In October, the Bulgarian industrial sector sales increased by 6.5% yoy, which demonstrates significant deceleration as compared with the 10.4% yoy growth in September and 10.8% yoy in August. The slowdown was backed by a sharp decrease in sales in the country’s mining sector, which shrunk during the month by 5.1% yoy after a 0.2% yoy decline posted in September. This drop is mainly due to a decrease in sales of the mining of metal ores, where prices slightly decreased. On the other side, manufacturing continued to show strong positive developments posting a growth of 8.6% yoy, which is only marginally lower than performance of the previous three months, when this sector demonstrated average monthly growth of 9.0% yoy.

In October, retail trade continued to show very positive developments. During the month it posted 15.5% yoy growth compared to 16.5% yoy in the previous month. Significant growth in this sector brings the cumulative growth in January-October to 12.6% yoy. The growth of retail trade is backed by the growth of household incomes, which increased in October by around 14% yoy in real terms. The performance of wholesale trade was not as impressive and posted 2.5% yoy growth in October and 1.8% yoy in January-October.

**Fiscal Policy**

In January-October, the government continued to conduct prudent fiscal policy. During the period, the fiscal surplus increased by 41.7% yoy as compared to the same period of last year and reached Lev 2.3 billion (EUR 1.2 billion). The considerable increase in the budget surplus was driven by a rebound in the growth rate of revenues, which considerably exceeded the growth rate of expenditures.

In January-October, revenues were growing at an accelerated rate after a slight deceleration in January-September. During the period, revenues grew by 10.5% yoy as compared to 10% yoy in January-September and reached Lev 16.2 billion (EUR 8.3 billion). Tax revenues, which are the biggest contributor to total budget revenues, continued to grow at an accelerated rate and constituted Lev 13.2 billion (EUR 6.7 billion) by the end of October. On a positive note there was acceleration in the growth rate of non-tax revenues. In January-October, they grew by 0.6% yoy, after a drop of 0.2% yoy demonstrated in the first nine months of the year, and reached Lev 2.5 billion (EUR 1.3 billion).

**Monetary Sector**

In November, CPI constituted 6.1% yoy. The biggest price increase was registered in the food sector where prices increased by 4.6% yoy as compared to 3.1% yoy in October. Non-food prices also increased at an accelerated rate of 11.3% yoy and, occupying the biggest share in the consumer price index (CPI), is the primary contributor to total inflation.
basket, contributed 3.4 pps to overall consumer price inflation. Services, on the other hand, demonstrated deceleration in the growth rate of their prices. In November, service rates were growing at a rate of 2.6% yoy as compared to 3.6% yoy in the previous month.

Contrary to consumer prices, producer prices on domestic markets have been rising at a decelerated rate. During October, PPI was rising at a rate of 8.5% yoy, which is 1.6 pps lower than in September. Deceleration in the growth rate of producer prices was registered in the mining and manufacturing sectors, where prices grew at a rate of 46.8% yoy and 3.4% yoy respectively as compared to 54.7% yoy and 5.6% yoy in the previous month. At the same time, prices in electricity, gas and the water supply sector continued to rise at an accelerated rate, which in October constituted 12.4% yoy.

During October 2006, the volume of bank loans to the non-government sector increased to Lev 21.1 million up from Lev 20.7 million in September. At the same time, the growth rate of bank credits remained stable during the last 3 months at a rate of 23% yoy, which is only 2 pps higher than the average rate since the beginning of the year. The largest share of loans (59.4%) continued to be issued to non-financial corporations, but the fastest growth (29.4% yoy) was registered in loans issued to households.

International Trade and Capital
In January–October, the Bulgarian trade deficit in goods and services continued to post further deterioration and reached EUR 4 billion, which translated into 16.5% of the country’s period GDP compared to the 14.3% deficit posted one month earlier. In nominal terms, the trade deficit surged by EUR 0.5 billion in October alone. The main reasons for acceleration in the trade deficit are a decrease in world prices for metals as compared with the previous year with a parallel increase in energy prices.

In May 2006, the Bulgarian economy continued to show positive developments when exports began to grow at a faster rate than imports. In October, the rate of growth in exports reached 29.1% yoy, while growth in imports was 25.6% yoy. A geographical breakdown of Bulgarian exports shows that the country is already deeply integrated with the EU, which consumes 54.2% of the country’s exports. The further breakdown shows that more than 90% of the exports directed to the EU are consumed by the EU-15 and less than 10% by the new member states (EU-10). The role of interregional trade has also been strengthening over the last several months and now 25.5% of total exports are sold in the Balkans countries.

On the import side, the volume of trade continued to post some deceleration in its rate of growth. In October, imports grew by 25.6% yoy, which is 0.8 pps lower than in September and 1.5 pps lower than August. The increase in imports is mainly due to increasing prices for energy resources and surging domestic consumption. As in the case with exports, the lion’s share of Bulgarian imports comes from the EU countries. In particular, 48.5% of Bulgaria’s total imports arrive from the EU zone, out of which 86% comes from the EU 15. The second largest importer to Bulgaria is the Russian Federation, whose share in total imports is 13.5%. The goods composition of imports from Russia shows that it mainly consists of energy resources.

In January–October, the CA deficit continued to widen and reached EUR 2.66 billion, which translated into 11% of projected full-year GDP. In October alone, the increase in the CA gap was EUR 0.55 billion. The main reason for such an increase in the CA deficit was, as before, a significant deterioration in the trade balance.
The Bulgarian government to Bulgaria in the amount of SZL 3.625 million. The financing will be directed to the “Hospital Waste Incineration System-Plovdiv” Project. The project is financed under the Agreement on the Granting of Financial Assistance between the Government of the Republic of Bulgaria and the Government of the Swiss Confederation. Under this agreement, the Swiss government has already provided SZL 60 million, SZL 50 million of which was used to carry out various projects in health, energy and environmental protection fields.

During December, the final session of the ISPA (Instrument for Structural Policies for Pre Accession) Monitoring Committee took place. The Bulgarian government was applauded for progress made in the implementation of 39 ISPA projects in transport and environment sectors and for strengthening the structures for work under the Extended Decentralized Implementation System (EDIS). Under the EDIS, Bulgarian implementing authorities will no longer be subject to control by local EC Delegations. Bulgarian authorities were also congratulated with the accreditation received under EDIS by 3 of the ISPA Implementing Agencies within Ministries of Transport, Regional Development and Public Works and the National Road Infrastructure Fund. Although ISPA, one of the 3 pre-accession assistance program provided by the EC to candidate countries, will finish by the end of 2006, the project implementation will continue through the end of 2010, which will in turn guarantee the preparation of projects for absorption of resources for basic infrastructure from EU Structural Funds.

Other Developments and Reforms Affecting the Investment Climate

At the end of December, the Bulgarian Parliament completed final voting on the 2007 budget. The new budget target has a surplus of 0.8% of GDP. In 2007, budget revenues and expenditures were raised to 41.8% and 41% of GDP, respectively. Other macroeconomic projections include (i) real GDP growth of 5.8%, (ii) year-end CPI inflation of 3.1% and year average of 4.4%, (iii) a CA deficit of 11.8% of GDP, (iv) net FDI inflows of 10.4% of GDP.

In October, household gross real income surged by 13% yoy with a corresponding increase in household consumption by 5.5% yoy. An increase in wages was the main factor driving the increase in household income. At the same time, the additional factor for such growth was sales of real estate.

A recently completed study by the Economic and Social Council showed that around 35% of all employees underreport income in order to evade social insurance and tax charges. The average size of underreporting is seen at 40-45% of actual income, which corresponds to a total evasion of 14% to 16% of overall payroll.