

## Bulgaria (the Republic of)

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

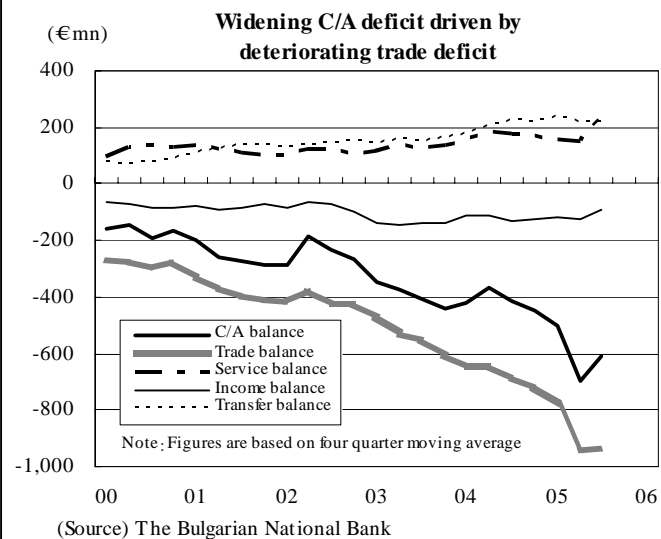
### Main Factors for the Ratings

#### Positive Factors

- Progress on political, economic and budgetary reforms in pursuit of EU entry.
- Prudent 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.



### Updated: from October 2005 to December 2005

#### Positive Factors

- The government moved up the date for raising excise duties on alcoholic beverages and tobacco to January 2006. Finance Minister Plamen Oresharski withdrew a bill to reduce the value-added tax rate prepared by the former government (October 4)
- General government fiscal balance in the first 11 months of 2005 registered a substantial surplus of BGN1,779 million or 4.2% of GDP. The finance minister indicated that he expects the surplus for 2005 as a whole to be around 2% of GDP (December 28)
- The government's draft budget for 2006, aimed at balanced budget, was approved in parliament (December 20)
- National Revenue Agency started its operation in January 2006.
- Government external debt at the end of October 2005 decreased by 21.4% year-on-year to EUR5,203 million.

#### Negative Factors

- Current account deficit in the first 10 months of 2005 widened 2.4 fold year-on-year to EUR2,226 million or 8.5% of GDP.
- According to an opinion poll conducted by the European Commission (EC) in autumn 2005, 49% of the total respondents expressed support for a further enlargement of the EU, down 1 percentage point from the previous poll in spring 2005.
- Consumer price inflation in November 2005 accelerated to 6.9% year-on-year on higher food and energy prices.

## <Prospects and Noticeable Points>

### Decision on EU entry date expected this spring

#### (1) Due to further lending curbs by the central bank, the economy is likely to start slowing down moderately in mid-2006

Bulgaria's real GDP in the July-September quarter of 2005 sharply slowed down to 4.6% year-on-year from 6.2% in the first half of the year. The growth was unbalanced, with domestic demand surging on expansion of consumer spending and gross fixed capital formation, and external demand undermining the economy through slower exports and stronger imports. The export slowdown was apparently due to the reduced shipments of foods and other consumer goods in the wake of the massive flood disaster in July and August 2005. The rapid growth of bank loans to the private sector, which had pushed up domestic demand, decelerated to 35.5% in November 2005 from almost 50% at the end of 2004. However, higher real wages and better employment continued to support strong consumer spending. The consumer inflation rate rose from a low 3.3% year-on-year in January 2005 to 6.9% in November on higher food and energy prices

A restraint fiscal policy has been kept in place, with the general government fiscal balance in the first 11 months of 2005 registering a substantial surplus of BGN1,779 million or 4.2% of GDP. Much of the surplus stemmed from a

continued restraint on expenditures and increased revenues centering on value-added tax amid strong domestic demand. On December 20, 2005, parliament approved a draft of balanced budget for 2006 proposed by the government. In the budget plan, the government moved up the date for raising excise duties on alcohol beverages and tobacco to January 2006 while postponing a reduction of the VAT rate proposed by the previous government. The budget plan also called for containing wage increases and cutting jobs in the public sector.

The economy is likely to start slowing down moderately in the middle of 2006, as personal consumption will weaken following implementation by the central bank of additional measures on bank lending restriction as agreed with the IMF on top of the current restraint fiscal policy. As a result, the economic growth rate in 2006 will decelerate to below 5% from 5.3% in 2005. Consumer price inflation, however, is set to rise to around 5.5% in 2006 from 4.8% in 2005 due primarily to the increase in excise duties in January 2006.

### (2) Current account deficit likely to remain large for a while as investment outpaces domestic savings

Due to a widened trade deficit, the current account deficit in the first 10 months of 2005 swelled 2.4 fold year-on-year to EUR2,226 million or 8.5% of GDP. The larger trade deficit was attributable to a surge of imports driven by strong domestic demand and higher energy prices amid a rapid slowdown of exports. In 2005 as a whole, the country is seen certain to have posted a record current account deficit equal to more than 13% of GDP. In Bulgaria, as in Romania, total investment continues to exceed domestic savings against the backdrop of massive inflows of foreign direct investment prior to EU accession and robust consumer spending. Both the service and transfer accounts will remain in marginal surpluses on increased tourism revenues and subsidy from the EU. All told, the annual current account deficit may improve slightly but is likely to remain larger than 10% of GDP in 2007.

### (3) JCR has retained the ratings. A decision on date for EU accession expected to come this spring.

The new government is set to adhere to a prudent fiscal policy and promote reforms in pursuit of EU accession in January 2007. Before realizing its goal, however, the country needs to make further efforts to carry out reforms such as fight against corruption and organized crime as required by the EC. Moreover, the Accession Treaty must be ratified by all 25 EU member countries. A decision on a date for Bulgaria's EU accession will be made this spring after a review by the EC of the reform progress made by the country. It is highly likely that the new government will be able to push through the reforms since a two-thirds majority it commands in parliament provides it with a power to amend the Constitution without much difficulty. JCR expects that the new government will be able to secure the country's EU accession in January 2007. It looks highly likely for the Accession Treaty to be ratified despite the modest decline in popular support for the EU enlargement following the French and Dutch rejection of the EU Constitution. An opinion poll conducted by the EC in autumn 2005 showed that the support ratio dipped to 49% from 50% in the previous poll in spring 2005. The latest support rate is relatively high as compared with the 37% registered in a poll conducted in May 2004, when ten countries became new EU members.

#### **Main Economic Indicators: The Republic of Bulgaria**

		2001	2002	2003	2004	2005 (f)	2006 (f)	2007 (f)
Real GDP growth rate	(%)	4.1	4.9	4.5	5.6	5.5	4.8	5.0
CPI (annual average)	(%)	7.4	5.8	2.3	6.1	4.8	5.3	4.5
Unemployment rate	(%)	17.3	16.3	13.5	12.2	11.5	10.5	9.8
General government balance/GDP	(%)	-0.6	-0.6	0.0	1.7	2.0	1.4	1.0
General government debt/GDP	(%)	69.9	55.8	48.0	40.7	32.2	28.0	25.5
Current account balance	(EURmn)	-1,102	-925	-1,630	-1,447	-2,912	-2,710	-2,629
Current account balance/GDP	(%)	-7.3	-5.6	-9.3	-7.4	-13.5	-11.4	-10.1
Trade balance/GDP	(%)	-11.7	-10.2	-12.5	-13.9	-19.4	-18.0	-17.4
Net foreign direct investment	(EURmn)	914	1,009	1,874	1,939	1,800	1,950	2,450
Net foreign direct investment/GDP	(%)	6.0	6.1	10.6	9.9	8.4	8.2	9.4
Foreign exchange reserves (excl. gold)	(EURmn)	4,061	4,575	5,309	6,770	7,700	8,600	8,950
Import (G&S) coverage	(months)	5.2	5.6	5.7	6.1	5.5	5.5	4.9
Forex reserves / ST external debt	(times)	3.7	3.0	3.5	2.7	2.5	2.4	2.6
External debt/GDP	(%)	78.6	65.1	60.5	64.1	61.3	60.2	57.7
External debt/ exports (G&S)	(%)	147.4	126.1	112.5	110.3	99.6	91.8	80.2
External public debt/ exports (G&S)	(%)	113.8	87.4	70.0	51.3	37.0	28.9	26.7
Debt service ratio	(%)	20.8	16.4	14.1	23.0	36.2	19.3	18.7

(Note) Figures from 2005 to 2007 are based on JCR projection

(Sources) Bulgarian National Bank, Ministry of Finance

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