

Bulgaria (the Republic of)

Foreign LT: BBB/Positive, Local LT: BBB+/ Positive (Affirmed on July 21, 2005)

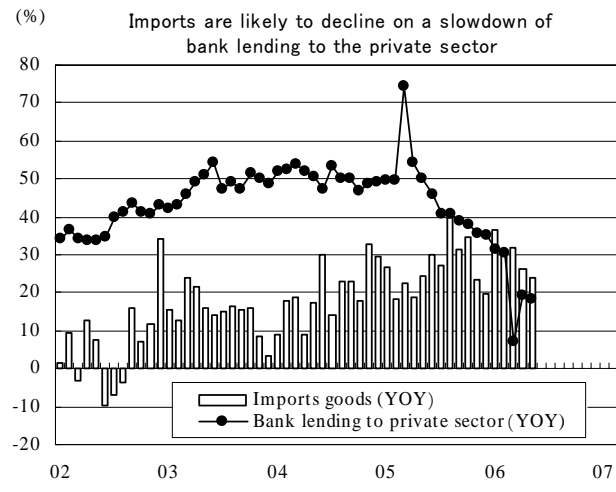
Main Factors for the Ratings

Positive Factors

- Progress on political, economic and fiscal reforms in pursuit of EU accession.
- Prudent fiscal management and considerable reduction of government debt.
- 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 April 2006 to June 2006

Positive Factors

- In May, the government and IMF agreed a six-month extension of stand-by arrangement which will be expired at the end of March 2007.
- Real GDP growth rate in the January-March quarter of 2006 remained strong at 5.6% year-on-year on the robust domestic demand.
- The government debt at the end of May 2006 further fell to 27.5% of GDP thanks mainly to the prepayment of loans to the IMF and World Bank.
- The general government fiscal balance in the first five months of 2006 registered a substantial surplus of BGN1,229 million or 2.6% of GDP.
- Year-on-year growth of bank lending to the private sector decelerated to 18.5% in May 2006.

Negative Factors

- On May 16, the European Commission (EC) has decided to postpone from May 2006 to October 2006 its final recommendation to the European Council on whether Bulgaria and Romania should join the EU in January 2007.
- Current account deficit in the first five months of 2006 rose by 73% year-on-year to EUR1,745 million or 7.3% of GDP.
- Consumer price inflation accelerated to 8.2% year-on-year in June 2006 on rises in food prices and excise duties.

<Prospects and Noticeable Points>

EC postponed the decision to enter the EU until October

(1) JCR has affirmed the ratings in annual review

On July 21, 2006, JCR has retained the ratings on foreign currency and local currency long-term senior debts and revised the rating outlooks to positive. The rating affirmation reflects progress on various reforms including political, economic and budgetary systems in harmony with those of EU in pursuit of EU membership in January 2007, stabilization of prices and its currency under currency board arrangement and sounder fiscal structure underpinned by fiscal surplus and a substantial reduction of government debt. On the other hand, the ratings are constrained by deteriorating external imbalances and the primary stage of industrial transformation with a quarter of the labor force still engaged in agriculture, that leaves the country's per-capita GDP (in terms of purchasing power parity) less than a third of the average for the EU25.

Revisions of rating outlooks to positive are based on the prospects that Bulgaria sets to become an EU member as early as in January 2007. A coalition government formed after the election in June 2005 supports the country's accession to the EU at an early date and the maintenance of tight fiscal policies and the currency board arrangement. Deteriorating external imbalances is likely to improve gradually underpinned by the measures adopted by the government and the central bank.

(2) Bulgaria to join EU as early as in January 2007

The European Commission (EC) has decided to postpone from May 2006 to October 2006 its final recommendation to the

European Council on whether Bulgaria and Romania should join the EU in January 2007. The decision was apparently taken mainly because the progress on reforms of outstanding issues raised by the EC proved slower than it had expected. The EC had urged Bulgaria to push ahead with reforms in such problems areas as the judiciary system, corruption, organized crime, money laundering, food safety and administrative capacity to deal with EU subsidy.

Bulgaria and Romania are aiming to attain EU accession in January 2007. However, a delay in reform programs for those remaining issues could lead to a postponement until 2008. JCR holds that both countries are highly likely to join the EU in January 2007. Firstly, Bulgaria's reform initiatives are likely to accelerate by October since both the majority coalition government and main opposition parties support EU accession. Secondly, there can be arranged a conditional accession with a safeguard clause that obliges Bulgaria to attain reforms in areas where progress has been slow within three years of its membership. Meanwhile, the Bulgarian government is aiming to join the Exchange Rate Mechanism II soon after its EU entry in January 2007 and introduce the euro as early as in 2009.

(3) External balances deteriorates in the midst of strong economic growth

Real GDP growth rate in the January-March quarter of 2006 remained strong at 5.6% year-on-year on the robust domestic demand. While domestic demand surged on expansion of consumer spending and gross fixed capital formation, external demand contributed negatively to the economic growth with stronger imports outpacing exports. Consumer price inflation accelerated to 8.2% year-on-year in June 2006 due primarily to one-off factors such as the surge of food and energy prices and hikes of excise duties. Without these, inflation remained moderate.

On the other hand, external imbalances continued deteriorating on surging imports driven by strong domestic demand and higher energy prices. Current account deficit in the first five months of 2006 rose by 73% year-on-year to EUR1,745 million or 7.3% of GDP. The trade deficit widened to 7.6% of GDP in the same period on strong imports of energy and FDI-related capital goods and raw materials which were to be turned into export products. However, risks related to external shocks have been largely mitigated as the current account deficit is amply covered by FDI inflows and sufficient external liquidity.

In the first five months of 2006, the general government fiscal surplus stood at 2.6% of GDP, growing faster than the year before. The government debt at the end of May 2006 further fell to 27.5% of GDP thanks mainly to the prepayment of loans to the IMF and World Bank. The government had initially proposed a balanced budget for 2006, but later revised it to produce a surplus equivalent to 3.0% of GDP, based on its agreement with IMF aimed to reduce the current account deficit. The budget plan for 2007, which was approved by the Cabinet, envisaged a surplus equivalent to 0.8% of GDP. Thus, the government is expected to maintain a sound fiscal policy in 2006 and 2007.

(4) External imbalances are likely to improve on the fiscal and monetary policies implemented by the government and the central bank

In a bid to stem any further deterioration of external imbalances, the government and the central bank have adopted a series of fiscal and monetary measures respectively since 2004 to cool down the robust domestic demand. As a result, the surging bank lending to the private sector, which had pushed up domestic demand, has begun distinctly decelerating since mid-2005. Year-on-year growth of bank lending to the private sector decelerated to 18.5% in May 2006. JCR expects that Bulgaria's economic growth will slow down moderately to less than 5% annually in 2006 and 2007 on a slower domestic demand and that external imbalances will improve gradually despite a chronic increase in imports of FDI-related capital goods.

Main Economic Indicators: The Republic of Bulgaria

		2001	2002	2003	2004	2005	2006 (f)	2007 (f)
Real GDP growth rate	(%)	4.1	4.9	4.5	5.7	5.5	4.8	5.0
CPI (annual average)	(%)	7.4	5.8	2.3	6.1	5.0	6.8	5.0
Unemployment rate	(%)	17.3	16.3	13.5	12.2	11.5	10.5	9.8
General government balance/GDP	(%)	-0.9	-0.9	-0.4	1.5	2.3	2.8	1.0
General government debt/GDP	(%)	69.9	55.8	47.8	40.6	31.9	24.6	20.8
Current account balance	(EURmn)	-855	-403	-972	-1,131	-2,531	-2,920	-2,646
Current account balance/GDP	(%)	-5.6	-2.4	-5.5	-5.8	-11.8	-12.2	-10.0
Trade balance/GDP	(%)	-11.7	-11.4	-13.7	-15.1	-20.4	-18.4	-16.9
Net foreign direct investment	(EURmn)	895	951	1,827	2,244	1,856	1,950	2,450
Net foreign direct investment/GDP	(%)	5.9	5.8	10.3	11.5	8.7	8.1	9.3
Foreign exchange reserves (excl. gold)	(EURmn)	4,061	4,575	5,309	6,301	6,690	7,300	8,500
Import (G&S) coverage	(months)	5.1	5.6	5.7	5.6	4.8	4.6	4.7
Forex reserves / ST external debt	(times)	3.7	3.0	3.5	2.6	1.9	1.7	1.8
External debt/GDP	(%)	78.6	65.1	60.2	64.2	67.8	71.0	73.7
External debt/ exports (G&S)	(%)	146.6	126.4	113.2	111.8	112.7	111.3	105.7
External public debt/ exports (G&S)	(%)	113.8	87.7	70.5	51.8	34.1	22.9	15.3
Debt service ratio	(%)	20.8	16.4	14.1	23.2	44.3	25.0	16.4

(Note) Figures for 2006 and 2007 are based on JCR projection

(Sources) Bulgarian National Bank, Ministry of Finance

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