

Bulgaria (the Republic of)

Foreign LT: BBB+/Stable, Local LT: A-/Stable (Upgraded on November 29, 2006)

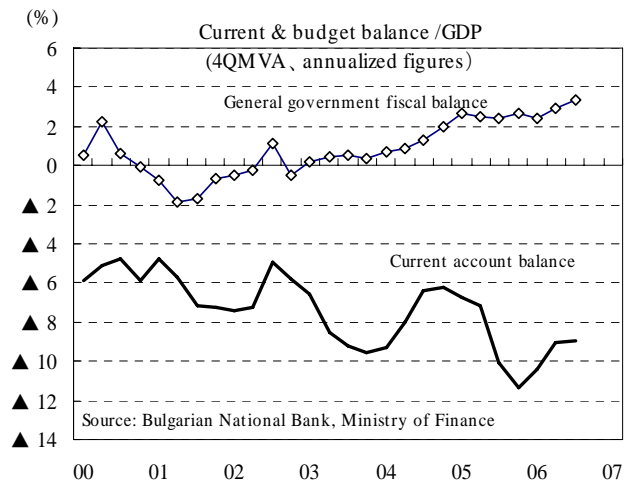
Main Factors for the Ratings

Positive Factors

- High economic growth prospects following the EU accession.
- Prudent fiscal management and considerable reduction of government debt.
- Stability of currency and inflation underpinned by the currency board arrangement.
- Increasing exports on expanding production capacity rendered by inflows of foreign direct investment.

Negative Factors

- Widening current account deficit on the robust domestic demand.
- Transformation of industrial structure still at primary stage.



Updated: from October 2006 to December 2006

Positive Factors

- On January 1, 2007, Bulgaria and Romania joined the EU.
- Real GDP growth rate in the July-September quarter of 2006 remained strong at 6.7% year-on-year on the continued robust domestic demand.
- The general government fiscal balance in the first eleven months of 2006 registered a substantial surplus of BGN 2,514 million or 5.3% of GDP.
- The inflows of foreign direct investment in the first ten months of 2006 doubled to EUR 3,156 million or 13.0% of GDP.
- Unemployment rate in October in 2006 fell to 8.38% reaching the lowest ever recorded.
- Year-on-year growth of bank lending to the private sector decelerated to 23.6% in November 2006.

Negative Factors

- Current account deficit in the first ten months of 2006 rose by 68.9% year-on-year to EUR 2,661 million or 10.9% of GDP.
- On December 20, 2006, European Commission invokes safeguard clause against Bulgaria on Aviation safety

<Prospects and Noticeable Points>

Acceded the EU on January 1, 2007

(1) JCR has upgraded the ratings on the foreign and local currency long-term senior debts

On November 29, 2006, JCR has upgraded the ratings on foreign and local currency ratings of the Republic of Bulgaria. The rating action is prompted by Bulgaria's high economic growth prospects secured by its sophisticated political, economic and budgetary systems and a substantial amount of subsidy it will receive from the EU following its EU accession in January 2007. Also supporting the ratings are the country's sound fiscal structure underpinned by fiscal surplus and a substantial reduction of government debt, stabilization of prices and its currency under currency board arrangement, and growing exports thanks to an expanding production capacity rendered by massive foreign direct investment (FDI) inflows in recent years.

On the other hand, the ratings remain constrained by a deteriorating current account deficit resulting from strong imports spurred by robust private-sector demand and the fact that the country is still at a primary stage of industrial transformation as exemplified by more than 20% of the total workforce still being engaged in the primary industry with extremely low productivity.

The rating outlooks are stable. Refinance risk of the widening current account deficit is largely mitigated by the continued massive FDI inflows and ample foreign exchange reserve. Amid high economic growth prospects, the current account deficit is likely to improve gradually, underpinned by the measures adopted by the government and the central bank as the surging bank lending to the private sector has begun distinctly decelerating.

(2) Current account deficit continues deteriorating amid robust private-sector demand

Real GDP growth rate in the July-September quarter of 2006 accelerated to 6.7% year-on-year on continued robust demand in the private sector. While domestic demand surged on expansion of gross fixed capital formation and consumer spending, external demand contributed negatively to the economic growth with stronger imports outpacing exports. Consumer price inflation accelerated to 8.8% year-on-year in February 2006 due primarily to the surge of food prices in the wake of the flood damage last summer and energy prices as well as hikes of excise duties, but slowed down to 6.1% in November 2006 on falls in food prices. Unemployment rate in October in 2006 fell to 8.38% reaching the lowest ever recorded.

On the other hand, the current account deficit continued deteriorating on surging imports driven by strong domestic demand and higher energy prices. Current account deficit, which widened to 11.3% of GDP in 2005, reached 10.9% of GDP in the first eleven months of 2006. In particular, the trade deficit widened substantially on strong imports of energy and FDI-related capital goods and raw materials which were to be turned into export products. However, risks related to refinance of the deficit have been largely mitigated by the country's strong external position as massive FDI inflows in the first eleven months of 2006 covered more than 120% of the deficit and ample foreign exchange reserves enough to pay for more than four months of imports.

(3) Sound fiscal structure underpinned by fiscal surplus and a substantial reduction of government debt

The general government fiscal balance in the first eleven months of 2006 registered a substantial surplus, equivalent to 5.3% of GDP. The government had initially envisaged a balanced budget for 2006, but later revised it to produce a surplus equivalent to at least 3.0% of GDP, based on its agreement with the IMF aimed to reduce the current account deficit. Given the ongoing fiscal developments, the fiscal surplus is highly likely to widen more than 3% of GDP. The ratio of government debt to GDP at the end of October 2006 halved to 27.1% in the past three years thanks mainly to the prepayment of Brady bonds and loans to the IMF and World Bank. The budget plan for 2007 envisaged a reduction of the corporate tax rate from 15% to 10% and a surplus equivalent to 0.8% of GDP. Thus, the government is expected to maintain a restrictive fiscal policy in 2007.

(4) Current account deficit to improve on restraint fiscal and monetary policies

In a bid to stem a further deterioration of the current account deficit, the government and the central bank have adopted a series of fiscal and monetary measures since 2004 aimed to cool down the robust domestic demand. As a result, the surging bank lending to the private sector, which had pushed up domestic demand, has begun decelerating appreciably since mid-2005. Year-on-year growth of bank lending to the private sector, which stood at around 50% at the beginning of 2005, decelerated to 23.6% in November 2006. The country's financial system remains sound as asset quality of banking system kept sound under the central bank's stringent supervision. Thanks to appropriate fiscal and monetary measures, Bulgarian economy will return to sustainable economic growth rate, with its external imbalances improving gradually.

Main Economic Indicators: The Republic of Bulgaria

		2002	2003	2004	2005	2006 (f)	2007 (f)	2008 (f)
Real GDP growth rate	(%)	4.9	4.5	5.7	5.5	6.0	5.5	5.0
CPI (annual average)	(%)	5.8	2.3	6.1	5.0	7.2	5.2	3.5
Unemployment rate	(%)	17.7	14.3	12.7	11.5	9.6	8.2	7.6
General government balance/GDP	(%)	-0.9	-0.4	1.5	2.3	3.9	2.5	1.7
General government debt/GDP	(%)	55.8	47.8	40.6	31.7	27.0	23.3	20.6
Current account balance	(EURmn)	-403	-972	-1,131	-2,531	-3,148	-3,179	-3,330
Current account balance/GDP	(%)	-2.4	-5.5	-5.8	-11.8	-13.2	-12.1	-11.6
Trade balance/GDP	(%)	-11.4	-13.7	-15.1	-20.4	-19.1	-16.7	-15.6
Net foreign direct investment	(EURmn)	951	1,827	2,244	1,856	3,300	3,120	3,000
Net foreign direct investment/GDP	(%)	5.8	10.3	11.5	8.7	13.9	11.8	10.2
Foreign exchange reserves (excl. gold)	(EURmn)	4,575	5,309	6,301	6,690	7,600	8,500	9,500
Import (G&S) coverage	(months)	5.6	5.7	5.6	4.8	4.5	4.4	4.3
Forex reserves / ST external debt	(times)	3.0	3.5	2.6	1.7	1.8	1.7	1.8
External debt/GDP	(%)	65.1	60.2	64.2	70.5	74.8	77.4	81.5
External debt/ exports (G&S)	(%)	126.4	113.2	111.8	117.2	111.1	104.9	104.3
External public debt/ exports (G&S)	(%)	87.7	70.5	51.8	34.3	25.0	16.5	12.5
Debt service ratio	(%)	16.4	14.1	23.2	44.2	31.2	23.1	22.4

(Note) Figures for 2006 and 2008 are based on JCR projection

(Sources) Bulgarian National Bank, Ministry of Finance

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