

Atradius Country Report

Bulgaria – August 2010



Overview

General information

Capital:	Sofia
Government type:	Republic/parliamentary democracy
Currency:	Lev (BGL)
Population:	7.56 million
Status:	Upper middle income country (GDP/capita: US-\$ 6,328 in 2010)

Most important sectors (% of GDP, 2009)

Services:	64 %
Industry:	30 %
Agriculture:	6 %

Main import sources (2009)

Russia:	13.1 %
Germany:	12.2 %
Italy:	7.8 %
Greece:	6.1 %

Main export markets (2009)

Germany:	11.2 %
Greece:	9.4 %
Italy:	9.3 %
Romania:	8.6 %

Main expenses of foreign exchange

Fuels/minerals (28%), machinery, and equipment (25%)

Main sources of foreign exchange

Light industrial products, machinery and tourism

Key indicators

	2007	2008	2009	2010*	2011*
GDP (US-\$ million)	39,549	49,905	47,100	47,777	48,390
Real GDP growth (%)	6.2	6.0	-5.0	0.1	2.8
GDP per capita (US-\$)	5,177	6,575	6,230	6,328	6,418
Inflation p.a. (%)	8.4	12.3	2.8	2.1	2.5
Fiscal balance (% of GDP)	0.1	1.8	-3.9	-3.5	-3.1
Total foreign debt (US-\$ million)	32,968	38,000	37,500	35,000	34,700
Foreign debt/GDP (%)	83	76	80	73	72
Foreign debt/XGS (%)	120	119	153	137	130
Short-term debt/inter. reserves (%)	88	107	99	101	85
Debt service ratio (%)	45	60	96	88	76
Current account balance (US-\$ m.)	-11,237	-11,898	-4,420	-2,100	-2,400
Current account/GDP (%)	-28.4	-23.8	-9.0	-4.4	-5.0
Nom. exchange rate to US-\$ (average)	1.43	1.34	1.41	1.45	1.50
International reserves (US-\$ million)	16,028	17,321	16,916	14,600	16,000
In months of merchandise imports	6.4	5.7	8.7	8.5	8.4

* forecast

Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Reasonably stable

Head of state:	President Georgi Parvanov (since January 2002)
Head of government:	Prime Minister Boyko Borrisov (since July 2010)
Form of government:	Minority government of the centre-right Citizens for European Development for Bulgaria (GERB) party

Political situation

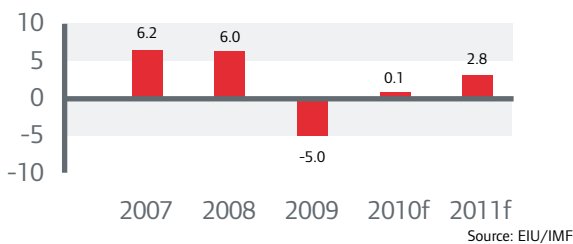
In the general election of July 2010 the 2006 established Citizens for European Development for Bulgaria (GERB) party gained a landslide victory over the ruling coalition led by the socialist party. However, with 116 of the 240 seats GERB lacks a few seats for an absolute majority, and therefore relies on the support of some smaller centre-right parties. New prime minister Boyko Borrisov announced to seriously tackle graft and organised crime.

Bulgaria and the EU

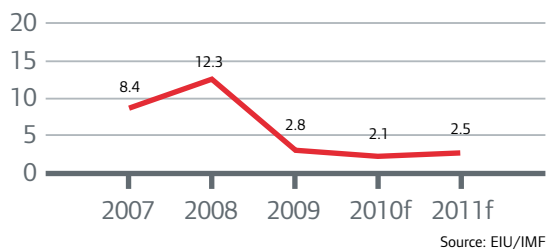
Bulgaria entered the EU on the 1st of January 2007. According to the entry conditions, the country is subject to strict monitoring by the European Commission, especially on progress in reforming the judiciary and fighting corruption. Bulgaria will risk sanctions imposed by Brussels if the reforms prove to be insufficient. In June 2008 the European Commission issued a critical report, highlighting a lack of political will in fighting corruption and a failure to account for the spending of EU funding. The commission consequently withheld aid and subsidies and finally cut Euro 220 million support in 2008. In its latest report from July 2010 the EU Commission acknowledged some reform successes achieved in the past 12 months, but has also increased the pressure on the government to speed up efforts in launching a new penal code and to make the judiciary more effective.

Internal economic situation: Weak recovery from recession

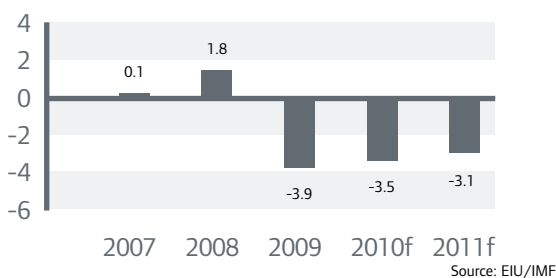
Real GDP growth (%)



Inflation p.a. (%)



Fiscal balance (% of GDP)



General situation

The robust economic expansion between 2004 and 2008 was fuelled by massive foreign direct investment inflows and very strong credit growth supported by low real interest rates. However, after yearly growth rates above 6%, real GDP-growth decreased 5% in 2009. Industrial output shrank 17.4% and exports decreased 9.8% year-on-year as Bulgaria was hit by a rapid deterioration of demand in the EU and the Balkan countries. Domestic demand decreased 15% because of the poor situation on the real estate market and the scaling back of new loans by commercial banks since the end of 2008, causing an acute shortage of refinancing and new credit. After a decline of 5.9% year-on-year in Q4 of 2009, Bulgaria's economic contraction slowed in Q1 of 2010 (-4%) as demand and industrial output showed signs of recovery.

During the boom years the mainly foreign-owned main banks fuelled the upswing with loans to the private sector, also denominated in Euro. However, due to the recession and the collapse of the real estate market many companies and private households have encountered problems in meeting their contractual obligations on due dates. This has strongly aggravated the commercial credit risk, triggering a high number of defaults. More non-performing loans (NPL) are to be expected this year, burdening the portfolio of the financial institutions. A problematic factor for the viability of Bulgaria's financial sector is the foreign ownership structure, as two of the largest institutions are owned by Greek financial institutes, which are now vulnerable by themselves as a consequence of the Greek debt crisis (DSK is owned by OTP and UBB by the National Bank of Greece).

Annual inflation decreased significantly in 2009 to 2.8% (2008: 12.3%) due to lower commodity prices (particularly food and energy prices) and lower domestic demand. Decreasing nominal wage growth also contributed to the decline, as labour market conditions weakened and unemployment rose. Inflation is expected to remain low in 2010 (2.1%).

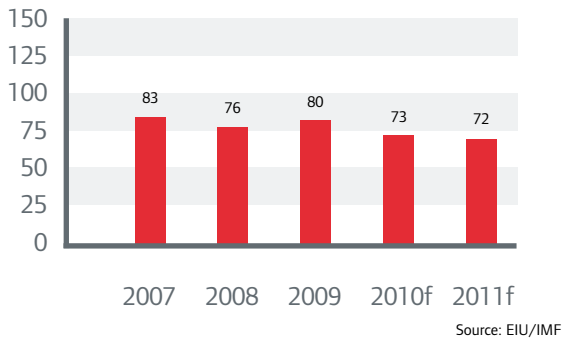
Economic policy

The Bulgarian lev is anchored to the euro through a currency board system, as a consequence of which the central bank has only limited discretion in adjusting monetary conditions, and corrective economic measures have to be of fiscal origin. This mechanism has been successful so far, thanks to a fiscal consolidation after years of budget surpluses and a low public debt (14% of GDP in 2008). But after the unexpectedly poor fiscal performance in 2009 (a deficit of 3.9% of GDP due to an unwillingness to curb spending and a drop in tax revenues) the prospects for budgetary consolidation remain rather poor.

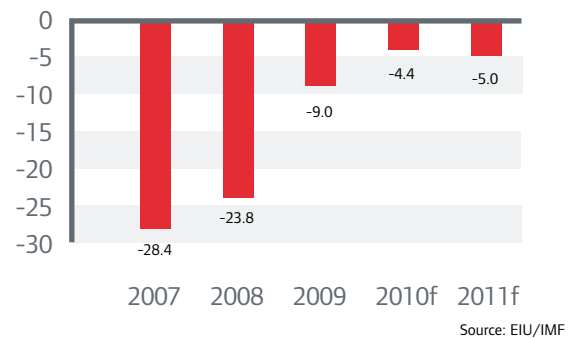
The privatisation of the non-financial sector is well advanced. However, the government has to reform healthcare, pensions and local government finance, and urgently step up judicial reforms. It must also tackle corruption and organised crime if it is to improve the business environment and meet EU compliance targets. Bulgaria still suffers heavily from influential mafia practices, serious crime, weak property rights and an ineffective judiciary. What is more, insolvency proceedings continue to be lengthy and complicated.

External economic situation: Very high private sector debt

Foreign debt/GDP (%)



Current account/GDP (%)



Foreign debt

- Level: High: US-\$ 35 billion by the end of 2010
(73 % of GDP; 137 % of exports of goods and services)
- Structure: High short-term-share (42 % in 2010), mainly corporate and banking debt
- Debt service ratio: High, especially including short-term (88 % in 2010)

Remarks:

Bulgaria's solvency has worsened after years of rapid foreign debt accumulation by the private sector (companies as well as banks) until the end of 2008.

Balance of payments

- Trade balance: Falling, but still large deficits
- Current account: Deficits have fallen from more than 25% of GDP in 2007 to 4.5 % of GDP in 2010)
- Capital account: Fallen surpluses
- Total Account: Fallen surpluses, possibly negative

Remarks:

Another consequence of the economic overheating until the end of 2008 was a dramatic deterioration of the external position, which also jeopardized the currency board. But thanks to a massive decrease in imports (33 % year-on-year in 2009), the trade and current account balances have improved strongly since 2009. That said, capital imports (EU- and other transfers, inflows of foreign direct investments and borrowing from parent banks) have decreased as well and fail to cover the current account deficits in 2009 and 2010, giving rise to an erosion of reserves in nominal US-\$ terms. However, the international liquidity position is still sufficient with more than 8 months of import cover.

Outlook: More fiscal discipline urgent to consolidate the currency board

Political situation

The government is currently stable despite its lack of a parliamentary majority, mainly thanks to the weakness of the opposition. The new administration seems to be more inclined than former administrations to implement the comprehensive reforms requested by the EU. But given the endemic nature of corruption, the transition to a more transparent society and business world will be very difficult and slow. The EU has resumed the distribution of some frozen EU-funds (Euro 115 million), but the Commission will continue to closely monitor the progress of reforms and measures to fight corruption and crime in Bulgaria.

Economic situation

Production activity recovers slowly as exports are expected to increase again in the second and third quarter of 2010 due to rising international demand. Imports will continue to lag behind the export growth rate, which will lead to a further trade deficit decrease. That said, the reduction of the private (especially banking) sector debt burden will hamper a comprehensive economic recovery this year. GDP is expected to grow just 0.1 % in 2010, as domestic demand still decreases.

A potential threat is posed by the fiscal slippages since last year, as budget deficits were higher than planned in 2009 (3.9 % of GDP) and this will probably continue in 2010 (3.5 % of GDP). Further budgetary consolidation is urgent, and the EU Commission has placed Bulgaria under its excessive deficit watch in early July: the country has been given time until end-2011 to bring its budget deficit below a 3 % of GDP threshold.

Bulgaria's liquidity position is still sufficient, and despite a weaker solvency there are no payment problems ahead. That said, with a debt service ratio of more than 80% including short-term debt the country continues to be vulnerable to adverse global financial market sentiment. The largest part of the debt service is to be honoured by the heavily indebted private sector, and the very large financing gaps are a potential threat to the currency board. Any abolition of this system and a subsequent devaluation of the lev would further increase the service of private sector debt denominated in Euro. However, there is still a broad-based political commitment to preserve the currency board mechanism, although the currency peg has eroded Bulgaria's competitive position.