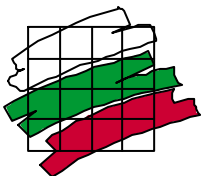


BUSINESS SURVEY SERIES

BULGARIA: THE ECONOMY IN THE FIRST HALF OF 1995



**AGENCY FOR ECONOMIC
COORDINATION & DEVELOPMENT**

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MACROECONOMIC STABILIZATION: MECHANISM, CONSEQUENCES, PROSPECTS

In the light of the classical concept of macroeconomic stabilization - restored economic growth under an „acceptable“ (non-rising) level of inflation - the dynamics of the Bulgarian economy in the first half-year period of 1995 illustrates the unquestionable success of the economic policy stabilization measures.

At the same time, however, the lack of a clear understanding of the cause-and-effect link between economic processes and the instruments of current economic policy, as well as of the mounting pressures and the limitations of the approach followed by the Government and the BNB since the beginning of 1995, may induce a new inflation rise and a new economic slump. The increase in bank liquidity and the accelerated price growth in late August-early September 1995 attest to such a possibility.

The internal restructuring of the Bulgarian economy along the transition from a command to market model has clearly outlined two parallel segments of the economic system, whose interaction determines the alteration of stabilization-destabilization.

The first segment (sector) may be defined as the production of goods and services which are influenced by competition from abroad, and, respectively, pertain to foreign trade. Generally, it is the system of links which function through convertible currency disbursements.

The second segment has been developing in relative isolation from the world economy, and relates to the overall structure of domestic exchange, distribution, and redistribution relations, functioning through national currency disbursements.

Assuming that the market economy is in essence the ability of monetary and credit mechanisms to induce a more efficient real resource distribution, we can expect the different intensity of links of the two segments with the world financial and currency system to condition two fundamentally different types of market evolution.

In general, these differences may be illustrated in the following way. Overall, since the onset of the radical economic reform, the nominal fluctuations of the BGL/USD exchange rate measured by the standard deviation have been stronger compared to the real rate. Vice versa, the fluctuations of the real interest rate on bank credits extended to the non-banking sector have been stronger compared to the nominal interest.

This indicates that forex market changes give certain additional information to the real sector and the remaining economic agents (as examined in detail in the Forex Market chapter) in view of optimizing their decision-making, while the fluctuations of the nominal leva interest cannot perform such functions from the viewpoint of balancing domestic savings and investment. In other words, the nominal interest as the price of money (resp. of credit and capital) is not a suitable instrument for rational economic decision-making on the macro- and micro-level in the Bulgarian money and credit market situation.

This asymmetric evolution of the competitive and uncompetitive sectors signals the generation of real (rational) market relations between the Bulgarian economic agents „from the outside inwards“, i.e. by adjusting to the price structure on the international commodity and financial markets.

Since from a macroeconomic point of view the inwardly and outwardly oriented sectors are integrated (the trade deficit is equal to the difference between savings and investment), the economic stabilization depends to a great extent on their interaction.

This interaction may be most clearly outlined by comparing the dynamics of the current exchange rate (spot rate) and the implicit time exchange rate (forward rate), since in this way the difference between the (relatively) rational expectations based on the exchange rate (forex market) and the actual dynamics of the monetary-credit system can be traced.

Irrespective of the underdeveloped forward forex market in Bulgaria, an estimation of an equilibrium exchange rate can give an idea about the future BGL price which should have dominated the forex market if the ratio of the interest rates on the domestic and the international credit markets had a real basis.

As will be shown in detail, the Bulgarian forex market is characterized by strong and long-lasting deviations of the calculated spot rate and the current exchange rate at the end of the corresponding period. Uneven time periods alternate: periods during which the implicit forward rate exceeded the spot rate (profit-bearing long leva position) - April 1993 - November 1993; July 1994 - October 1994; January 1995 till now, are followed by periods of lower time rate than the spot rate - November 1993 - July 1994; October 1994 - January 1995, when a short leva position is more profitable.

The periods of „long leva positions“ are characterized by a relatively stable rate and moderate inflation. The „short leva positions“ are usually concurrent with a BGL depreciation and economic destabilization. On the other hand, it will be further illustrated that the dynamics of the nominal and especially the real exchange rate strongly influence export and import, resp. economic growth.

Therefore, in the transitional period the speculative operations on the forex markets, the processes unfolding in the real sector, the monetary, credit, and fiscal policies are entangled in a tightest knot, the untying of which is the only way to the complete stabilization of the Bulgarian economy.

The existence of considerable differences between the spot and the implicit forward rates dooms the country to a recurring „tequila effect“, i.e. to alternating periods of forex market stability and sharp leva depreciations as a result of alternating inflows and outflows of short-term speculative capital, and of higher and lower effects of currency substitution.

The narrowing of this differences is inconceivable without the participation of the

BNB which is legally responsible for both the domestic and foreign purchasing power of the leva. Since interest is not an efficient instrument against inflation in the transition period, but is a basic factor determining the spot/forward rate differential, the interest policy should be tied down to stabilization (long term) of the foreign rather than the domestic purchasing power of the leva.

In the Bulgarian case this signifies that monetary policy should be oriented towards a sustained flexible interest level that determines an interest differential between the leva and the main foreign currencies equal to the difference between the current inflation rates, plus a certain risk premium accounting for the objective instability of the Bulgarian economy.

In this case, domestic and foreign economic agents would be interested in keeping stable „long“ leva positions. This would help stabilize the leva both in terms of the exchange rate and the „negative“ currency substitution of the leva.

The difference between the interest policy thus outlined and the one pursued by the BNB boils down to two main aspects. First, the lack of a systematic link of the interest policy „instrument“ to the „target“ - a spot/forward interest differential. Second, the need for interest policy orientation towards relatively longer-term objectives than the present ones.

As a result of the current approach, the January-July 1995 period was characterized by an unprecedentedly high and stable deviation of the current from the implicit time rate (cf. Fig.2 on page 25).

This difference reproduces the inflationary expectations and fosters their realization (automatic forecast). This is an outcome of the objective need for a U-turn in the behaviour of economic agents at a given moment in order to gain from the interest arbitrage, in case their long-range forecasts anticipate a BGL depreciation based on domestic inflation (resp. are threatened by exchange rate declines and elimination of

the expected profit from the interest differential).

Therefore, after a period of forex market stability dominated by long leva positions, the opposite „short“ positions may be filled and a real-term exchange rate depreciation set on. Any sharp change in the forex markets situation is activated by a similar mechanism.

The new short position allows an additional profit from the appreciation of the convertible currency component of the forex portfolio. In this way the insufficiently clear and dynamic tieup of the interest policy with the adequate objective (the interest differential) is a major factor programming the periodic BGL destabilization.

The interest policy orientation toward a „foreign“ objective raises the issue of inflation control. Figures indicate a strong correlation (with a lag of about 1 month) between the growth rate of broad money and inflation. Besides, the instable (increasing) velocity of money stock circulation has a definite impact on price growth.

Without ascribing causality to these links, we can justifiably conclude that the control on the money supply and the possibility for influencing the velocity of monetary unit circulation are a major aspect as long as monetary policy can be viewed as a main inflation-curbing instrument.

BNB experience since the second half of 1994 indicates that the use of the rate of required reserves is a fairly efficient instrument for lowering the money multiplier, resp. for controlling broad money growth. This requires the dynamic use of the reserves policy as a main anti-inflation instrument. International experience suggests that under a high financial risk and instability (incl. the transition from a command to market economy), such a tie-up of objectives (lowering of monetary supply and inflation) with instruments (the required reserves rate and the multiplier) is extremely effective.

The sustaining of a relatively high rate of reserves has secondary effects. It creates conditions for the development of the extra-banking structures of financial

intermediation, resp. for the slowdown of the velocity of money stock circulation, as a result of the so-called „deepening“ of capital markets. On the other hand, due to the relative shortage of money and the low multiplier the BNB may curb the rise of the reserve money stock, resp. of the banking sector and budget refinancing, in order to prevent a liquidity crisis and support the real economy.

The relatively lower inflation and the emerging trade surplus in the first six months of 1995 challenge not only the monetary and credit policies, but also the implementation of the Annual Budget Act. The lower than expected price growth and the fall in imports are objective factors reducing the budget revenues from VAT and customs duties.

However, there are also trends conditioning a decline in budget expenditures. The falling interest and the relatively expensive leva alleviate the payments on the domestic and foreign debt, whose servicing is a major budget expenditure item.

Finally, there is a third group of factors pertaining to the current economic policy and the existing institutional structures. Any change of approach in that direction would help check the upward trend in the budget deficit, resp. prevent a new cycle of inflation acceleration and economic destabilization.

The analysis of experts from the Ministry of Economic Development (MED) and the AECD indicates that one of the main channels of tax avoidance, resp. of falling budget revenues, is the so-called temporary import. Besides, the paper temporary import encourages unfair competition and has a highly negative impact on domestic production.

The most radical option for eliminating this important mechanism for evasion of customs and tax payments is to abolish the different customs and tax treatment of temporary and final consumption imports.

BNB's profit remittance is another item greatly contributing to the decline in budget revenues. In the first six months of 1995 it fell by 1,6 bn leva relative to the same period of 1994. Adjusting for inflation, this difference becomes even larger. The fall is conditioned

by two factors: the payment arrears of Economic Bank and Mineralbank to the BNB in early 1995, as well as the interest on the commercial banks' required reserves in the BNB introduced in 1994.

The financial aid for the two troubled state-owned banks may entail increased budget revenues in the second half-year period. It would also be advisable to resume the practice of interest arrears on required reserves which was common till 1994. The introduction of such a measure will be made easier by the relative inflation slowdown and the drop of the overall interest level.

Government debt servicing remains an extremely important negative factor in budget balancing. There are certain serious problems in that respect.

First, since domestic debt is BGL-denominated and foreign debt - denominated in convertible currency, factors which alleviate foreign debt servicing (expensive BGL, low inflation) usually aggravate domestic debt servicing and vice versa.

Second, the servicing of the domestic debt is still relatively rather more expensive than of the foreign debt. This is due to the fact that from the domestic debt point of view, the budget is in a short leva position, which, given the predominant periods of higher implicit time BGL rate than the spot rate, entails considerable losses through high interest payments.

The radical solution is to issue bonds denominated in USD or any other convertible currency, which earn dividends based on the interest on the Euro-currency market and payable at the day rate. This would raise the credibility of government securities and would allow the issuing of securities with longer maturity. Parallel to that, the price of domestic debt servicing may drop several times, which, in turn, would facilitate a more active government economic policy.

Overall, the above-mentioned problems coexist with certain opportunities for raising the budget revenues collection rate and for curbing financial expenditures without

resorting to artificial inflation acceleration. We will just note that the real volume of budget revenues (i.e. nominal revenues adjusted for price rises) in the first six months of 1995 fell by some 18% on an year earlier (excise revenues fell by some 40%, customs revenues - by 29% etc).

However, no financial measures would be effective without a growth in industry, agriculture and services. The emerging first-half growth in 1995 is an encouraging signal.

Economic upswing has some major characteristics. First, growth is concentrated within a relatively small range, mainly the energy- and material-intensive industries. Second, foreign, and not domestic, demand is the driving force of growth. Domestic demand, in turn, is largely conditioned by the cyclic economic recovery in the EU and the other developed market economies. Third, growth in export-oriented branches is highly dependent on the (real) exchange the real interest rates. In this respect the situation in Bulgaria has both common and different features with the other East European economies. The common features boil down to the role of export as the engine of economic recovery. There are two main focuses of differences: although in relatively small terms, domestic demand in most of the other transitional economies rises, giving the economy an additional boost; second, growth is rather more diversified and dynamic, extending over sectors such as mechanical, electric and electronic engineering.

MED/AECD studies indicate that the exchange rate changes may account for 40-50% of the export and import dynamics. This is a relatively high value, reflecting the fact that Bulgarian exporters still rely mainly on price competitiveness. The relatively low domestic prices of energy are also an export-boosting factor, resp. for economic growth.

As global trends suggest, a wider diversification of the export mix and a stronger non-price competitiveness are possible only on the basis of specialization, cooperation,

and the use of trans-national corporative channels. For instance, the much wider diversification of the export mix of Hungary compared to Bulgaria may be linked to the fact that 40% of Hungarian exports is handled by the subsidiaries of international companies.

The extremely high level of the real interest on bank credits is a powerful deterrent to real-sector development, and has an extremely negative impact on the budget. From March 1992 till July 1995 (except for a short period in late 1994) the real interest fluctuated within 20-40% on an annual basis - a level which may push any industry into decline. For comparison note that the real interest in the developed economies is some 10 times lower. Under the present circumstances interest expenditures account for about 40% of production costs in the non-financial sector.

Nevertheless, the level of real interests on deposits is still predominantly negative. Therefore, instead of serving as a financial intermediary between savers and investors, the banking system functions to the disadvantage of both. At the same time, the system itself consists mostly of banking institutions with negative net worth.

This paradox may be attributed only to the use of the banking system for transfer of resources from profitable to loss-making activities (incl. from the state-owned to the private sector) on one hand, and to the incomes flight due to high interest differential between the leva and the convertible currencies.

In this case, the lowering of the base interest rate by the BNB is not sufficient. Other measures should be taken regarding banking supervision, forex control, taxation, and the introduction of bankruptcy and speculation legislation.

In strategic terms, however, the problem can be solved only by developing competitive market structures in both the banking and the real sectors, as well as by consolidating ownership_and expanding privatization.

The general conclusion is that the economic recovery and stabilization in the first

half of 1995 give a rare chance to develop and strengthen the positive trends. At the same time, the need to sustain the balance and stability of the system of state finance and the monetary and credit system as a whole requires a re-adjustment of the economic policy of the cabinet and the BNB.

The main issue to dominate the macroeconomic policy decision-making of both the cabinet and the BNB will be the prospects for combining economic growth with a sustained inflation slowdown. This is an extremely difficult task, but some major options are already emerging.

Since, as we mentioned, foreign demand is the main source of growth, growth in Bulgaria's biggest trade partners can largely determine the dynamics of GDP and exports. The forecasts for the West European countries presume sustained positive growth or a slight slowdown of growth rates. Bulgaria's main trade partner, Germany, will probably have higher growth rates, particularly in the Eastern states with 9.2% GDP forecast growth in 1996 against the expected 9% in 1995. Higher growth in the second half of 1995 and in 1996 is also expected in the United States and Japan.

For the first time since the start of the economic reform the good economic prospects for the Western economies combine with a favourable outlook for Eastern Europe. Most international economic experts expect stabilization in the Russian economy on the basis of the sensible monetary, credit and fiscal policies, leading to inflation slowdown and a halt in economic decline. Forecasts favour a continuing economic recovery in Central and East Europe.

In case the economic slump in another major Bulgarian trade partner - Turkey - is overcome, we can expect a positive foreign economic environment. In addition, in case Bulgaria reaches agreement with the WTO and advances the negotiations with the countries of the Central European Free Trade Zone and Russia, Bulgarian exporters may gain access to additional markets.

The foreign exchange rate is a key output and export stimulus. If, however, on one hand Bulgaria's major trade partners register growth and Bulgarian exports is not subjected to negative trade policies by the importer countries, and on the other, the monetary and credit policy mechanisms suppress the trend for a new price growth acceleration, the Bulgarian economy may combine the smooth adjustment of the exchange rate to the expected long-term rate of inflation with a moderate economic growth.

There are several options in that respect. The first entails the sustaining of the current level of required reserves and interest. In this case we can expect a higher rate of inflation relative to the first six months of the year. This will inevitably lead to larger BGL depreciation and inflation growth. This option is relatively neutral to the real sector.

The second option is to raise the interest rate only, in order to offset the price rise. This will inevitably bring a temporary stabilization of the BGL exchange rate, an increase in the real interest rate on credits to producers. As a result, the emerging unstable economic upturn will be slowed down. In a longer-term perspective, this option may disrupt the forex market as in the spring and end-summer of 1994.

The third option requires the tightening of the restrictive stance of BNB's reserves policy without raising the base interest rate. This should help check inflation growth and enable a smooth transition to a longer-term depreciation of the exchange rate. Together with the other economic policy measures, this option may combine inflation slowdown with growth in the real sector.

Economic policy may receive a freer hand in case it may rely on a growth in effective domestic demand. This, however, requires certain changes in the structure of government revenues and expenditures, as well as a clear system of structural priorities. The changes in the budget sector mainly depend on two above-mentioned problems - to lower expenditures on domestic deficit servicing and raise the rate of budget revenues collection.

The restructuring of government revenues and expenditures may be achieved by solving the problems of capital market institutionalization, activating the government-debt-reducing privatization mechanisms, consolidating the legislative and administrative basis of financial control and supervision, applying adequate instruments for government debt management and financing, rehabilitation of the banking system.

The government may raise the necessary resources for a non-inflationary growth in the context of a sensible industrial, agrarian and innovation policy only after it achieves sizable cuts in financial expenditures and a higher rate of tax collection. However, the overcoming of the structural fiscal barrier is a medium-term task. □

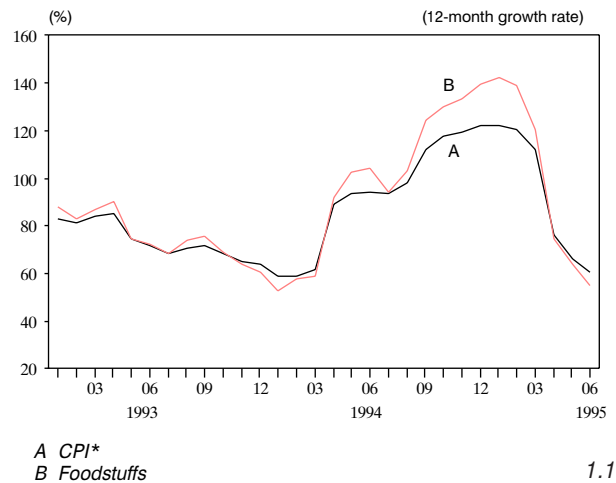
INFLATION

Cumulative inflation in the six-month period of 1995 amounted to 15.2%. The average monthly consumer price growth (2.4%) was substantially lower than the same period in the last four years. The inflation rate in June was 0.5%, or 1.4 percentage points above May. This is the weakest rise in consumer prices since their monthly dynamics began to be monitored in mid-1990.

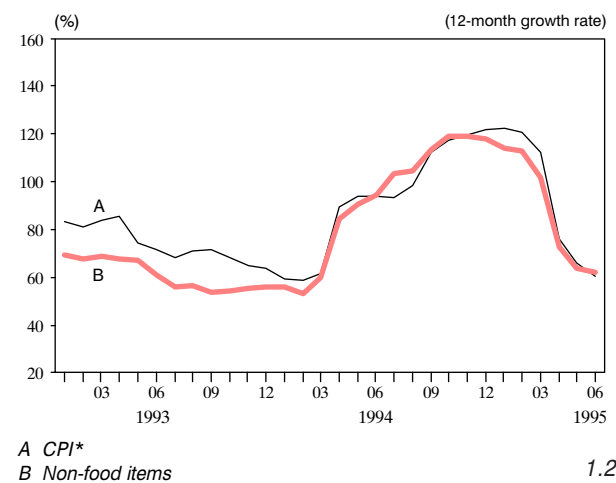
Figures 1.1, 1.2 and 1.3 illustrate the consumer price index (CPI) dynamics measured on a 12-month basis. This type of presentation outlines the dominant trends in the direction and intensity of inflation dynamics.

The rate of consumer price inflation declined throughout 1993. Under a BGL appreciation, the slowdown of inflation in the period was due to commodity prices (mainly of non-food items), while the 12-month rate of service price inflation was substantially higher and more fluctuating. The inflation rate began accelerating in March 1994 to reach in early 1995 its highest

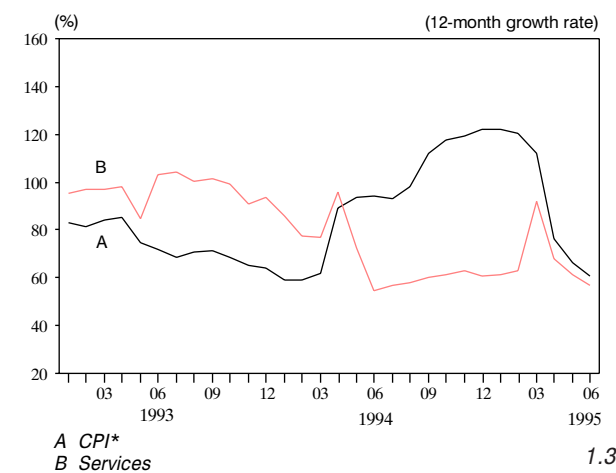
CPI



1.1



1.2



1.3

* The 12-month rates of inflation are calculated by multiplying monthly indexes.

Fig. 1

Source: NSI, AECD

ever annual rate since the price liberalization in February 1991. As a result of disinflation in February-June 1995 relative to the same period in 1994, the 12-month inflation rate gradually dampened (from 122.1% in January to 60.5% in June).

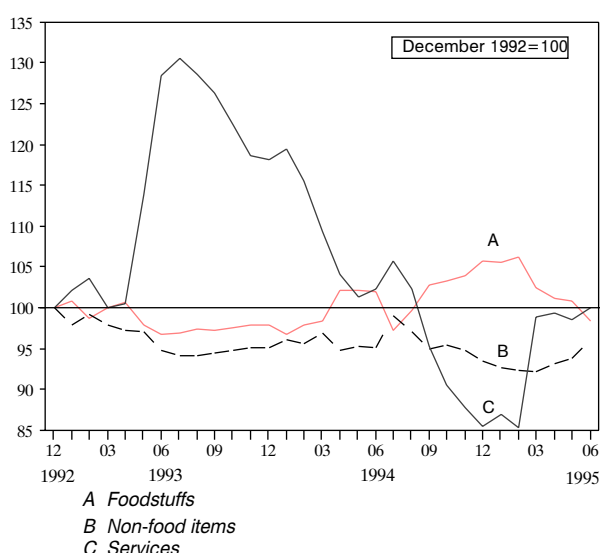
Contribution of the commodity and service sub-groups to the overall CPI in June

	contribution to overall inflation (in % points)
A. Controlled prices	-0.22
1. Government-monitored prices of foods and services	-0.65
o/w:	
- foodstuffs	-0.9
2. Fixed and limit prices	0.43
o/w:	
- energy, coal and fuels	-0.01
B. Free prices	0.72
Inflation	0.5%
A. Food items and alcoholic drinks	-0.93
B. Non-food items and tobacco products	1.12
C. Services	0.31

There are different rates of price growth across economic sectors. It is not always easy to distinguish the changes in the average price level from the changes in the relative prices of commodity or service groups. This requires the isolation of sub-indices and analysis of the separate components of the overall CPI.

Inflation may be decomposed in two ways: 1) by commodities (food and non-food

Relative Prices*



* Ratios to the average CPI.
Fig. 2

Source: NSI, AECD

items) and services; 2) into core inflation and inflation of controlled prices. This makes it possible to analyze the different aspects of the main inflationary sources. The systematic study of the impact of import competition on the rate of domestic inflation allows the construction of an index of the prices of tradables.

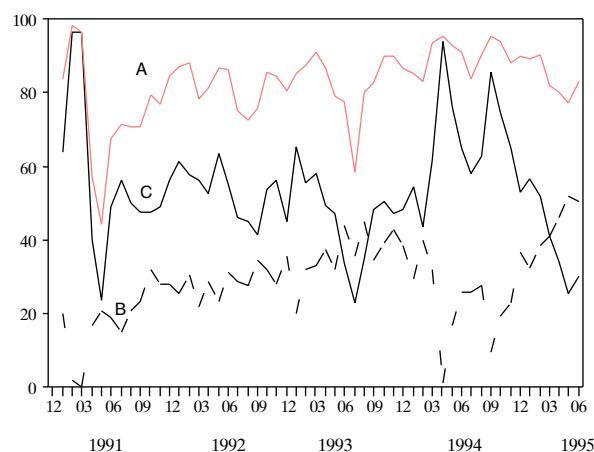
After the March and April deflation and the rise in May, food prices again fell in June. The prices of non-food items and

services increased relative to May.

The changes in relative prices are mainly caused by the sharp fluctuations in the indices of food and service prices, some of which remain under partial control or are subject to regular adjustments. In 1993 as a result of the considerable increase in the tariffs of some basic services, the prices in the service sector sharply exceeded the overall index, but in subsequent months they steadily decreased.

The changes in the prices of goods in 1994 were rooted in the BGL depreciation and the demand-pushed rise in basic food prices. Relative prices underwent a new substantial restructuring as a result of the sharply higher growth of food prices in the last five months of 1994. This extended in the first two months of 1995 as well (base: December 1992). March 1995 witnessed a sharp turnabout as a result of the relatively large increase in service prices based on the rise in electricity and heating tariffs. Thus in June relative prices came close to their December 1992 level. In June service prices registered the highest rise relative to the end of 1994 (34.7%), followed by the prices of non-food (18.5%) and food items (7.2%).

Diffusion Index: Consumer Prices *



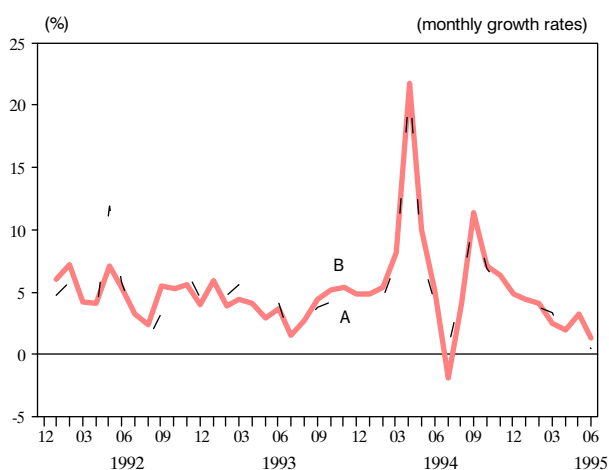
A - % of goods and services with increasing prices
B - % of goods and services with prices increasing up to 3%
C - % of goods and services with prices increasing above 3%

* Since January 1993 the indexes encompass 83 groups of goods and services instead of 80 in 1992 and 1993.

Fig. 3

Source: AECD

CPI and "Core inflation"



A CPI*
B "Core inflation"

* Till Dec. 1992 inflation is measured by the RPI, whose values are very close to the CPI. Since Jan. 1993 the official measure of the inflation has been CPI.

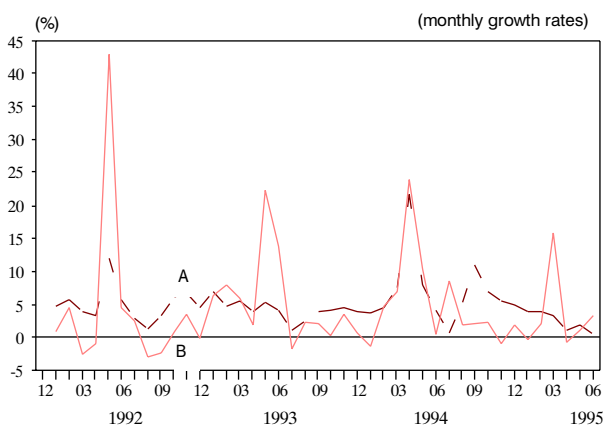
Fig. 4

Source: NSI, AECD

The scope of inflation is gauged by the diffusion index¹. In 1994 the values of the index were higher than in 1993, falling below the 90% level in four months only. The high-inflationary component of the diffusion index (goods and services whose prices rise by more than 3% on a monthly basis) increased sizably in 1994 after the reduction in 1993. The changes in the level and structure of the index indicate a broad base of inflation acceleration in 1994.

In June 1995 the prices of 83.1% of goods and services registered increases, with 30.1% of them rising by over 3%.

CPI and Controlled-Prices

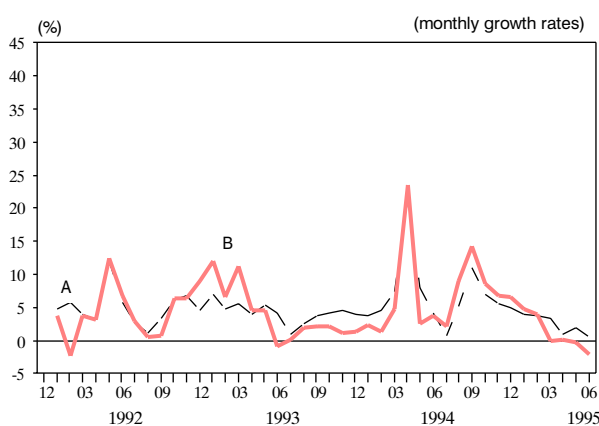


A CPI
 B Average monthly price index of fuels, energy, coal, postal services and railway transport (till 1993)* and of tobacco products (since March 1994) (13%)** 5.1

30.1% of them rising by over 3%.

The AECD makes a regular assessment of the core inflation² which determines the dynamics of essential inflation processes.

As the figure illustrates, the core inflation index „trims“ the peaks to an extent without, however, eliminating the considerable



A CPI
 B Average monthly index of government-monitored prices of essential goods and services (33%)** 5.2

* Ceiling price for fuels; services prices are fixed and/or periodically adjusted.
 ** The group's weight in the CPI in parentheses.

Fig. 5

Source: NSI, AECD

¹ The index indicates the share of CPI items which have increased in the corresponding month. By the end of 1992 80 items were surveyed. Since 1993 the diffusion index has been covering 83 items.

² The essence of this indicator was discussed in previous AECD Monthly Business Surveys. Core inflation is assessed by excluding the prices of controlled food items and other government-controlled goods; electricity and central heating; coal; fuel (petrol and diesel fuel by the end of 1992; fuels and lubricants since 1993); postal, telephone and telegraph services and railway transport from the CPI. Having discarded the above-mentioned components of the CPI, the core inflation is essentially inflation of the free prices. It amounted to 84% of the weights in the overall RPI by the end of 1992, to 74% in 1993, and 72% since the beginning of 1994. After the introduction of fixed prices of tobacco products in March 1994, core inflation is calculated on the basis of 69% of the weights in the overall CPI, and since April (with the increased number of monitored prices) - of only 57.5%. In January 1995 the list of monitored prices was again expanded and now core inflation includes some 54% of the CPI weights.

rable inflation fluctuations. The lower levels of core inflation (such cases were more frequent in 1993) reflect the adjustment of administratively set prices. And vice versa, in periods of higher rates of core inflation than the official inflation measure, controlled prices restrained the inflation processes. Free price growth in June 1995 (1.33%) was higher than overall inflation (0.5%).

Controlled prices declined by 0.5% on average in June as a result of the slight fall in the indirectly controlled (government-monitored) prices which dropped by 2% on average. Directly-controlled (fixed and limit) prices rose by 3.3% in June due to the higher prices of fuels. (Fig. 5).

Despite their increase in 1995, railway tariffs lagged farthest behind the overall inflation accumulated in the post-liberalization period. (Figure 6).

The impact of exchange rate changes on the relative prices of certain goods (and hence on the overall price level) may be approximately assessed by isolating a sub-index of import prices from the overall CPI. The leva price index of importables may be seen as a leading indicator of forthcoming changes in the average price level. The prices of these goods are the first to respond to exchange rate changes. The adjustment of the others comes with a certain lag in an attempt to bring down the differences in relative prices - to offset higher production costs or adjust to the prices of foreign substitutes.

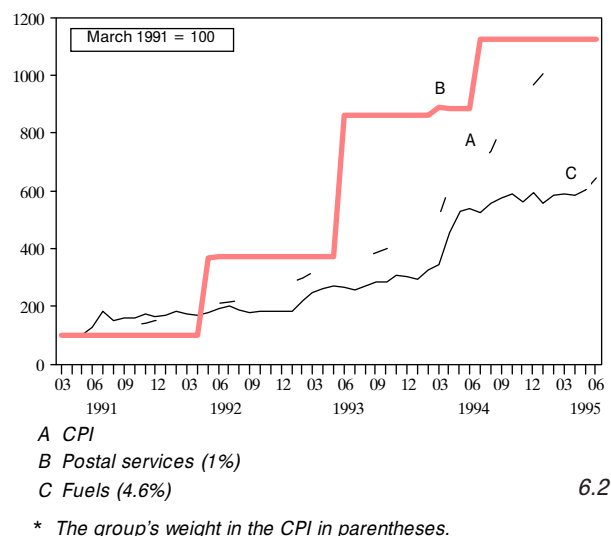
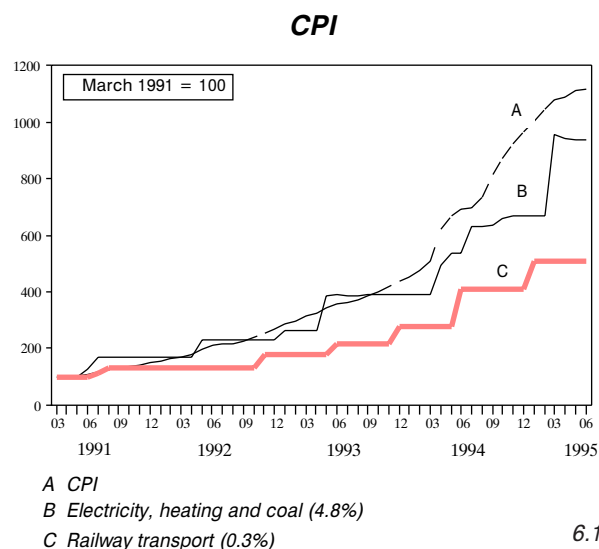
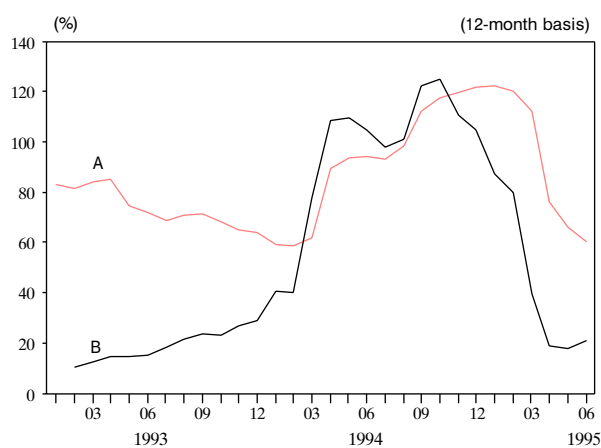


Fig. 6

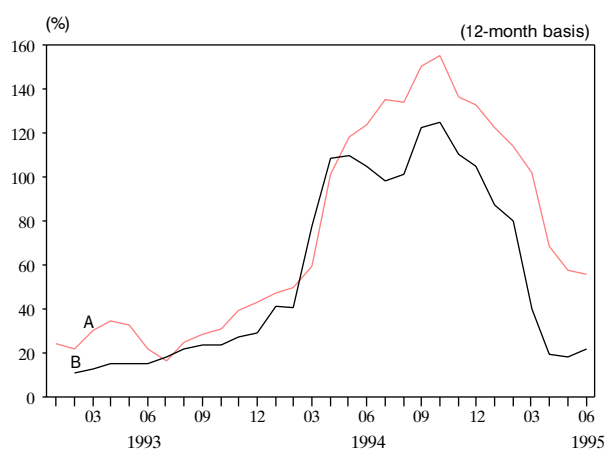
Source: NSI, AECD

Depreciation of the Leva and Inflation



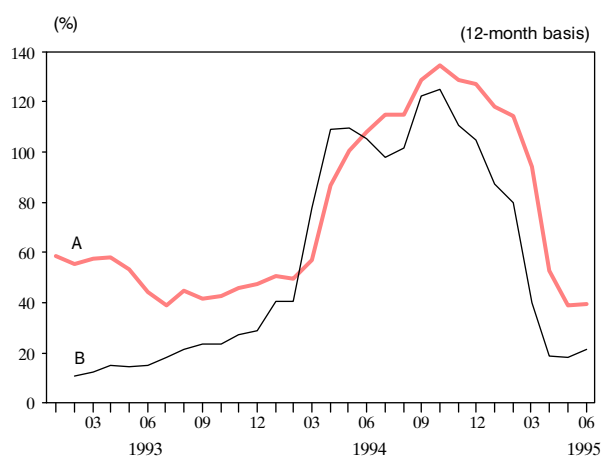
A Inflation
B Leva per USD

7.1



A "Pure" imports inflation
B Leva per USD

7.2



A Tradables inflation
B Leva per USD

7.3

Fig. 7

Source: NSI, AECL

In the narrow sense the sub-index covers goods that are explicitly defined as imported in the consumer goods basket, or which are not (or are to a very low degree) domestically produced³. The prices of these commodities („pure“ imports) respond first and adjust immediately to the BGL depreciation.

Using a more broadly defined criterion (goods with a relatively highest degree of export potential and import penetration into final consumption⁴), a relatively representative indicator of the prices of tradables was conceived⁵. The average index of these prices also follows the exchange rate dynamics, although reflecting it to a lesser degree.

³ These are citrus fruits, bananas, coffee, sugar, imported vodka and whisky, diapers, vacuum cleaners, watches, cameras, colour TV sets, video cameras, VCRs, tape recorders, auto cassette players, personal vehicles and spare parts, imported coal and compressed slack, and fuels whose limit prices in leva are set by the Council of Ministers on the basis of international prices at the current BGL/USD exchange rate. The number of such goods is too small - in 1993 they accounted for 13% of household money expenditures which are used as CPI weights, and in 1994 - to 15%

⁴ Due to the lack of data on the consumption of individual goods, the estimates are made indirectly by comparing domestic production with export and import volumes.

⁵ These include household electric appliances, electric equipment for leisure time (tape recorders, cameras etc); clothing, footwear and personal belongings; personal vehicles and all other „pure“ imports. The index covers some 30% of consumer expenditures.

In periods of relatively stable nominal exchange rate and overvalued real exchange rate, the average indices of both „pure“ imports and tradables are lower than overall inflation, acting as its deterrent. Vice versa, in periods of steady BGL depreciation both indices exceed the CPI, immediately responding (in the same or following month) to the BGL depreciation.

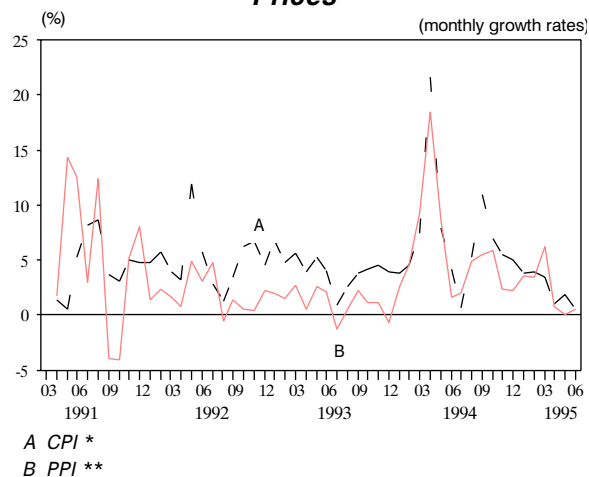
The slight nominal BGL depreciation in the last two months of 1994 and in early 1995 reduced „imported“ inflation. The June 1995 growth rate of the prices of „pure“ imports and tradables were 3.3% and 3% respectively.

In June producer prices in industry remained almost unchanged. Their monthly growth (0.5%) was equal to consumer price inflation.

By sectors the highest price rises were recorded in the printing industry (4.8%), electrical engineering (4.4%) and the clothing industry (4.1%).

NSI estimates show indicate a dampening annual growth rate of producer prices: from 51% in May to 47% in June. □

Consumer Prices and Industrial Producer Prices

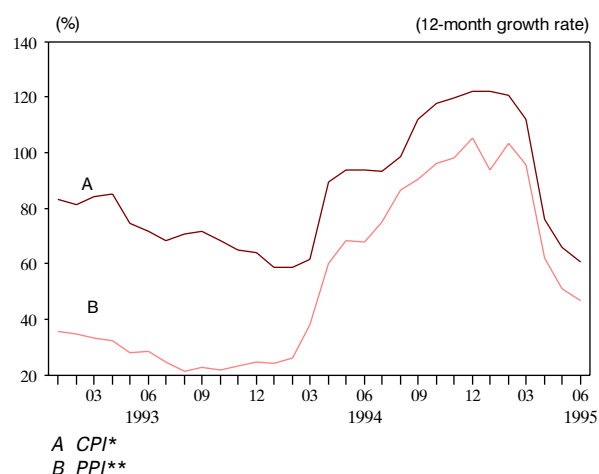


* The consumer price indexes have been calculated according a new methodology since January 1993. They are not strictly comparable to the preceding series.
** It is calculated in AECD on the basis of raw data from NSI till April 1992. Since May 1992 NSI official data are used.

Fig. 8

Source: NSI, AECD

CPI and PPI



* The 12-month rates of inflation are calculated by multiplying monthly indexes.
** Current weights. Indexes are calculated by NSI.

Fig. 9

Source: NSI, AECD

MONETARY AND CREDIT POLICY

In the first five months of 1995 the BNB eased monetary restrictions relative to the end of 1994. This translated into increased commercial bank refinancing and a gradual lowering of the base interest rate.

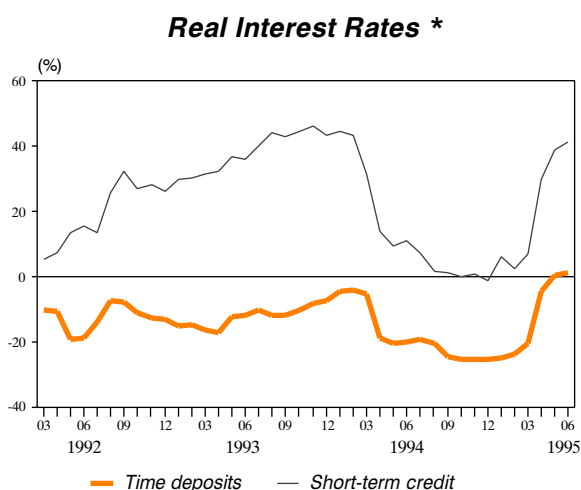
The slowdown of the inflation rate, the dampening of inflationary expectations, as well as the slight fluctuations of the exchange rate allowed the BNB to lower the interest levels without disrupting the money market. From the beginning of April till the end of June 1995 the BNB made four reductions of the base interest by an average of 6 percentage points each.

Thus, the simple annual interest rate fell from 72% to 48% at the end of the six-month period. This reduced all interest levels, with interests on deposits falling faster than interests on credits.

The monthly spread between the interests on deposits and credits amounted to 2.27 percentage points in May (relative to 2.05 in December 1994). Commercial banks offset their losses in credit arrears by widening the spread between interests on passive and active operations. There was no outflow of leva deposits; adjusting for interest

accrued they grew over the whole period.

Interest rates on deposits (deflated by the CPI) have been positive since the turn of the year. However, their 12-month profitability turned positive as late as May. 12-month interests on short-term credit, deflated by the PPI, became positive in January. Their high-rate growth in the second quarter raised the compound annual interest to 40% in June.



* Interest on time deposits is deflated by the consumer price index, interest on short-term credit is deflated by the producer price index.

Fig. 1

Source: BNB, AECD

The temporarily restored credibility in the BGL determined the opposite, though not so explicit, trend in the dynamics of foreign exchange deposits. They declined from November 1994 till April 1995, with the exception of January when forex deposits grew by 1.2 in dollar terms.

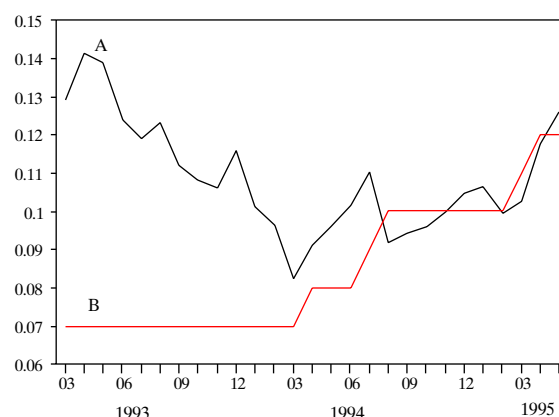
The BNB regulated commercial bank liquidity by changing their required reserves. The decision to acknowledge 60% of commercial banks' cash BGL assets and 15% of their cash foreign exchange assets as required reserves since the turn of the year did not change much the ratio of required reserves to deposits. The share of cash assets acknowledged as reserves fluctuated within the narrow range of 0.06%-0.07% of the required reserves deposited with the BNB.

The BNB raised the required reserves to 11% in March and 12% in April. Instead of shrinking, as a result money supply only slowed down its growth. However, the change reduced the money multiplier to 4.79%.

Net foreign assets of commercial banks and the BNB claims to them had the greatest contribution from all sources of increased reserve money supply. BNB's

net purchases of foreign exchange increased the gross foreign exchange reserve in December 1994 - May 1995 by 420 mn USD. To offset the impact of foreign exchange purchases on the money supply (the so-called sterilization), interventions should go hand in hand with the sale of government securities. According to BNB's balance, interventions are not fully offset by the change in claims to the government. May 1995 even saw an increased credit to the government. This situation reflects both the difficult

Total and Required Bank Reserves

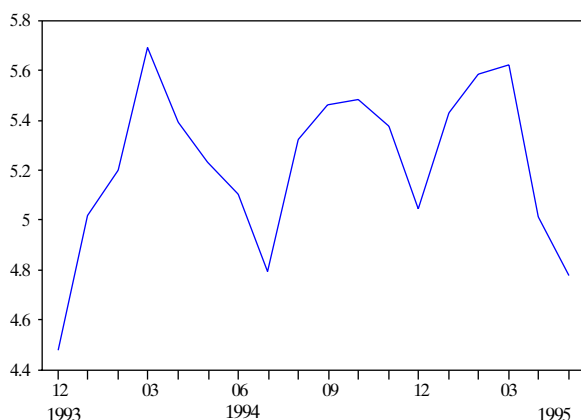


A Total
B Required minimum reserve rate

Fig. 2

Source: BNB, AECD

The Money Multiplier *

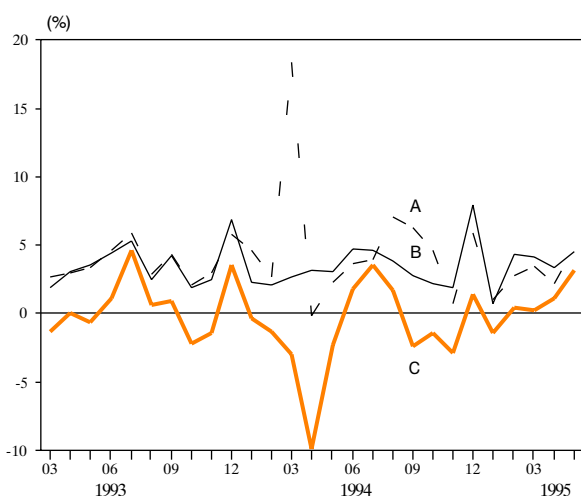


* The ratio of Broad money to BNB reserve money

Fig. 3

Source: BNB, AECD

Money Stock Dynamics (M2)*



A Nominal money stock
 B Nominal money stock (exchange rate of Dec. 1992)
 C Real money stock (prices and exchange rate of Dec. 1992)

* Monthly growth rate.

Fig. 4

Source: BNB, AECD.

collection of fiscal revenues and the relatively strict reserves policy which generates shortages of leva liquidity.

Commercial bank refinancing grew mostly at the expense of uncollateralized deposits, whose share rose from less than 1% in November 1994 to one-third of total refinancing in end-May 1995. This trend builds up high risk in the banking sector, may revive the precedent with the interest arrears on BNB deposits in Economic Bank and Mineralbank, and create new problems for the budget.

The incomplete sterilization of foreign exchange purchases, on one hand, and BNB claims to commercial banks on the other, increased the reserve money and the money supply. Since the end of 1994 the money supply has been growing at increasing rates, higher than the change in consumer prices. The only exception to the

trend was the slight decline of M2 deflated by CPI in January 1995. □

THE FOREIGN EXCHANGE MARKET

The foreign exchange market remained relatively calm during the six-month period of 1995. The nominal exchange rate in January-May 1995 followed a steady although weak downward trend. The monthly average BGL appreciation fell in the 0.7%-0.01% range.

Together with domestic price growth, the nominal BGL appreciation resulted in additional real leva appreciation. It was more substantial in early 1995 when the CPI and PPI were still relatively high. The inflation drop since March slowed down the process of BGL appreciation.

In June the BGL/USD exchange rate increased slightly for the first time since the turn of the year - by 0.48 BGL/USD (0.73%). The low values of the CPI and PPI in June resulted in a real BGL depreciation by 0.49% and 0.41% resp.

The effective exchange rate calculated against a basket of foreign currencies followed the dynamics of BGL/USD rate. This was due to the large relative weight of USD in foreign trade settlements. The tiny differences between the two exchange rates were mainly due to the changes in the position of the major foreign currencies on the international forex market which influenced BNB's central exchange rate.

Foreign exchange supply exceeded demand throughout the first half of the year.

Cumulative for the six months, the amount of currency bought by the BNB and the fully licensed commercial banks amounted to 3406.1 mn USD, and the amount sold - 2989.6

Nominal and Real Exchange Rate

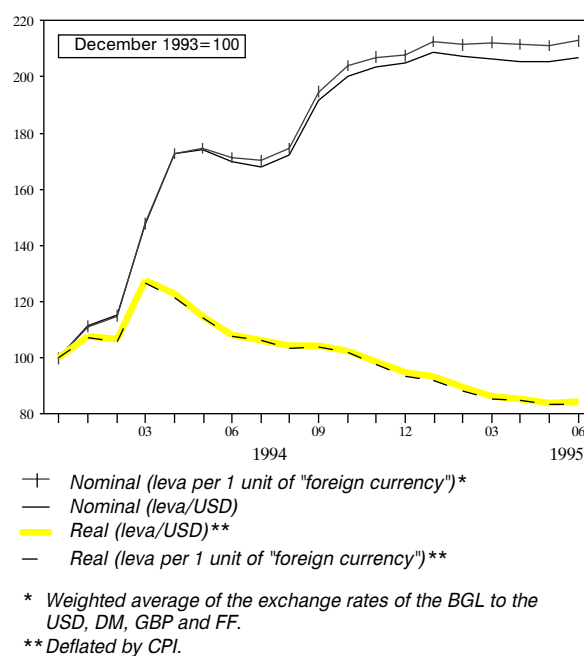


Fig. 1

Source: BNB, AECD

mn USD. BNB's foreign exchange reserves increased, reaching 1421.6 mn USD at the end of May.

The higher foreign exchange supply may be partially attributed to the conversion of foreign exchange into leva deposits. This was typical of both state-owned and private firms which sold USD because of shortage of BGL resources and expectations for a stable exchange rate.

The only exception to the trend were household foreign currency deposits which sustained their January level in May 1995.

Estimated expected exchange rate

The efficiency rate of a financial market (in this case: the forex market) can be evaluated by comparing expected and the actual state. The smaller the difference the less likely substantial non-market re-distribution of assets to the advantage of some economic agents and disadvantage of others can appear.

The forward exchange rate is one of the best estimates of the future spot rate expectations. This is rooted in the natural investors' choice of higher-profitability assets at an equal risk level. Forward contracts are concluded on the international market as hedging against unfavourable exchange rate changes or arbitrage. The key factor in the choice of strategy is the sign and the amount of the so-called covered difference of interest rates (CD).

CD is calculated using the formula:

$$CD = (1+i_2)r_f / r_s - (1+i_1), \quad (1)$$

where i_1 and i_2 are interest rates, r_s is the spot rate, and r_f - the forward rate.

Since arbitrage profits tend to decrease in time, the value of CD converges to 0. When $CD=0$ there is an interest parity which is a necessary condition for a market equilibrium.

There is no developed forward/futures forex market in Bulgaria, and the rationale

behind the calculation of the 'forward' rate is to evaluate an equilibrium exchange rate at a given moment and a given profitability of assets denominated in both leva and foreign currencies, in order to ensure interest parity.

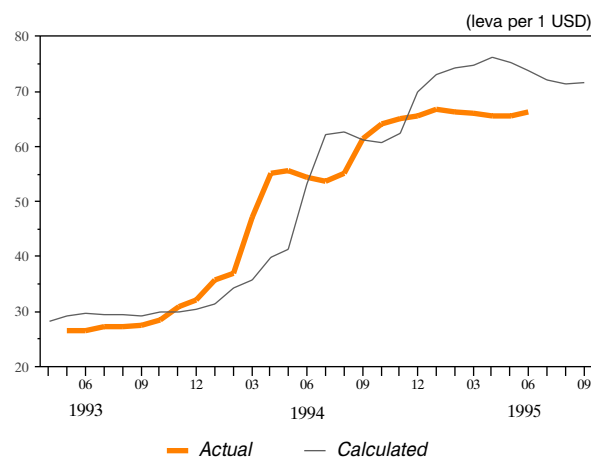
From (1) we can derive the formula of the estimated forward rate:

$$r_f = r_s(1+i_1) / (1+i_2)$$

The quarterly forward BGL/USD rate is calculated using the quarterly LIBOR and the interest rate on time leva deposits. The results are shown on Fig.2.

In April-November 1993 the exchange rate level fell below the expected in the equilibrium market hypothesis. The positive interest differential for leva deposits was offset by the rise in the BGL/USD rate as late as November. BGL depreciation in the year-end and the beginning of 1994 made foreign currency assets more profitable than the leva, the largest difference being reached in February-May.

Exchange Rates: calculated and actual



The situation in the first six months of 1995 is quite similar to early 1993. High interests on BGL deposits under nearly unchanged exchange rate bias potential investors strongly in favour of leva assets.

Source: BNB, AECC

The sustaining of a sizable positive interest differential over a longer period of time may have a powerful detrimental impact on the Bulgarian forex market in case of foreign capital inflow attracted by arbitrage opportunities.

Despite the lowering of the base interest rate and the USD appreciation in June, the difference remains substantial, as seen on Fig.2. In case interest rates on BGL deposits remain unchanged in the forthcoming months, the equilibrium level will be reached at 71-72 BGL/USD. □

FISCAL POLICY

After the agreement with the London Club the dominant issue of fiscal policy has been foreign debt servicing. Foreign interest expenditures in the first half of 1995 increased 4-fold relative to the same period in 1994. Nevertheless, foreign debt servicing is not yet the heaviest burden on the budget. The domestic debt outstanding is much lower than the foreign debt outstanding, but the payments are much larger. This is due to the alleviated repayment scheme on the foreign debt till 1998.

Expenditure Structure of the Consolidated Government Budget

(in % of total expenditures)

	1993-half-year	1994-half-year	1995-half-year
<i>Non-interest expenditures</i>	80.2	71.9	63.3
<i>o.w: wages</i>	11.7	10.6	10.2
<i>pensions and social benefits</i>	33.9	29.3	25.4
<i>Interests</i>	19.8	28.1	36.7
<i>o.w: domestic</i>	17.2	25.6	29.6
<i>foreign</i>	2.6	2.5	7.1

Consolidated Government Budget Deficit/Surplus

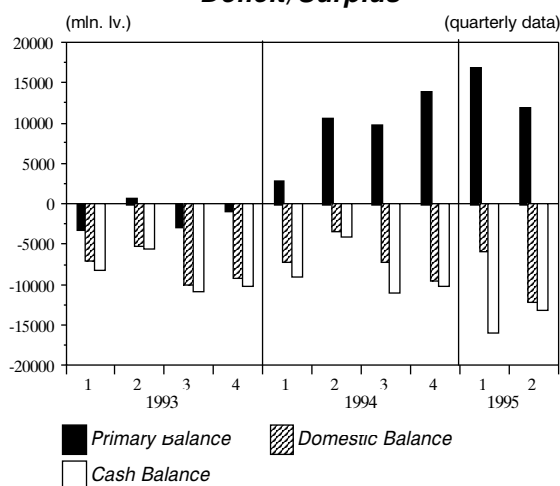


Fig. 1

Source: MF, AECD

The sustained primary surplus since 1994 dampened the growth rates of the domestic debt issued to finance current budget expenditures. The May-June indexation of budget-financed household incomes raised the nominal monthly level of non-interest expenditures and reduced the primary budget surplus. The cumulative primary surplus of the state budget since the turn of the year amounted to

25788.2 mn leva against a budget target of 64815.1 mn leva.

The cash deficit share in PSBR⁶ fell in relative terms at the expense of increased financing expenditures.

Structure of the PSBR of the consolidated government budget

(in %)

	1993-half-year	1994-half-year	1995-half-year
Cash deficit	45.2	29.7	36.6
Financing expenditures	54.8	70.3	63.4
o.w: government securities amortizations	57.3	56.5	71.5
budget deposit		31.9	12.4

The uneven interest payments schedule by months requires the maintaining of a substantial amount of state budget deposits. Government securities issues are the main source of budget deficit financing. Their share in PSBR rose from 74.6% in the first half of 1993 to 93.5% in the first half of 1995. Since their average maturity is up to 1 year, however, the expenditures for paying off government securities increased as well.

Half of the domestic government debt is formed by the liabilities of state-owned enterprises under the Bad Credits Act (BCA). Although interests on bad debts under BCA are reduced, budget deficit financing transforms them into government debt, serviced at normal interest rates.

Composition of Domestic Government Debt

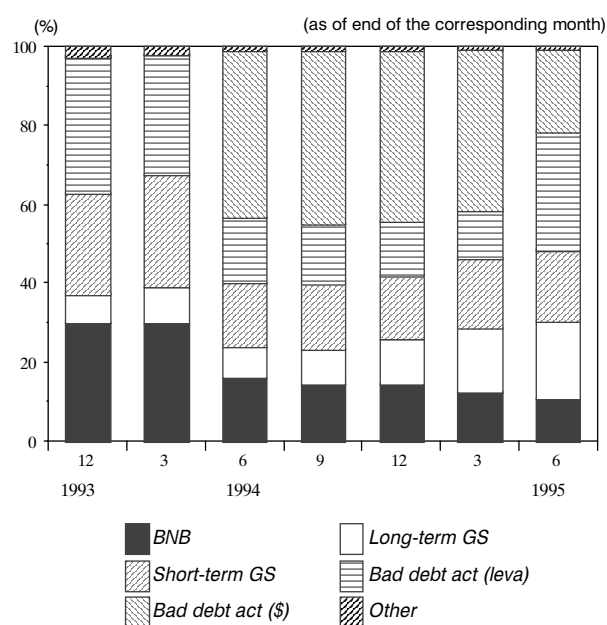


Fig. 2

Source: MF, AECD

⁶ PSBR include resources for covering the cash budget deficit and the financing expenditures.

Structure of Domestic Government Debt

(in %)

half-year	1993	1994	1995
Government securities	32.8	27.3	38.0
o.w: long-term	7.3	10.6	17.7
short-term	25.5	16.3	18.3
securitized debt to BNB		0.6	2.0
BNB credits	30.1	14.6	10.6
Bad debts of state-owned enterprises	34.8	57.2	50.7
o.w: in BGL		13.6	29.8
in USD		43.6	20.9

Composition of Government Interest Payments

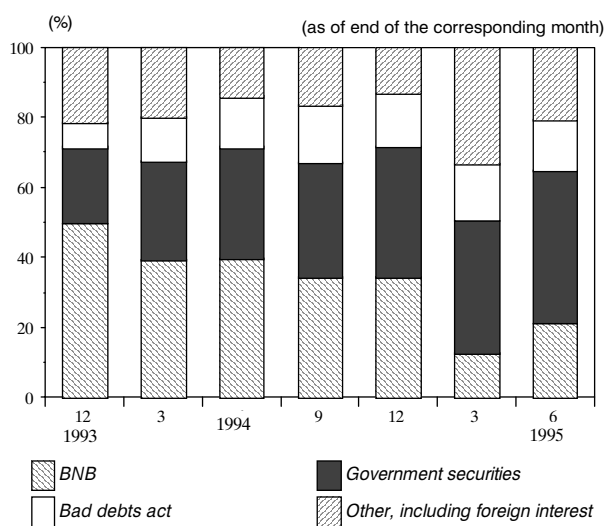


Fig. 3

Source: MF, AECD

Average Term to Maturity of Government Securities

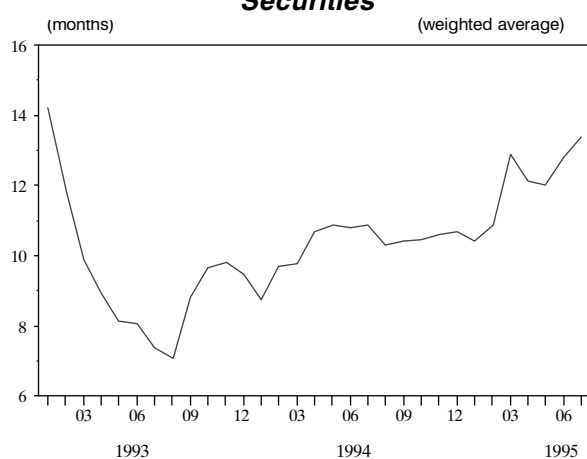


Fig. 4

Source: BNB, AECD

Since external financing is limited, the budget deficit and financing expenditures should be covered by internal resources. The maturity of government securities whose issue began in mid-1991 is still too short - about 1 year on average. The efforts to raise the average government securities maturity by issuing securities with maturity of 2 and more years have been unsuccessful so far.

One of the reasons for a higher demand for short-term government securities is the offered level of interest payments. Long-term government securities are offered at an interest equal to the base interest rate.

The acceleration of privatization, even at the cost of liberalizing the debt instruments regime, can also ease the interest budget expenditures on the domestic and foreign debts by reducing the absolute amount of the debt. □

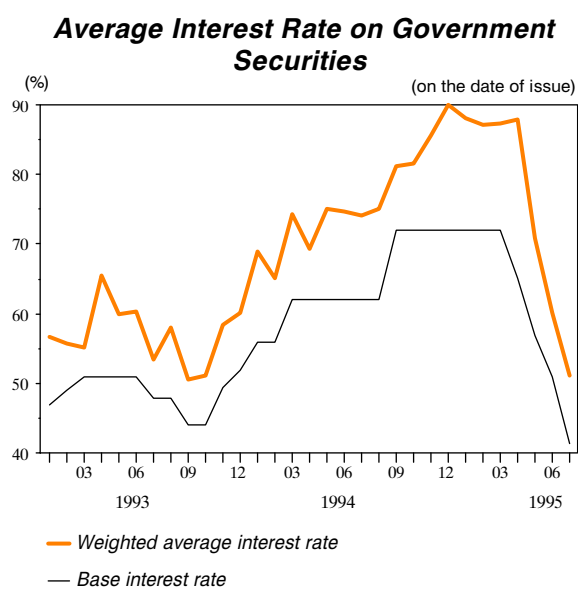


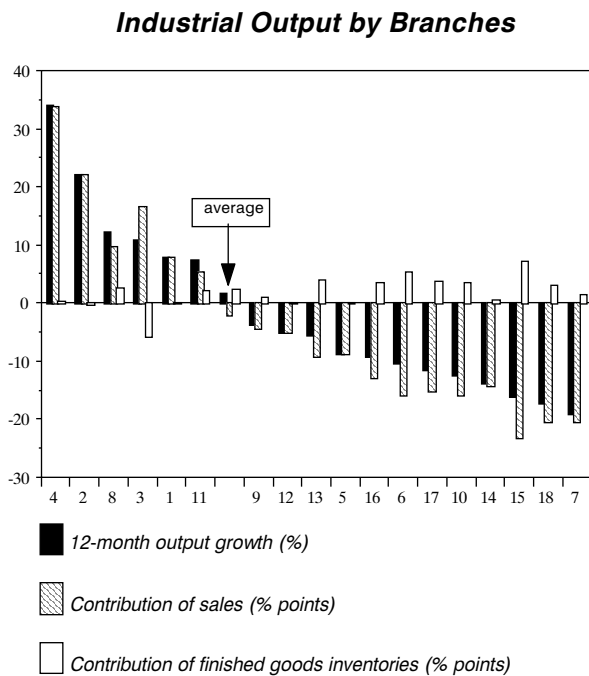
Fig. 5

Source: BNB, AECD

INDUSTRIAL OUTPUT AND GROWTH

In the first six months of 1995 industrial output in the state-owned sector amounted to 296.2 bn leva, 97.6% of which in sales, and 2.4% in finished goods inventories. Relative to the same period in 1994, output grew by 1.6%. The highest growth was registered in ferrous metallurgy (34%), coal industry (22%), chemical industry (12.1%), and oil-extraction (10.9%).

The largest slump was registered in electrical and electronic engineering (018.9%), leather industry (-16.1%), and clothing industry (-13.6%).



1. Electric Power Generation; 2. Coal-Mining; 3. Oil and Gas-Extraction; 4. Ferrous Metallurgy (Incl. Ore-Mining); 5. Non-Ferrous Metallurgy (Incl. Ore-Mining); 6. Mechanical Engineering and Metal Processing; 7. Electrical and Electronic Engineering; 8. Chemical and Oil-Processing Industry (Incl. Rubber Industry); 9. Construction Materials Industry; 10. Timber and Wood-Processing Industry; 11. Pulp and Paper Industry; 12. Glass and China Industry; 13. Textile and Knitwear Industry; 14. Clothing Industry; 15. Fur, Leather and Footwear Industry; 16. Printing Industry; 17. Food Industry; 18. Other Industrial Branches.

Fig. 1

Source: NSI, AECD

The scope of recovery measured by the diffusion index of industrial output indicates a slowdown of monthly growth rates after the peak in end-1994, when 72% of industrial branches increased their output.

The weaker rise in output dynamics is rooted in the sharp incomes decline which directly influences domestic demand. According to NSI data domestic market sales fell by 2.8% in the first half of 1995.

The active export strategy of some industrial branches was the main factor for the growth since the second half of 1994. Another favourable factor was the improved international business situation and the rise in the world prices of certain groups of

manufactured products.

Thus, the relative advantage of Bulgarian producers on the international markets revived industry and boosted growth. Financial statistics, however, indicates that exports are concentrated in a relatively small number of firms, mainly in ferrous metallurgy, chemical and food industries. The export list is topped by raw materials and (with a few exceptions) the

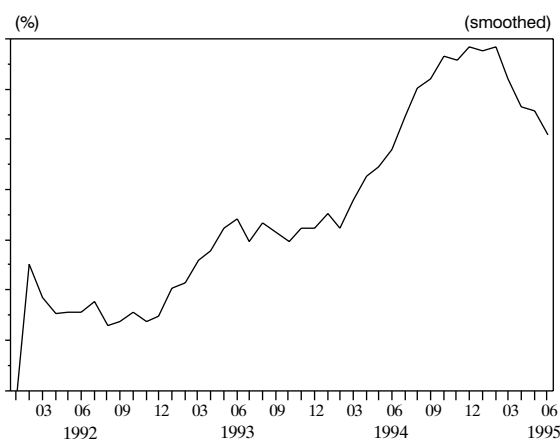
products of low-technology industries - water vessels, metal constructions, hoisting devices, inorganic chemical products, chemical fertilizers, medicines, tinned vegetables and fruit, wines and tobacco, ferrous and non-ferrous metals.

The export of the above-mentioned products underlies the growth of industry as a whole, offsetting the fall in the other industrial branches, which sell their products on the domestic market. Therefore, the possibilities of a group of firms to „tow away“ the whole industrial sector are temporary and instable due to the high sensitivity of exports to changes and cyclic fluctuations in the international markets. That is why a steady industrial growth should be sought by participation in the so-called inner industrial trade (cooperation and specialization), as well as by encouraging domestic demand and the respective consumption.

The answers to the different questions in the entrepreneurial surveys give a more detailed account of the business cycle development in recent months.

- The low level of orders remains the gravest problem of producers. This is evident in the extremely low balance of answers of responding enterprises. There has been an

Diffusion Index: Industrial Output*



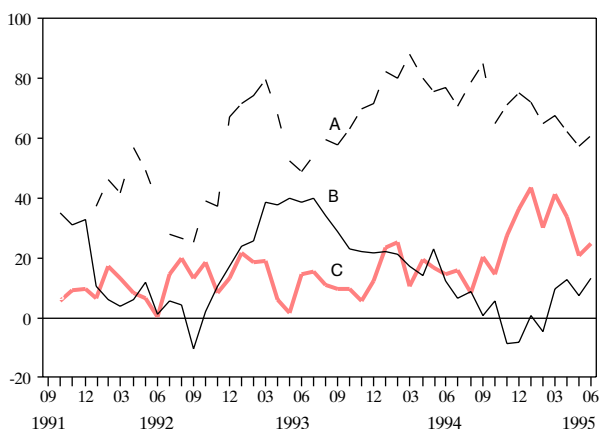
* Share of industrial branches with growing output (compared to the same month of the previous year). Total of 17 branches, oil-extraction excluded.

Fig. 2

Source: AECD

upward trend since May 1993 when the net balance plunged to a minimum. Producers have been more optimistic about the level of export orders than of domestic market orders. Despite a certain improvement, the level of orders as a whole is below normal.

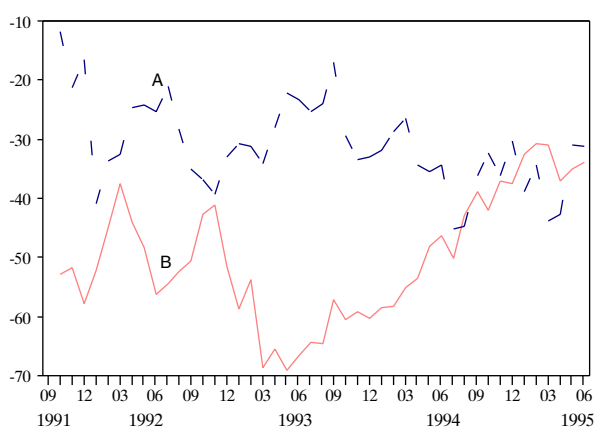
Entrepreneurial Business Surveys in Industry*



A Price expectations
 B Finished good inventories-net opinion
 C Output expectations

3.1

■ Net assessments of the level of finished goods inventories have been steadily falling since July 1993. This indicates that most producers have depleted unwanted inventories to an optimum. In the second quarter of 1995, however, the balance of inventory assessments rose slightly.



A Raw materials inventories-net opinion
 B Level of orders-net opinion

3.2

* % of firms with positive opinion (expectations) - % of firms with negative opinion (expectations)

Fig. 3

Source : NSI - Entrepreneurial Business Surveys

■ After peaking in end-1994 and early 1995, the balance of output expectations reversed its trend downwards. Having in mind the seasonal nature of output, the balance of output expectations may be expected to improve again in the second half of the year.

Experience in using the entrepreneurial surveys shows that output expectations predict rather well the direction of industrial output change: expectations „lead“ actual output by 2 months.

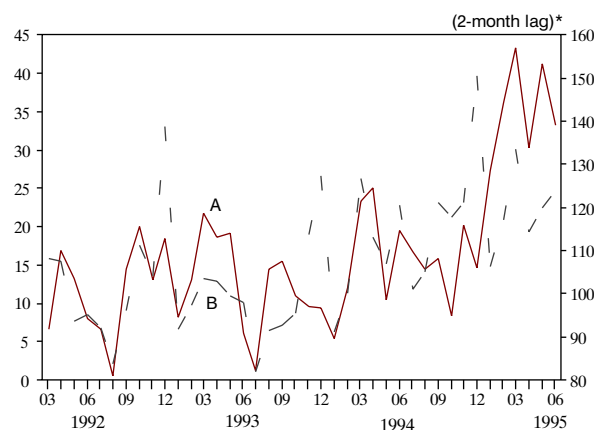
Output expectations are weakly correlated with price change expectations. This indicates that producers' expectations of higher prices are based on high expectations for the overall inflation rate, and not on expectations of higher prices of their products.

- The dynamics of expected output price changes has been falling in 1995. The lower sale price expectations are mainly due to the stable dynamics of the exchange rate.

- The private sector registered higher export expectations than the state-owned one. On the other hand, export expectations at the end of June 1995 do not differ substantially from January 1995.

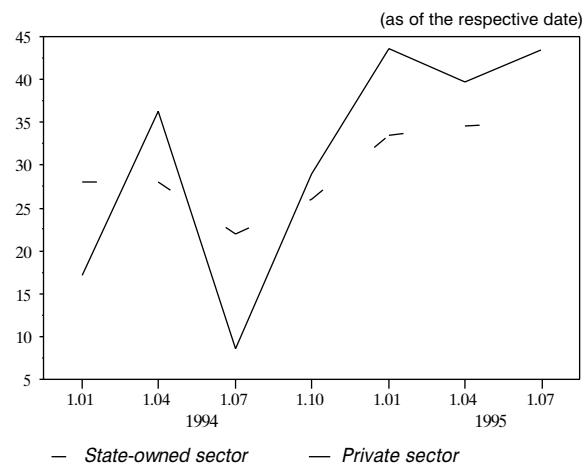
- Output demand expectations fell both in the state-owned and private sectors. State-owned enterprises, however, have a larger output capacity to meet a possible rise in demand, while private firms lack the production capacities to satisfy higher demand.

Output Expectations in Entrepreneurial Business Surveys and Actual Output



A Expectations - balance of answers (left scale)
 B Industrial Output Index: Jan. 1992=100 (right scale)
 * Data from the business surveys (A) are shown with a 2-month lag.
 Fig. 4 Source: NSI, AECD

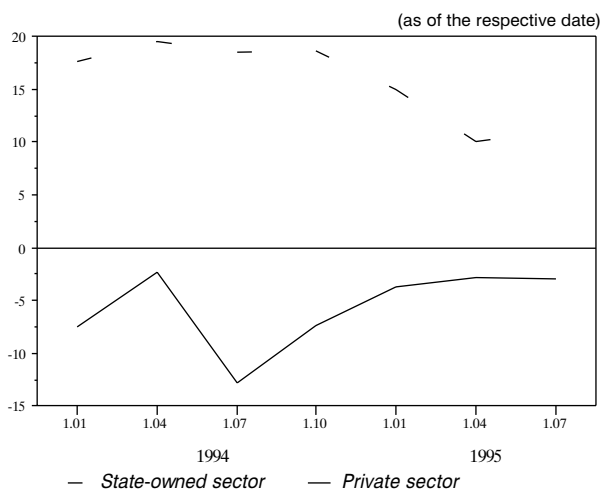
Business Surveys in industry
 Expected exports*



* % of firms expecting an increase in exports - % of firms expecting a decrease
 Fig. 5 Source: NSI

**Entrepreneurial Business Surveys
in Industry**

Current production capacity (with regard to expected demand in the next 12 month)*



* % of firm with positive assessment - % of firm with negative assessment

Fig. 6

Source : NSI - Entrepreneurial Business Survey

Surveys on the limits to industrial production point to two categories of adverse factors as most important: insufficient domestic demand and the financial difficulties of customers and producers. In the last few months limits to production were caused by the second group of factors. Since March 1995 competitive imports has been emerging as one of the main factors limiting production.

They were indicated by 23.7% of the respondents, against 9% at the beginning of the year. This is probably related to the stable exchange rate and the more favourable imports. □

FOREIGN TRADE

The preliminary customs statistics for the first six months of 1995 indicates a foreign trade surplus of some 60 mn USD.

Once again BNB data on foreign trade flows sharply diverge from the customs statistics. Banking estimates put the export and import volumes in the first quarter of 1995 at 2022 mn USD and 1934 mn USD resp.

Foreign trade is usually slow in the first quarter of the year. This is the reason for the January-March 1995 fall of export and import volumes below their level in the last quarter of 1994. The comparison of first-quarter data for 1995 and 1994 indicates that total exports increased by 3.4%, and exports for foreign consumption - by 7.7%.

Despite the overall rise in exports for foreign consumption, many commodity groups lose export positions. Relative to the first quarter of 1994, 49 out of 95 commodity groups registered export decline in 1995. Their relative share fell from 57.2% to 37.2%, indicating a growing export concentration.

The above conclusion is substantiated by the increase in the relative share of the top 15 commodity groups from 66.7% in January-March 1994 to 70% in the same period of 1995.

Exports for foreign consumption are concentrated in a few branches: chemical and oil-processing industries, ferrous and non-ferrous metallurgy. This largely reduces the opportunities for export growth.

The value of imports for domestic consumption in the first quarter of 1995 is 17.9% lower than the same period of 1994, but is close to the 1992 and 1993 levels.

The connection between export and import volumes and the exchange rate is still unclear. The calculation of the elasticity of these two variables from the nominal and real exchange rate (deflated by CPI and PPI) yields contradictory results.

The highest coefficient of determination (0.55) and a statistically significant

coefficient before the autonomous variable were achieved by testing the link between total imports and the real exchange rate deflated by the CPI. The value of R², however, is not high enough to justify more definite conclusions.

The coefficient of elasticity is negative (-0.71) which is justified by economic logic. The use of the real exchange rate deflated by PPI reduces the coefficient of determination considerably to the region of zero. This practically indicates a lack of any connection whatsoever.

The coefficient of the autonomous variable remains negative but insignificant. This may be attributed to the CPI dynamics till mid-1994, as well as to the large relative weight in imports of the raw materials which are not very sensitive to exchange rate changes. Assuming a low elasticity of raw material imports, the dynamics of the other imports is determined by the dynamics of the exchange rate deflated by the CPI.

Adjusting for temporary imports, imports for domestic consumption were tested for dependence on the exchange rate and the result was insignificant. Contrary to the hypothesis for a strong correlation between the variables in this case, the facts deny the existence of any stable link.

This raises doubts in the 'temporariness' of temporary imports. The difference between re-exports and temporary imports in 1994 was only 47 mn USD, or less than 4%. Moreover, the bulk of temporary imports is under the import regime for goods for processing where the value added is usually higher. The sum of temporary imports and re-exports over the last two years is much more indicative. Temporary imports exceeded re-exports by 240 mn USD. This indicates that temporary imports for at least 240 mn USD remained in the country. (Assuming the value added and profits for exporters to be 10%, the amount exceeds 500 mn USD).

The only noticeable response of imports for domestic consumption was to the exchange rate rise in March 1994. In the second quarter of 1994 it fell by some 30%

on a quarter earlier.

Since imports usually respond to exchange rate changes by a definite lag, the exchange rate was given lag values of 1 and 2 quarters resp. in elasticity evaluation. Results on both total and domestic consumption imports proved unsatisfactory.

The situation with exports is similar. No stable dependence of exports on the exchange rate could be detected. In most cases the coefficient of determination is below 0.1 and the coefficients before the autonomous variables are negative, which is an economic nonsense.

The best-parameters equation presents exports for foreign consumption as a function of the real exchange rate (deflated by CPI) with a lag of 2 quarters.

There is 0.48 positive elasticity which is statistically significant. However, the value of the coefficient of determination remains relatively low.

One possible explanation for the lack of a stable link between exports and the exchange rate is the fact that the domestic prices of most goods in Bulgaria are lower than the respective international prices (i.e. the leva is undervalued in comparison with the purchasing power parity). The leading Bulgarian export goods (especially exports to the industrialized countries) are standard and technologically low-intensive, so that price is the key factor.

We can expect a growing impact of the exchange rate on exports in a longer term, especially if the present unfavourable export-import structure is preserved. A wider diversification of the export mix as well as an easier access to garnished markets may even diminish the impact of the exchange rate.

Bulgarian exports to Western Europe rose highest compared to the other four groups of trading partners - by over 80 mn USD. (Growth was registered only by exports to the European Union. Bulgarian exports to the EFTA area fell due to the three Association members which joined the EU as of 01.01.1995.) Exports to Germany, Italy,

France and the UK increased. Exports to OECD's non-European members - to Turkey and the US in the first place - rose by over 33 mn USD. Next comes the Central and East European area, Bulgarian exports to which grew by over 24 mn USD (mainly to Macedonia from among the major partners; on the other hand Bulgarian exports to Russia and the Ukraine declined). A 13,7 mn USD rise was also registered by the Bulgarian exports to the non-Arab countries of Asia, Africa, and to the Americas. The only decrease in this area was recorded by exports to the Arab states - by over 18 mn USD.

The highest increase from among the five groups of trade partners was registered by imports from Central and Eastern Europe (mainly from Russia and Macedonia) - by some 70 mn USD. However, the growth in West European imports was too small, slightly over 4 mn USD (EU imports increased more but EFTA imports fell due to the three member states which joined the EU). The rise in imports from OECD's non-European members was also slight - some 8 mn USD. Imports from the Arab states fell by nearly 2 mn USD, and imports from the other countries of Asia, Africa and the Americas - by over 50 mn USD. This decline nearly offsets the growth in Central and East European imports.

Therefore, in a regional aspect, the key factors for the change of the trade balance from negative in the first quarter of 1994 to positive in the first quarter of 1995 are the fall in imports from non-European countries and the increase in exports mainly to Western Europe and to a lesser degree to Central and Eastern Europe and OECD's non-European members. □

PRIVATIZATION

According to Privatization Agency data, 610 privatization procedures were opened in 1994. The sectorial structure of procedures is: 32.5% in industry, 20.8% in trade, 18.9% in agriculture, 13.9% in tourism, 6.9% in construction, 3.3% in transport, and 3.8% in other sectors. This structure indicates that instead of focusing on one or two, local and foreign investors show interest in different sectors of the economy. By virtue of the concluded privatization deals, the new owners have committed themselves to 96.76 mn USD, 41.47 mn DEM and 3.5 mn GBP worth of investments.

In 1994 privatization proceeds amounted to 10 bn leva. 55% of this amount was paid in cash. The remainder was paid by debt instruments: bad credit and Brady bonds.

340 privatization procedures were opened and 130 privatization deals concluded in January-July 1995.

Privatization is a key element of the structural reform in the Bulgarian economy. Data for the first half of 1995 indicate that output recovery is outward-oriented and concentrated in ferrous metallurgy, chemical and food industries. This runs contrary to the diverse interests of local and foreign investors. The Bulgarian economy can sizably expand its export list in the eyes of the investors. ??? Privatization is a necessary condition for the expansion of growth over a larger sector of the economy. The other important privatization effect will be the

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