

The Autumn macroeconomic forecast of the Ministry of Finance reflects the better than expected performance of the Bulgarian economy in the first half of 2016. In comparison with the Spring forecast, the expected 2016 economic growth is revised upwards. It is based on the most recent assumptions on the external demand and world prices. In comparison with the Spring forecast, the expectations about the EU and world economy has been revised downwards through the whole forecast period.*

1. External Environment

Global growth has been revised downwards for 2016 due to weaker economic activity in advanced economies. The increase of both European and U.S. economy is expected to slow down over the current year.

The expected favourable economic development of the emerging markets as well as the acceleration of the GDP growth in the United States will shape the dynamics of the world economy in 2017. At the same time, the development of the European economy will remain subdued due to the increased uncertainty in the region related to the geopolitical tensions, the migration flows towards the EU countries, the impact of “Brexit”, and the worsening economic and political environment in Turkey.

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. The latter is assumed to remain unchanged over the projection horizon at the average levels for the two-week period ending on the cut-off date of 12 September 2016.

The spring projection of \$39.7/bbl for the Brent price in 2016 has been revised upwards to \$43.6/bbl, thus its anticipated fall for the year on average is 16.8%. A lesser decline is also expected for non-energy commodity prices. All main commodity price indices are forecast to increase in the period 2017-2019, mainly due to stronger demand and subdued supplies on the global scale. ●

External assumptions. Revisions since the Spring forecast.

INDICATORS	Autumn forecast 2016				Spring forecast 2016				Revisions since the Spring forecast			
	2016	2017	2018	2019	2016	2017	2018	2019	2016	2017	2018	2019
World economy (real growth, %)	3.1	3.4	3.6	3.7	3.2	3.6	3.7	3.9	-0.1	-0.1	-0.1	-0.1
EU 28 GDP (real growth, %)	1.8	1.6	1.8	1.8	2.0	2.0	1.9	1.9	-0.2	-0.4	-0.1	-0.1
USD/EUR exchange rate	1.12	1.12	1.12	1.12	1.09	1.09	1.09	1.09	0.02	0.03	0.03	0.03
Oil price, Brent (USD/barrel)	43.6	50.9	53.9	56.2	39.7	45.3	49.2	52.6	3.9	5.6	4.7	3.6
Non-energy commodity prices (in USD, %)	-0.8	1.5	2.4	2.4	-9.5	-0.7	0.1	0.6	8.7	2.2	2.4	1.8

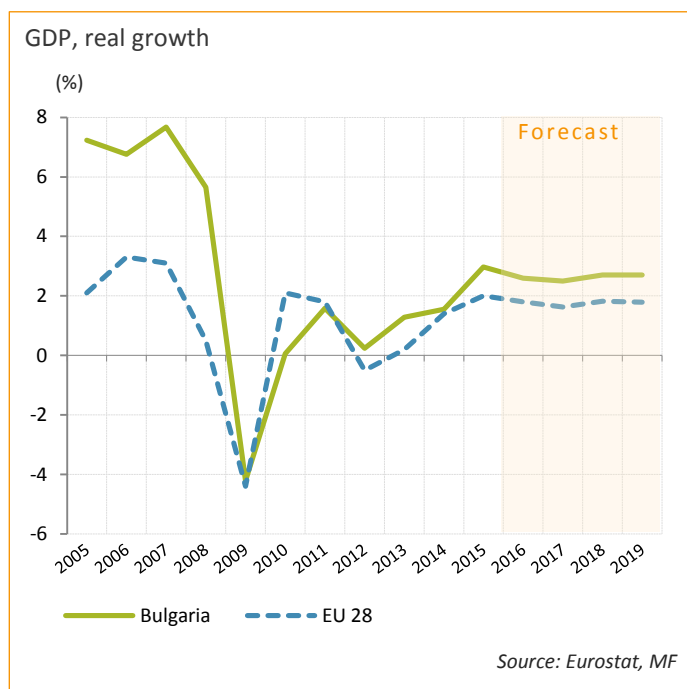
Source: MF, EC, IMF, WB

* The forecast is based on statistical data up to 12 September 2016 with the exception of the specifically mentioned.

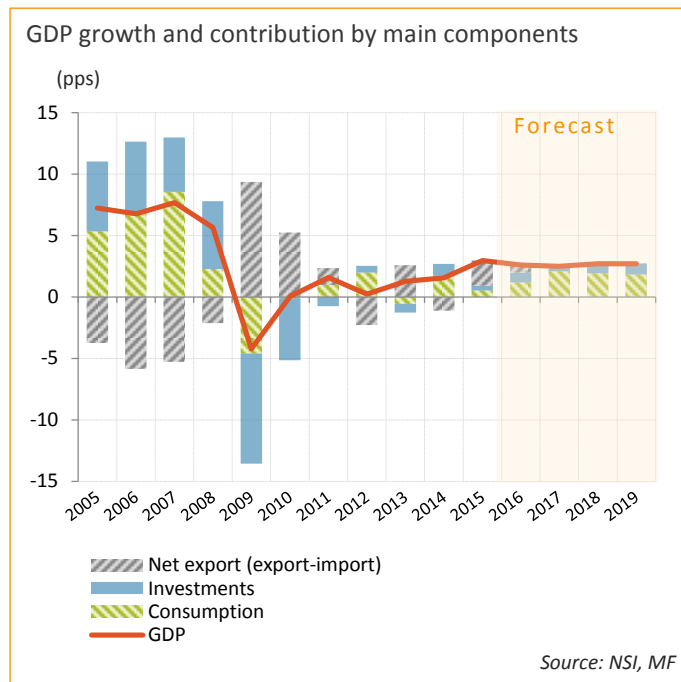
2. Gross Domestic Product

Bulgarian economy is expected to expand by 2.6% in 2016. The growth will be driven by domestic demand (consumption and investment). It is expected that the favourable dynamics of private consumption recorded in the first half of 2016 will continue until the end of the year and that the decline in public spending will slow down significantly. As a result, final consumption will increase by 1.5%. The investments in the economy increased by 7.1% in the period January-June¹ with a major contribution coming from the change in inventories. In 2016 the growth rate of investments will decelerate to 3.7% due to the smaller increase in both inventories and private investments compared to the first half of the year as well as the decline in public capital expenditures associated with the transition to the new 2014–2020 EU funds financial framework. The external sector will have a positive contribution to the GDP growth, close to the one recorded in the first half of the year (0.6 pps).

GDP growth will slow down slightly to 2.5% in 2017. Weak external demand will contribute for the lower



economic growth as it will lead to deceleration in export growth to 3.9% compared to the expected increase of 4.4% in 2016. Import growth will reach 3.8% due to the expected upward trend in domestic demand. As a result, the contribution of net export will decrease to 0.2 pps. The increase in consumption will be supported by the continued positive trends on the labour market and the registered improvement in the consumers' expectations about the purchase of durable goods. The increase in wages in some activities linked to the public sector will also have a positive effect. The growth of investments in fixed capital is expected to accelerate to 1.1% due to suspension of the negative trend in public capital expenditures and preserve positive dynamics of private investments.



The increase of GDP will gradually accelerate to 2.7% over the period 2018-2019 driven by domestic demand (consumption and investment). Higher increase in domestic demand will lead to acceleration in import growth. As a result, the contribution of the net export will continue to decrease and is expected to reach zero at the end of the forecasting period. ●

¹ Not seasonally adjusted data

3. Current Account

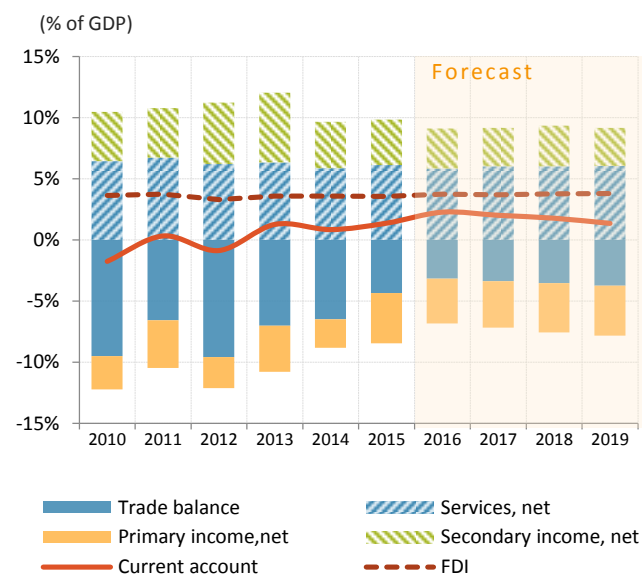
The tendency of improving trade balance, which is reflected in rising current account surplus, was preserved in 2016. However, nominal decrease in annual terms was recorded in both export and import of goods. The downward dynamics were driven by falling international prices and, subsequently, the negative trade deflators, while an increase in volume was observed for many of the commodity groups. The price decline is expected to decelerate in the remainder of the year, thus it will lead to higher deflators and positive terms of trade. In real terms export and import dynamics in the second half will be closer to those in the first half of the year. Export is expected to report small positive nominal increase at the year-end, while import will remain almost unchanged. In 2016 the trade deficit will narrow to 3.2% of GDP and the current account surplus will reach 2.1% of GDP.

International prices are expected to start increasing in 2017. Since the rise in oil prices will be more pronounced, there will be a stronger increase in the deflator of import compared to that of export and thus negative terms of trade. Taking into account price and volume dynamics, we expect that the nominal increase in import will surpass the rise in export in 2017 and the trade balance will worsen to 3.4% of GDP. Following a one-off improvement in the primary income balance in 2016, its deficit is expected to gradually increase from 2017 onwards, thus being in line with the economic activity in Bulgaria. As regards secondary income, the positive contribution of the sub-account will remain subdued, reflecting the lower inflows due to the transition period

4. Labour market and incomes

The recent labour market developments which were more favourable than previously expected in the spring forecast led to an upward revision in employment dynamics outlook for 2016. Since the beginning of the year

Current account components and FDI



Source: BNB, MF

between the two financing frameworks of the EU. As a result of the above mentioned dynamics, current account surplus will narrow to 2% of GDP in 2017.

The gradual recovery of consumption and the acceleration of investment activities in the period 2018-2019 will result in a higher growth of import compared to export, which will further shrink the current account surplus to 1.4% of GDP in 2019. The Foreign Direct Investments (FDI) inflow will continue its gradual recovery, whereas the ratio of FDI to GDP is expected to be about 3.7-3.8% average per annum for the entire forecast horizon. ●

employment has gained momentum, up by 1.5%² yoy in Q2. Its growth is expected to remain high in the second half of the year but to decelerate gradually under the influence of manufacturing economic activity slowdown,

² According to ESA 2010 figures.

worsened expectations of entrepreneurs for employment dynamics in services in August and September, and the expected slower decrease of unemployment. Thus, the average growth of employed in 2016 is expected at 1.1%. The unemployment rate went down to 8%³ in Q2, furthermore monthly data proved the downward trend continued during the summer months, as well. In the last three months of 2016 a seasonal increase of unemployment is expected, up to its level in the corresponding period of 2015. Thus, the average 2016 unemployment rate will come at 8.1⁴%.

The expected worsening of external environment in 2017 will be the main driver behind the slowdown of employment growth to 0.6% yoy. At the same time, positive development of domestic economic activity will support employment in services, which will offset the negative influence of the weaker external demand on the employed in manufacturing. The unemployment rate is expected to slow down the pace of decrease and to reach 7.3%. A deterring impact on the unemployment decline will come with the slower expected decrease of the labour force due to the measures undertaken for retirement age and length of service increase, which are expected to keep people at working age longer in the labour market. The latter will make a stronger influence on the economically active population till the end of the forecast period due to the gradual increase in the age and length of service needed for retirement during the years. The rise in the participation rate of the population will be also supported by the active labour market policies implemented in due course.

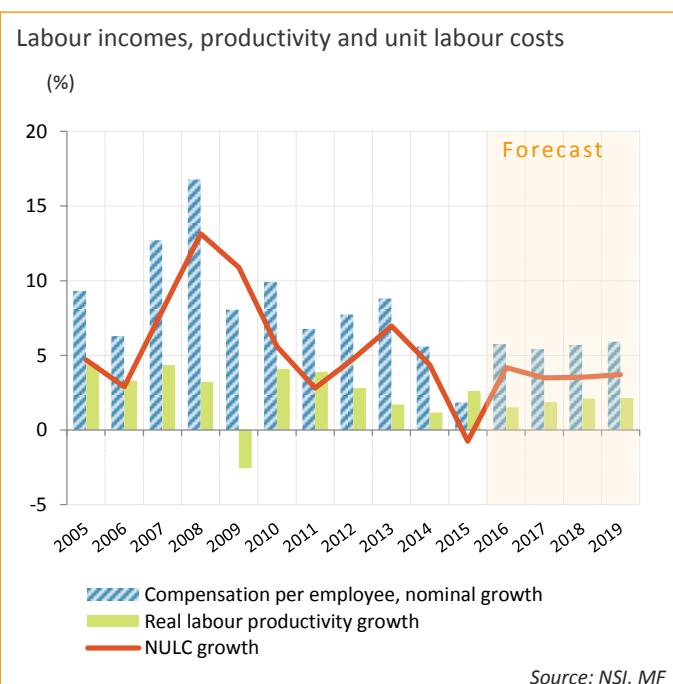
In the medium term the unemployment rate is expected to decrease to 6.5% in 2019, while employment growth will be kept at about 0.6% per year in 2018-2019, sustained by domestic demand improvement and strengthening of the positive influence from the external environment.

³ According to the Labour Force Survey (LFS) figures.

⁴ According to the LFS figures



The recent uptick in compensation per employee and the projected further improvement of the labour market and the overall economic conditions resulted in an upward revision of the compensation per employee expectations. Its nominal growth rate stepped up to 7.8% in the first half of the year but its annual average rate of change is expected to remain lower at 5.8%.



On the back of weaker economic activity the compensation per employee growth is projected to slow down in the second half of 2016 mainly due to the industrial sector. This trend is expected to continue in the beginning of 2017, as well, and thus its nominal growth will decelerate to 5.4% in 2017. However, the latter is set to remain strong reflecting the expected real productivity upward trends, positive consumer prices' dynamics and higher labour demand in the country. These factors will support the further increase in compensation per em-

5. Inflation

The annual HICP inflation rate in the country remained negative in 2016. There's been a temporary deepening in the deflation rate during the first half of the year driven by the decrease in energy and food prices, as well as lower prices of services related to communication. During the summer months, however, the negative headline rate decelerated significantly to -1.1% yoy in August.

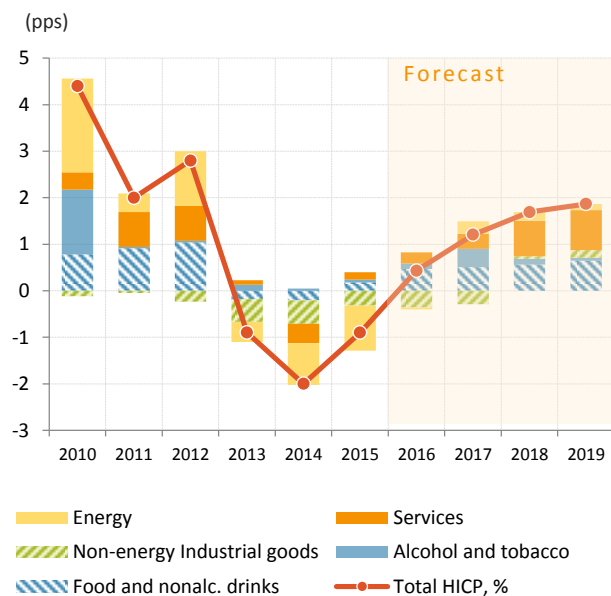
The current HICP dynamics and the considerable slowdown in the rate of decrease in major international price indices suggest that we could expect slightly positive end-of-period inflation rate in 2016. It will be largely on the account of higher prices of food and transport fuels. The energy component, however, is projected to report a decrease due to the cuts in administered prices of central heating and gas supply during the year. The negative core inflation will decelerate. Prices of non-energy industrial goods are expected to continue declining particularly due to still cheaper consumer durables, while prices of services are projected to increase slightly in December 2016. The average inflation rate is expected to be -1.0%, given the higher deflation rate in April-May.

The accumulated inflation at the end of 2017 is forecast to accelerate to 1.2%. Only consumer durables are still expected to have a negative contribution, albeit smaller, to the change in the headline rate. The annual average inflation rate in 2017 is projected at 1.5% and it is expected to accelerate in 2018-2019 under the assumption

ployee at the end of the forecast horizon. The real growth of labour productivity is projected to reach an annual average rate of 2% in the period 2016-2019, while the compensation per employee is expected to increase by 5.7%. It would imply gradual increases in the labour share in gross value added and in the unit labour cost. The latter is estimated to increase at an annual average rate of 2.5% and 3.5% in real and nominal terms respectively. •

for higher international prices of crude oil and the other major non-energy commodities, as well as an increase in domestic demand.

End-of-period HICP Inflation Rate contributions by main components



Source: NSI, ECB, MF

The envisaged hike in excise stakes on tobacco in 2017 and 2018 is expected to contribute by 0.3 pps and 0.1 pp to the change in the headline rate in the end of the corresponding year.

Risks to the inflation outlook are largely tilted to the downside and are related to a stronger-than-assumed

fall in prices of crude oil and other non-energy commodities given the relatively weak global demand. At the same time, weaker domestic demand growth could result in more subdued core inflation than currently expected. On the other hand, supply disruptions especially of food products, due to adverse weather conditions

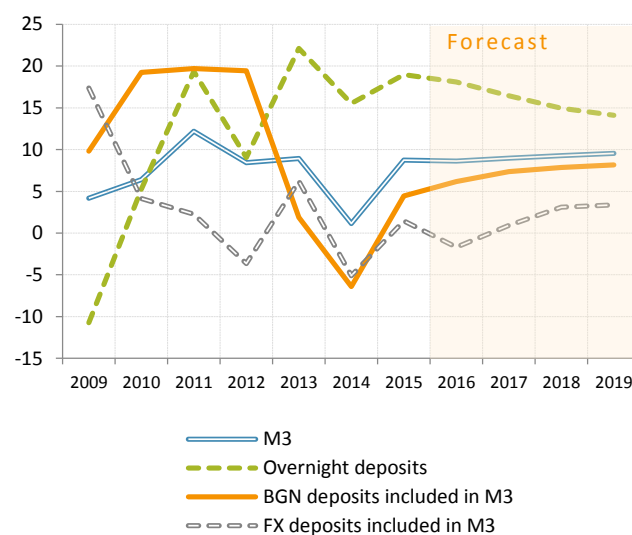
6. Monetary Sector

Money supply is expected to increase by 8.6% at the end of 2016. Its growth rate will gradually accelerate through the forecast period. It is expected to be 9% in 2017, and to reach 9.5% by the end of 2019. The main drivers behind this are the current dynamics and the expected growth of the foreign exchange reserves and deposits in the banking system. Overnight deposits are projected to lose momentum on the account of a slight acceleration of the growth of deposits with agreed maturity and those redeemable at notice. This will reflect both lower levels of interest rates and gradual decrease of economic agents' preferences to higher liquidity, as well as restored confidence in the banking system.

Credit to the private sector will report slightly positive annual growth of 0.2% at the end of 2016 due mostly to the positive contribution of loans to households, while the growth rate of claims on non-financial corporations will be close to zero. Expectations are revised upwards compared to the Spring forecast reflecting positive current developments of the credit aggregates. In 2017 credit to the private sector will continue to recover, thus its annual growth rate will reach 3%. Loans to non-financial corporations will have the largest contribution, reflecting the positive dynamics of private investments. On the other hand, the growth rate of loans to households will accelerate more gradually following developments in private consumption and labour market. These trends will continue until 2019, when the annual growth rate of claims on the private sector will increase to 5.8%.

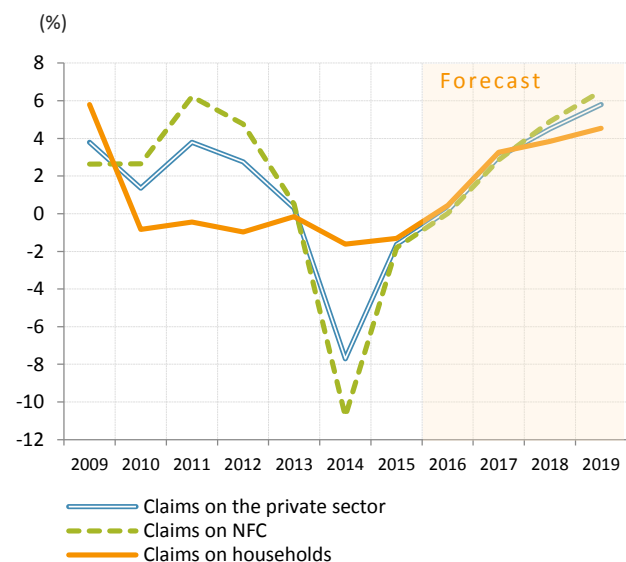
could cause higher inflation in the country. A possible supply freeze agreement among OPEC members could also result in a faster-than-assumed rebound in crude oil prices. ●

Money supply and deposits
(%)



Source: BNB, MF

Credit to private sector
(%)



Source: BNB, MF

MAIN ECONOMIC INDICATORS	ACTUAL DATA*		PROJECTIONS			
	2014	2015	2016	2017	2018	2019
International environment						
World real GDP (%)	3.4	3.1	3.1	3.4	3.6	3.7
EU28 real GDP (%)	1.4	2.0	1.8	1.6	1.8	1.8
USD/EUR exchange rate	1.33	1.11	1.12	1.12	1.12	1.12
Crude oil, Brent (USD, bbl)	98.9	52.4	43.6	50.9	53.9	56.2
Non-energy commodity prices (in USD, %)	-4.6	-15.0	-0.8	1.5	2.4	2.4
Gross domestic product						
Nominal GDP (mln BGN)	83 612	86 373	88 874	92 395	96 338	100 557
Real GDP growth (%)	1.5	3.0	2.6	2.5	2.7	2.7
Consumption	2.2	0.7	1.5	2.7	2.5	2.4
Gross fixed capital formation	3.4	2.5	0.1	1.1	3.2	4.2
Export of goods and services	-0.1	7.6	4.4	3.9	4.1	4.3
Import of goods and services	1.5	4.4	3.5	3.8	4.1	4.5
Labour market and prices						
Employment growth (SNA, %)	0.4	0.4	1.1	0.6	0.6	0.6
Unemployment rate (LFS, %)	11.4	9.1	8.1	7.3	6.8	6.5
Compensation per employee (%)	5.6	1.8	5.8	5.4	5.7	5.9
GDP deflator (%)	0.4	0.3	0.3	1.4	1.5	1.6
Annual average HICP inflation (%)	-1.6	-1.1	-1.0	1.5	1.6	1.8
Balance of payments						
Current account (% of GDP)	0.9	1.4	2.3	2.0	1.8	1.4
Trade balance (% of GDP)	-6.5	-4.3	-3.2	-3.4	-3.5	-3.7
Foreign direct investments (% of GDP)	3.6	3.6	3.7	3.7	3.8	3.8
Financial sector						
Money M3 (%)	1.1	8.8	8.6	9.0	9.3	9.5
Claims on enterprises (%)	-10.8	-1.8	0.0	2.9	4.9	6.5
Claims on households (%)	-1.6	-1.3	0.4	3.3	3.8	4.5

* The forecast is based on statistical data up to 12 September 2016.