



## Summary

Bulgaria, EU's poorest member in terms of GDP per capita, is slowly recovering from the recession that hit the country in 2009. Boosted by export growth, the economy grew at 1.8% in 2011. For 2012, we expect growth to come in at 0.4%, as export growth declines. As domestic demand and investment remain weak and Bulgaria is a very open economy, the country remains vulnerable to the European sovereign debt crisis. Other weaknesses are on an institutional level and consist of a weak rule of law and heavy bureaucracy, while progress in combatting corruption and crime is slow. With low public debt, modest fiscal deficits and sound macroeconomic policies, Bulgaria shows prudent fiscal policy. After large current account deficits in 2007/08 owing to a construction boom, the current account turned into a surplus of 2% of GDP in 2011 on the back of a lower trade deficit and higher remittances. With a decline in export growth, the current account balance is estimated to show a small surplus of 0.1% of GDP this year. Bulgaria's external position remains worrisome. External debt has declined since 2009, but remains high at 72% of GDP.

## Things to watch:

- Export and import growth
- Government's combat against corruption and crime
- High external debt

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<b>Bulgaria</b>			
<b>National facts</b>		<b>Social and governance indicators</b>	
Type of government	Parliamentary democracy	Human Development Index (rank)	55 / 187
Capital	Sofia	Ease of doing business (rank)	59 / 183
Surface area (thousand sq km)	111	Economic freedom index (rank)	60 / 179
Population (millions)	7.4	Corruption perceptions index (rank)	86 / 183
Main languages	Bulgarian (84.5%) Turkish (9.6%)	Press freedom index (rank)	70 / 178
Main religions	Bulgarian Orthodox (82.6%) Muslim (12.2%) other Christian (1.2%)	Gini index (income distribution)	45.3
Head of State (president)	Rosen Plevneliev	Population below \$1.25 per day (PPP)	2%
Head of Government (prime-minister)	Boyko Borisov	<b>Foreign trade</b>	
Monetary unit	lev (BGN)	<b>2010</b>	
<b>Economy</b>		<b>2010</b>	
<b>Economic size</b>		<b>Main export partners (%)</b>	<b>Main import partners (%)</b>
Nominal GDP	bn USD    % world total	Germany	Russia
Nominal GDP at PPP	54    0.08	Greece	Germany
Export value of goods and services	95    0.12	Italy	Italy
IMF quatum (in mln SDR)	34    0.16	Romania	Greece
<b>Economic structure</b>		<b>Main export products (%)</b>	
<b>2011</b>		<b>5-year av.</b>	
Real GDP growth	1.9    2.8	Clothing & footwear	12
Agriculture (% of GDP)	5    6	Iron & steel	9
Industry (% of GDP)	31    29	Other metals	4
Services (% of GDP)	62    59	Chemicals, plastics & rubber	4
<b>Standards of living</b>		<b>Main import products (%)</b>	
<b>USD</b>		<b>2011</b>	
Nominal GDP per head	7393    69	Crude oil & natural gas	17
Nominal GDP per head at PPP	12878    104	Textiles	8
Real GDP per head	4570    56	Machinery & equipment	8
		Chemicals, plastics & rubber	5
		<b>Openness of the economy</b>	
		Export value of G&S (% of GDP)	62
		Import value of G&S (% of GDP)	61
		Inward FDI (% of GDP)	0.8

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

### Economic structure and growth

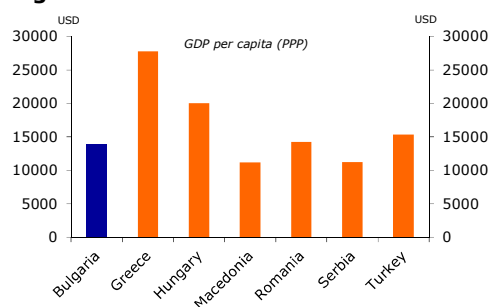
Bulgaria joined the European Union in 2007 and is its poorest member, having a GDP per capita of nearly USD 7,400. The country has an open economy and is slowly recovering from the recession that hit the country in 2009 predominantly by a reduced external demand and slashed incomes and jobs.<sup>1</sup> Most of the labor force is employed in the manufacturing, construction, repair and trading sectors, while the proportion of Bulgarians working abroad, 12% of the population, is one of the highest in the world. About 50% of these expatriates send money to relatives in Bulgaria, which predominantly increases domestic spending in retail trade and the housing market, and thereby has a positive impact on the economy. 2009's recession caused unemployment to rise from 7.6% to 9.5% in 2010. Since then, unemployment has risen further, to 10.9% in November 2011. Standing at 62% of GDP, the services sector contributes most to Bulgaria's GDP, dominating the agricultural sector (5% of GDP) and the industrial sector (31% of GDP). Main exported and imported services are tourism and transport.

Driven by export growth, the economy stabilized in 2010 (0.2% growth), after a 5.5% contraction the year before. Last year, the country continued its upward path, growing at 1.8%, again resulting from export growth, while domestic demand remained subdued. As export growth is expected to decline from 8.7% in 2011 to 1.0% in 2012, we forecast the economy to grow at a modest rate of 0.4%. Growth is still very moderate compared to pre-recession levels (around 6%), because of

<sup>1</sup> The global banking crisis did not have a substantial direct impact on the Bulgarian economy.

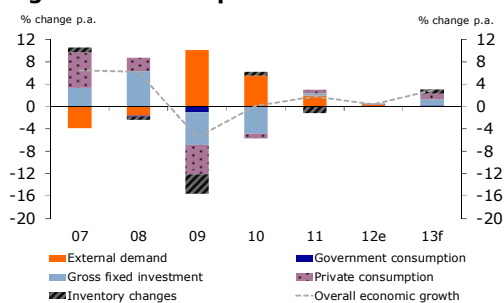
modest prospects for exports, still-fragile business and consumer confidence, slow growth of domestic credit, and the need to continue tight fiscal policy. An uncertain outlook for the euro zone may put further downward pressure on the forecast, as Bulgaria is a very open economy, with Germany, Greece and Italy as most important trading partners. Foreign investment's contribution to growth is very modest, as illustrated by net FDI inflows into Bulgaria that stood at 0.8% of GDP in 2011. However, East-Asian investors, predominantly from China and South Korea, have shown their interest in boosting investment in the car assembly industry and agriculture.

**Figure 1: Income level**



Source: World Bank

**Figure 2: Growth performance**



Source: EIU

Bulgaria is widely praised for its healthy banking sector, which is well capitalized and liquid. Despite the fact that the Greek lenders control 25% of the Bulgarian banking sector, the sector's vulnerability to the Greek sovereign debt crisis is limited, as Greek subsidiaries in Bulgaria do not hold significant quantities of Greek sovereign debt. However, the debt crisis in Greece may trigger Greek parent banks to transfer back their funds to Greece.

### Political and social situation

Bulgaria enjoys a relatively stable political system, but the rule of law in the country remains weak. Most of the power in the country rests with the prime-minister and parliament, but the president heads the army, has the right to veto legislation and is allowed to sign international treaties. In presidential elections in October 2011, Rosen Plevneliev of the center-right GERB party beat socialist Ivailo Kalfin. Observers made an overall positive assessment of the elections, but expressed their concerns about persistent allegations of vote-buying, a few incidents of errors in ballot papers and the near absence of any editorial coverage of the campaign in the media. By winning the presidency, the GERB party has strengthened its grip on power, as the party now controls the country's top two executive positions (prime minister and president) and parliament. However, the GERB lacks an outright majority in parliament (by four seats) and relies on support from independent parliamentarians. Protests in November and December 2011 about austerity measures in 2012's budget, show widespread discontent about the proposed cuts.

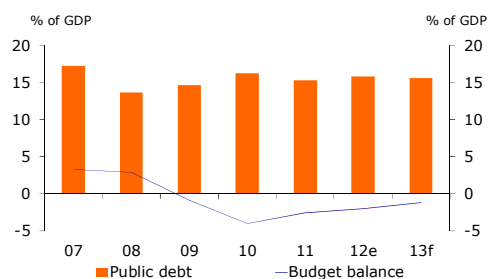
A slow and complicated bureaucracy, as well as widespread corruption continues to hamper the business environment. Bulgaria ranks on Transparency's Corruption Perceptions Index as the most corrupt country of the EU. The index shows that Bulgaria ranks 86 out of 183 countries, at a comparable level to Panama and Sri Lanka. However, this affects local companies more than western companies. The courts and law-enforcement agencies are an exception to this rule, they are likely to show favors to local businesses. Another weakness of the country is the persistence of crime. In 2011, crime indirectly increased tensions between ethnic Bulgarians and the significant Roma minority. Tensions between these groups are longstanding, but these were exacerbated by difficult economic conditions, leading to severe anti-Roma protests after a young man was run over

by a Roma crime boss. Later, these protests turned into protests against the government’s failure to impose strict rule of law and put an end to a climate of impunity for organized crime. Internationally, Bulgaria is trying to join the passport-free Schengen area, but this is prevented by one country, the Netherlands, which vetoes Bulgaria’s application because of the country’s lack of progress in combatting corruption and organized crime.

**Economic policy**

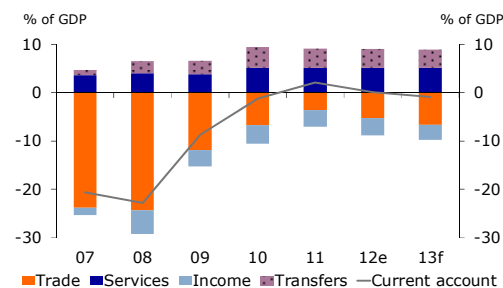
Bulgaria is largely praised for its sound macroeconomic and fiscal policies.<sup>2</sup> The budget balance in 2011 showed a deficit of 2.1% of GDP, which is lower than the 2.5% of GDP budget deficit target in the government’s budget, reflecting tight control over expenditures along with some gains from improved revenue collection. Still aiming to adopt the euro, Bulgaria will continue its prudent budgeting, with an expected fiscal deficit of 2.0% of GDP this year. However, growth stimulating measures may slightly temper Bulgaria’s image of prudent policy. In 2012’s budget, the government allocates extra expenditures to higher minimum pensions and minimum wages, while revenues may decline, as the government mulls over lower value added taxes. Despite these growth stimulating measures, Bulgaria’s policies remain fairly prudent. This is also shown by its public debt. Public debt stood at 16% of GDP last year, far below most other European countries. After an economic crash in 1996-97, the Bulgarian government introduced an IMF-backed currency board. The board limits monetary policy by pegging the country’s lev to the euro and is intended to remain in place until the country adopts the euro. In 2011, Bulgaria fulfilled the criteria for joining Exchange Rate Mechanism (ERM II), the waiting room for adopting the euro, for the second year. However, the application had not yet been submitted, as Bulgaria wants to await the developments in the turbulent euro zone. As a result, it is not likely that Bulgaria will join the euro zone before 2015. After two years of an inflation rate around 2.5%, inflation has gone up to 4.1% in 2011, owing to higher food and fuel prices. As inflationary pressures are expected to continue to weaken, inflation may come down to 2.5% in 2012.

**Figure 3: Public finances**



Source: EIU

**Figure 4: Current account**



Source: EIU

**Balance of Payments**

Bulgaria’s trade balance shows a deficit that has remarkably declined in recent years. After a construction boom contributed to a high trade deficit of 24% of GDP in 2007/08, the deficit shrank to 3.7% of GDP last year, owing to lower imports and higher exports. The deficit is expected to slightly rise again, to 5.3% of GDP this year. The services balance is forecast to show a constant surplus of 5% of GDP in 2012, at a comparable level to recent years. The transfer balance, which contains a large amount of remittances from Bulgarians abroad, has risen from USD 0.45bn in 2007 to USD 2.2bn in 2011. All in all, the current account deficit reached its lowest point of 22.9%

<sup>2</sup> See for example IMF’s Conclusions (December 9, 2011) and rating agency Standard & Poor’s Research Update (December 21, 2011).

of GDP in crisis year 2008. However, since then the current account balance has notably improved. As the services and transfer surpluses surpassed the trade and income deficits in 2011, the current account balance showed a small surplus of 2% of GDP last year. Owing to a decline in export growth, the surplus is expected to move to balance this year. In the medium term, the current account balance is expected to turn into deficit again, as the trade deficit will rise again owing to stronger economic growth. However, the trade deficit is not expected to reach the high pre-crisis levels of more than 10% of GDP, as a new construction boom is not expected. The same holds for the resulting current account balance, that is expected to remain in modest deficits below 5% of GDP in the medium term.

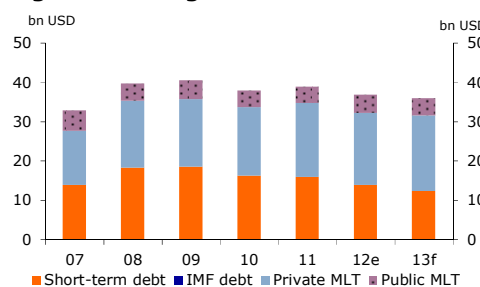
The current account surplus in 2011 resulted in a USD 1bn rise in foreign exchange reserves last year, after it declined by USD 1.3bn the year before. This rise in foreign exchange reserves is important to maintain the peg of the lev. Net foreign direct investment inflows have seen a large decline since 2007. Owing to the financial crisis, the inflows have declined from nearly USD 13bn in 2007 to a mere USD 350mln last year.

**External position**

Bulgaria’s external position remains vulnerable. External debt has been shrinking from 83% of GDP in 2009 to 72% of GDP last year, but the size remains worrisome. While public external debt has been reduced from 35% of GDP in 2003 to less than 8% of GDP last year, private external debt has increased markedly, from below 30% of GDP in 2003, to nearly 65% of GDP last year. An additional risk factor is that about 40% of total external debt is short-term debt. A mitigating factor is that 40% of total external debt consists of intra-company lending, which remained very stable during the global financial crisis of 2008/09 and has reduced rollover risks. Bulgaria has no record of arrears in principal or interest payments.

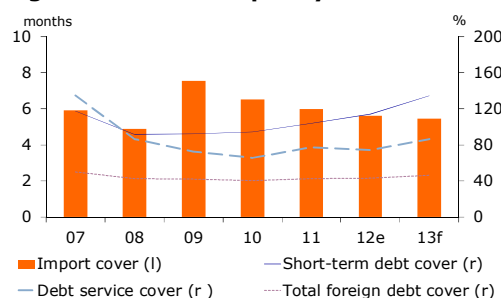
Foreign-exchange reserves stood at USD 16.6bn in 2011, and will slightly decline to USD 15.9bn this year, mainly owing to portfolio investment outflows. As imports slightly rise, reserves will cover 5.6 months in 2012, from 6.0 months last year. Even so, the import cover remains favorable. Reserves are able to cover all short-term debt, but not to cover the entire debt service due. The liquidity ratio showed resilience, as it went from 96% in 2010 to a more favorable 107% in 2011. The liquidity ratio may slightly decrease this year, but is expected to remain above 100%.

**Figure 5: Foreign debt**



Source: EIU

**Figure 6: External liquidity**



Source: Covers offered by official FX-reserves, EIU

<b>Bulgaria</b>							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	6.4	6.2	-5.5	0.2	1.8	0.4	2.9
Consumer prices (average % change pa)	8.4	12.3	2.8	2.4	4.1	2.5	3.1
Current account balance (% of GDP)	-20.7	-22.9	-8.8	-1.2	2.0	0.1	-0.9
Total foreign exchange reserves (mln USD)	16478	16824	17127	15421	16571	15930	16690
<i>Economic growth</i>							
GDP (% real change pa)	6.4	6.2	-5.5	0.2	1.8	0.4	2.9
Gross fixed investment (% real change pa)	11.8	21.9	-17.6	-16.5	2.0	-0.5	4.0
Private consumption (real % change pa)	9.0	3.4	-7.6	-1.2	1.0	0.3	1.6
Government consumption (% real change pa)	0.3	-1.0	-6.5	-0.9	0.0	0.3	1.5
Exports of G&S (% real change pa)	6.1	3.0	-11.2	16.2	8.7	1.0	4.2
Imports of G&S (% real change pa)	9.6	4.2	-21.0	4.5	5.0	0.6	4.0
<i>Economic policy</i>							
Budget balance (% of GDP)	3.3	2.9	-0.9	-4.0	-2.1	-2.0	-1.2
Public debt (% of GDP)	17	14	15	16	15	16	16
Money market interest rate (%)	4.0	5.2	2.0	0.2	0.5	1.3	2.4
M2 growth (% change pa)	31	9	4	6	10	11	19
Consumer prices (average % change pa)	8.4	12.3	2.8	2.4	4.1	2.5	3.1
Exchange rate LCU to USD (average)	1.4	1.3	1.4	1.5	1.4	1.5	1.6
Recorded unemployment (%)	7.7	6.3	7.6	9.5	9.4	9.0	8.3
<i>Balance of payments (mln USD)</i>							
Current account balance	-8716	-11909	-4267	-579	1114	40	-500
Trade balance	-10071	-12691	-5786	-3223	-2012	-2770	-3650
Export value of goods	18575	22604	16409	20642	26712	26840	28360
Import value of goods	28646	35296	22195	23864	28723	29610	32000
Services balance	1515	2044	1856	2442	2765	2620	2760
Income balance	-624	-2592	-1664	-1838	-1821	-1850	-1730
Transfer balance	464	1330	1327	2040	2182	2040	2110
Net direct investment flows	12903	9187	3525	1931	350	930	2750
Net portfolio investment flows	-715	-372	-72	-213	-139	-1250	160
Net debt flows	10702	8756	429	-1853	24	-540	-480
Other capital flows (negative is flight)	-8396	-5273	983	-578	-311	180	-1380
Change in international reserves	5779	390	599	-1292	1037	-640	560
<i>External position (mln USD)</i>							
Total foreign debt	32967	39767	40582	37987	38927	37000	36080
Short-term debt	14037	18334	18578	16338	15985	13980	12440
Total debt service due, incl. short-term debt	12238	19412	23544	23589	21493	21520	19310
Total foreign exchange reserves	16478	16824	17127	15421	16571	15930	16690
International investment position	-36679	-49174	-51952	-47701	n.a.	n.a.	n.a.
Total assets	29085	29606	32020	31183	n.a.	n.a.	n.a.
Total liabilities	65765	78780	83971	78884	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-23.9	-24.4	-11.9	-6.7	-3.7	-5.3	-6.7
Current account balance (% of GDP)	-20.7	-22.9	-8.8	-1.2	2.0	0.1	-0.9
Inward FDI (% of GDP)	31.3	19.2	7.0	4.5	0.8	1.9	5.5
Foreign debt (% of GDP)	78	76	83	79	72	71	66
Foreign debt (% of XGSIT)	117	115	153	122	103	98	91
International investment position (% of GDP)	-86.9	-94.4	-106.7	-99.7	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	43	56	88	76	57	57	48
Interest service ratio incl. arrears (% of XGSIT)	4	5	6	3	3	3	2
FX-reserves import cover (months)	5.9	4.9	7.5	6.5	6.0	5.6	5.5
FX-reserves debt service cover (%)	135	87	73	65	77	74	86
Liquidity ratio	105	89	94	96	107	103	107

Source: EIU

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