2010-015
July 29, 2010

Bulgaria (the Republic of)

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

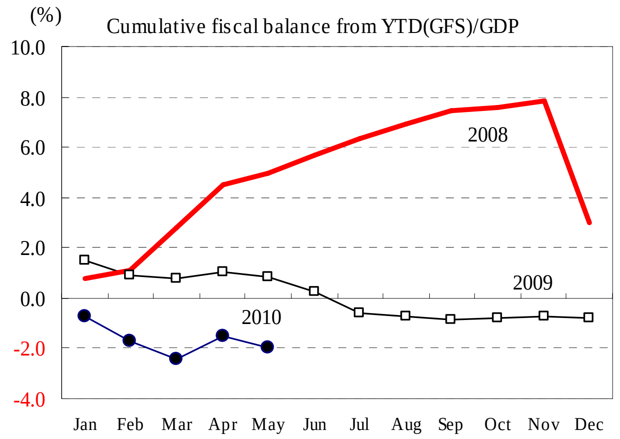
<Rating Perspective>

Positive Factors

- Lower government debt supported by a moderate fiscal deficit
- 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



Source: Bulgarian Ministry of Finance

<Updated: from April to July 2010>

Positive Factors

- The economy continued shrinking in real GDP terms by 3.6% year-on-year in the January-March quarter of 2010, but the contraction slowed on improved investment. The government on April 17 revised its economic growth forecast for 2010 to 1.0% from 0.3%.
- Industrial output picked up 1.5% and 0.2% year-on-year in March and April, buoyed by a rapid pickup of exports.
- The current account deficit in the first five months of 2010 narrowed dramatically to 1.0% of GDP from 7.0% a year earlier.
- Leading Greek banks have had their liquidity position improved on loans provided by the ECB. They are the top shareholders of five major Bulgarian banks which together account for nearly 30% of the country's total banking assets.
- The Bulgarian National Bank has announced that the combined gross profit of all lending institutions exceeded the total amount of their operating costs and loan-loss provisions as of the end of May 2010.

Negative Factors

- On April 9, Prime Minister Boiko Borissov announced that Bulgaria will not apply to join the European Exchange Rate Mechanism (ERM) in 2010 in view of the increased budget deficit in 2009.
- On June 9, the EU said it will send a mission in September to investigate the revised fiscal indices presented by Bulgaria. The EU also urged Bulgaria to bring the fiscal deficit below 3% of GDP by the end of 2011 to avoid excessive deficit procedures
- The government revised in June its budget deficit estimate for 2010 to 3.8% of GDP from earlier projected 0.8%.
- The general government fiscal balance in the first five months of 2010 slipped into a deficit equivalent to 2.0% of GDP from a 0.8% surplus a year before due mainly to revenue shortfalls.
- Net foreign direct investment in the first five months of 2010 shrank to 0.5% of GDP from 3.5% a year earlier.

<Outlook and Points to Watch>

Government revises fiscal deficit estimate upward

(1) Bulgarian economy is likely to grow moderately in 2010 on pickup of external demand

The Bulgarian economy has been contracting since the January-March quarter of 2009. It shrank a further 3.6% in real GDP terms in the January-March quarter of 2010 after a 5.9% contraction the previous quarter, but the contraction somewhat slowed on improved gross fixed capital formation. The industrial output picked up 1.5% and 0.2% year-on-year, respectively, in March and April, buoyed by a steep increase of exports. 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 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, the finance minister announced an upward revision of the economic growth estimate for 2010 to around 1% from initially projected 0.3%. The country's financial system remains sound as banks keep their capital adequacy sufficient (at 18.24% as of the end of March 2010) to absorb any deterioration in the quality of their assets.

(2) Impact of Greek debt crisis less severe than expected

The Bulgarian economy is more susceptible to the ongoing Greek debt crisis than many other EU member countries. The Bulgarian subsidiaries of major Greek banks account for nearly 30% of the total banking assets. Greece takes 9% of Bulgaria's total exports. ECB loans to major Greek banks have helped improve their liquidity position, reducing their possibility of withdrawing capital from Bulgaria at least in the short-term. Bulgaria's declining exports to Greece have been more than offset by increased exports to other major EU trading partners. Thus, the impact of the Greek crisis on Bulgaria has so far been less severe than expected. However, JCR will continue watching future possible implications.

(3) External debt burden remains heavy despite improved current account deficit

Bulgaria's external position remained weak with its external debt exceeding 110% of GDP at the end of March 2010. The debt grew sharply from 2005 to 2008, but a further increase was averted with its balance staying almost unchanged since the end of 2008. Currently, more than 90% of the external debt is owned by the private sector. The foreign exchange reserves totaling EUR12.1 billion at the end of June 2010 were not large enough to cover short-term foreign debts. Capital inflows (FDI, portfolio investment and other investments) in the first five month of 2010 ended up in a net outflow equivalent to 2.8% of GDP in a turnaround from a net inflow equivalent to 1.15% a year earlier due mainly to a substantial reduction of FDI inflows, the private sector's debt repayments and outflows of deposits from the banking sector. Meanwhile, the current account deficit narrowed dramatically to 9.4% of GDP in 2009 from 25.2% a year earlier. In the first five months of 2010, it further improved to 1.0% of GDP from 7.0% a year earlier.

(4) Government pushes ahead with fiscal consolidation measures

The new government led by the Citizens for European Development of Bulgaria which took office in July 2009 adopted fiscal consolidation measures equivalent to 2.3% of GDP aimed at attaining a balanced budget in 2010. The package primarily calls for cutbacks in expenses, public investments and the number of public employees. However, the government was forced to revise its fiscal deficit (ESA95) in 2009 to 3.9% of GDP from initially estimated 1.9%. The deficit estimate for 2010 was also revised to 3.8% from initially targeted 0.8%. The revision was made necessary because the previous government had not booked expenditures to pay for public contracts for two years. It forced Prime Minister Boiko Borissov to give up on Bulgaria's application for the ERM this year. On June 9, the EU decided to send a mission in September to investigate the revised fiscal indices presented by Bulgaria. At the same time, the EU urged Bulgaria to bring the fiscal deficit below 3% of GDP by the end of 2011 to avoid excessive deficit procedures.

In the first five months of 2010, the fiscal balance slipped into a deficit equivalent to 2.0% of GDP from a 0.8% surplus a year before. Under its 2010 budget, the government envisages a 20% cut of expenses, which is equivalent to 1.3% of GDP. The government now plans to attain a balanced budget in 2012 onward, assuming that the economy will grow over 3% annually. Meanwhile, despite the widening fiscal deficit, the general government debt has been kept at around 15% of GDP for over a year. This is mainly because much of the deficit was covered by the fiscal reserves which totaled 9.6% of GDP at the end of May 2010. Bulgaria's government debt (ESA 95) is one of the lowest among those in the EU member countries.

Main Economic Indicators: The Republic of Bulgaria

		2005	2006	2007	2008	2009	2010 (f)	2011 (f)
(Convergence criteria for adopting the euro)								
1. CPI (annual average)	-0.5%(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	-3.9	-4.0	3.5
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	0.2	2.5
Unemployment rate	(%)	10.1	9.1	7.0	5.6	6.8	7.5	6.8
Current account balance / GDP	(%)	-12.4	-18.4	-26.8	-24.0	-9.4	-3.7	-5.1
Trade balance / GDP	(%)	-20.2	-22.0	-25.1	-25.2	-12.1	-6.8	-7.5
Net foreign direct investment / GDP	(%)	13.3	24.1	30.6	18.2	9.8	4.6	7.6
Net foreign direct investment / C/A balance	(%)	107.3	130.8	114.1	75.8	103.6	124.9	149.5
Forex reserves (excl. gold)	(EURmn)	6,690	8,193	11,179	11,886	11,241	10,800	11,500
Forex reserves / monthly imports	(months)	4.8	4.7	5.5	5.1	7.0	6.3	6.1
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	108.9	101.9
Gross external debt / exports (G&S)	(%)	117.7	125.3	160.7	182.3	226.2	193.4	174.6
Gross public external debt / exports (G&S)	(%)	29.1	18.9	10.6	7.5	7.4	8.4	8.0
Debt service ratio	(%)	46.3	26.4	34.3	36.0	43.2	40.7	39.6

(Note1) Figures for criteria 1 and 2 are annual average of 2009. Figures for 2010 and 2011 are based on the 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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