

Bulgaria (the Republic of)

Foreign LT: BBB-/Positive, Local LT: BBB/Positive (Rating outlooks revised on August 11, 2004)

Main Factors for the Ratings

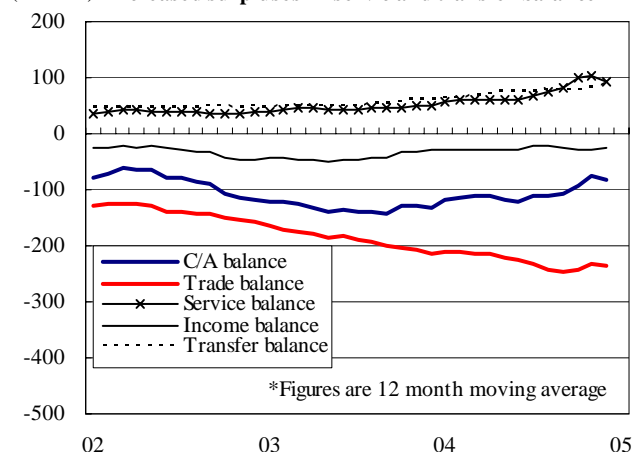
Positive Factors

- Progress on political, economic and budgetary reforms in pursuit of EU entry in 2007.
- Improved fiscal flexibility through budgetary discipline and significant reduction of public debts.
- Stability of currency and inflation underpinned by the currency board arrangement.
- Expanding production capacity through inflows of foreign direct investment.

Negative Factors

- Transformation of industrial structure still at primary stage.
- High unemployment deterring further economic growth.
- Increasing external debts centering on private sector.

Improvement of current account deficit due to increased surpluses in servic and transfer balance



Updated: from December 2004 to January 2005

Positive Factors

- Bulgaria was officially accepted to sign the Accession Treaty on April 25, 2005 following the progress it has made in preparation for EU accession (February 22).
- The government debt at the end of January 2005 was reduced substantially to 34.8% of GDP from 40.9% at the end of 2004 following early repayments made on a portion of Brady bonds. General government fiscal balance in 2004 turned into a surplus equivalent to 1.7% of GDP.
- Consumer price inflation in January 2005 declined further to 3.4% year-on-year.
- Current account deficit in 2004 narrowed to 7.5% of GDP from 9.3% in the previous year.
- Foreign direct investment inflows in 2004 totaled EUR1.96 billion, the largest on record.
- On February 12, a non-confidence vote against the Simeon Saxe-Coburg cabinet was rejected with the backing of the Movement for Rights and Freedoms and the New Time.

Negative Factors

- Prime Minister Simeon Saxe-Coburg dismissed his economy and agriculture ministers after the unsuccessful sale of the state tobacco company on February 12.
- Bank lending to the private sector in January 2005 continued to grow by 49.6% year-on-year.

<Prospects and Noticeable Points>

Bulgaria is steadily headed for EU accession in 2007: The EU Accession Treaty due to be signed next month

(1) Possible economic overheating remains a concern

Bulgaria's real GDP in the July–September quarter grew by 5.8% year-on-year, down slightly from 6.0% in the previous quarter. As compared with the previous quarter, the growth of domestic demand remained strong. While a slowdown of consumer spending became more obvious as it declined 3.7% year-on-year, gross fixed capital formation gained a strong 12.0%. With regard to external demand, exports expanded faster than imports, registering a 15.5% year-on-year growth. As far as the July–September quarter GDP statistics are concerned, the economy slowed down slightly, but no sings of deceleration are discernible as industrial production in the October–December quarter accelerated 19.8% year-on-year and bank lending to the private sector continued to grow a robust 49.6% year-on-year in January 2005. Meanwhile, the consumer inflation rate picked up 7.6% year-on-year in July 2004 due to temporary factors such as a surge in food prices and a tax increase but fell to 3.4% in January 2005 as the impact of those factors weakened. The unemployment rate remained still high, though it declined to 11.8% in the October–December quarter, down 0.9 point from the same

period of 2003, on economic expansion and a set of measures implemented by the government.

(2) Government debts decreased substantially centering on foreign debt

The general government fiscal balance in 2004 registered a large surplus equivalent to 1.7% of GDP due in part to the maintenance of a prudent fiscal policy and due in part to increased tax revenues brought by strong economic performances. Ahead of the June 2005 election, no major spending measures were implemented. Expenditures were rather constrained as compared with the year earlier. The government debts tended to decrease substantially with foreign debt leading the way. The outstanding balance of government debt dropped to 40.9% of GDP at the end of 2004 and fell further to 34.8% of GDP at the end of January 2005, following early repayments made on a portion of Brady bonds.

(3) Large current account deficit remains a concern, but external liquidity is amply secured by a strong liquidity position

Current account deficit in 2004 was EUR1,453 million or 7.5% of GDP, down 11% from the previous year, on increased service and transfer account surpluses. While the bigger service balance surplus was largely attributable to tourist revenues, much of the transfer balance surplus apparently stemmed from increased remittances from workers overseas and financial assistance from the EU in preparation for EU accession. Trade deficit, the main cause of the country's large current account deficit, totaled a record EUR 2,718 million or 10.2% of GDP in 2004. The widening trade deficit stemmed from deteriorating deficits in the raw materials and investment trade and deficits in trade with the EU and Russia. JCR does not consider that growing imports of investment goods and raw materials will pose any serious concern over the medium term since they will contribute to expanding the country's production capacity and exports. The current account deficit in 2004 was mainly covered by large net FDI inflows. There were no problems about the country's external liquidity given its increasing foreign exchange reserves, which were twice as big as short-term external debts and more than six times the value of monthly imports.

(4) Outcome of the election will put only limited impact on the ratings

With a parliamentary election scheduled for June 25, 2005, the government has been maintaining a prudent fiscal policy. JCR remains concerned about a possible economic overheating, but considers that the measures taken by the government will prove effective in curbing the strong domestic demand and gradually narrowing the trade deficit. The European Commission positively evaluated the progress made by the Bulgarian government in preparation for its EU accession. Bulgaria is set to sign the EU Accession Treaty on April 25, 2005. Before its actual accession, Bulgaria needs to call a national referendum, ratify the EU treaty and agree with the EU on financial assistance. At the present stage, JCR sees Bulgaria's EU entry in 2007 as a strong possibility. A change of administration looks highly likely in the June election. However, the outcome of the election will have only a limited impact on the ratings since no major policy shift is likely under a next administration, given the cross-party commitment to the country's EU accession. JCR will consider a possible revision of the ratings primarily in consideration of the significant reduction of government debt and the progress being made toward EU accession in 2007.

Main Economic Indicators: The Republic of Bulgaria

| | | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 (f) | 2006 (f) |
|--|----------|-------|--------|-------|--------|--------|----------|----------|
| Real GDP growth rate | (%) | 5.4 | 4.0 | 4.8 | 4.3 | 5.8 | 5.0 | 5.2 |
| CPI (annual average) | (%) | 10.3 | 7.4 | 5.8 | 2.3 | 6.2 | 4.0 | 3.5 |
| Unemployment rate | (%) | 17.9 | 17.3 | 16.8 | 12.7 | 11.8 | 10.9 | 10.0 |
| General government balance/GDP | (%) | -0.6 | -0.6 | -0.6 | 0.0 | 1.7 | -0.5 | 0.0 |
| General government debt/GDP | (%) | 77.1 | 69.9 | 55.8 | 48.0 | 40.8 | 33.2 | 27.7 |
| Current account balance | (EURmn) | -762 | -1,101 | -926 | -1,631 | -1,453 | -1,415 | -1,249 |
| Current account balance/GDP | (%) | -5.6 | -7.3 | -5.6 | -9.3 | -7.5 | -6.7 | -5.4 |
| Trade balance/GDP | (%) | -9.4 | -11.7 | -10.2 | -12.5 | -13.9 | -12.2 | -11.0 |
| Net foreign direct investment | (EURmn) | 1,107 | 915 | 1,009 | 1,874 | 1,133 | 1,950 | 1,450 |
| Net foreign direct investment/GDP | (%) | 8.1 | 6.0 | 6.1 | 10.6 | 5.8 | 9.2 | 6.3 |
| Foreign exchange reserves (excl. gold) | (EURmn) | 3,719 | 4,061 | 4,575 | 5,309 | 6,770 | 7,700 | 8,600 |
| Import (G&S) coverage | (months) | 5.3 | 5.2 | 5.6 | 5.7 | 6.1 | 6.2 | 6.2 |
| Forex reserves / ST external debt | (times) | 2.4 | 3.0 | 2.6 | 2.3 | 2.0 | 1.9 | 1.8 |
| External debt/GDP | (%) | 86.9 | 78.6 | 65.1 | 60.7 | 63.5 | 65.0 | 67.6 |
| External debt/ exports (G&S) | (%) | 156.0 | 147.4 | 126.1 | 112.9 | 109.0 | 105.9 | 104.5 |
| External public debt/ exports (G&S) | (%) | 129.6 | 119.7 | 93.2 | 75.0 | 56.5 | 44.5 | 34.2 |
| Debt service ratio | (%) | 16.6 | 20.8 | 16.4 | 14.1 | 20.2 | 16.9 | 15.4 |

(Note) Some figures for 2004 are JCR's estimate based on actual figures and figure for 2005 are based on JCR forecast.

(Sources) Bulgarian National Bank, Ministry of Finance

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