

2009-17  
July 30, 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 enabled by robust investment amid massive inflows of foreign direct investment (FDI)

#### Negative Factors

- Continuing huge current account deficit despite the recent improvement
- Sizable foreign debts owed by the private sector
- Transformation of industrial structure still at a primary stage

### Results of general election

(Parliamentary seats)	July, 2009	%	June, 2005	%
Citizens for European Development of Bulgaria	116	48.3	0	0.0
Blue Coalition	15	6.3	—	—
Democrats for a Strong Bulgaria	—	—	17	7.1
United Democratic Forces	—	—	20	8.3
Coalition for Bulgaria	40	16.7	82	34.2
National Movement for Stability and Progress	—	—	53	22.1
Movement for Rights and Freedoms	38	15.8	34	14.2
Order, Lawfulness, Justice	10	4.2	0	0.0
National Union Attack	21	8.8	21	8.8
Bulgarian Peapole's Union	0	0.0	13	5.4
合計	240	100.0	240	100.0
Ruling parties	116	48.3	169	70.4

### <Updated: from April 2009 to July 2009>

#### Positive Factors

- In the parliamentary election held in July 5, the center-right "Citizens for European Development of Bulgaria (GERB)" won 116 out of 240 seats.
- Industrial production continued to fall by 22.1% year-on-year (yoy) in May 2009
- The current account deficit in the first four months of 2009 narrowed sharply to 5.0% of GDP from 8.1% of a year earlier due mainly to plummeted imports
- The external debt at the end of March 2009 decreased slightly to EUR 36.4 billion, down by 0.8% from the previous quarter
- Bank lending to the private sector in April 2009 decelerated further to 19.9% yoy
- Consumer price inflation declined further to 3.0% yoy in May 2009

#### Negative Factors

- Real GDP growth rate in January-March quarter of 2009 contracted by 3.5% yoy on the decreased domestic demand
- Foreign exchange reserves at the end of May 2009 decreased by 22% to EUR 10,851 million from the highest amount recorded in September 2008
- Net position of banking sector in the first four months of 2009 (international current account balance) fell into outflow by EUR 303 million from inflows by EUR 2,397 million from a year earlier
- The general government fiscal surplus (GFS) in the first five months of 2009 narrowed to 1.4% of GDP from 5.0% a year earlier
- The net FDI inflow reduced to 2.8% of GDP from 4.4% in the same period of last year

## <Outlook and Points to Watch>

### Center-right GERB form a minority government

#### (1) As a result of annual review, JCR has affirmed Bulgaria's ratings

JCR has affirmed the ratings on foreign currency long-term senior debts and on the local currency long-term senior debts of the Republic of Bulgaria. The outlook of the ratings has been kept negative.

The ratings are based on Bulgaria's solid fiscal structure underpinned by a continued fiscal surplus and the substantial reduction of the government debt, its maintenance of the firm currency board arrangement through collaboration between the government and the Bulgarian National Bank (BNB), and its expanding production capacity enabled by robust investments amid massive inflows of foreign direct investment (FDI) and EU subsidies. On the other hand, the ratings remain constrained by the country's large current account deficit despite its rapid improvement in the recent months, a sizable foreign debt in the private sector and the fact that its industrial transformation still remains at a primary stage.

The outlook of the ratings remains negative. Following the parliamentary election on July 5, the center-right GERB formed its own government on July 27, and will pursue more reliable policies than its predecessors. Nonetheless, the external finance of country's sizable foreign debts in the private sector remains vulnerable to the ongoing global economic and financial turmoil.

**(2) Despite the moderating global economic and financial turmoil, Bulgaria's external finance of private-sector debts needs to be watched**

The foreign debts accumulated in the process of the country's rapid economic expansion since 2004 swelled to 108% of GDP at the end of 2008 from 64% at the end of 2004. Of the total, private-sector debts (including inter-company loans) accounted for 89% and short-term debts for 36% at the end 2008. Notably, most major Bulgarian banks are subsidiaries of big European banks and they depend on their parents for some part of their financing. While the current account deficit started improving on a sharp fall in domestic demand in the four months of 2009, net capital inflows (FDI, portfolio investment and other investments) into Bulgaria have dropped noticeably due partly to a reduction of foreign liabilities in the private sector. Should the turmoil intensified again, capital inflows into Bulgaria could suffer setbacks, putting greater pressure to bear on the financing of the private-sector foreign debts. Moreover, maintenance of the currency board arrangement may have adverse impact. In this regard, JCR holds that it is crucial for Bulgaria to enlist financial assistance from the IMF and EU as a precautionary measure.

**(3) Fiscal position solid enough to meet worse fiscal balance and contingencies**

The government has been keeping its fiscal policy tighter since 2004 with the aim of harnessing strong aggregate demand. As a result, the fiscal balance (ESA95) has been in surplus since that year, with the general government debt substantially reduced to 14% of GDP (ESA95) at the end of 2008 from 37.9% in 2004. A deterioration of the fiscal balance looks inevitable in 2009 and 2010 due mainly to revenue shortfalls stemming from a severe economic downturn. Nonetheless, with its fiscal reserves standing at a level equivalent to more than 12% of GDP at the end of May 2009, the government has sufficient capacity to meet contingencies including systemic risks. The country's financial system remains stable thanks to the stringent supervision conducted so far by BNB, with its stress test showing that it has enough capitalization to absorb any deterioration in the quality of assets held by banks.

**(4) The economy to suffer steep setback in 2009 but may retain strong medium-term growth potential**

The Bulgarian economy grew a solid 6% in 2008, but began decelerating sharply in the October-December quarter of that year, contracting by 3.5% yoy in the January-March quarter of 2009. The growth of bank lending to the private sector, which had fueled consumer spending and investment, decelerated to 15.7% yoy in May 2009 from its peak 62.5% in December 2007. JCR projects that the economy is likely to contract by more than 5% in 2009 on continued restraints on bank lending to the private sector and the recession in major trading partners in Europe. In the medium term, however, the Bulgarian economy will retain its strong growth potential, underpinned by massive inflows of FDI and EU subsidies.

**(5) New government seen to pursue more credible policies**

Following the parliamentary election held on July 5, the center-right GERB formed a minority government on July 27 and Mr. Boiko Borisov, GERB leader and Sofia mayor, became new prime minister. Regardless of minority status in the parliament (116 out of 240 seats), new government will pursue policies to uphold the currency board management, fight against crimes and corruption, enlist financial assistance from the IMF and revise its economic and fiscal plans for 2009 in a realistic way with the support from other right-wing parties. JCR believes that new government will take more credible policies than its predecessor.

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

		2004	2005	2006	2007	2008 (f)	2009 (f)	2010 (f)
<b>(Convergence criteria for adopting the euro)</b>								
1. CPI (annual average)	2.8%(note)	6.1	6.0	7.4	7.6	12.0	3.2	3.0
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 <sup>(note2)</sup>	1.5	-1.0	0.5
4. General government debt / GDP	Below 60%	37.9	29.2	22.7	18.2	14.0	15.2	14.8
Real GDP growth rate	(%)	4.8	5.3	6.3	6.3	6.1	-5.0	-1.0
Unemployment rate	(%)	12.0	10.1	9.1	7.0	5.7	6.5	6.8
Current account balance / GDP	(%)	-6.6	-12.4	-18.4	-25.1	-25.3	-12.3	-9.4
Trade balance / GDP	(%)	-14.9	-20.2	-22.0	-25.1	-25.7	-13.3	-11.0
Net foreign direct investment / GDP	(%)	14.6	13.3	23.1	28.7	16.7	8.1	10.8
Net foreign direct investment / C/A balance	(%)	209.4	116.5	132.8	116.8	71.4	84.9	134.5
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	6.0	6.3
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	111.9	118.5
Gross external debt / exports (G&S)	(%)	112.5	117.72	127.2	160.0	177.9	235.1	223.0
Gross public external debt / exports (G&S)	(%)	47.3	29.0	18.0	10.6	7.4	6.7	6.2
Debt service ratio	(%)	23.3	44.3	26.4	34.3	28.5	40.7	38.6

(Note1) Figures for criteria 1 and 2 are moving average between June 2008 and May 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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