

BULGARIAN NATIONAL BANK



ECONOMIC REVIEW

2/2019



Това време на много оръжия
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Славяно

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

The Economic Review, issue 2/2019 was presented to the BNB Governing Council at its 25 July 2019 meeting. It employs statistical data published up to 15 July 2019.

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ABBREVIATIONS

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

SUMMARY

The slowdown in global economic activity observed in 2018 persisted in the first half of 2019. Global sentiment indicators in industry signalled a contraction in activity, while those in services recorded further growth deceleration. Risks to the world trade largely stemming from protectionist measures launched in the course of the trade talks between China and the USA began to materialise. As a result, world trade growth rates slowed down significantly at the end of 2018 and in early 2019. In the second quarter of 2019, US and euro area central banks witnessed a deterioration in the economic situation and higher risks to economic growth. Both the European Central Bank (ECB) and the Federal Reserve System pointed to a possible move to an accommodative monetary policy in the second half of 2019, should inflation and inflation expectations continue their downward trend.

International environment is expected to further limit growth of external demand for Bulgarian goods and services over the second half of 2019. The main factors that are expected to affect the external demand for Bulgarian goods and services relate to the negative effects of protectionist measures in world trade and the resulting slowdown in trade growth and global industrial production, in particular in the euro area countries, Bulgaria's major trading partners. Concurrently, the deteriorated economic situation in Turkey coupled with the increased uncertainty over Brexit will still be risk factors for potential adverse effects on the external demand for Bulgarian goods and services.

Between January and April 2019 the overall current and capital account balance remained positive, with a strong surplus increase on the same period of 2018 due to a contraction of the trade balance deficit driven by higher real growth of exports of goods than that of imports along with favourable terms of trade for Bulgaria. In the second half of 2019 the annual positive overall balance on the current and capital account is expected to decrease as a percentage of GDP compared with end-2018, reflecting the higher deficit on the net primary income and, to a lesser extent, the projected increase in the trade balance deficit.

The accelerated annual growth rate of non-government sector deposits over the first five months of 2019 was driven by the increased disposable income of households and corporate profits amid higher uncertainty and lack of an alternative to bank savings. Over the same period, credit to non-financial corporations and households continued growing at comparatively high rates, reflecting the persistently strong domestic demand in the economy and low lending rates. In the second half of 2019, growth in non-government sector deposits is expected to remain strong tending to gradually slow down. In the context of strong domestic demand, credit growth is anticipated to stay comparatively high. Lending rates will remain close to the attained low levels, further supporting the demand for loans by households and corporations. Payment of loans extended by the government under the National Programme for Energy Efficiency of Multi-family Residential Buildings and decreased volumes of new loans under it will continue limiting credit growth to households.

In the first quarter of 2019 quarterly growth of real GDP accelerated on the previous quarter and accounted for 1.2 per cent. Private consumption contributed most to this dynamics, while the other components of domestic demand and net exports contributed less to quarterly growth.

In the first quarter of 2019 the seasonally adjusted number of employed increased in the total economy mainly due to the services sector and construction. The unemployment rate further declined reaching 4.8 per cent, while the economic activity rate of working age population increased. The nominal compensation *per* employee rose by 3.4 per cent on a quarterly basis, with all economic sectors contributing to this growth.

In the first six months of 2019 short-term economic indicators continued to give mostly positive signals about the economic development. In the second half of 2019 real GDP is expected to grow further

quarter on quarter, with domestic demand contributing most to this effect. Employment growth, increasing nominal labour income and still low interest rates are expected to continue favouring growth of private consumption. The projected improvement of investment activity and stronger government consumption will also support domestic demand growth. Given these trends, quarterly GDP growth is anticipated to vary between 0.8 and 1.1 per cents in the second half of 2019. Year-on-year economic growth is expected to gradually slow down.

In June annual inflation remained unchanged from end-2018 at 2.3 per cent, with core HICP components and food contributing most. Goods and services with administratively controlled prices and tobacco products were another group adding to the overall inflation. In the context of a year-on-year decline in euro international oil prices, energy products contributed negatively to the overall inflation in June. In the second half of the year consumer price inflation is expected to accelerate slightly, mainly driven by the anticipated price increase of energy products as a result of the higher annual euro oil price at the end of 2019. Inflation in services is projected to moderate due to exhausted base effects in accommodation services and insurance connected with transport, but to keep its comparatively high contribution to the overall annual inflation. Food price inflation is also expected to continue contributing strongly to inflation, mainly driven by domestic factors.

This issue of the Economic Review includes the BNB forecast of key macroeconomic indicators for the 2019–2021 period. The forecast is based on data published as of 24 June 2019 and employs assumptions on global economic developments and dynamics of major commodity group prices in international markets as of 7 June 2019.

In line with these assumptions growth of external demand for Bulgarian goods and services is expected to moderate in 2019 due to further weakening of global trade growth, increased uncertainty over international trade conflicts and Brexit, the unfavourable economic situation in Turkey and expectations of slower economic growth in Romania and some euro area countries. With the weakening of the negative contribution of Turkey, external demand for Bulgarian goods and services is anticipated to increase in the 2020–2021 period. Petroleum product prices in US dollars are expected to decline between 2019 and 2021 compared to 2018, while prices of non-energy products in US dollars will initially decline in 2019 before rising in 2020 and 2021.

In 2019 Bulgaria's real GDP growth rates are projected to reach 3.7 per cent, posting an increase on 2018. This will reflect the decrease in the negative contribution of net exports, while the positive contribution of domestic demand to real GDP growth will slow down compared to 2018 due to weaker growth of private consumption. Between 2020 and 2021 real GDP growth is expected to gradually slow down compared with 2019, reaching 3.4 per cent in 2021. This will depend on the decrease in the positive contribution of all main components of domestic demand to real GDP growth and weaker export growth compared to 2019. Real GDP growth is expected to be higher in 2019 and lower over the remaining projection horizon compared to projections published in the Economic Review, issue 4 of 2018.

Annual inflation is expected to accelerate slightly at the end of 2019 to 2.6 per cent before decelerating and staying at levels close to 2 per cent until the end of the projection horizon. The expected overall inflation in 2019 remains unchanged compared with the projections published in the Economic Review, issue 4 of 2018, while the inflation forecast for 2020 has been revised downwards and that for 2021 upwards. Revisions take into account mainly changes in the assumptions of the dynamics of international prices of major commodity groups and some internal factors.

Risks to the macroeconomic outlook are assessed as oriented towards lower real GDP growth, mainly stemming from the external environment where there are risks of weaker than projected demand growth for Bulgarian goods and services. An internal factor creating uncertainty to the outlook is the dynamics of public investment co-financed by the EU and the national budget. Risks to the inflation outlook are mainly assessed as increasing, mostly arising from the possibility of higher inflation in energy products and core HICP components.

1. EXTERNAL ENVIRONMENT

The slowdown in global economic activity observed in 2018 persisted in the first half of 2019. Global sentiment indicators in industry signalled a contraction in activity, while those in services recorded further growth deceleration. Risks to the world trade largely stemming from protectionism introduced over the course of the trade talks between China and the USA began to materialise. As a result, world trade growth rates slowed down significantly at the end of 2018 and in early 2019. In the first five months of the year global inflation was lower than the average rates reported in 2018, but it tended to slightly accelerate since the beginning of the year.

In the second quarter of 2019, US and euro area central banks noted the deterioration in the economic situation and increased risks to economic growth. As expected, the ECB Governing Council left unchanged euro area interest rate levels. The forward guidance on reference rates was changed and the ECB Governing Council expected interest rates to remain at their current levels at least until end-June 2020. The ECB announced the parameters of the third series of Targeted Longer-term Refinancing Operations (TLTRO III), starting in September 2019. At its second quarter's meetings, the US Federal Open Market Committee decided to keep its target range for the federal funds rate at 2.25–2.50 per cent. The Committee pointed to a possible move to a monetary accommodative policy in the second half of 2019, should inflation and inflation expectations in the USA continue their downward trend.

The international environment is expected to further limit external demand growth for Bulgarian goods and services over the second half of 2019. The main factors that are expected to affect the external demand for Bulgarian goods and services relate to the negative effects of protectionist measures in world trade and the resulting slowdown in trade growth and global industrial production, in particular in the euro area countries, Bulgaria's major trading partners. Concurrently, the deteriorated economic situation in Turkey coupled with increased uncertainty over Brexit will still be risk factors for potential adverse effects on the external demand for Bulgarian goods and services.

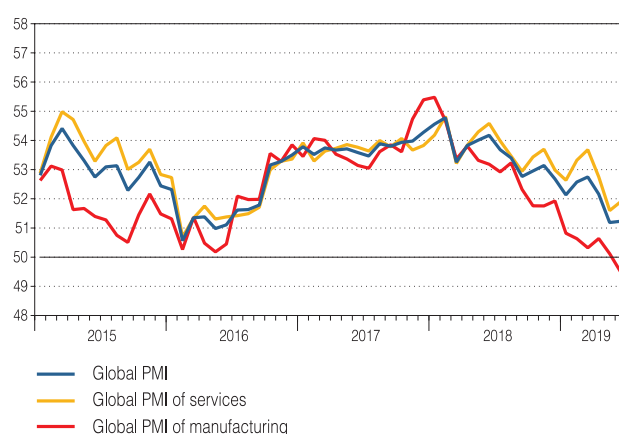
Current Business Situation

The 2018 downward trend in global PMI dynamics was retained in the first half of 2019, signalling continuing slowdown in global economic activity growth. By sector, downward PMI dynamics was driven by a decline in manufacturing PMI whose value in June dropped below the neutral 50-point mark. Expectations in the services sector also weakened, though to a lesser extent. PMI decreases on end-2018 across regions were largely reported in developed economies, including the euro area, and to a lesser degree, in emerging markets. Factors behind this dynamics are largely associated with the retained global uncertainty amid international trade conflicts, slowing economic growth in China and Brexit developments.

In the first four months of 2019 world trade growth¹ decelerated significantly from the same

¹ CPB Netherlands Bureau for Economic Policy Analysis as of 21 June 2019.

Global PMIs



Source: JP Morgan.

period of 2018, and even a decline was reported on an annual basis in February. Weaker annual growth in trade volumes was recorded in both developed and emerging market economies. Euro area had the largest contribution to the slowing annual trade growth in the group of developed countries, similar to Asian countries in emerging markets.

In the first five months of 2019 annual global inflation accelerated moderately to 2.4 per cent in May.² This increase was due to emerging markets which could be partly explained by depreciation of their currencies against the dollar.³ At the same time, declines in US dollar commodity prices in international markets had a limiting effect on consumer price inflation.

In the second half of 2019 the global environment is expected to continue to limit growth in external demand for Bulgarian goods and services. This will be in line with the reported moderation in world trade and industrial output growth, the expected slowdown in euro area economic activity compared to the first quarter of 2019, the worsened economic situation in Turkey, the increased uncertainty over Brexit and foreign trade conflicts.

Euro Area

In the first quarter of 2019 euro area real GDP quarterly growth accelerated to 0.4 per cent, from 0.2 per cent in the previous quarter. Private consumption, investments and net exports were the GDP components with positive contributions to quarterly growth. For a second consecutive quarter, inventories had a large negative contribution to the quarterly change in GDP. The accelerated economic activity in the euro area was partially due to regional factors of a temporary nature. By country, GDP quarterly growth accelerated in Germany and Spain to 0.4 and 0.7 per cent (from 0.0 and 0.6 per cent in the prior quarter), decelerating in France to 0.3 per cent (0.4 per cent a quarter earlier). Following a technical recession, Italy reported slight growth of 0.1 per cent on a quarterly basis.

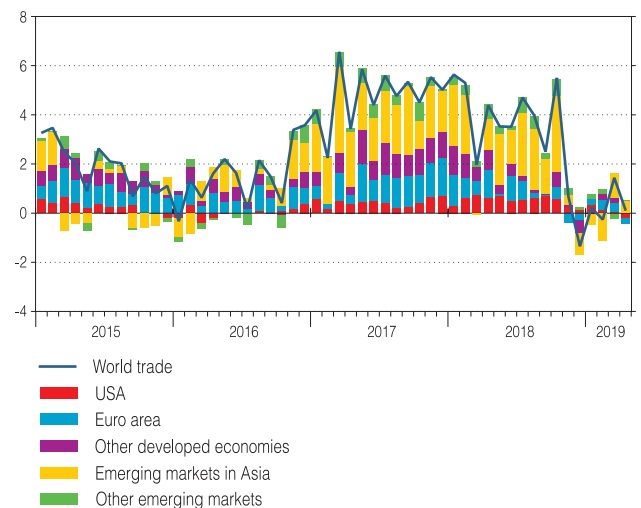
Over the second quarter euro area PMIs stabilised at levels close to those in March, while EC

² World Bank data as of 3 July 2019.

³ Referred to as the US dollar below.

World Trade

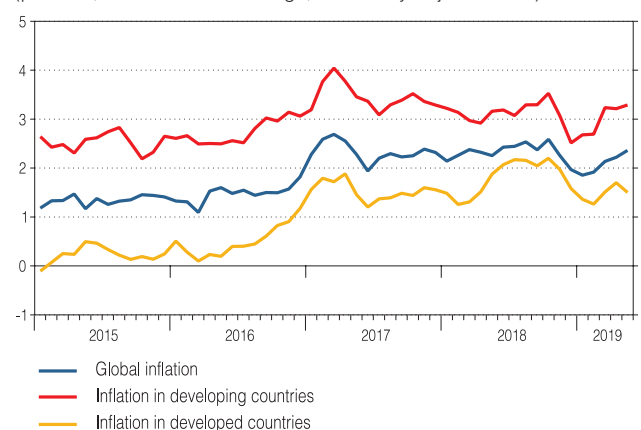
(annual rate of change in volumes, per cent; contribution of individual economies, percentage points)



Source: CPB Netherlands Bureau for Economic Policy Analysis.

Inflation Measured through CPI

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

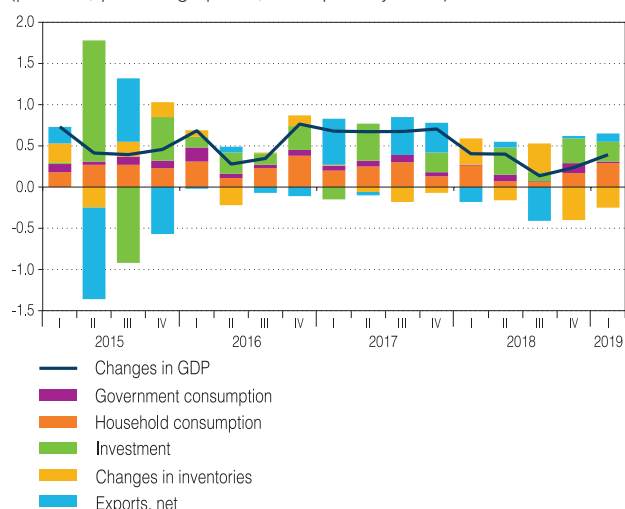


Note: The World Bank measures CPI changes in individual groups of countries as a weighted median of CPI changes in individual countries of the group. Real GDP based on purchasing power parity is used for calculating country weights. Groups include only World Bank Member States classified by the Bank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

Source: the World Bank.

Contribution to Real GDP Growth in the Euro Area by Component

(per cent, percentage points; on a quarterly basis)



Source: Eurostat.

indices declined. Overall, index levels signalled comparatively weak economic activity in the euro area and a continuous decline in the industrial sector.

The gradual improvement in labour market indicators was sustained, with euro area unemployment rate reaching 7.5 per cent in May, the lowest level since July 2008. The indicator of the expected unemployment rate in the next 12 months included in the EC consumer confidence index shows improved consumer expectations about labour market trends.

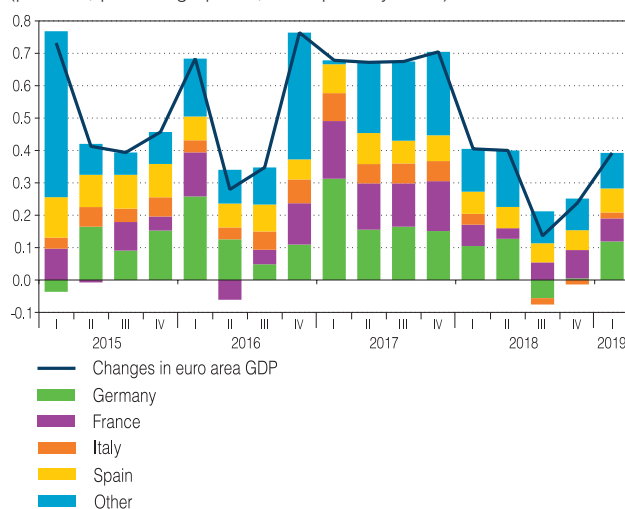
After a temporary rise in April, euro area HICP inflation decreased in May and June to 1.2 per cent on an annual basis, a lower rate than the average value of 1.4 per cent for the first quarter. This dynamics was mainly driven by the slow-down in energy price growth.

In June 2019 the ECB revised downwards its euro area real GDP growth projections for 2020 and 2021 (by 0.2 and 0.1 percentage points), raising its expectations for 2019 by 0.1 percentage points. According to the ECB risks surrounding the outlook for the euro area economic activity remain tilted to the downside due to the persistent uncertainty stemming from geopolitical factors, the likelihood that new protectionist measures will be introduced in international trade and vulnerabilities in some emerging economies.

The ECB revised its inflation forecast for 2019 (from 1.2 to 1.3 per cent) and for 2020 (from 1.5

Contributions of Individual Countries to Real GDP Growth in the Euro Area

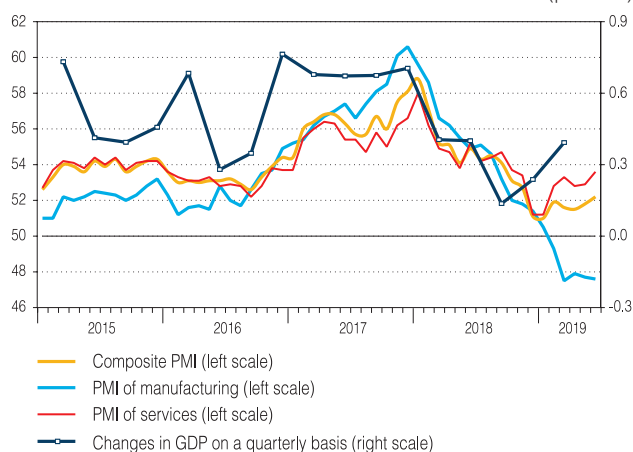
(per cent, percentage points; on a quarterly basis)



Sources: Eurostat and BNB calculations.

Changes in Euro Area GDP and Manufacturing and Services PMIs

(per cent)

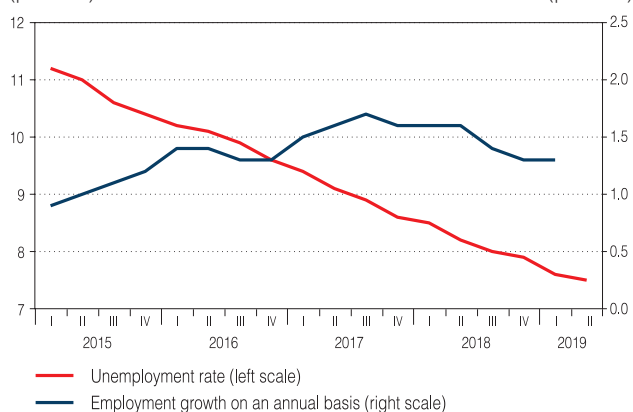


Sources: Eurostat, Markit.

Euro Area Unemployment Rate and Employment Growth

(per cent)

(per cent)



Note: The chart on unemployment in the second quarter of 2019 includes no data for June.

Source: Eurostat.

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

(per cent)

Institution	Date of re-release	2019		2020		2021	
		latest	previous	latest	previous	latest	previous
the ECB	June 2019	1.2	1.1	1.4	1.6	1.4	1.5
the EC	July 2019	1.2	1.2	1.4	1.5	-	-

Sources: the ECB, EC.

to 1.4 per cent), leaving it unchanged for 2021 at 1.6 per cent. Core inflation forecast⁴ reflected expectations of its medium-term increase in line with ECB projections of economic growth acceleration and wage growth in the euro area.

At its 6 June monetary policy meeting, the ECB left reference interest rates unchanged. The Bank changed its forward guidance on monetary policy, with the Governing Council expecting policy rates to remain at their present levels at least through the first half of 2020, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to the aim of below, but close to, 2 per cent over the medium term. New TLTRO III modalities were announced providing for a quarterly schedule from September 2019 to March 2021. The ECB Governing Council decided that the interest rate in each operation will be set at a level that is 10 basis points above the average rate applied in the Eurosystem's main refinancing operations over the life of the respective TLTRO. For banks whose eligible net lending exceeds a benchmark, the rate applied in TLTRO III will be lower and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation plus 10 basis points.

At the ECB Forum on Central Banking in Sintra, Portugal, on 17–19 June 2019, the President of the ECB suggested a possible reactivation of monetary accommodation in the second half of 2019, restating that the Governing Council would discuss adjustment of monetary policy instruments to the severity of the risks to price stability. Euro area inflation expectations declined substantially, creating risks for achieving the ECB's inflation aim. The President outlined also the ECB capabilities to react to these processes by using all monetary policy instruments, including reference

⁴ HICP, excluding energy products, food, alcohol and tobacco products.

Projections of Euro Area Annual Inflation Rate

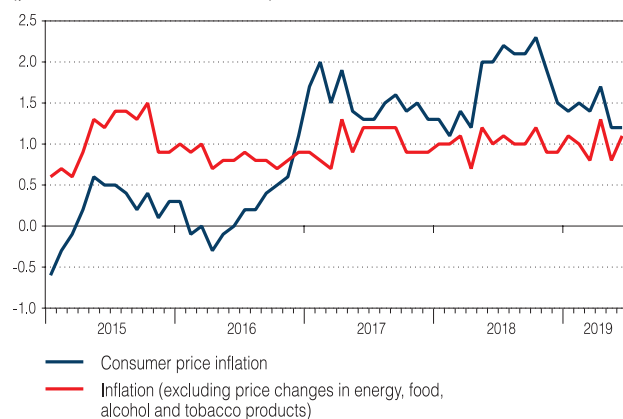
(per cent)

Institution	Date of re-release	2019		2020		2021	
		latest	previous	latest	previous	latest	previous
the ECB	June 2019	1.3	1.2	1.4	1.5	1.6	1.6
the EC	July 2019	1.3	1.4	1.3	1.4	-	-

Sources: the ECB, EC.

Euro Area Inflation Rate

(per cent, on an annual basis)

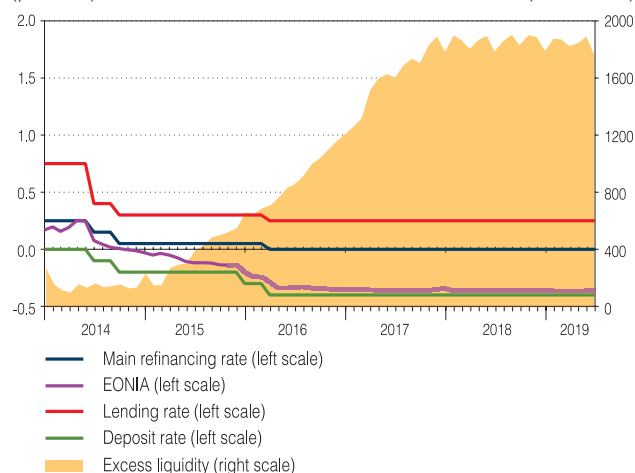


Source: Eurostat.

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

(per cent)

(EUR billion)



Note: Average EONIA values for the month.

Source: the ECB.

rate cuts and the asset purchase programme (APP).

As of 28 June 2019 excess liquidity in the euro area banking system decreased to EUR 1759.9 billion, from EUR 1819.1 billion by end-March, the Eurosystem balance sheet figure reaching EUR 4693 billion.

In the second quarter of 2019 the average EONIA value retained its previous quarter's level (-0.37 per cent). The trade volume of overnight deposits in the euro area interbank market declined, with its average daily value reaching EUR 2.1 billion (EUR 2.9 billion for the first quarter). Interbank unsecured deposit rates (EURIBOR) decreased over the period. On 28 June 2019 the one-month deposit rate was -0.39 per cent (-0.37 per cent by end-March) and six-month and 12-month rates were -0.31 and -0.21 per cent (-0.23 and -0.11 per cent by end-March).

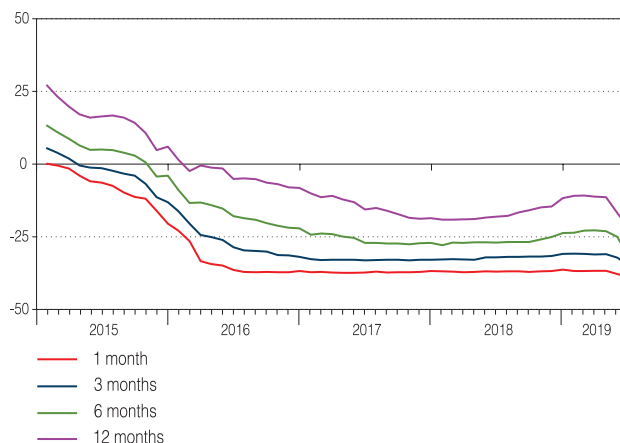
The United States

In the first quarter of 2019 US real GDP growth accelerated to 0.8 per cent on a quarterly basis against 0.5 per cent in the fourth quarter of 2018, largely due to the significant positive contribution of net exports, the recovered growth of government consumption and public investment, as well as to accelerated inventories growth. At the same time, household consumption and business investment rose at slower rates over the first quarter.

In the second quarter of 2019 US leading economic indicators recorded volatile and divergent developments. In June US manufacturing and services ISM-PMIs declined, with data signalling more substantial slowdown in manufacturing activity. Consumer confidence indicators posted an increase in May, followed by a significant fall in June. Average second quarter's values of the University of Michigan consumer confidence index and the analogous Conference Board index were higher than the averages for the first quarter. Monthly data on US household consumption and retail sales in April and May suggest a positive change. Data for the construction sector showed a slight rise in sector's economic activity *vis-à-vis* the preceding quarter. Available data as of early July 2019 indicated certain moderation in US GDP growth over the second quarter.

EURIBOR Dynamics

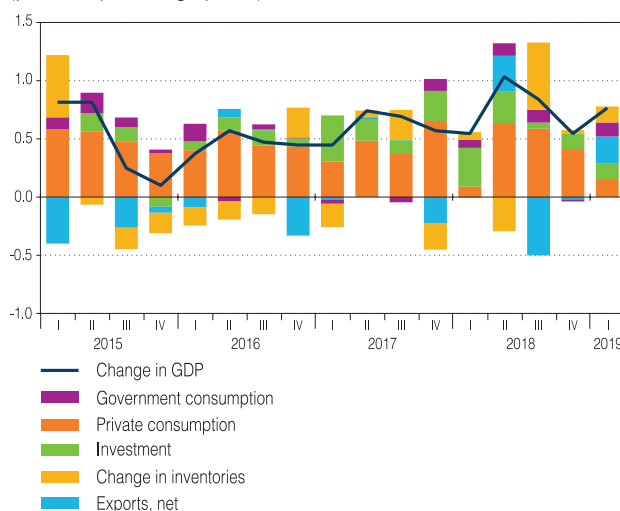
(basis points)



Source: the ECB.

Contribution to US GDP Growth by Component (Quarterly)

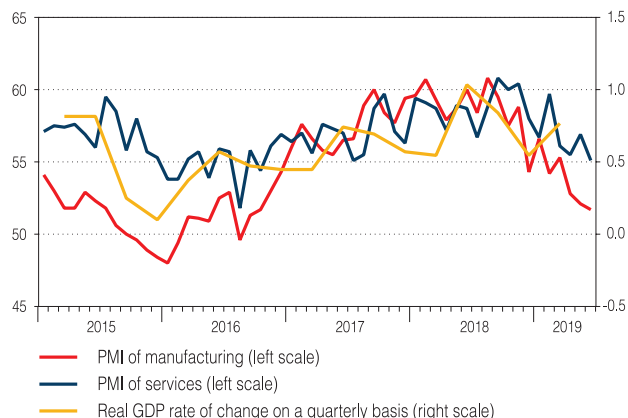
(per cent; percentage points)



Source: Bureau of Economic Analysis.

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

(per cent)



Sources: Institute for Supply Management, Bureau of Economic Analysis.

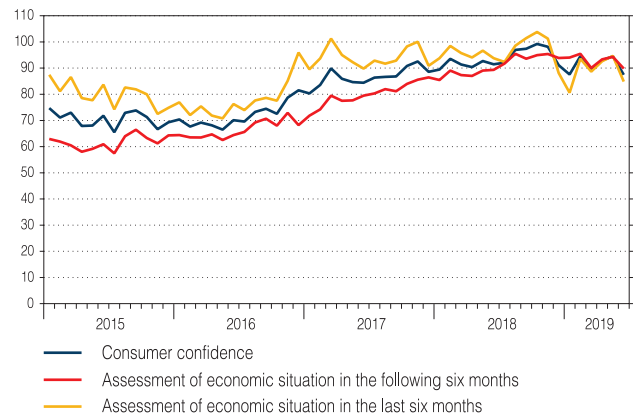
In the second quarter of 2019 inflation remained below the Federal Reserve's target range of 2 per cent. In May the annual inflation rate measured by the price index of personal consumption expenditure (PCE) dropped to 1.5 per cent, from 1.8 per cent in December 2018. On an annual basis, the rise in the core PCE price index (excluding food and fuels) in May was also lower than that at the end of 2018 (1.6 per cent against 2.0 per cent). May data on the consumer price index, the other key measure of the US inflation, showed a slowing annual inflation rate to 1.8 per cent against 1.9 per cent by end-2018. The annual change in the core CPI, excluding food and energy, was also lower, pointing to core inflation of 2.0 per cent in May, from 2.2 per cent at the end of 2018. June data on the expected change in consumer prices at a one to five-year horizon, which are part of University of Michigan's consumer confidence index, suggested a fall in both short-term and longer-term inflation expectations.

Over the second quarter US labour market conditions underwent no significant changes *vis-à-vis* the previous period, although the increase in employment was slower than in 2018. The average quarterly number of new employees in the non-farm sector was 171,000 compared to 174,000 in March and 233,000 in December 2018. In June the US unemployment rate dropped to 3.7 per cent, from 3.9 per cent by end-2018. The economically active population rate was 62.9 per cent against 63.1 per cent in December 2018. Economic survey data on employment suggest that US labour market conditions remain favourable.

At its 18 and 19 June meeting, the Federal Open Market Committee (FOMC) decided to maintain the current federal funds rate range at 2.25–2.50 per cent. The press release highlighted deteriorated prospects and growing risks to US inflation and inflation expectations. The word 'patient' in describing Federal Reserve's approach to policy was dropped, giving a sign of somewhat more accommodative policy. FOMC members revised downwards their expectations of the headline and core inflation measured through the PCE index *vis-à-vis* their March projections. Members' expectations were for substantially lower headline inflation in 2019 and slightly lower core inflation in 2019 and 2020. Unemployment forecasts were adjusted downwards for the whole

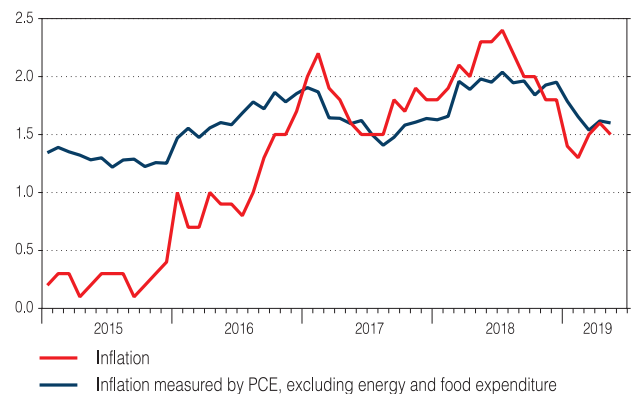
US Consumer Confidence Indices

(2000 = 100)



US Inflation Rate

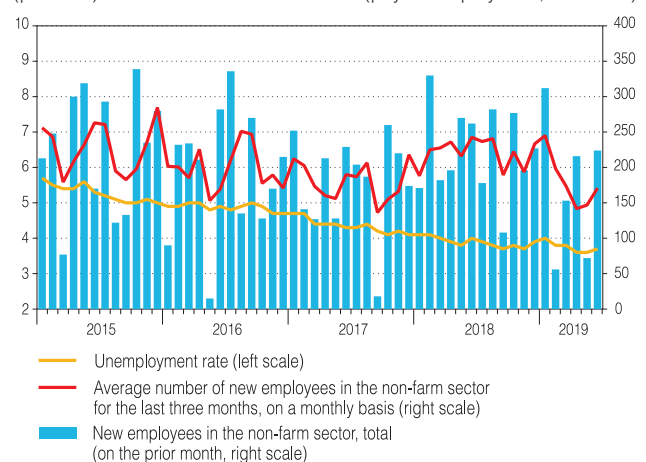
(per cent, on an annual basis)



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

(per cent)

(payroll employment, thousand)



forecast period, including its long-run equilibrium level. FOMC projections about the growth rate of the US economy remained broadly unchanged, with the sole upward revision of 2020 growth. The median projection suggested a decrease in the expected federal funds rate by 50 basis points at the end of 2020 and a rise by 25 basis points at the end of 2021 compared to the March 2019 forecasts. The estimated long-term equilibrium level of the federal funds rate was also lowered to 2.50 per cent, from 2.75 per cent. At the press conference after the meeting, the Chairman of the US Federal Reserve emphasised that adverse risks to the projection of the future economic development had significantly increased.

China

In the second quarter of 2019 China's manufacturing and services PMIs declined, with a more pronounced quarterly drop reported in the sector of services. PMI sub-components for new orders, total, as well as new export orders sub-index decreased from the previous quarter. PMI dynamics signalled continued slowdown in economic activity despite the planned and initiated measures⁵ to stimulate China's economy. Trade conflicts between the USA and China have continued to weigh on economic indicators of the Chinese economy. Despite the decision of end-June to relaunch negotiations between the two countries, major risks to the Chinese economy continue to reflect a possible imposition of US protectionist measures for goods imported by China.

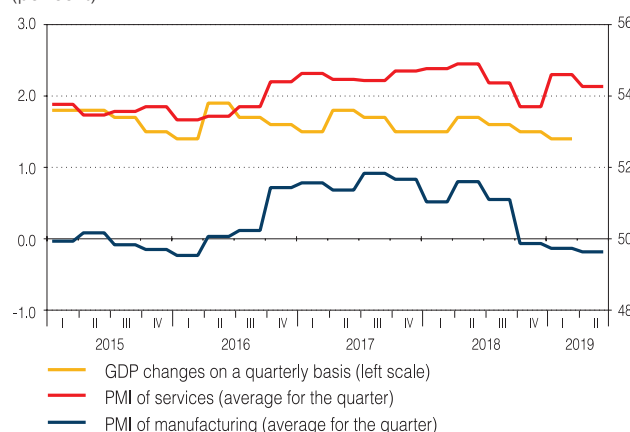
In early June the IMF revised downwards its economic growth projection for China to 6.2 per cent in 2019 due to expected negative effects of long-running trade negotiations with the USA. The IMF considers that the Chinese economy would possibly need additional monetary policy incentives if the trade conflict continues to expand.

Over the second quarter of 2019 China's consumer price index dynamics was mainly driven by accelerating growth in food prices. In April and May the annual inflation rate accelerated to 2.5 and 2.7 per cent, from 1.9 per cent by end-2018. The upward price dynamics was mainly due to

⁵ These measures include a VAT rate cut from 16 to 13 per cent for the manufacturing sector, from 10 to 9 per cent for the transport and construction sectors along with cuts in certain income and corporate taxes.

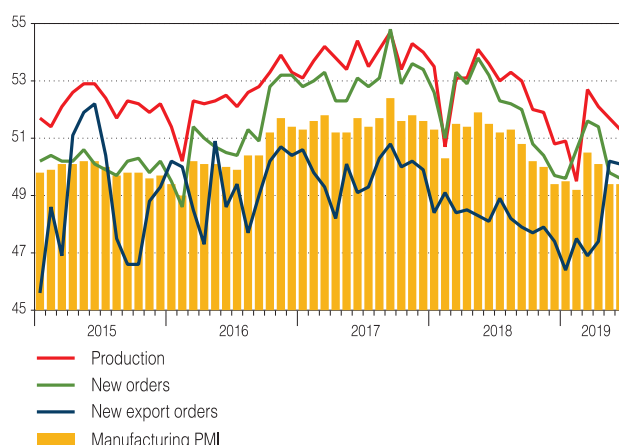
China's Manufacturing and Services PMIs and GDP Growth (Quarterly)

(per cent)



Sources: National Bureau of Statistics of China, China Federation of Logistics and Purchasing.

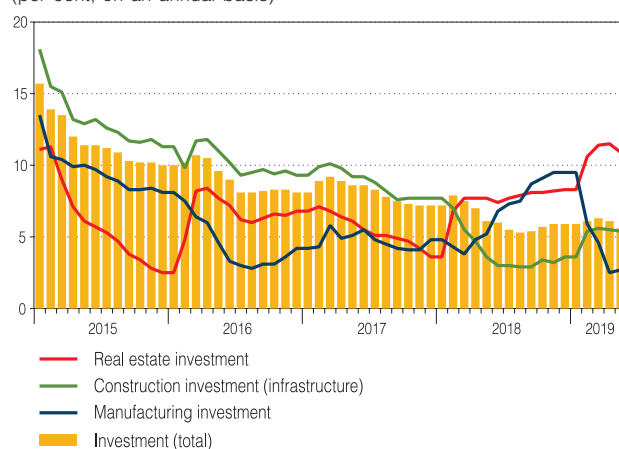
Manufacturing PMI in China and its Major Components



Source: China Federation of Logistics and Purchasing.

Total Fixed Capital Investment in Selected Sectors in China

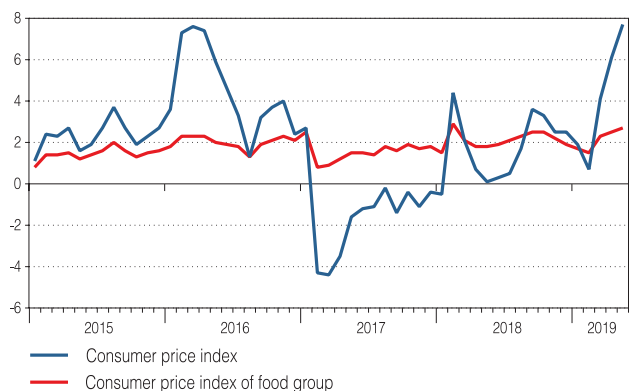
(per cent, on an annual basis)



Source: National Bureau of Statistics of China.

Inflation in China

(per cent, on an annual basis)



Source: National Bureau of Statistics of China.

food whose inflation reached 6.1 per cent in April and 7.7 per cent in May, reflecting the price increase in vegetables and pigmeat. The price increase of pigmeat resulted from its reduced supply due to the spread of African swine fever.⁶

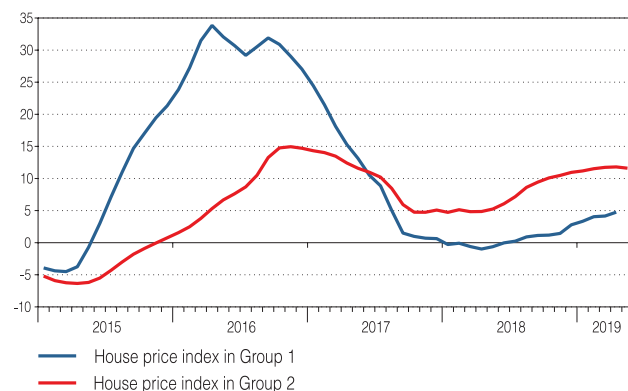
In April and May annual growth of house prices in China continued to accelerate mainly due to more expensive houses in towns and, to a lesser extent, in large cities. In some towns with an increasing volume of unsold houses, administrative restrictions to homebuyers were eased to stimulate consumer confidence and demand.

Over the second quarter the People's Bank of China left its monetary policy unchanged, though taking an especially active position in managing interbank market liquidity through a series of auctions. At the end of May the central bank announced that Baoshang Bank (based in the Inner Mongolia autonomous region, with assets of CNY 576 billion in mid-2017) would be put under government control for a year. This measure was taken as result of the significant deterioration of the bank credit portfolio. The People's Bank of China will ensure a 100 per cent guarantee on deposits, excluding interbank exposures, which created interbank market access problems for other regional banks reliant on funding in this market.

⁶ African swine fever in China was registered in August 2018 and led to destruction of more than 1.2 million animals.

House Prices in China

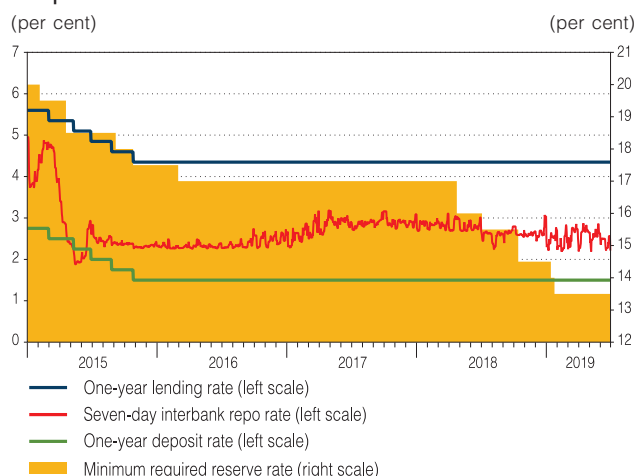
(per cent, on an annual basis)



Note: Group1 includes the four largest cities: Beijing, Shenzhen, Guangzhou, and Shanghai. Group 2 includes the capitals of the rest provinces.

Source: National Bureau of Statistics of China.

People's Bank of China Reference Rates and Minimum Required Reserve Rate



Source: People's Bank of China.

International Commodity Prices

Crude Oil

In the first half year Brent crude oil prices in dollars and euro declined *vis-à-vis* the first half of 2018, reaching in June USD 63.3 (EUR 56.1) *per barrel*. This decrease was driven by the expectations of lower oil demand, reflecting projected slowdown in global economic growth in 2019 amid negative effects of a growing trade dispute between the US and China. Concurrently, the decrease in crude oil prices was limited by supply side factors, such as extension of the oil output cuts agreement between OPEC and other large oil-producing countries,⁷ and recent United States sanctions on Iranian oil exports.⁸

Oil price decreases observed over the first half year *vis-à-vis* January–June 2018 were in line with International Energy Agency data suggesting that oil supply in the first quarter of 2019 continued to exceed demand.

In June, given the expected lower global economic growth and weaker industrial production growth, market expectations about crude oil prices (approximately USD 60.0 *per barrel*) in the second half year were lower than prevailing March expectations.

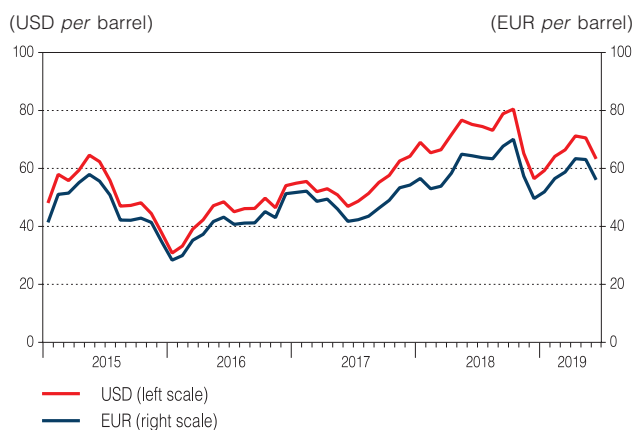
Commodity and Food Prices

Between January and June 2019 international metal prices in dollars declined on an annual basis. The fall was mainly due to weakening demand, given the lower growth in global trade and moderating growth of the Chinese economy consuming about the half of the world metal production. Another factor behind the downward metal price dynamics was the recovery in production in key sector producers following temporary disruptions (largely aluminium and nickel). Reflecting the US dollar appreciation against the euro, metal prices in euro rose slightly year on year over the first half of 2018. The dollar

⁷ On 6 December 2018 OPEC and Russia agreed to curb oil output by 1.2 million barrels *per day* for a six-month period, extending on 2 July the agreement by nine months until the end of March 2020.

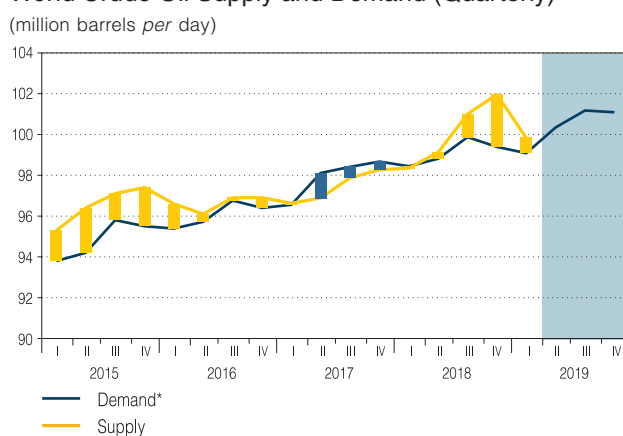
⁸ In early May 2018 the United States announced it would impose sanctions against Iran over its nuclear programme. Following their introduction on 4 November 2018, eight top importers of Iran's oil (China, India, South Korea, Japan, Italy, Greece, Taiwan and Turkey) were granted a temporary waiver on US sanctions for 180 days.

Brent Crude Oil Price



Source: the World Bank.

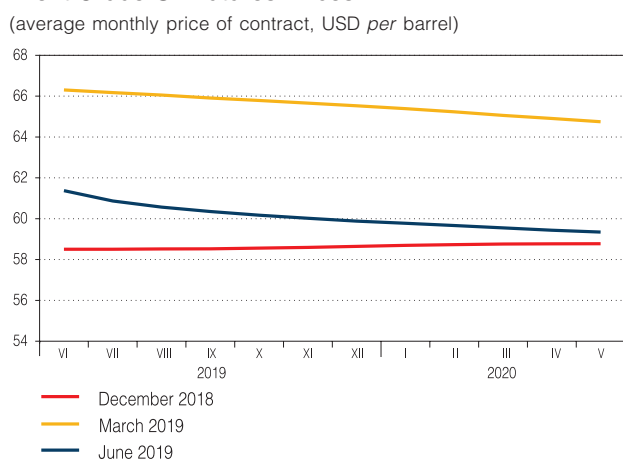
World Crude Oil Supply and Demand (Quarterly)



* IEA latest available data of June 2019 on crude oil demand.

Source: the IEA.

Brent Crude Oil Futures Prices



Source: JP Morgan.

and euro price of copper which is essential for Bulgarian goods exports declined in international markets on an annual basis despite the temporary output disruptions in Chile and Peru. Copper price decreases were primarily driven by concerns about lower demand from China.

In the second half of 2019 metal prices are expected to recover their growth on an annual basis in both dollars and euro.

Between January and June 2019 the total food price index in US dollars decreased from the first half of 2018. Slowing global growth, high US harvests, depreciated currencies of some emerging market economies against the dollar and lower food demand were the main factors behind this downward dynamics. Given the dollar appreciation against the euro, euro food prices increased on an annual basis. Divergent developments were recorded across the sub-components of the food price index. On average, the price of wheat, which is essential for Bulgarian goods exports, increased on an annual basis for the first half of the year in both US dollars and euro for the first half year. However, it fell in the second quarter, reflecting preliminary data on expected record high yields for the 2019/2020 season.

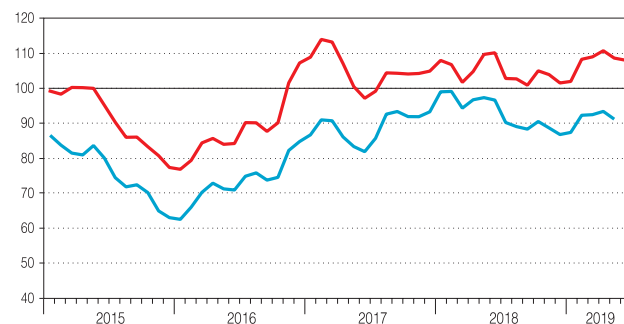
Food prices are projected to start growing on an annual basis over the forecast horizon in both dollars and euro.

Given international commodity price developments, the terms of trade in Bulgaria were favourable in the first quarter of 2019. They are expected to be close to neutral over the projection period.

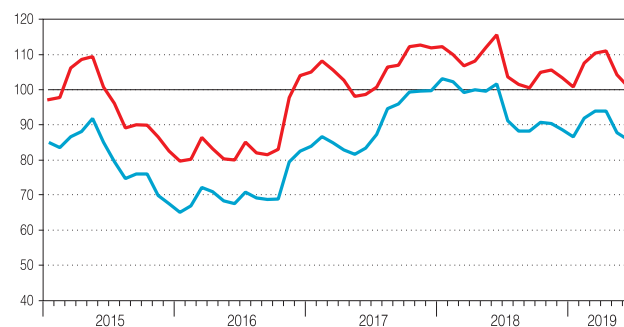
Price Indices of Major Raw Materials and Commodity Groups

(2014 = 100)

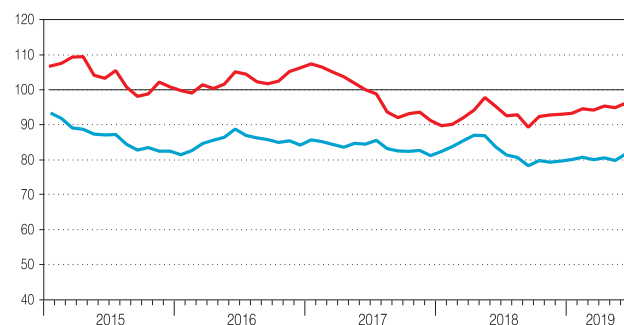
Metals



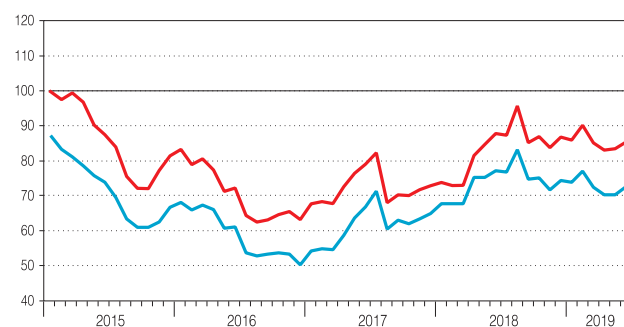
Copper



Food



Wheat



— EUR — USD

Sources: the ECB, BNB calculations.

2. FINANCIAL FLOWS, MONEY AND CREDIT

Between January and April 2019 the overall current and capital account balance remained positive, with a strong surplus increase on the same period of 2018 due to a contraction in the trade balance deficit driven by higher real growth of exports of goods than that of imports along with favourable terms of trade for Bulgaria. In the second half of 2019 the annual positive overall balance on the current and capital account is expected to decrease as a percentage of GDP compared with end-2018, reflecting the higher deficit on the net primary income and, to a lesser extent, the projected increase in the trade balance deficit.

The accelerated annual growth rate of non-government sector deposits over the first five months of 2019 was driven by the increased disposable income of households and corporate profits amid uncertainty and lack of a safe alternative to bank savings. Over the same period, credit to non-financial corporations and households continued growing at comparatively high rates, reflecting the strong domestic demand in the economy and low lending rates.

In the second half of 2019, growth in non-government sector deposits is expected to remain strong tending to gradually slow down. These developments will be driven by weaker than expected rise in compensation per employee in the third and fourth quarters of the year, which will result in a slowdown of household disposable income growth. In the context of sustained strong domestic demand, credit growth is anticipated to stay comparatively high. Lending rates will remain close to the attained low levels, further supporting the demand for loans by households and corporations. Government payment of loans extended under the National Programme for Energy Efficiency of Multi-family Residential Buildings and the lower volume of new loans under this programme will continue hamper household lending growth.

External Financial Flows

Between January and April 2019 the current account balance remained positive, with a strong surplus increase reported against the corresponding period of the previous year.⁹ This dynamics reflected mainly the lower trade deficit from the same period of 2018 resulting from higher annual growth of real exports of goods compared to that of imports, along with favourable terms of trade in Bulgaria. Higher positive services trade balance coupled with lower deficit on the net primary income item and the slight rise in the net secondary income surplus helped boost the current account surplus. Services trade saw an increase in the exports of services on an annual basis with information¹⁰ and technical services¹¹ recording the highest growth. Concurrently, service imports declined mainly due to lower transport expenditure

⁹ The analysis of balance of payments flows employs information from its analytical reporting. Preliminary data.

¹⁰ It should read telecommunications, computer and information services subgroup.

¹¹ It should read technical, trade-related, and other business services subgroup.

Flows on Major Balance of Payments Accounts

(EUR million)

	2017	2018	On an annual basis as of April 2019
Current account	1 578.2	2 547.5	3 663.2
Trade balance	-765.8	-2 264.1	-1 691.1
Services, net	2 858.4	3 407.4	3 577.6
Primary income, net	-2 368.5	-547.2	-196.4
Secondary income, net	1 854.2	1 951.4	1 973.1
Capital account	530.3	597.5	887.9
Financial account	1 252.0	627.4	-292.9
Change in reserves	-98.9	1 361.6	1 899.1

(per cent of GDP)

	2017	2018	On an annual basis as of April 2019
Current account	3.1	4.6	6.5
Trade balance	-1.5	-4.1	-3.0
Services, net	5.5	6.2	6.3
Primary income, net	-4.6	-1.0	-0.3
Secondary income, net	3.6	3.5	3.5
Capital account	1.0	1.1	1.6
Financial account	2.4	1.1	-0.5
Change in reserves	-0.2	2.5	3.4

Source: the BNB.

of Bulgarian residents for travels abroad.¹² The drop in the net primary income deficit from the first four months of 2018 was largely driven by the lower outflows under the reinvested profit item.¹³ The net secondary income surplus slightly increased between January and April 2019 on the same period of last year as a result of higher current transfers under EU programmes, but it was almost entirely offset by the increased expenditure on Bulgaria's contribution to the EU budget.

Greater absorption of funds under EU investment projects and, to a lesser extent, higher revenue from exhaust emission allowances in the first four months of 2019 compared to the January–April 2018 period were the major factors behind the capital account surplus increase over that period.

Reflecting the above developments in current and capital account flows, in April 2019 the total surplus accumulated for the last 12 months rose from December 2018, with trade deficit decline contributing most substantially.

In the second half of 2019 the surplus on the current and capital account of the balance of payments is expected to decrease gradually¹⁴ as a percentage of GDP on an annual basis compared with end-2018, reflecting the larger deficit on net primary income and, to a lesser extent, the projected increase in the trade balance deficit. The higher deficit on net primary income is expected to reflect the accelerated gross operating surplus in the overall economy in 2018 and in early 2019. The trade balance deficit increase will be driven by the expected stronger growth in real imports of goods than that in exports under terms of trade almost neutral. Higher imports of goods will be supported mostly by the anticipated increase in investments and private consumption in Bulgaria.¹⁵ Concurrently, growth of exports of goods is projected to be limited by weaker external demand growth and the gradual exhaustion of base effects associated with the decline in exports of mineral products in early 2018. The capital account surplus as a

¹² For a more detailed analysis of foreign trade flows and services trade, see Chapter 3, Exports and Imports of Goods and Services Section.

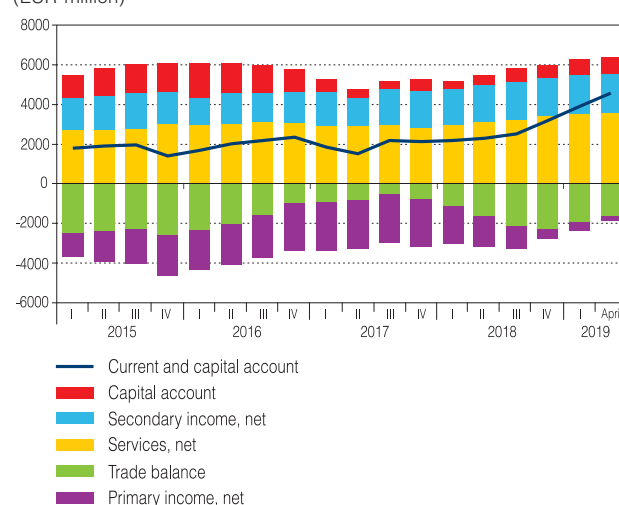
¹³ Preliminary data subject to revision; revisions usually show an increase in outflows to non-residents.

¹⁴ It should read the current and capital account balance for the last four quarters.

¹⁵ For a more detailed analysis of foreign trade flows, see Chapter 3, Exports and Imports of Goods and Services Section.

Current and Capital Account Dynamics and Contributions of Individual Components (on an Annual Basis)

(EUR million)

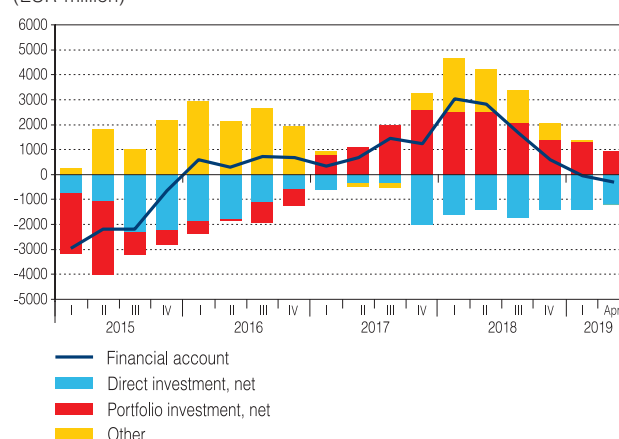


Notes: For each quarter, the chart shows item balances accumulated in the last four quarters. April 2019 data on the chart are accumulated for the last 12 months.

Source: the BNB.

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

(EUR million)



Notes: The Other item includes Other Investments, Net, and Financial Derivatives (Other than Reserves) and Employee Stock Options, Net. For each quarter, the chart shows item balances accumulated in the last four quarters. April 2019 data on the chart are accumulated for the last 12 months.

Source: the BNB.

share of GDP is anticipated to grow further with the implementation progress of projects under the 2014–2020 EU programming period.

In the January–April 2019 period the financial account balance was positive with Bulgarian residents' foreign assets again growing stronger than foreign liabilities. The foreign assets developments were mainly driven by banks' operations increasing their foreign assets primarily in the form of other investment.¹⁶ Other sectors¹⁷ foreign assets also recorded strong growth mainly in the form of direct and portfolio investment. Between January and April 2019 the rise in foreign liabilities on the financial account was largely due to direct and portfolio investment attracted from other sectors. As of April the financial account surplus accumulated for the last 12 months was negative (against a surplus in December 2018) mainly as a result of the significant decline in portfolio investment assets and the rise in other investment liabilities¹⁸.

Between January and April 2019 direct foreign investment liabilities decreased.¹⁹ In April 2019 funds on direct investment liabilities accumulated for the last 12 months in Bulgaria amounted to EUR 2.1 billion, posting a decrease from December 2018.

Reflecting balance of payments net current, capital and financial account flows, Bulgaria's gross international reserves accumulated in the last 12 months²⁰ increased by EUR 2173 million in April 2019. The international reserve coverage of the average nominal imports of goods and non-factor services over the last 12 months came to 8.5 months in April 2019, staying close to the end-2018 level.

In April 2019 Bulgaria's gross external debt rose by EUR 622.1 million from the end of 2018 to EUR 33,965 million (60.1 per cent of GDP). Foreign debt decreased only in the general government sector mainly as a result of residents' purchases of Bulgarian government securities issued in international markets by non-residents.

¹⁶ For a more detailed analysis of bank operations, see Chapter 2, Monetary and Credit Aggregates Section.

¹⁷ It should read sectors other than general government, banks and the central bank.

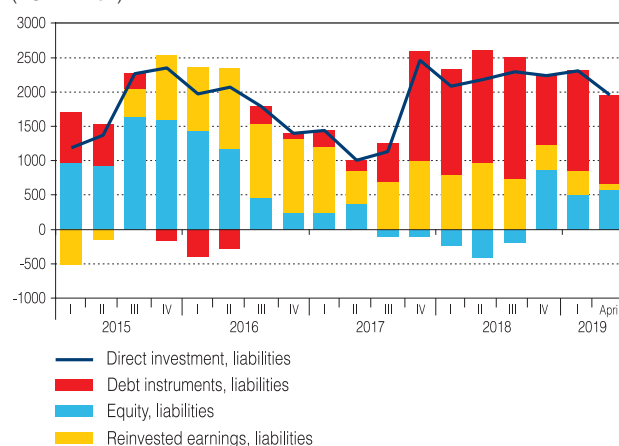
¹⁸ It should read investment other than direct and portfolio investment.

¹⁹ Preliminary data subject to revisions which usually show an increase in foreign direct investment liabilities.

²⁰ Valuation adjustments and price revaluation excluded.

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

(EUR million)



Notes: For each quarter, the chart shows item balances accumulated in the last four quarters. April 2019 data on the chart are accumulated for the last 12 months.

Source: the BNB.

Gross External Debt as of April 2019

(EUR million)

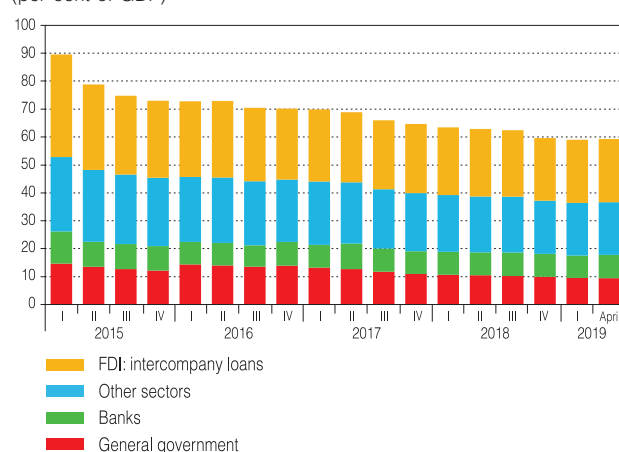
	Amount	Change	
		Since December 2018	For the last 12 months
General government	5 410.3	-140.2	-249.1
Central bank	0.0	0.0	0.0
Banks	4 768.1	165.2	350.8
Other sectors	10 827.4	197.2	89.1
FDI – intercompany loans	12 959.0	399.8	144.6
Total	33 964.8	622.1	335.3

Note: Further details on individual institutional sectors are available on the BNB website, Statistics, External sector/Gross External Debt.

Source: the BNB.

Gross External Debt as a Share of GDP

(per cent of GDP)



Notes: Further details on individual institutional sectors are available on the BNB website, Statistics, External sector/Gross External Debt. April 2019 data calculated using GDP accumulated data for the last four quarters as of March 2019.

Source: the BNB.

The share of long-term debt in Bulgaria's total gross external debt was 74.8 per cent in April, remaining broadly unchanged from the end of the previous year.

The new external debt held by Bulgarian residents in the January–April 2019 period increased compared with the first four months of 2018 due to intercompany lending and banks' higher new external debt. The first four months of the year saw a decline in foreign debt interest payments compared with the corresponding period of 2018, which signalled that the terms for servicing external obligations of Bulgarian residents remained favourable.

Monetary and Credit Aggregates

In the first five months of 2019 the inflow of funds attracted from residents in the banking system continued to increase contributing to accelerated M3 annual growth, with broad money rising by 9.1 per cent in May against 8.8 per cent at the end of the prior year.

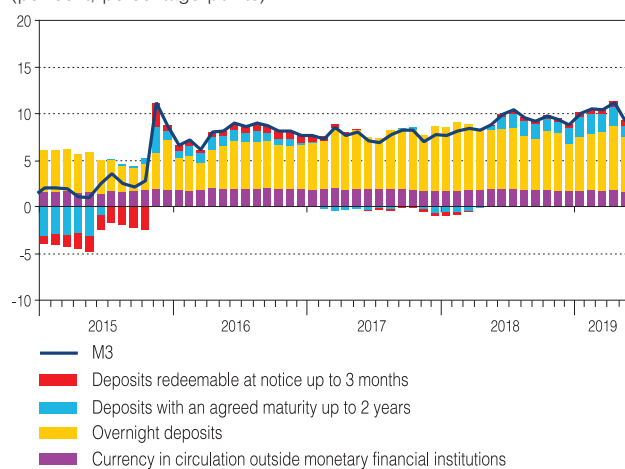
Favourable labour market conditions in the beginning of the year boosted significantly households' labour income growth in the first quarter of 2019. At the same time, corporate profits measured by gross operating surplus increased further. Higher economic agents' funds amid uncertainty arising from external environment changes and the lack of sufficiently safe alternatives to bank savings were the main factors driving the year-on-year M3 growth. Probably due to still low interest rates both households and non-financial corporations chose a more flexible form of saving. As a result overnight deposits remained the main contributor to broad money growth. Quasi-money continued to contribute to M3 growth, though to a lesser extent. The contribution of money outside MFI in the first five months of 2019 remained close to previous year's one thus maintaining its positive effect on overall M3 growth.

Non-government sector's deposits²¹ continued to form a major part of the total amount of funds attracted from banks, their share reaching

²¹ Non-government sector's deposits include deposits of households, non-financial corporations and financial corporations. Deposits of households and non-financial corporations comprise the largest share of all non-government sector's deposits (96.1 per cent on average for the last 12 months in May 2019) and therefore the analysis is focused on these two sectors.

Annual Rate of Change in M3 and Contribution by Component

(per cent, percentage points)

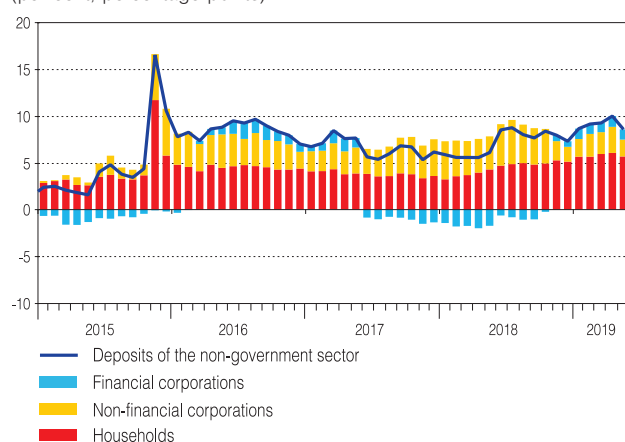


Notes: The marketable instruments component is not shown on the chart due to its insignificant contribution to broad money growth. The annual growth rate of M3 in November 2015 reflects the exhausted base effect of KTB removal as a reporting unit from the monetary statistics in November 2014.

Source: the BNB.

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

(per cent, percentage points)



Note: The annual growth rate of non-government sector deposits in November 2015 reflects the exhausted base effect of KTB removal as a reporting unit from the monetary statistics in November 2014.

Source: the BNB.

87.1 per cent on average for the first five months of the year. Over the same period their annual growth accelerated from the end of the prior year accounting for 8.6 per cent in May (7.3 per cent in December 2018). Household deposits contributed most to this dynamics, their annual growth rate reaching 8.5 per cent (7.7 per cent in December 2018). In the first five months of the year corporations and households continued to save mostly in national currency. The share of deposits in levs averaged 62.5 per cent of total non-government sector deposits.

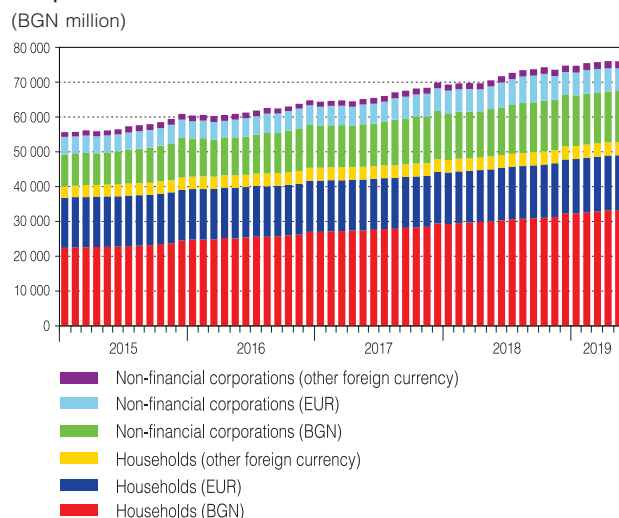
The effective implicit rate of minimum required reserves²² remained at levels similar to the previous year ones, reflecting the retained high inflow of attracted funds from residents in the banking system in January–May 2019. In May it was 9.37 per cent (9.40 per cent in December 2018) with bank deposits with the BNB comprising 8.32 percentage points in the fulfilment of minimum required reserves, and the remaining 1.05 percentage points forming recognised cash balances.

In the first half of 2019 annual growth of reserve money tended to slow down, accounting for 4.3 per cent in June (10.1 per cent at the end of 2018). This dynamics reflected mainly the contribution of lower bank reserves due to a reduction of banks' excess reserves and, to a lesser degree, of their funds in the TARGET2-BNB. In June 2019 excess funds on banks' minimum reserve accounts over the required minimum of reserve assets under Ordinance No 21 was 26.8 per cent on an average daily basis, from 33.1 per cent in December 2018. Concurrently, minimum required reserves continued to grow due to a rise in the deposit base.

In the first five months of the year the annual growth rate of banknotes and coins in circulation remained similar to that observed at the end of the prior year, reaching 10.5 per cent in May (10.3 per cent at the end of 2018). Accelerated growth of household disposable income and increasing corporate profit, including the strong demand for goods and services in the economy

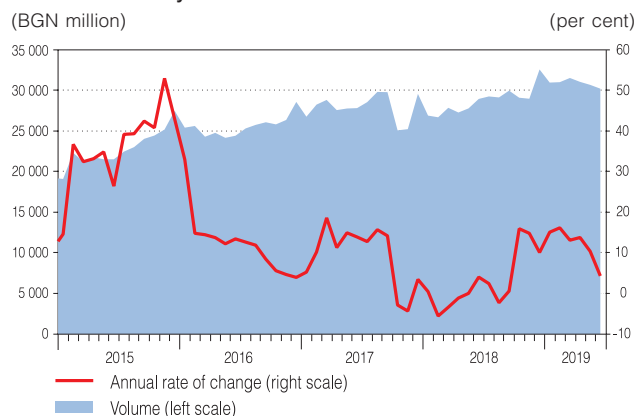
²² According to Article 3 of BNB Ordinance No 21 on the Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks, the rate of minimum required reserves on funds attracted from residents is 10 per cent of the reserve base, from non-residents 5 per cent and from the state and local government budgets 0 per cent.

Currency Structure of Deposits of Non-financial Corporations and Households



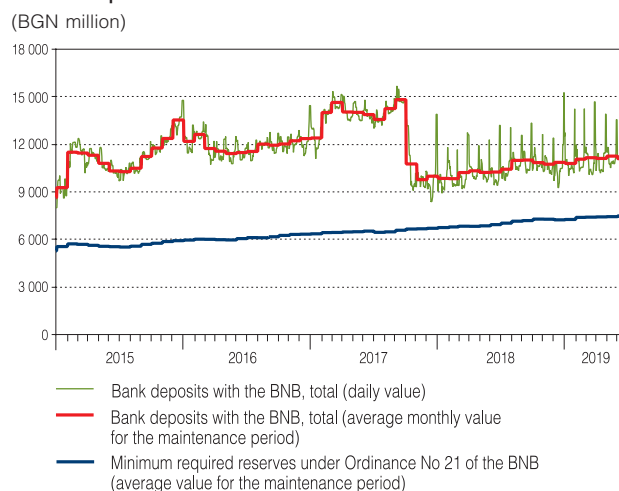
Source: the BNB.

Reserve Money



Source: the BNB.

Bank Deposits with the BNB



Source: the BNB.

had a favourable effect on the currency in circulation dynamics.

Reserve currency (euro) transactions with the BNB is banks' main lev liquidity management instrument under currency board arrangements. In May 2019 net BNB purchases of euro from banks amounted to EUR 2172.4 million on an annual basis.

Bank assets grew 8.5 per cent on an annual basis in May 2019. The substantial contribution of higher claims on the non-government sector and the significant support of increased foreign assets and bank deposits with the BNB underpinned growth of banks' assets. Claims on the general government sector recorded a decline on the corresponding period of the previous year.

Credit to households and non-financial corporations²³ continued to grow at comparatively high rates in the first five months of 2019, accounting for 6.1 per cent on an annual basis in May (7.7 per cent by end-2018). This dynamics reflected the high demand by corporations and households and still low interest rates.

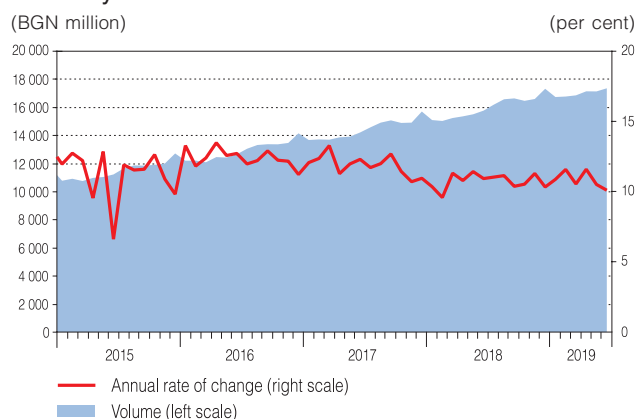
Loans to non-financial corporations posted a year-on-year growth of 4.8 per cent in May 2019 (5.4 per cent at the end of 2018). In the last three months of this period the loan growth rate moderated gradually, entirely due to the lower increase of overdraft, while the contribution of loans excluding overdrafts, stayed at levels close to those recorded in the beginning of the year. Concurrently, in the first five months of 2019 newly extended loans²⁴ to non-financial corporations tended to increase gradually.²⁵ In terms of the currency structure, a slight increase was recorded in the share of newly extended loans to corporations in euro at the expense of those in levs and US dollars. In May the share of lev-denominated

²³ Loans represent the bulk of bank claims on the non-government sector with a share of 97.5 per cent on average for the last 12 months as of May 2019, and the analysis was therefore focused on them. In addition to loans, claims include also repurchase agreements, securities other than shares, and shares and other equity instruments. Non-government sector's deposits, in turn, include loans to households, non-financial corporations and financial corporations. The share of loans to households and non-financial corporations in total loans to the non-government sector accounted for 95.2 per cent on average in the last 12 months as of May 2019 and therefore the changes in deposits of these two sectors are addressed.

²⁴ The terms "new" and "newly extended" hereinafter referred to as the statistical category "new business".

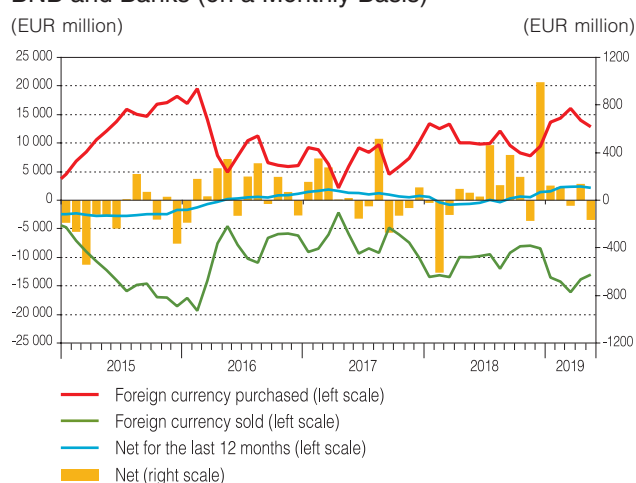
²⁵ Based on 12-month moving average.

Currency in Circulation



Source: the BNB.

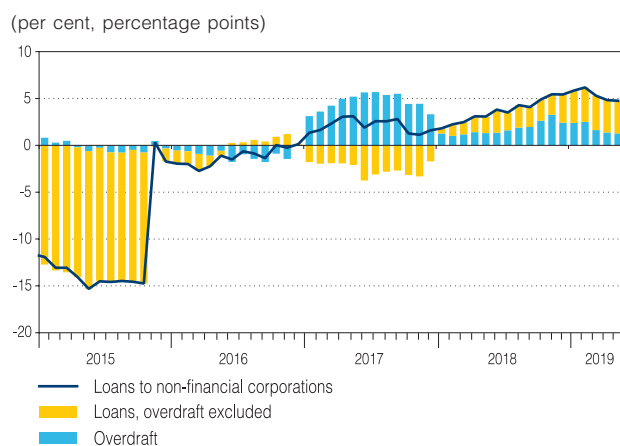
Foreign Currency Purchases and Sales between the BNB and Banks (on a Monthly Basis)



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

Source: the BNB.

Annual Growth of the Credit to Non-financial Corporations and Contributions of Individual Types of Loans



Note: The annual growth rate of loans to non-financial corporations in November 2015 reflects the exhausted base effect of KTB removal as a reporting unit from the monetary statistics in November 2014.

Source: the BNB.

loans (for the last 12 months on average) was 48.9 per cent of total new corporate loans, that of euro loans 50.4 per cent and dollar-denominated loans 0.7 per cent.

In the first five months of 2019 the growth rate of loans to households remained high, accounting for 8.0 per cent on an annual basis in May (11.2 per cent in December 2018). Since April consumer lending growth has moderated significantly compared to prior year's end, reflecting the exhausted base effect of a new reporting unit included in the scope of monetary statistics in April 2018. Annual growth of housing loans tended to accelerate slightly. Concurrently, other credit continued to contribute negatively to growth of loans to households largely as a result of government repayment of loans extended under the National Programme for Energy Efficiency of Multi-family Residential Buildings (the National Energy Efficiency Programme), which exceeded the volume of new loans. Over the first five months of 2019 newly extended consumer loans continued to follow a slight upward trend, while new housing loans remained close to end-2018's levels.

Summarised weighted results of the bank lending survey²⁶ in the first quarter of 2019 suggest that bank standards²⁷ in approving credit applications of corporations and households remain broadly unchanged. At the same time, banks reported further easing of credit conditions²⁸ for corporations and households in terms of interest rates and interest rate spread and, to a lesser extent, in terms of fees and commissions. In respect of housing loans further tightening of collateral requirements is observed. Major factors behind the eased banks' lending policy (lending standards and conditions) over the quarter included high liquidity and enhanced competition in the banking sector, an increasing volume and low cost of attracted resources and lowered

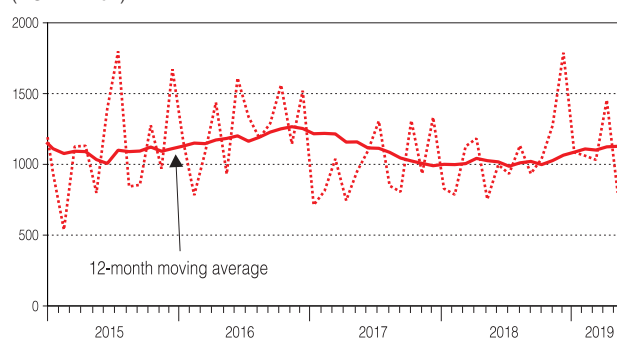
²⁶ Summarised results of the bank lending survey are presented through weighting bank responses by their market share in the relevant credit segment.

²⁷ Credit standards are understood as internal bank guidelines or criteria for loan approvals established prior to negotiating the terms of extended loans. Credit standards determine the type of the loan and collateral considered admissible by banks, taking into account specific priorities by sector, etc. Credit standards specify also all relevant conditions to be met by a borrower.

²⁸ Credit conditions typically involve the reference interest rate surcharge, the loan amount, conditions for its utilisation and other conditions, fees and commissions, collateral or guarantees to be provided by a borrower.

New Loans to Non-financial Corporations (Monthly Volumes)

(BGN million)

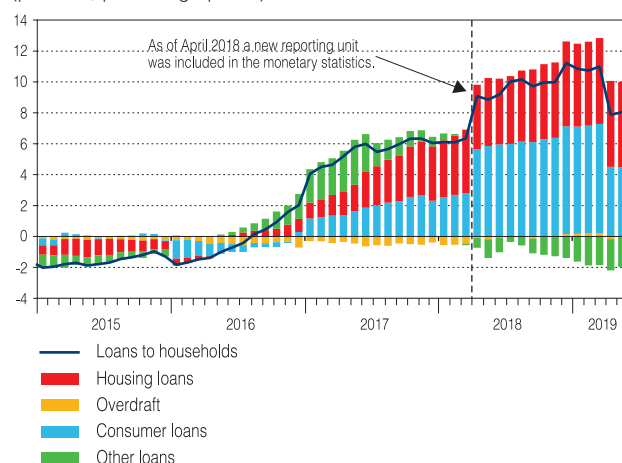


Note: For data characterised by significant volatility, additionally moving averages computed for suitably selected periods are provided, in order to smooth the fluctuations in corresponding time series and present the trends in their development.

Source: the BNB.

Annual Growth of Household Credit and Contributions of Individual Types of Loans

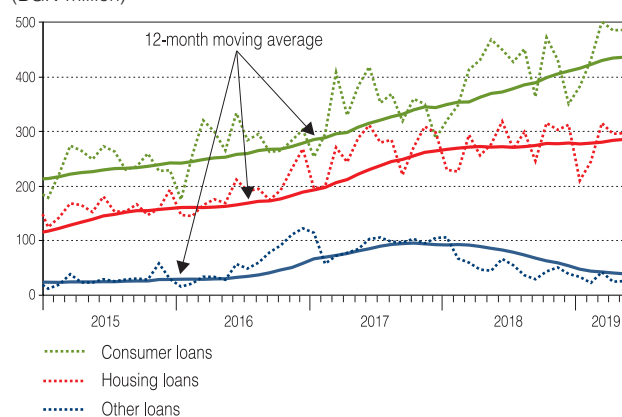
(per cent, percentage points)



Source: the BNB.

New Loans to Households (Monthly Volumes)

(BGN million)



Source: the BNB.

perception of risk. Risk assessments reflected the overall macroeconomic environment improvement, increased borrowers' creditworthiness, favourable prospects in the housing market and lower collateral risk. Concurrently, bank risk aversion was a factor for tighter lending policies regarding small- and medium-sized corporations and households during the first quarter. Bank expectations for the April–June period show that corporate, consumer and household lending standards will remain unchanged from the previous quarter.

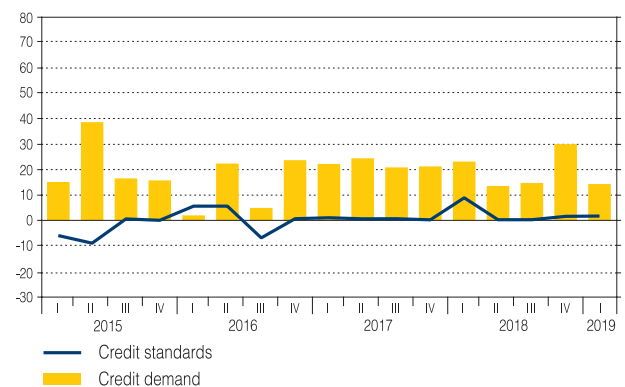
In the January to March 2019 period banks reported higher demand for loans by both corporations and households, with the largest growth recorded in consumer loans. According to the weighted balance of opinions, the main reasons behind the increased demand for corporate loans involved firms' working capital and inventories needs, funds required for investment purposes, refinancing, restructuring or renegotiating debts and low interest rates. In addition to low interest rates and funds needed for old debt refinancing, higher demand for household loans over the quarter was largely driven by the need for funds to purchase durable goods, positive consumer assessments of the macroeconomic environment and favourable housing market outlook. Bank expectations for the April–June 2019 period show that demand for corporate and household loans will further increase, and demand for housing loans will stay the weakest.

In the second half of 2019, growth in non-government sector deposits is expected to remain strong tending to gradually slow down. These developments will be driven by weaker than expected growth of compensation *per* employee in the third and fourth quarters of the year, which will result in a slowdown of household disposable income growth. Low interest rates are also expected to have a limiting effect on savings at banks. However, due to the lack of a sufficiently safe alternative to bank savings, deposits are expected to remain the preferred form of saving for corporations and households. In the context of sustained strong domestic demand in the second half-year, credit growth is anticipated to stay comparatively high. Lending rates will remain close to the attained low levels, further supporting the demand for loans by households and corporations. Government payment of loans extended under the National Energy Efficiency Programme

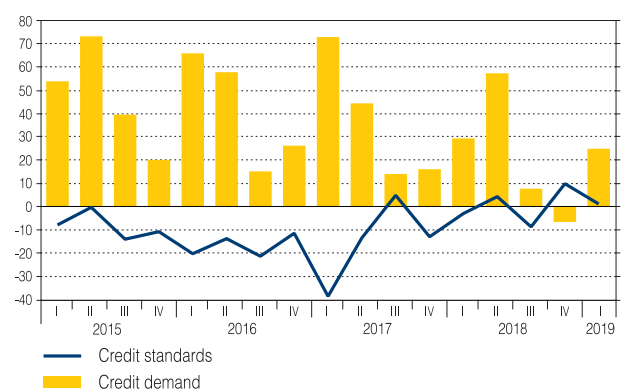
Changes in Demand and Credit Standards

(balance of opinions; percentage points)

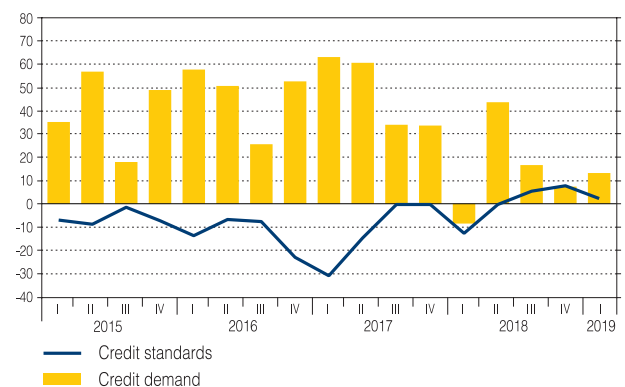
a) corporate loans



b) consumer loans



c) housing loans



Notes: As regards credit standards, charts present banks' balance of opinions defined as a difference in percentage points between the percentage of banks responding 'tightened' ('considerably' and 'somewhat'), and the percentage of banks responding 'eased' ('considerably' and 'somewhat'). As regards credit demand, the balance of opinions is defined in percentage points as a difference between the percentage of banks responding 'increased' ('considerably' and 'somewhat') and the percentage of banks responding 'reduced' ('considerably' and 'somewhat'). All opinions are weighted by the bank's market share in the relevant credit segment.

Source: the BNB.

and the lower volume of new loans under this programme will continue hamper household lending growth.

Interest Rates

Amid increasing inflow of attracted funds, high liquidity of the Bulgarian banking system and historically low interest rates in the euro area, the interest rates on new time deposits stabilised at attained low levels in the first five months of 2019. Rising volumes and low cost of attracted resources, enhanced competition in the banking sector and lowered risk assessment were reflected in the continuing declines in interest rates on new loans to non-financial corporations and new housing loans.

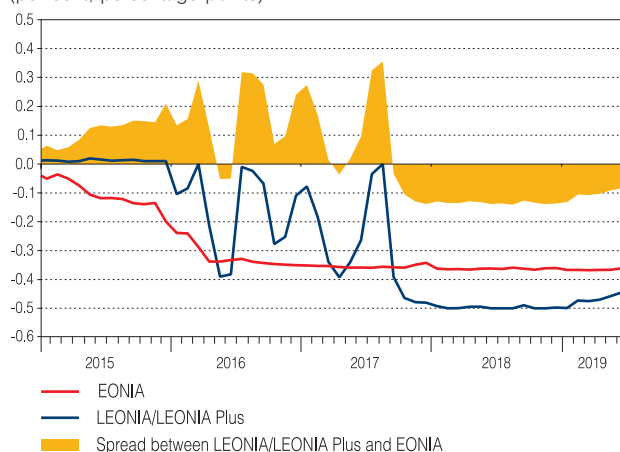
In the first half of 2019 a gradual downward trend in traded volumes in the lev interbank market with an insignificant interest rise was observed. In June 2019 the average interest rate on deposits and repurchase agreements was -0.46 per cent, rising by 4 basis points on end-2018. Interbank money market continued to reflect mainly overnight transactions, comprising 66.1 per cent on average of all transactions in the first six months. In line with interbank money market developments LEONIA Plus index²⁹ has slightly increased since early 2019, coming to -0.45 per cent in June (-0.50 per cent in December 2018). Over the review period EONIA index remained relatively stable. As a result, in June 2019 the spread between EONIA and LEONIA Plus declined by 5 basis points from the end of 2018 to -0.08 basis points.

The increasing inflow of attracted funds from residents and high banking liquidity system continued to contribute to the maintenance of deposit rates at the attained low levels. In May 2019 the average weighted interest rate on new time deposits of non-financial corporations and households was 0.2 per cent, down 13 basis points from the end of 2018. Interest rates on new time deposits of non-financial corporations posted a stronger decline than at previous year's end, while those of households have remained comparatively stable since early 2019. The overall

²⁹ LEONIA Plus (LEv OverNight Interest Average Plus) is a reference rate of unsecured overnight deposit transactions in Bulgarian lev on the interbank market.

Overnight Interbank Money Market Rates (Average Monthly Value)

(per cent, percentage points)



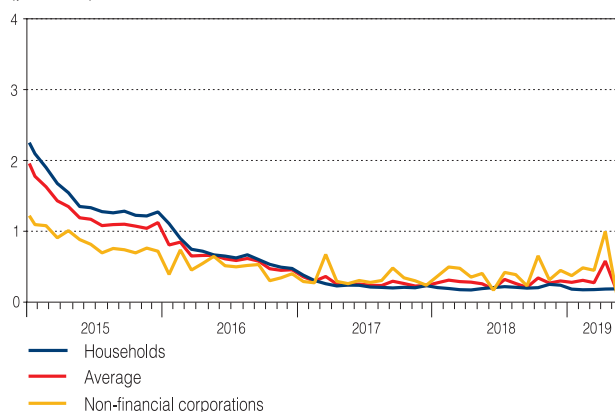
Notes: LEONIA Plus replaced LEONIA on 1 July 2017. LEONIA Plus monthly values are calculated as an arithmetic average for days when overnight unsecured lending transactions are concluded in the interbank market in lev.

Sources: the BNB, the ECB.

Interest Rates on New Time Deposits

a) by sector

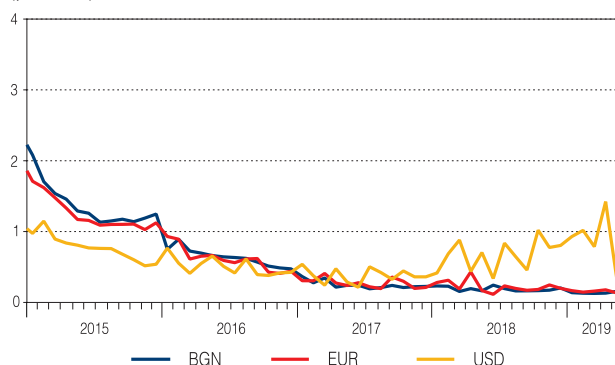
(per cent)



Notes: The average interest rate is calculated for all sectors, maturities and currencies weighted by the relevant volumes of new deposits. Average deposit rates for non-financial corporations and households are based on interest rates for all maturities and currencies weighted by relevant volumes of new business.

b) by currency

(per cent)



Note: The average interest rate by currency is based on rates for all sectors and maturities weighted by relevant volumes of new business. Source: the BNB.

decrease in interest rates on non-financial corporation deposits largely reflected the significant decline in interest rates on corporate dollar deposits recorded in May 2019, which reversed the early 2018 upward trend in rates on these deposits. Concurrently, interest rates on new lev and euro deposits remained almost unchanged compared to their levels of end-2018.

In May 2019 the breakdown of average weighted interest rates on new time lev deposits of households showed a decline on March in the number of banks with average interest rate within ranges from 0.50 to 0.75 per cent and from 0.75 to 1.00 per cent and an increase in the number of banks with interest rates ranging up to 0.25 per cent and above 1.00 per cent. The standard deviation measuring the variation of interest rates offered by banks slightly increased, reaching 0.30 per cent in May 2019.

The gradual downward trend in interest rates on new loans to non-financial corporations and new housing loans continued in the first five months of 2019. At the same time, interest rates on consumer loans stabilised at end-2018 levels. Results from Bank Lending Survey for the first quarter of 2019 show that major factors behind lending rate developments were the high liquidity and enhanced competition in the banking sector, increasing volume and falling cost of attracted resources and lowered risk assessment. Risk assessments reflected the overall improved macroeconomic environment, increased borrowers' creditworthiness, favourable prospects in the housing market and lower collateral risk.

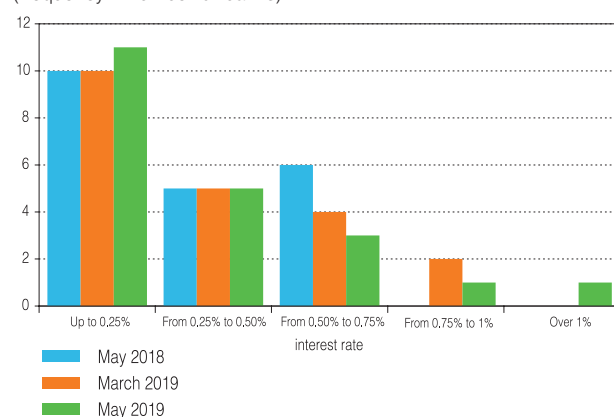
In the first five months of 2019 new loans to non-financial corporations by currency showed a slight decline in lending rates on loans in levs, unchanged levels of loans in euro and an increase in USD-denominated corporate loans. In May 2019 lending rates on new corporate loans were 3.6 per cent for lev-denominated, 3.0 per cent for euro-denominated and 4.5 per cent for USD-denominated loans.³⁰

In the first five months of 2019 the annual percentage rate of charge (APRC) on housing loans to households continued to follow a slight

³⁰ The above values are the weighted average values of the interest rates on loans to non-financial corporations on a 12-month basis.

Distribution of Interest Rates on New Household Time Lev Deposits

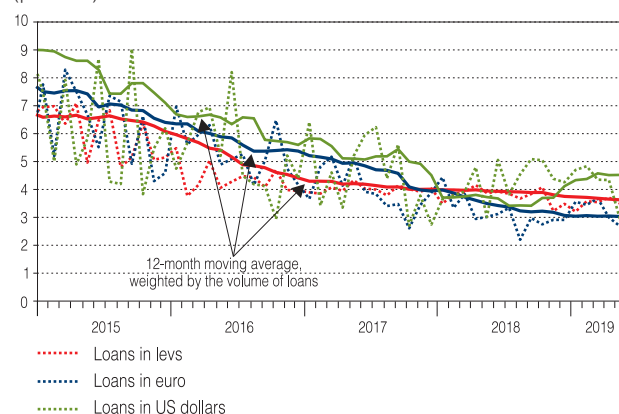
(frequency – number of banks)



Source: the BNB.

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

(per cent)



Source: the BNB.

downward trend, reaching 3.7 per cent in May.³¹ This dynamics was entirely driven by the interest rate component of charges, while the implicit rate of non-interest service charges was retained at the end-2018 level. The APRC on consumer loans stabilised at levels reached at the end of 2018 (10.5 per cent).

In May the breakdown by bank of average weighted interest rates on new housing loans in euro showed an increase on March in the number of banks with average interest rates within the range above 6.0 per cent and a decline in the number of banks with interest rates ranging up to 3.00 per cent and from 3.00 to 4.00 per cent. In May the standard deviation reflecting variation of interest rates offered by banks went up 33 basis points on March, accounting for 1.11 per cent.

Spreads between lending rates on new corporate and housing loans in Bulgaria and the corresponding euro area rates continued to contract to reach in April 2019 historical lows of 188 and 152 basis points respectively.³²

In the second half of 2019 new time deposit and lending rates are expected to remain at the attained low levels. These trends will be supported by the ECB's extended period of keeping euro area interest rates at current levels (at least until mid-2020) and the retention of the high savings rate in the economy amid uncertainty arising from the external environment and the lack of a sufficiently safe alternative to bank deposits. These developments, in turn, will contribute to the further increase in available resources in banks, which may be used for lending.

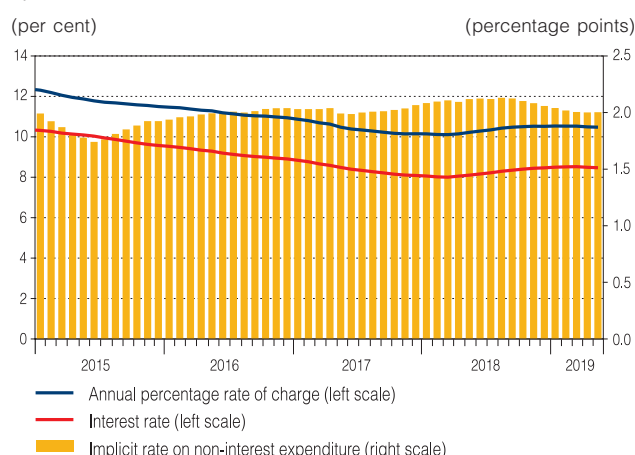
In the second quarter two auctions for BGN-denominated government securities with original maturity of ten years and six months (0.5 per cent coupon interest) and 20 years (1.5 per cent coupon interest) were held, with nominal value of bids approved amounting to BGN 200 million and BGN 100.6 million respectively. The average annual weighted yields attained at the auctions were 0.41 per cent on ten years

³¹ Values indicating the APRC and interest rates are weighted averages of the interest rates on household consumer and housing loans on a 12-month basis.

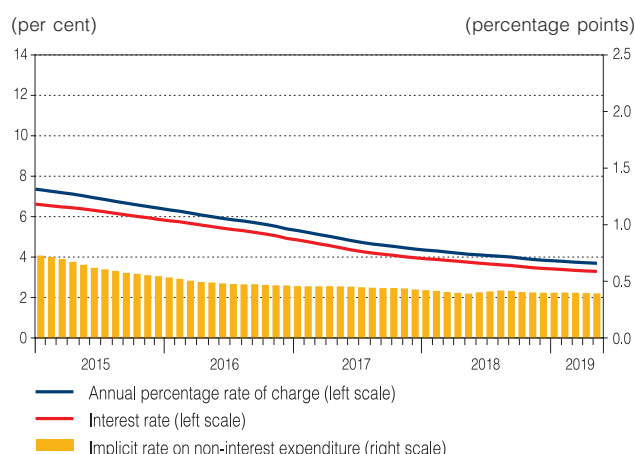
³² Spreads are calculated as a difference between average interest rates in Bulgaria and in the euro area in all maturities for the relevant type of loan, overall in national currency and euro, weighted by the relevant volumes of new loans for a 12-month period.

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

a) consumer loans



b) housing loans

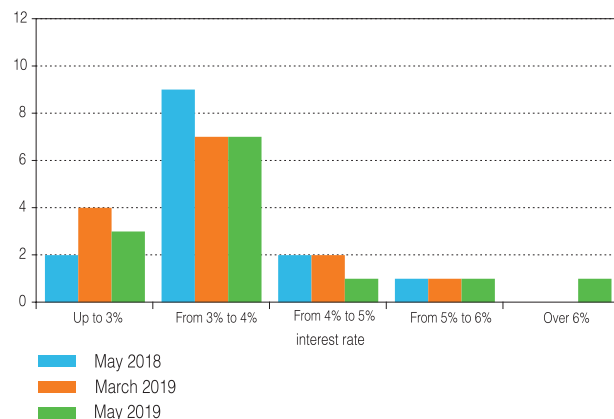


Notes: Interest rates in all maturities and currencies are weighted by the relevant volumes of new loans for a 12-month period. Implicit per cent is the difference between the APRC and the relevant interest rates and reflects the approximate per cent of all non-interest service charges on loans (including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

Source: the BNB.

Distribution of Interest Rates on New Housing Loans in Euro

(frequency – number of banks)



Source: the BNB.

and six months and 1.60 per cent on 20-year government securities. The strong demand on the primary market, especially with respect to the benchmark issue, was in line with the continuous decline in the long-term interest rate used to assess the degree of convergence to 0.32 per cent in June (from 0.67 per cent at the end of March).

The downward trend in the yields of Bulgarian eurobonds issued in international capital markets continued in the second quarter of 2019. The sharpest decline was in the long end of the maturity curve. A decrease in the term premium was also reported in most euro area countries, mainly as a result of the prevailing market expectations of sustained ECB's accommodative monetary policy and the continuing uncertainty surrounding global foreign trade relations. In the context of strong investors' appetite for low risk assets, spreads between yields of Bulgarian and German bonds remained almost unchanged in year's second quarter.

In the third and fourth quarters of 2019 Bulgarian government bond yields are expected to remain at the attained low levels driven by both ECB Governing Council expectations for keeping interest rates unchanged for a longer period and the continuing strong investment interest by resident financial institutions. Further decline in euro area government bond rates, which may be transferred relatively quickly and affect Bulgarian government security yields, could be expected in case of risks to lower euro area economic growth.³³

Financial Flows between the Consolidated Budget and Other Sectors of the Economy

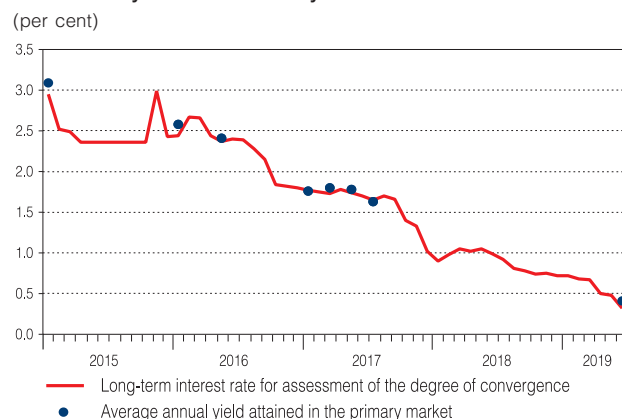
Government's revenue and expenditure policy, and budget financing operations affect the allocation of liquidity across economic sectors³⁴.

In the first quarter of 2019 the non-government, non-bank sector was the main source of liquidity

³³ For a more detailed description of external risks to the BNB economic growth forecast for the 2019–2021 period, see Chapter 5.

³⁴ The division of economic sectors in this section is based on the information in the monthly reports under the Consolidated Fiscal Programme and therefore does not match the sector classification used in the National System of Accounts.

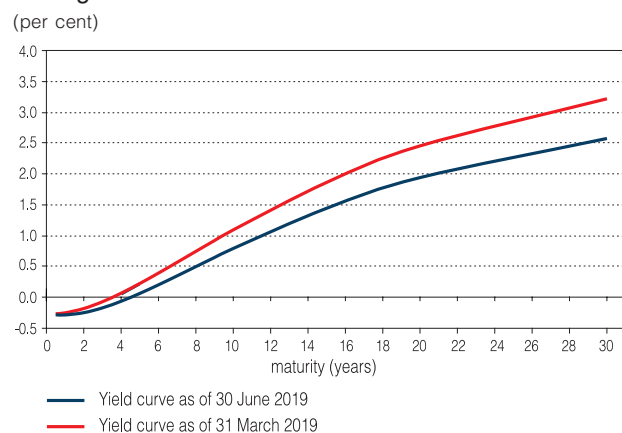
Ten-Year-and-Six-Month Government Bond Rates on the Primary and Secondary Markets



Note: The chart shows the yields reported on the primary and secondary markets on government bonds with ten-year-and-six-month original maturity. The frequency of auctions for issues with this maturity corresponds to the number of observations in blue. The last primary market offering was in June 2019 (issue BG2040119211 maturing in December 2029).

Source: the BNB.

Reference Government Securities Yield Curve in Bulgaria



Notes: The reference yield curve of Bulgarian government securities is based on BNB own calculations under the version of *Nelson–Siegel–Svensson* model (1994). The yield change refers to the previous quarter. The chart employs daily yield data on Bulgarian government securities traded in capital markets.

Source: the BNB.

to the budget (accounting for 5.6 per cent of GDP for the quarter) as a result of government tax and non-tax revenue exceeding non-interest expenditure. Net financial flows from the external sector were positive (accounting for 2.8 per cent of GDP for the quarter), with reimbursed funds from the EC under the EU Common Agricultural Policy (BGN 758 million) and grants received under EU programmes (BGN 554 million), exceeding EU budget contribution costs (BGN 466 million) and interest due to non-residents (BGN 165 million).³⁵ In the first quarter the amount of the net external debt financing was rather small and therefore did not affect the allocation of liquidity across economic sectors, while the negative net domestic government securities financing was the major factor for the reallocation of liquidity to the financial sector (the BNB excluded), accounting for 4.5 per cent of GDP for the quarter. In the January to March period significant interest payments on matured government securities (BGN 920 million) were made without holding government securities auctions in the primary market. As a result of interest payments in the amount of BGN 211 million³⁶ made to resident financial institutions over the period, additional liquidity was redirected to the financial sector (the BNB excluded). The liquidity redirected from the external and non-government non-bank sector to the budget exceeded the net inflow of liquid funds from the budget to the financial sector (the BNB excluded). Consequently, the government deposit with the BNB rose BGN 968 million (3.9 per cent of GDP for the quarter) compared to December 2018.

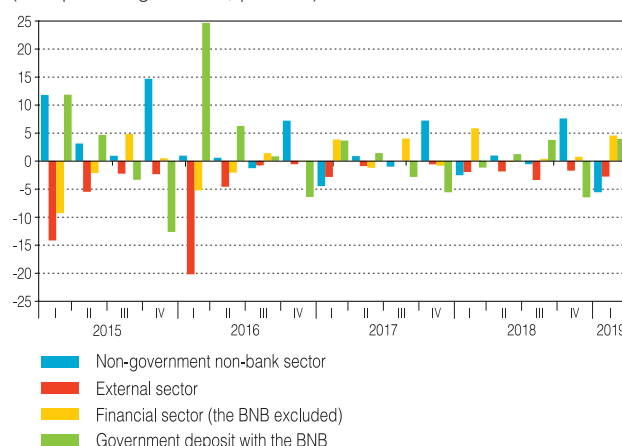
Based on preliminary monthly data as of early July 2019, positive though rather limited financial flows from the external sector and the non-government non-bank sector to the budget are expected. Financial sector (the BNB excluded) is also expected to be a source of liquid funds for the budget, reflecting government securities issued in the primary market in the total amount

³⁵ Interest payments to non-residents are estimated by adjusting external interest expenditure with interest payable to residents. The latter have been calculated on the basis of the value of Eurobonds held by residents, according to the MF Central Government Debt and Guarantees Monthly Bulletin as of 30 April 2019.

³⁶ See footnote 35 on the information used for calculating interest payments made to residents.

Consolidated Budget Effect on Other Sectors' Liquidity (Quarterly)

(as a percentage of GDP, per cent)



Sources: the MF, the BNB.

of BGN 300.6 million at the end of June and the lack of government securities maturing over the period. Redirected liquidity from these three sectors explains the continuing increase in government deposit with the BNB (by BGN 1237 million on end-March) in the second quarter.

Developments in financial flows generated in the process of external and internal economic factor interaction contributed to the insignificant rise in gross international foreign exchange reserves. By end-June 2019 the market value of international reserves (including valuation adjustments and price revaluations), an asset on the BNB Issue Department balance sheet, rose by EUR 0.1 billion from the previous year's end to EUR 25.2 billion (BGN 49.3 billion). According to the currency board principles, the increase in international reserves corresponds to the increase in the Issue Department balance sheet liabilities. The increase in the government deposit with the BNB observed since early 2019 was entirely offset by the decreased banks' reserves due to a decline in their excess reserves, with banknotes and coins in circulation remaining broadly unchanged from end-2018. The Banking Department deposit and liabilities to other depositors slightly rose over the period.

In the third and fourth quarters of 2019 bank reserves with the BNB are expected to remain close to the levels reported in the first half-year. Projected higher budget expenditure at year end, possible payments in relation to the acquisition of a new type of fighter aircraft by the Armed Forces of the Republic of Bulgaria and payments under the EU Common Agricultural Policy at a schedule similar to that of the previous year are expected to cause a significant fall in the government deposit with the BNB in the second half of 2019. A further increase in labour income and keeping deposit rates at attained low rates will contribute to maintaining comparatively high growth rates of the currency in circulation over the forecast horizon.

3. ECONOMIC ACTIVITY

In the first quarter of 2019 quarterly growth of real GDP accelerated from the previous quarter and came to 1.2 per cent. Private consumption contributed most to this dynamics, while the other components of domestic demand and net exports contributed less to quarterly growth.

In the first quarter of 2019 the seasonally adjusted number of employed increased in the total economy mainly due to the services sector and construction. The unemployment rate further declined reaching 4.8 per cent, while the economic activity rate of working age population increased. The nominal compensation per employee rose by 3.4 per cent on a quarterly basis, with all economic sectors contributing to this growth.

In the first six months of 2019 short-term economic indicators continued to give mostly positive signals about the economic development. In the second half of 2019 real GDP is expected to grow further quarter on quarter, with domestic demand contributing most to this effect. Employment growth, increasing nominal labour income and still low interest rates are expected to continue favouring growth of private consumption. The projected improvement of investment activity and stronger government consumption will also support domestic demand growth. Given these trends, quarterly GDP growth is anticipated to vary between 0.8 and 1.1 per cents in the second half of 2019. Year-on-year economic growth is expected to gradually slow down.

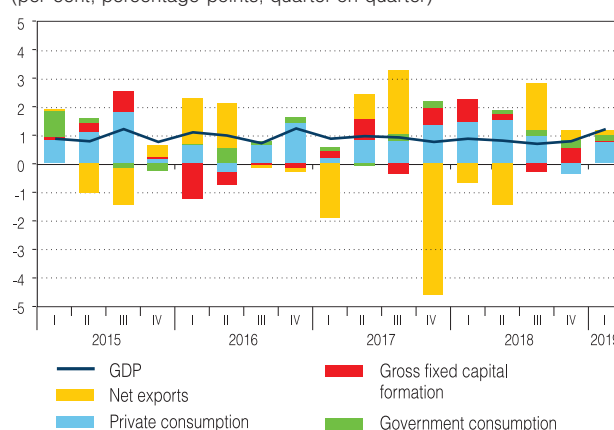
Current Economic Environment

In the first quarter of 2019 real GDP growth accelerated from the previous quarter to 1.2 per cent (seasonally adjusted NSI national accounts data). The stronger economic activity was driven by the increase in both domestic demand and net exports.

Among domestic demand components private consumption contributed most to quarterly growth of real GDP in early 2019. This reflected restored growth of final consumption expenditure of households following the reported fall at the end of 2018. Consumption growth was underpinned by higher employment and increased labour income of households, and also by low interest rates which continue to stimulate the demand for consumer loans. Factors limiting household consumption reflected the slightly deteriorated consumer confidence indicator³⁷ and increased uncertainty. This contributed to the increased share of savings in the household disposable income.

In the first quarter of 2019 government consumption also contributed to quarterly growth of real GDP, reflecting higher public expenditure on wages and, to a lesser extent, on health insur-

Contribution to GDP Growth by Final Use Component
(per cent; percentage points; quarter-on-quarter)



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

Sources: the NSI, BNB calculations.

³⁷ BNB seasonally adjusted data on the consumer confidence indicator.

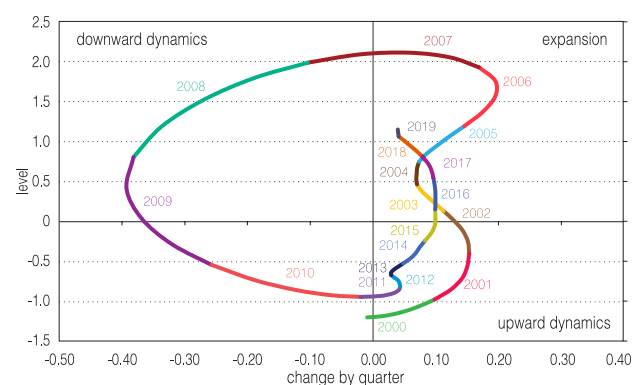
ance payments.³⁸ Over the quarter investment in fixed capital continued rising quarter on quarter, though at slower rates compared with end-2018. BNB estimates³⁹ point to a subdued dynamics of both public and private investment. Factors limiting private investment growth over the quarter involved the economic uncertainty in important trading partners of Bulgaria and worsening business expectations about future production activity. As to the type of assets, investments in machines, information and communication equipment⁴⁰, and in residential buildings contributed more significantly to the increased gross fixed capital formation in the first quarter of 2019.

Net exports had a positive contribution to economic activity developments in the first quarter of 2019 driven by the increase in exports of goods and services at a higher rate than that of imports.⁴¹ Geographical breakdown of foreign trade flows shows an increase in exports both to EU and non-EU countries.⁴² Notwithstanding, growth of exported goods and services slightly moderated from the previous quarter due to subdued growth of external demand. Imports of goods and services also posted lower quarter-on-quarter growth, reflecting the weak dynamics of investment activity in Bulgaria.

The comprehensive and stable economic development observed in the domestic demand components, the improvement of the labour market, and high levels of business climate and consumer confidence indicators suggest that the economy continues to be in an expansion phase in the first quarter of 2019.

The BNB's estimates of the cyclical position of the economy show that in early 2019 the economic activity in Bulgaria exceeded its potential

Business Climate Indicator Dynamics

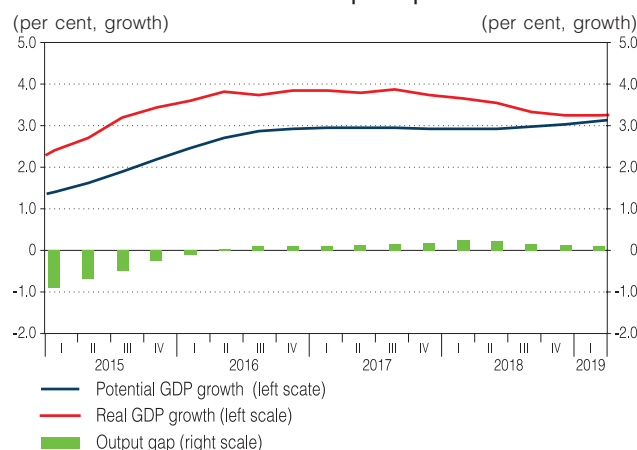


Notes: The chart compares the business climate level (the vertical axis) and its quarterly change (the horizontal axis). The business climate series has been transformed using the HP filter (with a parameter $\lambda = 100$) in order to eliminate short-term fluctuations, after which it has been standardised.

The four chart grids allow to distinguish the four phases of the business cycle:

Sources: the NSI, BNB calculations.

Potential GDP Growth and Gap Output



Notes: Results are obtained through the application of a multivariate model with unobserved components presented in the research topic on Methods for Estimating the Cyclical Position of the Economy. The output gap is the deviation of the current level of economic activity and potential output measured as a percentage of potential output.

Sources: the NSI, BNB calculations.

³⁸ For details, see the Impact of Fiscal Policy on the Economy Section in Chapter 3.

³⁹ The analysis employs data from quarterly non-financial accounts of the general government sector and reports on the implementation of the consolidated fiscal programme, published by the NSI and the MF respectively.

⁴⁰ This refers to the information and communication technology equipment, weapons systems and other machinery and equipment group.

⁴¹ For details, see the Exports and Imports of Goods and Services Section in Chapter 3.

⁴² BNB seasonally adjusted data on nominal foreign trade.

level⁴³. These estimates signal that in terms of supply, a part of the resources in the economy are still employed above their potential level, which is in line with the long-term trend toward a significant unemployment decline and high production capacity utilisation.

Short-term economic indicators over the second quarter of 2019 remained at comparatively high historical levels giving signs of positive economic developments in the following quarters. At the same time, the reversal in the upward dynamics of some indicators signalled potential risks of lower than expected growth in Bulgaria's real GDP. In the second quarter of 2019 the business climate indicator tracking the business sentiment slightly worsened from the first quarter of 2019, reflecting the more unfavourable assessments of managers on the expected business situation in Bulgaria⁴⁴. This coupled with the continuing tendency from the previous year towards an increase in the uncertainty indicator constructed by the BNB may dampen the investment activity of firms. Notwithstanding, according to the NSI survey firms in industry, construction, trade and services preserved the attained relatively high levels of production assured with orders, which is a prerequisite for further improvement of the remaining domestic demand components and exports. Between April and May 2019 the nominal industrial turnover continued to increase on both quarterly and annual basis reflecting mainly the increase in traded volumes.⁴⁵

The NSI Consumer Survey of April showed a slight decline in the composite consumer confidence indicator from January 2019. The NSI survey points to a further worsening of consumer expectations of the economic situation in Bulgaria and their financial position in the following 12 months, which is a precondition to postpone consumption.⁴⁶ This dynamics is likely to reflect the enhanced uncertainty surrounding the international environment since the beginning of the year. The more negative sentiment of some consumers

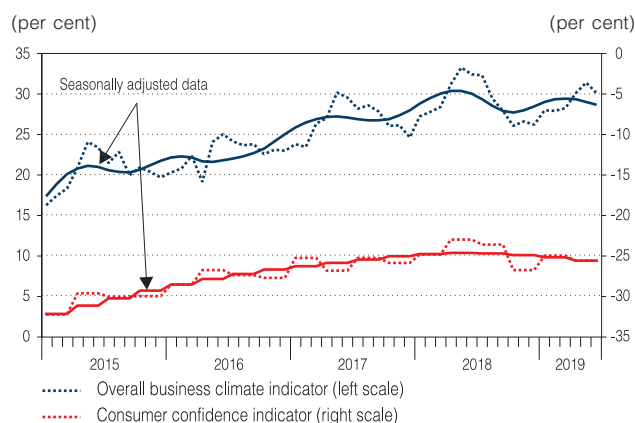
⁴³ To estimate the potential output level and the cyclical position of the economy a multivariate production function model, Phillips Curve and Okun's Law are used, presented in the in the research topic on Methods for Estimating the Cyclical Position of the Economy, *Economic Review*, 1/2019.

⁴⁴ BNB seasonally adjusted data.

⁴⁵ For details on the industry turnover dynamics, see the Behaviour of Firms Section in Chapter 3.

⁴⁶ BNB seasonally adjusted data.

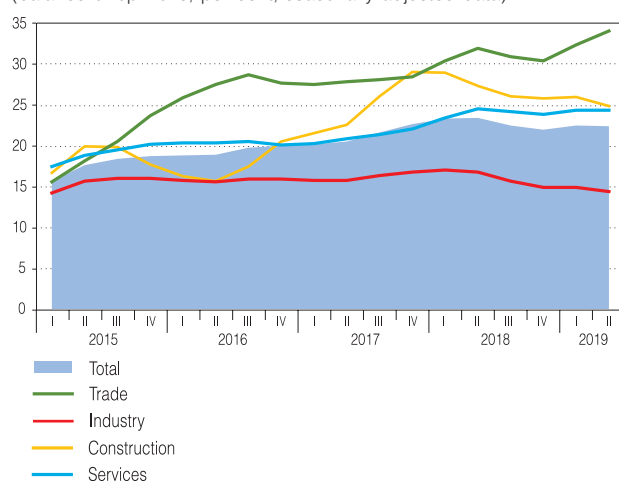
Business Climate and Consumer Confidence



Sources: the NSI, BNB calculations.

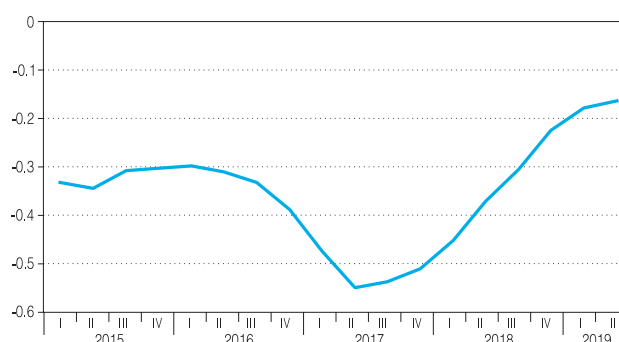
Expectations about Future Economic Activity

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



Sources: the NSI, BNB calculations.

Uncertainty Indicator in the Economy (Corporations and Households)



Notes: Higher values of this indicator should be interpreted as an increase in uncertainty. Positive/negative values indicate that the uncertainty is above/below its long-run level. This indicator is constructed under a methodology presented in: Ivanov, E. 'Constructing an Uncertainty Indicator for Bulgaria', BNB Discussion Papers 109/2018, and corresponds to the indicator *U1* constructed in the paper.

Sources: EC, BNB calculations.

was in line with the slowdown in annual growth of retail sales at comparative prices in early 2019 and the increase in household deposits⁴⁷.

In the second and third quarters of 2019 real GDP is projected to continue growing on both a quarterly and annual basis, but at slower rates than in early 2019. Private consumption is expected again to make a major positive contribution to quarterly and annual GDP growth. Positive developments in the labour market and low interest rates, which will boost demand for consumer loans, will add to this effect. At the same time, the expected slowdown of annual growth in the nominal compensation *per* employee in the second half of 2019 will hamper the growth rate of household disposable income and final consumption expenditure. In addition to private consumption, government consumption and the projected increase in public investment will contribute positively to domestic demand over the projected horizon. Private investment dynamics is expected to remain relatively subdued, driven mainly by the continuous uncertainty in the international environment and weaker annual growth of external demand for Bulgarian goods and services.

In the second half of 2019 real exports of goods and services is expected to rise at relatively lower quarterly and annual rates compared with those recorded in the beginning of the year.⁴⁸ Robust domestic demand will be a factor responsible for the stronger increase in imports of goods and services compared with exports. As a result the contribution of net exports to quarter-on-quarter and annual GDP growth is projected to be negative in the third and fourth quarters of 2018.

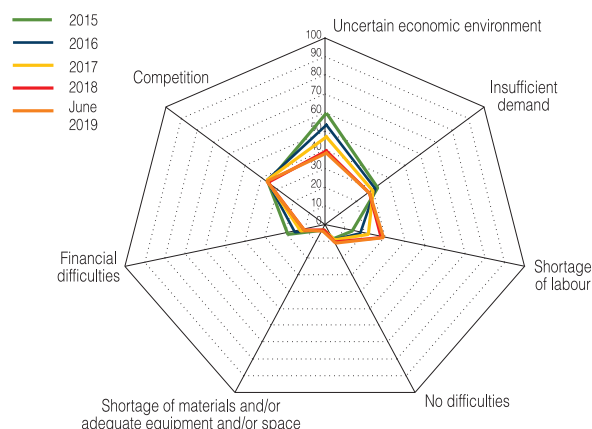
The balance of risks to the outlook is tilted to lower than expected real GDP growth. This is mainly attributable to the external environment, where there are risks of lower than projected growth of economic activity in some trading partners important for Bulgaria. Additional risk to the outlook stems from possible lower than projected growth in government investment.

⁴⁷ For details on developments in nominal retail trade volumes and household propensity to save, see the Household Behaviour Section in Chapter 3.

⁴⁸ For details, see the Exports and Imports of Goods and Services Section in Chapter 3.

Factors Limiting Economic Activities of Corporations

(relative share of all corporations)



Note: Average for the period calculated as sector-weighted (industry, construction, trade and services).

Sources: the NSI, BNB calculations.

Real GDP Growth by Final Use Component

(%, quarter-on-quarter; seasonally adjusted data)

	2015				2016				2017				2018				2019
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumption	1.4	1.4	2.0	0.2	0.9	0.4	0.7	1.8	0.5	1.1	1.4	1.7	1.8	1.8	1.4	-0.1	1.3
incl.																	
Household consumption	1.2	1.7	2.8	0.2	1.0	-0.5	1.0	2.2	0.3	1.3	1.2	2.1	2.3	2.2	1.4	-0.6	1.1
Government final consumption expenditure	2.0	2.3	-0.9	-0.5	-0.9	3.2	0.0	2.2	1.3	-1.9	1.4	0.3	1.0	0.1	0.5	0.0	2.4
Collective consumption	5.0	-1.2	0.7	-0.1	-0.5	2.6	1.3	1.1	1.0	0.3	1.9	1.7	-0.1	1.0	1.0	2.0	1.1
Gross fixed capital formation	0.5	1.5	3.5	0.4	-5.9	-2.2	-0.3	-0.9	1.2	4.0	-1.9	3.2	4.1	1.1	-1.5	2.8	0.2
Exports of goods and non-factor services	2.2	-0.8	-3.3	3.9	3.0	4.0	0.7	1.9	0.7	1.4	3.5	-2.1	-1.7	-1.6	1.7	3.1	1.9
Imports of goods and non-factor services	2.1	0.8	-1.3	3.1	0.4	1.5	0.8	2.1	3.5	0.1	0.2	4.8	-0.7	0.7	-0.8	2.4	1.5
GDP	0.9	0.8	1.2	0.8	1.1	1.0	0.7	1.2	0.9	1.0	0.9	0.7	0.9	0.8	0.7	0.8	1.2

Source: the NSI.

Exports and Imports of Goods and Services

Mostly negative signals reported in the international environment in early 2019 had no significant negative effect on Bulgaria's foreign trade flows. In the first quarter of 2019 nominal exports of goods increased by 10.6 per cent on an annual basis and nominal imports of goods by 6.0 per cent.⁴⁹ According to non-seasonally adjusted national accounts GDP data, in the first quarter of 2019 real exports of goods rose by 8.3 per cent and real imports of goods by 5.5 per cent. The comparison of exports and imports of goods in nominal and real terms suggests that global price developments in the first quarter of 2019 contributed positively to their nominal growth.

In the first quarter of 2019 exports of mineral products and fuels grew strongly on an annual basis, which may be explained primarily by the low base in the corresponding period of the previous year, when a key sector company cut significantly the production due to a scheduled repair of production capacities.⁵⁰ BNB calculations⁵¹ show that in the first quarter of 2019 exports of mineral products and fuels had the main positive contribution to annual growth of total Bulgaria's exports in both real and nominal terms. In addition to mineral fuels, exports of

⁴⁹ Foreign trade data.

⁵⁰ NSI data on production and supplies of oil and oil products.

⁵¹ Real volumes of imports have been constructed under the commodity groups of Standard International Trade Classification (SITC) by using NSI data on export prices and nominal values of exports under the SITC.

Net Exports of Commodity Groups by Use, January–March 2019

	Balance (EUR million)	Change* (EUR million)	Growth of exports** (per cent)	Growth of imports** (per cent)
Consumer goods	72.4	31.9	8.3	6.6
Raw materials	-100.4	137.1	6.1	1.0
Investment goods	-313.1	95.1	10.7	3.8
Energy resources	-382.6	-23.0	44.6	28.3
Other exports	-24.7	1.9	15.9	1.0
Total	-748.4	243.1	10.6	6.0

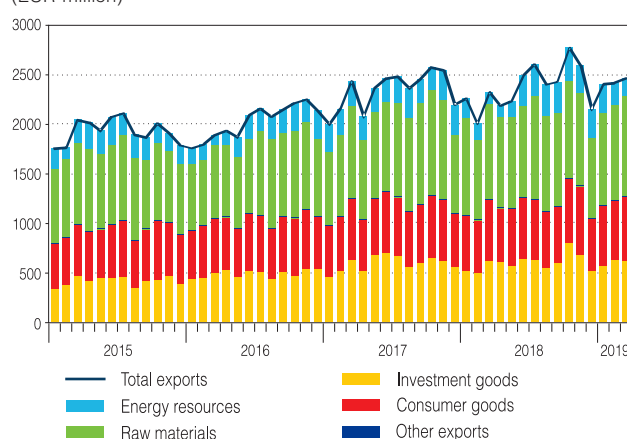
* Balance change on same period of previous year.

** Exports and imports growth for the period on an annual basis.

Source: the BNB.

Exports of Commodity Groups by Use

(EUR million)



Source: the BNB.

Exports by Commodity Group, January–March 2019

	Value (EUR million)	Change* (EUR million)	Growth** (per cent)	Contribution**, percentage points
Wood products, paper, ceramics and glass	341.5	21.8	6.8	0.3
Machines, vehicles, appliances, instruments and weapons	2 006.4	233.7	13.2	3.6
Mineral products and fuels	822.8	257.4	45.5	3.9
Base metals and related products	1 140.8	-89.2	-7.2	-1.4
Animal and vegetable products, food, drinks and tobacco	1 079.3	135.0	14.3	2.1
Textiles, leather, clothing, footwear and other consumer goods	886.1	3.4	0.4	0.1
Chemical products, plastics and rubber	966.8	135.0	16.2	2.1
Total exports	7 243.6	697.1	10.6	-

* Change on the corresponding period of previous year.

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

Source: the BNB.

machines⁵² also contributed substantially to real and nominal growth of exports on an annual basis in the first quarter of 2019. Only base metals posted a decline in annual exports by commodity group in both real and nominal terms due to lower exports of copper products. This is probably attributable to one-off factors related to temporary unscheduled stoppages of production in the Bulgarian and foreign branches of a key sector company⁵³.

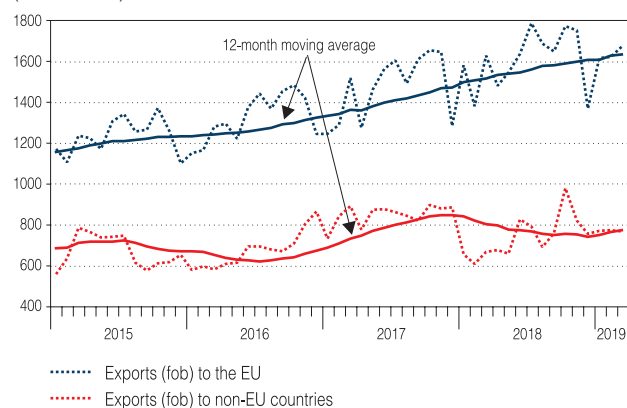
In the first quarter of 2019 exports of goods to EU Member States increased by 7.0 per cent on an annual basis, with exports to Romania and Germany making the major contribution. In the first quarter of 2019 exports to the EU in all commodity groups (excluding base metals) grew year on year, with exports of machines having the largest positive contribution. Exports to non-EU countries increased by 19.3 per cent from the first quarter of 2018 due mostly to higher exports to Egypt (mineral products and fuels), China (base metals) and Serbia (mineral products and fuels). In the first quarter of 2019 the share of exported goods to EU Member States in total exports of goods decreased by 2.3 percentage points on the first quarter of 2018 to 67.8 per cent.

⁵² In this chapter, it should read the machines, vehicles, appliances, instruments and weapons group under the Combined Nomenclature.

⁵³ For further details see p. 20 of the Aurubis Group's October–December 2018 Quarterly Report https://www.aurubis.com/binaries/content/assets/aurubis-en/dateien/financial-reports/2018-19/q1/aurubis_quarterly-report_q1_2018_19.pdf

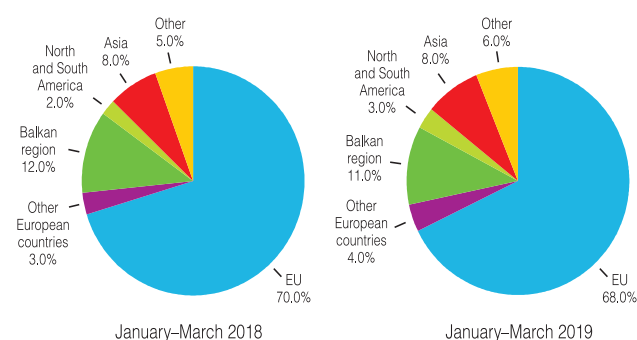
Dynamics of Goods Exports to the EU and non-EU Countries

(EUR million)



Source: the BNB.

Exports of Goods: Geographical Breakdown



Source: the BNB.

In the first quarter of 2019 nominal imports of goods picked up on an annual basis. By use, growth was reported in all sub-groups. Energy resources, followed by consumer goods contributed most substantially to growth of total imports. BNB calculations⁵⁴ show that in the first quarter of 2019 only metal ores had a negative contribution to growth of imported goods in real terms, which is probably ascribable to one-off factors.⁵⁵

In the first quarter of 2019 imports of goods from EU Member States rose by 2.8 per cent on the first quarter of 2018. Imports from the Netherlands and Poland contributed most strongly to growth. Imports from non-EU countries also rose on an annual basis (by 9.6 per cent), with imports from Russia, Turkey and China making the largest positive contribution to this dynamics. The share of imports from the EU decreased by 1.6 percentage points on the first quarter of 2018 and reached 50.9 per cent.

The balance of payments data for April 2019 indicate continuous annual growth of nominal exports and imports of goods, with growth of exports significantly exceeding that of imports.

In the second half of 2019 real exports of goods are expected to continue growing year on year but at a slower rate compared with the first quarter of the year. This slowdown will reflect the exhausted base effect in exports of mineral products in the context of continued subdued growth of external demand.

In the third and fourth quarters real imports of goods are expected to increase further on an annual basis, with the growth rate accelerating on early 2019. Major factors behind this are the projected acceleration of growth in investment and private consumption.

In the second half of 2019, the year-on-year increase in import and export prices will have a positive contribution to the nominal change in foreign trade flows.

According to balance of payments data for the January–April 2019 period exports of services increased on an annual basis, while imports of services decreased insignificantly. According to

⁵⁴ Real volumes of imports have been constructed under the commodity groups of SITC by using NSI data on imports prices and nominal values of imports under SITC.

⁵⁵ See footnote 53.

Imports of Commodity Groups by Use, January–March 2019

	Value (EUR million)	Change* (EUR million)	Growth** (per cent)	Contribution** (percentage points)
Consumer goods	1 775.9	109.6	6.6	1.5
Raw materials	3 011.2	29.8	1.0	0.4
Investment goods	2 084.1	76.3	3.8	1.0
Energy resources	1 079.1	237.9	28.3	3.2
Other exports	41.7	0.4	1.0	0.0
Total	7 991.9	454.0	6.0	-

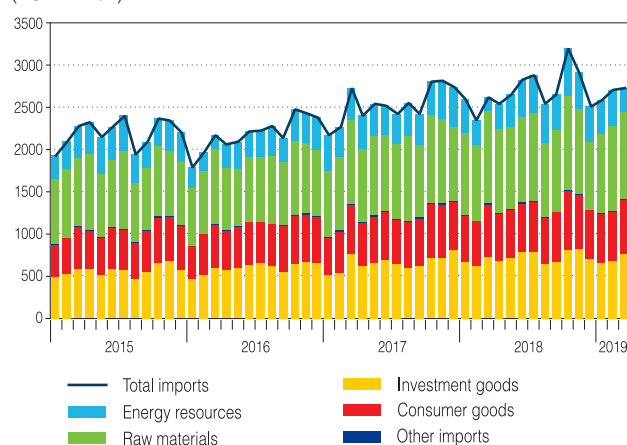
* Change on the corresponding period of previous year.

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

Source: the BNB.

Imports of Commodity Groups by Use

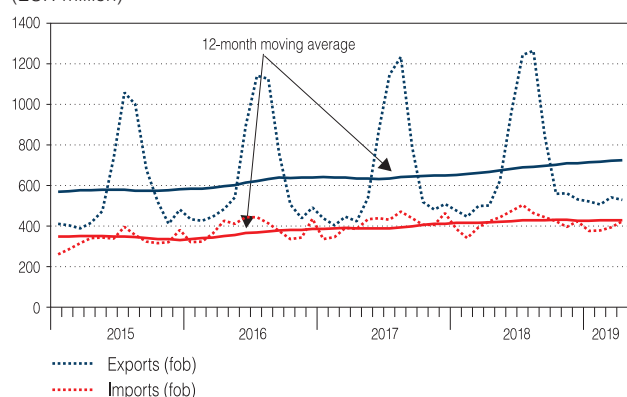
(EUR million)



Source: the BNB.

Exports and Imports of Services Dynamics

(EUR million)



Source: the BNB.

national accounts data, in the first quarter of 2019 the real component had a positive contribution to the nominal change of exports and imports of services on an annual basis. At the same time, lower import prices were the reason behind the fall in imports of services in nominal terms, while the price component contributed positively to nominal exports of services.

Between January and April 2019 services exports increased by 7.8 per cent year on year in nominal terms, with information and technical services contributing most to growth. Revenue from visits of foreign nationals to Bulgaria increased by 4.5 per cent on an annual basis. According to NSI data visits of foreign nationals to Bulgaria in the January–April 2019 period increased by 4.3 per cent on the corresponding period of 2018, with visits from the UK and Romania contributing most to this growth.

Between January and April 2019 imports of services fell by 0.3 per cent on an annual basis, mainly due to lower imports of transport services. According to NSI data, Bulgarians' visits abroad between January and April 2019 increased by 3.4 per cent on an annual basis, with the visits to Turkey and Greece having the most significant contribution to growth.

In the second half of 2019 exports and imports of services are expected to increase on an annual basis in nominal terms. This will be driven by both the retained trend towards an annual increase in price components and the projected rise in real trading volumes amid growing external and domestic demand.

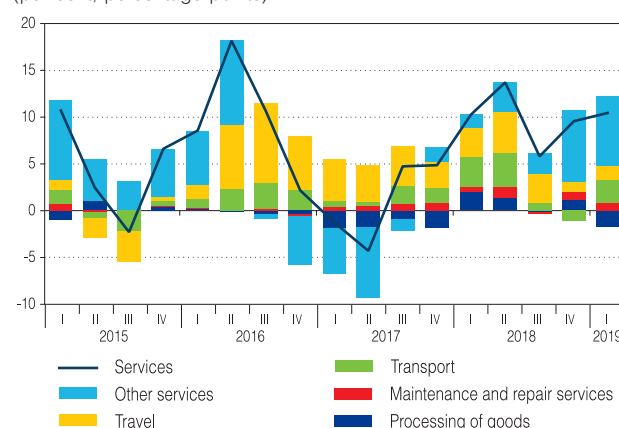
Behaviour of Firms and Competitiveness

In the first quarter of 2019 real value added in the total economy grew by 0.7 per cent quarter on quarter (against an increase of 0.8 per cent in the previous quarter). The services sector, followed by industry, had the main positive contributions to value added growth. At the same time, the agricultural sector contributed negatively to the change in the value added compared with end-2018.

Real value added in industry went up 1.2 per cent quarter on quarter in the first quarter driven entirely by the increased economic activity in industry, while construction reported a fall. The

Annual Change of Services Exports and Contribution by Sub-component

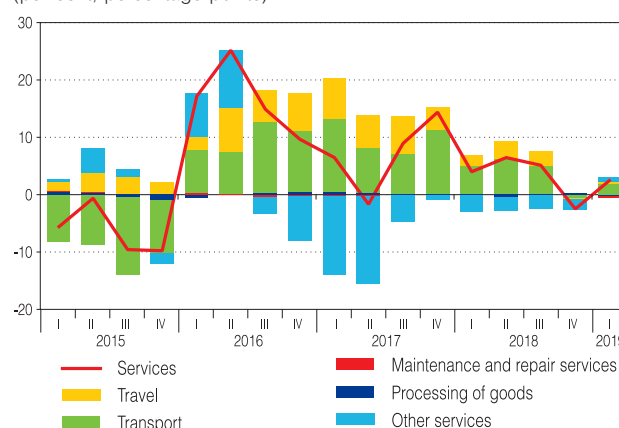
(per cent, percentage points)



Source: the BNB.

Annual Change of Services Imports and Contribution by Sub-component

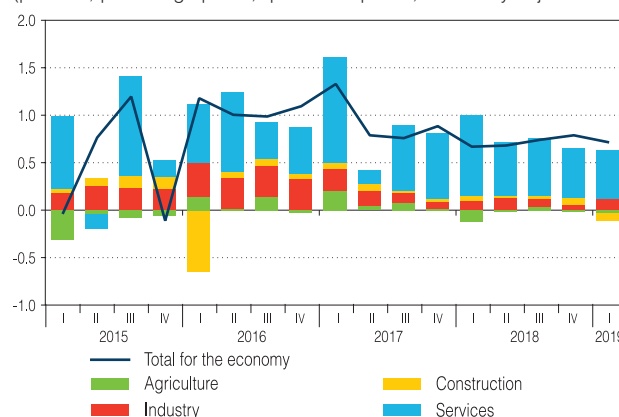
(per cent, percentage points)



Source: the BNB.

Value Added Growth in Real Terms and Contribution by Sector

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



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

Sources: the NSI, BNB calculations.

NSI short-term business statistics data show similar positive developments in industrial turnover and construction production (in real terms) on a quarterly basis in the first quarter of 2019. As regards the geographical breakdown, growth of the industrial turnover (at constant prices) reflected the turnover on international markets, which was in line with national accounts data on exports of goods. In the first quarter of 2019 construction production accelerated its growth on both quarterly and annual basis, which was mainly due to growth of building construction supported by the early 2014 upward trend in house prices.

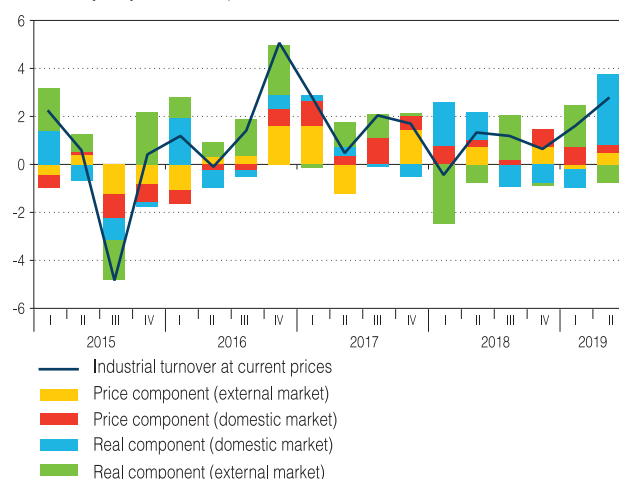
Value added in services continued its upward developments, increasing by 0.7 per cent on a quarterly basis in the first quarter of 2019. Trade, transportation and storage, accommodation and food service activities, and real estate activities had the main positive contribution to its growth. Value added growth in trade, transportation and storage, accommodation and food service activities was in line with reported growth in early 2019 of final consumption expenditure of households compared with end-2018. The NSI data on the turnover index in services show a strong quarterly and annual increase in nominal volumes of transportation, storage and posts, and accommodation. The quarter-on-quarter growth rate of nominal volumes in retail trade continued to slow down in the first quarter of 2019, which was attributable to the lower volume of sales.

The NSI short-term business statistics data on production and turnover in industry, trade and construction production in April and May 2019 gave mostly positive signs of the change in gross value added in the relevant sectors in the following quarters of 2019. Nominal industrial turnover in industry increased in the April–May period from the first quarter of 2019 owing mainly to the real component in the domestic market and, to a lesser extent, to the price component in domestic and external markets. Concurrently, the real component in international markets had a low negative contribution. In April and May 2019 only the construction production index posted a slight decrease from the previous quarter, with civil engineering having the main negative contribution to this effect.

In the first quarter of 2019 employment in the total economy rose quarter on quarter according to seasonally adjusted NSI data. The services

Industrial Turnover Dynamics

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



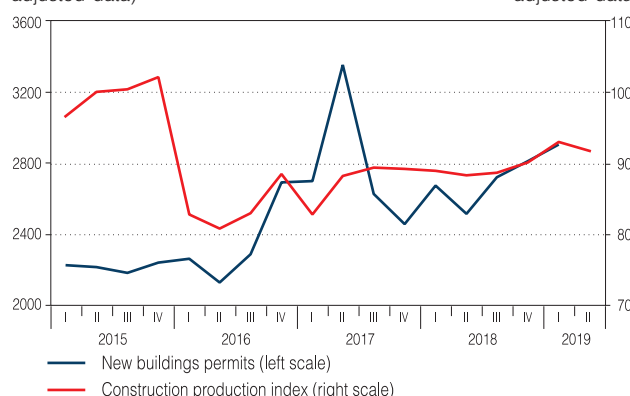
Note: Data for the second quarter of 2019 are for April and May.

Sources: the NSI, BNB calculations.

Construction Production Dynamics and New Buildings Permits Issued

(number of buildings; seasonally adjusted data)

(2015 = 100; seasonally adjusted data)

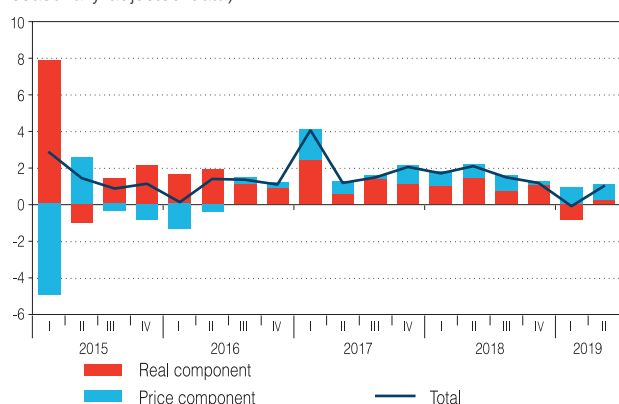


Note: Data for the second quarter of 2019 are for April and May.

Sources: the NSI, BNB calculations.

Dynamics of Nominal Retail Trade Volumes

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



Notes: Non-additive data on contributions due to direct seasonal adjustment of the total amount and its components. Data for the second quarter of 2019 are for April and May.

Sources: the NSI, BNB calculations.

sector and the two industrial sub-sectors – construction and industry, had the main positive contribution to the change in employment, while the number of employed in agriculture continued to decrease. Employment growth in construction was probably driven by the increasing construction output over the period, while the higher number of employees in industry was in line with higher exports of Bulgarian goods in the first quarter of 2019. In the third and fourth quarters of 2019 employment is expected to increase at moderate rates on a quarterly basis due to steady labour demand by firms. Concurrently, the expected wage growth will be a reason for an increase in labour supply by households.

In the first quarter of 2019 labour productivity continued to increase on a quarterly basis driven by stronger growth of value added in the economy compared with employment. Labour productivity growth was also favoured by the larger number of hours worked *per* employee. The dynamics across sectors was divergent, with industry contributing most substantially to higher productivity, while construction retained its negative contribution.

The nominal compensation *per* employee accelerated its quarterly growth rate in the first quarter of 2019, which was mainly due to the services sector. The upward wage dynamics reflected steady labour demand and limited supply, as well as the increased minimum wage, higher insurance thresholds⁵⁶ and public sector wage rises, effective since the beginning of the year. The compensation *per* employee is expected to increase further on an annual basis in the second quarter of 2019 but at a slower pace due to worsening business expectations about production activity. Notwithstanding, the major factor responsible for the wage dynamics will be the steady labour demand amid declining labour supply.⁵⁷

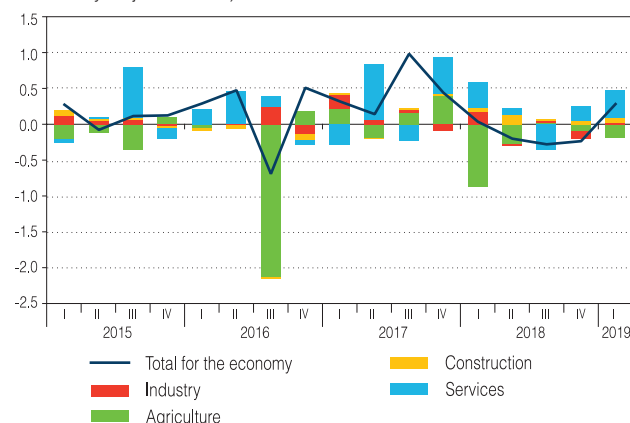
Labour productivity growth in the total economy at rates slower than compensation *per* employee growth resulted in higher unit labour costs in

⁵⁶ Since early 2019 the monthly minimum wage in Bulgaria was raised from BGN 510 to BGN 560, the monthly amount of minimum social security income for registered farmers and tobacco-growers from BGN 350 to BGN 400 and the maximum monthly contribution income from BGN 2600 to BGN 3000.

⁵⁷ Labour demand is measured by companies' expectations about staff employment according to NSI survey of business developments, and labour supply is measured by an unemployment rate.

Employment Growth Rate in the Total Economy and Contribution to Changes in the Number of Employed by Economic Sector

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

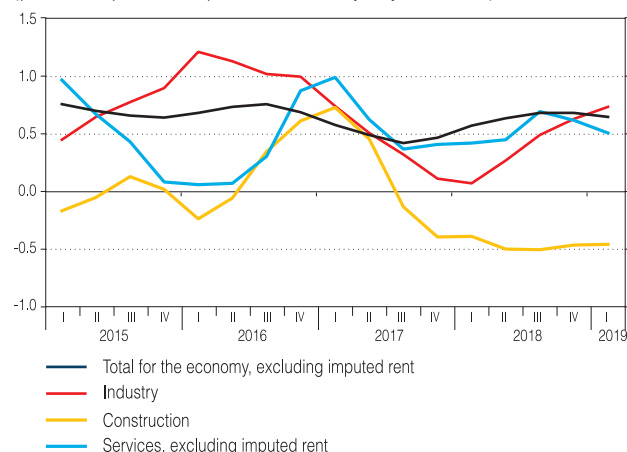


Note: Non-additive data on contributions due to direct seasonal adjustment of the total amount and its components.

Sources: the NSI, BNB calculations.

Labour Productivity Developments (Value Added *per* Employee)

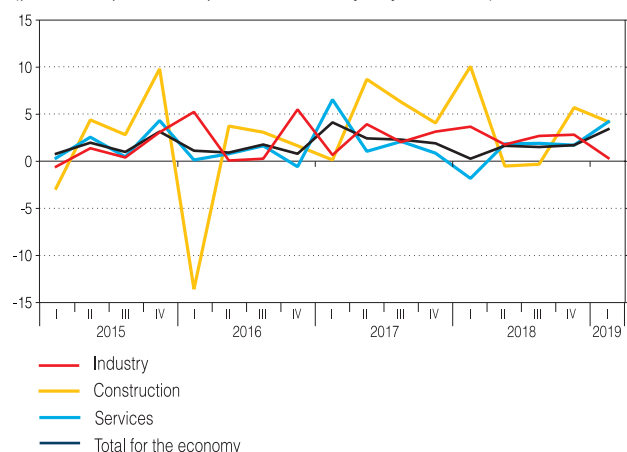
(per cent, quarter-on-quarter; seasonally adjusted data)



Sources: the NSI, BNB calculations.

Compensation *per* Employee at Current Prices

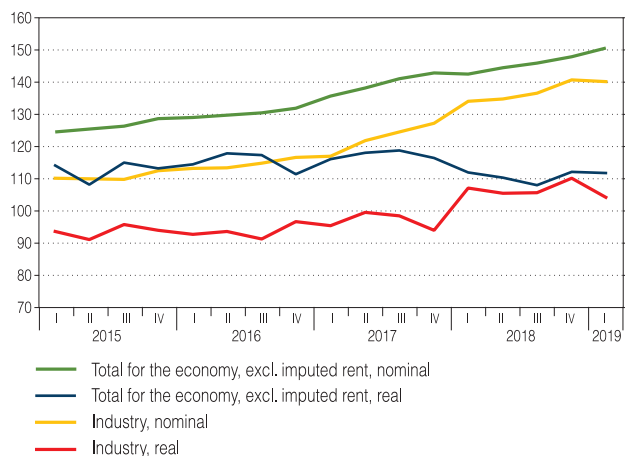
(per cent, quarter-on-quarter; seasonally adjusted data)



Sources: the NSI, BNB calculations.

Unit Labour Costs

(2010 = 100; seasonally adjusted data)



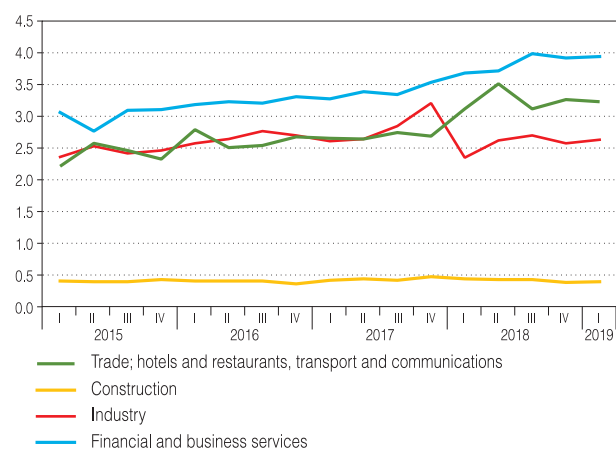
Sources: the NSI, BNB calculations.

nominal terms in the first quarter of 2019. This was most strongly pronounced in agriculture and in the information and communication services sub-sector.

In the first quarter of 2019 gross operating surplus accelerated its growth rate from the previous quarter, with all main sectors contributing positively to growth. Financing of firms from sources other than the gross operating surplus again

Gross Operating Surplus at Current Prices

(billion BGN; seasonally adjusted data)



Sources: the NSI, BNB calculations.

Gross Value Added Growth

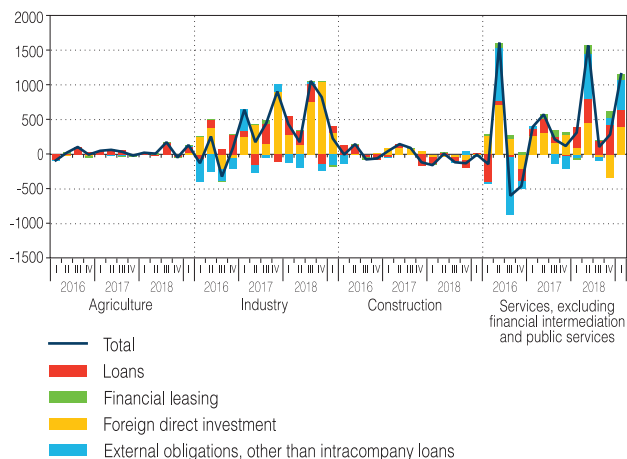
(per cent, quarter-on-quarter; real rate, seasonally adjusted data)

	2015				2016				2017				2018				2019
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Agriculture, forestry and fishing	-6.6	-0.8	-1.9	-1.4	3.5	0.5	3.3	-0.6	4.9	1.0	1.8	0.3	-2.7	-0.4	0.9	-0.2	-0.6
Mining and quarrying; manufacturing; electricity, gas, steam and air conditioning supply; water supply; sewerage, waste management and remediation activities	0.8	1.2	1.1	1.0	1.6	1.4	1.5	1.5	1.0	0.7	0.4	0.3	0.4	0.6	0.4	0.3	0.6
Construction	0.7	1.3	1.9	2.1	-10.2	1.1	1.2	1.0	1.0	1.2	0.4	0.4	1.0	0.4	0.5	1.3	-1.5
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	2.7	-0.2	2.1	-0.8	0.1	1.8	0.5	1.2	0.6	0.6	0.2	0.8	1.0	0.4	0.5	0.5	1.1
Information and communication	0.2	0.3	0.9	1.0	15.3	-1.7	-0.4	1.0	1.7	2.1	1.7	1.6	1.2	1.6	0.8	0.9	0.8
Financial and insurance activities	-1.7	-4.6	6.0	1.6	1.9	2.9	-0.3	-1.3	1.9	-2.4	1.0	0.7	4.2	-0.3	0.6	3.0	-0.2
Real estate activities	0.4	0.9	1.0	0.8	1.5	1.4	1.6	1.7	1.9	1.8	1.6	1.9	1.7	1.7	2.7	0.8	1.1
Professional, scientific and technical activities; administrative and support service activities	3.6	0.9	1.5	2.1	-1.4	1.3	0.3	-0.6	1.2	-0.3	0.6	1.4	0.5	1.3	0.4	0.2	0.9
Public administration, education, human health and social work activities	0.1	0.0	0.0	-0.6	-3.2	0.8	1.2	0.5	3.4	-1.2	1.4	0.6	0.8	0.8	0.2	0.2	0.4
Culture, sport and entertainment; other activities; activities of households as employers; non-identified activities of households producing goods and services for own use; activities of extraterritorial organisations and bodies	2.1	2.0	-2.2	1.4	-1.9	0.2	-0.9	1.5	2.1	-0.1	3.5	-0.1	-2.6	0.8	0.1	-0.2	0.1
Gross value added, total for the economy	0.0	0.8	1.2	-0.1	1.2	1.0	1.0	1.1	1.3	0.8	0.8	0.9	0.7	0.7	0.7	0.8	0.7

Source: NSI.

Financing Sources*

(million BGN, quarter-on-quarter volume change)



* Sources of financing other than gross operating surplus.

Source: the BNB.

suggested a concentration of attracted financing in the industrial and services sectors (excluding public services and financial intermediation). In the first quarter of the year industry was financed mostly by foreign direct investment and loans from residents, while the sources of services financing included also loans from non-residents.

Fixed capital investment growth, improved labour productivity and the high rate of production capacity utilisation were the major reason for the capital and total factor productivity to retain their significant positive contribution to growth of real GDP by production factor. Labour also had a positive contribution to GDP growth, but it was lower due to slower employment growth.

Household Behaviour

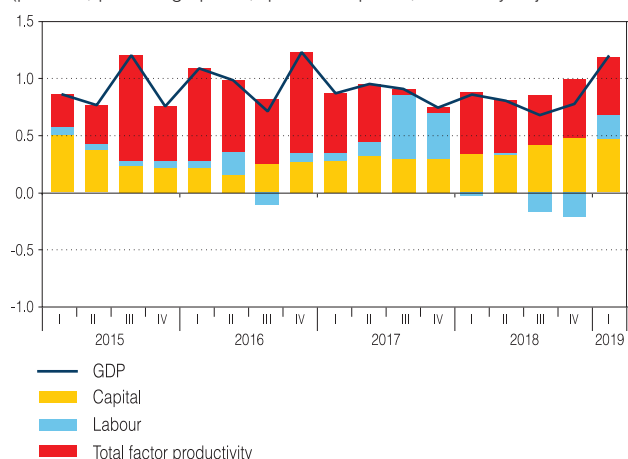
Labour market indicators related to the employment dynamics and labour income continued to improve in the first quarter of 2019. This favoured the quarter-on-quarter increase in private consumption. Concurrently, the consumer confidence indicator was worsening from the beginning of the year, which was a reason for a portion of household disposable income to be saved in the form of deposits.

The NSI Labour Force Survey shows that in the first quarter of 2019 labour supply, as measured by the labour force⁵⁸, increased. The downward

⁵⁸ The labour force (currently economically active population) comprises persons aged 15 and older who provide the supply of labour for the production of goods or services. Labour force includes both employed and unemployed persons.

Contribution of Changes in Production Factors to GDP Growth

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

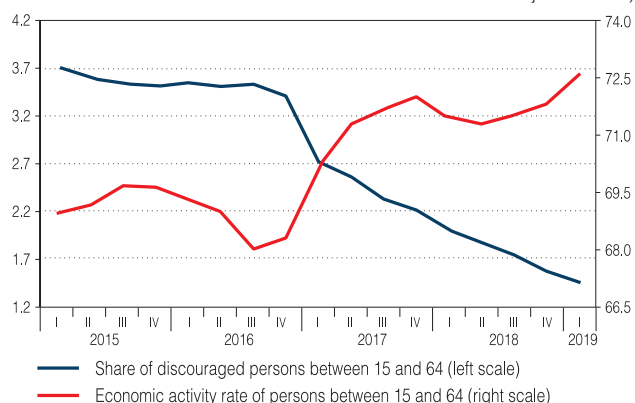


Sources: the NSI, BNB calculations.

Economic Activity and Share of Discouraged Persons

(per cent, seasonally adjusted data)

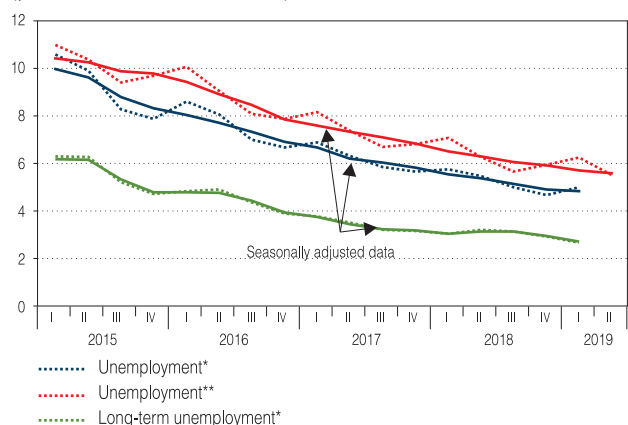
(per cent, seasonally adjusted data)



Sources: NSI Labour Force Survey, BNB calculations.

Unemployment Rate

(per cent, share of labour force)



* NSI data.

** Employment Agency data.

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

trend in the number of discouraged persons continued in the first three months of 2019. As a result, the participation rate⁵⁹ rose on the previous quarter and on an annual basis.

The Labour Force Survey shows that in the first quarter of 2019 the seasonally adjusted unemployment rate⁶⁰ continued to decrease, reaching 4.8 per cent (according to non-seasonally adjusted data: 5.0 per cent). The fall in unemployment was mostly due to the decline in the number of long-term unemployed (more than one year) and, to a lesser extent, to persons unemployed for less than a year. The seasonally adjusted unemployment rate⁶¹ calculated using the Employment Agency data also continued to decrease, reaching 5.6 per cent in June 2019 (according to non-seasonally adjusted data: 5.2 per cent).

Labour remunerations accelerated their growth rate in the first quarter of 2019 (both annually, according to non-seasonally adjusted data on the wage bill and average wage *per* employee, and quarterly according to seasonally adjusted national accounts data)⁶².

Despite the positive dynamics of labour market indicators, the consumer confidence indicator declined due to worsening expectations of households for their financial position and the overall economic situation in Bulgaria as reported in the NSI Consumer Survey of April 2019.

In the first quarter of 2019 quarter-on-quarter real private consumption growth was positive, reflecting accelerated wage growth and higher employment over the period. However, the lower consumer confidence resulted in slower annual growth of consumer expenditure according to national accounts data. Slower growth in nominal volumes of retail trade on a quarterly basis in the first quarter was reversed in the April–May period, with the real component of food contributing most significantly.

⁵⁹ The labour force participation rate is the proportion between economically active persons (labour force) and the population of the same age.

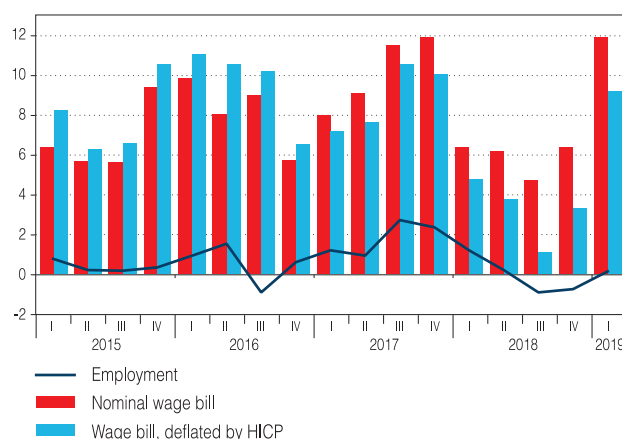
⁶⁰ The unemployment rate is the proportion between the number of unemployed and the labour force based on Labour Force Survey data. Data are seasonally adjusted by the BNB.

⁶¹ The definition of the unemployment rate according to the Employment Agency corresponds to that referred to in footnote 60, but using a constant rate of labour force comprising the number of persons in the respective age group since the last census of the population.

⁶² For details, see the Behaviour of Firms and Competitiveness Section in Chapter 3.

Employment and Nominal Wage Bill

(annual change, per cent)

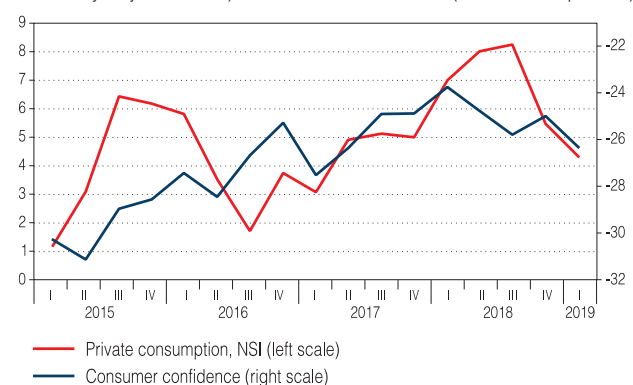


Sources: the NSI – SNA, BNB calculations.

Private Consumption and Consumer Confidence

(quarterly change, per cent; seasonally adjusted data)

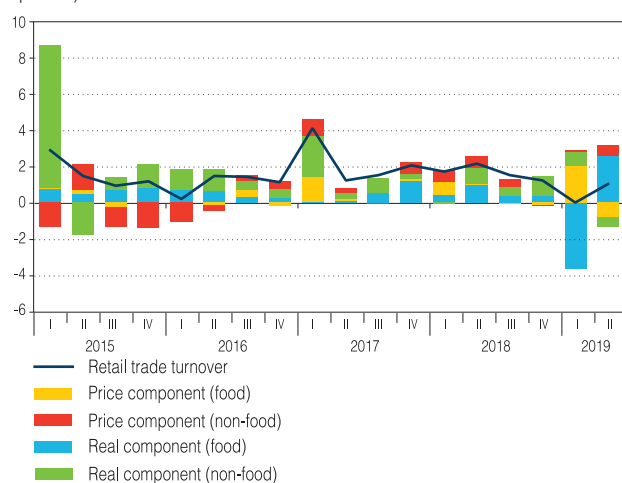
(balance of opinions)



Sources: the NSI, BNB calculations.

Retail Trade Turnover

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



Notes: Non-additive data on contributions due to direct seasonal adjustment of the total amount and its components. Data for the second quarter of 2019 are for April and May.

Sources: the NSI, BNB calculations.

This is indicative of continuous private consumption growth in the second quarter of the year.

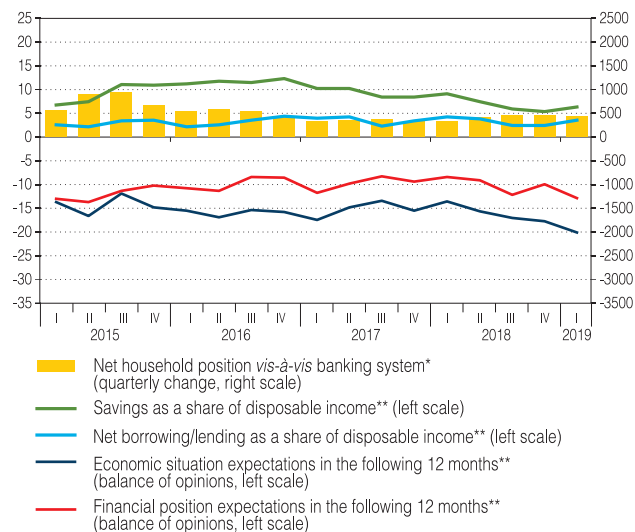
The NSI Household Budget Survey data show that the share of savings in household disposable income rose in the first quarter of 2019 in line with lower consumer confidence and increased uncertainty. The share of households intending to increase their savings in the following 12 months remains high (according to the NSI Consumer Survey of April 2019). Household assets measured by their net position in the banking system slightly decreased in the first quarter of 2019.

In the third and fourth quarters of 2019 the economic activity rate of working age population is expected to continue increasing at moderate rates. This will be driven by the expected further labour remuneration rises and the corporations' positive sentiment about staff employment. Concurrently, the unemployment rate will continue declining. Employment growth and labour remunerations will have a positive effect on private consumption growth, while possible further worsening of consumer confidence poses risks of lower consumer expenditure.

Household Propensity to Save and Expectations

(per cent; seasonally adjusted data)

(BGN million; seasonally adjusted data)



* BNB data.

** NSI data.

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

Employment and Income Dynamics

	2015				2016				2017				2018				2019
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
(per cent, quarter-on-quarter; seasonally adjusted data)																	
Employed persons	0.3	-0.1	0.1	0.1	0.3	0.5	-0.7	0.5	0.3	0.1	1.0	0.4	0.0	-0.2	-0.3	-0.2	0.3
Nominal wage <i>per employee</i> *	0.9	2.0	1.3	3.1	1.6	0.8	1.7	0.8	3.6	2.6	2.1	1.8	0.2	1.4	1.6	1.6	3.2
Real wage <i>per employee</i> **	1.3	1.8	1.8	3.6	2.0	1.3	1.3	0.7	3.2	2.1	2.5	0.5	-0.5	0.6	0.7	0.9	2.7
Wage bill, nominal terms	1.6	2	1.7	3.2	1.6	1.5	1.9	1.4	3.5	2.3	2.4	2.0	0.8	1.6	1.2	2.0	3.4
Wage bill, real terms**	2.0	1.9	2.2	3.8	2.0	2.1	1.6	1.3	3.2	1.8	2.7	0.7	0.1	0.9	0.2	1.4	2.9
(per cent, on corresponding quarter of previous year, non-seasonally adjusted data)																	
Employed persons	0.8	0.2	0.2	0.3	0.9	1.5	-1.0	0.6	1.2	0.9	2.7	2.4	1.2	0.2	-0.9	-0.8	0.1
Nominal wage <i>per employee</i> *	5.5	5.1	4.2	8.1	8.2	5.9	7.4	3.6	6.9	9.3	11.3	11.7	5.0	4.7	4.7	5.8	11.4
Real wage <i>per employee</i> **	7.4	5.8	5.2	9.2	9.4	8.4	8.6	4.4	6.1	7.8	10.4	9.8	3.4	2.3	1.0	2.7	8.7
Wage bill, nominal terms	6.4	5.7	5.6	9.5	9.9	8.0	9.1	5.7	8.0	9.1	11.5	12.0	6.4	6.2	4.7	6.4	12.0
Wage bill, real terms**	8.3	6.3	6.6	10.6	11.1	10.6	10.3	6.5	7.2	7.6	10.6	10.1	4.8	3.7	1.1	3.3	9.2

* The wage is calculated according to NSI data (SNA), with social security contributions paid by the employer deducted from the compensation *per employee*. The difference is divided by the number of employees.

** Data deflated by HICP.

Sources: NSI – SNA, BNB calculations, Eurostat.

Retail Trade Turnover

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

	2015				2016				2017				2018				2019	
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II*
Retail trade, excluding motor vehicles and motorcycles incl.	7.9	-1.1	1.4	2.1	1.6	1.9	1.1	0.8	2.4	0.5	1.4	1.1	1.0	1.4	0.7	1.1	-0.9	0.2
Food, drinks and tobacco products	2.1	1.4	1.9	2.2	1.9	1.9	1.0	0.7	0.2	0.4	1.5	3.2	1.2	2.7	1.0	1.1	-9.9	7.0
Textile, clothing, footwear and leather	-0.8	0.1	3.9	2.9	2.5	2.9	1.3	-0.2	12.6	-2.7	-5.3	0.5	-0.8	2.6	1.0	2.6	1.1	-4.5
Household appliances, furniture and other household goods	0.7	-0.1	1.8	-0.2	2.3	0.3	1.2	2.0	1.0	2.9	1.5	1.2	0.7	2.5	2.8	-1.0	12.2	-7.3
Computer and communication equipment	16.4	-5.5	0.3	-2.7	-1.8	5.3	1.9	7.7	-1.8	0.5	0.5	2.1	-4.2	1.1	-1.8	-3.6	8.5	1.0
Pharmaceutical and medical goods, cosmetics and toiletries	2.4	1.6	1.9	2.5	2.0	3.5	3.6	0.9	0.9	2.4	1.3	1.3	6.4	2.0	2.9	5.3	-14.2	0.8
Unspecialised shops with different kinds of goods	1.3	0.4	1.5	2.3	0.0	1.2	2.5	1.4	4.2	2.0	2.1	0.3	-1.2	1.6	1.1	-1.0	6.6	-2.0
Automobile fuels and lubricants	38.6	-6.5	-0.4	5.4	0.8	1.5	-2.2	-3.0	6.8	-2.3	1.2	-1.1	-2.3	2.3	0.1	5.5	2.5	-3.2

* Data for the second quarter of 2019 are for April and May.

Source: NSI, short-term business statistics.

Impact of Fiscal Policy on the Economy

In the first five months of 2019 the fiscal policy continued to have a comparatively strong effect on the economic activity in Bulgaria mostly through government current expenditure in terms of government consumption and transfers to households.

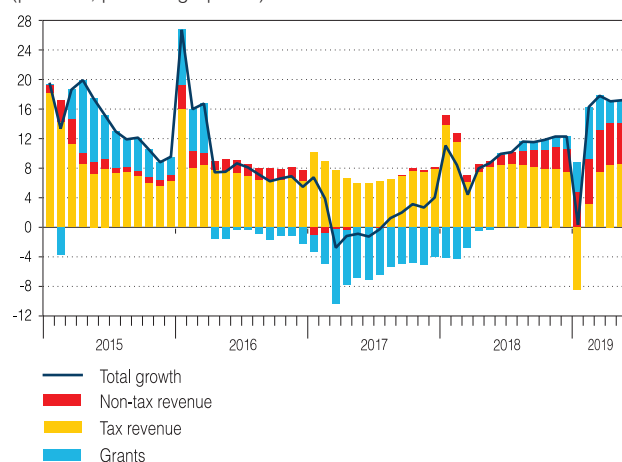
At the end of May 2019 the consolidated fiscal programme surplus came to BGN 3026 million (2.6 per cent of the projected GDP for the year)⁶³ against a surplus of 1.3 per cent of GDP in the same period of 2018. The higher surplus in the January–May 2019 period compared with the first five months of the previous year was a result of significantly increased revenue on the consolidated fiscal programme (by 1.4 per cent of GDP) amid the stable total expenditure/GDP ratio.

At the end of May total budget revenue growth was 17.2 per cent reflecting mainly tax revenue (8.6 percentage points) and, to a lesser degree, non-tax revenue (5.4 percentage points). The strong contribution of non-tax revenue to growth of revenue on the consolidated fiscal programme continued to be driven by the changes in the budget of the Security of the Electricity System

⁶³ GDP forecasts of the Ministry of Finance for 2019 based on the spring macroeconomic forecast for the 2019–2022 period published on 4 April 2019.

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

(per cent; percentage points)



Sources: the MF, BNB calculations.

Fund.⁶⁴ The contribution of revenue from grants was 3.1 percentage points, with its dynamics reflecting mainly the reimbursed funds on public investment spending co-financed under EU programmes at the close of 2018.

The accelerated economic activity, stronger growth of labour income and the higher number of employed persons in early 2019 added substantially to the upward dynamics of tax revenue in the first five months of the year. At the end of May the annual growth rate of tax revenue was 10.2 per cent underpinned mainly by the dynamics of the revenue from social security and health insurance contributions (up 11.6 per cent) and VAT revenue (up 10.1 per cent). Sustainable growth in revenue from social and health insurance contributions continued to reflect wage rises and the higher number of employed in the economy. It was also affected by the increased maximum amount of social security income, minimum wage and minimum social security income, in force from the beginning of 2019. Concurrently, strong growth of VAT revenue on an annual basis at the end of May reflected mainly household consumption developments and the gradually exhausting one-off effect of lower revenue in March 2018.

Favourable labour market conditions were the major factor behind the increase in personal income tax revenue, with the annual rate of growth accelerating from early 2019 to reach 9.7 per cent in May. Corporate tax revenue growth accounted for 3.3 per cent at the end of the first five months of 2019.

Following the strong January fall, the annual growth rate in excise revenue accelerated to 14.4 per cent due mainly to the base effect from lower revenue between February and May 2018 as a result of excessive stockpiling in the commercial network at end-2017 after the excise duties on cigarettes had been raised.⁶⁵

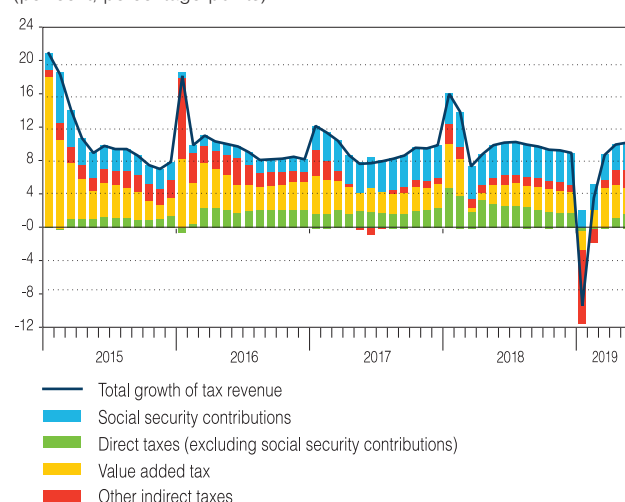
In May 2019 the annual growth in total consolidated fiscal programme expenditure was lower

⁶⁴ As of 1 July 2018 revenue into the Electric Power System Security Fund's budget included income from public service obligations under the Energy Law Article 30 paragraph 1 item 17 which obliges power grid consumers to assume some compensation of Article 34 and 35 costs.

⁶⁵ As of 1 January 2018 the overall excise duty on cigarettes was increased from BGN 168 to BGN 177 per 1000 cigarettes.

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

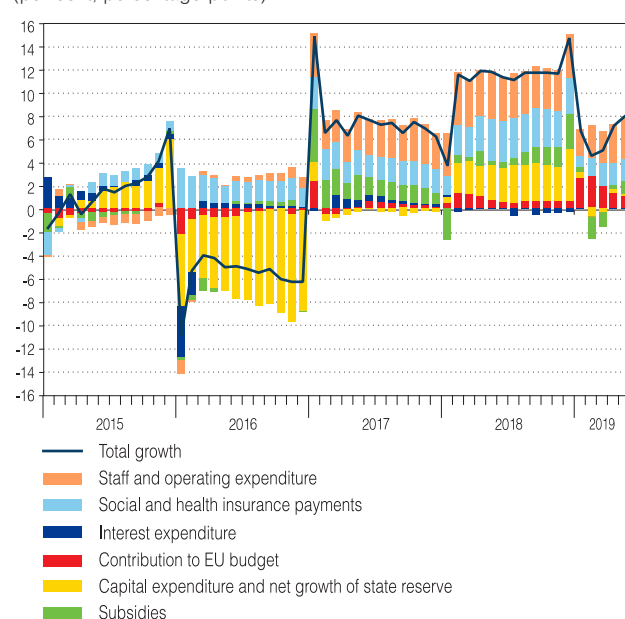
(per cent; percentage points)



Sources: the MF, BNB calculations.

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

(per cent; percentage points)



Notes: In the consolidated fiscal programme reports of January 2016 staff costs include wage, insurance and other remuneration expenditure, while in the reports for past periods, they are included in the operating expenditure. To prevent data inconsistencies prior to and after January 2016 resulting from methodological change, staff and operating expenditures are presented aggregately in the chart and separately in the table Key Budget Indicators Performance for 2018 and 2019.

Sources: the MF, BNB calculations.

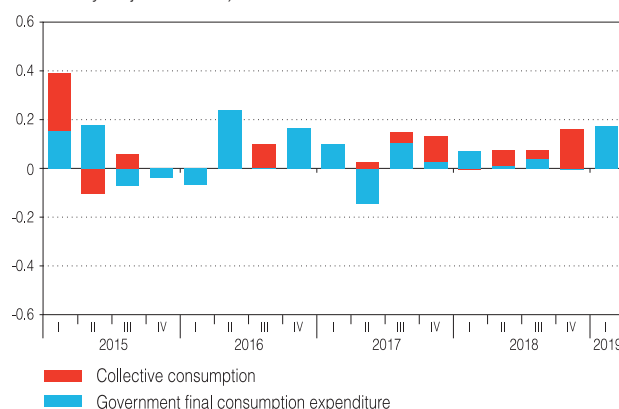
than the previous year's rates of change: 7.8 per cent. Staff costs (3.3 percentage points) contributed most significantly to growth of total budget expenditure, followed by the lower contribution of social payments (2.1 percentage points), subsidies (1.1 percentage points), and expenditure on Bulgaria's contribution to the EU budget (1.0 percentage point). Higher staff costs by 13.9 per cent on an annual basis at end-May was driven mainly by the 10 per cent rise in the public sector staff costs projected in the budgetary framework and the continued policy of wage increases in education. The growth rate of social expenditure also gradually accelerated from the beginning of the year, reflecting mainly the strong increase in health insurance payments. Pension and other cash benefit costs continued to add to the higher household disposable income having a potential positive effect on the economic activity through stronger private consumption. Concurrently, subsidy payment dynamics compared with the corresponding period of 2018 reflected mainly subsidies paid by the Security of the Electricity System Fund.

Government consumption contribution to real GDP growth on a quarterly basis in the first quarter of the year remained close to 2018's last quarter growth (0.2 percentage points). Government consumption growth in early 2019 was primarily ascribable to the higher public expenditure on wages and, to a lesser extent, to the increased health insurance payments. Given the high growth rate of these expenditures in the first five months of the year and gradually recovering growth of operating expenditure (to 2.9 per cent in May following the fall to -3.8 per cent on an annual basis in March), government consumption is expected to retain its positive contribution to real GDP growth in the second quarter of the year.

At the end of the first quarter of 2019 government capital expenditure fell by 5.2 per cent on an annual basis due entirely to the lower national investment expenditure (by -11.9 per cent), while capital expenditure under EU programmes remained close to the levels reported in the corresponding period of the previous year. In May the annual growth rate of capital expenditure accounted for 3.5 per cent, reflecting a 13.1 per cent increase in investment expenditure co-financed by the EU and the slower decline in national investments to 8.2 per cent. For the

Contribution of Government Consumption Components to Real GDP Growth

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



Sources: the NSI, BNB calculations.

first five months of the year the dynamics of capital expenditure under the consolidated fiscal programme indicates a gradual increase in the contribution of government investment to GDP growth in the first half of the year.

Developments in the labour market and household consumption will play an essential role in increasing tax and social security revenue in the second half of the year. Changes to the tax and social security legislation, in force from the beginning of 2019, are expected to have a weaker effect.

Based on the 2019 budgetary framework parameters related to the public sector staff expenditure rises, and the continuous increase in health insurance payments and operating expenditure, the contribution of government consumption to real GDP growth is expected to remain relatively high until the end of the year. The current measures aimed at increasing social payments coupled with the average pension rise by 5.7 per cent from 1 July 2019 are expected to help sustain the fiscal policy's positive effect on the economic activity through larger transfers to households.

In the third and fourth quarters of the year the forecast includes an assumption for a significant positive contribution of government investment to economic growth. The contribution is expected to be driven by further accelerating capital expenditure under EU programmes in parallel with the progress of EU projects implementation. Total government expenditure growth is expected to be influenced by the national capital expenditure on constructing a Hemus motorway section as approved by the government at end-2018. Possible delays in expected government investment expenditure pose a potential risk to lower than projected real economic growth in the second half of the year.

Key Budget Indicators Performance for 2018 and 2019

Consolidated Fiscal Programme	2018 January – May ¹		2019 January – May ¹	
	BGN million	per cent ²	BGN million	per cent ²
Total revenue and grants	15,978	8.6	18,720	17.2
Tax revenue	13,405	9.9	14,777	10.2
incl. social security and health insurance contributions	3,797	14.1	4,238	11.6
Non-tax revenue	2,085	5.3	2,953	41.6
Grants	488	-9.3	990	102.7
Total expenditure (incl. the contribution to EU budget)	14,557	11.7	15,694	7.8
Staff	3,470	11.3	3,954	13.9
Operating expenditure	1,601	12.9	1,648	2.9
Interest	412	-2.3	403	-2.2
Social expenditure, scholarships ³	6,654	7.5	6,938	4.3
Subsidies	948	6.0	1,102	16.2
Capital expenditure and government reserve growth	1,015	61.8	1,050	3.4
incl. capital expenditure	1,016	61.4	1,052	3.5
Contribution to general budget of the European Union	456	25.5	599	31.3
	BGN million	difference ⁴ (BGN million)	BGN million	difference ⁴ (BGN million)
Budget balance, on a cash basis	1,422	-262	3,026	1,604
Tax revenue under the state budget	2018 January – May ⁵		2019 January – May ⁵	
	BGN million	per cent ²	BGN million	per cent ²
Tax revenue	9,106	8.4	10,010	9.9
Corporate tax	1,189	9.9	1,229	3.3
Income tax for individuals	1,545	15.8	1,695	9.7
Value added tax	4,220	6.9	4,648	10.1
Excise duties	1,928	4.5	2,205	14.4
Customs duties and taxes	98	25.9	97	-1.7
Insurance premia tax	18	13.0	21	16.0
Other taxes	107	6.9	115	7.4

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

¹ Based on monthly reports on cash-based performance of the consolidated fiscal programme.

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

³ Including also expenses on current and capital transfers, which in 2018 are presented in monthly reports on cash-based performance of the consolidated fiscal programme as a separate item in the expenditure side of the budget.

⁴ The change of the budget balance on the same period of previous year.

⁵ Based on monthly reports on cash-based implementation of the state budget.

Source: the MF.

4. INFLATION

In June annual inflation remained unchanged from end-2018 at 2.3 per cent, with core HICP components and food contributing the most. Goods and services with administratively controlled prices and tobacco products also added to overall inflation. In the context of a year-on-year decline in euro international oil prices, energy products contributed negatively to the overall inflation in June.

In the second half of the year consumer price inflation is expected to accelerate slightly, mainly driven by the anticipated price rise of energy products as a result of higher annual euro oil prices at the end of 2019. Inflation in services is projected to moderate due to exhausted base effects in accommodation services and insurance connected with transport, but to keep its comparatively high contribution to the overall annual inflation. Food price inflation is also expected to continue contributing strongly to inflation, mainly driven by domestic factors.

In June annual inflation remained unchanged from end-2018 accounting for 2.3 per cent⁶⁶. Core HICP components (mainly services and, to a lesser extent, industrial goods) and food had a major positive contribution to inflation, with their inflation rate increasing significantly from end-2018.

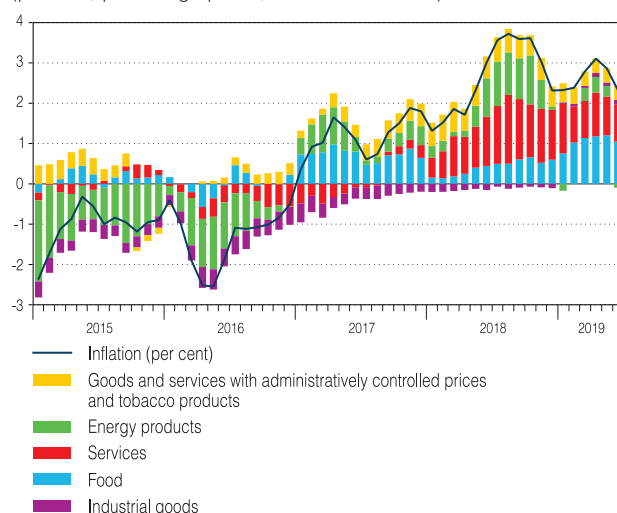
Goods and services with administratively controlled prices also had a positive contribution to annual inflation, reflecting price rises in electricity, central heating and gas supply in the second half of 2018, and the increased prices of water supply and natural gas in early 2019.

In June 2019 energy products reported a deflation on the same month of 2018 (-0.9 per cent in June against 1 per cent at the end of 2018) in line with the lower international euro oil price.

The effect of the international prices of fuels, food and commodities on inflation may be seen through price developments of the goods imported in Bulgaria. According to national accounts data, annual growth in the price deflator for imported goods slowed down to 0.4 per cent in the first quarter of 2019 from 1.0 per cent at the end of 2018. Notwithstanding, individual components of imported prices accelerated their growth in line with HICP developments⁶⁷. BNB calculations show⁶⁸ that prices of imported

Inflation and Contributions of Major Commodity and Services Groups to It

(per cent, percentage points; on an annual basis)

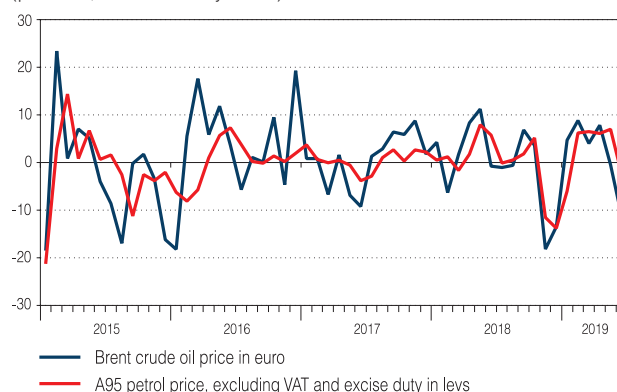


Notes: This structure corresponds to the Eurostat classification; tobacco products and goods and services with administratively controlled prices are presented separately. The index of goods and services with administratively controlled prices is calculated through the elementary aggregates level in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

Sources: the NSI, BNB calculations.

Rate of Change in Brent Crude Oil and A95 Petrol Prices

(per cent; on a monthly basis)



Sources: the ECB, the NSI, BNB calculations.

⁶⁶ The analysis in this Chapter employs NSI data on HICP.

⁶⁷ Imports data under the Standard International Trade Classification (SITC).

⁶⁸ Real import volumes under SITC groupings are constructed, with NSI data used for import prices and nominal exports under the SITC.

cereals⁶⁹ and vegetables⁷⁰ increased in the first quarter of 2019, with their end prices measured by HICP also rising. This points to external factors contributing to the positive annual inflation of some food products.

In May 2019 the annual growth rate of the total producer price index (PPI) accelerated to 3.4 per cent in the domestic market, from 2.9 per cent in December 2018. The price rise in annual producer prices in May was largely due to the production and distribution of electricity and heating sub-sector⁷¹, which was in line with the price hikes in electricity, heating and gas supply in the second half of 2018⁷² and the gas price rise in early 2019⁷³, as well as to the manufacturing sub-sector. Production of food, beverages and tobacco products had the largest contribution to annual price rises in manufacturing in line with the upward inflation developments in the food group.

According to the end-use classification, in May 2019 the PPI increase in the domestic market on the corresponding period of 2018 was mainly driven by energy products (electricity, natural gas and refined petroleum products), which comprise a significant part of firms' costs. At the same time, in May 2019 the accelerated producer price rise in the manufacture of bakery and farinaceous products group, which started in mid-2018, was sustained, contributing most substantially to the higher producer prices of non-durable consumer goods.

Higher producer prices were a precondition for a rise in end-user prices of processed food, with inflation accelerating to 4.0 per cent on an annual basis in June 2019, from 2.5 per cent at the

⁶⁹ This refers to the sub-group of cereals and mill products under the SITC.

⁷⁰ This refers to the sub-group of vegetables and fruit under the SITC.

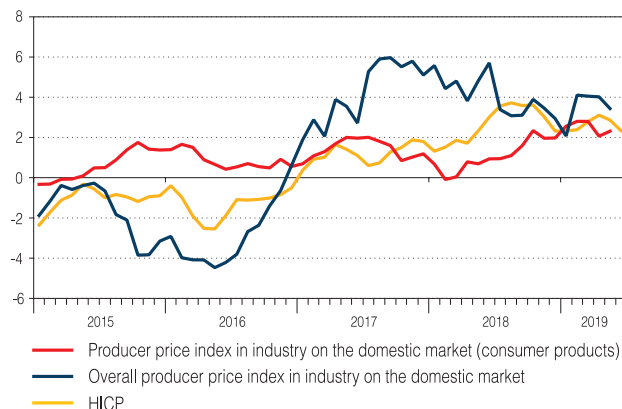
⁷¹ This refers to the production and distribution of electricity, heating, and gaseous fuels.

⁷² For details, see: <http://www.dker.bg/news/222/65/kevr-utvrdiv-okonchatelnite-tseni-ot-1-yuli-na-elektricheskata-i-na-toplinnata-energiya-i-na-energiyata-proizvedena-ot-toplotsentrali-po-visokoefektiven-kombiniran-sposob.html> and <http://www.dker.bg/news/253/65/kevr-utvrdiv-okonchatelnite-tseni-ot-1-oktomvri-na-toplinnata-energiya-i-na-elektricheskata-energiya-ot-visokoefektivno-kombinirano-proizvodstvo.html>

⁷³ For details, see: <http://www.dker.bg/news/293/65/komisiyata-za-energijno-i-vodno-regulirane-utvrdiv-tsenata-na-prirodniya-gaz-za-prvoto-trimesechie-na-2019-g.html> and <http://www.dker.bg/news/318/65/komisiyata-za-energijno-i-vodno-regulirane-utvrdiv-tsenata-na-prirodniya-gaz-za-vtoroto-trimesechie-na-2019-g.html>

Rate of Change in Industrial PPI and HICP

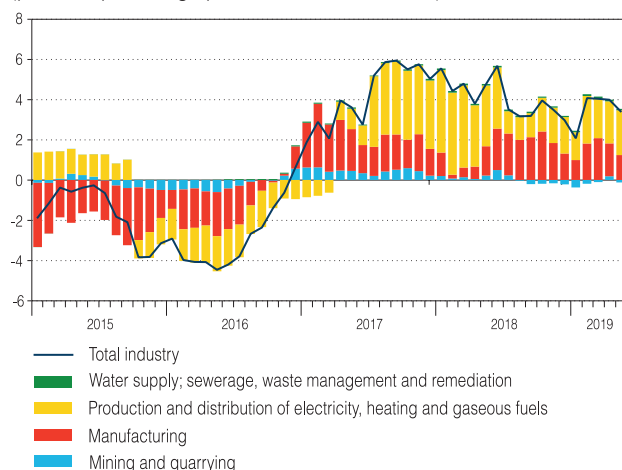
(per cent; on an annual basis)



Source: the NSI.

Rate of Change in Industrial PPI on the Domestic Market and Contribution by Major Sub-sectors

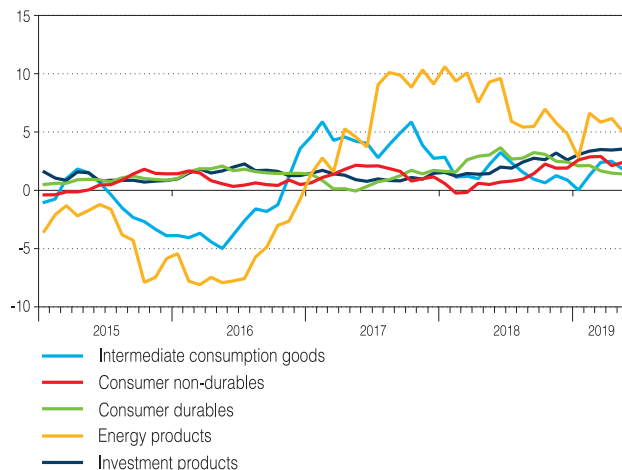
(per cent; percentage points; on an annual basis)



Source: the NSI.

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

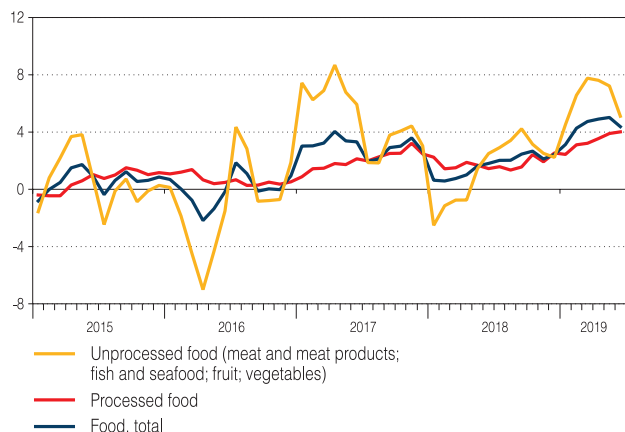
(per cent; on an annual basis)



Source: the NSI.

Rate of Change in the Food Price Index

(per cent, on an annual basis)



Sources: the NSI, BNB calculations.

end of December 2018. The accelerated annual inflation rate of processed food since early 2019 was driven to a large extent by the milk, dairy products and eggs and other processed food groups. Concurrently, in June the bread and cereals group, recording a 10.7 per cent annual growth rate, retained its highest contribution to the inflation of processed food. Important internal factors behind these developments involve poorer wheat harvests in Bulgaria due to unfavourable weather conditions⁷⁴ and an increase in producer prices of energy products, which started in early 2017.

Annual inflation in unprocessed food rose to 5.1 per cent in June 2019, from 2.2 per cent in December 2018 driven to a large extent by the strong positive contribution of the vegetables group. This rise was in line with the increase in producer prices⁷⁵ of these products since early 2019, poorer harvest in Bulgaria⁷⁶ and higher prices of imported vegetables.

In June 2019 core inflation (including services and non-food prices) slowed down to 2.3 per cent from the end of 2018 (2.5 per cent in December 2018) due mainly to weaker growth in the overall services price index.

In June 2019 annual inflation in services slowed down to 3.7 per cent from 5.0 per cent by end-2018, reflecting cheaper telecommunication

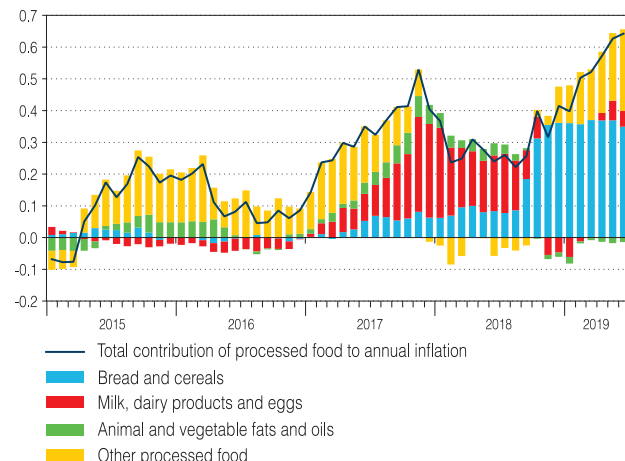
⁷⁴ NSI data derived from agricultural economic accounts statistics.

⁷⁵ The analysis employs NSI data on prices and producer price indices of agricultural output for the first quarter of 2019.

⁷⁶ See footnote 74.

Contributions of Major Sub-Groups of Processed Food to Headline Inflation

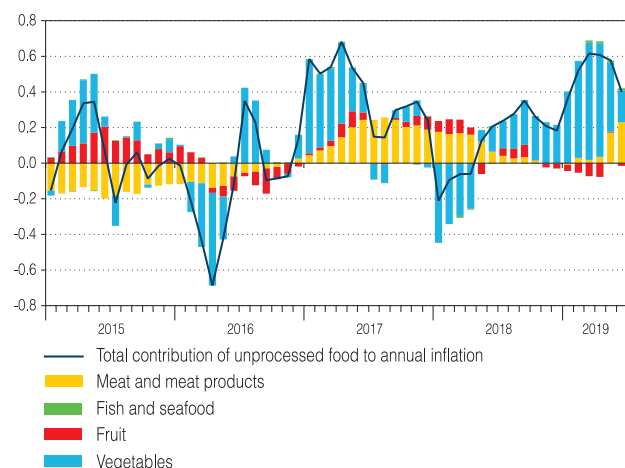
(percentage points, on an annual basis)



Sources: the NSI, BNB calculations.

Contributions of Major Sub-Groups of Unprocessed Food to Headline Inflation

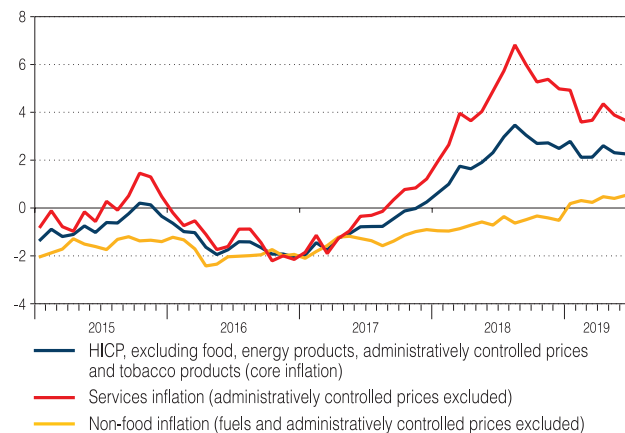
(percentage points, on an annual basis)



Sources: the NSI, BNB calculations.

Core Inflation

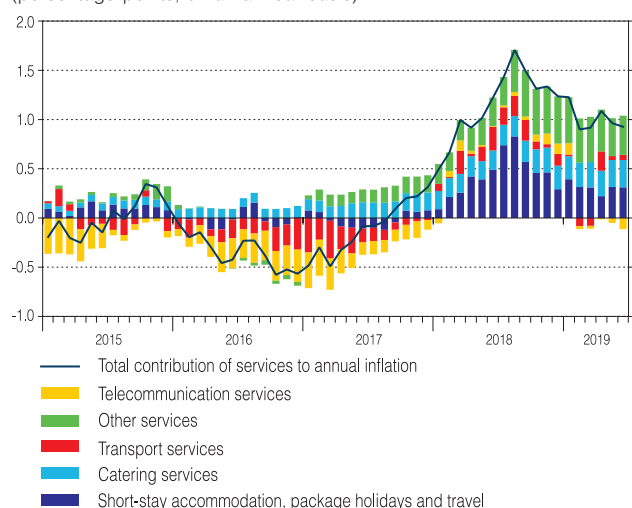
(per cent, on an annual basis)



Sources: the NSI, BNB calculations.

Contributions of Services and Major Services Sub-groups to Headline Inflation

(percentage points; on an annual basis)



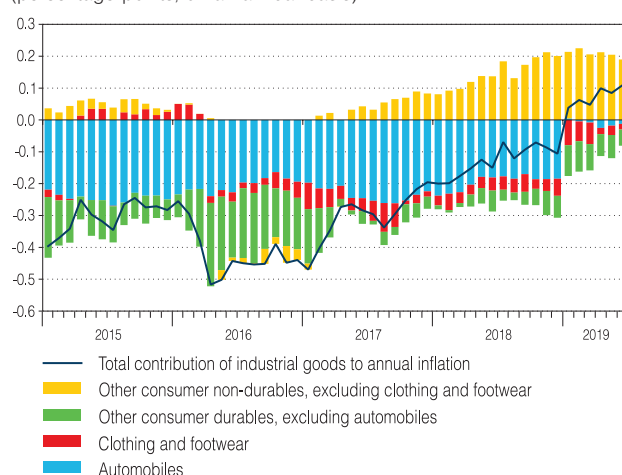
Sources: the NSI, BNB calculations.

services and the lower growth rate in transport services. Catering (where the accelerated inflation reflects the upward dynamics in food prices and consumer demand), accommodation services⁷⁷ and insurance connected with transport were the services components contributing most to headline inflation. In June 2019 higher prices of insurance connected with transport compared with the corresponding period of 2018 were attributable to a large extent to a base effect from the summer of 2018, when the Supreme Court of Cassation extended the circle of persons entitled to claim compensation for the death of a relative.⁷⁸ Another factor behind the price increase in insurance connected with transport was the higher demand resulting from the termination of an insurance company's activities in August 2018.⁷⁹

The deflation observed in non-food goods since early 2010 was reversed in early 2019 and in June the annual inflation in this group accounted for 0.5 per (-0.5 per cent in 2018). Non-durable goods had the major positive contribution to the upward price dynamics in the non-food goods group. The negative contribution of the motor vehicles group contracted significantly. Prices of

Contributions of Major Sub-groups of Non-food Goods (Excluding Energy Products) to Headline Inflation

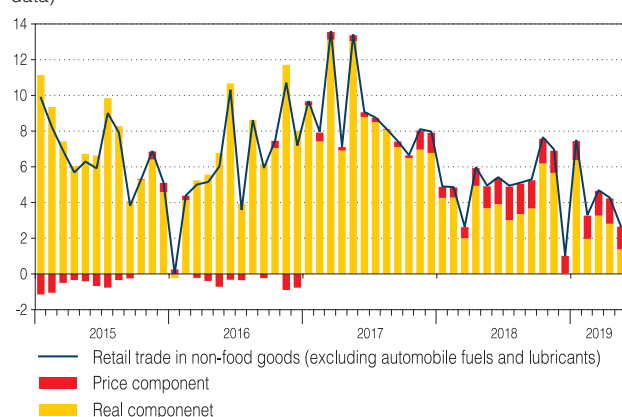
(percentage points; on an annual basis)



Sources: the NSI, BNB calculations.

Annual Growth Rate of Nominal Retail Trade in Non-Food Goods (Excluding Trade in Automobiles and Lubricants)

(per cent, percentage points, on an annual basis; seasonally adjusted data)



Sources: the NSI, BNB calculations.

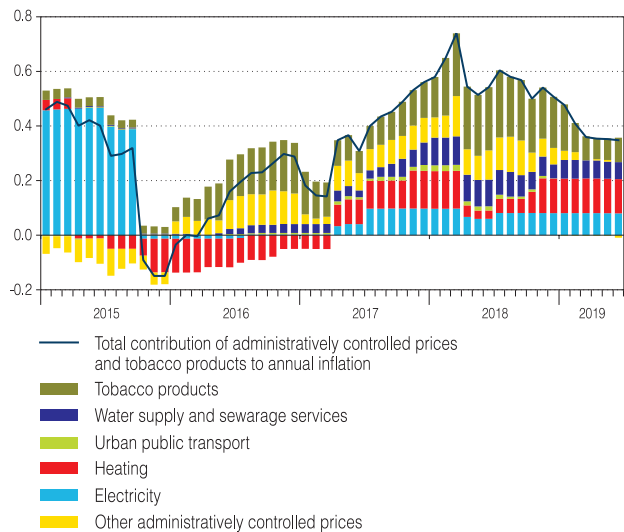
⁷⁷ The rate of inflation in accommodation services since early 2018 reflects a methodological change in calculating the price index of this group.

⁷⁸ For details, see: http://www.vks.bg/vks_p02_0500.htm

⁷⁹ For details, see: <http://www.fsc.bg/bg/novini/dogovorite-pograzhdanska-otgovornost-sklyucheni-s-klona-na-zk-olimpik-shtebadat-avtomatichno-prekrateni-9044.html>

Contribution of Major Sub-groups of Administratively Controlled Prices and Tobacco Products to Headline Inflation

(percentage points; on an annual basis)



Sources: the NSI, BNB calculations.

durable goods continued falling, though at slower rates. Developments in nominal volumes of retail trade indicate a retention of the positive trends in household demand for goods of the group, with nominal non-food retail trade turnover⁸⁰ posting annual growth of 2.7 per cent in May 2019, driven largely by the increase in traded volumes.

In the first six months of 2019 prices in the group of goods and services with administratively controlled prices and tobacco slowed their growth rate to 1.6 per cent annually in June, from 2.3 per cent in December 2018. Lower inflation in the group was driven by the decreased positive contribution of tobacco products due to the exhausted base effect from increases in excise duties on cigarettes in early 2018.⁸¹ In early 2019 the Energy and Water Regulatory Commission (EWRC) approved the increase in the prices of water and sewerage services in Bulgaria,⁸² which contributed to the accelerated growth rate of water supply prices. EWRC' decisions to raise

⁸⁰ Non-food goods retail trading, excluding trade in automobile fuels and lubricants.

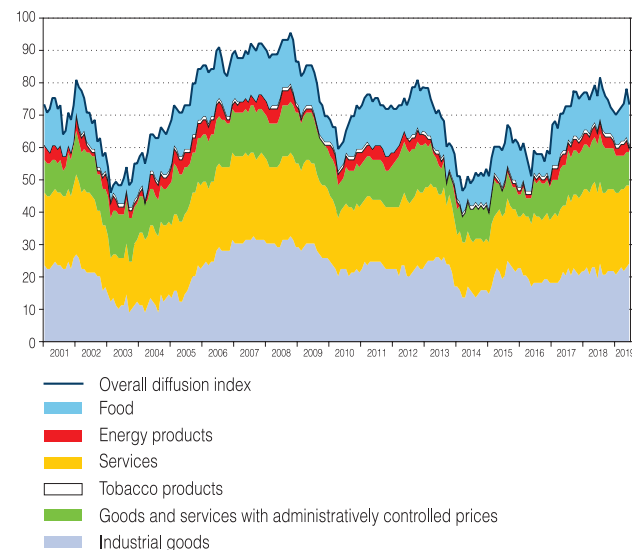
⁸¹ With effect from the beginning of 2018, the specific excise duty was raised from BGN 101 to BGN 109 per cent *per* 1000 cigarettes, the *ad-volarem* excise duty on cigarettes was cut from 27 to 25 per cent and the minimum amount of the overall excise duty (specific and *ad-volarem*) was raised from BGN 168 to BGN 177 *per* 1000 cigarettes.

⁸² For additional information, see: <http://www.dker.bg/news/294/65/kevr-prie-reshenie-za-izmenenie-na-odobrenite-s-biznesplanovete-tseni-na-uslugi-na-vik-druzhestvata-za-2019-g.html>

Diffusion Index of Major Goods and Services Groups

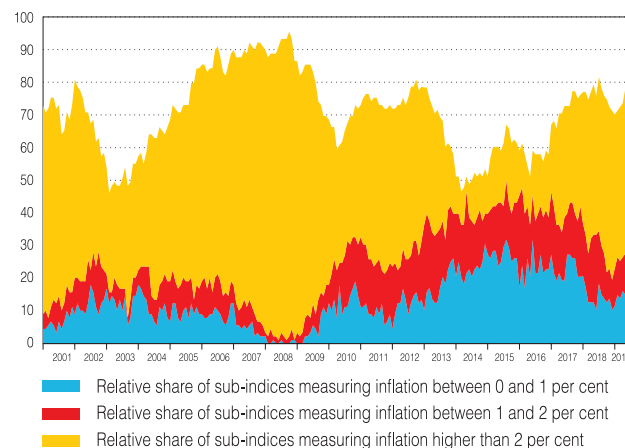
a) relative shares of increasing HICP sub-indices on an annual basis

(per cent)



b) relative shares of increasing HICP sub-indices on an annual basis)

(per cent)



Sources: the NSI, BNB calculations.

the regulated natural gas price in the first and second quarters also added to the inflation in the group.

In June 2019 the diffusion index, showing the share of groups of goods and services with rising prices on an annual basis, increased to 73.6 per cent, from 71.3 per cent at the end of 2018. This pattern was mainly attributable to the increasing number of food sub-groups with rising prices. At the same time, the higher number of goods and services sub-groups with inflation higher than 2 per cent is a prerequisite for upward HICP inflation dynamics in the coming months.

According to the NSI business survey, in June 2019 most managers in industry (91.3 per cent), services (90.6 per cent) and retail trade (87.7 per cent) expect selling prices to remain stable over the following three months. Concurrently, in the retail trade and services sectors, which are the closest to end users in the supply chain, most managers, who expect a change in selling prices, foresee a rise, which resulted in an increase in the balance of opinions from the end of 2018.

In the first quarter of 2019 the annual growth rate in the house price index accelerated from the end of 2018 reaching 7.3 per cent, from 5.5 per cent at the end of 2018. The acceleration was entirely due to the upward developments in prices of new houses. The first quarter of 2019 saw year-on-year higher house prices in each of the six largest cities in Bulgaria (cities with a population of over 120,000 citizens). Despite accelerated growth, in early 2019 house prices remained 15.9 per cent lower than the maximum values recorded in the third quarter of 2008.

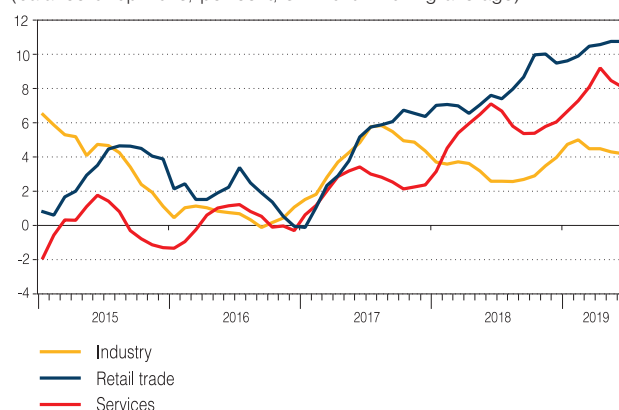
House price growth was consistent with the improving home purchase sentiment of households in the following 12 months.⁸³ The annual percentage rate of charge (APR) on new housing loans continued to decline, reaching 3.8 per cent in the first quarter of 2019 (against 3.9 per cent on average for 2018),⁸⁴ thus improving further housing affordability. Against a background of accelerated growth in household labour income, creating conditions for increasing savings, the

⁸³ The analysis employs data on the house purchase sentiment of households in the following 12 months based on NSI surveys.

⁸⁴ Values indicating APRC on housing loans to households are averages weighted by the relevant volumes of new business for a 12-month period.

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

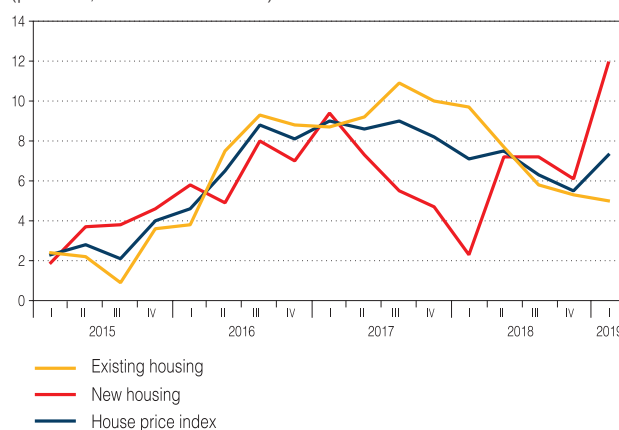
(balance of opinions, per cent, six-month moving average)



Source: the NSI.

Rate of Change in House Prices

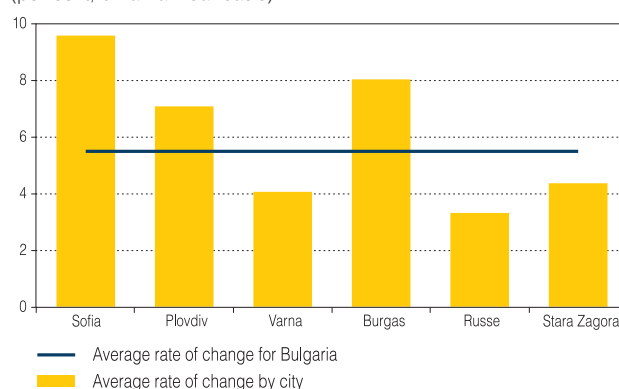
(per cent; on an annual basis)



Source: the NSI.

Changes in House Prices in Cities of More Than 120,000 Inhabitants over the First Quarter of 2019

(per cent; on an annual basis)



Source: the NSI.

Key indicators of the Housing Market in Bulgaria

(per cent; year-on-year change)

Indicators	2015	2016	2017	2018	2018			2019
					II	III	IV	I
Price developments								
House price index, total	2.8	7.0	8.7	6.6	7.5	6.3	5.5	7.3
New dwellings	3.5	6.4	6.7	5.7	7.2	7.2	6.1	11.9
Existing dwellings	2.3	7.3	9.7	7.0	7.7	5.8	5.3	5.0
Inflation (HICP)	-1.1	-1.3	1.2	2.6	2.4	3.6	3.0	2.5
House rentals, paid by tenants (HICP)	0.7	0.6	1.0	1.9	1.6	2.2	2.4	3.1
Lending								
New housing loans	39.2	17.0	38.1	15.5	18.2	10.3	5.5	3.3
APRC on new housing loans (per cent, at end of period)*	6.4	5.4	4.4	3.9	4.6	4.4	4.3	4.1
Housing loans balances	-1.8	0.6	5.3	9.7	9.0	9.9	11.4	11.5
Construction and investment								
Permits issued for the construction of new residential buildings (square meters)	13.0	4.8	32.5	39.0	31.0	25.6	61.1	26.6
Value added in construction (at average annual prices for 2010)	2.8	-6.8	4.4	4.0	0.7	2.1	6.6	-1.9
Constriction production Index, building construction	8.9	-16.1	10.9	2.6	1.2	-2.6	1.4	10.2
Fixed capital investment; residential buildings	-10.3	102.1	19.2	15.0	15.4	11.2	15.1	8.6
Construction cost index for new buildings	1.3	0.8	2.5	2.9	3.6	4.0	2.0	4.7

* Values indicating the amount of the APRC on housing loans to households are averages weighted by the relevant volumes of new business for a 12-month period.

Sources: the NSI, the BNB, Eurostat.

low interest rates achieved on new time deposits were an additional factor for households to seek alternative investment opportunities in the form of real estate purchases. The BNB quarterly lending survey showed that after the slight tightening of household residential credit standards⁸⁵ in the third and fourth quarters of 2018, in early 2019 they remained unchanged.

The behaviour of firms in the construction sector was also in line with the reported upward dynamics in house prices. Higher growth rates of house prices compared to construction costs in early 2019 continued to be a driver for improving economic activity in this sector. Over the first quarter of 2019 construction production increased from the end of 2018, its index growing by 10.2 per cent (1.4 per cent by end-2018). At the same time, new residential building permits issued (measured by the gross building area) rose by 26.6 per cent on the relevant quarter of the previous year. These developments indicate that in the following months an increase in supply of new housing may be expected, which is a potential factor for a slowing growth rate of house prices.

⁸⁵ For details, see Monetary and Credit Aggregates in Chapter 2.

Households' Home Purchase Sentiment in the Following 12 Months

(balance of opinions)



Sources: the NSI, BNB calculations.

Over the second half year the headline consumer price inflation is expected to increase slightly under the influence mainly of energy prices which are expected rise as a result of higher year-on-year international oil prices in euro by end-2019. Services inflation is projected to slow down due to the exhausted base effects in accommodation services and insurance connected with transport, though retaining its comparatively high contribution to the annual headline inflation. Industrial goods are anticipated to sustain their low positive inflation. The food group is expected to retain its substantial positive contribution to headline inflation, mainly reflecting internal factors, including projected weaker farm yields in Bulgaria.⁸⁶

Risks to the inflation forecast for the second half of the year are largely associated with higher than expected inflation. Higher than projected euro international oil prices could be a precondition for an inflation increase in both energy products and some services groups and goods and services with administratively controlled prices. After the cut-off date of our forecast, the Energy and Water Regulatory Commission announced on 1 July 2019 its decision to raise from the beginning of that month electricity and heating prices by 2.9 and 3.5 per cent on average.⁸⁷ These price changes are not reflected in our forecast and would lead to higher inflation in goods and services with administratively controlled prices. Stronger than expected growth in labour costs and their potential spillover into end-user prices of some services, as well as higher growth rates of household consumption are also likely to contribute to higher inflation.

Construction Production Dynamics and New Residential Building Permits Issued

(number of buildings; seasonally adjusted data)

(2015 = 100; seasonally adjusted data)



Sources: the NSI, BNB calculations.

⁸⁶ Data derived from the Situational Perspective Analysis of the Ministry of Agriculture, Food and Forestry.

⁸⁷ For additional information, see: <http://www.dker.bg/news/366/65/kevr-utvr-di-okonchatelnite-tseni-ot-1-yuli-na-elek-tricheskata-i-na-toplinnata-energiya-i-na-energiyata-proizvedena-ot-toplotsentrali-po-visokoefektiven-kombiniran-sposob/d,news-detail.html>

Rates of Change in Major Goods and Services Groups Prices and Contributions of These Groups to Inflation

	Inflation accumulated as of June 2018 (December 2017 = 100)		Inflation accumulated as of June 2019 (December 2018 = 100)		Annual rate of inflation as of June 2019 (June 2018 = 100)	
Inflation (per cent)	1.4		1.5		2.3	
	inflation rate by group (per cent)	contribution (percentage points)	inflation rate by group (per cent)	contribution (percentage points)	inflation rate by group (per cent)	contribution (percentage points)
Food	1.0	0.3	2.9	0.70	4.4	1.05
Processed food	0.5	0.1	1.9	0.31	4.0	0.64
Unprocessed food	2.1	0.2	5.0	0.40	5.1	0.41
Services	2.2	0.5	0.9	0.24	3.7	0.93
Catering	1.8	0.1	2.5	0.14	5.1	0.28
Transport services	2.1	0.1	0.1	0.00	1.6	0.05
Telecommunication services	1.2	0.1	-3.3	-0.16	-2.2	-0.11
Other services	2.8	0.3	2.1	0.27	5.9	0.71
Energy products	6.0	0.5	4.0	0.32	-0.9	-0.10
Transport fuels	7.3	0.5	5.7	0.35	-1.9	0.32
Industrial goods	-0.5	-0.1	0.6	0.12	0.5	0.11
Goods and services with administratively controlled prices*	0.6	0.1	0.3	0.05	1.5	0.26
Tobacco products	2.9	0.1	0.8	0.03	2.0	0.09

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

Sources: the NSI, BNB calculations.

5. BULGARIAN NATIONAL BANK FORECAST OF KEY MACROECONOMIC INDICATORS FOR 2019–2021

The BNB forecast of key macroeconomic indicators is based on data published as of 24 June 2019. Assumptions on the global economic developments and dynamics of major commodity group prices in international markets as of 7 June 2019 were used.

In line with these assumptions growth of external demand for Bulgarian goods and services is expected to moderate in 2019 due to further weakening of global trade growth, increased uncertainty surrounding international trade conflicts and Brexit, unfavourable economic situation in Turkey and expectations of slower economic growth in Romania and some euro area countries. With the weakening of the negative contribution of Turkey, external demand for Bulgarian goods and services is anticipated to increase in the 2020–2021 period. Petroleum product prices in US dollars over 2019–2021 are expected to decline from 2018, while prices of non-energy products in US dollars will initially fall in 2019 before rising in 2020 and 2021.

In 2019 Bulgaria's real GDP growth rate is projected to accelerate from 2018 and to come to 3.7 per cent. This will reflect the decrease in the negative contribution of net exports, while the positive contribution of domestic demand to real GDP growth will weaken compared to 2018 due to lower growth of private consumption. Between 2020 and 2021 real GDP growth is expected to gradually slow down compared with 2019, reaching 3.4 per cent in the last year of the projection horizon. This will depend on the decrease in the positive contribution of all main components of domestic demand to real GDP growth and weaker export growth compared to 2019. Real GDP growth is expected to be higher in 2019 and lower over the remaining projection horizon than the forecast published in the Economic Review, issue 4 of 2018.

Annual inflation, the dynamics of which is largely driven by international euro oil and food prices, is expected to accelerate slightly to 2.6 per cent at the end of 2019 before decelerating and staying at levels close to 2 per cent until the end of the projection horizon. The expected overall inflation in 2019 remains unchanged compared with the forecast published in the Economic Review, issue 4 of 2018, while the inflation forecast for 2020 has been revised downwards and that for 2021 upwards. Revisions take into account mainly changes in the assumptions about the dynamics of international prices of major commodity groups and some internal factors.

Risks to the macroeconomic outlook are assessed as oriented towards lower real GDP growth, mainly stemming from the external environment where there are risks of weaker than projected growth of demand for Bulgarian goods and services. An internal factor creating uncertainty to the outlook is the dynamics of public investment co-financed by the EU and the national budget. Risks to the inflation outlook are assessed broadly to be on the upside, mostly arising from the possibility of higher inflation in energy products and core HICP components.

Forecast

The BNB forecast of key macroeconomic indicators is based on data published as of 24 June 2019. ECB, EC and IMF assumptions on global economic developments and the dynamics of international prices of major commodity groups as of 7 June 2019 are used. Based on these assumptions global economic growth in 2019 is expected to slow down from 2018 which will depend to a greater extent on the advanced economies. Economic activity developments in advanced economies will reflect the weaker effect of cyclical factors, which had a temporary positive effect on the output gap in 2018. Negative effects of the global foreign trade protectionist measures and the impact of some country-specific factors will contribute to slower growth. The rate of economic growth in the euro area in the following quarters is expected to slow down from the first quarter of 2019, reflecting the higher global uncertainty and slower growth of international trade. Economic activity growth in emerging markets is also expected to slow in 2019, reflecting mainly the expectations for lower growth in China and worsened economic situation in

Turkey and Iran. Between 2020 and 2021 global growth is expected to accelerate driven by emerging economies, while growth in developed economies will slightly moderate.

Expectations about external demand for Bulgarian goods and services in 2019 point to slower growth than in 2018. This will reflect the continuous weakening of world trade growth, higher uncertainty over international trade conflicts and Brexit, unfavourable economic situation in Turkey, an expected economic activity slowdown in Romania and in some euro area countries. With the weakening of the negative contribution of Turkey, growth of external demand for Bulgarian goods and services is anticipated to accelerate in 2020 and 2021. The baseline scenario of external demand takes into account the impact of the foreign trade tariffs launched by the USA but it does not include a further escalation of international trade conflicts during the forecast period. As regards the UK leaving the EU, the forecast includes an assumption of a withdrawal agreement and negotiations on future trade relationships.

Over the first six months of the year average annual USD prices of energy products decreased irrespective of the agreement concluded in January 2019 between OPEC and other leading oil-producing countries on production cuts and some unplanned disruptions in oil supplies. This was attributable to weaker oil demand due to lower global economic activity, uncertainty over trade conflicts and enhanced supply by non-OPEC countries. As a result of US dollar appreciation *vis-à-vis* the euro international oil prices in US dollars and in euro showed divergent developments. Average petroleum product prices in US dollars over 2019 are expected to decline from 2018. Due to technical assumptions for retaining the exchange rate unchanged over the projection horizon⁸⁸ the euro prices of energy products are anticipated to increase in 2019. Between 2020 and 2021 oil demand will remain subdued, which coupled with limited supply growth will result in a slight fall in international market oil prices in US dollars and in euro.

Non-energy product prices exhibited a divergent dynamics both in euro and in US dollars in the first six months of 2019 reflecting the appreciated US dollar against the euro. USD metal and food prices posted a fall. The decline in metal prices reflected the increased supply by China, the recovered production in key sector undertakings after temporary disruptions and lower global demand for metals. Weaker world demand and high yields in the USA had also a negative effect on USD food prices in the first half of the year. Non-energy product prices are expected to start rising over the forecast horizon both in US dollars and in euro amid gradually recovering global demand.

In 2019 the rate of real GDP growth in Bulgaria will accelerate on 2018 owing to the contraction of the negative contribution of net exports. Growth in exports of goods is anticipated to recover over 2019 following the 2018's fall caused by the temporary decline in production of metals and petroleum products due to refurbishment of production facilities. A factor which will limit exports of goods and services over the year will be subdued growth of external demand. Real imports of goods and services will slightly accelerate its growth rate in 2019 in line with the described export dynamics and the expected domestic demand growth. The contribution of domestic demand to real GDP growth in 2019 is expected to decrease, which will reflect slower growth of private consumption due to lower consumer confidence and higher uncertainty reported at the end of 2018 and in early 2019. Over 2019 private consumption growth will be supported by the persistent long-term upward trend in nominal and real household labour income and also by low interest rates stimulating credit demand. The projected improvement of investment activity and increased government consumption will continue to support domestic demand growth, partly offsetting the lower contribution of private consumption. Fixed capital investment growth will be mainly driven by the projected strong rise in public investment due both to the accelerated implementation of projects co-financed by EU funds and higher national-financed government investment. Concurrently, the uncertain international environment will be a limiting factor for corporate investments. In line with stronger public sector wage increases in 2019 projected in the budgetary framework, government consumption growth is expected to remain buoyant.

⁸⁸ The euro price forecast is based on the technical assumption about the EUR/USD exchange rate, which is fixed at its average value for the last ten days as of 7 June 2019, the date of external environment assumptions. In line with the technical assumption, the US dollar is appreciating *vis-à-vis* the euro in 2019 compared to 2018.

Between 2020 and 2021 real GDP growth is expected to gradually slow down compared with 2019, reaching 3.4 per cent in the last year of the projection horizon. This will depend on the contraction of the positive contribution of all major domestic demand components to real GDP growth and lower growth of exports on 2019. The projected slower increase in household real disposable income as compared with 2019 and the high savings rate will be the main factors behind the slowdown in private consumption. The expected completion of infrastructure projects financed by the national budget is projected to result in a weaker investment activity at the end of the projection horizon. At the same time, this effect will be partly offset by the greater absorption of EU funds at the final phase of the current EU funding cycle and also by the expected gradual rise in private investment given the long-term decrease in labour force and higher labour costs. The expected slower rise in costs on staff remunerations and healthcare will add to the projected slowdown in government consumption growth between 2020–2021. The negative contribution of net exports to the real GDP change will continue to decrease driven by the strengthening demand for Bulgarian goods and services over this period. Exports of goods and services is projected to increase faster than external demand in the 2020–2021 period due to competitive advantages of Bulgarian exporters, which will help increase Bulgaria's market share in the world trade. In 2020 and 2021 growth in imports is anticipated to moderate on 2019 in line with the domestic demand dynamics.

Between 2019 and 2021 the trade deficit balance is expected to expand as a percentage of GDP from 2018 despite the projected positive terms of trade for Bulgaria (measuring the change between prices in exported and imported goods) due to a faster increase in real imports of goods than exports of goods. Concurrently, imports of services will grow faster than exports in 2019 resulting in a slight fall in services trade surplus as a percentage of GDP compared with 2018. Over the remaining forecast horizon the services positive balance is expected to stabilise as a percentage of GDP. Enhanced economic activity in Bulgaria will boost corporate profits and payment of dividends to non-residents, which will result in a higher deficit of the balance of payments net primary income account over the forecast horizon. Net transfers on the balance of payments secondary income account are projected to remain comparatively stable as a percentage of GDP in the 2019–2021 period. As a result of the described component dynamics the surplus on the balance of payments current account will gradually decrease as a percentage of GDP over the projection horizon.

In 2019 employment growth will increase from 2018 reflecting mainly the contribution of services and industry sectors, while the number of self-employed in agriculture is expected to further decrease. Over the forecast horizon employment growth is expected to remain weak and to gradually subside curbed by unfavourable demographic developments in Bulgaria. This trend will be partly offset by the projected rise in the rate of economically active population amid comparatively high wage growth and increasing average effective retirement age⁸⁹. The unemployment rate will continue to fall, though at slower rates, as a result of changes in employment, which is expected to reach 4.1 per cent in 2021. Labour productivity will largely follow the real GDP dynamics pattern due to projected slight increase in the number of employed. In 2019 the compensation *per* employee will grow at an accelerated pace due to limited labour supply and projected wage rises in the public sector, including also further wage increases in the sector of education. The expected slower staff expenditure rise in the public sector and slower labour productivity growth will result in gradual weakening of labour remuneration growth in the total economy. Reflecting such sub-component dynamics, growth in nominal unit labour costs is expected to accelerate over 2019, though gradually slowing in the following two years.

Projected slight acceleration in annual inflation to 2.6 per cent by end-2019 and its subsequent moderation to 1.9 per cent by end-2020 reflect largely the expectations for international oil and food prices in euro over the projection horizon. The anticipated positive contribution of core inflation components throughout the whole period will be mainly driven by services price developments, with industrial goods inflation expected to remain low. Goods and services with administratively controlled prices are projected to make a low positive contribution to the overall inflation over the forecast horizon, reflecting natural gas

⁸⁹ Source: the NSI.

price rises since the beginning of 2019 and water supply price increases in 2019–2020⁹⁰ as announced by the Energy and Water Regulatory Commission (EWRC)⁹¹.

Over the forecast period non-government sector's deposits are expected to grow at an annual rate of around 7.0–8.0 per cent. This dynamics will depend on retention of a high savings rate in the economy in the context of increased uncertainties stemming from the external environment, favourable labour market conditions and continued income growth, as well as lack of a sufficiently safe alternative to bank savings. The increasing inflow of attracted funds and high banking liquidity will contribute to the maintenance of achieved low deposit rates. In line with expectations of a continuous high inflow of attracted funds and market expectations of holding euro area rates at the achieved low levels, domestic lending rates are anticipated to remain low over the projection period, slightly rising from the second half of 2020. Low interest rates will continue to stimulate demand for loans by corporations and households. Lending to the non-government sector is projected to increase at rates close to 7.0 per cent, favoured by continued growth in domestic demand, in addition to low lending rates. Concurrently, a factor that is expected to have a dampening effect on credit growth in 2019 and 2020 is the continuing government payment of loans under the National Programme for Energy Efficiency of Multi-family Residential Buildings (the National Energy Efficiency Programme) and significant cuts in the volume of new loans under this programme.

Forecast Revisions

Real GDP growth is expected to be slightly higher in 2019 and lower over the remaining projection horizon compared to Economic Review, issue 4/2018 projections.

The upward revision of 2019 GDP growth projection reflects mainly a stronger than expected recovery in goods exports over the first quarter as a result of the exhausted short-term factors. Stronger than projected GDP growth *vis-à-vis* the previous forecast is also driven by an upward government consumption revision which in turn reflects primarily the reported higher growth rate in government consumption in early 2019. Compared with the previous projection, fixed capital investment growth is slightly revised upwards, while the expected growth in private consumption remains unchanged. In line with domestic demand component and export dynamics, imports of goods and services are expected to grow at higher rates than estimates in the previous forecast.

Our expectations of real GDP growth in 2020 and 2021 are revised downwards *vis-à-vis* the previous projection, which is due mainly to changed assumptions about external environment developments. Current external assumptions indicate weaker external demand in 2020–2021, which is reflected in lower export growth rates over the same period. The weaker external demand and increased uncertainty surrounding the external environment are a prerequisite for a slight downside revision in private investment growth over 2020–2021. Nevertheless, total investment in 2020 enjoys a minimal upward revision as a result of more optimistic expectations about an increase in EU co-financed public investment. Compared to the prior projection, 2021 public investment is expected to have a larger negative contribution to the change in total investment. Private consumption is anticipated to grow in 2020–2021 at rates similar to the previous forecast since such factors, as an increase in household disposable income and sustainable financing conditions, will continue to act. Projected lower growth in goods exports over 2020 is the driver for a downward revision in goods and services imports.

Overall inflation expectations at the end of 2019 remain unchanged from the previous projection. Our forecast for 2020, however, has been revised downwards and for 2021 upwards, reflecting primarily a change in assumptions about international oil and food prices in euro. Core inflation at the close of 2019 is revised downwards which is largely due to a lower increase in core HICP components' prices over the first quarter *vis-à-vis* the previous forecast. The EWRC' decision to raise regulated natural gas prices since

⁹⁰ For more details, see: <http://www.dker.bg/news/289/65/otkrito-zasedanie-po-zayavlenieto-na-bulgargaz-ead-za-tsenata-na-prirodniya-gaz-za-to-trimesechie-na-2019-g.html> and <http://www.dker.bg/news/318/65/komisiyata-za-energijno-i-vodno-regulirane-utvrdi-tsenata-na-prirodniya-gaz-za-vmesto-trimesechie-na-2019-g.html>

⁹¹ For more details, see: <http://www.dker.bg/news/294/65/kevr-prie-reshenie-za-izmenenie-na-odobrenite-s-biznesplanovete-tseni-na-uslugi-na-vik-druzhestvata-za-2019-g.html>

the second quarter of 2019 is the main factor for the upward revision in administratively controlled inflation. Expected higher food inflation (due to the weaker domestic harvests) and energy products inflation is another factor for keeping the overall inflation forecast unchanged. Downward inflation revisions for the end of 2020 are mainly driven by assumed lower oil prices the effect of which will be limited, to a certain extent, by the upward inflation revision in the food group. Lower oil prices in 2020 are expected to have an indirect effect on services inflation, giving grounds to expect lower core inflation compared to that in issue 4 of 2018 Economic Review. The main driver for the upward 2021 inflation forecast revision is the higher core inflation, whereas lower oil prices will have a dampening effect on it.

GDP and Inflation Forecast Revisions (24 June 2019 *vis-à-vis* 21 December 2018)

Annual rate of change, per cent	Forecast as of 24 June 2019				Forecast as of 21 December 2018				Revision (percentage points)			
	2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
GDP at constant prices	3.1	3.7	3.6	3.4	3.1	3.6	3.8	3.6	0.0	0.1	-0.2	-0.2
Private consumption	6.4	4.0	3.9	3.7	6.4	4.0	3.9	3.7	0.0	0.0	0.0	0.0
Government consumption	4.7	4.8	3.5	3.5	4.7	3.6	3.0	3.0	0.0	1.2	0.5	0.5
Gross fixed capital formation	6.5	7.2	5.3	3.6	6.5	6.9	5.0	3.9	0.0	0.3	0.3	-0.3
Exports of goods and services	-0.8	4.6	3.4	3.6	-0.8	3.8	4.1	3.8	0.0	0.8	-0.7	-0.2
Imports of goods and services	3.7	5.8	4.0	3.8	3.7	5.1	4.3	3.8	0.0	0.7	-0.3	0.0
HICP at end of period*	2.3	2.6	1.9	2.1	2.3	2.6	2.1	2.0	0.0	0.0	-0.2	0.1
Core Inflation	2.5	2.5	2.1	2.8	2.5	2.9	2.6	2.6	0.0	-0.4	-0.5	0.2
Energy products	1.0	2.5	-2.7	0.0	1.0	1.0	0.7	0.5	0.0	1.5	-3.4	-0.5
Food	2.4	5.0	4.5	3.4	2.4	4.9	3.2	2.9	0.0	0.1	1.3	0.5
Goods and services with administratively controlled prices and tobacco products	2.3	0.2	0.1	0.1	2.3	-0.2	0.1	0.1	0.0	0.4	0.0	0.0

* Reporting inflation data for 2018 and projections as of 21 December 2018.

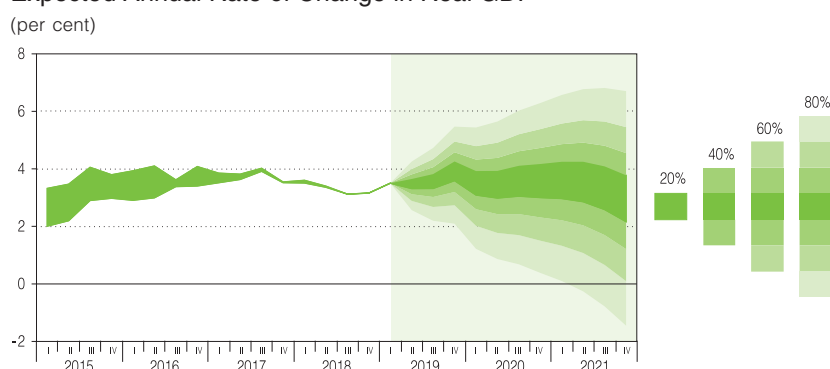
Source: the BNB.

Risks to the Forecast

Risk balance to the baseline scenario of the macroeconomic projection is assessed as oriented towards lower GDP growth, with main down-side risks stemming from external demand and public investment.

Lower than projected demand for Bulgarian goods and services could be reported in case of: lower than projected economic growth in Bulgaria's important trade partners, further deteriorating economic situation in Turkey, the UK leaving the EU without a deal and potential additional protectionist trade measures by the USA. At the same time, if euro area economic activity growth rates of the first quarter of 2019 are retained for an extended period of time, external demand for Bulgarian goods and services would be higher than projected. Currently, materialisation of such a scenario is estimated as less likely to occur

Expected Annual Rate of Change in Real GDP



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

Source: the BNB.

against the above described risks to the external environment, as reflected in our views on prevailing downward risks to external demand.

Possible delays in government investment projects co-financed by EU and national funds in 2019 pose the major risk to lower than projected domestic demand. In such a scenario, a lower increase in public investment may be expected in 2019, likely to be offset by its stronger growth in the coming two years of the projection period. Such a move forward in time of the project implementation would have a dampening effect on real GDP growth for 2019, likely to result in higher economic growth in 2020–2021. The baseline scenario of the public investment projection involves no potential

positive effects on domestic demand from the implementation of a Bulgarian army modernisation project due to the uncertain schedule for delivering military technology and equipment.

Domestic demand higher than projected in the baseline macroeconomic projection would materialise in case of a potential stronger rise in labour income in the total economy. If such a scenario occurs, we could also expect higher growth rates in private consumption. Currently, these upside risks to the economic growth forecast are assessed as relatively less likely than the downside risks to real GDP growth arising from potential weaker external demand and public investment.

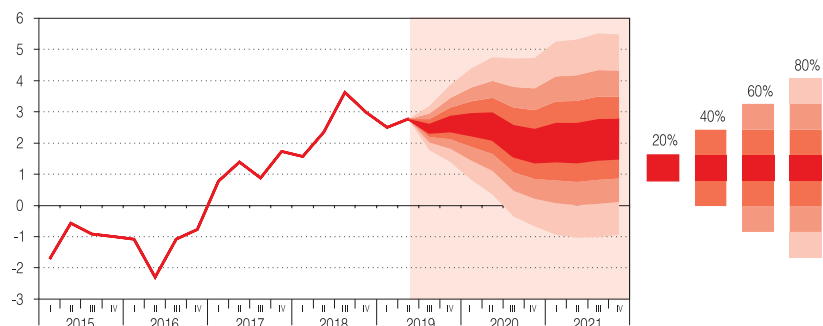
The uncertainty over the outlook for a particular indicator may be graphically illustrated by means of a fan chart. Chart bands of a specific colour set an interval in which with a certain probability the projected value is expected to fall (for further details, see the note to the chart on GDP growth). Each interval widens with the increase of the forecast horizon, reflecting the increasing uncertainty about more distant future. The fan chart on annual real GDP growth shows, for example, that there is a 60 per cent probability for the annual GDP growth to range from 2.7 to 5.0 per cent in the last quarter of 2019.

Risks to the inflation outlook are assessed as broadly on the upside. Higher than expected inflation could be seen in energy products and core components of inflation, while risks to the food inflation outlook are balanced. Materialisation of higher than expected international oil prices in euro would be a precondition for both higher inflation in energy products and higher services and administratively controlled prices. There is a risk of a larger than expected rise in unit labour costs and stronger growth in private consumption, along with their potential upward pressure on inflation, especially in services. The balance of risks regarding inflation is graphically shown in the fan chart. It suggests, for example, that there is a 60 per cent probability for annual HICP growth to range between 1.8 and 3.4 per cent at the end of 2019.

Risks to the projection of non-government sector's deposits tilt to the upside. Higher than expected growth in labour income amid a stronger uncertainty stemming from the external environment could lead to an increased savings rate in the economy. At the same time, risks to growth of non-government sector's credit appear more balanced. Uncertainties around the credit outlook involve potential sales of credit portfolios and writing-off NPLs by banks, as well as the effect of the countercyclical capital buffer increase on overall domestic lending.

Expected Annual Rate of Change in Inflation at the End of the Period

(per cent)



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

The chart employs reporting data for the second quarter of 2019.

Source: the BNB.

BNB Forecast of Key Macroeconomic Indicators for 2019–2021

(per cent)

	2017	2018	2019	2020	2021
<i>Annual rate of change</i>					
GDP at constant prices	3.8	3.1	3.7	3.6	3.4
Private consumption	4.5	6.4	4.0	3.9	3.7
Government consumption	3.7	4.7	4.8	3.5	3.5
Gross fixed capital formation	3.2	6.5	7.2	5.3	3.6
Exports of goods and services	5.8	-0.8	4.6	3.4	3.6
Imports of goods and services	7.5	3.7	5.8	4.0	3.8
HICP at end of period	1.8	2.3	2.6	1.9	2.1
Core Inflation	0.3	2.5	2.5	2.1	2.8
Energy products	6.9	1.0	2.5	-2.7	0.0
Food	2.7	2.4	5.0	4.5	3.4
Goods and services with administratively controlled prices and tobacco products	2.6	2.3	0.2	0.1	0.1
Employment	1.8	-0.1	0.2	0.2	0.1
Unit labour costs	8.4	2.4	5.1	4.6	4.3
Labour productivity	2.0	3.2	3.7	3.4	3.3
Unemployment rate (share of labour force, per cent)	6.2	5.2	4.6	4.3	4.1
Claims on non-government sector	4.5	8.9	6.9	6.9	6.8
Claims on corporations*	1.5	6.4	5.6	6.0	6.2
Claims on households	6.1	11.2	6.9	7.1	7.2
Deposits of the non-government sector	6.2	7.3	8.1	7.5	7.6
<i>Share of GDP</i>					
Balance of payments current account	3.1	4.6	2.8	1.1	1.0
Trade balance	-1.5	-4.1	-4.4	-4.4	-4.3
Services, net	5.5	6.2	6.0	6.0	6.0
Primary income, net	-4.6	-1.0	-2.2	-3.7	-3.8
Secondary income, net	3.6	3.5	3.4	3.2	3.0
<i>Annual rate of change</i>					
External assumptions					
External demand	6.7	2.9	1.9	3.0	3.4
Average annual Brent oil price (in USD)	23.5	30.7	-3.7	-4.9	-2.8
Average annual price of non-energy products (in USD)	7.9	3.9	-2.7	3.4	2.8
Brent oil price at the end of period (in USD)	22.7	9.6	2.6	-7.1	-2.3
Price of non-energy products at the end of period (in USD)	5.4	-1.2	2.4	3.2	2.8

* Data refer to non-financial corporations.

Source: the BNB.

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