

2009-06
April 28, 2009

Bulgaria (the Republic of)

Foreign LT: BBB/Negative, Local LT: BBB+/Negative

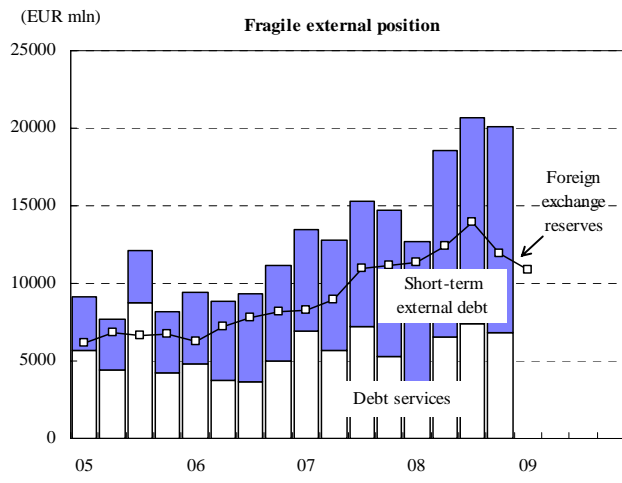
<Rating Perspective>

Positive Factors

- Sound fiscal position underpinned by a sustained fiscal surplus and significant reduction of government debt
- The maintenance of the currency board arrangement
- Expanding production capacity rendered by robust investment amid massive inflows of foreign direct investment (FDI)

Negative Factors

- Weakening resilience to external financing amid the deepening global de-leveraging process
- Snowballing short-term foreign debts in tandem with the continuing huge current account deficit
- Transformation of industrial structure still at primary stage



<Updated: from January 2009 to April 2009>

Positive Factors

- The general government fiscal balance (GFS) in 2008 registered a surplus equivalent to 3.0% of GDP
- The current account deficit in the first two months of 2009 narrowed to 0.9% of GDP from 2.2% the year earlier
- The external debt at the end of January 2009 decreased slightly to EUR 36.4 billion
- Bank lending to the private sector in February 2009 fell further to 26% year-on-year
- Consumer price inflation decelerated further to 4.9% year-on-year in March 2009

Negative Factors

- Real GDP growth rate in October-December quarter of 2008 slowed down sharply to 3.5% year-on-year from 6.8% in the previous quarter
- Foreign exchange reserves at the end of March 2009 decreased by 19% to EUR 10,886 million from September 2008
- Industrial production fell sharply by 17.7% year-on-year in February 2009
- Total exports in February 2009 decreased rapidly by 27.1% year-on-year, five consecutive contraction from October 2008
- The ratio of net FDI inflow to the current account deficit lowered to 71% in 2008 from 117% in 2007

<Outlook and Points to Watch>

Fragile External Position

(1) 2009 economy is projected to contract for the first time since 1997

The Bulgarian economy, which grew more than 5% annually in the past four years, began deteriorating markedly from the end of 2008. The real GDP growth rate in the October-December quarter of 2008 decelerated sharply to 3.5% year-on-year from 6.8% the previous quarter. The growth of bank lending to the private sector, which had fueled consumer spending and investment, decelerated to 26% year-on-year in February 2009 from its peak of 62.5% in December 2007. Exports also began losing steam in October amid the deepening economic recession in the country's major European trading partners. With industrial production down 17.7% year-on-year in February 2009, the real GDP growth rate is believed to have slowed down in the January-March quarter. Judging from the decelerating bank lending and the recession in the country's major European trading partners, JRC holds that the Bulgarian economy is projected to contract by around 1% in 2009.

(2) Despite recovering financial stability, banking system needs to be watched

Bulgaria's financial market came under pressure in October 2008 as interbank interest rates shot up amid the liquidity shortfalls in the banking sector and the Bulgarian currency lost more than 10% in value against the U.S. dollar. However, the market has regained its stability after the BNB took a spate of measures to replenish liquidity such as a reduction of the minimum reserve ratio. The country's financial system remains stable so far. However, should the global credit crunch worsen, the banking sector's liquidity problem may intensify as the balance of bank loans to the private sector had swollen to 76% of GDP at the end of 2008 from 46% at the end of 2006. Major Bulgarian banks are

the subsidiaries of big European banks. The parent banks may move to reduce their exposure in the country should their fiscal structure and liquidity deteriorate.

(3) Revenue shortfalls, increased spending may leave marginal fiscal deficit in 2009

The general government fiscal balance registered a surplus equivalent to 3.0% of GDP in 2008. However, the balance started deteriorating due mainly to revenue shortfalls amid the worsening economy and increased public investment expenditures aimed to stimulate the economy. In its 2009 budget, the government again projected a fiscal surplus equivalent to 3.0% of GDP, assuming a 4.7% economic growth rate and increased public spending equivalent to 1.3% of GDP. JCR holds that there will probably be a marginal fiscal deficit in the year due mainly to increased spending and revenue shortfalls resulting from the economic downturn. However, the government still held fiscal reserves equivalent to more than 17% of GDP at the end of 2008 and has sufficient capacity to absorb unforeseeable shocks. Should the economy recover in 2010, the fiscal balance may return to a surplus. The general government fiscal debt at the end of February 2009 was reduced further to 15.3% (GFS) of GDP from 16.1% at the end of 2008.

(4) Weakening resilience to external financing of private sector

The current account deficit in 2008 widened modestly to 25.3% of GDP from 25.1% in 2007. The persistent trade deficit narrowed to 1.0% of GDP from 1.8% the year before as imports slowed down faster than exports. Until 2007, the current account deficit had been fully covered with net FDI inflows. However, the ratio of net FDI inflows to the current account deficit fell to 71% in 2008. As a consequence, the external debt increased to 108% of GDP at the end of 2008 from 101% the year earlier. In particular, the short-term external debt grew robustly to EUR13.3 billion or 36% of the total external debt. The foreign exchange reserves excluding gold stood at EUR10.9 billion at the end of March 2009, falling short of the short-term external debt, indicating that the country's external financing resilience has been weakening.

(5) The center right-wing CEDB enjoys the highest popularities ahead of the election

Parliamentary elections will be held in Bulgaria on 28 June or 5 July 2009. According to the recent opinion poll, the Citizens for European Development of Bulgaria (CEDB) takes clear lead with 26%, followed by the main ruling Bulgarian Socialist Party (BSP) with 19%. While the left-wing ruling coalition parties, which consists of BSP, Movement for Rights & Freedoms and National Movement of Stability & Progress, altogether secures close to 30%, the center right-wing CEDB and alliance of Union of Democratic Forces and Democrats for a Strong Bulgaria (UDF-DSB) enjoys their increased popularity to around 30%. There is growing chance that the CEDB will form the center right-wing coalition with alliance of UDF-USB after the election. Currently, all parties support the currency board arrangement until euro entry, but there is disagreement about the credit assistance from the IMF and spending policy. Should the center-right coalition be formed, it is highly likely that Bulgaria will pursue more sound policies in the midst of the global financial and economic crisis. In this regard, Bulgaria will receive the IMF's new lending arrangement, Flexible Credit Line, in order to ensure the external finance and revise the current fiscal policy.

Main Economic Indicators: The Republic of Bulgaria

		2004	2005	2006	2007	2008 (f)	2009 (f)	2010 (f)
(Convergence criteria for adopting the euro)								
1. CPI (annual average)	4.0%(note)	6.1	6.0	7.4	7.6	12.0	4.2	3.6
2. 10 year government bond yield	5.9%(note)	5.4	3.9	4.2	4.5	4.8	n.a.	n.a.
3. General government balance / GDP	Below -3.0%	1.6	1.9	3.0	3.4 (note2)	4.0	-1.0	0.5
4. General government debt / GDP	Below 60%	37.9	29.2	22.7	18.2	14.3	14.5	14.0
Real GDP growth rate	(%)	4.8	5.3	6.3	6.3	6.1	-1.0	1.3
Unemployment rate	(%)	12.0	10.1	9.1	7.0	5.7	8.1	7.4
Current account balance / GDP	(%)	-6.6	-12.4	-18.4	-25.1	-25.3	-15.3	-10.7
Trade balance / GDP	(%)	-14.9	-20.2	-22.0	-25.1	-25.7	-20.1	-17.5
Net foreign direct investment / GDP	(%)	14.6	13.3	23.1	28.7	16.7	9.5	7.3
Net foreign direct investment / C/A balance	(%)	209.4	116.5	132.8	116.8	71.4	74.4	88.4
Forex reserves (excl. gold)	(EURmn)	6,301	6,690	8,193	11,179	11,886	9,500	10,500
Forex reserves / monthly imports	(months)	5.6	4.8	4.7	5.4	5.0	4.6	5.1
Forex reserves / ST external debt	(times)	2.6	1.7	1.3	1.2	0.9	0.7	0.8
Gross external debt / GDP	(%)	63.8	70.1	81.6	101.1	107.7	105.4	103.7
Gross external debt / exports (G&S)	(%)	112.5	117.72	127.2	160.0	177.9	199.5	198.4
Gross public external debt / exports (G&S)	(%)	47.3	29.0	18.0	10.6	7.4	6.7	9.1
Debt service ratio	(%)	23.3	44.3	26.4	34.3	28.5	35.0	31.1

(Note1) Figures for criteria 1 and 2 are moving average between March 2008 and February 2009. Figures for 2009- 2010 are projection made by JCR

(Note 2) the figure excludes a debt cancellation towards Iraq.

(Sources) The Bulgarian National Bank, Ministry of Finance, Eurostat

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