Bulgaria

Macroeconomic Situation

June 2007

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Summary

- The EU projected 6.1% economic growth in Bulgaria in 2007 and 6.2% in 2008.
- Industry sales showed robust growth of 9.7% yoy in April, driven by the surge of sales in mining and utilities.
- In April, the government's fiscal reserves increased to EUR 3 billion (Lev 5.88 billion) from EUR 2.9 billion (Lev 5.67 billion) in March.
- The consolidated national budget achieved a surplus of EUR 649 million (Lev 1.27 billion) in April, a sharp increase from the surplus of EUR 275 million (Lev 539 million) in March.
- Government and government guaranteed debt decreased by EUR 270 million to EUR 5.59 billion, while gross external debt increased to EUR 20.5 billion (76.7% of GDP) at the end of April.
- In May, consumer prices as measured by the CPI increased 4.3% yoy, a considerable deceleration compared to the 8.5% yoy growth in May 2006.
- In January-April, the current account (CA) deficit widened to EUR 2.14 billion (8% of GDP) compared to EUR 1.5 billion for the same period in 2006. Net foreign direct investment (FDI) covered 51% of the current account deficit.

Economic Growth

The EU released its spring forecast on economic growth in Bulgaria. Growth is projected at 6.1% in 2007 and 6.2% in 2008. According to the EU report, there are no threats for export potential due to productivity gains offsetting wage pressures. Labor productivity is expected to "accelerate steadily from around 3.5% in 2005 to 5% in 2008" as a result of economic restructuring and increases in investments. The European Commission projections are shown below:

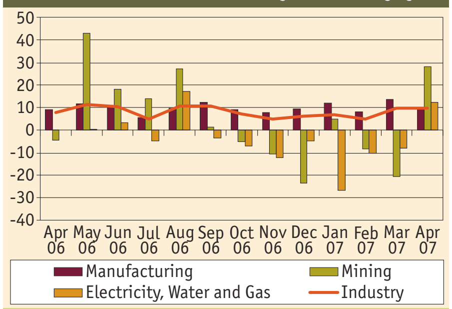
The European Commission Projections

	2007	2008
GDP (%, yoy)	6.1	6.2
HICP (year-average,%)	4.2	4.3
Unemployment (year-average, %)	8.2	7.4
Current Account Balance (% of GDP)	–16.6	–17.2
General Budget Surplus (% of GDP)	2.0	2.0
Public Debt (% of GDP)	20.9	19.0

Source: European Commission

Industrial sales showed robust growth of 9.7% yoy in April according to preliminary data from the Statistical Committee. After a surge of industrial sales by 17% mom in March, in April industrial sales decreased 6.3% mom as a result of slower sales in manufacturing and utilities, which decreased 7.1% mom and 5.4% mom. On an annual basis, sales in manufacturing expanded by 9.2%, by 12.5% in utilities and by 28.1% in mining (after a contraction by 20.6% in March.) Industrial production grew at a faster rate of 11.2% yoy due to faster growth in utilities, which posted 21.3% yoy growth. Manufacturing, food products, fabricated metals, mineral products, furniture and textiles are major contributors to the growth of industrial sales. In the mining sector, the sharp changes in sales and production are explained by fluctuations in external demand and world prices, while the utilities sector is highly dependent on weather-dependent energy demand.

Index of Industrial Sales by Sector, % yoy



Source: National Statistical Institute

Retail trade grew by 10.6% yoy, while wholesale trade increased 4.2% yoy in January-April 2007. The wide margin between retail and wholesale growth rates is a result of the structural changes of trade. Direct sales through large chains of supermarkets and department stores grew faster than retail sales in small shops. In April, the sales of electrical household appliances and food posted the strongest growth rates of 9.6% yoy and 9.7% yoy respectively.

In agriculture, the Association of Agricultural Producers forecasted an output loss of EUR 256 million (Lev 500 million) due to a severe drought. However, the agricultural ministry does not confirm these projections.

The prospects for economic growth remain favorable. Despite a slight drop of 0.8 pps mom to 49.6% in May, the composite business sentiment indicator is just 1.1 pps below its 13 year high of 50.7%. The composite business climate indicator in industry reached a new high of 51% since 1994 due to managers' improved expectations of orders from the domestic market. Managers in the construction industry were optimistic regarding the present and expected activity (the business climate indicator increased 1.4 pps mom). In retail and service sectors, the economic climate remains favorable despite a moderate decrease of 4.9 pps mom and 4.5 pps mom, respectively, in managers' assessment of the business situation.

Fiscal Policy

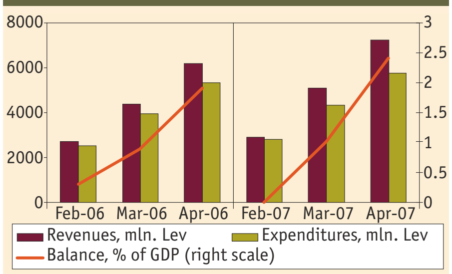
In April, the government's fiscal reserve increased to EUR 3 billion (Lev 5.88 billion) from EUR 2.9 billion (Lev 5.67 billion) a month earlier. The fiscal reserve is above the government target of 2% of projected full year GDP. As a result of the government's restrictive fiscal policy, the full year surplus is forecasted to reach 5% of GDP. The government fiscal reserve covers 54% of government and government guaranteed debt.

The consolidated budget achieved a surplus of EUR 649 million (Lev 1.27 billion) in April, a sharp increase as compared to a surplus of EUR 275 million (Lev 539 million) in March. The revenue growth accelerated to 17.5% yoy up from 15.4% yoy growth in January-March. Consolidated fiscal revenue reached EUR 3.71 billion (Lev 7.26 billion). Tax and social insurance revenues performed better than expected. Tax revenue grew 17.1% yoy and reached EUR 3.01 billion (Lev 5.9 billion). The revenue growth was driven by individual and corporate tax collections. Despite a decrease in the tax rate, corporate profit tax revenue reached 66% of the full year projection in 4 months. In April, VAT revenues recovered to the previous year's level after a 7.2% yoy drop in March due to the 45 day delay in VAT payment on imports from the EU. Non-tax revenue increased 20% yoy to EUR 625 million (Lev 1.22 billion).

According to the National Revenue Agency (NRA) chief Maria Murgina, strong budget performance creates good opportunities for further reduction of direct taxes and social insurance contributions. In the second half of the year, the overall burden of mandatory pension insurance contributions may be reduced by 3% of gross personal income.

Consolidated budget expenditures amounted to EUR 2.95 billion (Lev 5.77 billion), an increase of 9.8% yoy. In January-April, social expenditures accounted for 40.7% of all budget allocations. The consolidated national budget allocated EUR 1.2 billion (Lev 2.35 billion) to social expenditures and EUR 0.28 billion (Lev 0.55 billion) to capital expenditures according to the national strategy of social sector and infrastructure development. Wages and salaries and maintenance allocations increased to EUR 0.45 billion (Lev 0.89 billion) and EUR 0.57 billion (Lev 1.12 billion), with growth rates of 9.3% yoy and 3.1% yoy respectively.

Consolidated Budget Flows



Source: Bulgarian Ministry of Finance

The government continues to implement its Debt Management Strategy aimed at reducing public debt and service costs. In April, government and government guaranteed debt decreased to EUR 5.59 billion, a decrease of EUR 270 million as compared to a month earlier. The debt to GDP ratio fell to 21.4%. External debt dropped to EUR 4.07 billion as compared to EUR 4.24 billion in March. The share of external debt in government and government guaranteed debt is 72.9%. Domestic public debt increased by EUR 8 million to EUR 1.51 billion. In the debt interest structure, fixed interest rate debt increased to 69.2% and debt with floating interest rates dropped to 30.8%. In the structure of exter-

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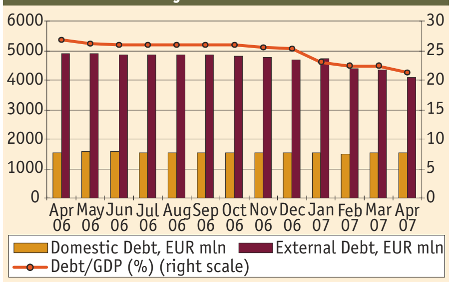
nal debt, the share of Eurobonds increased to 31.6%, government securities increased to 27.1%, obligations to the World Bank were 14% and government investment loans and guaranteed debt were 19.9%.

Gross external debt increased to EUR 20.5 billion (76.7% of GDP) as of the end of April. In January-March, external debt surged by EUR 836 million (4.3%). Long-term liabilities accounted for 67.4% of total external debt. Gross external debt service reached EUR 1.95 billion by the end of April (7.3% of GDP). Private sector external debt continues to grow rapidly. In January-April, intercompany lending increased by EUR 487 million (8.7%) to EUR 6.08 billion, external liabilities in the banking sector increased by EUR 299 million (8.9%) to EUR 3.68 billion, and private sector debts surged by 594 million (8.5%) to EUR 7.62 billion.

Dynamics of Domestic and External Public and Publicly Guaranteed Debt



Source: Ministry of Finance

Monetary Sector

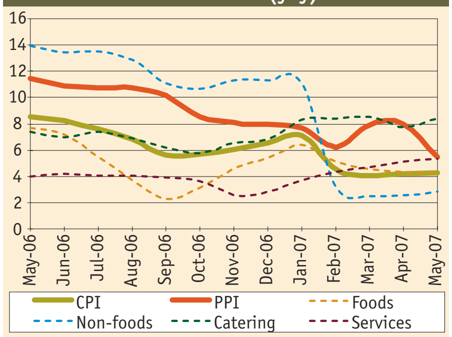
In May, consumer prices as measured by the CPI increased 4.3%[1] yoy, a considerable deceleration as compared to 8.5% yoy growth in May 2006. Since the start of the year, the CPI has grown 2.4%. Year-end CPI is expected to reach 3.7% in 2007 and decelerate to 2.9% in 2009. The National Bank inflation target for 2007 is set at 4.4%. The country is expected to accommodate the ERM-2 currency mechanism in the middle of the year and meet the Maastricht price criterion in 2009. The Bulgarian Central Bank strategy is to maintain the present exchange rate peg of Lev 1.95583 for EUR 1 and adopt the EU single currency in the middle run.

Consumer prices in catering and services predictably grew at a faster rate than in other sectors as a result of their adjustments to EU average levels. In May, prices in services and catering grew 5.3% yoy and 8.4% yoy, while prices in food and non-food sectors grew 4.3% yoy and 2.8% yoy. On a monthly basis, food prices decelerated 0.6%, while prices in non-food, catering and services advanced 0.6%, 0.7% and 0.3% respectively.

The harmonized index of consumer prices (HICP), calculated on the basis of consumer weights and standardized product groups of EU countries, increased 4.5% yoy in May (4.4% in April). The difference between HICP and the national CPI is attributed to the larger weight of catering and services in the consumer basket of the EU.

In May, producer prices measured by the producers' price index (PPI) increased 5.5% yoy, down from 8% yoy growth in April. The producers' prices for the domestic market grew 0.7% mom as compared to 1.9% mom growth in the prior month. The deceleration of producer prices is driven by mining and manufacturing sectors where PPI advanced 5% yoy (17.7% yoy in April) and 4% yoy (6% yoy in April). Prices in the utilities sector posted 0.2% mom growth, pushing PPI to 10.4% yoy growth.

Changes in CPI, PPI and CPI Major Components in 2006–2007 (yoy)



Source: Bulgarian National Statistical Institute

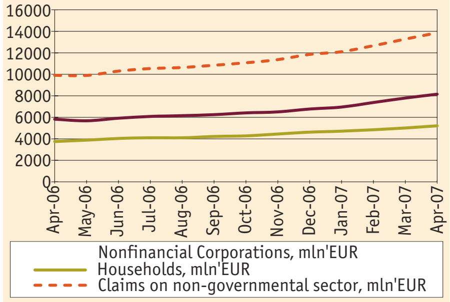
In April, the monetary base and money supply grew by 2.1% mom and 1.9% mom respectively. Broad money (M3) reached EUR 17.07 billion (Lev 33.38 billion) and narrow money (M1) increased to EUR 8.39 billion (Lev 16.42 billion). On an annual basis, the growth of the money supply is 29.5% as compared to 28.2% in the prior month. The money supply multiplier was 3.16 versus 3.17 in March. The ratio of money supply to GDP increased to 63.9%. Deposits with a maturity of up to 2 years grew by EUR 231.2 million (Lev 452.3 million) to EUR 7.16 billion (Lev 14 billion), posting an annual growth rate of 27.4% (25.1% in March). Deposits redeemable at notice of up to 3 months increased by EUR 11.84 million (Lev 23.1 million) to EUR 1.5 billion (Lev 2.93 billion), up 25.5% yoy.

Overnight deposits decreased by EUR 21 million (Lev 41 million) to EUR 5.27 billion (Lev 10.32 billion). On an annual basis, overnight deposits grew 42.5%, down from 42.7% in March. The share of deposits in foreign currencies was 46.1% of all deposits, unchanged from a month earlier.

The Bulgarian National Bank increased its base interest rate to 3.81% p.a. in May and 3.84% p.a. in June.

In April, claims on the non-government sector grew by EUR 0.58 billion (Lev 1.14 billion) and amounted to EUR 13.85 billion (Lev 27.09 billion), which is an increase of 39.3% yoy (36.6% yoy in March). The share of claims in foreign currency increased to 47.4% from 47.1% in the prior month. Loans to non-financial corporations reached EUR 8.15 billion (Lev 15.94 billion), up 39.9% yoy. The monthly increase in loans to non-financial corporations is EUR 363 million (Lev 710 million), which is 4.7% mom growth. Loans to households amounted to EUR 5.2 billion (Lev 10.18 billion), up 38.8% yoy. The monthly growth in household loans is EUR 201 million (Lev 393 million) or 4% mom.

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

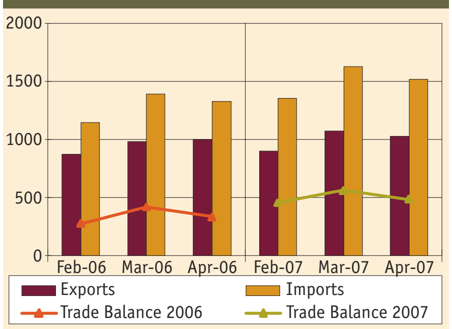


Source: Bulgarian National Bank

International Trade and Capital

The trade deficit shrank to EUR 487 million (Lev 954 million) in April as compared to EUR 559 million (Lev 1094 million) in March according to customs' reports for non-EU countries and incomplete INTRASTAT files for EU states. In January-April, the trade deficit reached EUR 2.07 billion (Lev 4.05 billion), a growth of 51.9% yoy. In April, the trade deficit increased to 7.8% of GDP. Imports continue to grow faster than exports, posting 17.3% yoy growth in April. On a positive note, imports growth decelerated for the fourth month in a row from 25.2% yoy in January 2006 to 20.2% yoy in February and 18.7% yoy in March. Despite lost opportunities in the energy sector and unfavorable price dynamics for non-ferrous metals, exports grew 5.4% yoy in April.

Balance of Trade in Goods, EUR million



Source: Bulgarian National Statistical Institute

[1] Preliminary statistics by the NSI.

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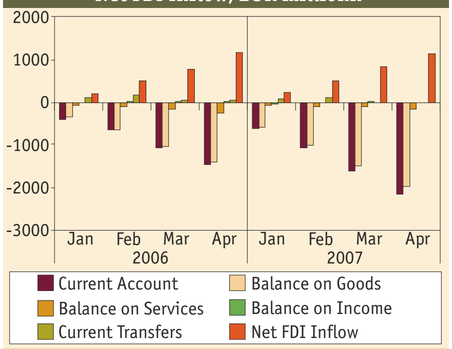
Bulgaria exported EUR 1.26 billion worth of goods in April, EUR 43 million less than in March. Monthly imports decreased by EUR 115 million to EUR 1.51 billion. The EU is the largest trading partner with respective shares of 60.7% and 63.4% in total imports and exports[2].

According to revised monthly data for 2007, the current account (CA) deficit widened to EUR 2.14 billion (8% of GDP) in January-April as compared to EUR 1.5 billion for the same period in 2006. In April, the CA deficit increased slightly to EUR 531 million (EUR 512 million in March) due to a large trade deficit in goods and services. Net foreign direct investment (FDI) covered 51% of the current account deficit. In January-April, FDI amounted to EUR 1.15 billion (4.3% of GDP) compared to EUR 1.16 billion (4.6% of GDP) for the same period last year. Attracted equity capital reached EUR 800 million as compared to EUR 513 million in the same period last year. Receipts from real estate sales to nonresidents grew sharply to EUR 468 million, the largest share in equity investments. The share of equity capital in FDI was 69.3%. The financial account posted a surplus of EUR 286 million in April and EUR 2.05 billion in January-April 2007. 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

In April, the Bulgarian National Bank (BNB) reserve assets dropped by EUR 192 million to EUR 9.17 billion. The reserve assets grew 24.98% yoy due to external debt financing and net FDI inflows.

International Programs

The National Assembly approved a resolution that allows the government to sign a EUR 280 million loan agreement with the European Investment Bank (EIB). The EIB loan will be used for development of road infrastructure on national and cross-border routes in accordance with the government 7-year plan for infrastructural development from 2007 to 2013. The government plan includes rehabilitation of 1,517 kilometers of roads to be financed by private-public partnerships. The EIB will provide up to EUR 500 million for infrastructure projects in 2007–2008.

Other Developments and Reforms Affecting the Investment Climate

The basic unemployment rate dropped to 8.38% as of the end of April. Strong economic growth and increasing seasonal demand improve employment opportunities. The jobless ratio might reach an all time low of about 7% in the summer months.

The government approved changes to the wage regulations that govern state and municipal enterprises. As a result of these changes, enterprises will be able to raise salaries even if they are not profitable. This change was triggered by the public transportation company employees' intention to carry out a strike to fight wage constraints if their demands were not met. Four ministers of the ruling coalition from the National Movement Simeon II (NMS-II) party protested the changes, but confirmed that the unity of the coalition will not be affected.

After 7 years of delays, the Prime Minister Sergei Stanishev officially started construction works for the second bridge across the Danube River to connect the Bulgarian city of Vidin and the Romanian city Calafat. Currently, there is only one bridge across the Danube river on the 470 kilometer border between Bulgaria and Romania. The cost of building the bridge and related infrastructure is estimated at EUR 236 million. The construction work will be performed by FCC CONTRUCCION, S.A., a Spanish company that won the tender for this work.

The National Assembly ratified two intergovernmental agreements for construction of oil pipelines from the Bulgarian coast to Greek and Albania ports. The new pipelines will be built as alternative oil transportation routes to the Bosphorus and Dardanelles Straits. One of the pipelines is designed to transport Caspian oil from the port of Pomorie near the city of Burgas to the Adriatic port of Vlora in Albania, where the oil will be loaded onto petrol tankers. The cost of building the 912-kilometre pipeline is estimated at EUR 1 billion.

In the first election of lawmakers to the European Parliament, the centre-right opposition CEDB (Citizens for European Development of Bulgaria) received 21.7% of the votes, the left-wing Bulgarian Socialist Party (BSP) got 21.4%, the Movement for Rights and Freedoms (MRF) got 20.3%, nationalist union Attack received 14.2% and National Movement Simeon II (NMS-II) passed the threshold of 5.56%. Bulgaria has a quota of 18 seats out of 785 seats in the European Parliament.

[2] Preliminary data of the NSI.

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