

The 2015 Autumn forecast of the Ministry of Finance of the Republic of Bulgaria reflects the better than expected performance of the Bulgarian economy in the first half of 2015. Projections are based on the most recent assumptions on the external environment, particularly on external demand and prices. Expectations about the European economy growth in 2015 and 2016 are more optimistic compared to the spring forecast, while the short-term outlook for several developing economies has worsen. According to the new assumptions, US dollar-denominated commodity prices are expected to decline, during the current and the following year, s being lower for the whole projection horizon compared to the previous forecast.*

1. International environment

Global economic growth in 2015 has been revised downwards. Despite the more favourable prospects for advanced economies, there are increased downside risks for the growth in emerging economies stemming from their growth structure and accumulated macroeconomic imbalances. World economy is expected to gather speed over the rest of the horizon.

The assumption on the BGN/USD exchange rate is based on the pegged exchange rate of the local currency vis-à-vis the euro and a technical assumption for the USD/EUR exchange rate.

All main commodity price indices are expected to decline in 2015 and 2016, mainly due to abundant supplies

and, in the case of industrial commodities, weak demand on the global scale. The earlier projection of the Brent price has been revised downwards in both years, reflecting still large global supply surplus and growing inventories, especially in the United States. A stronger decline is also expected for non-energy commodity prices in 2015, while their previously expected recovery in 2016 has been revised to a further decline. Metals prices are projected to decline largely on the account of capacity increases and slowing demand in China. All main agricultural prices indices are also expected to decrease amid abundant supply and high levels of stocks. ●

External assumptions: revisions since the Spring forecast

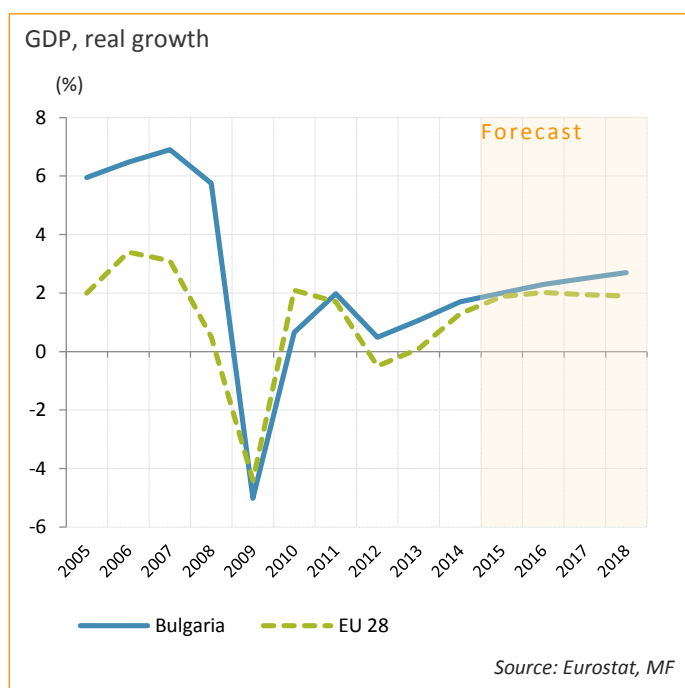
INDICATORS	Autumn forecast 2015				Spring forecast 2015				Revisions since the Spring forecast			
	2015	2016	2017	2018	2015	2016	2017	2018	2015	2016	2017	2018
World real GDP, %	3.2	3.8	3.9	3.9	3.5	3.7	3.8	3.8	-0.3	0.1	0.1	0.1
EU28 real GDP, %	1.9	2.0	1.9	1.9	1.6	1.8	1.9	1.9	0.3	0.2	0.0	0.0
USD/EUR exchange rate	1.12	1.13	1.13	1.13	1.11	1.10	1.10	1.10	0.0	0.0	0.0	0.0
Oil price, Brent (USD/barrel)	53.1	51.8	57.0	61.5	61.5	68.8	74.4	77.8	-8.4	-17.0	-17.4	-16.3
Non-energy commodity prices, in USD (annual percentage change)	-13.1	-5.2	0.3	0.0	-5.0	0.8	0.8	0.9	-8.0	-6.0	-0.6	-0.9

Source: MF

* The Autumn 2015 Macroeconomic forecast is based on materials and statistical data received up to September 4, 2015.

2. Gross Domestic Product

The economic growth for the first half of the year was higher than expected. Export largely accounted for the better performance while households' consumption growth was below the projection in the Spring forecast. A reversal in this tendency is expected until the end of the year with acceleration in domestic demand and slower pace of growth in export. This will result in GDP growth of 2% for the whole 2015 (1.4% in the spring forecast).



There are good prospects for household consumption, which is expected to strengthen in the second half of the year. It will be supported by the increase in the real disposable income of households as a result of the positive developments on the labour market, the increase of incomes, the indexation of pensions and low energy prices. According to the latest consumer survey of NSI, the present situation is assessed as favourable for purchases of major durable goods. We expect households' consumption growth of 1.4% in 2015.

The growth of gross fixed capital formation in 2015 will be mainly due to the public investment increase, being

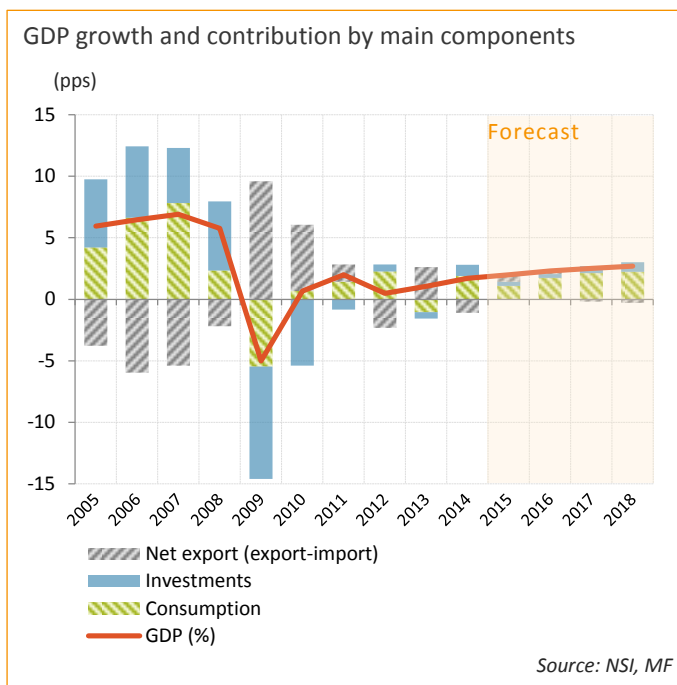
related to the measures implemented in recent years for higher absorption of EU funds. Significant payments are expected until the end of the current year on the Operational programmes under SCF for 2007-2013 programming period, as projects are already at the final stage of realization.

The H1 rate of growth of export of goods and services significantly surpassed earlier projections. The main contribution for the upward dynamics came from trade with goods, which was positively affected by the benign foreign demand as well as by the export operations of several domestic companies, which resumed full-scale production following maintenance procedures. The growth rate of import of goods also surpassed expectations, but its pace of increase lagged behind export. Given the dynamics above, export of goods is now expected to grow by 9.9% yoy, while import growth is projected at 5.9%. Current year data, along with the negative expectations for the tourist season led to a downward revision in the services export to -0.3%. The overall export of goods and services growth is forecast at 7.2%, while that of import – at 6.3%, thus the contribution of net export to GDP growth is now expected to be positive (0.6 pps).

Bulgarian economy growth will accelerate slightly to 2.3% in 2016. Consumption will increase by 2.5% supported by the improvement in households' confidence. Government consumption expenditures are expected to grow during the forecasting period, while their contribution to GDP growth will narrow in 2015 and 2016 due to the implementation of the fiscal consolidation measures and the commitment to the Stability and Growth Pact rules. The growth of investments is expected to decelerate in 2016 in line with the transition to the new financial perspective 2014-2020, while also taking into consideration the approximate time needed for formulation and submission of the projects before the actual project realization begins.

Export of goods will slow down in 2016 mostly because of base effects, which will also lead to lower import of raw materials for the export-oriented industries. The contribution of net export will be limited to 0.3 pps.

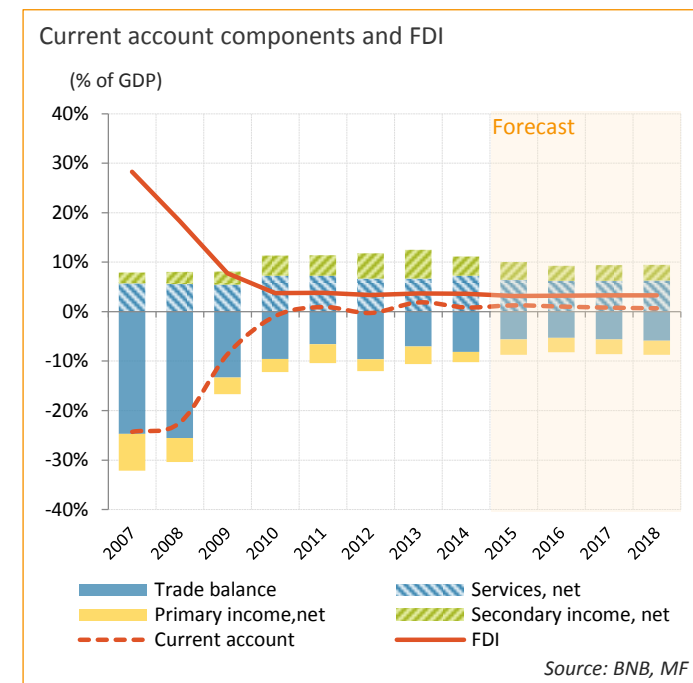
GDP growth will gradually accelerate to 2.7% over the period 2017-2018 with domestic demand as the main driver. The contribution of private consumption and investment as well as the public sector will increase. The stronger domestic demand will result in higher import growth. Thus, although export growth will also accelerate, net export will have negative contribution to real GDP growth rate. ●



3. Current account

The decline in international prices in 2015 will result in negative trade deflators. The price decline in USD terms will be partially offset by the depreciation of the euro, and the effect is expected to be stronger on the export of goods, thus resulting in positive terms of trade for 2015. The projected further decline in US dollar-denominated commodity prices in 2016, along with the marginal increase in USD/EUR rate will still keep export and import deflators below zero. The latter will change from 2017 onwards in line with the envisaged change in global price dynamics. Terms of trade will remain neutral.

Reflecting changes in both volume and value terms, nominal export growth in 2015-2016 is expected to outpace that of import and to result in lower trade deficit. Trade deficit will shrink from 8.2% of GDP reported in 2014 to 5.6% in the current fiscal year and 5.3% in 2016. Services surplus is expected to narrow due to the decelerating export growth in 2015-2016. The positive balance on secondary income will decline, too, due to lower inward flows related to the EU funds – the projects un-



der the operational programs from 2007-2013 programming period are almost completed and final payments are being made, while payments under the new

programs are yet to start as there is technical time required for the new projects to be approved and the implementation to start.

The current account surplus will reach 1.3% of GDP in 2015 and 1% in 2016.

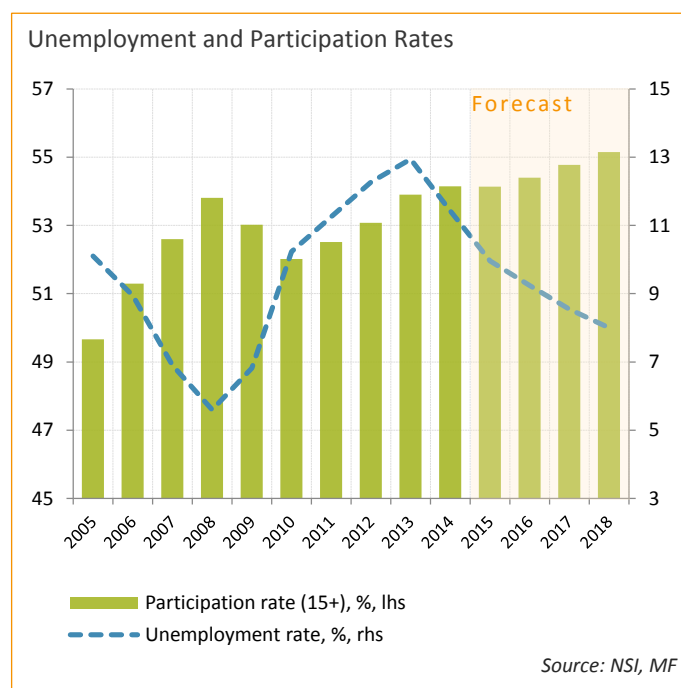
4. Labour market and incomes

Labour market followed the expected path of development in H1 2015, but with a more sizable positive dynamics, which resulted in upward revision in expectations for the employment growth and the unemployment decrease in 2015 and 2016, as compared to the spring forecast.

Employment dynamics in the second half of 2015 is expected be close to the one in the first half of the year at about 0.5%¹. The current unemployment rate has been following a downward trend in July and August to 9.3%, and expectations for employees' dynamics in manufacturing in the short-term business statistics remain positive. Meanwhile, expectations for employment developments in construction and services worsened in July and August, and these sectors are considered to hold back the overall employment growth till the year-end. Thus, employment number in 2015 is expected to increase by 0.5% yoy. With the fall off of seasonal activities the unemployment rate will go up in the last quarter of 2015 compared to summer months and its average level is expected to come to 10%², down by 0.8 pps compared to the spring forecast. The lower rate of unemployment reflects both the higher employment growth and lower than expected participation rate of the population in March, in line with the stronger decrease in the labour force.

The trade deficit will gradually increase in 2017-2018, as nominal import growth will outpace the rise in export. The lower trade balance will not be offset by the improved services and secondary income surpluses and current account balance will decline to 0.8% and 0.7% of GDP, respectively. ●

The gradual domestic demand recovery in 2016 is expected to support demand of labor, and the employment growth is expected to slightly accelerate to 0.6%. This would sustain the further decrease in the unemployment rate to 9.2%, which is expected to be slower compared to 2015, as the fall in labour force would be smaller due to the measures undertaken for raising the retirement age and the length of service requirements. These measures are expected to have a stronger impact on the work force towards the end of the forecast horizon due to the gradual increase in the age and length of service needed for retirement.



¹ Following the ESA 2010 definition.

² According to the Labour force survey definition.

With the expansion of domestic economic activity and the strengthening positive influence from the foreign environment, employment growth is expected to reach an annual average of 0.7% in 2017 and 2018, while the unemployment rate will go down to 8% at the end of the forecast horizon.

In line with the reported favourable labour market developments, the income growth in 2015 is expected to exceed the spring forecast. The upward dynamics of compensation per employee observed in H1 2015 will boost the annual growth rate of the indicator above the value laid in the spring forecast, amounting to 1.8%.

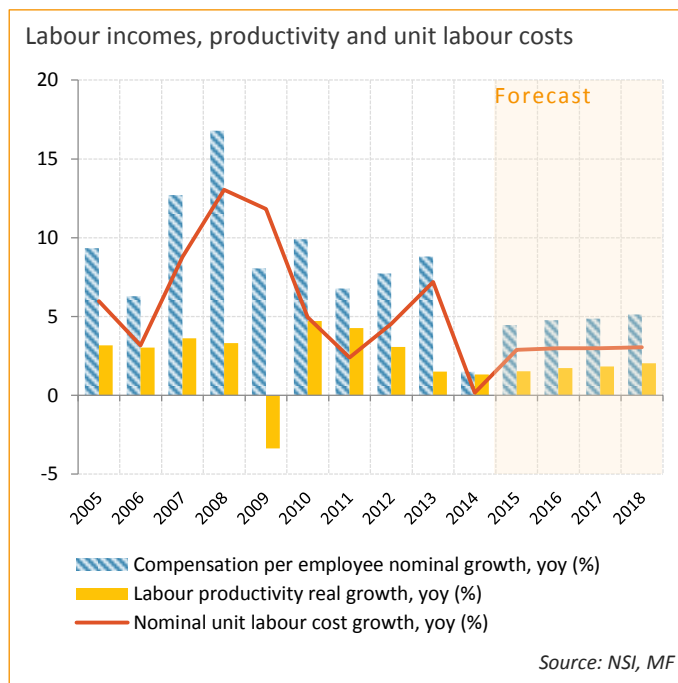
Recent income developments are expected to continue in the second half of 2015 as well, following the increasing labour demand. The lower activity in some service sector branches is likely to restrain income dynamics there as compared to first half of the year, but still the annual average growth rate of compensation per employee will speed up to 4.5% in nominal terms in 2015.

In 2016, labour income growth is foreseen to accelerate slightly to 4.8% in nominal terms supported by the higher real productivity, the upward trend in consumer prices and higher demand for labour in the country. Thus,

5. Inflation

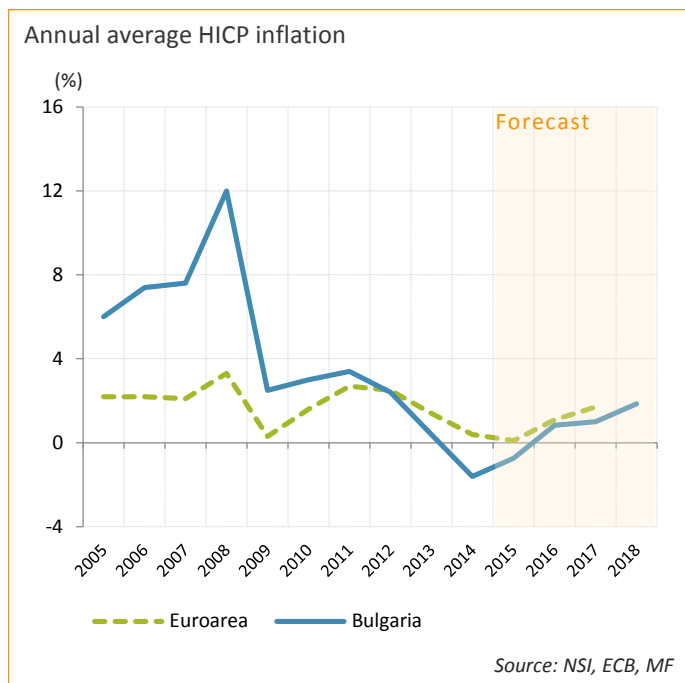
The revised assumptions for the international commodity prices resulted in a subsequent revision of expected consumer price dynamics in the country. As a result, the headline HICP inflation at the end of 2015 will be lower by 0.3 pps compared to the spring forecast due to the already reported administrative cuts in prices of natural gas, electricity and heating for household needs. Apart from the higher downward contribution from the energy component, there will be also a larger expected decline in non-energy industrial goods. The one-off effect, which accounted for the substantial decrease in services prices

the share of compensation of employees in the gross value added will gradually increase in 2015 and 2016, while unit labour costs growth will be moderate at an annual rate of 2-3%.



The upward trend in incomes will continue throughout the entire forecasting period, given the expected increase in the economic activity in the country. ●

in H2 2014, will wane throughout the second half of 2015. Thus, services will report a positive price change by the year-end, supported also by the strengthening of domestic demand. The revision in external assumptions led to a negligible change in the annual average inflation rate, which was lowered by 0.1 pp to -0.7%. The latter is expected to remain negative due to the acceleration in the negative annual inflation rates in late-2014 and early-2015.

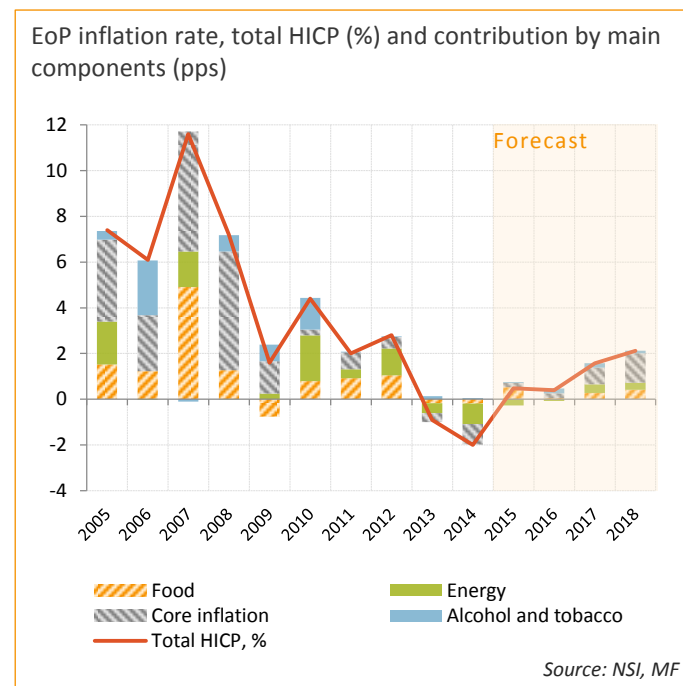


The recovery of non-energy commodity prices and higher euro-denominated prices of imported durable goods in 2016, as expected in the spring forecast, have been revised to a further decline. The latter resulted in a more significant downward correction of inflation expectations. The previously projected 1.7% increase in the headline HICP rate at the end of 2016 has been revised to 0.4%. It was mainly due to the expected further decrease in international crude oil prices which will lead to continuing decline in domestic fuel prices. Food prices are also expected to report a marginal positive change at the year-end and thus will have a lower contribution for the increase in the total HICP. The projected minimal appreciation of the euro against the USD in 2016 will result in a larger decline of non-energy industrial prices

6. Monetary sector

Expectations about the monetary sector are revised downwards compared to the spring forecast, as a result of the current dynamics of the main indicators until July and the lower expectations about deposit and credit activity. The autumn forecast projects a weaker growth of credit to the private sector throughout the forecast horizon, as the

through lower import prices of durable goods. Prices of services are expected to report an increase which will be comparable to the one at the end of the current year at 1.2%.



The inflation rate will average 0.8% in 2016 and it should accelerate in 2017-2018 driven by higher international prices of crude oil and other major commodities as well as the stronger domestic demand through lower import prices of durable goods. Prices of services are expected to report an increase which will be comparable to the one at the end of the current year at 1.2%.

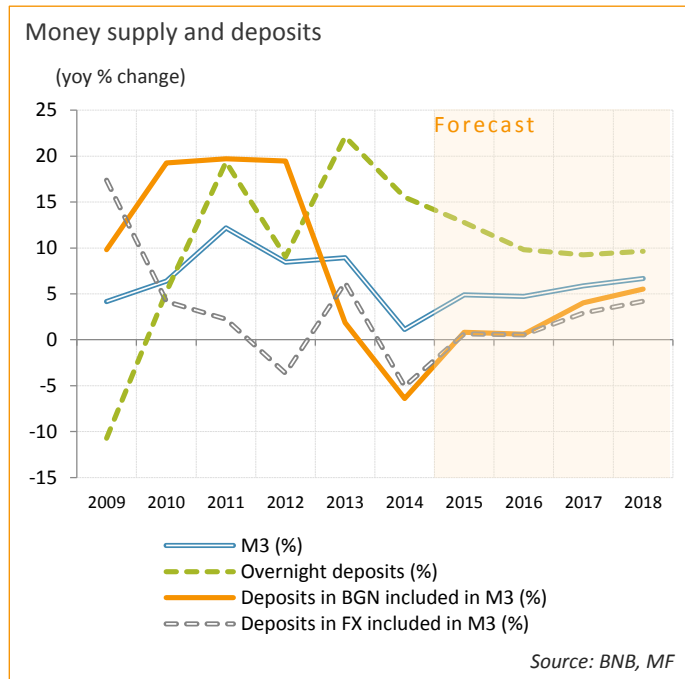
The inflation rate will average 0.8% in 2016 and it should accelerate in 2017-2018 driven by higher international prices of crude oil and other major commodities as well as the stronger domestic demand. ●

main contributor to the revision was the credit to non-financial corporations, which failed to recover despite the higher than expected economic growth.

The forthcoming asset quality review and stress test of the banking sector, the relatively high real interest rates and the high level of indebtedness in the corporate sec-

tor will have a deterrent effect on the growth of private sector credit in 2015 and 2016. The lower forecasted annual growth rates of deposits stem from the expectations of slower growth of households' savings and the acceleration of private consumption growth after 2015. Along with the acceleration of GDP growth, we expect deposits of non-financial corporations to slow down their pace, too.

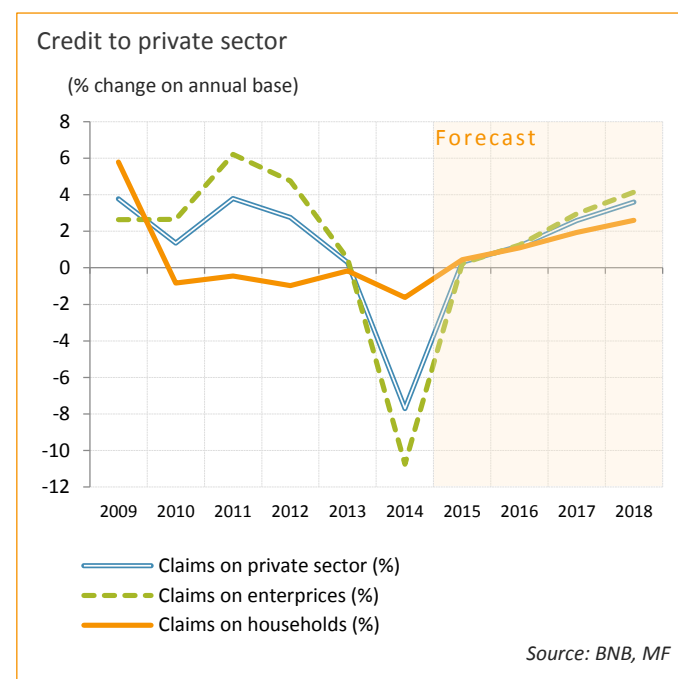
The annual growth rate of money supply is expected to reach 4.9% yoy at the end of 2015, and broad money growth is expected to slow down slightly to 4.7% yoy at the end of the next year. Overnight deposits will have a slower annual growth rate, which would reflect the base effect of the increased preferences towards them since mid-2014. The growth of deposits in local and foreign currency included in monetary aggregate M3 will return to positive territory at the end of 2015 after the exhaustion of the technical effect coming from the exclusion of Corporate Commercial bank (CCB) balance sheet from monetary statistics.



The annual growth rate of total deposits will start to accelerate in 2017 and 2018, but it will stay at a relatively low level during the entire forecast period compared to its average rate for the period between 2009 and the

exclusion of CCB balance sheet in November 2014. The forecast lower growth rates of total deposits reflect the expected gradual recovery in households' consumption after 2015, as well as domestic demand. Money supply will slightly accelerate its annual growth to 5.9% in 2017 and 6.7% at end of 2018 along with the smooth acceleration of nominal GDP growth.

Net foreign assets of the banking system will continue their upward trend, but they will slow down their pace of increase in 2016 and 2017. Their dynamics will be determined mainly by the expectations that deposits attracted from residents will significantly exceed the amount of loans extended during the period.



Credit to the private sector will increase at a relatively slow pace during the period 2015-2018. At the end of 2015 its annual growth rate will stand at 0.3%, and by the end of 2016 it will recover to 1.2%. Private credit growth will accelerate to 2.6% and 3.6% yoy in 2017 and 2018, respectively, mainly driven by the increase of corporate credit. Contribution from credit to households will gradually increase over the period, following expectations for recovery in the labour market, slight increase in nominal wages and faster private consumption growth. ●

MAIN ECONOMIC INDICATORS	ACTUAL DATA *		PROJECTIONS			
	2013	2014	2015	2016	2017	2018
International environment						
World real GDP (%)	3.4	3.4	3.2	3.8	3.9	3.9
EU28 real GDP (%)	0.1	1.3	1.9	2.0	1.9	1.9
USD/EUR exchange rate	1.33	1.33	1.12	1.13	1.13	1.13
Crude oil, Brent (USD, bbl)	108.9	98.9	53.1	51.8	57.0	61.5
Non-energy commodity prices (in USD, %)	-7.1	-4.6	-13.1	-5.2	0.3	0.0
Gross domestic product						
Real GDP growth (%)	1.1	1.7	2.0	2.3	2.5	2.7
Consumption	-1.3	2.4	1.4	2.2	2.7	2.9
Gross fixed capital formation	-0.1	2.8	1.8	1.5	2.9	3.6
Export of goods and services	9.2	2.2	7.2	4.2	4.6	5.3
Import of goods and services	4.9	3.8	6.3	3.9	5.0	5.8
Labour market and prices						
Employment growth (SNA, %)	-0.4	0.4	0.5	0.6	0.7	0.7
Unemployment rate (LFS, %)	12.9	11.4	10.0	9.2	8.5	8.0
Compensation per employee (%)	8.8	1.5	4.5	4.8	4.9	5.1
GDP deflator (%)	-0.8	0.6	1.2	1.0	1.1	1.4
Annual average HICP inflation (%)	0.4	-1.6	-0.7	0.8	1.0	1.9
Balance of payments						
Current account (% of GDP)	1.9	0.9	1.3	1.0	0.8	0.7
Trade balance (% of GDP)	-7.0	-8.2	-5.6	-5.3	-5.6	-5.9
Foreign direct investments (% of GDP)	3.7	3.6	3.2	3.2	3.3	3.3
Financial sector						
Money M3 (%)	8.9	1.1	4.9	4.7	5.9	6.7
Corporate credit (%)	0.5	-10.8	0.2	1.2	2.9	4.1
Credit to households (%)	-0.2	-1.6	0.4	1.1	1.9	2.6

- *The Autumn 2015 Macroeconomic forecast is based on materials and statistical data received up to September 4, 2015.*