2005-14
June 24, 2005

Bulgaria (the Republic of)

Foreign LT: BBB-→BBB/Stable, Local LT: BBB→BBB+/Stable (Upgraded on May 9, 2005)

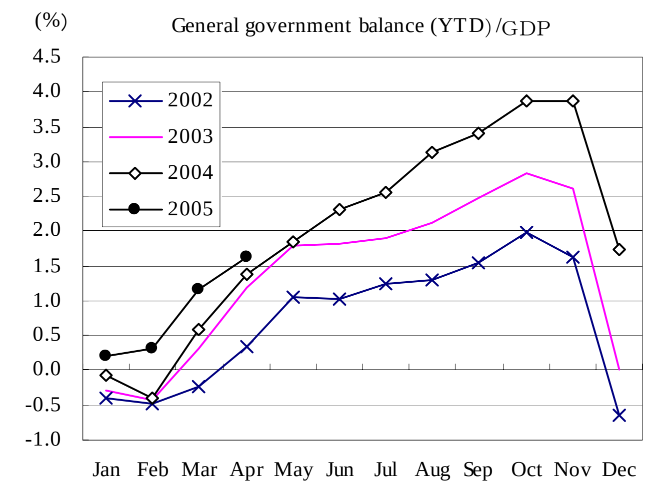
Main Factors for the Ratings

Positive Factors

- Progress on political, economic and budgetary reforms in pursuit of EU entry in 2007.
- Sound fiscal management and considerable reduction of government debts.
- 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 lows-level domestic savings.



Updated: from February 2005 to May 2005

Positive Factors

- Bulgaria signed the Accession Treaty on April 25, 2005.
- General government fiscal balance in the first four months of 2005 registered a surplus of BGN673 million or 1.6% of GDP.
- To counter the surging bank lending to the private sector, the central bank implemented new reserve requirements for commercial banks as one of additional restraint measures in April.
- Consumer price inflation rate in the first four months of 2005 decelerated to 4.1% year-on-year.

Negative Factors

- France and the Netherlands rejected the ratification of the EU constitution in referendums
- The European Commission warned Bulgaria to step up fight against corruption on May 16.
- Current account deficit in the first quarter of 2005 rose by 42% year-on-year to EUR707million.
- Bank lending to the private sector in May 2005 continued to grow by 47% year-on-year.

<Prospects and Noticeable Points>

Upgraded the ratings of local and foreign currency debts

(1) JCR upgraded the ratings on May 9

JCR upgraded the foreign currency rating to BBB/stable and the local currency rating to BBB+/stable.

The upgrading reflects the stronger probability that Bulgaria, now set to join the EU in January 2007 following the signature of the Accession Treaty on April 25, 2005, will continue to make progress on reforms, inspired by a strong political will to attain its objective. Another positive factor is that the country's finance has been stabilizing following considerable reduction of government debts centering on external debts. The currency board arrangement (CBA) is in stable operation through the cooperation between the government and the central bank, giving a boost to the country's economic stability. To counter the surging bank lending to the private sector, the central bank implemented new reserve requirements for commercial banks in April and the government on its part adopted a restrictive budget plan for 2005. JCR expects that these measures will gradually contribute to holding rapid expansion of bank lending to the private sector and a deterioration of the trade deficit.

On the other hand, the ratings are constrained by the fact that the transformation of the industrial structure remains at a primary stage with a quarter of the labor force still engaged in agriculture, keeping per-capita GDP (in terms of purchasing power parity) as low as 30% of the average for the EU25 and that while the government external debt has decreased considerably, the private external debt continues growing due mainly to low-level domestic savings.

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The rating outlooks are stable. It is likely that a general election scheduled for June 25, 2005 will give birth to a coalition government led by the Bulgarian Socialist Party. JCR considers that irrespective of election results, a new administration will hold fast to the current reform policies to pave the way for the country's EU accession.

(2) Excessive domestic demand will ease following implementation of restrictive measures by the central bank and the government

Bulgaria's real GDP rose 5.6% year-on-year in 2004, with the growth in the October–December quarter accelerating to 6.2%. The GDP growth in 2004 was the fastest since the introduction of CBA in 1996. While monthly economic indicators such as industrial production suggested that the GDP growth slowed in the January-March quarter, domestic demand remained generally strong. The economy is likely to slow in the latter half of 2005, as personal consumption weakens following implementation of restrictive measures by the central bank and the government. A restrictive fiscal policy has been kept in place, with the general government balance in the first four months of 2005 registering a surplus of BGN673 million or 1.6% of GDP. In contrast, the current account deficit in the first quarter of 2004 widened 42% year-on-year to EUR707 million due primarily to a bigger trade deficit. The consumer inflation rate, which soared to 7.6% year-on-year in July 2004 due to temporary factors such as a surge in food prices and a tax increase, slowed down to 4.1% in the first four months of 2005 as the impact of those factors weakened. The unemployment rate remained still high, though it declined to 11.3% in the January–March quarter of 2005, down 2.0 points from the same period of 2004, on economic expansion and a set of measures implemented by the government.

(3) Impact the rejection of the ratification of the EU constitution by France and the Netherlands may have on ratings

The ratification of the EU constitution was rejected in a referendum in France on May 29 and the one in the Netherlands on June 1. At this stage, JCR considers that the rejection by the two countries will have only a limited impact on Bulgaria's ratings. This is because the EU constitution does not question an expansion of the EU but envisages a set of reforms to make EU institutions more effective. Bulgaria signed the Accession Treaty on April 25. Before its actual accession, however, Bulgaria needs to carry out reforms including a combat against corruption as required by the European Commission. Moreover, the treaty must be ratified by all the 25 EU member countries. JCR considers that it is low probability, but the rejection of the EU constitution by France and the Netherlands could lead to the rejection of the Accession Treaty by some member countries. The ratification procedures for the treaty are due to be completed in the course of 2006. In this respect, JCR will closely monitor future developments of the EU constitution.

Main Economic Indicators: The Republic of Bulgaria

		2000	2001	2002	2003	2004	2005 (f)	2006 (f)
Real GDP growth rate	(%)	5.4	4.0	4.8	4.3	5.6	4.8	5.0
CPI (annual average)	(%)	10.3	7.4	5.8	2.3	6.1	4.0	3.5
Unemployment rate	(%)	17.9	17.3	16.8	12.7	11.8	10.9	10.0
General government balance/GDP	(%)	-0.6	-0.6	-0.6	0.0	1.7	-0.5	0.0
General government debt/GDP	(%)	77.1	69.9	55.8	48.0	40.8	33.2	27.7
Current account balance	(EURmn)	-762	-1,101	-926	-1,631	-1,453	-1,415	-1,249
Current account balance/GDP	(%)	-5.6	-7.3	-5.6	-9.3	-7.5	-6.7	-5.4
Trade balance/GDP	(%)	-9.4	-11.7	-10.2	-12.5	-13.9	-12.2	-11.0
Net foreign direct investment	(EURmn)	1,107	915	1,009	1,874	1,133	1,950	1,450
Net foreign direct investment/GDP	(%)	7.9	5.9	5.6	7.0	9.1	9.2	6.3
Foreign exchange reserves (excl. gold)	(EURmn)	3,719	4,061	4,575	5,309	6,770	7,700	8,600
Import (G&S) coverage	(months)	5.3	5.2	5.6	5.7	6.1	6.2	6.2
Forex reserves / ST external debt	(times)	2.4	3.0	2.6	2.3	2.0	1.9	1.8
External debt/GDP	(%)	86.9	78.6	65.1	60.7	63.5	65.0	67.6
External debt/ exports (G&S)	(%)	156.0	147.4	126.1	112.9	109.0	105.9	104.5
External public debt/ exports (G&S)	(%)	129.6	119.7	93.2	75.0	56.5	44.5	34.2
Debt service ratio	(%)	16.6	20.8	16.4	14.1	20.2	16.9	15.4

(Note) Figures for 2005 and 2006 are based on JCR forecast.

(Sources) Bulgarian National Bank, Ministry of Finance

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