SigmaBleyzer

Bulgaria
Macroeconomic Situation

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Summary

- In Q1 2007, Bulgaria posted robust economic growth. By the end of March, industry expanded 9.8% yoy underpinned by particularly strong performance of the manufacturing sector.
- In March, the consolidated budget achieved a surplus of EUR 275 million (Lev 539 million) compared to a deficit of EUR 10 million (Lev 19.9 million) in February. The fiscal reserve of the government increased to EUR 2.9 billion (Lev 5.67 billion) from EUR 2.6 billion (Lev 5.12 billion) in February.
- Consumer price inflation (CPI) accelerated slightly to 4.2% yoy[1] in April, which was a substantial deceleration as compared to 8.1% yoy growth in April 2006.
- In Q1 2007, the current account (CA) deficit widened to EUR 1.5 billion (5.6% of GDP) as compared to EUR 1.1 billion (4.4% of GDP) for the same period in 2006. The financial account posted a surplus of EUR 0.65 in March and EUR 1.55 in Q1 2007.
- Net foreign direct investment (FDI) inflow accelerated 6.6% yoy to EUR 0.3 billion in March.
- In March, the BNB reserve assets increased by EUR 0.48 billion to EUR 9 billion.

Economic Growth

The National Statistical Institute (NSI) restated real GDP growth rates for 2002–2006 after revision of its methodology for GDP calculation. The NSI revision was caused by new methodology for indirectly estimated services of financial intermediaries (FISIM) and Bulgarian National Bank (BNB) adjustments of data on foreign trade. The released GDP data shows that the real GDP growth rate slightly decelerated to 6.1% in 2006 from 6.2% in 2005 (revised from 5.5%) and 6.6% in 2004 (revised from 5.6%).

Real GDP Break down (%, yoy)

	2002	2003	2004	2005	2006*
GDP	**4.5**	**5.0**	**6.6**	**6.2**	**6.1**
Consumption	4.2	5.9	5.4	5.3	6.5
Investment	8.5	13.9	13.5	23.3	17.6
Exports	8.1	10.7	12.7	8.5	9
Imports	5.0	16.4	14.5	13.1	15.2
By sector					
Agriculture	4.7	-2.3	2.3	-9.5	-1.9
Industry	4.7	5.7	4.1	4.8	8.3
Services	5.9	4.7	5.7	8.2	6.1

*Preliminary data by National Statistical Institute

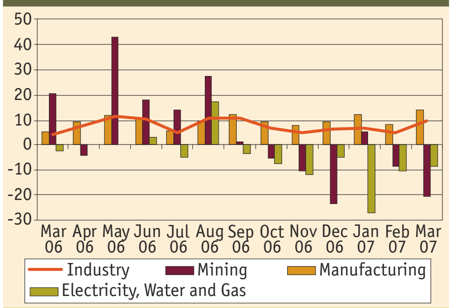
In 2006, investment expressed by gross capital formation reached EUR 15.7 billion (EUR 8 billion) or 31.9% of GDP as compared to 28% of GDP a year earlier. Investment continued to be the fastest growing component of GDP (with a growth rate of 17.6% yoy) despite the moderate slow down from 23.3% yoy growth in 2005. Consumption grew at 6.5% yoy and reached Lev 42.5 billion (EUR 21.7 billion). The increase in consumption is driven primarily by individual consumption, which surged 7.1% yoy; its share in total consumption is 89%. The share of final consumption in GDP decreased slightly to 86.6% from 88.2% in 2005.

Underpinned by robust investment and consumption growth, industry and services expanded 8.3% yoy and 6.1% yoy respectively. The share of industry in GDP increased to 25.6% from 24.2% in 2005. The services sector slightly decreased its share in GDP to 48.8% from 50.4% in 2005. The services sector has the greatest share in Gross Value Added (60% in 2006, down from 61.2% in 2005). The industry contribution to value added increased to 31.4% from 29.4% in 2005.

The agricultural sector decreased for the second year in a row. The 9.5% yoy drop in 2005 and further decline of 1.9% yoy in 2006 is the result of insufficient investments, small agricultural land parcels and undeveloped agricultural distribution infrastructure as well as unfavorable weather conditions in 2005. The agricultural contribution to value added is down to 8.6% (9.4% in 2005).

In 2007, the government forecasts a further deceleration of GDP growth to 5.8%. The GDP growth rate is forecasted to recover to 6.45% in 2009 driven by sustained high growth of investment and consumption.

Index of Industrial Sales by Sector, % yoy



Source: National Statistical Institute

In February-March 2007, industry expanded by 5%[2] yoy and 9.8%[3] yoy respectively. Industry performance was particularly strong in March when industry sales surged 17% mom. On an annual basis, industrial production surged at a slightly slower rate of 8.7% yoy. Manufacturing growth is a major factor of industry expansion. Manufacturing grew 14.7% yoy in February and 13.7% yoy in March. Manufacturers' sales kept up with production, posting a growth of 8.1% yoy in February and 13.6% yoy in March. The industry sectors of tobacco, furniture, mineral products, fabricated metals, textile, food and beverages performed strongly with annual sales growth rates 39%, 35%, 34%, 29%, 26% and 20% respectively. Both mining and utilities showed a decline in sales and production. Mining sector sales dropped 8% yoy in February and 20.4% yoy in March as a result of the steep decline in sales of metal ores (29.9% yoy). On a positive note, mining sector sales increased 4.7% mom in March. Utilities sector sales declined 10.2% yoy in February and 8.1% yoy in March due to warmer weather and reduced power generation capacities.

The NSI released final data on retail and wholesale trade for January and February 2007. Retail trade expanded 11.6% yoy in January, 10.2% yoy in February, and 13.4% yoy in March (preliminary data). Wholesale trade steadily increased 3.3% yoy in January, 3.6% yoy in February and 5.2% yoy in March. Electrical appliances posted the strongest retail sales growth of 21.3% yoy. The wide margin between retail and wholesale growth rates is a result of the structural changes of trade. The direct sales through large chains of supermarkets and department stores grew faster than retail sales in small shops.

Despite the strong performance of industry and trade, in the April NSI survey, the business climate indicator (BCI) decreased 0.3% percentage points (pps) from a 13-year high of 50.7%. The BCI in construction and industry increased 1% and 1.3% as compared to March, while BCI in retail trade and services fell 3% and 1.5%. Managers from all sectors confirmed their optimistic assessment of the economic situation.

Fiscal Policy

In March, the fiscal reserve of the government increased to EUR 2.9 billion (Lev 5.67 billion) from EUR 2.6 billion (Lev 5.12 billion) a month earlier. The government continues to pursue its fiscal objective of budget surplus at 2% of GDP in 2007. The current level of fiscal reserve is above the threshold of EUR 1.84 billion (Lev 3.6 billion) set in the budget law for 2007. The stock of fiscal reserve is forecasted to grow at a fast pace in the forthcoming months as a result of seasonal factors, changes in tax policies and strong fiscal revenue performance shown in the first quarter 2007.

The consolidated budget achieved a surplus of EUR 275 million (Lev 539 million) in March compared to a deficit of EUR 10 million (Lev 19.9 million) in February. The first quarter consolidated budget surplus accounts for 1% of the projected full-year GDP. The revenue growth accelerated to 15.4% yoy up from 6.8% yoy growth in January-February despite a reduced corporate profit tax, an increased personal income tax-free threshold and lower custom duties. The Q1 tax revenue increased to EUR 2.12 billion (Lev 4.15 billion), which is 82% of the total revenue of EUR 2.58 billion (Lev 5.05 billion). On an annual basis, tax revenues are up 12.2% as compared to 1.9% in January-February. Income tax related duties and insurance contributions performed strongly while VAT revenue is down by 7.2% yoy due to VAT payment delays (45 days) on imports. The budget revenue growth is forecasted to accelerate further as a result of strong consumer demand and improved VAT performance on imports.

[1] Preliminary statistics by NSI

[2] Revised statistics by NSI

[3] Preliminary statistics by NSI

Where Opportunities Emerge.

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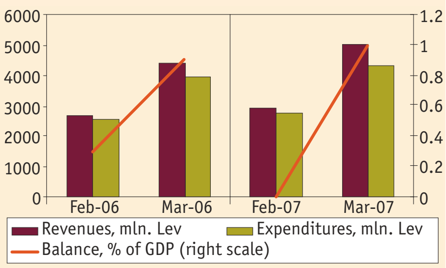
The first quarter expenditures of the consolidated budget amounted to EUR 2.26 billion (Lev 4.33 billion), an increase of 9.8% yoy. The consolidated national budget allocated EUR 0.89 billion (Lev 1.74 billion) to social expenditures and EUR 0.19 billion (Lev 0.38 billion) to capital expenditures according to the national strategy of social sector and infrastructure development. Social expenditures account for 40% of all budget allocations. Capital expenditures increased 48% yoy as a result of government commitments to improve infrastructure in the country. Wages and salaries and maintenance allocations increased to EUR 0.34 billion (Lev 0.65 billion) and EUR 0.42 billion (Lev 0.83 billion), with growth rates of 9% yoy and 6.9% yoy respectively.

Consolidated Budget Flows



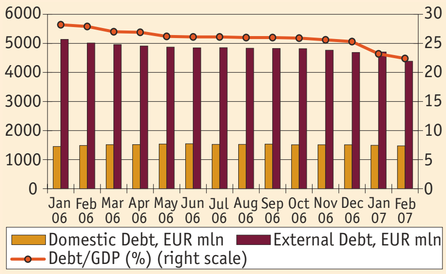
Source: Bulgarian Ministry of Finance

According to the Debt Management Strategy, the government continues strict debt level monitoring and reduction of public debt and service costs. The stock of public and publicly guaranteed debt dropped 5% mom to EUR 5.86 billion in February due to payments of EUR 320 million of external and Lev 111.8 million (EUR 57.2 million) of domestic debt. In March, public debt is expected to decrease further due to the planned repayment of the entire outstanding debt of EUR 230 million to International Monetary Fund (IMF).

The debt to GDP ratio fell to 22.4% in February, down by 1.3 pps from January's level. Domestic and external debt to GDP stood at 5.6% and 16.8% respectively. The government accumulated fiscal reserve covers 44% of public and government guaranteed debt. External debt amounted to EUR 4.39 billion, including EUR 3.84 billion in government debt and EUR 0.55 billion in government guaranteed debt. Domestic and external debt shares in the public debt structure were 25.2% and 74.9%. Euro denominated debt changed slightly to 50.9% and debt in US dollars reached 21.9%, while Bulgarian Lev debt was 18.3% and 8.9% in other currencies. In the debt interest structure, fixed interest rate debt was 66.2% and debt with floating interest rates was 33.8%. In the structure of external debt, the share of Eurobonds was 30.7%, government securities 25.1%, obligations to the World Bank 13.4%, government investment loans and guaranteed debt 19.3%.

Gross external debt decreased by EUR 376.8 million to EUR 19.3 billion (72.2% of GDP) as of the end of January. Long-term liabilities accounted for 70.9% of total external debt. Gross external debt service was EUR 684.2 million (2.6% of GDP). External borrowing is expected to increase after the national bank abolished credit restrictions on January 1, 2007.

Dynamics of Domestic and External Public and Publicly Guaranteed Debt



Source: Bulgarian National Bank

Monetary Sector

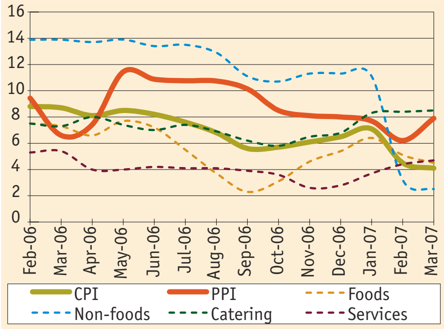
After two months of deceleration, consumer price inflation (CPI) accelerated slightly to 4.2% yoy[4] in April, a substantial deceleration as compared to 8.1% yoy growth in April 2006. The consumer prices as measured by CPI increased 2.3% from the start of the year. In March, CPI showed a disinflation of 0.1% mom and 0.5% mom growth in April. Consumer prices in catering and services predictably grew at a faster pace than in other sectors as a result of their adjustments to EU average levels. In March-April, prices in services and catering sectors grew by 0.5% and 0.4% each month while prices in food and non-food sectors decreased 0.4% and 0.2% in March and increased 0.5% and 0.4% in April. The decrease in average customs tariffs, liberalized access of 3rd countries' importers of agricultural products to the Bulgarian market and increased competition will continue to exert downward pressure on prices in food and non-food sectors.

The harmonized index of consumer prices (HICP), calculated on the basis of consumer weights and standardized product groups of EU countries, increased 4.4% yoy in April (4.4% in March). The difference between HICP and the national CPI is attributed to the larger weights of catering and services in the consumer basket of the EU.

The deceleration of inflation is a government priority since the country complies with all Maastricht criteria except price stability. The National Bank inflation target for 2007 is set at 4.4%.

In March, producer prices measured by the producers' price index (PPI) increased 7.9% yoy from 6.2% yoy in February. The producers' prices for the domestic market grew 1.4% mom as compared to 0.1% mom growth in the prior month. The acceleration of producer prices is driven mostly by the mining sector where PPI advanced 22.8% yoy as compared to 14.9% yoy in February. The price growth in manufacturing and utilities sectors accelerated moderately to 5.3% yoy and 10.3% yoy driven by price hikes of chemical products (29.2% yoy), metals (17.5% yoy) and electricity (18% yoy). After a slowdown in February and March, consumer prices slightly increased in April, in part due to a lagged effect of PPI growth in March.

Changes in CPI, PPI and CPI major components in 2006-2007 (yoy)



Source: Bulgarian National Statistical Institute

In March, the monetary base and money supply grew by 1.27% mom and 2% mom respectively. Broad money (M3) reached EUR 16.75 billion (Lev 32.76 billion) and narrow money (M1) increased to EUR 8.32 billion (Lev 16.27 billion). On an annual basis, the growth of money supply is 28.2% as compared to 27.8% in the prior month. The money supply multiplier was 3.17 versus 3.14 in February. The ratio of money supply to GDP increased to 62.7%. The deposits with a maturity of up to 2 years grew by EUR 164.8 million (Lev 322.3 million) to EUR 6.92 billion (Lev 13.54 billion), posting an annual growth rate of 25.1% (23.1% in February). The deposits redeemable at notice of up to 3 months increased by EUR 28 million (Lev 54.8 million) to EUR 1.49 billion (Lev 2.9 billion), up 24.5% yoy. The fastest growing component of the money supply was overnight deposits, which had a growth rate of 42.7% yoy, down from 45.1% yoy in February. Overnight deposits reached EUR 5.3 billion (Lev 10.36 billion). Deposits in foreign currencies constituted 46.1% of all deposits, up from 45.7% a month earlier.

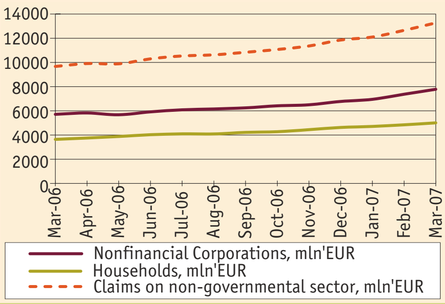
The Bulgarian National Bank increased its base interest rate to 3.68% p.a. in April and 3.81% p.a. in May.

In March, claims on the non-government sector grew by EUR 0.57 billion (Lev 1.12 billion) and amounted to EUR 13.27 billion (Lev 25.95 billion), which is an increase of 36.6% yoy (31.1% yoy in January). The share of claims in foreign currency is 47%. Loans to non- financial corporations surged 37.5% yoy in contrast to 29.6% yoy in February. The monthly increase in loans to non-financial cor-

[4] Preliminary statistics by NSI

porations is 0.41 EUR billion (Lev 0.8 billion), which is 5.6% mom. Loans to households posted a slower growth of 37.5% yoy (31.8% yoy in February) and reached EUR 5 billion (Lev 9.79 billion).

Growth of Loans to Nonfinancial Corporations and Households, 2006–2007

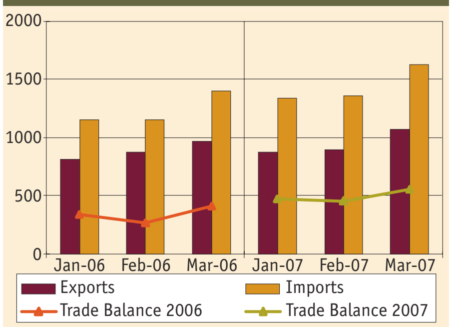


Source: Bulgarian National Bank

International Trade and Capital

In March, the trade deficit widened to EUR 0.55 billion (Lev 1.09 billion) driven by strong private consumption, up from a EUR 0.46 billion (Lev 0.89 billion) trade deficit in February. In Q1 2007, the annual deterioration in the trade deficit was 43.4%, although the deficit expanded 31.8% yoy in March. Imports continue to grow faster than exports, posting 16.4% yoy growth, while exports advanced 9.7% yoy. On a positive note, export growth accelerated 7.1 pps from 2.6% yoy growth in February.

Balance of Trade in Goods, EUR million



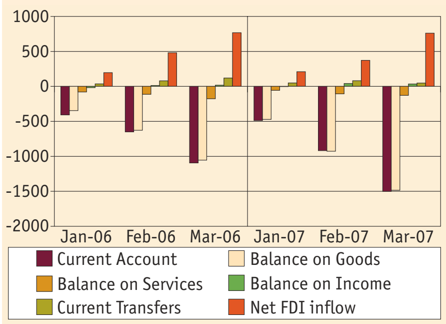
Source: Bulgarian National Statistical Institute

Bulgaria exported EUR 1.07 billion worth of goods in March as compared to EUR 0.9 billion in February. Imports reached EUR 1.63 billion in March (EUR 1.36 billion in February). The EU is the largest trading partner with respective shares of 60.8% and 65% in total imports and exports. The largest non-EU export markets are Turkey (31.7%), Serbia (9.4%), Russia (6.7%), the USA (6.3%) and Macedonia (5.4%) with a 60.5% share of total non-EU exports. More than two-thirds of the country's non-EU imports came from Russia (31.7%), Turkey (17.5%), Ukraine (13.5%) and China (6.8%). As opposed to trade with EU countries, Q1 export and import to non-EU countries dropped 3.5% yoy and 1% yoy (CIF) respectively[5].

The data on foreign trade will be substantially revised. As of January 1, the trade data with EU countries is reported in accordance with the INTRASTAT requirements. Since such statistics are now based on INTRASTAT declarations submitted to the National Revenue Agency and not the customs' declarations, the current data is not complete.

In Q1 2007, the current account (CA) deficit widened to EUR 1.5 billion (5.6% of GDP) as compared to EUR 1.1 billion (4.4% of GDP) for the same period in 2006. In March, the CA deficit expanded by EUR 0.51 billion (EUR 0.43 billion in February) due to the trade deficit in goods and services. The financial account posted a surplus of EUR 0.65 billion in March and EUR 1.55 billion in Q1 2007. Net foreign direct investment (FDI) inflow accelerated 6.6% yoy to EUR 0.3 billion in March. According to preliminary data, FDI amounted to EUR 0.77 billion (2.9% of GDP) in Q1 2007, down from EUR 0.79 billion (3.1% of GDP) in Q1 2006. In March, net FDI covered 59% of the current account deficit. The Bulgarian government forecasts continued growth in net FDI inflows to EUR 2.7 billion in 2007 (11.8% of GDP) due to a favorable investment climate, predictable macroeconomic environment and transparent legislation.

Current Account Components and Net FDI Inflow, EUR millionn



Source: Bulgarian National Bank, The Bleyzer Foundation

In March, the BNB reserve assets increased by EUR 0.48 billion to EUR 9 billion as opposed to a decrease of EUR 0.43 billion in January-February 2007. The reserve assets grew 28% yoy due to external debt financing and net FDI inflows.

International Programs

The Ministry of Finance made the last payment of SDR 204.8 million (EUR 230 million) under the 3 year Extended Agreement with the IMF signed on September 25, 1998. The IMF Executive Board successfully completed the final review of the country's performance under the precautionary Stand-by Arrangement (SBA) for the period from August 6, 2004 to March 31, 2007. In the letter of intent, the government announced that it does not plan to enter into a successor arrangement, and cooperation with IMF will continue on a general basis.

Other Developments and Reforms Affecting the Investment Climate

The unemployment rate dropped further in March to 8.92% as compared to 9.48% in February, and it is expected to drop further as a result of a seasonal demand increase in tourist, agricultural, and construction sectors.

The privatization agency signed a EUR 85.1 million contract with Holding Slavenske Elektrarne for the sale of the RUSE power plant in the city of Ruse. The deal is yet to be confirmed by the supervisory board of the privatization agency. The Slovene company won the privatization tender in December 2006. Two other tender participants were France's Dalkia International and Germany's E.ON.

The Council of Ministers authorized the regional minister to sign the concession agreement for completion and rehabilitation of the 443 kilometer highway. The construction works will be financed by three private equity investors from Portugal, which received a 51% stake in a public-private consortium. The investment in new construction is estimated at EUR 590 million. The project is to be completed in 3 years. The Cabinet of Ministers is expected to approve the concession by June 30, 2007.

The Greek parliament ratified the agreement on the Burgas-Alexandroupolis oil pipeline project. This 280-kilometre oil pipeline will transport the crude oil from the Bulgarian Black Sea port of Burgas to the Greek Aegean Sea port of Alexandroupolis. The project is estimated at EUR 783 million and expected to start in the first quarter of 2008. Bulgarian and Greek companies will hold stakes of 24.5% each while Russian firms will control 51% in the project. The Bulgarian parliament is expected to ratify the agreement next month.

Moody's released a report on the Baltic countries (Estonia, Latvia, and Lithuania), Bulgaria and Romania. According to the agency report, Bulgaria is to experience hard convergence but it will not negatively affect its long-term credit rating. Low public debt, significant improvements and reforms, a stable banking system and transparent regulatory mechanisms will support Bulgaria's creditworthiness in the long run. The effects of potential external shocks on the balance of payments are seen to have a minor influence on the country's economy.

[5] Data is preliminary by NSI