down method and its main aim was to assess resilience to hypothetical adverse macroeconomic and financial shocks. The simulation results were one information source in the supervisory review and evaluation process of bank capital adequacy under baseline and adverse scenarios. Key banking system credit risk ratios were modelled, subjected to major macroeconomic variables. Results showed adequate system equity capacity to cope with basic and hypothetical aggravated shocks.

The year saw reviews of the systemic risk and other systemically important institutions (O-SII) risk buffers.[70] Systemic risk buffer level was confirmed at 3 per cent of the bank risk exposures of Bulgarian banks. The review acknowledged banking system's structural features, its leading position in the financial system, and its key role in financial intermediation and support to the sustainable development of the national economy. When quantifying the buffer for O-SII, the Bank looked at banks' changing systemic importance since buffer introduction.

Quarterly macroprudential assessments and analyses of potential system losses from cyclical systemic risk accumulation in excessive credit growth periods used countercyclical capital buffers. Given the negative deviation of the credit to GDP ratio from its long-term value, in 2017 there was no cyclical systemic risk, and the countercyclical capital buffer stayed at nil.

The Bank's macroprudential mandate entailed announcing banking system risks and major trends.

Optimising Single Data Depository/Banking Supervision Reports noted changes in the financial reporting framework and supervisory information and analytical needs.

Specific Supervisory Activities

Specific supervision focused on the systemic effort to create a reliable expertise and technology backed environment to prevent transfers of criminal proceeds through the financial system.

Inspections reviewed systems preventing money laundering and terrorist financing amid changing national legislative framework aimed at achieving compliance with the principles laid down in Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. On-site inspections at ten banks found 27 breaches. Fifty-five recommendations addressed administrative capacity and due diligence of higher risk customers.

Interinstitutional inspections with the Financial Supervision Commission at two banks acting as supplementary pension insurance fund custodians showed statutory compliance.

The Bank inspected Law on Bank Deposit Guarantee adherence on reporting guaranteed deposits at four credit institutions. Breaches in calculating deposit bases and guaranteed deposit amounts were found and recommendations for removing them made.

The BNB was active in expert debates on the draft of a new Law on Measures against Money Laundering. Work continued on the national money laundering and terrorist financing risk assessment (NRA) to which Bulgaria is committed under Directive (EU) 2015/849. The administrative resources provided significant progress in the overall process of gathering and analysing the required information to complete an important stage of NRA by the year's end.

The number of complaints and poor practice signals on credit institutions to the BNB continued declining. Updated Information for Financial Product and Services Users explains the way to complain to credit institutions and before special conciliation committees reviewing disputes on matters like consumer loans, interest rates, and charges.

[70] For more information on capital buffers, see the BNB website: http://www.bnb.bg/BankSupervision/BSCapitalBuffers/index.htm.

To simplify credit intermediary registration under the Law on Real Estate Loans for Consumers, the Bank automated registrations and paperwork submissions. The Bank also published new Guidelines on the implementation of BNB Ordinance No 19 on Credit Intermediaries. The Credit Intermediary Register under Article 51 of the Law on Real Estate Loans for Consumers listed 24 Bulgarian and nine EU Member State intermediaries. More than 70 companies suspected of unauthorised credit intermediation were inspected during the year. Several received instructions to change the information they present to consumers.

From its international contacts, the Bank received numerous references on persons – qualifying owners or members of financial institution's boards. Alongside registering new financial institutions, the Bank declined to register three companies because of unclear own funds origins. The year saw four financial institutions charged and warned in writing of administrative breaches of BNB Regulation No 26. A prosecutor's office signal prompted an inspection against a company for unlicensed deposit taking and imposition of a fine.

Issue of Licences, Permits, and Approvals

There were no new bank operations licences or bank licensing procedures in 2017. The BNB completed preapprovals for two bank equity acquisitions: a D Commerce Bank application to acquire 100 per cent of Commercial Bank Victoria equity was declined in March; a KBC Bank N.V., Belgium application to directly acquire 99.91 per cent of United Bulgarian Bank (UBB) equity was approved, making the UBB part of the KBC Group. The Bank subsequently authorised CIBANK AD's merger into the United Bulgarian Bank AD.[71] In the second half of 2017 the Bulgarian American Credit Bank AD and Investbank AD applied to acquire 100 per cent of Commercial Bank Victoria equity. The applications were in response to the sale of shares and claims in and on Commercial Bank Victoria by assignees in bankruptcy of the insolvent Corporate Commercial Bank AD. Following assessment of compliance with the criteria set out in Article 28a, paragraph 3 of the Law on Credit Institutions and in view of both banks' intentions to transform the bank subject to acquisition through merger with the relevant applying bank within six months, the Bank granted preapprovals to Bulgarian American Credit Bank AD and Investbank AD to directly acquire Commercial Bank Victoria AD's shares.[72]

In December 2017 Novito Opportunities Fund AGmvK applied to acquire 67.646407 per cent of Municipal Bank AD paid-in share capital. Following assessment of compliance of the declared acquisition with the criteria set out in Article 28a, paragraph 3 of the Law on Credit Institutions the Bank granted the requested approval.[73]

Over the year 22 new EU Member State credit institutions exercised the freedom to provide services under the mutual recognition of single European passport through notices to the BNB from their licensing authorities, bringing the number of received direct services notices in Bulgaria to 288.

In August 2017 IšBank AG of Germany notified the Bank of its intention to close its Bulgarian branch. IšBank AG's competent authority notified the BNB of its consent on branch closure. On assessing compliance with bank operation termination requirements the BNB concurred in consent.[74]

In August the ECB as competent authority advised the BNB that BNP Paribas Personal Finance S.A. of France intended to operate in Bulgaria through a branch.

[71] In October CIBANK AD requested, and in January the BNB granted the merger of CIBANK AD with the UBB.

[72] In March 2018 the BNB took decisions on both procedures.

[73] BNB decision of January 2018.

[74] BNB letter of February 2018.

Subsequently,[75] the BNB consented to BNP Paribas Personal Finance EAD terminating its payment institution business from 1 February 2018. BNP Paribas Personal Finance S.A. will launch credit institution operations in Bulgaria through a branch.

The year saw approvals for 19 new supervisory and 28 management board members at banks, 22 of whom also for executive directors. One approval was granted for a bank procurator and another for a deputy manager of a third country bank branch.

There were six authorisations for recognition of instruments in banks' tier one capital and one for early repayment of a debt instrument.

Supervisory measures

2017 saw supervisory measures imposed on five banks for supervisory framework breaches. Two other banks received supervisory prescriptions to remove weaknesses in their operations.

The Regulatory Framework and Internal Rules

The BNB was involved in drafting legislative amendments to improve the regime regulating risk stemming from the exposures of banks to related parties: administrators, shareholders with qualified or higher shares, persons controlling the bank, subsidiaries, and other parties identified as related (internal exposures).[76] The legal mechanism for transposing EBA guidelines, recommendations, and other measures into Bulgarian law on the grounds of Article 16 of Regulation (EU) No 1093/2010 was streamlined.

At the end of 2017 the European Commission adopted a regulatory standard providing for transitional measures to mitigate the IFRS 9 implementation impact from 1 January 2018. This allows institutions to phase in potentially negative changes to capital, capital ratios, and leverage over five years. The BNB surveyed banks' readiness to introduce IFRS 9 classification, measurement, and impairment of financial assets and gain a realistic idea of changed impairments, capital, and capital ratios. The results suggested banks were in the final stages of implementation and remained sufficiently capitalised and above minimum capital requirements and buffers.

BNB Governing Council Resolution 17 of 9 February approved a Bank Supervisory Process Manual formulated under the Banking Supervision Reform and Development Plan. It defines individual units rights and duties and sets interaction rules.

Participating in Single Supervisory Mechanism Colleges

Gaining awareness of group and parent risk profile and vulnerability was a priority. Colleges discussed strategic plans for bank groups and subsidiaries, analysed the impact of key markets' operational environments on bank groups, the results of 2017 ECB stress tests, the main findings of supervisory reviews, and all significant supervisory measures. Exchanging information and continuously cooperating on capital and liquidity assessments contributed to joint decision making on relevant groups. Reviewing group recovery plans formed another focus. Plans still showed weaknesses, all competent authorities pointing especially to insufficient cover of significant subsidiaries. In 2017 group recovery plan review was followed by joint decisions on eight European bank groups in Bulgaria.

Preapproval moves for the KBC Group takeover of the UBB involved intensive exchange with the joint ECB supervisory team responsible for KBC.

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[75] In January 2018.

[76] Published in the Darjaven Vestnik, issue 97 of 2017.

VII. BNB Work on Resolution of Credit Institutions

The Law on the Recovery and Resolution of Credit Institutions and Investment Firms (LRRCIIF) tasks the BNB with resolution of credit institutions.

In 2017 the BNB as a body responsible for resolution of credit institutions focused on resolution plans. Development and improvement of methodologies and procedures for a common approach to assessments and analyses in resolution plans and discharging other Bank LRRCIIF duties continued. The Bank adopted a number of internal rules and statutory instruments. Among them was a detailed methodology setting third country banks and branches dues to the Bank Resolution Fund (BRF) under the Commission Delegated Regulation (EU) 2015/63.[77] Ordinance No 9 of the BNB on the information and documents proving compliance with the requirements to temporary administrators or special managers of a bank was adopted pursuant to Article 46, paragraph 3 and Article 54, paragraph 2 of the LRRCIIF. New internal rules settle internal Ordinance implementation. To facilitate practical BNB resolution duties under Article 2, paragraph 1 of the LRRCIIF on decision making as a resolution authority, internal rules set preparation and decision making procedures and assigned responsibilities.

As a resolution authority of subsidiary banks of parent companies from the EU the BNB participates in international colleges for resolution of cross-border banking groups from the EU (banking groups). In the first half of 2017 eight international colleges for resolution were active in which the BNB jointly with the group-level resolution authority and other resolution authorities of subsidiary companies from the EU worked on assessing the opportunities for resolution and preparing resolution plans for the relevant bank groups and their subsidiaries licensed in Bulgaria. Within these colleges, the BNB adopted resolution plans for relevant groups and subsidiaries by early 2017. The plans include assessments of bank group resolvability, significant corporations in banking groups and their critical functions, and business model analyses. The plans include resolution strategies for banking groups and all significant subsidiaries. They also include additional detailed assessments of interdependencies within banking groups. The plans assess the eight banking group subsidiaries in Bulgaria as significant corporations within their groups and define their critical functions.

The plans set no minimum requirements for own funds and eligible liabilities for 2017. The minimum requirements will be set after finalisation of the legal framework for determining minimum requirements for own funds and eligible liabilities in the European Union.

Seven international resolution colleges worked in the second half of 2017: one fewer after the KBC Group took over the United Bulgarian Bank. These colleges launched the next annual resolution plan review in May and June 2017. Updates should be ready in the first half of 2018. In the review the BNB consults group-level and national resolution authorities.

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[77] Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regards to *ex-ante* contributions to resolution financing mechanisms (OJ, L 11 of 17 January 2015, p. 44).

As resolution authority of cross-border banking group subsidiaries the BNB is an observer of the Single Resolution Mechanism (SRM) extended executive session. Bank SRM representatives helped debate banking group resolution plan drafts for 2017.

The BNB continued collecting standardised credit institution information for assessing resolvability and preparing resolution plans.

In March the BNB set 2017 banking system Bank Resolution Fund dues at BGN 111,274,000 to LRRCIIF requirements. In April 2017 it apportioned this to individual banks. All banks paid their dues into the Fund within the term set in the LRRCIIF.

VIII. Participating in the ESCB and EU Bodies

In 2017 EU bodies and institutions focused on the implementation of measures to recover economic growth, promote investment, establish a functional integrated capital market union, and raise confidence in the financial system. The March 2017 White Paper on the Future of Europe initiated debate on five possible scenarios for EU development in the next decade in view of current challenges. Two European Commission reflection papers focused debate on the future of the Economic and Monetary Union (EMU) and EU funding. In December 2017 the EC presented a package of documents aimed at strengthening national economic and fiscal policy coordination within the EMU, including concrete steps towards its deepening.

The European System of Central Banks

The BNB Governor sits on the ECB General Council with EU central bank governors and the ECB President and Vice President. The four 2017 ECB General Council's meetings addressed important issues of economic development, EU financial performance, and the ECB reports on non-euro area EU countries' outlook and monetary policies, central bank observance of the prohibition of monetary financing, and public finance.

BNB representatives sat on 12 ESCB committees,[78] 46 working groups, and the Human Resource Conference. Bank representatives on ESCB bodies, committees, and working groups helped elaborate ECB instruments on monetary and banking policy, payment and settlement systems, statistical reporting and research, and other central banking issues. The Bank also helped formulate ECB standpoints in written consultations with Member States on bills within ECB purview. Over the year Bulgaria held two written consultations: on the Bill to amend the Law on Limiting Cash Payments with gradually lower limits; the Bill to amend the Law on Payment Services and Payment Systems to transpose Directive (EU) 2015/2366 on payment services in the internal market; the Bill to amend the Law on Credit Institutions to strengthen banking supervision with particular regard to related parties; the Bill to amend the Law on Credit Institutions to change the BNB decision making framework; and the Bill to amend the Law on Payment Services and Payment Systems to transpose some provisions from Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts.

In May 2017 the BNB hosted the ESCB Monetary Policy Committee Working Group on Econometric Modelling.

The European Systemic Risk Board, the European Banking Authority, and Colleges of Supervisors

The BNB Governor and BNB Deputy Governor are members of the ESRB General Board. The four 2017 General Board's meetings mainly debated EU financial stability risks. The probable global financial markets risk premia reassessment which, amid heightened geopolitical uncertainty, might renew concerns over public and private

[78] The Accounting and Monetary Income Committee (AMICO), the Financial Stability Committee (FSC), the Banknotes Committee (BANCO), the Eurosystem/ESCB Communications Committee (ECCO), the Information Technology Committee (ITC), the Internal Auditors' Committee (IAC), the International Relations Committee (IRC), the Legal Committee (LEGCO), the Market Operations Committee (MOC), the Monetary Policy Committee (MPC), the Market Infrastructure and Payments Committee (MIPC), and the Statistics Committee (STC).

debt in set EU countries, was identified as a key risk despite expectations of world and European recovery. The General Board's meetings also discussed banking structural and cyclical vulnerabilities from poor profitability in set Member States, asset quality degradation, and risks related to price dynamics in the residential property sector. On the EC review of the EU macroprudential framework, the General Board approved proposed legislative amendments on structural macroprudential buffers.

The March General Board addressed Member States' 2016 macroprudential measures to curb risks to systemically important institutions and risks in the residential property sector. The General Board approved the adverse scenario for the occupational retirement institutions' stress tests coordinated by the European Insurance and Occupational Pensions Authority (EIOPA) in 2017. The June General Board adopted approaches, core principles and recommendations to cut non-performing loans. Second half year General Board's meetings addressed EU market derivatives and stressed the need for yet better data and derivatives markets awareness to spot possible systemic risks and develop relevant macroprudential policies.

The Bank reported macroprudential policy cross-border effects and moves to transparency and accountability in line with 2015 ESRB Recommendation on cross-border effect assessment and voluntary reciprocity for macroprudential policy measures.

Compliance with the ESRB Recommendation on recognising and setting countercyclical buffer rates for exposures to third countries was assessed. The overall assessment of the BNB as a body responsible for setting countercyclical buffer rates for the banks in Bulgaria is that the Bank complies with the requirements of the Recommendation.

Fast growing investment funds and their increasing role in financial intermediation could result in a more serious financial crisis in the future. Therefore, at the end of 2017 the General Board recommended tackling the systemic risk related to liquidity imbalances and the use of leverage by investment funds to improve EU mactoprudential framework applicable to the asset management sector.

Bank representatives were actively involved in the work of the ESRB General Board, Advisory Technical Committee, two working groups, and task forces, preparing positions on topics discussed at meetings, written procedures, and consultations.

The ESRB General Board High Level Task Force established in 2016, in which the BNB is represented by a Deputy Governor, continued compiling a portfolio of low risk assets. The Task Force explored the potential creation of low risk securities comprising senior and subordinated claims (tranches) backed by a diversified portfolio of government bonds without risk sharing. Having discussed the key conclusions of the report in December, the General Board approved its publication on the ESRB website.

Cooperation with the supervisory colleges[79] and international colleges for resolution[80] continued in 2017.

The Ecofin Council and Economic and Financial Committee (EFC)

BNB representatives took part in the discussions of the EU Council Working Party on Financial Services, which meets in different formats on concrete EC legislative proposals. Eleven Bank representatives sat on 25 Working Party meetings, helping the Ministry of Finance and debating EC proposals on a package of measures to curb banking system risks and the rewiew of the European System of Financial Supervision.

[79] For more information, see Chapter VI.

[80] For more information, see Chapter VII.

In 2017 the BNB took part in negotiations on the November 2016 package of legislative proposals to reduce banking system risks and boost credit institution stability and resilience to external shocks. Priority went to the legislative package components of satisfying bank creditors and the phase-in of the International Financial Reporting Standard on Financial Instruments (I-FRS 9) impact. BNB representatives also addressed bank prudential requirements (capital, liquidity and supervision) and recovery and resolution (the framework on minimum own funds and eligible liabilities under the Financial Stability Board total loss absorbing capacity standard for global systemically important banks).

Bank representatives debated the 20 September 2017 EC European System of Financial Supervision legislative package on further financial integration and reforming the European Supervisory Authorities (ESA) and the ESRB. Discussions focused on EC proposals to amend regulations on ESA powers, management, and financing.

Bank representatives sat on seven technical level deliberations of the EU Council Ad Hoc Working Party on the Strengthening of the Banking Union debating the European Deposit Insurance Scheme (EDIS) proposal.[81] The Government and the Bank desire additional analysis of EDIS effects, including on non-euro area countries. Debate also aimed EDIS scope and membership, risk based contribution calculations, funding, methodology, and alternative and preventive measures.

The BNB helped harmonise Bulgarian and EU law. Bank representatives helped draft a Bill on Payment Services and Payment Systems[82] transposing the Payment Services Directive II[83] and implementing some elements of Regulation (EU) 2016/1011.[84]

The BNB participated in the Economic and Financial Committee. Debate focused on reviewing the economic situation, risks to financial stability, EU financial sector trends, and EU government debt markets. Another circle of regular topics concerned the implementation of agreed measures towards Banking Union and key issues of risk reduction and sharing. Attention went on progress towards laying the foundations of the Capital Markets Union by 2019. The Committee and its Ecofin informal April meeting, which included the BNB Governor and Deputy Governor, discussed reducing non-performing loans at the EU level and the five scenarios in the White Paper on the Future of Europe.

Second half year Economic and Financial Committee debate addressed deepening the EMU, sustainable development funding, and Member State structural reforms. Committee members held a preliminary debate on the EC Communication on agreement to complete the Banking Union based on existing Council commitments. The Committee also addressed further EU moves to strengthen supervision included in the EC Communication on the European System of Financial Supervision review. The Committee helped prepare discussions on financial technologies and deepening the EMU for the September Informal Ecofin meeting which the BNB Governor and a Deputy Governor attended.

By participating in the Council of Ministers Council for European Affairs, the BNB contributed to formulating Bulgarian standpoints on key economic governance areas and the financial sector.

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[81] See BNB Annual Report, 2016, p 79.

[82] For more information, see Chapter III.

[83] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

[84] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

IX. International Relations

The Law on the Bulgarian National Bank entitles the Bank to participate in international organisations furthering currency, monetary, and credit policy cooperation. Where Bulgaria participates in international financial institutions, the BNB is sovereign fiscal agent and depository.

The Bulgarian National Bank holds equity in the Bank for International Settlements (BIS). The BNB Governor sat on BIS central bank governors' regular meetings: a major forum for cooperation and debate on world economic development and prospects, and international financial markets. The BIS Governors allocated net profit at the Annual General Shareholder Meeting in late June 2017, the BNB receiving EUR 2.9 million dividend for its 8000 shares.

The Governor represents Bulgaria on the IMF Board of Governors. Bulgaria's IMF quota is SDR 896.3 million or 10,427 voting shares: 0.21 per cent of IMF voting shares. In October the BNB Governor led a Bulgarian delegation to the regular IMF and World Bank Group annual meetings.

In April 2017 the BNB contributed USD 10,000 to the Group of Thirty.

In February representatives of the Central Bank of the Republic of Turkey visited the BNB to boost bilateral relations. They discussed possible areas of cooperation and expertise sharing. In March the Bank ran a training session for Central Bank of the Republic of Turkey and Turkish State Mint representatives funded by the Pericles 2020 EC programme. It looked at national analysis centres' structures, functions, and organisation, and at experience and best practice in protecting the euro and other currencies from counterfeiting.

The BNB continued ramping up cooperation with Western Balkans central banks and backing their EU accession preparations. In April Central Bank of Montenegro representatives visited the BNB under the European Commission's Enlargement Technical Assistance and Information Exchange mechanism (TAIEX). The Bank provided technical assistance on developing a roadmap on Central Bank of Montenegro ESCB membership.

The BNB invited a Portuguese Central Bank Statistical Department representative to present projects in the area of statistics. The Bank heard Portuguese experience of the ECB AnaCredit project which is of key importance for ensuring harmonised and detailed data on Eurosystem, ESCB, ESRB, and SSM commitments in monetary policy, risk management, financial stability, macroprudential policy and analysis, banking supervision, and European statistics.

In November the BNB, through the World Bank, hosted a central bank of Belarus delegation to share framework for recovery and resolution of credit institutions experience.

Helping step up regional cooperation, the Bank also participated at summit level in the Central Banks Governors' Club of Central Asia, Black Sea Region and Balkan Countries.

X. Statistics

The BNB collects, compiles, and publishes statistical information under Article 42 of the Law on the Bulgarian National Bank and Article 5 of the Statute of the ESCB and the ECB. Alongside regular submissions of reliable and sound statistical information to the ECB, Eurostat, the ESRB, the IMF, and other international institutions, the Bank disseminates timely and up-to-date data to all other users.

In monetary and interest rate statistics, the Bank continued collecting and disseminating MFI balance sheet data and information on deposits and loans broken down by quantitative categories and business, interest applied by MFI to household and non-financial corporation deposits and loans, and the long-term interest rate for assessing the degree of convergence.

The BNB continued gathering and publishing statistics on non-bank financial institutions, insurance and investment funds, and pension fund assets and liabilities. ECB information on insurance statistics expanded to include flow data.

Updating methodological guidelines and reporting forms in statistics on monetary and interest rates,[85] investment funds,[86] financial vehicle corporations engaged in securitisation,[87] insurance companies,[88] and pension funds, continued to satisfy additional statistical information user requirements and ESA 2010 implementation.

Work on providing and maintaining up-to-date information to the ECB Register of Institutions and Affiliates Data (RIAD) continued. This contains reference information on credit institutions, money market funds, financial vehicle corporations, investment funds and their management companies, payment service providers and payment system operators, insurance and reinsurance companies, alongside holding companies and head offices. Implementation began of new ECB requirements on broadening the scope of information for the updated version of the register, due to go live in 2018.

In 2017 the BNB continued gathering and disseminating data on the balance of payments, international investment position, gross external debt, and the reserve and foreign currency liquidity template.

Work continued on the ESCB Centralised Securities Database project and on maintaining a Bulgarian securities database. As member of the ESCB, the BNB took part in the Securities Holdings Statistics project on compiling sundry statistics and financial stability analyses.

On financial accounts, the BNB continued to compile data on the quarterly financial accounts of the general government sector, government finance statistics, and all institutional sectors' quarterly financial accounts.[89]Work ended on compiling and

[85] Regulation (EU) No 1071/2013 concerning the balance sheet of the monetary financial institutions sector and Regulation (EU) No 1072/2013 of the European Central Bank of 24 September 2013 concerning statistics on interest rates applied by monetary financial institutions.

[86] Regulation (EU) No 1073/2013 of the European Central Bank of 18 October 2013 concerning statistics on the assets and liabilities of investment funds.

[87] Regulation (EU) No 1075/2013 of the European Central Bank of 18 October 2013 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions.

[88] Regulation (EU) No 1374/2014 of the European Central Bank of 28 November 2014 on statistical reporting requirements for insurance corporations.

[89] Under Regulation (EC) No 501/2004 of the European Parliament and of the Council, Guideline of the European Central Bank of 25 July 2013 on the Statistical Reporting Requirements of the European Central Bank in the Field of Quarterly Financial Accounts (recast) (ECB/2013/24), and Guideline of the ECB of 25 July 2013 on Government Finance Statistics (ECB/2013/23).

disseminating quarterly financial accounts data of all institutional sectors from the fourth quarter of 2006 to 2012 to make longer time series available.

In compliance with BIS requirements, the BNB regularly provides macroeconomic statistics.

As coordinator of the IMF statistical data dissemination standard, the Special Data Dissemination Standard Plus (SDDS Plus), the BNB completed annual metadata certification for all standard data categories. As data complier for SDDS Plus categories, the Bank continued regular updates of information published in National Summary Data Plus (NSDP Plus) to the data dissemination schedule.

The Bank continued developing and elaborating the Integrated Statistical Information System and the Information System for Monetary and Interest Rate Statistics. They automate management, improve the reliability and quality of statistical information the BNB receives, processes and disseminates, and greatly reduce the administrative burden on individuals and legal entities by offering electronic submission of statistical reports and declarations.

XI. The Central Credit Register and the Register of Bank Accounts and Safe Deposit Boxes

The Central Credit Register

The Bulgarian National Bank maintains an information system on customer debt to Bulgarian banks, other financial institutions, and payment and electronic money institutions extending loans under Article 19 of the Law on Payment Services and Payment Systems (reporting units). BNB Ordinance No 22 on the Central Credit Register sets out CCR operation, scope, terms, procedure, and information flows.

Following the amendments to Article 56 of the Law on Credit Institutions[90] Ordinance No 22[91] introduced methodology for calculating statement and certificate charges. This sets charging terms and procedures under Article 28 of the Ordinance No 22 on the Central Credit Register.

New requirements for information on co-borrowers, guarantors, and avalists on loans will boost Register information quality. The additional data will allow CCR participants to assess customer creditworthiness better.

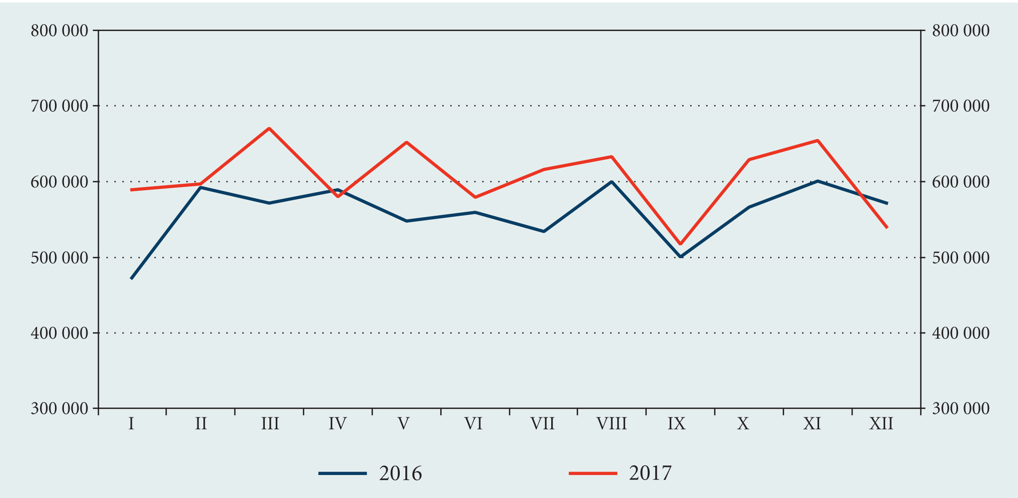
Register information does not depend on amount. The CCR provides information in real time. It includes loan status, arrears, and repaid loans for five years back.

By the end of 2017 the CCR had 207 participants: 28 banks, 176 financial institutions, and three payment institutions. Over the year 14 new financial institutions entered and four left the Register information system as they ceased trading.

At the end of 2017 the CCR listed 5,130,000 loans from 4,945,000 a year earlier, with a balance sheet exposure of BGN 70,216 million from BGN 67,809 million. Borrowers numbered 2,383,000, of whom 2,240,000 individuals, 97,000 legal entities, 38,000 non-residents not registered at Bulgarian addresses or BULSTAT/PIK coded, and 8000 self-employed persons practising liberal professions or crafts.

CCR Searches by Reporting Units by Month

(number)



Source: the BNB.

[90] Published in the Darjaven Vestnik, issue 98 of 2016.

[91] Published in the Darjaven Vestnik, issue 103 of 2016, effective as of 1 January 2017.

Residual debt up to BGN 5000 predominated with individuals (63.7 per cent), debt of BGN 5000 to 50,000 predominating with legal entities (34.7 per cent).

CCR information was essential to creditors wishing to assess borrower creditworthiness. Historical data on arrears and repaid loans added an important aspect to this. In 2017 the Register conducted 7,258,000 electronic searches. The average monthly number was 605,000, of which 68.3 per cent by banks and 31.7 by other participants.

Articles 21 and 22 of Ordinance No 22 grant individuals (including for probate purposes) and legal entities access to debt information. In 2017 there were 15,480 applications for CCR statements: 14,085 by individuals and 196 by legal entities.

CCR Searches Based on Applications /Letters Submitted to the BNB by Month

(number)

Source: the BNB.

The CCR has a modern information system adhering to state of the art information use requirements on three user interfaces based on new data processing technologies. The Register exchanges information with other European credit registers to improve its technological and methodological performance. CCR information compiling and maintenance follows relevant best practice.

The CCR provides research, statistical analyses, and annual summary information to the World Bank under the Doing Business project, the ECB, the IMF, and other international bodies.

The Register of Bank Accounts and Safe Deposit Boxes

The Register of Bank Accounts and Safe Deposit Boxes (RBASDB) launched on 3 January 2017 under Article 56a of the Law on Credit Institutions (LCI) and BNB Ordinance No 12. The Register lists bank account numbers, holders, and attorneys, and deposit box holders supplied by banks and foreign bank branches.

The Law on Credit Institutions grants Register information access to judicial authorities (Courts, the Prosecutor’s Office, and the investigation authorities), the Ministry of the Interior Chief National Police Directorate and Combating Organised Crime Chief Directorate, the State Agency for National Security, the National Revenue Agency, the Countering Corruption and Forfeiture of Illegally Acquired Assets Commission, bailiffs in enforcement proceedings, and other bodies listed in Article 56a of the Law on Credit Institutions. From February the Register also became available to banks and foreign bank branches.

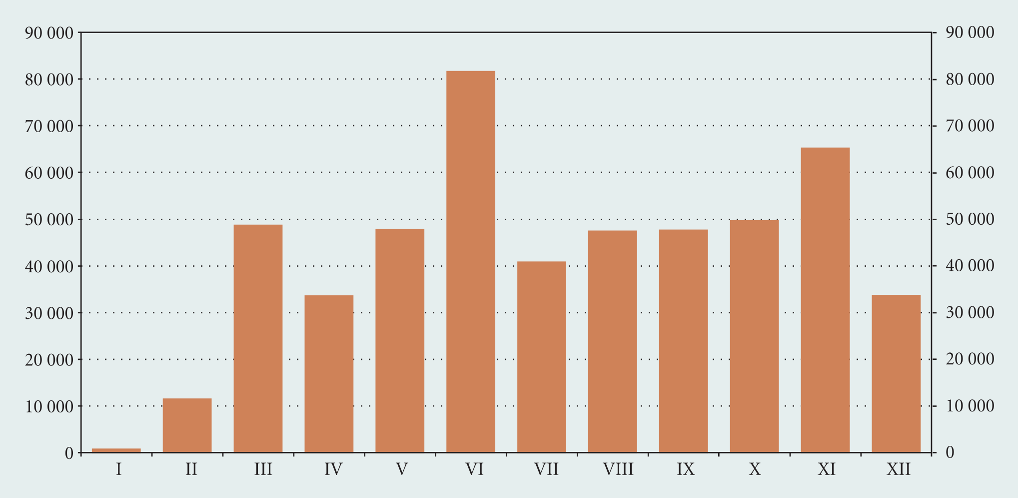
At launch the Register held details of 16.62 million bank accounts and 32,000 safe deposit boxes. By the end of 2017 it listed 2.98 million new and 3.45 million closed accounts.

At launch, the Register issued mainly paper statements. In February 2017 electronic access began being provided in stages to relevant bodies. At the year's close the share of electronic statements was 92 per cent.

Bodies entitled to Register access under Article 56a, paragraph 3 of the Law on Credit Institutions conducted searches on 508,066 individuals.

RBASDB Searches under Article 56a of the Law on Credit Institutions in 2017

(number)

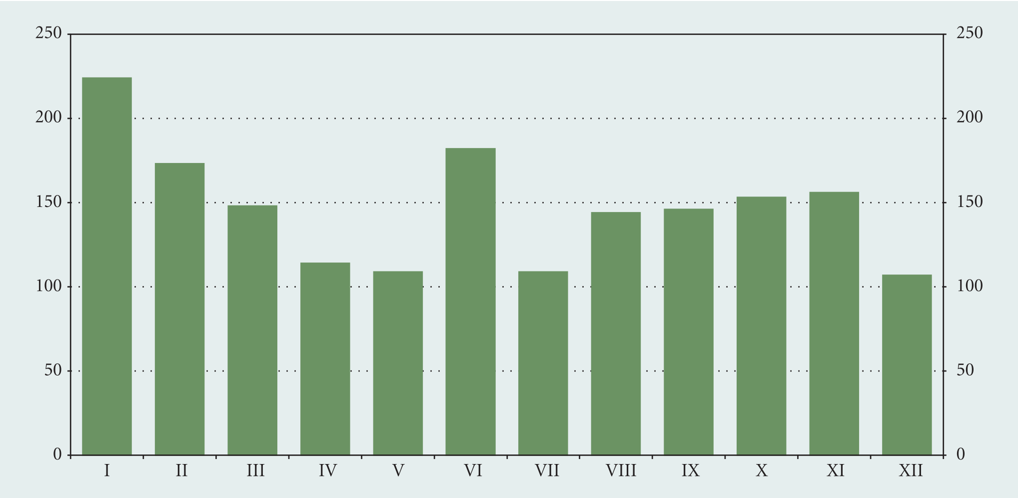


Source: the BNB.

Article 56a, paragraph 4 of the Law on Credit Institutions and Article 12 of BNB Ordinance No 12 grant individuals and legal entities access to Register data. In 2017 individuals (including heirs of deceased persons) conducted 1683 searches and legal entities conducted 82 searches.

RBASDB Statement Applications by Individuals and Legal Entities in 2017

(number)



Source: the BNB.

Amendments to Article 56 of the Law on Credit Institutions[92] prompted BNB Ordinance No 12[93] changes introducing RBASDB statement charges. The methodology establishes the terms and conditions for determining the fees provided for in Article 16 of the BNB Ordinance No 12. Changes also called for additional Register information with regard to Regulation (EU) No 655/2014 of the European Parliament and of the Council of 15 May 2014 establishing a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters.

The RBASDB boosts its data quality and reliability by applying EU experience on bank account registers.

[92] Published in the Darjaven Vestnik issue 98 of 2016.

[93] Published in the Darjaven Vestnik, issue 103 of 2016; issue 49 of 2017.

XII. The Fiscal Agent and State Depository Function

The Law on the BNB tasks the Bank with acting as the fiscal agent and official depository pursuant to contract. These duties call for maintaining and improving the GSAS system for conducting government securities auctions; the ESROT electronic system for registering and servicing government securities trading; the GSSS government securities settlement system; the Register of Special Pledges; the AS ROAD automated system for registering and servicing external debt; and the IOBFR system for budget and fiscal reserve information servicing.

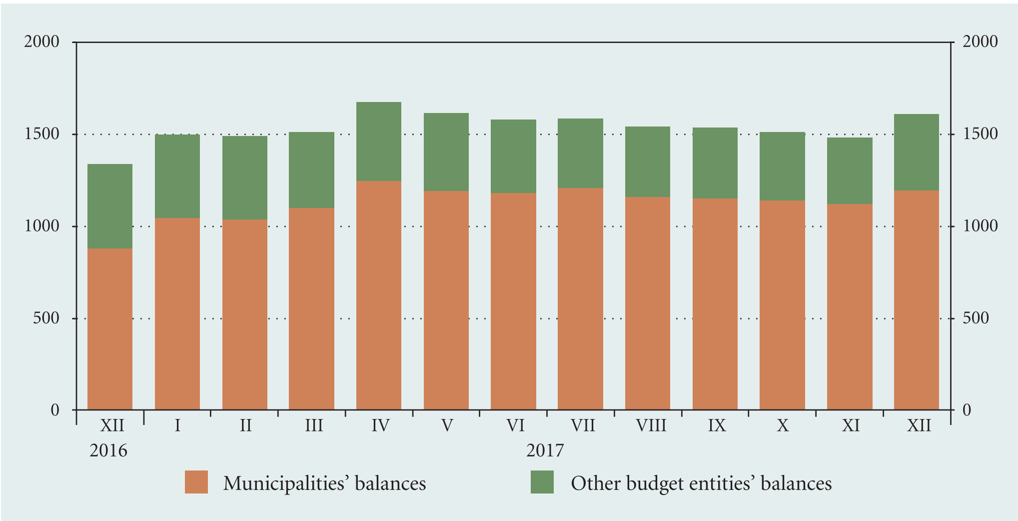
Revenue raised in 2017 from system participants under the Tariff of Fees and Commissions Charged on Processing Government Securities Transactions and from the MF under LBNB Article 43 was BGN 2,005,500, from BGN 1,681,600 in 2016.

Information Service

Providing state budget information under the MF contract involved issuing 984 statements on budget entity operations and balances at the BNB and Bulgarian banks *via* IOBFR, a system designed for that purpose. Summarised information sets the overall balance of budget entities' accounts (including municipalities) at BGN 11,011.8 million,[94] down 8.5 per cent on 31 December 2016. Some BGN 9401.8 million or 85 per cent was in BNB accounts and the rest with 19 domestic banks.

Budget Entities' Accounts with Domestic Banks (BNB excluded)

(BGN million)



Source: the BNB.

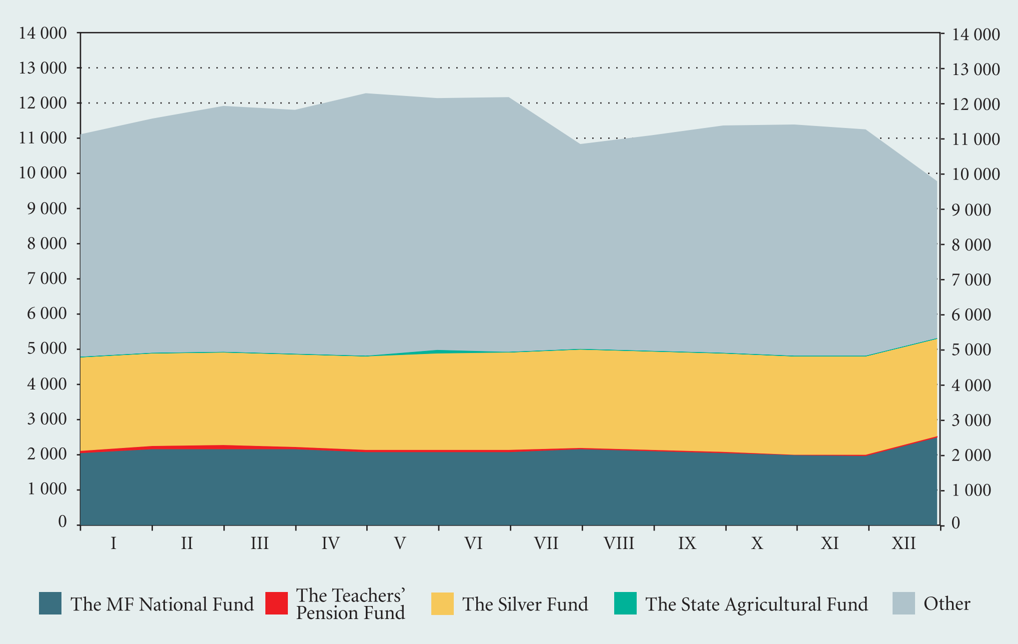
Budget entities' account balances outside the central bank rose by 20.6 per cent on 2016. As in previous years, five banks held over 70 per cent of these balances.

[94] Foreign currency account balances are recalculated in levs at the BNB exchange rate on 31 December 2017.

Approximately 90.0 per cent of budget funds at the BNB and other domestic banks formed the fiscal reserve's[95] liquidity portion: BGN 9765.1 million on 31 December 2017. Of this, BGN 5293.7 million was allocated to earmarked funds: the State Fund for Guaranteeing the Stability of the State Pension System (the Silver Fund), the MF National Fund, the Agricultural State Fund Disbursement Agency and the Teachers' Pension Fund.

Structure of Bank Account Balances within the Fiscal Reserve Scope in 2017

(BGN million)



Source: the BNB.

Standing Minister of Finance and BNB Governor joint instructions task the Bank, on behalf of the Ministry of Finance, to monitor security pledged by banks under the Law on Public Finance and the 2017 State Budget Law and to tally it with IOBFR balances daily.

The AS ROAD system maintains up-to-date information on the government's foreign financial obligations on which the Bank, as part of its agency functions, is calculating and paying agent.[96] Based on that information and upon MF clearance, payments of EUR 1273.3 million[97] were effected, comprising EUR 1032.1 million principal and EUR 241.2 million interest. EUR-denominated obligations registered in AS ROAD on 31 December were EUR 7874.7 million.

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[95] According to § 1, item 41 of the Additional Provisions of the Law on Public Finance, the fiscal reserve is an indicator comprising the balances of all budget entities' bank accounts (excluding municipalities and their budget spending units) and other assets and claims on EU funds.

[96] Under the government debt agency agreement between the BNB and MF.

[97] The payments total was recalculated in euro at the BNB official rate for 31 December 2017.

Servicing Government Securities Trading

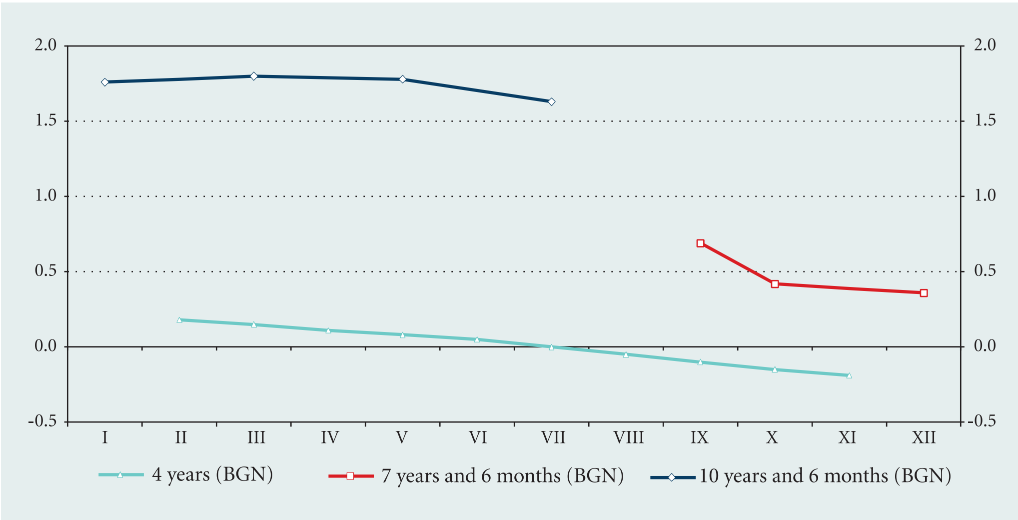
The MF issuing policy in 2017 involved 11 auctions for BGN-denominated government securities *via* the GSAS system. They offered three medium and two long-term issues. The average weighted residual term to maturity of sold issues was seven years eight months.

The total nominal value of government securities offered for sale was BGN 800 million. Over 60 per cent of bids were made by banks (BGN 1141.4 million), non-bank institutions bidding BGN 752.4 million.

The total volume of government securities sales was BGN 789.5 million, or 98.7 per cent of the scheduled volume. Primary and non-primary dealer banks bought nearly 46 per cent of all sold bonds.[98] Average annual yields of four year, 7.5-year and 10.5-year issues were 0.1, 0.5 and 1.7 per cent, respectively.

Average Annual Yield Attained at Domestic Government Securities Auctions in 2017

(per cent)



Note: The MF announced no government bond auctions in August 2017.

Source: the BNB.

ESROT registered BGN 1028.7 million[99] (down BGN 288.1 million or 21.9 per cent compared to 2016) of corporate event payments on behalf and for the account of the issuer. The 27 circulating MF issues had an overall nominal value of BGN 6711.6 million[100] or 0.2 per cent less than at the end of 2016. Bond currency structure did not change, with BGN-denominated issues redeemable in levs with the largest share at 76.7 per cent, followed by EUR-denominated issues redeemable in euro at 22.4 per cent, and EUR and USD-denominated issues redeemable in levs at 0.9 per cent. The maturity structure underwent no essential changes from the end of 2016, with medium and long-term bonds comprising 27.6 and 72.4 per cent.

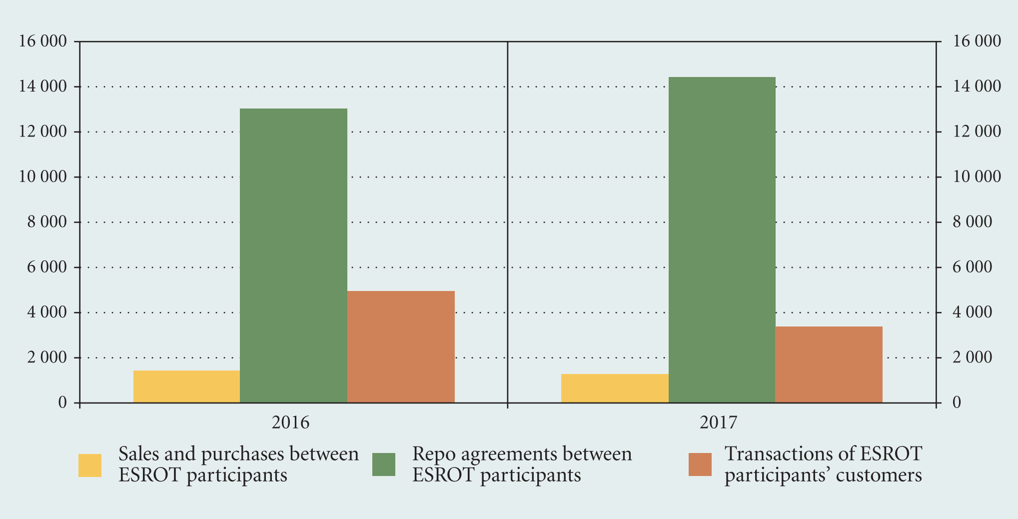
[98] Eleven primary dealers were selected under MF and BNB Ordinance No 15.

[99] The lev equivalent of payments on foreign currency denominated government securities issues was calculated at the BNB rate on the date of payment.

[100] The lev equivalent of government securities denominated in foreign currency is calculated at the BNB rate for 31 December 2017. The total was reduced by the amount of government securities removed from the MF register/accounts on instructions from the title holder and transferred to the disposition of the Minister of Finance under Article 152, paragraph 9 of the Law on Public Finance.

Volume of Transactions in Tradable Government Securities

(BGN million)



Source: the BNB.

The nominal value of government securities registered in ESROT was BGN 19,040 million, down 1.7 per cent on 2016.

Repos had the largest share at 83.7 per cent, including one-day ones (52.7 per cent), mostly in lev-denominated government securities. Government securities sale and purchase transactions totalled BGN 2660.5 million or 16.3 per cent. Of this, transactions between ESROT participants accounted for BGN 1250.1 million, those between participants and customers for BGN 1410.4 million and between ESROT participants' customers for BGN 434.9 million.[101]

The secondary government bond market liquidity ratio[102] was 2.8 against 2.9 in the previous year. ESROT participants encountered no problems and provided government bonds and cash in levs and euro for the delivery *versus* payment (DvP) settlement of government securities transactions, the averaged settlement ratio[103] reaching 100 per cent.

Over the review period ESROT blocking and unblocking operations in domestic government securities related to securing funds in budget entities' bank accounts under the Law on Public Finance and the Law on Special Pledges totalled BGN 3010.1 million, from BGN 3083.8 million for 2016.

Reflecting secondary market trade in circulating domestic government securities, at the end of 2017 government securities portfolio investment declined in major bond holder categories: banks (down BGN 75.9 million) and insurance corporations and pension funds (down BGN 50 million), while increasing in portfolios of non-bank financial institutions, corporations and individuals (up BGN 100.4 million) and foreign investors (up BGN 12.6 million). This changed government bond holder exposures on 31 December 2017 to: 67 per cent with banks; 23 per cent with insurance corporations and pension funds, 9 per cent with non-bank financial institutions,

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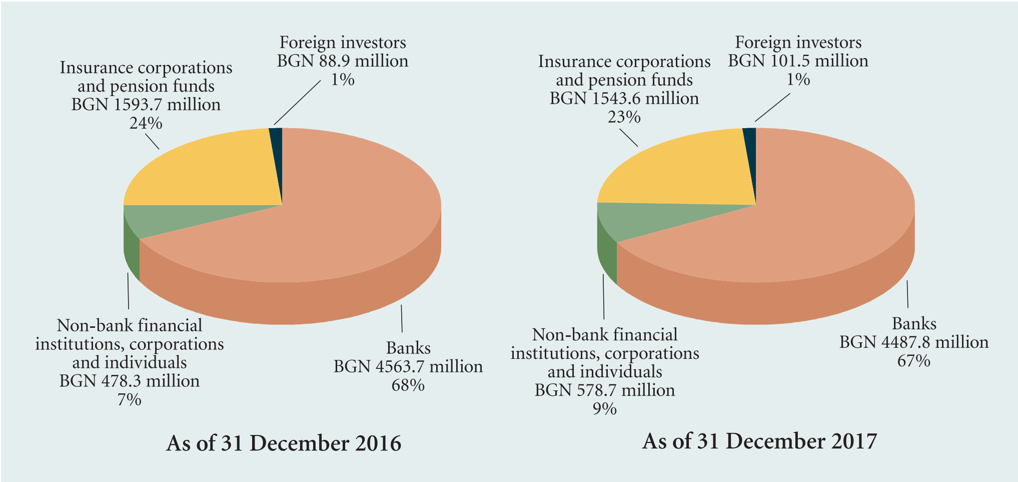
[101] The ESROT system registered no transactions between customers of the same participant.

[102] Liquidity ratio is the ratio between the volume of secondary market government bond transactions concluded over a year and the volume of circulating government securities by that year's end.

[103] Settlement ratio is the ratio of the number of transactions settled on a specific date to all transactions subject to registration and settlement within the system for the reporting period.

corporations and individuals, and 1 per cent with foreign investors (from 68, 24, 7 and 1 per cent on 31 December 2016).

Holders of Government Securities Issued in the Domestic Market



Source: the BNB.

Over the review period the ESROT offered 99.8 per cent availability,[104] with no call for contingency rules for interaction between systems operated by the BNB.

On 31 December 2017 there were 1147 accounts in the government securities settlement system under BNB Ordinance No 31 on Government Securities Settlement. Of them, 27 were for government securities of the issuer (the MF), 467 for participants' own government securities portfolios, 279 for encumbered bonds, and 374 for participants' customers. Account nominals tallied with the amount of outstanding issues at BGN 6711.6 million.[105]

In compliance with Ordinance No 15 of the MF and BNB on the Control over Transactions in Government Securities, in October there were joint on-site inspections at banks participating in ESROT and performing sub-depository functions for their customers. There were no breaches of statutory instruments regulating the government bond market.

System Development

At the end of 2017 the first stage of the GSAS upgrade project was finalised, allowing the BNB to move to a new version of the system in line with the business requirements approved by the MF. Migrating to new hardware, software, and application architecture will go hand in hand with business process optimisation involving 15 debt management operations set by the issuer. This will foster its future smooth upgrades, if needed.

As agreed with the MF, the BNB completed its preparations in providing a direct link between the BNB Government Securities Depository and the Bulgarian Stock Exchange – Sofia AD system to admit government securities trading in the regulated market organised by the Bulgarian Stock Exchange. Under §9 of Final Provisions

[104] The ratio of time when the system is operational to scheduled operating time.

[105] The lev equivalence of government securities issues denominated in foreign currency is shown at the BNB exchange rate for 31 December 2017.

of Ordinance on Amendment of BNB and MF Ordinance No 5,[106] the Minister of Finance and the BNB Governor approved Rules for Admission to Government Securities Trading on the Bulgarian Stock Exchange – Sofia Regulated Market and Completion of Government Securities Transactions with the BNB, Government Securities Sub-Depository Banks and the Central Depository AD, thus allowing *bourse* government bond trading to launch on 1 November 2017.

[106] Published in the Darjaven Vestnik, issue 29 of 7 April 2017.

XIII. Research

Economic research, Bulgarian economic analyses, and macroeconomic forecasts prepared by BNB experts support the Bank's management decisions and economic policy formulation. Specialised research under the 2017 to 2018 BNB Research Plan supported the Bank's operations by analysing individual economic processes and issues and improving forecasting and modelling tools.

The 2017 Research Plan covered analysis of labour cost setting in non-financial corporations, the effects of non-financial corporations' debt on the economy, factors driving investment, the transmission mechanism, relations between the financial and business cycles, and the potential mismatch between labour supply and demand. The Bank featured research results in technical reports and seminars for other bodies, academia, and non-governmental organisations.

Testing and honing the basic model for BNB macroeconometric forecasting continued to improve related BNB forecasting. Satellite models were developed to support various aspects of BNB's analytical and forecasting activities.

In 2017 the BNB continued to encourage the research potential of Bulgarian economic science and practice in the area of macroeconomics and finance through its Discussion Papers research series. The BNB Publications Council reviewed eleven new submissions, of which six were published.

The BNB quarterly Economic Review presents information and Bulgarian economic forecasts, analyses of the balance of payments flows dynamics, monetary aggregates, their link with the development of the real economy, and their bearing on price stability. It also analyses external developments directly affecting the Bulgarian economy. The Economic Review also carries quantitative assessments of anticipated developments in a set of key macroeconomic indicators. The results of BNB analyses of particular economic issues are presented briefly under special headings and in dedicated topics. In 2017 thematic research on house price dynamics in Bulgaria between 2000 and 2016 was published.

XIV. Human Resource Management

Developing and maintaining competitive human resource management remained a key objective in 2017. Priorities included providing a favourable working and sociable environment to attract and keep qualified employees and ensuring their career development. Optimisation of employee assessment and remuneration linked to performance and statutory adherence continued in 2017.

At the end of 2017 the BNB had 876 employees, from 862 a year earlier. Of them, 96 were new recruits (from 80 in 2016), seven covering long-term absences. The BNB continued recruiting highly qualified staff in line with its staffing policy. The Bank advertised 33 vacancies (from 19 in 2016), attracting 800 applicants.

Seventy-eight employees left in 2017 (from 64 in 2016) including 25 to retire (from 14 in 2016). Three leavers had been covering absences.

Staff turnover increased slightly from 7.4 per cent in 2016 to 8.9 per cent.

University graduates led staff educational attainment structure at 73.9 per cent (from 73.1 a year earlier), of them 85.2 per cent with master's degrees and 11.1 per cent with baccalaureates. Twenty-four employees had doctorates, from 25 in 2016. By category, specialists held the largest share at 60.2 per cent, followed by support staff (21.9 per cent) and management (17.9 per cent). The share of employees up to 30 rose by 1 percentage point and that of 31 to 40 year olds fell by 2 percentage points, other age groups remaining practically unchanged. At the end of 2017 women were 63.9 per cent and men 36.1 per cent of staff.

Exchanging experience across business areas and knowledge and skill acquisition by moving between positions and units continued in 2017. Employees moving internally numbered 23, from 67 in 2016. Three BNB employees worked on ECB and EU short-term assignments.

BNB remuneration relates pay to performance, taking into account each employee's contribution to Bank tasks and goals.

The annual schedule offered employees plentiful opportunities to take a variety of training and qualification boosting programmes. Induction training and intrabank refreshers helped new employees perform sooner and spread knowledge, skills, and information.

The year saw internal training and information sharing on credit register operation, statistical information requirements, and issuing and cash operations.

Seventeen employees boosted their educational attainments without stopping work, five reading for doctor's, three for master's degrees, and nine for baccalaureates. Distance learning and certification programmes drew attention from employees in specific functional units, participating in international programmes on reserve management, internal audit, and information security. Ten employees took part in three programmes, the certified financial analyst one attracting most participants.

Employees took inland specialised courses and seminars in internal audit, law, accounting, human resource management, public procurement and security, as well as training in personal development. Information technology training boosted confidence, taught secure communications and data storage, and imparted advanced finance and digitalisation, software, networking, and web skills.

The BNB continued cooperating with ESCB central banks and international financial institutions and training centres. Employees attended international courses, seminars, practical training, expert group meetings, and conferences in banking supervision, financial stability, prudential regulation and credit institution resolution, policy management, development and application, financial markets, asset management and market operations, information systems, international cooperation, and personal development. On-line economics, finance and banking supervision training also enjoyed interest. Bank employees continued to take specialised courses, seminars, and working meetings on ESCB committees and working groups and European supervisory bodies.

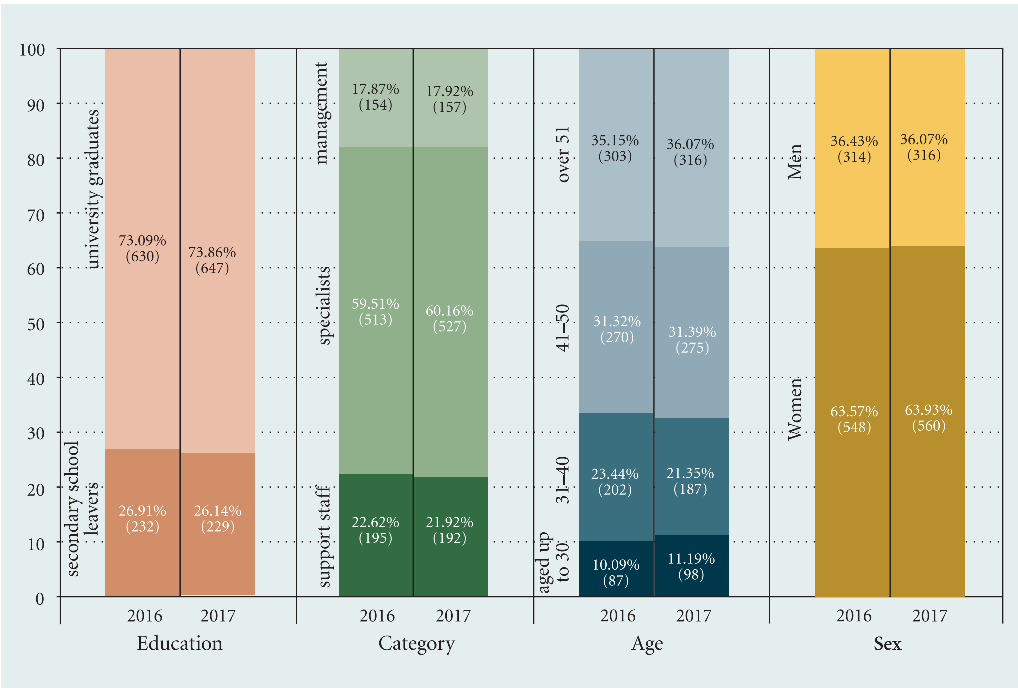
Targeted English courses, advanced business English, and English conversation courses improved speaking skills. Employees also attended courses in other languages.

Health and safety at work training focused on limiting occupational risk, instilling awareness, and motivating staff.

With students, the BNB continued providing career opportunities and encouraging knowledge acquisition and research. Twenty-three applicants enquired into the annual scholarship programme for master's and doctor's degree holders. The Bank awarded two master's degree scholarships. In 2017 the Bank was at two career student and young professional fora, presenting its career development programmes, traineeships, scholarships, guest researcher programmes, recruitment procedures, and employment conditions. Seven of 36 applicants were approved for the traineeships programme.

Staff Structure on 31 December

(per cent, number)



Source: the BNB.

XV. BNB Internal Audit

BNB internal audit conforms to the International Standards for the Professional Practice of Internal Auditing, the Code of Ethics of Internal Auditors, ESCB Internal Auditor Committee Rules and Audit Rules approved by the BNB.

In 2017 there were eleven audits of which eight under the annual Internal Audit Unit Programme approved by the BNB Governing Council and three under the ESCB Internal Auditors Committee Programme. Audits sought assurance of risk management, control and management of inherent risks to ensure:

– effective attainment of objectives and tasks;
– reliability and completeness of financial and operational information;
– effective and efficient operations and programmes;
– safeguarding assets;
– legal, regulatory, internal rule, policy, procedure, and contractual observance.

BNB Internal Audit Programme Audits

BNB Functions	Audits
Banknotes and coins	Coin minting
Banknotes and coins	Protection of banknotes and coins against counterfeiting
Internal Audit	Assessment of BNB Internal Audit quality
Financial accounting and statements	BNB Consolidated Financial Statements as of 30 June 2017
Payment and securities settlement systems	RINGS, Real-time Gross Settlement System
Supervision and financial stability	Adequacy and efficiency of the bank supervision internal regulatory framework: overall review
Planning, control, and organisation	Drafting, implementing, and reporting the BNB budget
Result monitoring	Follow up on recommendations from past BNB Internal Audit Programme audits

Source: the BNB.

ESCB Internal Auditor Committee Programme audits focused on information and communication technologies and payment and securities settlement systems. Implementation of past audit recommendations was monitored.

In 2017 the BNB Chief Auditor coordinated Internal Audit Unit work with external auditors and the Republic of Bulgaria Court of Auditors auditing team.

BNB Internal Audit continued to submit opinions on draft internal regulations concerning major BNB functions.

XVI. BNB Budget Implementation in 2017

This report on Bank budget implementation comprises two sections pursuant to BNB Internal Rules on Drafting, Implementing, and Reporting the BNB Budget: Operating Expenditure and Investment Programme. The Bank adheres to environmental protection requirements.

Operating Expenditure

In 2017 the BNB spent BGN 78,511,000 or 83.6 per cent of budget.

Currency circulation cost BGN 19,666,000 or 91.3 per cent of budget and 25.0 per cent of Bank operating expenditure. New banknotes cost BGN 7,015,000 and coin minting BGN 12,116,000, of which BGN 11,370,000 on circulating coins. The BNB Governing Council 2017 Commemorative Coin Programme cost BGN 746,000. New banknote and coin design accounted for BGN 33,000. This included four 2018 commemorative coin design competitions. Spending on machines for servicing circulating cash was BGN 63,000 and on cash processing consumables BGN 205,000. Premise rentals for Bank issue and cash operations cost BGN 233,000.

Materials, services, and depreciation accounted for BGN 26,541,000: 72.2 per cent of budget and 33.8 per cent of operating expenditure.

Materials cost BGN 838,000: 68.8 per cent of budget and 1.1 per cent of operating expenditure. Vehicle fuel and spares (BGN 304,000) and office consumables (BGN 222,000) occupied the largest share in this group. The Bank spent BGN 130,000 on inventories.

External services cost BGN 14,602,000: 68.3 per cent of budget and 18.6 per cent of operating expenditure. Software maintenance subscriptions at BGN 3,471,000, Bloomberg, Reuters, and other systems at BGN 1,094,000, mandatory TARGET2 modules at BGN 1,006,000, and BORICA AD subscriptions at BGN 527,000 were notable in this group. Equipment maintenance subscriptions cost BGN 1,923,000. Property and refuse collection levies were BGN 1,333,000. Mail, telephone and fax cost BGN 584,000. Electric bills were BGN 802,000 and heating and water cost BGN 226,000. Property insurance expenses were BGN 101,000. Security and fire protection cost BGN 828,000. Major building maintenance cost BGN 1,467,000. Judicial protection and other legal services cost BGN 276,000 and health and safety at work and special clothing BGN 205,000. Consultancy services cost BGN 108,000, including legal services and banknote handler preventive maintenance.

Depreciation expenditure was BGN 11,101,000 or 79.3 per cent of budget and 14.1 per cent of operating expenditure.

Payroll, including social and healthcare, cost BGN 26,943,000 or 97.7 per cent of budget and 34.3 per cent of operating expenditure. The BNB had BGN 936,000 of current retirement obligations and unused paid leave under IAS 19, Income of Hired Persons.

Social expenditure was BGN 2,164,000: 91.9 per cent of budget and 2.8 per cent of operating expenditure.

Other administrative expenditure was BGN 1,135,000: 49.4 per cent of budgeted funds and 1.5 per cent of total operating expenditure. Inland travel worth BGN 87,000 involved mainly regional cash centre logistics and checks. Foreign travel unrelated to ESCB and other EU bodies cost BGN 247,000. The annual BNB Staff Education and Professional Training Programme cost BGN 608,000. Employees took part in professional courses and seminars organised by EU central banks and international financial institutions. They participated in distant learning, language, information technology, and other training at home and abroad.

The BNB spent BGN 2,062,000 (60.6 per cent of budget and 2.6 per cent of operating expenditure) on ESCB participation. The annual contribution to the European Banking Authority budget was BGN 1,225,000. Travel for BNB representatives on ESCB and other EU committees and working groups cost BGN 622,000 and training BGN 26,000. The annual contribution to the Centralised Securities Database was BGN 139,000. The Bank hosted an ESCB Monetary Policy Committee Econometric Modelling Working Group meeting at BGN 34,000.

The BNB Investment Programme

The Bank investment programme cost BGN 2,558,000 or 17.5 per cent of annual budget.

New construction, refurbishment and modernisation cost BGN 99,000: 4.6 per cent of budget and 3.9 per cent of investment programme.

Technical services, fees, and building permit procedures for the BNB Plovdiv Cash Centre cost BGN 24,000 and design cost BGN 75,000.

Machine and equipment, vehicle, and other equipment investment cost BGN 251,000: 14.3 per cent of budget and 9.8 per cent of investment programme.

Cash operations equipment cost BGN 5000. Security systems upgrades amounted to BGN 90,000. The BNB spent BGN 156,000 on purchasing other equipment, including BGN 59,000 for main building office equipment, BGN 29,000 for air conditioning and BGN 20,000 for office and other staff holiday centre equipment.

Information system development cost BGN 2,208,000: 20.6 per cent of budget and 86.3 per cent of investment programme.

Software cost BGN 1,756,000, including BGN 486,000 for licence purchases and BGN 1,270,000 for upgrades.

Hardware cost BGN 452,000, mainly for updating, expanding, and backing up existing systems.

No investment expenditure related to ESCB membership.

The investment programme involved public tendering, contractor selection, and project implementation. Some procurement procedures ended, were suspended, or postponed. The Bank analysed the two essential investment expenditure groups of information systems and construction, refurbishment, and modernisation. The analysis assigned priorities, postponing some projects for 2018.

BNB Budget Implementation as of 31 December 2017

Indicators	Report 31 December 2017 (BGN'000)	Budget 2017 (BGN'000)	Implementation (per cent)
Section I. Operating expenditure	**78,511**	**93,934**	**83.6**
Currency circulation	19,666	21,523	91.3
Materials, services, and depreciation	26,541	36,771	72.2
Staff	26,943	27,582	97.7
Social activities	2,164	2,355	91.9
Other administrative expenditure	1,135	2,298	49.4
ESCB membership	2,062	3,405	60.6
Section II. Investment programme	**2,558**	**14,647**	**17.5**
Construction, refurbishment, and modernisation	99	2,149	4.6
Expenditure on machines, equipment, vehicles, and other equipment	251	1758	14.3
Expenditure on BNB computerisation	2,208	10,736	20.6
ESCB membership investment	0	4	0.0

Source: the BNB.

XVII. BNB Consolidated Financial Statements for the Year Ended 31 December 2017

Building a better working world

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Independent auditor's report

To the Governing Council of

The Bulgarian National Bank

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of the Bulgarian National Bank and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Bulgarian National Bank as at 31 December 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Bulgarian National Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)* together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the consolidated financial statements in Bulgaria, and we have fulfilled our other ethical responsibilities in accordance with the requirements of the IFAA and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Information Other than the Consolidated Financial Statements and Auditor's Report Thereon

Management is responsible for the other information. The other information comprises the consolidated management report, prepared by management in accordance with Chapter

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Seven of the Accountancy Act, but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, unless and to the extent explicitly specified in our report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and presentation of the consolidated financial statements that give a true and fair view in accordance with IFRS as adopted by the EU and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Bulgarian National Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

— Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve

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collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bulgarian National Bank's internal control.
— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
— Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bulgarian National Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report.
— Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves true and fair presentation.
— Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Bulgarian National Bank to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Bulgarian National Bank audit. We remain solely responsible for our audit opinion.

We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

Additional Matters to be Reported under the Accountancy Act

In addition to our responsibilities and reporting in accordance with ISAs, described above in the *Information Other than the Consolidated Financial Statements and Auditor's Report Thereon* section, in relation to the consolidated management report, we have also performed the procedures added to those required under ISAs in accordance with the Guidelines on New and Expanded Auditor's Reports and Auditor's Communication of the professional organisation of certified public accountants and registered auditors in Bulgaria, *i.e.* the Institute of Certified Public Accountants (ICPA). These procedures refer to testing the existence, form and content of this other information to assist us in forming an opinion about whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act applicable in Bulgaria.

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Opinion in connection with Article 37, paragraph 6 of the Accountancy Act

Based on the procedures performed, our opinion is that:

a) The information included in the consolidated management report referring to the financial year for which the consolidated financial statements have been prepared is consistent with those consolidated financial statements.
b) The consolidated management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.

Audit Firm Ernst & Young Audit OOD:

Nikolay Garnev
Legal Representative and
Registered Auditor in charge of the audit

Milka Natcheva-Ivanova
Legal Representative and
Registered Auditor in charge of the audit

Sofia, Bulgaria
18 April 2018

Translation in English of the official Auditor's report issued in Bulgarian.

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

The Governing Council of the Bulgarian National Bank is responsible for preparing and approving financial statements to present the Bank's financial position and performance for the period.

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

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

Dimitar Radev

Governor of the Bulgarian National Bank

Consolidated Statement of Comprehensive Income for the Year Ended 31 December 2017

(BGN'000)

	Appendices	2017	2016
Interest income	7	318,137	398,031
Interest expense	7	(71,511)	(22,278)
Net interest income		**246,626**	**375,753**
Fee and commission income		7,400	9,727
Fees and commission expense		(4,630)	(5,228)
Net fee and commission income		**2,770**	**4,499**
Net (losses)/gains from financial assets and liabilities at fair value in the profit or loss	8	(399,523)	72,435
Other operating income	9	36,759	41,717
Total income from banking operations		**(113,368)**	**494,404**
Administrative expenses	10	(102,086)	(109,480)
(Loss)/profit for the period		**(215,454)**	**384,924**
Other comprehensive income			
Other comprehensive income that can be reclassified into profit or loss at a future point in time		-	-
Other comprehensive income that cannot be reclassified into profit or loss at a future point in time		*(1,261)*	*(18)*
Other comprehensive income, total		**(1,261)**	**(18)**
Total comprehensive income for the period		**(216,715)**	**384,906**
Profit attributable to:			
Equity holder of the Bank		(215,534)	384,747
Non-controlling interest		80	177
(Loss)/profit for the period		**(215,454)**	**384,924**
Total comprehensive income attributable to:			
Equity holder of the Bank		(216,795)	384,729
Non-controlling interest		80	177
Total comprehensive income for the period		**(216,715)**	**384,906**

The accompanying notes on pages 103 to 136 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Financial Position as of 31 December 2017

(BGN'000)

	Appendices	31 December 2017	31 December 2016
ASSETS			
Cash and deposits in foreign currency	11	20,948,427	14,783,663
Gold, instruments in gold and other precious metals	12	2,785,663	2,822,205
Financial assets at fair value through profit or loss	13	22,353,795	28,928,706
Financial assets available for sale	14	2,131,506	2,293,978
Tangible assets	15	156,021	165,285
Intangible assets	16	4,426	4,237
Other assets	17	82,238	82,040
Total assets		**48,462,076**	**49,080,114**
LIABILITIES			
Currency in circulation	18	15,703,197	14,152,921
Liabilities to banks and other financial institutions	19	13,892,496	14,670,285
Liabilities to government institutions and other borrowings	20	10,993,617	11,800,095
Borrowings against Bulgaria's participation in international financial institutions	21	3,274,519	3,515,099
Other liabilities	22	231,667	357,419
Total liabilities		**44,095,496**	**44,495,819**
EQUITY			
Capital	23	20,000	20,000
Reserves	23	4,341,723	4,559,518
Non-controlling interest	24	4,857	4,777
Total equity		**4,366,580**	**4,584,295**
Total liabilities and equity		**48,462,076**	**49,080,114**

The accompanying notes on pages 103 to 136 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Cash Flows for the Year Ended 31 December 2017

(BGN'000)

	Appendices	2017	2016
OPERATING ACTIVITIES			
Net (loss)/profit		(215,454)	408,448
Adjustments			
Dividend income	9	(14,857)	(31,394)
Depreciation	15, 16	14,609	16,642
Profit/(loss) on disposal of tangible assets		(357)	373
Profit/(loss) on financial assets and liabilities arising from market movements		45,120	(382,419)
Profit of associates		6,708	279
Other adjustments		(8,574)	(1,180)
Net cash flow from operating activities before changes in operating assets and liabilities		**(172,805)**	**10,749**
Change in operating assets			
(Increase) in gold, instruments in gold and other precious metals		(4,814)	(7,341)
Decrease/(increase) in financial assets at fair value through profit or loss		6,493,039	(2,611,616)
(Increase) in financial assets available for sale			
– Republic of Bulgaria's quota in the IMF		-	(628,992)
(Increase) in other assets		(2,288)	(2,970)
Change in operating liabilities			
Increase in currency in circulation		1,550,276	1,428,103
(Decrease) in due to banks and other financial institutions		(777,789)	(189,727)
(Decrease)/increase in due to government institutions and other liabilities		(806,478)	5,223,021
Increase in debt to international financial institutions for the increase of the Republic of Bulgaria's quota in the IMF		-	469,532
(Decrease)/increase in other liabilities		(125,752)	213,982
Net cash flow from/(used in) operating activities		**6,153,389**	**3,904,741**
INVESTMENT ACTIVITIES			
Acquisition of tangible and intangible assets		(5,572)	(9,597)
Dividends received		14,857	7,870
Net cash flow from/(used in) investing activities		**9,285**	**(1,727)**
FINANCING ACTIVITIES			
Payments to the state budget		-	(19,640)
Net cash flow (used in) financing activities		**-**	**(19,640)**
Net increase in cash and cash equivalents		**6,162,674**	**3,883,374**
Cash and cash equivalents at beginning of period		**14,835,050**	**10,951,676**
Cash and cash equivalents at the end of period	11, 17	**20,997,724**	**14,835,050**
Cash flows from interest and dividends			
Interest received		311,919	394,965
Interest paid		(64,218)	(17,704)

The accompanying notes on pages 103 to 136 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Changes in Equity for the Year Ended 31 December 2017

(BGN'000)

	Capital	Revaluation of non-monetary assets	Special and other reserves	Total capital and reserves	Non-controlling interest	Total equity
Balance as at 01 January 2016	**20,000**	**136,336**	**4,059,150**	**4,215,486**	**4,600**	**4,220,086**
Profit for the period	-	-	384,747	384,747	177	**384,924**
Other comprehensive income						
other income	-	79	(97)	(18)	-	**(18)**
Other comprehensive income, total	-	79	(97)	(18)	-	**(18)**
Total comprehensive income for the period	-	79	384,650	384,729	177	**384,906**
Contributions by and distributions to owners:						
contribution to the budget of the Republic of Bulgaria	-	-	(19,640)	(19,640)	-	**(19,640)**
dividend paid by subsidiaries to minority shareholders	-	-	(1,057)	(1,057)	-	**(1,057)**
Transactions with owners, total			(20,697)	(20,697)		**(20,697)**
Balance as at 31 December 2016	**20,000**	**136,415**	**4,423,103**	**4,579,518**	**4,777**	**4,584,295**
Balance as at 01 January 2017	**20,000**	**136,415**	**4,423,103**	**4,579,518**	**4,777**	**4,584,295**
(Loss)/profit for the period	-	-	(215,534)	(215,534)	80	**(215,454)**
Other comprehensive income:						
other income	-	(1,952)	691	(1,261)	-	**(1,261)**
Other comprehensive income, total	-	(1,952)	691	(1,261)	-	**(1,261)**
Total comprehensive income for the period	-	(1,952)	(214,843)	(216,795)	80	**(216,715)**
Contributions by and distributions to owners:						
contribution to the budget of the Republic of Bulgaria	-	-	-	-	-	-
dividend paid by subsidiaries to minority shareholders	-	-	-	-	-	-
Transactions with owners, total	-	-	-	-	-	-
Balance as at 31 December 2017	**20,000**	**134,463**	**4,208,260**	**4,362,723**	**4,857**	**4,367,580**

The accompanying notes on pages 103 to 136 form an integral part of the Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

1. Statute and Principal Activities

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

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

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

The Governing Council of the BNB approved the Consolidated Financial Statements, set out on pages 93 to 136, on 18 April 2018.

2. Applicable Standards

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

3. Basis of Preparation

The consolidated financial statements are presented in Bulgarian lev rounded to the nearest thousand (BGN'000), which is the functional currency of the Bank. They are prepared on a historical cost basis, except for the following items, which are measured on an alternative basis as at each reporting date:

Items	Measurement basis
Derivative financial instruments	Fair value
Non-derivative financial instruments at fair value through profit or loss	Fair value
Available-for-sale financial assets	Fair value
Tangible non-current assets	Revalued amount, which is the asset's fair value at the revaluation date less subsequent depreciation and impairment loss
Defined benefit liability	Present value of the defined benefit liability

Use of estimates and judgements

In preparing these Consolidated Financial Statements, the Bank has made judgements, estimates and assumptions that affect the reported amounts of assets and liabilities, incomes and expenses, and the disclosure of contingent receivables and payables as at the Financial Statements date. These estimates, judgements and assumptions are based on data available as at the date of the Consolidated Financial Statements; therefore actual future results may differ from these estimates.

The estimates and main assumptions are revised on an ongoing basis and are recognised prospectively.

Judgements

The Bank has estimated and classified cash in circulation as a financial liability (ref. note 18).

Assumptions and estimation uncertainties

Measurements of the present value of long-term obligations to retiring staff (following a defined benefit plan) use certified actuarial calculations based on mortality assumptions, rate of staff turnover, future level of salaries and discount factor, which assumptions may lead to adjustments in the next financial year; management however considers them to be reasonable and appropriate for the Bank (ref. note 10).

Some of the Bank's accounting policies and disclosures require fair value measurements of financial and non-financial assets and liabilities. For information on fair value measurements see note 6(e) and note 15.

New and amended standards and clarifications

The accounting policies adopted are consistent with those of the the previous financial year, except for the following amendments to IFRSs adopted as of 1 January 2017:

IAS 12 Income Taxes (Amendments): Recognition of Deferred Tax Assets for Unrealised Losses

The objective of these amendments is to clarify the accounting for deferred tax assets for unrealised losses in order to address diversity in practice in the application of IAS 12 Income Taxes with regard to: any deductible temporary differences arising upon a decrease in the fair value; recovery of an asset for more than its a carrying amount; probable future taxable profit; combined versus separate assessment. Adoption of these amendments has not impacted the financial position or performance of the Bank.

IAS 7 Statement of Cash Flows (Amendments): Disclosure Initiative

The objective of these amendments is to enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The Amendments specify that one way to fulfil the disclosure requirement is by providing a tabular reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities; including changes from financing cash flows, changes arising from obtaining or losing control of subsidiaries or other businesses; the effect of changes in foreign exchange rates; changes in fair values and other changes. The amendments affect presentation only and have no impact on the Bank's financial position or performance. The adoption of the above amendments to standards has no effect on the Bank's financial statements.

4. Basis of Consolidation

Subsidiaries

Subsidiaries are the entities controlled by the Bank. Control over an entity exists when the Bank is exposed to or has rights over the variable return from its participation in that entity, and is able to influence that return through its powers. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The share in the net assets of the Bank's subsidiaries, which corresponds to the minority shareholders' proportionate share, is disclosed separately from Capital and Reserves under the Non-controlling Interest item.

Associates

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

Transactions eliminated on consolidation

All receivables and payables, incomes and expenses, as well as intragroup profits, resulting from inter-company transactions within the group, are eliminated, except where these are immaterial.

5. Significant Accounting Policies

a) Income recognition

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

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

Interest income and expense presented in the statement of profit or loss include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on available-for-sale investment securities calculated on an effective interest basis.

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

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

b) Financial instruments

i) Classification

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

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

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

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

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

ii) Recognition

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

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

iii) Amortised cost measurement

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

iv) Fair value measurement and disclosure principles

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

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

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

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

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

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

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

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

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

v) Derecognition

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

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

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

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

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

vi) Offsetting

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

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

vii) Impairment of assets

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

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

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

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

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

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

viii) Financial assets/liabilities held for trading

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

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

ix) Investments

1) Held-to-maturity investments

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

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

2) Available-for-sale investments

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

Differences in the fair value are recognised directly in equity until the investment is sold or fully impaired when the cumulative gains and losses recognised in equity are recognised in profit or loss.

c) **Gold and other precious metals**

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

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

d) **Equity investments**

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

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

e) **Property, plant, equipment and intangible assets**

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

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

i) Subsequent costs

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

ii) Depreciation

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

(per cent)

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

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

iii) Calculation of recoverable amount of assets

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

iv) Reversals of impairment

Impairment losses of tangible fixed assets are reversed when a change occurs in the estimates used to determine the recoverable amount and may be reversed only up to that carrying amount of the asset before recognising impairment losses.

f) **Foreign exchange**

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

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

The exchange rates of the major foreign currencies as of 31 December 2017 and 31 December 2016 are as follows:

Currency	31 December 2017	31 December 2016
US dollar	1 : BGN 1.63081	1 : BGN 1.85545
Euro	1 : BGN 1.95583	1 : BGN 1.95583
Special drawing rights	1 : BGN 2.32249	1 : BGN 2.49434
Gold	1 troy ounce: BGN 2117.09	1 troy ounce: BGN 2148.21

g) **Taxation**

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

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

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

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

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

h) **Cash in hand and deposits in foreign currency**

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

j) **Employee benefits**

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

Termination benefits

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

Short-term employee benefits

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

k) **Standards issued but not yet effective and not early adopted**

Standards issued by IASB/IFRIC but not yet effective and not early adopted up to the date of issuance of the Bank financial statements are listed below. This listing is of standards and interpretations issued, which the Bank reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Bank intends to adopt those standards when they become effective.

IFRS 9 Financial Instruments: classification and measurement

The standard is effective for annual periods beginning on or after 1 January 2018 with early adoption permitted. In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. Except for hedge accounting, retrospective application of the standard is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Bank plans to adopt the new standard on the required effective date and will not restate comparative information.

During 2017, the Bank has started an impact assessment of all three aspects of IFRS 9. This assessment is based on currently available information and may be subject to changes arising from further reasonable and supportable information being made available to the Bank in 2018.

The Bank does not expect any tangible impact on the Statement of Financial Position and Statement of Changes in Equity as a result of initial application of IFRS 9.

IFRS 15 Revenue from Contracts with Customers

The standard is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. IFRS 15 establishes a five-step model that will apply to revenue earned from a contract with a customer (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary activities (*e.g.*, sales of property, plant and equipment or intangibles). Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgements and estimates. It is not expected that these amendments would impact the financial position or performance of the Bank.

IFRS 15 Revenue from Contracts with Customers (Clarifications)

The clarifications apply for annual periods beginning on or after 1 January 2018, with earlier application permitted. The objective of the clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 Revenue from Contracts with Customers, particularly the accounting of identifying performance obligations amending the wording of the 'separately identifiable' principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The clarifications also provide additional practical expedients for entities that either apply IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach. These clarifications have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IFRS 16 Leases

The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, *i.e.* the customer (lessee) and the supplier (lessor). IFRS 16 requires lessees to recognise most leases on their balance sheet and to have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The standard has not been yet endorsed by the EU. The Bank will analyse and assess the impact of the new standard on its financial position or performance.

IFRS 17 Insurance Contracts

The standard is effective for annual periods beginning on or after 1 January 2021 with earlier application permitted provided that the entity applies also IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments. IFRS 17 Insurance Contracts sets out the principles for recognition, measurement, presentation and disclosure of issued insurance contracts. In addition, it requires the application of similar principles with regard also to reinsurance contracts and investment contracts containing a discretionary participation feature. The objective of this standard is to require companies to provide the information related to insurance contracts in a way that fairly reflects these contracts. This information enables users of financial statements to evaluate the effect of the contracts covered by IFRS 17 on the financial position, performance and cash flows of the company. The standard has not been yet endorsed by the EU. It is not applicable to the Bank.

Amendments in IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. A full gain or loss is recognised when a transaction involves a business or a partial gain or loss is recognised when a transaction involves assets that do not constitute a business. The IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IFRS 2 Share-based Payment (Amendments): Classification and Measurement of Share-based Payment Transactions

The amendments are effective for annual periods beginning on or after 1 January 2018, with earlier application permitted. The amendments provide requirements on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, for share-based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would be relevant to the Bank.

IFRS 4 Insurance Contracts (Amendments): Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

The amendments are effective for annual periods beginning on or after 1 January 2018. The objective of these amendments is to address issues arising from the different effective dates of IFRS 9 and the upcoming new insurance contracts standard.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

The interpretation is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. This interpretation addresses how to determine the date of the transaction for the purpose of determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. The interpretation has not yet been endorsed by the EU. The Bank will analyse and assess the impact of the new interpretation on its financial position or performance.

IFRIC 23 Uncertainty over Income Tax Treatments

The interpretation is effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. This interpretation addresses income tax accounting where tax treatments relate to an uncertainty surrounding the application of IAS 12. The interpretation provides guidelines on uncertain tax treatments separately or together as a group, examinations by tax authorities, reporting methods for reflecting uncertainties and accounting of changes in facts and circumstances. The interpretation has not yet been endorsed by the EU. The Bank will analyse and assess the impact of the new interpretation on its financial position or performance.

IAS 40 Investment Property (Amendments): Transfers of Investment Property

The amendments are effective for annual periods beginning on or after 1 January 2018, with earlier application permitted. The amendments clarify transfers of property to, or from, investment property when there is a change in the use of such property which is supported by evidence. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would be relevant to the Bank.

IFRS 9 Financial Instruments: classification and measurement (Amendments): prepayment features with negative compensation

The amendments, effective for annual periods beginning on or after 1 January 2019 with earlier application permitted, propose a change to IFRS 9 for particular financial assets that would otherwise have contractual cash flows that are solely payments of principal and interest but do not meet that condition only as a result of a negative prepayment feature. Specifically, for a financial asset that contains a prepayment option that may result in the payment of a reasonable negative compensation amount, the amendments require the financial asset to be measured at amortized cost or at fair value through other comprehensive income, subject to the assessment of the business model in which it is held. The amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IAS 28 Investment in Associates and Joint Ventures (Amendments): long-term interests in associates and joint ventures

The amendments are effective for annual periods beginning on or after 1 January 2019, with earlier application permitted. The Amendments clarify that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture that, in substance, form part of the net investment in the associate or joint venture but to which the equity method is not applied. An entity applies IFRS 9 to such long-term interests before it applies IAS 28. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying IAS 28. The amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IAS 19 Employee Benefits (Amendments): plan amendments, curtailments and settlements.

The amendments are effective for annual periods beginning on or after 1 January 2019, with earlier application permitted. The amendments require entities to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after a plan amendment, curtailment or settlement has occurred. The amendments also clarify how the accounting for a plan amendment, curtailment or settlement affects applying the asset ceiling requirements The amendments have not yet been endorsed by the EU. The Bank will analyse and assess the impact of the amendments on its financial position or performance.

Annual Improvements to IFRSs 2014–2016 Cycle

In the 2014–2016 annual improvements cycle, the IASB issued amendments to three standards which are effective for annual periods beginning on or after 1 January 2017 or 1 January 2018. Summary of amendments and related standards are provided below:

- *IFRS 1 First-time Adoption of International Financial Reporting Standards:* IFRS 1 First-time Adoption of International Financial Reporting Standards: deletion of short-term exemptions for first-time adopters (effective for annual periods beginning on or after 1 January 2018);
- *IFRS 12 Disclosure of Interests in Other Entities:* clarification of the scope of the Standard (effective for annual periods beginning on or after 1 January 2017), and

- *IAS 28 Investments in Associates and Joint Ventures:* measuring an associate or joint venture at fair value (effective for annual periods beginning on or after 1 January 2018).

It is not expected that these amendments would impact the financial position or performance of the Bank.

Annual Improvements to IFRSs 2015–2017 Cycle

In the 2015–2017 annual improvements cycle, the IASB issued amendments which are effective for annual periods beginning on or after 1 January 2019. Summary of amendments and related standards are provided below:

- IFRS 3 Business Combinations and IFRS 11 Joint Arrangements*:* clarification on the accounting of previously held interests in joint operations;
- *IAS 12 Income Taxes:* Clarification on income tax consequences of payments on instruments classified as equity, and
- *IAS 23 Borrowing Costs:* Clarification on borrowing costs meeting the requirements for capitalisation.

The improvements to IFRSs 2015–2017 Cycle have not yet been endorsed by EU. The Bank is in the process of assessing the impact of the amendments on its financial statements.

6. Financial Risk Management Policy Disclosure

a) Introduction and overview

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

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

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

General provisions of risk management

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

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

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

All approved financial instruments and asset classes, in which the BNB may invest, are specified in internal documents. The documents define the main portfolios and the respective model portfolios (benchmarks), all limits for credit, interest rate, currency and operational risk, and give a list of the foreign financial institutions which are counterparties of the Bank.

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

b) **Credit risk**

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

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

- investment programmes with central banks;
- automatic borrowings/lending of securities with the main depository;
- tri-party repo agreements with specially designated counterparties of the BNB carried out through the Bank's main depository as a third party;
- deposits in foreign currency (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- deposits in gold (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- commercial securities (of up to one year term to maturity), issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks, and other financial institutions – issuers of European covered bonds;
- bonds issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks and other financial institutions – issuers of covered bonds. All bonds must be with a one-off payment of their face value on the maturity date and without any embedded option;
- purchases and sales of foreign currency with a value date of up to two business days.

Two basic types of limits are set which are calculated on the basis of the market value of foreign currency reserves:: (i) a maximum or minimum limit on the weight of each asset class in the Issue Department balance sheet, and (ii) an individual maximum acceptable exposure of the BNB to a country, as well as an individual exposure to an issuer/counterparty (concentration limit).

c) **Liquidity risk**

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

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

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

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

(BGN'000)

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Undefined maturity	Total
As of 31 December 2017							
Financial assets							
Cash and deposits in foreign currency	20,327,135	621,292	-	-	-	-	20,948,427
Gold, instruments in gold, and other precious metals	2,785,663	-	-	-	-	-	2,785,663
Financial assets at fair value through profit and loss	253,399	618,114	6,777,831	14,677,416	27,035	-	22,353,795
Available-for-sale financial assets	227,898	-	-	-	-	1,903,608	2,131,506
Other assets	15,126	5,333	28,816	-	-	-	49,275
Total financial assets	**23,609,221**	**1,244,739**	**6,806,647**	**14,677,416**	**27,035**	**1,903,608**	**48,268,666**
Financial liabilities							
Currency in circulation	-	-	-	-	-	15,703,197	15,703,197
Liabilities to banks and other financial institutions	13,892,496	-	-	-	-	-	13,892,496
Liabilities to government institutions and other borrowings	2,766,605	2,923,074	5,303,938	-	-	-	10,993,617
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	3,274,519	3,274,519
Total financial liabilities	**16,659,101**	**2,923,074**	**5,303,938**	**-**	**-**	**18,977,716**	**43,863,829**
Asset-liability maturity mismatch	**6,950,120**	**(1,678,335)**	**1,502,709**	**14,677,416**	**27,035**	**(17,074,108)**	**4,404,837**
As of 31 December 2016							
Financial assets							
Cash and deposits in foreign currencies	13,225,289	907,472	650,902	-	-	-	14,783,663
Gold, instruments in gold, and other precious metals	1,139,949	1,682,256	-	-	-	-	2,822,205
Financial assets at fair value through profit and loss	1,185,358	2,436,966	6,902,621	13,940,161	4,463,600	-	28,928,706
Available-for-sale financial assets	244,760	-	-	-	-	2,049,218	2,293,978
Other assets	18,246	33,114	-	-	-	-	51,360
Total financial assets	**15,813,602**	**5,059,808**	**7,553,523**	**13,940,161**	**4,463,600**	**2,049,218**	**48,879,912**
Financial liabilities							
Currency in circulation	-	-	-	-	-	14,152,921	14,152,921
Liabilities to banks and other financial institutions	14,670,285	-	-	-	-	-	14,670,285
Liabilities to government institutions and other borrowings	1,712,660	4,399,265	5,688,170	-	-	-	11,800,095
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	3,515,099	3,515,099
Total financial liabilities	**16,382,945**	**4,399,265**	**5,688,170**	**-**	**-**	**17,668,020**	**44,138,400**
Asset-liability maturity mismatch	**(569,343)**	**660,543**	**1,865,353**	**13,940,161**	**4,463,600**	**(15,618,802)**	**4,741,512**

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

(BGN'000)

	Book value	Gross nominal outgoing cash flow	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years
As of 31 December 2017							
Currency in circulation	15,703,197	15,703,197	-	-	-	-	15,703,197
Liabilities to banks and other financial institutions	13,892,496	13,892,496	13,892,496	-	-	-	-
Liabilities to government institutions and other borrowings	10,993,617	10,984,165	2,766,586	2,922,288	5,295,291	-	-
Borrowings against Bulgaria's participation in international financial institutions	3,274,519	3,274,519	-	-	-	-	3,274,519
	43,863,829	**43,854,377**	**16,659,082**	**2,922,288**	**5,295,291**	**-**	**18,977,716**
As of 31 December 2016							
Currency in circulation	14,152,921	14,152,921	-	-	-	-	14,152,921
Liabilities to banks and other financial institutions	14,670,285	14,670,285	14,670,285	-	-	-	-
Liabilities to government institutions and other borrowings	11,800,095	11,796,652	1,712,660	4,399,299	5,684,693	-	-
Borrowings against Bulgaria's participation in international financial institutions	3,515,099	3,515,099	-	-	-	-	3,515,099
	44,138,400	**44,134,957**	**16,382,945**	**4,399,299**	**5,684,693**	**-**	**17,668,020**

d) Market risk

Market risk

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

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

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

(BGN'000)

	As of 31 December 2017	Average	Maximum	Minimum
Currency risk	(15,779)	(23,240)	(48,467)	(4,010)
Interest rate risk	(5,099)	(5,166)	(12,169)	(1,638)
Correlation (per cent)	(014)	0.45	0.72	(0.14)
Overall risk	**(19,015)**	**(25,729)**	**(54,391)**	**(4,815)**
	As of 31 December 2016	**Average**	**Maximum**	**Minimum**
Currency risk	(26,878)	(28,539)	(51,037)	(9,456)
Interest rate risk	(16,146)	(11,870)	(23,182)	(2,470)
Correlation (per cent)	0.40	0.33	0.90	0.01
Overall risk	**(36,097)**	**(35,740)**	**(60,966)**	**(17,401)**

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations, which impact the prices of interest-earning assets (including investments) and interest-bearing liabilities. Modified duration measures the effect of the change in the market value of an asset (liability) in percentage points in response to a 1 basis point (1/100th of 1 per cent) change in the interest rate levels. In addition, portfolios' technical parameters such as protuberance (convexity), duration in a fixed point of the yield curve, *etc.* are monitored on a daily basis. For each portfolio held by the BNB, the interest rate risk is limited by a model portfolio (benchmark) and by the investment limits for a maximum deviation of the modified duration of the portfolio from that of the respective benchmark. In the first three quarters of the year the relative interest rate risk of investment portfolios was set as a maximum deviation of the modified duration of the portfolio from that of the respective benchmark. From the beginning of the fourth quarter the relative interest risk limit of investment portfolios has been set on the basis of the more accurate risk measure *i.e.* relative yield volatility measure.

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

(BGN'000)

	Total	Floating rate instruments	Fixed rate instruments		
			Up to 1 month	From 1 to 3 months	Over 3 months
As of 31 December 2017					
Interest-earning assets					
Cash and deposits in foreign currency	20,844,164	11,322,824	8,898,782	622,558	-
Gold, instruments in gold, and other precious metals	1,662,158	-	1,662,158	-	-
Financial assets at fair value through profit or loss	22,540,705	121,501	259,529	643,586	21,516,089
Available-for-sale financial assets	227,897	-	227,897	-	-
Other interest-earning assets	49,275	15,123	3	5,333	28,816
Total	**45,324,199**	**11,459,448**	**11,048,369**	**1,271,477**	**21,544,905**
Interest-bearing liabilities					
Due to banks and other financial institutions	13,892,496	-	13,892,496	-	-
Liabilities to government institutions and other borrowings	8,783,597	-	551,444	2,925,847	5,306,306
Borrowings against Bulgaria's participation in international financial institutions	1,418,752	1,418,752	-	-	-
Total	**24,094,845**	**1,418,752**	**14,443,940**	**2,925,847**	**5,306,306**
Interest-bearing asset/liability gap	**21,229,354**	**10,040,696**	**(3,359,571)**	**(1,654,370)**	**16,238,599**
As of 31 December 2016					
Interest-earning assets					
Cash and deposits in foreign currency	14,588,581	1,995,820	11,033,578	907,892	651,291
Gold, instruments in gold, and other precious metals	1,681,530	-	-	1,681,530	-
Financial Assets at Fair Value through Profit or Loss	29,096,173	68,446	1,195,920	2,446,452	25,385,355
Available-for-sale financial assets	244,760	-	244,760	-	-
Other interest-earning assets	51,360	14,226	4,020	33,114	-
Total	**45,662,404**	**2,078,492**	**12,478,278**	**5,068,988**	**26,036,646**
Interest-bearing liabilities					
Due to banks and other financial institutions	14,670,285	-	14,670,285	-	-
Liabilities to government institutions and other borrowings	10,170,026	-	82,000	4,399,586	5,688,440
Borrowings against Bulgaria's participation in international financial institutions	1,523,731	1,523,731	-	-	-
Total	**26,364,042**	**1,523,731**	**14,752,285**	**4,399,586**	**5,688,440**
Interest-bearing asset/liability gap	**19,298,362**	**554,761**	**(2,274,007)**	**669,402**	**20,348,206**

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

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

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

(BGN'000)

	100 b.p. intraday instant parallel increase	100 b.p. intraday instant parallel decrease	50 b.p. parallel increase in the beginning of the period	50 b.p. parallel decrease in the beginning of the period
As of 31 December 2017	(360,049)	360,049	(172,698)	(227,714)
As of 31 December 2016	(734,510)	734,510	(329,892)	(12,338)

Currency risk

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

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

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

(BGN'000)

	31 December 2017	31 December 2016
Assets		
Bulgarian lev and euro	42,115,441	42,298,587
US dollar	68,818	209,554
Japanese yen	60	93
Pound sterling	253	300
SDR	3,527,917	3,786,748
Gold	2,748,964	2,784,379
Other	623	453
	48,462,076	49,080,114
Liabilities, capital and reserves		
Bulgarian lev and euro	44,951,608	45,195,831
US dollar	69,100	206,925
Japanese yen	1	1
Pound sterling	-	-
SDR	3,424,985	3,676,477
Other	16,382	880
	48,462,076	49,080,114

	31 December 2017	31 December 2016
Net position		
Bulgarian lev and euro	(2,836,167)	(2 897 444)
US dollar	(282)	2,629
Japanese yen	59	92
Pound sterling	253	300
SDR	102,932	110,271
Gold	2,748,964	2,784,379
Other	(15,759)	(427)

e) **Using accounting judgements and assumptions**

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

These disclosures supplement the notes to the financial risk management.

The Bank is operating in a gradually improving global financial and economic environment which has been positively influencing the Bulgarian market over the last few years. Management's major priorities in the next few years will still be to maintain monetary and financial system stability in the country, keep the Bank's stable liquidity position and improve continuously Bank's valuation methods and techniques, international reserves management and control on international financial markets.

i) Determination of fair values

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

ii) Valuation of financial instruments

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

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

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

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

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

(BGN'000)

	Level 1 Quoted market prices on active markets	Level 2 Valuation techniques (using market data)	Total
31 December 2017			
Cash and deposits in foreign currency	20,948,427	-	20,948,427
Gold, instruments in gold, and other precious metals	2,785,663	-	2,785,663
Financial assets at fair value through profit or loss	22,353,795	-	22,353,795
Total	**46,087,885**	-	**46,087,885**
31 December 2016			
Cash and deposits in foreign currency	14,783,663	-	14,783,663
Gold, instruments in gold, and other precious metals	2,822,205	-	2,822,205
Financial assets at fair value through profit or loss	28,840,698	88,008	28,928,706
Total	**46,446,566**	**88,008**	**46,534,574**

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

(BGN'000)

	Level 1 Quoted market prices on active markets	Level 2 Observable inputs other than quoted prices	Total
31 December 2017			
Liabilities to banks and other financial institutions	-	13,892,496	13,892,496
Liabilities to government institutions and other borrowings	-	10,993,617	10,993,617
Borrowings against Bulgaria's participation in international financial institutions	-	3,274,519	3,274,519
Total	-	**28,160,632**	**28,160,632**
31 December 2016			
Liabilities to banks and other financial institutions	-	14,670,285	14,670,285
Liabilities to government institutions and other borrowings	-	11,800,095	11,800,095
Borrowings against Bulgaria's participation in international financial institutions	-	3,515,099	3,515,099
Total	-	**29,985,479**	**29,985,479**

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

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

f) Maturity structure of assets and liabilities

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

(BGN'000)

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Undefined maturity	Total
As of 31 December 2017							
Assets							
Cash and deposits in foreign currency	20,327,135	621,292	-	-	-	-	20,948,427
Gold, instruments in gold, and other precious metals	2,785,663	-	-	-	-	-	2,785,663
Financial assets at fair value through profit or loss	253,399	618,114	6,777,831	14,677,416	27,035	-	22,353,795
Available-for-sale financial assets	227,898	-	-	-	-	1,903,608	2,131,506
Tangible assets	-	-	-	-	-	156,021	156,021
Intangible assets	-	-	-	-	-	4,426	4,426
Other assets	15,126	5,333	28,816	-	-	32,963	82,238
Total assets	**23,609,221**	**1,244,739**	**6,806,647**	**14,677,416**	**27,035**	**2,097,018**	**48,462,076**
Liabilities							
Currency in circulation	-	-	-	-	-	15,703,197	15,703,197
Liabilities to banks and other financial institutions	13,892,496	-	-	-	-	-	13,892,496
Liabilities to government institutions and other borrowings	2,766,605	2,923,074	5,303,938	-	-	-	10,993,617
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	3,274,519	3,274,519
Other liabilities	-	-	-	-	-	231,667	231,667
Total liabilities	**16,659,101**	**2,923,074**	**5,303,938**	**-**	**-**	**19,209,383**	**44,095,496**
Asset-liability maturity mismatch	**6,950,120**	**(1,678,335)**	**1,502,709**	**14,677,416**	**27,035**	**(17,112,365)**	**4,366,580**
As of 31 December 2016							
Assets							
Cash and deposits in foreign currency	13,225,289	907,472	650,902	-	-	-	14,783,663
Gold, instruments in gold, and other precious metals	1,139,949	1,682,256	-	-	-	-	2,822,205
Financial assets at fair value through profit or loss	1,185,358	2,436,966	6,902,621	13,940,161	4,463,600	-	28,928,706
Available-for-sale financial assets	244,760	-	-	-	-	2,049,218	2,293,978
Tangible assets	-	-	-	-	-	165,285	165,285
Intangible assets	-	-	-	-	-	4,237	4,237
Other assets	18,246	33,114	-	-	-	30,680	82,040
Total assets	**15,813,602**	**5,059,808**	**7,553,523**	**13,940,161**	**4,463,600**	**2,249,420**	**49,080,114**
Liabilities							
Currency in circulation	-	-	-	-	-	14,152,921	14,152,921
Liabilities to banks and other financial institutions	14,670,285	-	-	-	-	-	14,670,285
Liabilities to government institutions and other borrowings	1,712,660	4,399,265	5,688,170	-	-	-	11,800,095
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	3,515,099	3,515,099
Other liabilities	-	-	-	-	-	357,419	357,419
Total liabilities	**16,382,945**	**4,399,265**	**5,688,170**	**-**	**-**	**18,025,439**	**44,495,819**
Asset-liability maturity mismatch	**(569,343)**	**660,543**	**1,865,353**	**13,940,161**	**4,463,600**	**(15,776,019)**	**4,584,295**

7. Interest Income and Expense

(BGN'000)

	2017	2016
Interest income		
– securities	265,018	364,439
– deposits	53,117	33,590
– other	2	2
	318,137	398,031
Interest expense		
– deposits	71,511	22,278
– other	-	-
	71,511	22,278

As of 31 December 2017 interest expenses paid on government deposits in foreign currency amounted to BGN 916 thousand (compared to BGN 393 thousand as of 31 December 2016).

As of 31 December 2017 interest paid on deposits of other organisations in foreign currency amounted to BGN 109 thousand (compared to BGN 14 thousand as of 31 December 2016).

Interest expenses paid on deposits include interest paid of BGN 52,329 thousand (31 December 2016: BGN 16,578 thousand) on deposits and current accounts with foreign correspondent banks as a result of using negative reference interest rates.

In addition BGN 1115 thousand (31 December 2016: BGN 802 thousand) interest paid on the technical account of the national system component TARGET2-BNB at the ECB are included.

During the year, the ECB Governing Council continued to set negative interest rates for the Eurosytem's deposit facility and during the reporting period the interest rate was fixed at -0.40 per cent.

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

(BGN'000)

	2017	2016
Net (losses) from operations in securities	(328,169)	(317,960)
Net gains from operations in foreign currency	482	767
Net revaluation gains on futures	226	86
Net revaluation (losses)/gains on securities	(24,704)	78,904
Net revaluation (losses) on foreign currency assets and liabilities	(6,002)	290
Net revaluation (losses)/gains on gold	(41,356)	310,348
	(399,523)	72,435

Net losses from financial assets and liabilities carried at fair value through profit or loss as at 31 December 2017 are largely attributable to operations in securities of BGN 328,169 thousand. The main factor is the lower market yields on securities from their coupon yield which led to trades at premium above their face value.

During the reporting period the market yield on the securities in which the BNB primarily invested was highly volatile and with mixed movements between issuers, maturity sectors and quarters, but overall, during the year the yield securities increased between 10 and 25 basis points. The net effect from revaluation of securities resulting from these movements was negative: BGN 24,704 thousand.

As of 31 December 2017 the revaluation loss on gold was BGN 41,356 thousand and was due to a fall in the market price of gold denominated in euro: BGN 2148.21 *per* troy ounce as of 31 December 2016 to BGN 2117.09 as of 31 December 2017.

9. Other Operating Income

(BGN'000)

	2017	2016
Income from subsidiaries	26,288	31,744
Income from associates	(6,708)	(279)
Income from sale of coins	652	781
Dividend income	14,857	7,870
Other income, net	1,670	1,601
	36,759	41,717

Dividend income includes dividends from BNB's participation in: BIS, Basel amounting to BGN 5758 thousand, BORICA AD of BGN 8908 thousand, Cash Service Company AD of BGN 191 thousand.

In 2017 the BNB received a dividend payment of BGN 857 thousand from its participation in Bulgarian Mint EAD which is eliminated for the purpose of the consolidated financial statement.

The other net income includes financial income from subsidiaries of BGN 526 thousand, income from reallocated remuneration from the ECB in relation to TARGET2 of BGN 920 thousand.

10. General Administrative Expenses

(BGN'000)

	2017	2016
Staff expenditure	36,562	34,718
Administrative expenses	47,799	54,877
Depreciation	14,609	16,642
Other expenses	3,116	3,243
	102,086	109,480

The number of employees of the Bank and its subsidiaries is 1148 as of 31 December 2017 (31 December 2016: 1142), including the BNB staff of 876 (31 December 2016: 862).

Staff expenditure include salaries, social and health insurance costs charged under the local legislation provisions as of 31 December 2017, and social activities costs, respectively for the BNB: BGN 29,107 thousand (31 December 2016: BGN 27,344 thousand), for the Printing Works of the BNB Corp.: BGN 4590 thousand (31 December 2016: BGN 4596 thousand), and for the Bulgarian Mint EAD: BGN 2865 thousand (31 December 2016: BGN 2778 thousand).

Staff expenditure include expenses for remunerations paid to the BNB Governing Council members of BGN 1195 thousand for 2017 (31 December 2016: BGN 1209 thousand), presented, as follows:

(BGN'000)

	2017	2016
Total gross remuneration expenses*	1,173	1,161
including bonuses up to established threshold in accordance with Article 23, paragraph 3 of the LBNB by BNB Governing Council's resolution of 30 July 2015**	350	350
Expenses on BNB Governing Council members' retirement/ termination benefits	12	48
Total gross remuneration paid to the BNB Governing Council members	1,195	1,209

* Remunerations are before tax.
** http://www.bnb.bg/PressOffice/POPressReleases/POPRDate/PR_20150730_1_EN

In accordance with the BNB Governing Council's Decision of 30 July 2015 the monthly remunerations paid to the Governing Council members are set as follows: Governor – BGN 15,368; Deputy Governors – BGN 13,173; other Governing Council members – BGN 4391.

Based on actuarial calculations, the Bank has accrued compensation liabilities for personnel on retirement and for unused paid annual leave at BGN 679 thousand (31 December 2016: BGN 877 thousand). The retirement and unused paid annual leave compensation for the Bank's subsidiaries as of 31 December 2017 are BGN 177 thousand (31 December 2016: BGN 212 thousand).

Staff retirement liabilities calculated based on actuarial valuation and pursuant to IAS 19 'Employee Benefits' are given below:

(BGN'000)

	2017	2016
Defined benefit liabilities as of 1 January	**2,602**	**2,424**
Plan benefits paid	(329)	(212)
Current service cost	323	292
Interest expense	43	51
Re-measurements	-	-
Actuarial (gain)/loss arising from experience adjustment	18	(78)
Actuarial (gain) arising from change in demographic assumptions	-	(34)
Actuarial loss arising from change in financial assumptions	151	156
Actuarial (gain)/loss recognised in expenses	2	3
Defined benefit liabilities as at 31 December	**2,810**	**2,602**

Costs carried through profit and loss

(BGN'000)

	2017	2016
Current service cost	323	292
Interest expense	43	51
Actuarial (gains)/losses	2	3
Re-measurements	-	-
Total	368	346

Actuarial assumptions

The key actuarial assumptions as at the Financial Statements date are the following (weighted average):

(per cent)

	2017	2016
Discount interest rate as at 31 December	0.6	1.4
Future salary growth	4.5	4.5

Distribution of BNB staff liabilities (subsidiaries excluded) by residual term	2017	2016
Up to 1 year	296	353
From 1 to 3 years	402	433
From 3 to 5 years	277	247
From 5 to 10 years	360	301
Over 10 years	688	561
Total	**2,023**	**1,895**

Administrative expenses include the BNB's currency circulation expenses of BGN 19,666 thousand as of 31 December 2017 (31 December 2016: BGN 17,666 thousand) and international audit expenses of BGN 115 thousand (31 December 2016: BGN 115 thousand).

11. Cash and Deposits in Foreign Currency

(BGN'000)

	31 December 2017	31 December 2016
Cash in foreign currency	111,676	196,351
Current accounts in other banks	11,321,167	1,991,946
Deposits in foreign currency	9,515,584	12,595,366
	20,948,427	14,783,663

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

(BGN'000)

	31 December 2017	31 December 2016
Euro area residents		
In EUR	14,888,915	6,308,024
In other currencies	2	133,525
	14,888,917	6,441,549
Non-euro area residents		
In EUR	4,566,830	6,739,240
In other currencies	1,492,680	1,602,874
	6,059,510	8,342,114
	20,948,427	14,783,663

Deposits in foreign currency with correspondents with counterparty's credit rating graded by at least two of the six internationally recognised credit rating agencies – Standard&Poor's, Fitch Ratings, Moody's, DBRS, R&I and JCRA – are disclosed as follows:

(BGN'000)

	Counterparty short-term credit rating	31 December 2017	31 December 2016
Investment graded deposits by the counterparty's credit rating	*A-1+*	5,853,791	5,858,420
	A-1	3,660,155	6,732,463
		9,513,946	12,590,883

The disclosure by credit rating does not include demand deposits with external managers.

The BNB maximum exposure to credit risk is equivalent to the book value of cash on current accounts and deposits.

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

	31 December 2017		31 December 2016	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	1,086,158	513	1,102,124
Gold deposits in standard form	785	1,662,806	783	1,682,255
Gold in other form	16	33,733	16	34,518
Other precious metals		2,966		3,308
		2,785,663		2,822,205

Gold in standard form includes gold held for safekeeping with a depository and deposits. Deposits in gold are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognised rating agencies and bear interest between 0.07 per cent and 0.54 per cent annually.

Gold in other form includes commemorative gold coins of BGN 28,422 thousand.

Other precious metals include silver commemorative coins of BGN 552 thousand and platinum commemorative coins of BGN 2414 thousand.

13. Financial Assets at Fair Value through Profit and Loss

(BGN'000)

Securities at fair value through profit or loss	31 December 2017	31 December 2016
Foreign treasury bills, notes and bonds	22,353,795	28,928,706
	22,353,795	28,928,706

Securities comprise of both coupon and discount securities denominated in EUR. The maximum coupon interest of the EUR-denominated securities was 0.97 per cent as of 31 December 2017 (31 December 2016: 1.32 per cent). Similarly as at 31 December 2016, as at 31 December 2017 there were no securities pledged as collateral on futures transactions.

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

(BGN'000)

	Issue/issuer credit rating	31 December 2017	31 December 2016
Issue/issuer credit rating	AAA	20,977,496	16,520,652
	AA+	216,058	2,068,402
	AA	818,250	95,928
	AA-	-	8,037,373
	A+	341,991	2,152,689
	A	-	53,662
		22,353,795	28,928,706

14. Financial Assets Available for Sale

(BGN'000)

	31 December 2017	31 December 2016
Republic of Bulgaria's quota in the IMF	2,081,648	2,235,677
Equity investments in international financial institutions	30,081	31,799
Investments in associates	19,777	26,502
	2,131,506	2,293,978

The Republic of Bulgaria's quota in the IMF is SDR 896,300 thousand (31 December 2016: SDR 896,300 thousand). The increase of BGN 256,100 thousand is due to the contribution made by Bulgaria on 22 February 2016 to implement its quota increase in the IMF agreed under the 14th General Quota Review. BGN 227,897 thousand of the Republic of Bulgaria's quota in the IMF represents the reserve tranche held with the IMF (31 December 2016: BGN 244,760 thousand). The IMF pays remuneration (interest) to those members who have a remunerated reserve tranche position, at an average rate of 0.52 per cent.

Equity investments in international financial institutions include the equity investment in the Bank for International Settlements (BIS), Basel, and 25 per cent of the equity investment in BIS, Basel is paid up. As of 31 December 2017 the current value of SDR 10,000 thousand shares amounts to BGN 23,225 thousand while as of 31 December 2016 it was BGN 24,943 thousand (ref. note 28). The capital subscribed, but not paid-in has an option to be paid in within three months upon a decision of the BIS Board of Governors.

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

Investments in international financial institutions also include BNB's participation in the ECB. As of 1 January 2007 (when the Republic of Bulgaria joined the EU), the Bulgarian National Bank has a share in the ECB capital. As at 31 December 2017 the amount of the BNB paid-up share in the ECB capital is EUR 3487 thousand or BGN 6820 thousand.

Pursuant to Article 28 of the Statute of the ESCB and the ECB, only ESCB NCBs are entitled to participate in the ECB capital. Capital subscription follows the requirements and the key set forth in Article 29 of the Statute of the ESCB and of the ECB, *i.e.* the share of each NCB in the ECB capital is determined in percentage and corresponds to the share of the respective Member State in the EU's total population and GDP (in equal proportions). The percentage is adjusted every five years and whenever a new Member State joins the EU. As of 31 December 2017, the BNB's capital share in the ECB subscribed capital is 0.8590 per cent, which corresponds to EUR 92,986.8 thousand.

As a non-euro area NCB, the BNB is required to pay up the minimum percentage of its subscribed capital in the ECB, which is pursuant to Article 47 of the Statute of the ESCB and of the ECB (as set out by the ECB General Council) and represents the BNB contribution to the ECB operational costs. As of 29 December 2010 this percentage amounts to 3.75 per cent. Unlike euro area NCBs, the BNB is not entitled to the ECB's distributable profit, nor is it required to fund any loss of the ECB. Upon joining the euro area, the BNB will be required to pay up the remaining 96.25 per cent of its capital subscription to the ECB, which is EUR 89,499.8 thousand.

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

Associates	Share holding, per cent	Principal activity
BORICA AD	36.11	Interbank card payments
Cash Services Company AD	20.00	Handling of sealed parcels of Bulgarian coins and banknotes transferred from the BNB and the banks

15. Tangible Assets

The fair value of land and buildings is categorised as Level-3 fair value based on the input data for the given assessment technique.

For the remaining asset classes: Plant and Machinery, Equipment, Vehicles, Fixtures and Fittings, the fair value is considered to be their present value on the Bank's balance sheet as most of them were bought in the last four years and their book value is close to their fair value.

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

(BGN'000)

	Land and buildings	Plant and equipment	IT equipment	Office equipment	Other equipment (including motor vehicles)	Assets under construction	Total
As of 1 January 2017	183,232	90,297	48,156	9,829	8,374	1,871	341,759
Additions	864	1,415	300	120	-	1,009	3,708
Disposals	-	(813)	(706)	(58)	(145)	-	(1,722)
Transfers	-	154	487	93	4	(738)	-
As of 31 December 2017	184,096	91,053	48,237	9,984	8,233	2,142	343,745
Depreciation and impairment loss							
As of 1 January 2017	(50,592)	(71,285)	(39,568)	(8,575)	(6,454)	-	(176,474)
Charge for the period	(5,728)	(2,737)	(3,868)	(199)	(402)	-	(12,934)
On disposals	-	778	708	53	145	-	1,684
As of 31 December 2017	(56,320)	(73,244)	(42,728)	(8,721)	(6,711)	-	(187,724)
Net book value as of 31 December 2017	**127,776**	**17,809**	**5,509**	**1,263**	**1,522**	**2,142**	**156,021**
Net book value as of 31 December 2016	**132,640**	**19,012**	**8,588**	**1,254**	**1,920**	**1,871**	**165,285**
As of 1 January 2016	181,171	89,655	47,082	9,780	8,275	2,712	338,675
Additions	589	244	15	40	144	6,798	7,830
Disposals	-	(542)	(3,698)	(33)	(90)	(383)	(4,746)
Transfers	1,472	940	4,757	42	45	(7,256)	-
As of 31 December 2016	183,232	90,297	48,156	9,829	8,374	1,871	341,759
Depreciation and impairment loss							
As of 1 January 2016	(44,935)	(67,685)	(39,119)	(8,187)	(6,085)	-	(166,011)
Charge for the period	(5,657)	(4,140)	(4,137)	(421)	(468)	-	(14,823)
On disposals	-	540	3,688	33	99	-	4,360
As of 31 December 2016	(50,592)	(71,285)	(39,568)	(8,575)	(6,454)	-	(176,474)
Net book value as of 31 December 2016	**132,640**	**19,012**	**8,588**	**1,254**	**1,920**	**1,871**	**165,285**
Net book value as of 31 December 2015	**136,236**	**21,970**	**7,963**	**1,593**	**2,190**	**2,712**	**172,664**

In applying IAS 16 Property, Plant and Equipment and BNB's Internal Rules for Financial Statements and Accounting Policy, as of December 2013 a review was made of the book value of tangible fixed assets stated in the Bank's balance sheet. The fair value of land and buildings was determined by an external, independent and licensed assessor of recognised professional qualification and experience in assessing property of location and category similar to the assessed ones. As at 31 December 2017, the fair value of land and buildings did not differ materially from their book value as at the same date; therefore, it is considered that the present book value of land and buildings on the Bank's balance sheet fairly reflects their market value. The fair value of fully amortized tangible fixed assets as of 31 December 2017 was BGN 73,839 thousand (31 December 2016: BGN 73,958 thousand).

16. Intangible Assets

(BGN'000)

	Software	Other intangible assets	Development costs	Total
As of 1 January 2017	49,947	161	406	50,514
Additions	95	13	1,756	1,864
Disposals	(77)	-	-	(77)
Transfers	2,099	-	(2,099)	-
As of 31 December 2017	52,064	174	63	52,301
Depreciation and impairment loss				
As of 1 January 2017	(46,118)	(159)	-	(46,277)
Charge for the period	(1,673)	(2)	-	(1,675)
On disposals	77	-	-	77
As of 31 December 2017	(47,714)	(161)	-	(47,875)
Net book value as of 31 December 2017	**4,350**	**13**	**63**	**4,426**
Net book value as of 31 December 2016	**3,829**	**2**	**406**	**4,237**

Software includes, as of 31 December 2017, licenses purchased by the BNB to the total amount of BGN 486 thousand (31 December 2016: BGN 372 thousand), and software products to the amount of BGN 1170 thousand (31 December 2016: BGN 1395 thousand).

(BGN'000)

	Software	Other intangible assets	Development costs	Total
As of 1 January 2016	49,011	161	247	49,419
Additions	-	-	1,767	1,767
Disposals	(672)	-	-	(672)
Transfers	1,608	-	(1,608)	-
As of 31 December 2016	49,947	161	406	50,514
Depreciation and impairment loss				
As of 1 January 2016	(44,973)	(157)	-	(45,130)
Charge for the period	(1,817)	(2)	-	(1,819)
On disposals	672	-	-	672
As of 31 December 2016	(46,118)	(159)	-	(46,277)
Net book value as of 31 December 2016	**3,829**	**2**	**406**	**4,237**
Net book value as of 31 December 2015	**4,038**	**4**	**247**	**4,289**

Software includes, as of 31 December 2016, licenses purchased by the BNB to the total amount of BGN 372 thousand (31 December 2015: BGN 1401 thousand), and software products to the amount of BGN 1395 thousand (31 December 2015: BGN 1320 thousand).

17. Other Assets

(BGN'000)

	31 December 2017	31 December 2016
Cash held by subsidiaries with local banks	49,297	51,387
Investments of subsidiary undertakings in joint ventures and associates	8,791	8,791
Commemorative coins for sale	344	283
Inventories	17,786	18,743
Accounts receivable	3,880	1,238
Deferred charges	1,284	895
Other receivables	856	703
	82,238	82,040

Cash held by subsidiaries with local banks comprise BGN 44,063 thousand of the Printing Works of the BNB Corp. and BGN 5234 thousand of Bulgarian Mint EAD.

Investments of subsidiary undertakings in joint ventures and associates include a non-monetary contribution in the form of banknote production equipment to the capital of François-Charles Oberthur Group with which the Printing Works of the BNB Corp. has established a joint venture for banknote production.

18. Currency in Circulation

(BGN'000)

	31 December 2017	31 December 2016
Banknotes in circulation	15,333,225	13,838,892
Coins in circulation	369,972	314,029
	15,703,197	14,152,921

19. Liabilities to Banks and Other Financial Institutions

(BGN'000)

	31 December 2017	31 December 2016
Demand deposits from banks and other financial institutions		
– in BGN	8,341,080	10,154,008
– in foreign currency	5,551,416	4,516,277
	13,892,496	14,670,285

Demand deposits include BGN 6,707,578 thousand representing the required reserves, which all local banks are required to maintain on accounts with the BNB (31 December 2016: BGN 6,293,102 thousand).

On 26 November 2015 the Governing Council of the Bulgarian National Bank adopted a new Ordinance No 21 on the Minimum Required Reserves Maintained with the Bulgarian National Bank which came into force as of 4 January 2016. It removed the recognition of banks' funds in the TARGET2-BNB national system component as a component of reserve assets.

As of 30 September 2016, the amendments to Article 42 of BNB Ordinance No 3 on the Terms and Procedure for the Execution of Payment Transactions and Use of Payment Instruments transformed the Reserve Guarantee Fund into a guarantee mechanism for settling participant banks' payments in the BORICA card payments servicing system operated by BORICA AD. Pursuant to Article 42, paragraph 3 the participation in the guarantee mechanism is included in the reserve assets of the respective participant when reporting the performance of minimum required reserves with the BNB.

20. Liabilities to Government Institutions and Other Borrowings

(BGN'000)

	31 December 2017	31 December 2016
Current accounts		
– in BGN	2,086,817	1,251,609
– in foreign currency	123,203	378,460
Time deposit accounts		
– in BGN	5,325,000	5,512,000
– in foreign currency	3,458,597	4,658,026
	10,993,617	11,800,095

The government's deposits and current accounts with the Bank comprise funds held on behalf of the state budget and other government organisations. As of 4 January 2016 the Bank shall apply interest rates in line with the General Terms and Conditions of the Bulgarian National Bank on accepting cash deposits and servicing bank accounts, budget organisations and other customers adopted by a decision of the BNB Governing Council of 26 November 2015.

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

The borrowings against Bulgaria's participation in the IMF as of 31 December 2017 amount to BGN 1,848,546 thousand, or SDR 795,933 thousand (as of 31 December 2016: BGN 1,985,327 thousand, or SDR 795,933 thousand).

Borrowings from the IMF are denominated in SDRs. Borrowings related to Bulgaria's quota in the IMF are non-interest bearing with no stated maturity. This note includes account No 1 and account No 2 of the IMF in levs amounting to BGN 5524 thousand (as of 31 December 2016: BGN 5495 thousand).

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

22. Other Liabilities

(BGN'000)

	31 December 2017	31 December 2016
Funds of EU institutions and bodies	4,211	170,307
Salaries and social security payable	5,688	3,844
Deferred income	1,402	1,392
Other liabilities	220,366	181,876
	231,667	357,419

Funds of EU institutions and bodies include European Commission's funds and European Investment Bank's funds. Pursuant to Article 9 of Council Regulation No 1150 of 2000 and Bulgaria's participation in the funding of the EU budget, the Bank opened accounts of the European Commission. As at 31 December 2017 the funds on these accounts were BGN 4211 thousand.

23. Capital and Reserves

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

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

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

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

As of 31 December 2017 profit distribution in accordance with the profit distribution policy disclosed in note 5 (h) is as follows:

(BGN'000)

	2017	2016
Profit/(loss) for the period	**(215,454)**	**384,924**
Allocation to special reserve under Article 36 of the Law on the BNB:		
Unrealised loss/(gain) from gold revaluation	41,356	(310,348)
Unrealised loss/(gain) from revaluation of financial assets at fair value through profit or loss	81,872	(78,904)
Unrealised loss/(gain) from foreign currency valuation	6,002	(290)
Other unrealised (gain)	(226)	(86)
Result after allocation to special reserve including:	**(86,450)**	**(4,704)**
Allocation (from)/to Reserve Fund under Article 8 of the LBNB	*(81,174)*	*3,556*
Result from consolidation and non-controlling interest	*(5,276)*	*(18,927)*
Allocation (from)/to special-purpose fund under Article 8 of the LBNB	-	*10,667*
Planned contribution to the state budget	-	-

24. Non-controlling Interest

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

25. Monetary Liabilities and Gross International Reserves

(BGN'000)

	31 December 2017	31 December 2016
Gross international reserves		
Cash and foreign currency denominated deposits	20,948,427	14,783,663
Monetary gold and other instruments in gold	2,748,964	2,784,380
Security investments	22,353,795	28,928,706
Equity investments and quota in the IMF	227,897	244,760
	46,279,083	46,741,509
Monetary liabilities		
Currency in circulation	15,703,197	14,152,921
Liabilities to banks and other financial institutions	13,891,858	14,444,466
Liabilities to government institutions	9,397,550	10,699,824
Other liabilities	1,600,916	1,496,397
	40,593,521	40,793,608
Surplus of gross international reserves over monetary liabilities	5,685,562	5,947,901

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

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

26. Related Party Transactions

Bulgarian Government

International Monetary Fund

As of 31 December 2017, the Republic of Bulgaria has not received funds under IMF agreements.

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

Government bank accounts

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

Fiduciary activities

In accordance with the Law on the BNB and under the terms agreed upon with the Minister of Finance, the BNB acts as an agent in government or government-guaranteed debts. With regard to this role, the BNB performs agent and central depository services related to the administration and management of government securities issued by the Ministry of Finance. The Bank receives commission for providing these services. These government securities are not assets or liabilities of the BNB and are not recognised in its consolidated statement of financial position. The Bank is not exposed to any credit risk relating to government securities as it does not guarantee them. As of 31 December 2017, the par value of the government securities held in custody was BGN 6725 million (31 December 2016: BGN 6725 million).

27. Subsidiaries

(per cent)

Ownership interest	31 December 2017	31 December 2016
Bulgarian Mint EAD	100	100
Printing Works of the BNB Corp. (ref. note 24)	95 6	95.6

The net income from subsidiaries for the period comprises net profit of BGN 480 thousand from the Bulgarian Mint EAD (31 December 2016: BGN 857 thousand) and BGN 1807 thousand from the Printing Works of the BNB Corp. (31 December 2016: BGN 4019 thousand).

28. Commitments and Contingencies

(i) Participation in the Bank for International Settlements

The Bank holds 8000 shares of the capital of BIS, Basel, each amounting to SDR 5000. Twenty-five per cent of the equity investment in BIS, Basel is paid up. The capital subscribed but not paid in is with an option to be paid in within three months following a decision of the BIS Board of Governors. The contingent amount as of 31 December 2017 is BGN 69,675 thousand (31 December 2016: BGN 74,830 thousand).

(ii) IMF quota and borrowings

The IMF quota is secured by promissory notes jointly signed by the Bank and the Government of the Republic of Bulgaria amounting to BGN 1,952,683 thousand.

(iii) Capital commitments

As of 31 December 2017 the Bank has committed to BGN 2222 thousand to purchase non-current assets (31 December 2016: BGN 320 thousand).

(iv) Other commitments and liabilities

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

(v) Other contingent liabilities

Legal proceedings have been instituted against BNB as regards claims for delayed payment of deposits exceeding the insured deposit amount or to challenge bank transfers made by the customers of Corporate Commercial Bank AD (in bankruptcy) to a total amount of around BGN 54 million. Currently, in Bulgaria there is no settled case-law on similar issues including a number of open points as to the applicable law and the procedural rules for their examination. Court proceedings are at an early stage because most of them have been stayed pending the preliminary ruling on those issued from Bulgarian courts and the Court of the European Union. Therefore, and based on the available information on both cases Bank's management considers that it is not possible to assess the likely outcome of the legal proceedings and consequently no provisions for these contingent liabilities should be made.

29. Events Occurred after the Reporting Date

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

Information under Article 17, Paragraph 5 of the LBNB Concerning Resolutions Adopted by the BNB Governing Council in 2017

Reporting and Budget

RESOLUTION No 46 of 30 March

The BNB Annual Report for 2016 was approved on first reading.

RESOLUTION No 47 of 30 March

The Report on BNB Budget Implementation as of 31 December 2016 was approved.

RESOLUTION No 54 of 13 April

The BNB Annual Report for 2016 was approved.

RESOLUTION No 134 of 26 September

The Report on BNB Budget Implementation as of 30 June 2017 was approved.

RESOLUTION No 144 of 5 October

Draft Ordinance No 1 on the Format and Contents of Separate Balance Sheets of the Issue and Banking Departments and of the Consolidated Statement of Financial Position of the Bulgarian National Bank* was approved on first reading.

RESOLUTION No 148 of 31 October

The BNB Budget for 2018 was approved on first reading.

RESOLUTION No 169 of 30 November

The BNB Report for January–June 2017 was approved.

RESOLUTION No 173 of 30 November

The BNB Budget for 2018 was approved.

Gross International Reserves

RESOLUTION No 5 of 26 January

The BNB Governing Council took note of the selected benchmark for strategic asset allocation in the first quarter of 2017.

RESOLUTION No 32 of 9 March

The BNB Governing Council took note of the International Reserve Management Report in 2016.

* The Ordinance was adopted by Resolution No 8 of 10 January 2018 of the BNB Governing Council (published in Darjaven Vestnik, issue 11 of 2 February 2018).

RESOLUTION No 60 of 13 April

The BNB Governing Council took note of the selected benchmark for strategic asset allocation in the second quarter of 2017.

RESOLUTION No 76 of 30 May

The BNB Governing Council took note of the BNB International Reserve Management Report for the first quarter of 2017.

RESOLUTION No 97 of 13 July

The BNB Governing Council took note of the selected benchmark for dynamic asset allocation in the third quarter of 2017.

RESOLUTION No 138 of 26 September

The BNB Governing Council took note of the BNB International Reserve Management Report in the second quarter of 2017.

RESOLUTION No 157 of 31 October

The BNB Governing Council took note of the selected benchmark for dynamic asset allocation in the fourth quarter of 2017.

RESOLUTION No 175 of 30 November

The BNB Governing Council took note of the BNB International Reserve Management Report in the third quarter of 2017.

Payment Systems and Payment Oversight

RESOLUTION No 15 of 9 February

The BNB Governing Council took note of the 2016 Annual Report of the Conciliation Committee.

RESOLUTION No 19 of 9 February

The BNB Governing Council took note of the BNB Activity Report on Payment Infrastructure and Payment Oversight in 2016.

RESOLUTION No 20 of 9 February

Resolution No 25 of the BNB Governing Council of 17 March 2005 on establishing the National Council on Payment Systems was repealed and notified to the members of the Council.

RESOLUTION No 36 of 16 March

A draft law on payment services and payment systems was approved on first reading.

RESOLUTION No 48 of 30 March

Ordinance on Amendment of Ordinance No 3 of 16 July 2009 on the Terms and Procedure for the Execution of Payment Transactions and Use of Payment Instruments was adopted.

RESOLUTION No 55 of 13 April

The BNB Governing Council refused to issue a license to Smart Pay Bulgaria OOD for conducting activities as a payment institution.

RESOLUTION No 56 of 13 April

The BNB Governing Council terminated the procedure on issuing an electronic money license to Fintex Services EAD (formerly Cash Credit EAD).

RESOLUTION No 67 of 10 May

The BNB refused to issue a license to Best Pay OOD for conducting activities as a payment institution.

RESOLUTION No 84 of 8 June

Ordinance on Amendment of Ordinance No 16 of 16 July 2009 on Licensing of Payment Institutions, Electronic Money Institutions and Payment System Operators was adopted.

RESOLUTION No 90 of 20 June

A draft law on payment services and payment systems was approved together with supporting documents under the Law on Legal Acts.

The draft law and supporting documents had to be sent to the Minister of Finance for submission to the Council of Ministers.

RESOLUTION No 96 of 13 July

The BNB refused to issue a licence to Prima Latius EOOD for conducting activities as a payment institution.

RESOLUTION No 124 of 29 August

The BNB Governing Council took note of the license revocation of Change Centre – Bulgaria EOOD.

RESOLUTION No 136 of 26 September

The Governing Council suggests that in performing payment oversight, the BNB starts implementing until the end of the first half of 2018 Guidelines on the criteria on how to stipulate the minimum monetary amount of the professional indemnity insurance or other comparable guarantee under Article 5(4) of Directive (EU) 2015/2366 (EBA/GL/2017/08 of 12 September 2017) issued by the European Banking Authority.

RESOLUTION No 156 of 31 October

The BNB Governing Council took note of the revocation of the license of Small World Financial Services Bulgaria EOOD (formerly Choice Money Transfer Bulgaria EOOD and Master Envios Bulgaria EOOD) for money remittance transactions.

RESOLUTION No 159 of 31 October

Ordinance on Amendment of Ordinance No 16 of 16 July 2009 on Licensing of Payment Institutions, Electronic Money Institutions and Payment System Operators. was adopted.

RESOLUTION No 181 of 14 December

The BNB Governing Council issued a license to BORICA AD to operate as a payment institution.

RESOLUTION No 183 of 14 December

The Governing Council suggests that the BNB starts implementing until the end of the first half of 2018 Guidelines on the information to be provided for the authorisation of payment institutions and e-money institutions and for the registration of account information service providers under Article 5(5) of Directive 2015/2366 (EBA/GL/2017/09 of 8 November 2017) issued by the European Banking Authority.

RESOLUTION No 184 of 14 December

The Governing Council suggests that the BNB starts implementing until the end of the first half of 2018 Guidelines on procedures for complaints of alleged infringements of the Second Payment Services Directive (EBA/GL/2017/13 of 5 December 2017) issued by the European Banking Authority.

Currency in Circulation

RESOLUTION No 3 of 26 January

The BNB Governing Council took note of the availability and developments in the BNB Strategic Stock of Banknotes for 2016.

RESOLUTION No 4 of 26 January

The list of selling prices of Bulgarian coins, issues 1951–2016, was approved.

The list of selling prices of Bulgarian banknotes, issues 1950–2006, was approved.

RESOLUTION No 25 of 9 February

The BNB Governing Council decided to put into circulation on 20 March 2017 a gold commemorative coin ‘Annunciation’ with a nominal value of BGN 100.

RESOLUTION No 34 of 9 March

The BNB Governing Council chose the design of Stefan Ivanov for the silver commemorative coin ‘Rila Monastery’ of the Bulgarian Churches and Monasteries series, issue 2017, and determined its specifications.

RESOLUTION No 61 of 13 April

The BNB Governing Council launched a periodical publication *BNB Issue and Cash Operations Review* incorporating quarterly data on developments in currency in circulation and analyses of the trends observed during the relevant period *vis-à-vis* the end of the previous quarter and over a one-year period.

RESOLUTION No 70 of 10 May

As of 26 June 2017 the BNB put into circulation a partially gold-plated silver commemorative coin 'Khan Tervel' of the Medieval Bulgarian Rulers series with a nominal value of BGN 10.

RESOLUTION No 77 of 30 May

As of 3 July 2017 the BNB put into circulation a copper commemorative coin '140 Years since the Birth of Elin Pelin' of the Bulgarian Artists series with a nominal value of 2 BGN.

RESOLUTION No 89 of 20 June

To enhance banknote security, the BNB approved incorporation of new or improvements in existing security features of Bulgarian banknotes along with removal of some of them.

Designs of a new series of Bulgarian banknotes were approved.

RESOLUTION No 99 of 13 July

The BNB Governing Council adopted the Commemorative Coin and Banknote Production Programme for 2018.

The BNB Governing Council took note of the Preliminary Commemorative Coin and Banknote Production Programme for 2019–2020 as a basis for preparing annual programmes.

RESOLUTION No 119 of 26 July

As of 25 September 2017 the BNB put into circulation a silver commemorative coin 'Rila Monastery' of the Bulgarian Churches and Monasteries series with a nominal value of BGN 10.

RESOLUTION No 125 of 29 August

The BNB Governing Council chose the design of Mint EAD for the partially gold-plated silver commemorative coin, issue 2018, dedicated to the Bulgarian Presidency of the EU Council in 2018. It also determined coin specifications.

The BNB Governing Council chose the design of Mint EAD for the circulating BGN 2 coin issued in 2018 on the occasion of the Bulgarian Presidency of the EU Council. It also determined coin specifications.

RESOLUTION No 131 of 12 September

As of 27 November 2017 the BNB put into circulation a silver commemorative coin '150 Years since the Construction of the Kolyo Ficheto Bridge near Byala' with a nominal value of BGN 10.

RESOLUTION No 145 of 23 October

As of 2 January 2018 the BNB put into circulation a partially gold-plated silver commemorative coin 'Bulgarian Presidency of the EU Council 2018' with a nominal value of BGN 10.

RESOLUTION No 146 of 23 October

The BNB put into circulation on 2 January 2018 a circulating coin with a nominal value of BGN 2.

RESOLUTION No 165 of 16 November

Under Article 25, paragraph 6 of the Law on the BNB, the BNB fixed the price of the set containing a circulating BGN 2 coin, issue 2018, a capsule and a brochure at BGN 2.72 (excluding VAT) or BGN 3.26 (inclusive of VAT).

RESOLUTION No 166 of 16 November

The BNB Governing Council set the final ranking in the anonymous competition for the silver commemorative coin '140 Years since Bulgaria's Liberation' and chose the design by Elena Todorova and Todor Todorov. It also determined coin specifications.

RESOLUTION No 167 of 16 November

The BNB Governing Council set the final ranking in the anonymous competition for the silver commemorative coin 'The Old Elm in Sliven' and chose the design by Plamen Chernev. It also determined coin specifications.

RESOLUTION No 176 of 30 November

The BNB Governing Council set the final ranking in the anonymous competition for the gold commemorative coin 'St. Stefan Protomartyr' of the Bulgarian Iconography series and chose the design by Plamen Chernev. It also determined coin specifications.

RESOLUTION No 177 of 30 November

The BNB Governing Council set the final ranking in the anonymous competition for the gold-plated silver commemorative coin 'Tsar Ivan Asen II' of the Medieval Bulgarian Rulers series and chose the design by Elena Todorova and Todor Todorov. It also determined coin specifications.

Maintaining Banking System Stability and Protecting Depositor Interests

RESOLUTION No 16 of 9 February

The BNB Governing Council took note of the Annual Report of the Sectoral Conciliation Commission on Financial Services for 2016.

RESOLUTION No 17 of 9 February

The BNB approved the Bank Supervisory Process Manual.

RESOLUTION No 39 of 16 March

The countercyclical capital buffer rate applicable to credit risk exposures in the Republic of Bulgaria was set at 0 per cent for the second quarter of 2017.

RESOLUTION No 49 of 30 March

The BNB Governing Council took note of the Report on the State of the Banking System (fourth quarter of 2016).

RESOLUTION No 50 of 30 March

The BNB Governing Council took note of the Information on Supervisory Activities for the Fourth Quarter of 2016.

RESOLUTION No 73 of 10 May

In consultation with the Commission for Public Oversight on Statutory Auditors, the BNB adopted criteria and procedures for coordinating selection of bank auditors to perform joint financial audits under the Law on the Independent Financial Audit.

RESOLUTION No 91 of 20 June

The countercyclical capital buffer rate applicable to credit risk exposures in the Republic of Bulgaria was set at 0 per cent for the third quarter of 2017.

RESOLUTION No 92 of 20 June

The BNB Governing Council took note of the Report on the State of the Banking System (First Quarter of 2017).

RESOLUTION No 93 of 20 June

The BNB Governing Council took note of the first impact assessment of the enforcement of IFRS 9 Financial Instruments.

RESOLUTION No 104 of 20 July

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

RESOLUTION No 105 of 20 July

Ordinance on Amendment of Ordinance No 8 on Banks' Capital Buffers was adopted.

RESOLUTION No 108 of 20 July

The BNB Governing Council took note of the information on organisation, parameters and time limits of stress-test simulation under Article 80b of the Law on Credit Institutions in 2017.

RESOLUTION No 109 of 20 July

The BNB Governing Council approved issuance of Banks in Bulgaria quarterly.

RESOLUTION No 110 of 20 July

The BNB Governing Council took note of the Report on Information about Supervisory Activities for the First Quarter of 2017.

RESOLUTION No 139 of 26 September

The countercyclical capital buffer rate applicable to credit risk exposures in the Republic of Bulgaria was set at 0 per cent for the fourth quarter of 2017.

RESOLUTION No 140 of 26 September

The BNB Governing Council took note of the Report on the State of the Banking System (Second Quarter of 2017).

The BNB Governing Council took note of the publication of Banks in Bulgaria (April–June 2017).

RESOLUTION No 141 of 26 September

The BNB Governing Council took note of the Report on Information about Supervisory Activities (Second Quarter of 2017).

RESOLUTION No 149 of 31 October

The BNB Governing Council set other systematically important institutions according to their overall rating in line with pan-European guidelines of the European Banking Authority.

The BNB Governing Council set buffer rates for other systemically important institutions on an individual and consolidated basis which are to be communicated to the European Commission, the European Systemic Risk Board, the European Banking Authority and competent and designated authorities of relevant Member States.

RESOLUTION No 150 of 31 October

The systemic risk buffer rate was set at 3 per cent of risk exposures incurred by banks in Bulgaria.

RESOLUTION No 163 of 16 November

The Governing Council suggests that the BNB starts implementing until the end of the first quarter of 2018 *Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses* (EBA/GL/2017/06) issued by the European Banking Authority.

RESOLUTION No 174 of 30 November

The BNB Governing Council took note of the Report on Stress-Test Simulation under Article 80b of the Law on Credit Institutions.

RESOLUTION No 185 of 14 December

The BNB Governing Council took note of the second impact assessment of the enforcement of IFRS 9 Financial Instruments.

RESOLUTION No 186 of 14 December

The countercyclical capital buffer rate applicable to credit risk exposures in the Republic of Bulgaria was set at 0 per cent for the first quarter of 2018.

RESOLUTION No 187 of 14 December

The BNB Governing Council took note of the Report on the State of the Banking System (Third Quarter of 2017).

The BNB Governing Council took note of the publication of Banks in Bulgaria (July–September 2017).

BNB Activities on Resolution of Credit Institutions

RESOLUTION No 10 of 26 January

The BNB Governing Council approved the resolution plans of UniCredit, Société Générale, Raiffeisen, KBC, NBG, Eurobank Ergasias and Piraeus as proposed by the Single Resolution Mechanism as a group level resolution authority.

RESOLUTION No 11 of 26 January

The BNB Governing Council approved the resolution plan of OTP Group as proposed by the Magyar Nemzeti Bank as a group level resolution authority.

RESOLUTION No 40 of 16 March

The Governing Council of the BNB set the annual banking system contribution to the Bank Resolution Fund for 2017 at BGN 111,274,208.

RESOLUTION No 57 of 13 April

A methodology setting individual annual contributions by third country banks and branches to the Bank Resolution Fund was adopted.

RESOLUTION No 58 of 13 April

The BNB set the amount of individual annual contributions of banks and a branch of a third country bank to the Bank Resolution Fund for 2017.

RESOLUTION No 59 of 13 April

The BNB Governing Council approved the resolution plan of Raiffeisen Group along with the changes proposed by the Single Resolution Mechanism.

RESOLUTION No 98 of 13 July

The BNB shall observe and apply in its resolution practice the following guidelines issued and published on European Banking Authority's official website:

- Guidelines on the rate of conversion of debt to equity in bail-in;
- Guidelines on treatment of shareholders in bail-in or write-down or conversion of capital instruments;
- Guidelines concerning the interrelationship between the sequence of write-down and conversion under Directive 2014/59/EU and the Capital Requirements Regulation/Capital Requirements Directive.

RESOLUTION No 106 of 20 July

Draft ordinance on the information and documents which prove fulfilment of the requirements to temporary or special administrators of a bank was adopted on first reading.

RESOLUTION No 115 of 26 July

Ordinance on the information and documents which prove fulfilment of the requirements to temporary or special administrators of a bank was approved.

RESOLUTION No 164 of 16 November

The BNB Governing Council took note of the summarised information on resolution colleges and preparation of group resolution plans for 2017.

Statistics

RESOLUTION No 18 of 9 February

The BNB discontinued, as from 1 July 2018, the activities related to calculation of the SOFIBID and SOFIBOR reference rates.

RESOLUTION No 37 of 16 March

The BNB adopted a Methodology for Calculation of the LEONIA Plus Reference Rate of Concluded Overnight Deposit Transactions in Bulgarian levs on the Interbank Market, effective from 1 July 2017, and discontinued, as from that date, the calculation of the LEONIA reference rate.

The BNB adopted amendments to the Methodology for Setting the Base Interest Rate.

Banks and branches of banks in Bulgaria shall continue reporting to the BNB their daily interbank market transactions with various maturities, currencies and conditions under a procedure determined by the Deputy Governor heading the Banking Department.

RESOLUTION No 123 of 29 August

The BNB Governing Council approved draft legal provisions to bring the Bulgarian legislation into line with Regulation (EU) 2016/1011 on indices used as benchmarks.

The Central Credit Register and the Register of Bank Accounts and Safe Deposit Boxes

RESOLUTION No 9 of 26 January

Ordinance on Amendment of Ordinance No 12 of 29 September 2016 on the Register of Bank Accounts and Safe Deposit Boxes was adopted.

RESOLUTION No 27 of 22 February

Ordinance on Amendment of Ordinance No 22 of 16 July 2009 on the Central Credit Register was adopted.

RESOLUTION No 85 of 8 June

Ordinance on Amendment of Ordinance No 12 of 29 September 2016 on the Register of Bank Accounts and Safe Deposit Boxes was adopted.

The Fiscal Agent and State Depository Function

RESOLUTION No 8 of 26 January

The BNB Governing Council adopted the Tariff of Fees and Commissions Charged on Processing Government Securities Transactions.

RESOLUTION No 44 of 21 March

Ordinance on Amendment of Ordinance No 5 of the MF and the BNB on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities and Ordinance on Amendment of Ordinance No 15 of the MF and BNB on the Control over Transactions in Government Securities were adopted.

Research

RESOLUTION No 22 of 9 February

The BNB Governing Council took note of the assessments of developments in major macroeconomic indicators in the first and second quarters of 2017 along with BNB forecasts of major macroeconomic indicators for 2016–2018 to be published in the Economic Review quarterly (issue 4 of 2016).

RESOLUTION No 23 of 9 February

The BNB awarded no doctor's degree scholarships in 2017.

The BNB awarded two master's degree scholarships to:

- Andrian Yambolov in Rheinische Friedrich-Wilhelms-Universitat Bonn, Economics;
- Dimitar Stanchev in St. Kliment Ohridski University of Sofia, Law.

RESOLUTION No 42 of 16 March

The BNB Governing Council took note of the Report on Implementation of the Research Plan (2015–2016).

RESOLUTION No 43 of 16 March

The BNB Governing Council took note of the Research Plan for 2017–2018.

RESOLUTION No 71 of 10 May

The BNB Governing Council took note of the assessments of developments in major macroeconomic indicators in the second and third quarters of 2017 to be published in the Economic Review quarterly (issue 1 of 2017).

RESOLUTION No 78 of 30 May

The BNB Governing Council approved the 2016 Activity Report of the Commission on Selection of and Work with BNB Scholarship Holders.

Amendments to the Internal Rules for Selection of and Work with BNB Scholarship Holders were adopted.

RESOLUTION No 79 of 30 May

The BNB Governing Council discontinued further issue of the Monthly Bulletin in Bulgarian and English.

The BNB Governing Council discontinued further issue of the Government Securities Market quarterly bulletin in Bulgarian and English.

RESOLUTION No 111 of 20 July

The BNB Governing Council took note of the assessments of developments in major macroeconomic indicators in the third and fourth quarters of 2017 and BNB forecasts of major macroeconomic indicators for 2017–2019 to be published in the Economic Review quarterly (issue 2 of 2017).

RESOLUTION No 147 of 31 October

The BNB Report for January–June 2017 was approved on first reading.

RESOLUTION No 158 of 31 October

The BNB Governing Council took note of the assessments of developments in major macroeconomic indicators in the fourth quarter of 2017 and first quarter of 2018 to be published in the Economic Review quarterly (issue 3 of 2017).

BNB Internal Audit

RESOLUTION No 13 of 26 January

The BNB Governing Council took note of the Audit Report on Adequacy and Efficiency of the Internal Regulatory Framework of Bank Supervision: Overall Review.

RESOLUTION No 66 of 13 April

Amendments to the Annual Plan of the BNB Internal Audit for 2017 were approved.

RESOLUTION No 87 of 8 June

The BNB Governing Council approved the Chief Auditor Report for 2016.

RESOLUTION No 168 of 16 November

The BNB Governing Council adopted the Annual Plan of the BNB Internal Audit for 2018 and the updated strategy on the activity of the BNB Internal Audit unit for the period until 2020.

In 2017 the BNB Governing Council adopted resolutions on internal bank rules (16), representation in joint meetings of companies in which the BNB holds participation (11), public procurements and contracts[**] (26) and organisation of specific bank activities (28).

[**] Detailed information on procurement procedures is available on the BNB website, About BNB, Public Procurement: http://www.bnb.bg/AboutUs/index.htm

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