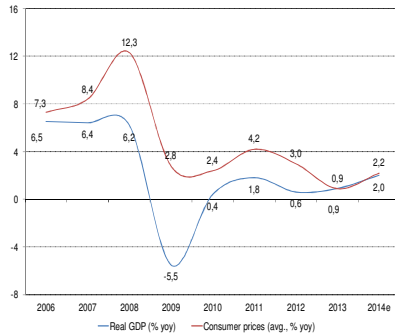
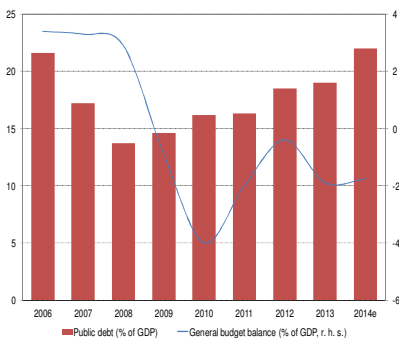


## Real GDP and inflation



Source: NSI, Raiffeisen RESEARCH

## Public debt and budget balance



Source: NSI, Raiffeisen RESEARCH

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Martin Stelzeneder

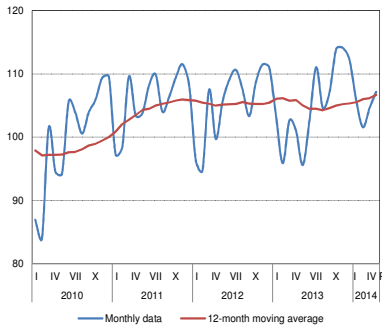
[martin.stelzeneder@rbinternational.com](mailto:martin.stelzeneder@rbinternational.com)

## Highlights

- In April, the industrial production grew for an eight consecutive month yoy, while construction and domestic trade declined.
- The state budget registered weak Value Added Tax (VAT) revenue, while the public indebtedness tendency accelerated.
- The current account turned again into negative, since the positive balances of services and transfers could not cover the trade balance deficit. Net foreign direct investments (FDI) were positive in April, remaining at low level.
- The coverage of the monetary base with FX reserves was significant. Currency board remained stable.
- Lending increased in a fourth consecutive month, while deposits kept growing further.

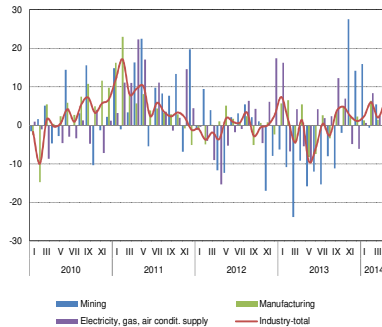
The Bulgarian National Bank (BNB) decided to prolong the special supervision of the Corporate Commercial Bank (CCB) and its subsidiary Credit Agricole Bulgaria (CAB) until September 23<sup>rd</sup>. Independent auditors had found out missing parts of the CCB records related to a credit portfolio of EUR 1.8 bn (EUR 2.8 bn total portfolio). Moreover, this credit portfolio showed a strong link between the debtors and the major shareholder. A conservators' separate audit revealed that an amount of EUR 105.3 mn was systematically withdrawn on behalf of the major shareholder. Due to suspected criminal acts the case was given to the Prosecutor's Office. The BNB, in turn, decided that it would not be reasonable anymore to nationalize CCB due to concerns about spillovers to Bulgarian Development Bank and other public lenders. Instead, BNB offered to nationalize the "healthy" CAB, transferring all "good" CCB assets and liabilities to its balance sheet. As a solvent state-owned bank, the CAB will be supported by the Deposit Insurance Fund, the state budget, and the BNB. Moreover, all deposits will be fully guaranteed, excluding only those connected with the CCB major shareholder. To fulfil this plan a special law is required, which will provide a full guarantee for all deposits. However, this part of the BNB's plan is still not accepted by the parliamentary parties. On a separate note, BNB decided to join the EU "Banking Union" (Single Supervisory Mechanism, SSM) as soon as possible. Hence, Bulgaria will be the first non-euro area country to join the SSM on a voluntary basis, which would be a positive signal for the long-term stability of the banking system.

## Index of industrial production



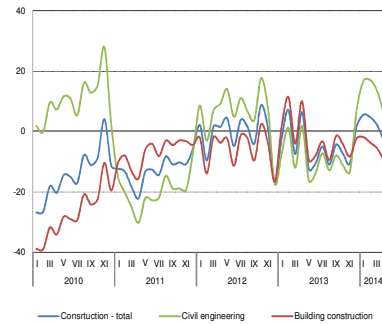
Source: NSI, Raiffeisen RESEARCH

## Industrial production by components (% yoy)



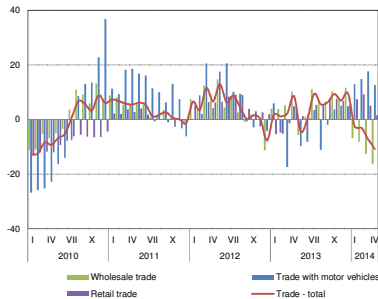
Source: NSI, Raiffeisen RESEARCH

## Construction by components (% yoy)



Source: NSI, Raiffeisen RESEARCH

## Internal trade by components (% yoy)



Source: NSI, Raiffeisen RESEARCH

## Growth in industry, decline in construction and trade

In April 2014, the industrial production index kept growing, after overcoming the decline, which had begun in November last year. The 12-month moving average of the index also increased slightly in line with the slow growth trend since August 2013. Indeed, this trend is a sign of industrial recovery, but its development was too slow.

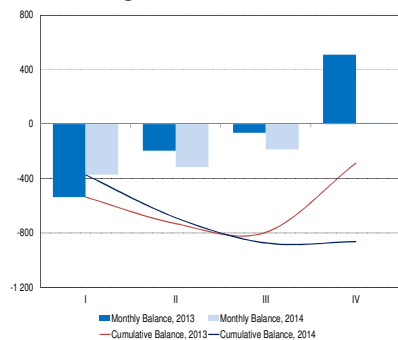
The industrial production grew up by 6.1% yoy in April 2014 in line with an upward trend, lasting for eight consecutive months. This gives confidence to believe that the development of the industry in the next few months will be positive. A momentum of this process was the manufacturing industry, which has also been growing up for eight months in a row, achieving 3.5% yoy for April. Extractive industry increased its production by 11.5% yoy mainly on the back of coal mining. In turn, the production of electricity, heat, and gas enhanced even more rapidly by 15.3% yoy. Within the manufacturing industry, the production of automobiles and trailers registered the most intensive growth (28.0% yoy) not only for April but also during the last 16 months, realizing high turnovers in the domestic and international market.

In April, a decline of 3.0% yoy was observed in the construction industry, after a four months growing period. Its dynamics was driven by a continuous drop in the civil building, which was 9.5% yoy for April, and a rise in the engineering building (6.0% yoy for April). The lasting shrinkage in the civil building resulted from the overproduction in this segment until the end of 2008, while the increase in the engineering building reflected the state policy for road infrastructure development.

In the first months of 2014, a growing decline in the domestic trade turnover was observed (-10.8% yoy for April) mainly due to the shrinkage in the wholesale trade (-16.4% for April). On the contrary, the segments of the automobile & motorcycles trade and the retail trade underwent a declining growth of 1.8% and 4.7% yoy, respectively. In the wholesale trade, the most serious drop realized the scrap metals trade, which had been declining since August 2012.

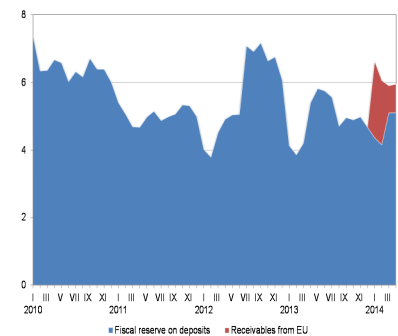
The end of period deflation for May reached 1.0%. The unemployment in Q1 remains high at 13.0%.

## Gross budget balance (BGN mn)



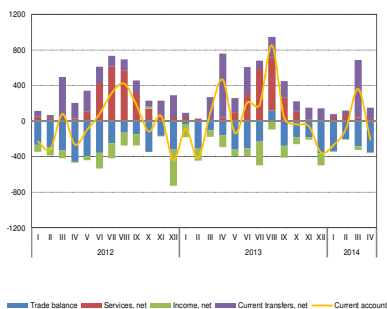
Source: MF, Raiffeisen RESEARCH

## Fiscal reserves (BGN bn)



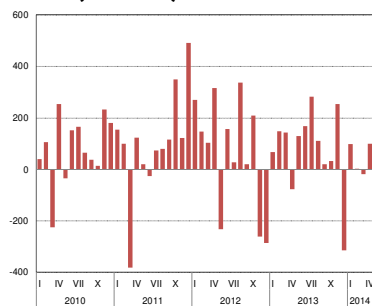
Source: MF, Raiffeisen RESEARCH

## Current account (EUR mn)



Source: BNB, Raiffeisen RESEARCH

## Net FDI (EUR mn)



Source: BNB, Raiffeisen RESEARCH

## Poor VAT collection and intensive public indebtedness

By the end of May, a deficit of BGN 888.6 mn was accumulated, which is with BGN 934.1 mn more than a year ago. Total revenues of BGN 11.8 bn for the first five months (a 0.2% drop yoy) and total expenses (including the contribution to EU) of BGN 12.2 bn (increase of 7.7%) were accrued. In May, the Fiscal Reserve decreased by BGN 118.9 mn up to BGN 4.9 bn (compared to April). At the same time government debt reached BGN 14.2 bn, i.e. 9.9% more than in May 2013.

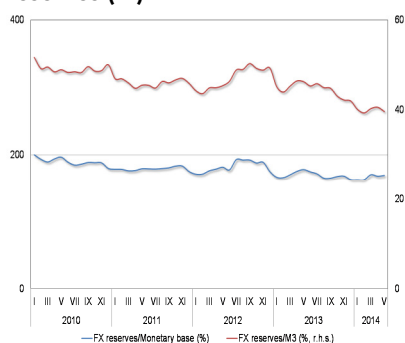
At the end of June, the government issued a 10-year Eurobond with a 2.95% coupon, designated year of maturity 2024, yield 3.055% and issue price of 99.085%. The new debt will be used to repay old government obligations. Due to liquidity issues of the First Investment Bank (one week after the run on the Corporate Commercial Bank), the Ministry of Finance issued a 5-month government bond (BGN 1.23 bn) to support the banking system. On 16th of June the Council of Ministers proposed an amendment of the State Budget Law. According it, the ceiling of public debt and budget deficit for 2014 will be changed. New debt in the amount of BGN 3.4 bn will be issued, out of which BGN 2.7 bn for stabilizing the banking system and the remaining BGN 725 mn for financing the growing budget deficit by 0.9% (total 2.7% of the GDP). The sum of BGN 725 mn will be spread out in BGN 225 mn for the National Health Insurance Fund and BGN 500 mn will be used to compensate the lower VAT revenues on imports. This proposal is still not approved by the National assembly.

In the first half of June, Standard&Poor's lowered Bulgaria's long-term foreign currency sovereign credit rating to BBB- with stable outlook. The main reason was the structural impediments facing Bulgaria which constrain institutional effectiveness and impede economic growth. In the beginning of July, Fitch affirmed long-term foreign currency Issuer Default Rating (IDR) at 'BBB-' already for a second time this year carrying stable outlook. Moody's said that Bulgaria's Baa2 rating with stable outlook reflects successive government's commitment to fiscal prudence and the resulting low government debt burden.

## Current account deficit

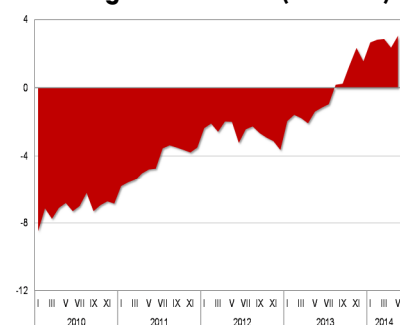
In April, the current account turned into negative (EUR -216.6 mn), due to expanding trade balance deficit (EUR -351.1 mn) and negative net income (EUR -10.5). On the other hand, the balance of services (EUR 24.9 mn) and of transfers (EUR 125.1) remained positive, although shrinking. On the side of the financial account, net foreign direct investments (FDI) were positive but quite low (EUR 99.1 mn).

## Coverage of monetary base with FX reserves (%)



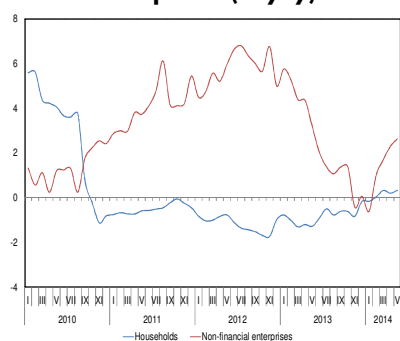
Source: BNB, Raiffeisen RESEARCH

## Net foreign bank assets (BGN mn)



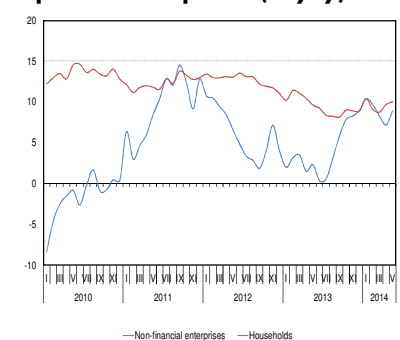
Source: BNB, Raiffeisen RESEARCH

## Loans development (% yoy)



Source: BNB, Raiffeisen RESEARCH

## Deposits development (% yoy)



Source: BNB, Raiffeisen RESEARCH

## High coverage of the monetary base

In May, FX reserves diminished by BGN 474.6 mn mom. For the same period the monetary base also declined by BGN 389.4 mn. As a result, the coverage of the monetary base with FX reserves rose slightly to 169.3%. The broad money (M3) also increased by BGN 431.1 mn, therefore their coverage was reduced by 1 pp to 39.6%. Both indicators confirmed the stability of the currency board.

After a temporary lowering of the net foreign bank assets in April, the indicator improved by BGN 707.7 mn mom (30.0%). Foreign bank assets rose by BGN 691.9 mn mom (4.9%), due to deposits made abroad in the amount of BGN 742.5 mn. At the same time, foreign bank liabilities decreased by BGN 15.7 mn mom (0.1%) as a result of withdrawing deposits by foreign residents. The current data reflected the trend of debt reduction to foreign creditors (mainly foreign-owned parent banks), which started in the middle of 2013. Furthermore, they indicated a lack of investment opportunities for liquid assets in the local market, steering them to foreign interest-bearing instruments.

## Lending and deposits grew up

The monetary statistics of the BNB showed an accelerating growth of loans (1.8% yoy) in May, for a fourth consecutive month. The increase of loans to non-financial enterprises was 2.6% yoy, while those to households only 0.3% yoy. Unlike in April, in May the average nominal interest rate on corporate loans went up by 0.4 pp to 7.6%. In contrast, consumer loans interest decreased to 10.9% (by 0.3pp), while mortgage rates rose by 0.2 pp to 6.8%. Despite deflation, unstable political situation, and increasing average interest rate, business lending stepped up. If these restraining factors improve, lending will significantly accelerate, supporting the growth of real economy.

In May, deposits also built up but much more significantly than loans (9.7% yoy), following a long-term rising trend. Deposits of households stepped up by 10.0% yoy, whereas those of non-financial enterprises rose by 8.9% yoy. The household deposits totalled BGN 37.6 bn, while these of non-financial enterprises amounted to BGN 14.9 bn. These significant savings (BGN 52.5 bn in total) are an excellent base for economic growth, which by now is restricted by the poor performance of the public institutions in the country.

# Key figures

	2009	2010	2011	2012	2013	2014e	2015f
Real GDP (% yoy)	-5.5	0.4	1.8	0.6	0.9	2.0	3.5
Nominal GDP (EUR bn)	34.9	36.1	38.5	39.9	39.9	42.1	44.5
Nominal GDP per capita (EUR)	4618	4804	5255	5483	5520	5858	6228
Nominal GDP per capita (EUR at PPP)	10300	10800	11700	12000	12238	12504	12975
Individual consumption (real, % yoy)	-7.6	0.6	1.7	3.2	-1.8	1.7	3.3
Government consumption (real, % yoy)	-4.9	-0.5	0.3	0.3	2.9	2.4	1.6
Gross fixed capital formation (real, % yoy)	-17.6	-18.3	-6.5	4.0	-0.3	0.7	5.4
Exports of goods and services (real, % yoy)	-11.2	14.7	12.3	-0.4	8.9	5.3	5.4
Imports of goods and services (real, % yoy)	-21.0	2.4	8.8	3.3	5.7	5.5	6.0
Industrial output (% yoy)	-18.3	2.0	5.8	-0.4	-0.1	3.5	5.0
Producer prices (avg, % yoy)	-6.6	8.7	9.4	4.2	-1.4	2.4	4.4
Consumer prices (avg, % yoy)	2.8	2.4	4.2	3.0	0.9	2.2	3.5
Consumer prices (eop, % yoy)	0.6	4.5	2.8	4.2	-1.6	2.0	3.4
Average monthly gross wages (BGN)	602	645	697	771	799	791	832
Average gross wages (% yoy)	11.9	7.2	8.0	10.6	3.7	-1.1	5.3
Average monthly gross wages (EUR)	308	330	356	394	396	404	425
Average gross industrial wages (% yoy)	13.4	8.6	10.1	11.5	0.9	5.1	6.3
Employed persons (LFS, thd, avg)	3254	3053	2965	2934	2935	2957	2986
Employment (avg, % yoy)	-3.2	-6.2	-2.9	-1.1	0.0	0.8	1.0
Unemployment rate (avg, %)	6.8	10.2	11.3	12.3	12.9	12.6	12.1
General budget balance (% of GDP)	-0.9	-4.0	-2.0	-0.4	-1.9	-1.8	-1.3
Public debt (% of GDP)	14.6	16.2	16.3	18.5	19.0	22.0	20.0
Export of goods (EUR mn)	11699	15561	20264	20770	22228	23771	25366
Import of goods (EUR mn)	15873	18325	22420	24230	24581	26646	28690
Trade balance (EUR mn)	-4174	-2764	-2156	-3460	-2353	-2874	-3325
Current account balance (EUR mn)	-3116	-533	33	-334	752	306	-201
Current account balance (% of GDP)	-8.9	-1.5	0.1	-0.8	1.9	0.7	-0.5
Net foreign direct investment (EUR mn)	2505	977	1213	802	957	1512	1667
Net foreign direct investment (% of GDP)	7.2	2.7	3.1	3.0	2.8	3.6	3.7
Official FX reserves (EUR bn)	12.9	13.0	13.3	15.6	14.4	17.2	17.9
Official FX reserves (% of GDP)	37.0	36.1	34.7	39.0	36.1	40.8	40.2
Gross foreign debt (EUR bn)	37.8	37.0	36.3	37.6	37.3	37.5	36.6
Gross foreign debt (% of GDP)	108.3	102.7	94.3	94.3	93.5	89.1	82.4
EUR/BGN (eop)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
EUR/BGN (avg)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
USD/BGN (eop)	1.37	1.46	1.51	1.48	1.42	1.45	1.50
USD/BGN (avg)	1.40	1.47	1.41	1.52	1.47	1.45	1.47
EUR/USD (eop)	1.43	1.34	1.30	1.32	1.38	1.35	1.30
EUR/USD (avg)	1.39	1.33	1.39	1.29	1.33	1.35	1.33
Key interest rate (% avg)	2.0	0.2	0.2	0.1	0.2	0.2	0.3
3 month Sofibid (% avg)	4.1	2.3	2.0	1.0	0.4	1.2	1.8
10 year T-bond yield (% avg)	7.2	6.0	5.4	3.4	3.5	4.4	5.1
Ratings, long-term, foreign currency	Current	Outlook					Comment
S&P	BBB-	stable					Rating upgraded in June 2014
Moody's	Baa2	stable					Rating confirmed in July 2014
Fitch	BBB-	stable					Rating confirmed in July 2014

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