

2004-15
June 21, 2004

Bulgaria (the Republic of)

Foreign LT: BBB-/Stable, Local LT: BBB/Stable (Upgraded on July 2, 2003)

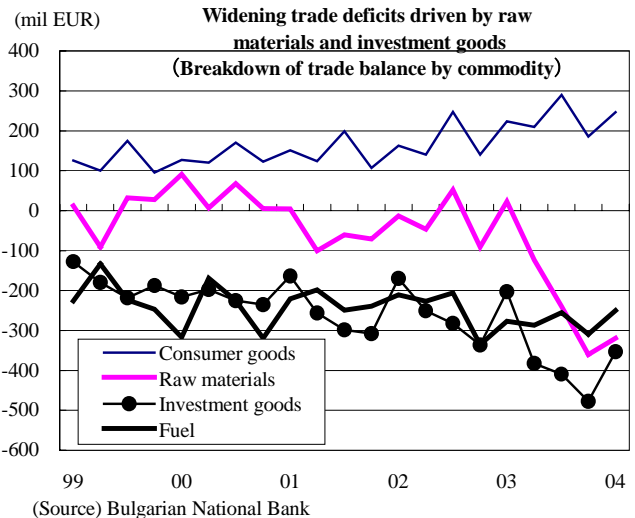
Main Factors for the Ratings

Positive Factors

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

Negative Factors

- Transformation of industrial structure still at primary stage.
- High level of external debt due to the expansion of private-sector debt.
- Inflexible labor market.



Updated: from March 2004 to May 2004

Positive Factors

- On April 1, Bulgaria officially joined NATO.
- Under the EU entry negotiation, the government provisionally closed all 31 chapters of the *acquis*, a body of EU laws.
- Following the completion of the deal, the government will receive EUR230 million from Viva Ventures Holdings (VVH) for the sale of a 65% stake in the state-owned Bulgarian Telecommunications Company (BTC) on June 20. However, there remains a possibility to delay the completion concerning over a sale of a Global System for Mobile Communication license.
- Foreign direct investment in the January - March quarter totaled EUR367 million, up 30% year-on-year.
- The government revealed a plan to resume the country's second nuclear power plant. Total construction cost is estimated at more than EUR 2 billion (The plant is due to become operational in 2010).

Negative Factors

- The current account deficit in the January - March quarter totaled USD617million, up more than 50% over the same period of last year.
- Following departure of 11 parliamentary members from the ruling Simeon II National Movement, the coalition parties lost its majority in parliament (The coalition parties now retains 117 out of 240 seats).
- March inflation remained as high as 6.2% year-on-year, mirroring a tax increase carried out in January and a surge in energy prices.

<Prospects and Noticeable Points>

Expansion of domestic demand and current account deficit.

Bulgaria's real GDP grew 4.9% year-on year in the October-December quarter of 2003, up from 4.4 % in the previous quarter. Consumer spending and gross capital formation showed strong growth, rising 7.0% and 10.0%, respectively, during the period. Buoyed by robust domestic demand, imports surged 14.0%, surpassing growth of exports. The economy showed signs of excessive demand mainly driven by strong consumer spending spurred by a 70% gain in consumer credits and accelerated investments triggered by massive inflows of foreign direct investment. Inflation

continued to pick up due to temporary factors such as a surge in food prices and a tax increase. Reflecting the increased imports, the current account deficit widened more than 50% year-on-year in the January-March quarter. The unemployment rate remained a serious concern, but it continues to decline. As the government maintained a tighter fiscal policy, the consolidated budgetary balance registered a slight surplus in the January-April period.

Future trends of imports and exports need to be watched

A commodity-wise breakdown of the current account balance shows that while a deficit from raw materials and investment goods continued widening, a surplus from consumer goods kept on increasing. JCR considers that the widening current account deficit is unlikely to pose any immediate concern in part because much of the deficit was caused primarily by increased imports of investment goods such as machinery which will be used to expand the country's production capacity and raw materials which will be turned into products for export and domestic shipment. Once the exchange rate of BGN, which appreciated more than 20% against the U.S. dollar in 2003, gets stabilized, the current account deficit may narrow gradually helped by a further rise in exports. Therefore, JCR sees it still premature for the government to adopt any drastic fiscal and monetary policies. If the proposed bank liquidity reduction measure and moderate fiscal tightening measure are adopted, the strong domestic demand is expected to gradually slow down. The current account deficit was almost covered by inflows of foreign direct investment and, to a growing extent, by inflows of portfolio investments. Furthermore, the foreign exchange reserves remained at sufficient levels.

Progress in EU entry negotiation and privatization

Under the EU entry negotiation, the government provisionally closed all 31 chapters of the *acquis*, a body of EU laws. As the government wound up the negotiation before the end of 2004 as originally scheduled, Bulgaria will stand a better chance of attaining its EU entry in 2007.

Breaking a deadlock that lasted over a year, the Bulgarian government agreed a deal with VVH on the sale of a 65% stake in the state-owned BTC. The government is now set to receive EUR230 million on June 20, though there remains a possibility to delay the completion concerning over a sale of a Global System for Mobile Communication license. The privatization of BTC had been a political issue as it could lead to large-scale layoffs, but the conclusion of the deal will have a favorable effect on other privatization plans involving Bulgarian Tobacco (BT) and seven regional power distribution companies.

No revision of ratings and outlooks needed

JCR closely watches the developments of the widening current account deficit and policies to be pursued by the coalition government which has lost a majority in parliament, but evaluates positively the progress in the EU entry negotiation and privatization of BTC and BT. JCR sees no need to change ratings, but will consider the possibility to revise outlooks upward.

Main Economic Indicators: The Republic of Bulgaria

		2000	2001	2002	2003	2004 (f)
Real GDP growth rate	(%)	5.4	4.0	4.8	4.3	5.0
CPI (annual average)	(%)	10.3	7.4	5.8	2.3	4.9
Unemployment rate	(%)	17.9	17.3	16.3	13.5	12.7
General government balance/GDP	(%)	-0.6	-0.6	-0.6	0.0	-0.5
General government debt/GDP	(%)	80.6	69.9	61.5	56.4	46.2
Current account balance	(US\$m)	-652	-702	-888	-1,666	-1,485
Current account balance/GDP	(%)	-5.6	-6.5	-5.3	-8.4	-7.3
Trade balance/GDP	(%)	-9.3	-11.6	-10.2	-12.5	-11.5
Net foreign direct investment	(US\$m)	998	803	450	876	1,398
Net foreign direct investment/GDP	(%)	7.9	5.9	5.4	7.0	6.4
Import coverage	(months)	5.4	5.1	6.2	6.4	5.4
External debt/GDP	(%)	88.9	78.3	71.8	66.2	62.8
External debt/ exports (G&S)	(%)	160.0	146.7	139.6	124.0	111.8
Forex reserves / ST external debt	(times)	2.4	2.9	2.6	2.4	2.1
Debt service ratio	(%)	16.7	20.1	15.8	12.0	16.3

Note: figures for 2004 are based on JCR's projection.

Sources: Bulgarian National Bank, Ministry of Finance

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