

Bulgaria (the Republic of)

Foreign LT: BBB/Negative, Local LT: BBB+/Negative

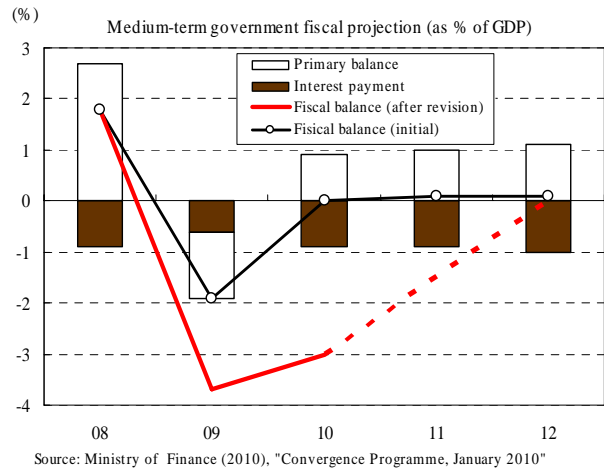
<Rating Perspective>

Positive Factors

- Low level of government debt with moderate fiscal deficit and the tight fiscal policy
- The maintenance of the currency board arrangement
- Increased production capacity rendered by robust investment amid massive foreign direct investment (FDI) inflows

Negative Factors

- Continuing current account deficit despite recent improvement
- Sizable foreign debts owed by the private sector
- Transformation of industrial structure still at a primary stage



<Updated: from January to April 2010>

Positive Factors

- The ruling government of the center-right Citizens for European Development of Bulgaria (CEDB) has been kept its tight fiscal policy as it implemented a fiscal consolidation package totaling 2.3% of GDP in the later half of 2009
- The general government fiscal debts (ESA95) at the end of 2009 remained slightly over 14% of GDP
- Bulgarian banks posted a combined net profit in 2009 though it halved from the previous year. The operating income fully covered the increased impairment charges
- The current account deficit in 2009 narrowed sharply to 9.4% of GDP from 25.2% a year earlier. The deficit was more than covered by FDI inflows
- Goods exports in February 2010 continued to grow year-on-year for four consecutive months due mainly to the increased exports to the developing countries

Negative Factors

- On April 9, the government was forced to revised the 2009 budget deficit to 3.7% of GDP from 1.9% as initially estimated
- On April 9, the Prime Minister Boiko Borissov said that Bulgaria will not apply for the European Exchange Rate Mechanism (ERM), in 2010 because of wider budget deficit for 2009
- Real GDP in 2009 contracted 5.1% on slumped domestic demand. The contraction in the October-December quarter of 2009 deepened further to 5.9% year-on-year from 5.4% in the previous quarter
- The unemployment rate in February 2010 surged by 2.7 percent points to 8.7%

<Outlook and Points to Watch>

Government was forced to scrap ERM entry this year

(1) Economy is expected to grow only slightly in 2010

The Bulgarian economy continued contracting since the January-March quarter of 2009. It shrank a further 5.9% in real GDP terms in the October-December quarter of 2009 after a 5.4% contraction in the previous quarter. In particular, gross fixed capital formation continued to dwindle more than 30% year-on-year in the October-December quarter of 2009 and the ratio of real GDP to gross fixed capital formation declined to around 27%, comparable to that of 2006. The growth of bank lending to the private sector, which had fueled consumer spending and investment, decelerated considerably to 2.7% year-on-year in February 2010 as banks tightened their credit conditions. Unemployment rate continued to worsen to 8.7% in February 2010, 2.7 percent point increase from a year before. By contrast, goods exports grew for four months running from November 2009, stemming from the increased exports to developing countries. JCR projects that the economy will restore a positive growth rate in 2010 but that the recovery momentum will remain weak. While external demand will pick up moderately on continued economic recovery in major European trading partners, domestic demand will stay subdued on worsening employment and wage conditions, continuation of a strict credit stance by banks and a tighter government fiscal policy. On April 16, Finance Minister said the economic projection for 2010 will be upgraded to around 1% from an initial estimate of 0.3%. The country's financial system remains sound with adequate capitalization to absorb

any deterioration in the quality of assets held by banks. Bulgarian banks posted a combined net profit in 2009 after absorbing increased impairment charges. Bulgarian economy is more susceptible to the ongoing Greek financial turmoil because Bulgarian subsidiaries of major Greek banks have relatively a large market share. We carefully watch how the financial turmoil in Greece will affect banking system in Bulgaria.

(2) Repayment of the short-term foreign debt of private sector is crucial

Bulgaria's foreign debt swelled to 111% of GDP at the end of 2009, but a further increase was averted as the debt stayed almost unchanged at 110% of GDP from the end of 2008. The current account deficit in 2009 narrowed sharply to 9.4% of GDP from 25.2% a year earlier. The deficit was more than covered by FDI inflows. However, foreign financing position of the private sector, which constitutes more than 90% of total foreign debts, remained weak. Net capital inflows (FDI, portfolio investment and other investments) in 2009 fell drastically to 6.5% of GDP from 34.4% a year earlier due in part to the private sector's repayment of foreign liabilities. The foreign exchange reserves totaling EUR 10.4 billion at the end of February 2010 were not large enough to cover the short-term foreign debts. The worst of the global financial turmoil may now be behind, but it remains crucial whether Bulgaria can maintain international investors' confidence and have the short-term foreign debts owed by the private sector rolled over without a hitch.

(3) The government pushes through with the fiscal consolidation measures

The general government fiscal deficit (ESA95) in 2009 was initially estimated a moderate deficit to 1.9% of GDP. The deficit of 2009 was mainly driven by revenue shortfalls stemming from a severe economic downturn. While the growth of expenditures in 2009 was a slight increase of 1.0%, almost unchanged from the previous year, revenues contracted by a steep 8.4%. The new government of CEDB which took office in July 2009 tightened the fiscal policy and adopted a fiscal consolidation measures totaling 2.3% of GDP aimed at a balanced budget for 2010. The measure mainly targeted spending cuts including goods and services, public investments and the number of public employee. In January 2010, the government unveiled its *Convergence Programme* which plans a balanced budget for 2011 onward, assuming that the economy will grow over 3% from 2011. The European Commission found the *Programme* was adequate at the current economic juncture on its assessment disclosed on March 17. Meanwhile, Bulgaria's government debt (ESA 95) is one of the lowest in the EU. Its ratio to GDP stayed at slightly over 14% of GDP at the end of 2009.

(4) The government was forced to revise the 2009 deficit due mainly to irregular accounting transaction made by the former government

On April 9, the government was forced to revise the 2009 budget deficit to 3.7% of GDP from 1.9%. The revision was due mainly to the irregular transaction made by the former government. The former government did not account some spending for public contracts in the previous two years. The government plans to revise the 2010 budget deficit to around 3% of GDP. JCR considers that the underlying fiscal policies of the government kept tight and will likely to narrow the deficit to below 3% of GDP in 2010. The revision of the deficit forced the government to scrap its bid to apply for the ERM this year. However, JCR expects that the government will apply for the ERM coming years.

Main Economic Indicators: The Republic of Bulgaria

		2005	2006	2007	2008f	2009	2010 (f)	2011 (f)
(Convergence criteria for adopting the euro)								
1. CPI (annual average)	-0.7%(note)	6.0	7.4	7.6	12.0	2.5	2.8	3.0
2. 10 year government bond yield	4.8%(note)	3.9	4.2	4.5	5.4	7.1	n.a.	n.a.
3. General government balance / GDP	Below -3.0%	1.9	3.0	3.4 (Note2)	1.8	-3.7	-2.8	0.5
4. General government debt / GDP	Below 60%	29.2	22.7	18.2	14.1	14.7	15.6	16.0
Real GDP growth rate	(%)	5.3	6.3	6.3	6.1	-5.1	0.5	2.5
Unemployment rate	(%)	10.1	9.1	7.0	5.7	6.9	7.5	6.8
Current account balance / GDP	(%)	-12.4	-18.4	-25.1	-25.2	-9.4	-4.9	-7.1
Trade balance / GDP	(%)	-20.2	-22.0	-25.1	-25.2	-7.5	-7.9	-9.9
Net foreign direct investment / GDP	(%)	13.3	24.1	30.6	18.2	9.8	6.8	7.8
Net foreign direct investment / C/A balance	(%)	107.3	130.8	114.1	75.8	103.6	143.8	113.7
Forex reserves (excl. gold)	(EURmn)	6,690	8,193	11,179	11,886	11,177	11,500	12,500
Forex reserves / monthly imports	(months)	4.8	4.7	5.5	5.1	7.0	7.1	6.7
Forex reserves / ST external debt	(times)	1.7	1.3	1.2	0.9	0.9	0.9	0.9
Gross external debt / GDP	(%)	70.1	80.4	101.6	110.0	111.3	105.4	103.4
Gross external debt / exports (G&S)	(%)	117.7	125.3	160.7	182.3	226.2	201.7	188.9
Gross public external debt / exports (G&S)	(%)	29.1	18.9	10.6	7.5	7.4	8.1	6.5
Debt service ratio	(%)	46.3	26.4	34.3	36.0	43.2	40.9	34.5

(Note1) Figures for criteria 1 and 2 are between February 2009 and January 2010. Figures for 2010- 2011 are projection made by JCR

(Note 2) the figure excludes a debt cancellation towards Iraq

(Sources) The Bulgarian National Bank, Ministry of Finance, Eurostat

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