

New Europe Economics & Strategy

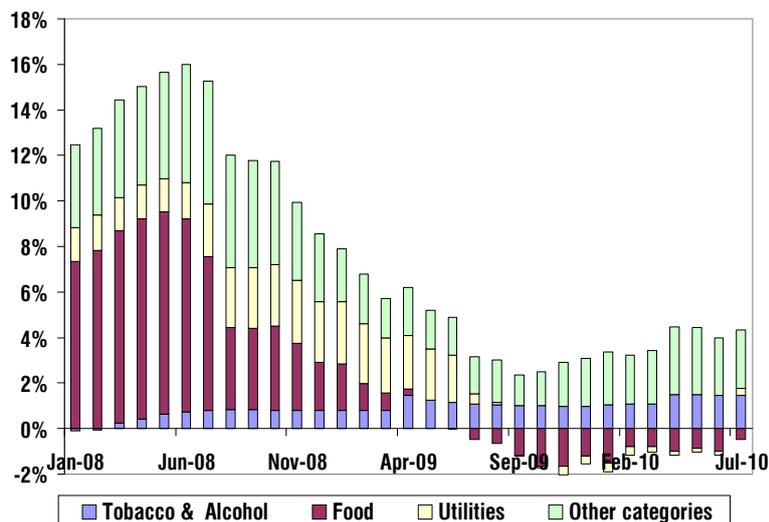
Focus Notes: Bulgaria

Bulgaria: Inflation creeping up on higher excise taxes & regulated prices

Following a period of subdued price pressures, domestic inflation is creeping up anew. The latter is not due to demand-side pressures, but rather it is mainly because of higher excise taxes and regulated prices. CPI stood at 2.4% yoy in July, compared to 1.4% yoy in the prior month and 0.4% yoy in January. Accordingly, the Harmonized Consumer Price Index (HICP) increased from 2.5% yoy in June to 3.2% yoy in July (the fourth highest rise in the EU-27) against 1.7% yoy in Eurozone.

The rise of indirect taxes on cigarettes and alcohol in early 2010 accounted for more than half of year-on-year inflation in July. Specifically, prices of tobacco & alcohol products increased by 27% yoy in July, contributing ca 1.5pps to July CPI (+2.4%). On top of that, the recently sanctioned hikes in gas and electricity (~17.5% weight in the CPI basket) pushed regulated prices 1.2% mom higher in July, adding another 0.3 pps to the corresponding year-on-year inflation figure that month (Figure).

Figure: Inflation is creeping up



Research Team:

Gikas Hardouvelis, *Chief Economist and Director of Research*
 Platon Monokroussos, *Head of Financial Markets Research*
 Tassos Anastasatos, *Senior Economist*
 Ioannis Gkionis, *Research Economist*
 Stella Kanellopoulou, *Research Economist*
 Galatia Phoka, *Emerging Markets Analyst*
 Theodoros Rapanos, *Junior Economic Analyst*

Sales Team:

Fokion Karavias, *Treasurer*
 Nikos Laios, *Head of Sales*
 Yiannis Seimenis, *Ioannis Maggel, Corporate Sales*
 Stogioglou Achilleas, *Private Banking Sales*
 Petropoulos Theodore, *Institutional Sales*
 Karanastasis Kostas, *Retail Sales*

EFG Eurobank Ergasias, 8 Othonos Str, GR 105 57, Athens, Tel: (30210) 3718 906, 3718 999, Fax: (30210) 3337 190, Reuters Page: EMBA, Internet Address: <http://www.eurobank.gr>

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We anticipate domestic inflation to remain in a rising trend during the second half of the year. Base effects from the components which recorded the steepest declines in 2009 will start to fade out, notwithstanding any second round effects from higher energy prices. For instance, components with high weights in the CPI basket such as food and beverages (~36.8%) are expected to record positive growth in H2, following a protracted period of deflation. As an illustration of this, food price deflation narrowed to 0.0%/-1.4% mom/yoy in July, from -2.7%/-2.8% mom/yoy in the prior month and 0.8%/-4.3% mom/yoy in January 2010. The rally in wheat prices recorded during the summer months as a result of the fires in Russia is expected to push food prices even higher in the remainder of the year. Nevertheless, we don't expect them to have such a pronounced impact on overall inflation as in 2008, when a severe drought destroyed domestic crops.

We expect domestic inflation to reach levels around 4% by the end of this year. If that happens, average annual inflation will remain broadly unchanged from last year (Eurobank EFG Research forecast: 2.7% yoy in 2010 vs. 2.8% yoy in 2009). Yet, our forecast is based on the implicit assumption of unchanged VAT rates during 2010. Should there be a rise in VAT tax rates, which is not the most probable scenario for the time being, domestic inflation should turn out to be even higher this year.

Ioannis Gkionis, Research Economist
igkionis@eurobank.gr