

2008-02
April 30, 2008

Bulgaria (the Republic of)

Foreign LT: BBB+/Stable, Local LT: A-/Stable

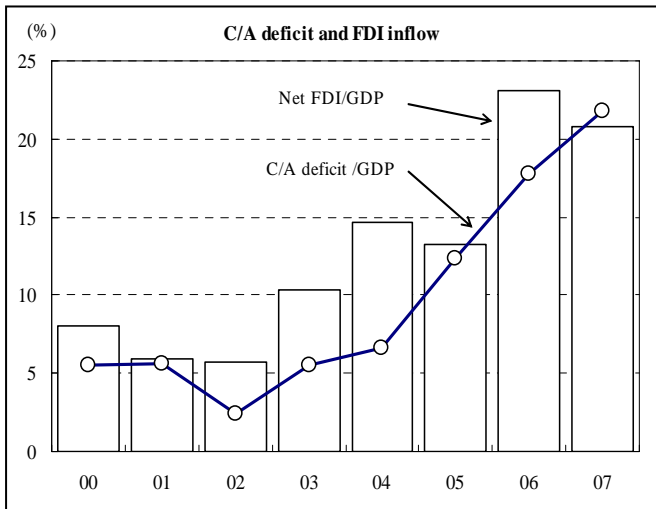
<Rating Perspective>

Positive Factors

- Sounder fiscal structure underpinned by continued fiscal surplus and substantial reduction of government debt.
- Stability of the currency and inflation supported by the currency board arrangement.
- High economic growth prospects mainly bolstered by massive FDI inflows and EU subsidy as well as the prudent fiscal and monetary policies.

Negative Factors

- Widening current account deficit on robust domestic demand.
- Transformation of industrial structure still at primary stage.



<Updated: from January to March, 2008>

Positive Factors

- Real GDP in the October-December quarter accelerated to 6.9% year-on-year from 4.9% in the previous quarter, but private sector demand centering on consumer spending and gross fixed capital formation continued deceleration.
- The general government fiscal balance (ESA95) in 2007 registered a substantial surplus equivalent to 3.4% of GDP
- The ratio of government debt (ESA95) to GDP declined further to 18.2% at the end of 2007 from 22.7% a year before
- The unemployment rate (Eurostat) fell to 6.0% in February 2008
- Net FDI inflows in 2007 totaled 20.7% of GDP, covering almost all the current account deficit in the same period
- Foreign exchange reserves at the end of 2007 increased to EUR 11.1 billion, equivalent to 5.5 times of monthly imports
- Socialist led government survived a no-confidence vote on allegation of having close links with organized crime

Negative Factors

- The consumer price inflation (Eurostat) surged to 12.2% year-on-year in February 2008 on higher food prices
- The current account deficit in 2007 widened to 21.8% of GDP from 17.8% in the same period of 2006
- Bank lending to the private sector swelled by 61.8% year-on-year in January 2008

<Outlook and Points to Watch>

Large C/A deficit was financed by FDI inflows

(1) The economy remains strong

Bulgaria's real GDP in the October-December quarter accelerated to 6.9% year-on-year from 4.9% in the previous quarter and the growth rate for 2007 ended in 6.3%, equivalent to the previous year. While private demand, driven by consumer spending, declined for three consecutive quarters from the April-June quarter of 2007, net exports, led by the decreased imports, continued to narrow the contribution to the whole economic growth. Nevertheless, the economic momentum remained strong as the growth of nominal GDP in the same quarter accelerated to 16.7% year-on-year from 14.1% in the previous quarter. The decline of the real GDP growth rate was mainly due to the increased inflation. The surging bank lending to the private sector showed no sign of deceleration. Its year-on-year growth rose further to 61.8% in January 2008, despite the Bulgarian National Bank's increase of the minimum reserve requirement ratio to 12% from 8% in September 2007. The consumer price inflation (Eurostat) climbed to 12.2% year-on-year in February 2008 on higher food and energy prices, as well as inflation pressure from strong demand. Increased employment created amid the strong economic expansion has contributed to a marked reduction of the unemployment rate. The unemployment rate (Eurostat) dropped to 6.0%, the lowest on record, in February 2008.

(2) Large C/A deficit was almost covered by FDI inflows

The current account deficit in 2007 widened to 21.8% of GDP to 17.8% in 2006. The large current account deficit was primarily attributable to the widening trade deficit which grew substantially to reach 25.8% of GDP in 2007 from

22.0% in 2006 on the strong imports of energy as well as FDI-related capital goods and raw materials, which were to be turned later into export products. However, risks of financing the deficit have been largely mitigated by strong FDI inflows which covered almost all the deficit. Furthermore, net financial inflows centering on bank loans helped the foreign exchange reserves swell to a record EUR 11.1 billion at the end of 2007, equivalent to nearly five months of imports. By contrast, total foreign debts at the end of 2007 surged to EUR 28.1 billion or nearly 100% of GDP on the increased borrowing of enterprises and inter-company loans.

(3) The government maintains restrictive fiscal policy in 2008

The government has been keeping a restrictive fiscal policy with the aim of curbing domestic demand. The general government fiscal balance in 2007 increased a substantial surplus equivalent to 3.4% of GDP. While tax revenues grew markedly on economic expansion and tightened tax collection following a full-fledged operation of the National Revenues Agency, expenditures stayed in line with the levels projected in the budget. The ratio of government debt to GDP declined further to 18.2% at the end of 2007 from 22.7% a year earlier.

The government envisaged a bigger fiscal surplus equivalent to 3.0% of GDP in the budget for 2008 while pledging to maintain a restrictive fiscal policy. The budget called for higher tax rates on alcohol, tobacco and energy and a unified 10% rate on personal income in lieu of the current progressive tax rate.

(4) Concern is the possibility of increased spending prior to the election in 2009

While the government maintained tight fiscal policy for aiming to rein strong domestic demand, inflation rates have been accelerating faster than the government's projection. JCR hold a view that the economy looks likely to slow down and is expected to grow below 6% in 2008 on the declining consumer spending which was dragged down by the reduced purchasing power due to the surging inflation. Inflation will decelerate only slightly as falls in food prices will be neutralized by inflation pressure resulting from higher wages amid a tighter labor market. Tight fiscal policy is likely to maintain as the increased fiscal surplus under the 2008 budget plan. Nevertheless, given the coalition government's weak approval rating as it lost both the European parliamentary and local elections in 2007, there is the possibility of boosting spending ahead of the general elections scheduled in 2009. JCR will closely watch how the government will steer its fiscal policy.

The effects derived from the international financial turmoil remained limited on the real economy as the bank lending to the private sector continued to surging, although share price, interest rates and exchange rate has some negative impacts. There is a concern about the large current deficit. However, the deficit was almost covered by the FDI inflows and the government continued to maintain the appropriate fiscal policy. Barring further drastic fluctuations of the domestic and international financial markets, investor confidence toward Bulgaria can be maintained.

Main Economic Indicators: The Republic of Bulgaria

		2003	2004	2005	2006	2007	2008 (f)	2009 (f)
(Convergence criteria for adopting the euro)								
1. CPI (annual average)	2.8%(note)	2.3	6.1	6.0	7.4	7.6	6.5	5.3
2. 10 year government bond yield	5.7%(note)	6.4	5.4	3.9	4.2	4.5	4.3	4.0
3. General government balance / GDP	Below-3.0%	0.0	1.4	1.8	3.0	3.4	3.0	2.5
4. General government debt / GDP	Below 60%	45.9	37.9	29.2	22.7	18.2	15.5	13.2
Real GDP growth rate	(%)	5.0	6.6	6.2	6.3	6.2	5.8	5.5
Unemployment rate	(%)	13.7	12.0	10.1	9.0	6.9	5.9	5.0
Current account balance / GDP	(%)	-5.5	-6.6	-12.4	-17.8	-21.8	-20.6	-19.4
Trade balance / GDP	(%)	-13.7	-14.9	-20.2	-22.0	-25.8	-25.1	-24.0
Net foreign direct investment / GDP	(%)	10.3	14.6	13.3	23.1	20.7	17.5	14.8
Net foreign direct investment / C/A balance	(%)	190.2	209.4	116.5	132.8	98.2	87.8	79.9
Forex reserves (excl. gold)	(EURmn)	4,791	6,301	6,690	8,193	11,179	12,500	14,600
Forex reserves / monthly imports	(months)	5.1	5.6	4.8	4.7	5.5	5.4	5.5
Forex reserves / ST external debt	(times)	3.1	2.6	1.8	1.3	1.2	1.0	0.9
Gross external debt / GDP	(%)	60.1	63.8	69.8	73.7	98.6	112.7	123.7
Gross external debt / exports (G&S)	(%)	113.2	112.5	117.2	114.8	155.4	171.4	177.9
Gross public external debt / exports (G&S)	(%)	70.5	53.2	33.7	23.4	16.7	13.3	10.1
Debt service ratio	(%)	14.2	23.3	44.3	26.5	31.6	19.9	14.6

(Note) Figures for criteria 1 and 2 are r 2007. Figures for 2008- 2009 are projection made by JCR
 (Sources) The Bulgarian National Bank, Ministry of Finance, Eurostat

(Toshihiko Naito, Senior Analyst)