

Bulgaria (the Republic of)

 Foreign LT: **BBB-/Stable**, Local LT: **BBB/Stable** (Latest rating review released on July 2, 2003)

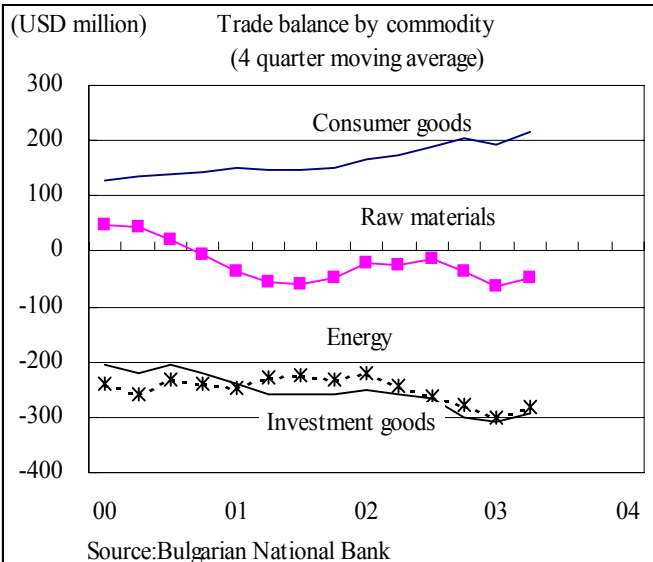
Main Factors for the Ratings

Positive Factors

- An emerging virtuous economic cycle triggered by the progress in economic and fiscal reforms ahead of EU accession in 2007.
- Rising exports boosted by the expansion in the production capacity through inflows of foreign direct investment.
- Constraints on budget deficits and significant reduction in government debts.

Negative Factors

- An early stage in transforming the industrial structure.
- High level of external debt due to the increase of the private-sector debt.
- Inflexible labor market.



Updated: from September 2003 to November 2003

Positive Factors

- The ruling coalition secured 20% of total seats at stake in the fourth local elections.
- The European Commission positively evaluated the overall progress of preparation for EU entry.
- Total foreign direct investment in the first ten months of 2003 totaled USD 1.2 billion, making it certain for the annual total to reach a record high.
- The government and IMF agreed on a budget deficit of 0.7% of GDP in 2004.
- The coalition government approved the new privatization plan of Bulgarian Tobacco.

Negative Factors

- The current account deficit in the first nine months of 2003 widened to 4.4% of GDP due mainly to a steep rise in imports.

<Prospects and Noticeable Points>

The ruling coalition secured 20% of total seats at stake in the local elections

In the fourth local elections held in October 26 and November 2, the ruling coalition which had been losing its popularity gained unexpectedly wider support, securing 20% of the total number of seats at stake. Compared with the previous elections in 1999; Bulgarian Socialist Party (BSP), the main opposition and former communist party, managed to keep the proportion of its seats little changed at 30.1%; the United Democratic Forces (UDF), a right-wing opposition party, saw its strength cut by half to 14%; the Movement for Right and Freedoms (MRF), one of the ruling two parties, boosted its strength to 13.2% and the Simeon II National Movement (SIINM), governing party and contesting in an election for the first time, secured 6.8%. Other parties took the rest of the seats, or equivalent to over 30%. Assured of a reasonable number of seats in the local elections, the coalition government is less likely to move forward the next parliamentary election scheduled in 2005. On the other hand, there is the possibility that the government may find it harder to maintain its policy because MRF, encouraged by its election victory, may seek to have a bigger say within the coalition camp. MRF has been rather cautious about a tighter budget policy and the planned privatization of Bulgarian Tobacco. In fact, MRF opposed the finance minister in August over his 2004 budget plan.

Favorable economic growth continues

The real economic growth rate accelerated to 4.4% year-on-year in the second quarter of 2003, up slightly from 4.1% in the previous quarter. While greater external demand driven by imports contributed adversely to the growth, domestic demand remained buoyant to push up the growth. Meanwhile, both inflation and unemployment rates continued to improve, CPI was up 3.3% year-on-year and the unemployment rate fell to 12.8% in October. The budgetary balance registered a surplus in the first nine months of 2003 due mainly to increased tax revenues. It is highly likely that budget deficits in 2003 as a whole will turn out smaller than 0.8% of GDP as projected by the government. Conversely, the current account deficit is deteriorating significantly reflecting robust imports. But it is unlikely to pose any serious concern because the growth of imports is due primarily to increase of investment goods and higher price of energy. Financially, the current account deficit can be easily offset by foreign direct investment estimated to total over USD 1.2 billion (6.2% of GDP) in 2003 and sufficient foreign exchange reserve.

Preparations for EU entry highly rated by the European Commission

In its latest report assessing the progress of preparations for EU accession (released on November 5), the European Commission said that Bulgaria has continued to fulfil the political criteria and is closer to fulfilling the economic and *acquis communautaire* (the law based on the EU founding treaties) criteria. As for economic criteria, the report said that “Bulgaria is functioning market economy and should be able to cope with competitive pressure within the union in the near term, provided that it continues to implement reforms”. The evaluation is more positive as compared with the one in the previous year’s report, which used “the medium term” in the same context. Hungary and Czech Republic, due to entry into EU in May 2004, received the same evaluation in 2000, four years prior to scheduled accession. As for Slovakia, which delayed the start of negotiation, the same evaluation came in 2001, three years prior to scheduled accession. For Bulgaria, it is significant to get such evaluation in 2003, four years prior to its intended 2007 entry. Bulgaria had already gone through negotiations in 26 of 31 *acquis communautaire* chapters by the end of October and is highly likely to deal with the remaining chapters by 2004 as planned by the government.

No revision of rating and its outlook is expected. The focal point is the sustainability of current policy

There are no economic and fiscal factors that could affect the short-term rating. The question, therefore, is whether the Bulgarian government can continue its policies in the current political environment. In this respect, JCR will closely watch how the government will carry out its tight fiscal policy in 2004 and what progress it will make in the privatization of big state enterprises such as Bulgarian Tobacco.

(Toshihiko Naito, Senior Analyst)

Main Economic Indicators: The Republic of Bulgaria

		1999	2000	2001	2002	2003 (f)	2004 (f)
Real GDP growth rate	(%)	2.3	5.4	4.0	4.8	4.6	5.0
CPI (annual average)	(%)	2.6	10.3	7.4	5.8	2.0	3.2
Unemployment rate (year-end)	(%)	16.0	17.9	17.9	16.3	15.0	14.7
General government balance/GDP	(%)	0.2	-0.7	-0.6	-0.8	0.0	-0.5
General government debt/GDP	(%)	84.7	80.6	69.9	60.7	50.3	45.6
Current account balance/GDP	(%)	-5.0	-5.6	-6.2	-4.4	-5.9	-5.0
Trade balance/GDP	(%)	-8.3	-9.3	-11.7	-10.2	-10.4	-9.0
Foreign Direct Investment/GDP	(%)	6.1	8.0	5.9	5.4	6.2	4.3
Import coverage	(months)	5.9	5.4	5.0	6.1	6.2	6.0
External debt/GDP	(%)	84.2	88.9	78.3	72.1	61.9	52.6
External debt/ exports (G&S)	(%)	188.3	160.0	140.8	135.5	122.9	105.0
Foreign exchange reserves/ short term external debt	(times)	2.5	2.4	2.9	2.6	3.2	3.1
Debt service ratio	(%)	18.0	16.7	20.1	15.8	15.2	16.3

Note: figures for 2003 and 2004 are JCR forecast.

Sources: Central bank, Ministry of Finance, IMF and EIU