Bulgaria
Macroeconomic Situation

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SigmaBleyzer

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Summary

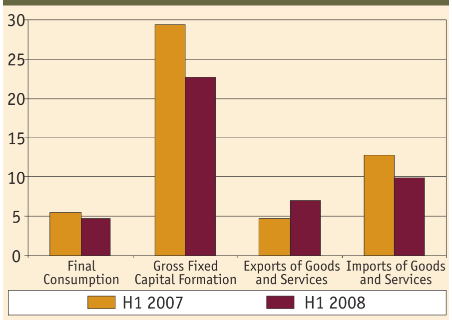
- In the second quarter of 2008, the Bulgarian economy continued to develop rapidly. During this period, GDP increased by 7.1% year over year (yoy). By final use, investments demonstrated the highest pace of growth (28.6% yoy), while agriculture was the leading sector by production (11.7% yoy).
- In January-July 2008, revenues of the Republican budget increased by 23.4% yoy and expenditures grew by 14.6% yoy. The budget surplus reached Lev 3.2 billion, which is 5.3% of projected full-year GDP.
- In July 2007, consumer inflation surged to 1.5% month over month (mom), mainly due to a steep rise in electricity prices. Producer prices grew by 2.3% mom, with the highest increase observed in electricity, water and gas supply.
- In the first half of 2008, the balance of payments was EUR 1,276 million. The current account deficit reached EUR 3,786 million (10.9% of projected full-year GDP) and the fiscal account surplus was 4,705 million (14.3% of GDP).
- In late September 2008, Moody's changed its Bulgaria's outlook from positive to stable. The agency's explanation for this is the country's deteriorating external imbalances, which will be difficult to maintain in an adverse external environment.

Economic Growth

In the second quarter of 2008, GDP growth was 7.1% yoy, which is a slight acceleration (0.1 pp) compared to the first quarter of 2008. By final use, acceleration occurred mainly due to the increasing pace of investments. Gross fixed capital formation grew by an impressive 28.6% yoy, which is almost twice as much as in the first quarter, when investments increased by 15.5% yoy. Meanwhile, final consumption growth remained almost unchanged — this component became larger by 4.8% yoy compared with 4.7% yoy in the first quarter. While individual consumption slightly decelerated (to 5.3% yoy in the second quarter from 5.7% in the first quarter), the growth of collective consumption, which was negative in the first quarter, accelerated and came in slightly above zero. At the same time, the dynamics of external sector components worsened. The pace of export growth decreased (to 5.1% yoy from 9.2% yoy) while import growth accelerated (to 13.7% yoy from 5.8% yoy).

In the first half of 2008, the dynamics of GDP by final consumption compared to that in the same period of the previous year was better by exports and imports but worse by consumption and investment. However, such comparisons are likely to look different at the end of 2008. In particular, investment growth in 2008 has been on an accelerating trend, while the dynamics of the external sector, on the contrary, has been worsening.

GDP by Final Use

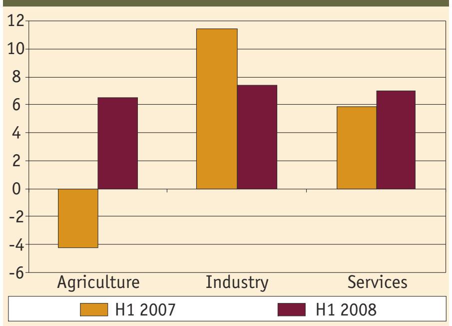


Source: National Statistical Institute

By economic sector, better GDP dynamics in the second quarter of 2008 compared to the first quarter are explained by rapid acceleration in agriculture. Gross value added in this sector increased by 11.7% yoy in the second quarter compared to a decline of 1.6% yoy in the first quarter. Such a considerable acceleration more than compensated for the decreasing pace of growth in industry (7.2% yoy in the second quarter compared to 7.7% yoy in the first quarter) and services (5.8% yoy compared to 8.3% yoy).

Impressive growth in agriculture is explained mainly by very good weather after extremely adverse conditions for the sector in the previous year. In 2008, the crop harvest and yield have been substantially higher than they were in 2007. According to the Ministry of Agriculture and Food, the wheat harvest is 4.5 million tones, twice as high as in 2007, with an average yield of 435 kg/ha, or almost twice that of the previous year. The barley harvest is 0.9 million tons (out of which 0.83 million tons is winter barley) with a yield of 408 kg/ha for winter barley and 297 kg/ha for summer barley.

GDP by Economic Sector



Source: National Statistical Institute

Fiscal Policy

In January-July 2008, the level of execution of the Republican budget for 2008 was 61.6% of revenues and 46.6% by expenditures. At the same time, growth of both revenues and expenditures exceeded the planned rate of 13.1% yoy. Budget revenues grew by 23.4% yoy and expenditures increased by 14.6%. The amount of budget surplus (Lev 3.2 billion) was 2.5 times higher than that planned by the end of 2008.

Tax and non-tax revenues grew by 22.5% yoy and 38.3% yoy respectively in the first seven months of 2008. While tax revenues reached 57.2% of the planned full-year amount by the end of July, non-tax revenues exceeded the projected full-year amount by as much as 3.3%. This happened primarily due to much higher than expected growth of entrepreneurial and property income, which exceeded the planned 2008 amount by 16.3%. Moreover, it is likely that by the end of 2008, all categories of non-tax revenues will be significantly over-executed, since their growth in the first seven months of 2008 was much higher than projected.

Meanwhile, expenditures and transfers increased by 6.8% yoy and 25.6% yoy respectively. The growth of almost all categories of expenditures was significantly lower than projected (except for subsidies, which increased much more rapidly than expected). At the same time, transfers grew fast. Moreover, while transfers to the Social Security Fund and Judiciary grew according to plan, those to municipalities and state education and science institutions increased much more than projected.

The government debt stood at EUR 5,277 million, or 16.7% of projected full year GDP, at the end of June 2008. In June, domestic government debt shrank 3.6% mom, and external government debt increased 0.9% mom. However, since the beginning of 2008, both domestic and external debt decreased significantly, by 6.1% and 8.2% respectively.

Monetary Sector

In January-July 2008, both consumer and producer prices grew rapidly. The consumer price index (CPI) increased by 6.1% year to date (ytd) and the producer price index (PPI) rose by 10.1% ytd. At the same time, growth of these indices in the preceding twelve months was 14.5% yoy and 13.1% yoy respectively.

In July 2008, consumer prices grew by 1.5% mom. Such high price growth is explained mostly by the rise in energy prices, which contributed 1.1 pp to inflation. On July 1st, electricity for households became 14.1% more expensive. Interestingly, since that date, the price for electricity for households, which had been uniform throughout the country, began to differ for the customers of the three electricity distributors, ČEZ, EVN and E.ON, which raised their tariffs by 13.3%, 13.5% and 16.1% respectively.

The other components besides energy that significantly contributed to consumer inflation in July were recreation and culture, restaurants and hotels, and transport (in sum their contribution to the CPI

Where Opportunities Emerge.

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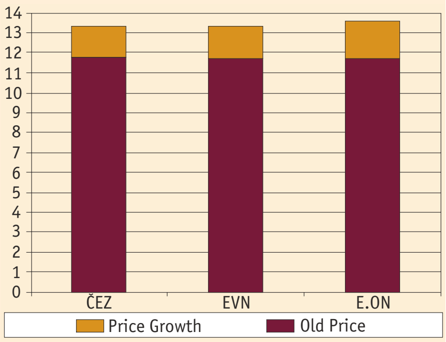
Price of Electric Energy for Households, stotinka for kilowatt-hour



Source: State Energy and Water Regulatory Commission

was 0.4 pp). The prices in the mentioned sectors have been constantly growing since the beginning of the year (in catering due to tightening competition for labor, and in transport because of increasing energy prices).

On a positive note, food deflation, which began in June, continued in July; food prices slipped by 0.2% mom. The other areas in which deflation was observed were clothing and footwear (-0.1% mom), health (-0.9% mom), and communication (-0.3% mom).

PPI increased 2.3% mom in July 2008. The highest price growth, 8.4% mom, occurred in electricity, water and gas supply; in mining, prices increased by 3.0% mom, and in manufacturing they rose by 1.0% mom. Among the mining and manufacturing industries, the most rapid inflation was observed in coal mining (6.6% mom), manufacture of tobacco products (4.6% mom), and manufacture of office machinery and computers (4.3% mom). Deflation occurred in four industries, namely in manufacture of food products and beverages (-0.3% mom), pulp, paper and paper products (-0.2% mom), other transport equipment (-0.2% mom), and other non-metallic mineral products (-0.1% mom).

International Trade and Capital

In the first half of 2008, the current account deficit rose by 31.2% yoy to EUR 3,786 million, or 10.9% of projected full year GDP. This happened due to an increase in the trade deficit, which grew by 31.5% yoy and reached EUR 4,288 million, or 13.1% of GDP. Though exports and imports grew at an almost equal pace (24.6% yoy and 27.0% yoy respectively), in absolute terms imports had a much more significant impact on the trade balance than exports, since its amount has been much bigger than that of exports. In the first half of 2008, the ratio of goods imports to goods exports reached one and a half times.

The financial account increased by 7.4% yoy and stood at EUR 4,705 million, or 14.3% of projected full year GDP. The amount of net foreign direct investment (FDI) was EUR 1,648 million, with FDI into the Bulgarian economy reaching EUR 2,079 million, and FDI coming out of Bulgaria rising to EUR 430 million, or five times as in the same period of the previous year. Liabilities on loans obtained by Bulgarian firms increased one and a half times to EUR 1,680 million. The overall balance, which is the sum of the current and financial accounts and the capital account (whose value was EUR 201 million), rose by 42% yoy to EUR 1,276 million, or 3.9% of GDP. This entire amount was used to increase official reserve assets.

Other Developments and Reforms Affecting the Investment Climate

In late September 2008, Moody's changed Bulgaria's outlook from positive to stable. According to the agency, the reason for this is a high current account deficit and large external debt, which will be difficult to maintain in an adverse global financial environment. Moody's says that external borrowings are going to be problematic for Bulgaria in the near future, due to the cooling of the European economy and growing interest rates. An additional factor was the country's failure to obtain ERM2 status. Its lack means that the likelihood of ECB support in case of a hard landing scenario is reduced.

On a positive note, Moody's says that Bulgaria's investment-grade status is not at risk, for the country has enough potential to counteract negative external developments. Over the past few years it's managed to significantly reduce its government debt and accumulate large fiscal reserves. In addition, EU membership will support high rates of investment and economic growth. Also, Moody's expects that large Bulgarian banks will get assistance from their parent structures if needed. Moody's became the second agency to change the outlook on Bulgaria's ratings in 2008. In January, Fitch decreased its outlook from stable to negative.

Bulgaria's Ratings

Agency	Rating	Date of the last revision or confirmation
Standard&Poor's	BBB+/Stable	29 November 2006
Moody's	Baa3/Stable	25 September 2008
Fitch	BBB/Negative	15 August 2008

Source: Cbonds.Info