2005-27
September 27, 2005

Bulgaria (the Republic of)

Foreign LT: BBB/Stable, Local LT: BBB+/Stable (Upgraded on May 9, 2005)

Main Factors for the Ratings

Positive Factors

- Progress on political, economic and budgetary reforms in pursuit of EU entry in 2007.
- Sound fiscal management and considerable reduction of government 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.
- Private external debt continues growing due mainly to low-level domestic savings.

The Election Results

		Seats
(Ruling Coalition)		
BSP	Socialist, former opposition	83
NMS	Centrist, Senior coalition	53
MRF	Ethnic Turkish, Junior coalition	33
Sub total		169
(Opposition)		
Attack	Nationalist	21
UDF	Center-right, former opposition	20
DSB	Right-wing , former opposition	17
BPU	Center-right, former opposition	13
合計		240

Updated: from June 2005 to August 2005

Positive Factors

- Following the June 25 election, the Bulgarian Socialist Party reached an agreement to form a coalition with the Simeon II National Movement and the Movement for Rights and Freedoms (August 16). The three coalition partners together secured a comfortable majority of 169 out of 240 seats in parliament.
- General government fiscal balance in the first seven months of 2005 registered a surplus of BGN1,133 million or 2.7% of GDP.
- Prior to the election, the finance minister had announced that Bulgaria would retire US$600 million worth of Brady Bonds.
- Consumer price inflation decelerated to 4.3% year-on-year in the first seven months of 2005 from 6.1% in 2004.
- Bank lending to the private sector grew 40% year-on-year in July 2005, showing a sign of slowdown.
- Government external debt at the end of June 2005 decreased by 24% year-on-year to EUR5,193 million.

Negative Factors

- Current account deficit in the first six months of 2005 rose by 43% year-on-year to EUR1,372 million.

<Prospects and Noticeable Points>

New government continues to make progress on reforms ahead of EU accession

(1) New coalition government led by the leftist party enjoys a comfortable majority

Bulgaria has its parliamentary election on June 25. As predicted by the opinion polls before the election, the left-wing Bulgarian Socialist Party (BSP) came out as the winner, though unable to gain a majority on its own. The former ruling National Movement Simeon II (NMS) was the runner-up, followed by the right-wing ethnic Turkish party, Movement for Rights and Freedom (MRF). After more than a month of hard bargaining, BSP, NMS and MRF struck a deal to form a coalition on August 16. Mr. Sergei Stanishev, leader of BSP, was elected new prime minister. The coalition government holds 169 out of 240 seats in parliament, more than enough to amend the Constitution that may become necessary in the process of the country's EU accession. The new government has declared that it will focus on Bulgaria's accession to the EU in 2007. In this sense, there will be no major policy changes for the present. In the new Cabinet, BSP members took most of the key economic portfolios. But the post of finance minister went to Mr. Plamen Oresharski, who was deputy finance minister between 1997 and 2001 and was until recently closely associated with the center-right opposition Union of Democratic Forces (UDF). The appointment of Mr. Oresharski is clearly intended to underline the new government's

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commitment to the prudent fiscal policies pursued by the previous government.

(2) Current account deficit will begin narrowing in 2006 following implementation of restrictive measures by government and central bank

Bulgaria's real GDP grew 5.6% year-on-year in 2004, the highest since the introduction of the Currency Board Arrangement in 1996. The economy continued to grow a strong 6.0% year-on-year in the January–March quarter of 2005. It is highly likely that the economic growth will slow down in the latter half of 2005, as personal consumption weakens following implementation of restrictive measures by the central bank and the government. In fact, the growth of bank lending to the private sector decelerated to 40% in July 2005 from 50% at the end of 2004, showing signs of gradual slowdown. A restrictive fiscal policy has been kept in place, with the general government balance in the first seven months of 2005 registering a surplus of BGN1,133 million or 2.7% of GDP. In contrast, the current account deficit in the first six months of 2005 showed no improvement. It stood at EUR1,372 million (6.4% of GDP), up 43% year-on-year, due primarily to a bigger trade deficit. The trade deficit largely stemmed from increased imports of capital goods and energy, which outpaced the growth of overall exports. The current account deficit is forecast to rise from 7.5% of GDP in 2004 to 9% in 2005, but will begin narrowing moderately in 2006 as the growth of imports will decelerate due to an economic slowdown. The consumer inflation rate, which soared to 6.1% year-on-year in 2004 due to temporary factors such as a surge of food prices and a tax increase, slowed down to 4.1% in the first seven months of 2005 as the impact of those factors weakened. The unemployment rate remained still high but continued improving thanks to an economic expansion and a set of measures implemented by the government.

(3) JCR has retained the ratings. It will keep a close watch on Regular Report due to be released by European Commission in late October and implementation of judicial reforms by the new government

The new government has declared that it will pursue the major policies of its predecessor, such as the EU accession in 2007 and prudent fiscal policy. It is highly likely that the new government will be able to push through necessary reforms as required by the European Commission (EC), in particular judicial systems, because a two-thirds majority in parliament provides it with a power to amend the Constitution without difficulty. JCR expects that the new government will make some headway in judicial reforms and secure Bulgaria's accession to the EU in 2007. There remains the possibility of the accession by Bulgaria and Romania being postponed until 2008 following the French and Dutch rejection of the EU Constitution. However, a delay of up to one year would have no impact on the ratings. The EC's Regular Report assessing the progress on various reforms will be released at the end of October. If Bulgaria gets a positive evaluation of its reform records, its EU accession in 2007 will become surer.

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	4.5	5.6	5.3	4.8
CPI (annual average)	(%)	10.3	7.4	5.8	2.3	6.1	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	2.0	1.5
General government debt/GDP	(%)	77.1	69.9	55.8	48.0	40.8	32.2	25.7
Current account balance	(EURmn)	-762	-1,101	-926	-1,631	-1,453	-1,873	-1,800
Current account balance/GDP	(%)	-5.6	-7.3	-5.6	-9.3	-7.5	-8.8	-7.8
Trade balance/GDP	(%)	-9.4	-11.7	-10.2	-12.5	-13.9	-14.6	-13.4
Net foreign direct investment	(EURmn)	1,107	915	1,009	1,874	1,939	1,450	1,950
Net foreign direct investment/GDP	(%)	7.9	5.9	5.6	10.6	9.9	6.8	8.4
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	6.0	5.9
Forex reserves / ST external debt	(times)	2.4	3.0	2.6	3.5	2.8	2.5	2.4
External debt/GDP	(%)	86.9	78.6	65.1	60.4	62.7	61.8	61.9
External debt/ exports (G&S)	(%)	156.0	147.4	126.1	112.5	107.8	99.9	94.1
External public debt/ exports (G&S)	(%)	129.6	119.7	93.2	70.0	51.3	37.1	29.6
Debt service ratio	(%)	16.6	20.8	16.4	14.1	18.5	16.7	15.1

(Note) Figures for 2005 and 2006 are based on JCR forecast.

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