

Bulgaria (the Republic of)

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

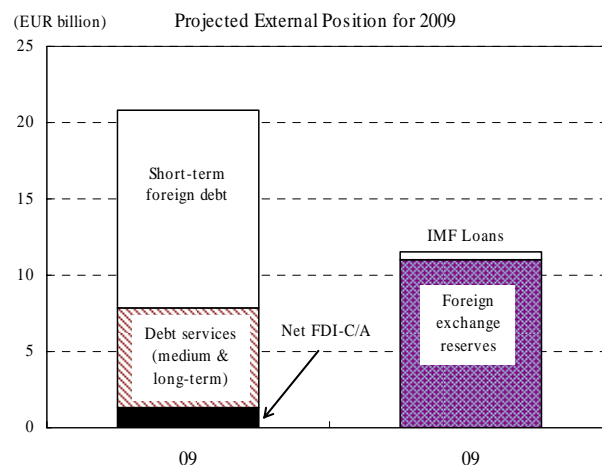
<Rating Perspective>

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



<Updated: from July 2009 to October 2009>

Positive Factors

- On September 16, the government approved the anti-crisis measures, which targets balanced budget in 2009 and 2010
- On August 28, the government was approved the special drawing right to receive around EUR 517 million from the IMF based on the facility established at the G-20 summit in London in April, for overcoming the global financial and economic crisis
- The Justice Minister, Margarita Popova, outlined 57 measures to reform the country's poor judiciary system
- The current account deficit in the first eight months of 2009 more than halved to 6.6% of GDP from 14.8% a year earlier
- The general government fiscal balance (GFS) in the first eight months of 2009 kept a marginal surplus at 0.1% of GDP

Negative Factors

- After securing 116 of 240 parliamentary seats in the July election, the center-right Citizens for European Development of Bulgaria (CEDB) decided not to form a coalition government and govern with a single-party minority government
- Real GDP growth rate in April-June quarter of 2009 contracted further by 4.9% yoy on the decreased domestic demand
- Foreign exchange reserves at the end of September 2009 decreased by 22% to EUR 10,812 million from the highest amount recorded in September 2008
- Net capital inflows in the country (FDI, portfolio investment and other investment) in the first eight months of 2009 fell to 2.5% of GDP from 25.7% a year earlier
- Unemployment rate in August 2009 surged to 7.1% from 5.3% a year earlier

<Outlook and Points to Watch>

Center-right GERB promotes stringent fiscal measures

(1) The 2009 economy will be the worst recession since 1997

The Bulgarian economy began decelerating sharply in the October-December quarter of 2008 and fell into recession as the real GDP in the January-March and the April-June quarters of 2009 contract by 3.5% and 4.9% yoy respectively. Industrial output and retail sales in July and August remained stagnant, but improved marginally on a yoy basis. By contrast, the growth of bank lending to the private sector, which had fueled consumer spending and investment, decelerated considerably to 5.6% yoy in August 2009, due mainly to tighter credit conditions adopted by banks. Given the fact that unemployment rate continued to climb up to 7.1% in August and the ratio of no-performing loan to total loan surged to 5.15% at the end of July from 2.15% a year earlier, banks will maintain their tighter credit conditions in 2009 and 2010. The country's financial system remains stable thanks to the stringent supervision conducted so far by Bulgarian National Bank, with its stress test showing that it has enough capitalization to absorb any deterioration in the quality of assets held by banks. JCR projects that the economy will 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, but restore positive growth rate in 2010.

(2) Continued weak external financing position in the private sector

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. The further increase of the foreign debt looks averted as the debt at the end of June 2009 remained at 109% of GDP. The current account deficit in the first eight months of 2009 more than halved to 6.6% of GDP from 14.8% a year earlier. However, JCR thinks that the external financial position of the private sector remained weak as net capital inflows (FDI, portfolio investment and other investments) into Bulgaria in the first eight months of 2009 fell noticeably to 2.5% of GDP from 25.7% a year earlier due partly to a reduction of foreign liabilities in the private sector. As consequence, foreign exchange reserves at the end of September 2009 decreased by 22% to EUR 10,812 million from the highest amount recorded in September 2008.

While the external financing needs for 2009 is estimated at around EUR 2.1 billion (refer to the Chart), foreign exchange reserves only cover half of that amount. The maintenance of the international investors' confidence in Bulgaria is critical if the country can roll over its maturing short-term foreign debts owed by 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 and on the currency board arrangement. 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 the worsened fiscal balance and contingencies

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 11.7% of GDP at the end of August 2009, the government has sufficient capacity to meet unforeseen events. The general government fiscal balance (GFS) in the first eight months of 2009 kept a marginal surplus at 0.1% of GDP, but deteriorated significantly from 6.9% a year earlier. While the revenue declined by 9% yoy due to severe economic downturn, the expenditure increased by 19% yoy on the economic stimulus to pull out the economy from the recession and pre-election fiscal expansion measures by the former government.

Since new CEDB government took office in July 2009, it tightened fiscal policy and adopted the anti crisis measures in September 2009, which targets balanced budget in 2009 and 2010. On the expenditure side, it plans to save BGN 1.15 billion (1.8% of GDP) by cuts in administration costs and lower investment spending. On the revenue side, the government plans to boost it by a similar amount through cracking down on tax avoidance. Given the weak economic outlook for 2009, JCR forecasts that the deficit will post a small fiscal deficit for 2009, but will produce a surplus for 2010 on the back of tightening fiscal policy and economic recovery.

(4) New government seen to pursue more credible policies

The center-right GERB formed a minority government on July 27 with 116 of 240 parliamentary seats will pursue policies with to uphold the currency board management, restore fiscal balance, fight against crimes and corruption and enlist financial assistance from the IMF with the support from other right-wing parties. JCR continues to watch the policies pursued by new government.

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)	2.8%(note)	6.1	6.0	7.4	7.6	12.0	2.9	3.0
2. 10 year government bond yield	5.9%(note)	5.4	3.9	4.2	4.5	5.4	n.a.	n.a.
3. General government balance / GDP	Below -3.0%	1.6	1.9	3.0	3.4 (Note2)	1.8	-0.8	0.5
4. General government debt / GDP	Below 60%	37.9	29.2	22.7	18.2	14.0	15.1	14.8
Real GDP growth rate	(%)	4.8	5.3	6.3	6.3	6.1	-5.0	0.5
Unemployment rate	(%)	12.0	10.1	9.1	7.0	5.7	6.5	6.6
Current account balance / GDP	(%)	-6.6	-12.4	-18.4	-25.1	-25.4	-9.9	-7.1
Trade balance / GDP	(%)	-14.9	-20.2	-22.0	-25.1	-25.2	-12.2	-9.6
Net foreign direct investment / GDP	(%)	14.6	13.3	23.9	29.0	17.8	7.2	8.4
Net foreign direct investment / C/A balance	(%)	209.4	116.5	132.4	118.2	75.7	84.4	142.7
Forex reserves (excl. gold)	(EURmn)	6,301	6,690	8,193	11,179	11,886	11,000	12,500
Forex reserves / monthly imports	(months)	5.6	4.8	4.7	5.4	5.0	6.8	7.4
Forex reserves / ST external debt	(times)	2.6	1.7	1.3	1.2	0.9	0.8	0.9
Gross external debt / GDP	(%)	63.8	70.1	81.6	101.1	108.6	108.7	107.0
Gross external debt / exports (G&S)	(%)	112.5	117.7	127.2	160.0	180.1	220.0	200.0
Gross public external debt / exports (G&S)	(%)	47.3	29.0	18.0	10.6	7.0	7.7	6.8
Debt service ratio	(%)	23.3	44.3	26.4	34.3	36.0	39.4	38.0

(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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