Rabobank

Country update

BULGARIA

Summary

Economic recovery in Bulgaria was weak in 2010 (-0.1%), largely because domestic demand and investment were suppressed by higher unemployment and still tight credit conditions. For 2011 and 2012, a slow recovery is expected to around 2.5% and 3.5%, respectively. This is not only below pre-crisis growth levels (growth was around 5-6% before the crisis), but also well below the level needed to catch up with the remainder of the EU. Bulgaria's fiscal situation was very good at the start of the financial crisis. During 2010, the budget deficit deteriorated to around 4% of GDP, which is still acceptable compared to other EU countries. The external position of Bulgaria is its main weakness. Although the current account deficit improved from a dramatic 23% of GDP in 2008 to around 1.5% of GDP in 2010, the deficit is expected to widen again. The level of foreign debt is rather high at 75% of GDP, but declining.

Things to watch:

- Progress of economic recovery
- Widening current account deficit
- Continued decline of foreign debt level
- Fiscal consolidation towards a balanced budget

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Bulgaria

National facts	
Type of government	parliamentary democracy
Capital	Sofia
Surface area (thousand sq km)	111
Population (millions)	7.5
Main languages	Bulgarian (84.5%)
	Turkish (9.6%)
Main religions	Bulgarian Orthodox (82.6%)
	Muslim (12.2%)
	other Christian (1.2%)
Head of State (president)	Georgi Parvanov
Head of Government (prime-minister)	Boyko Borissov
Monetary unit	leva (BGN)

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	47	0.08
Nominal GDP at PPP	91	0.12
Export value of goods and services	27	0.15
IMF quotum (in mln SDR, 2009)	640	0.29
Economic structure	*2010*	*5-year av.*
Real GDP growth	-0.1	4.1
Agriculture (% of GDP)	6	7
Industry (% of GDP)	27	28
Services (% of GDP)	60	58
Standards of living	*USD*	*% world av.*
Nominal GDP per head	6368	65
Nominal GDP per head at PPP	12230	105
Real GDP per head	4451	56

Social and governance indicators	rank / total
Human Development Index (rank)	58 / 169
Ease of doing business (rank)	51 / 183
Economic freedom index (rank)	75 / 179
Corruption perceptions index (rank)	73 / 178
Press freedom index (rank)	70 / 178
Gini index (income distribution)	29.2
Population below $1 per day (PPP)	1%

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Greece	11	Russia	16
Germany	9	Germany	12
Romania	9	Italy	8
Italy	7	Greece	2

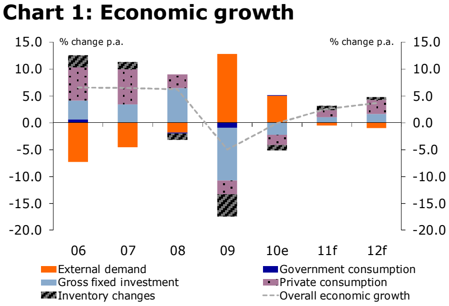
Main export products (%, 2009)	
Clothing & footwear	10
Other metals	10
Iron & steel	4
Chemicals, plastics & rubber	4
Main import products (%, 2009)	
Crude oil & natural gas	16
Machinery & equipment	10
Chemicals, plastics & rubber	7
Textiles	6
Openness of the economy	
Export value of G&S (% of GDP)	58
Import value of G&S (% of GDP)	59
Inward FDI (% of GDP)	4.2

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

Introduction and update

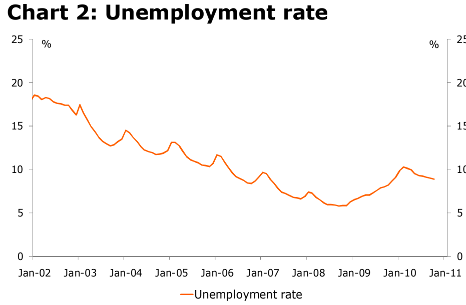
In the country risk report of February 2010, the economic downturn was expected to bottom out early 2010 with overall growth not much above zero for the full year. The recovery was indeed weak and it is now estimated that full year growth just failed to reach positive territories (-0.1%). Continued tight credit conditions and rising unemployment suppressed growth, while external demand supported growth. For 2011 and 2012, a slow recovery is expected to around 2.5% and 3.5%, respectively. This is not only below pre-crisis growth levels (which was around 5-6%), but also well below the level needed to catch up with the remainder of the EU. The recovery will depend on improving labor and credit markets, which will in turn support private consumption and investment. The speed of recovery in important trade partners will determine the contribution of the export sector, while fiscal tightening will put a drag on growth.

Chart 1: Economic growth



Source: EIU

Chart 2: Unemployment rate



Source: Ecowin

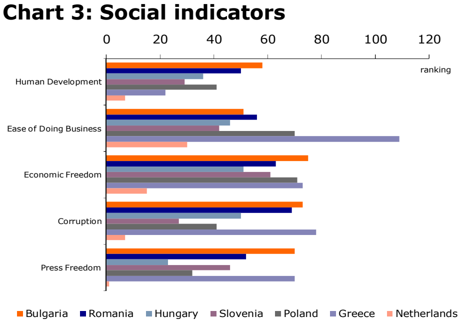
During the global financial crisis, the pressure to devaluate the pegged Bulgarian leva was high at times. However, the government was determined to defend the peg and this attitude was supported by the solid fiscal position at the start of the financial crisis. Previously Bulgaria intended to enter the ERMII (pre-phase for euro adoption) in the spring of 2010. However, the rising government deficit forced the government to put this off until later (see also section below of the fiscal situation). The aim, however, to join the euro zone remains present. No official target has been set, but euro adoption is not likely before 2015.

Fiscal prudence needed again

The centre-right Citizens for the European Development of Bulgaria (CEDB) party has been governing with a minority cabinet since the elections of July 2009. Prime minister Borisov and his cabinet are facing tough challenges. On the structural side, Bulgaria needs to address the low living-standards, speed up investment in infrastructure and deal with issues such as organized crime, a weak judiciary system and corruption. On the cyclical part, the deterioration of the fiscal deficit during 2010 warrants attention.

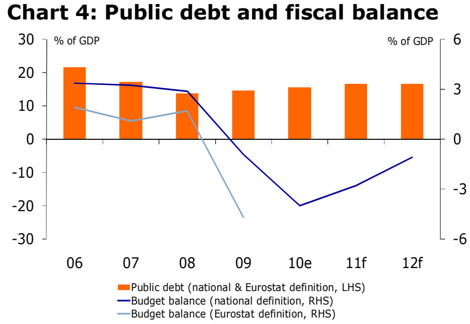
Although in our February 2010 country report a small surplus was expected for the government budget this year, the fiscal deficit is now estimated to be around 4% of GDP in 2010. The government indeed had to admit that the estimates were overly optimistic to begin with (and they also had to revise the budget deficit over 2009 due to unreported expenditures). The government aims to reduce the fiscal deficit to zero by 2012, in line with EU recommendations. To achieve this goal, higher taxes and/or spending cuts will be necessary. Considering the substantial share of social expenditures and the need to co-finance EU projects, cutting expenditures will be difficult without reforms in the pension, education, public administration and health care systems. After much discussion, some pension reforms have been adopted, but the reforms will not go as deep as originally discussed. More heated debate can be expected on these subjects.

Chart 3: Social indicators



Source: UN, World Bank, Heritage Foundation, Transparency International, Reporters Without Borders (NB: 1 is best).

Chart 4: Public debt and fiscal balance



Source: EIU, Eurostat (data until 2009)

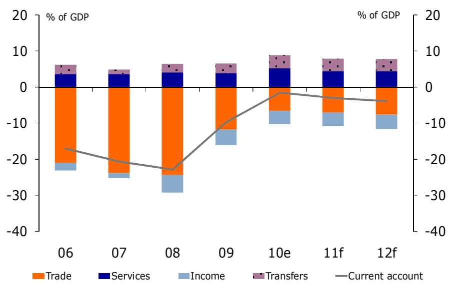
Despite the setback in 2010, Bulgaria's fiscal situation compares favourably to other European countries. Public debt to GDP is expected to be only 17% of GDP in 2011 (the EU average is around 75% of GDP, while the eurozone average lies around 80% of GDP) and the government's reputation on fiscal prudence is strong. The commitment to fiscal consolidation is broadly supported by the desire to maintain the currency peg.

External position weak, but improving

Bulgaria's external position is an important weakness of the country, but it improved in the past year. The current account deficit was a dramatic 23% of GDP in 2008, but improved over 2009 and

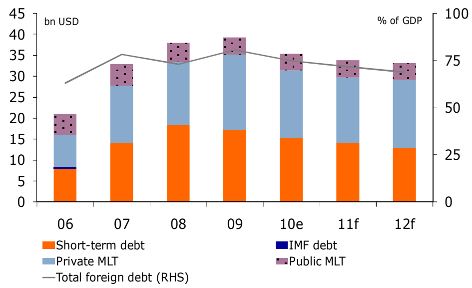
2010. For 2010, it is estimated that the current account deficit is 1.6% of GDP. The main progress stems from the shrinking trade deficit (from USD 12.4bn in 2008 to USD 5.8bn in 2009 and USD 3.2bn in 2010). Although external demand dropped rapidly in 2009 as export partners were hit by the global economic recession, import demand fell even further. In 2010, both imports (+6%) and exports (+24%) picked up, but on balance the trade deficit halved again. With the domestic economy recovering, the trade balance is expected to deteriorate. The services and transfer (EU transfers and remittances) balances tend to be in surplus, but are generally unable to offset the trade deficit. As the trade deficit is expected to widen again, so will the current account deficit. For 2011 and 2012, current account deficits around 3% of GDP and 4% of GDP, respectively, are expected. Assuming that this trend continues, the current account deficit will remain a major weakness to Bulgaria. But it must be said that for now it is at a much more acceptable level than before the crisis.

Chart 5: Current account balance



Source: EIU

Chart 6: Foreign debt



Source: EIU

Another vulnerability, which has recently improved, is the level of foreign debt. In the pre-crisis years, ample supply of foreign credit allowed Bulgaria to build up a foreign debt stock, which accumulated to USD 39.4bn (or 81% of GDP) end-2009. It is estimated that end-2010, the foreign debt has shrunk to USD 35bn (or 75% of GDP) on the back of lower external financing needs – debt financing tends to be the main source to cover the financing requirements. In 2011/12 this trend is expected to continue, aided by the anticipation that investment inflows are expected to increase again. The fact that short-term debt accounts for about 40% of total foreign debt is worrisome, although a large part of that is intra-company (bank) finance.

Bulgaria

Selection of economic indicators	2006	2007	2008	2009	2010e	2011f	2012f
Key country risk indicators							
GDP (% real change pa)	6.5	6.4	6.2	-4.9	-0.1	2.6	3.7
Consumer prices (average % change pa)	7.3	8.4	12.3	2.8	2.3	3.1	3.4
Current account balance (% of GDP)	-17.1	-20.7	-22.9	-9.8	-1.6	-3.1	-3.9
Total foreign exchange reserves (mln USD)	10943	16478	16824	17127	14653	15350	15770
Economic growth							
GDP (% real change pa)	6.5	6.4	6.2	-4.9	-0.1	2.6	3.7
Gross fixed investment (% real change pa)	13.1	11.8	21.9	-26.9	-9.0	4.0	6.5
Private consumption (real % change pa)	8.6	9.0	3.4	-3.5	-2.6	1.8	3.6
Government consumption (% real change pa)	3.4	0.2	-1.0	-6.5	0.5	0.5	0.5
Exports of G&S (% real change pa)	50.7	6.1	3.0	-10.3	10.6	3.8	4.3
Imports of G&S (% real change pa)	47.7	9.6	4.2	-21.5	1.7	4.0	5.0
Economic policy							
Budget balance (% of GDP)	3.4	3.3	2.9	-0.9	-4.0	-2.8	-1.1
Public debt (% of GDP)	22	17	14	15	16	17	17
Money market interest rate (%)	2.8	4.0	5.2	2.0	0.2	1.3	1.8
M2 growth (% change pa)	27	31	9	4	8	11	11
Consumer prices (average % change pa)	7.3	8.4	12.3	2.8	2.3	3.1	3.4
Exchange rate LCU to USD (average)	1.6	1.4	1.3	1.4	1.5	1.6	1.6
Recorded unemployment (%)	9.6	7.7	6.3	7.6	9.4	8.2	7.2
Balance of payments (mln USD)							
Current account balance	-5673	-8716	-11952	-4760	-766	-1450	-1900
Trade balance	-7028	-10071	-12691	-5786	-3150	-3350	-3700
Export value of goods	15101	18575	22604	16409	20338	21160	21920
Import value of goods	22130	28646	35296	22195	23488	24510	25620
Services balance	1189	1515	2044	1853	2421	2050	2090
Income balance	-679	-624	-2591	-2120	-1766	-1780	-1910
Transfer balance	844	464	1286	1293	1729	1630	1620
Net direct investment flows	7583	12903	9185	4737	1822	3500	5240
Net portfolio investment flows	85	-715	-496	-785	-401	170	-30
Net debt flows	5641	10704	8189	2050	-3206	-720	-30
Other capital flows (negative is flight)	-4576	-8398	-4537	-643	-72	-810	-2910
Change in international reserves	3060	5779	390	599	-2623	690	370
External position (mln USD)							
Total foreign debt	20990	32968	38045	39382	35421	33850	33210
Short-term debt	8040	14037	18493	17298	15296	14040	12940
Total debt service due, incl. short-term debt	6759	12238	19006	22919	23445	20860	19610
Total foreign exchange reserves	10943	16478	16824	17127	14653	15350	15770
International investment position	-20316	-36679	-48928	-54095	n.a.	n.a.	n.a.
Total assets	22861	29085	29606	31913	n.a.	n.a.	n.a.
Total liabilities	43176	65765	78533	86009	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-21.1	-23.9	-24.4	-11.9	-6.6	-7.1	-7.7
Current account balance (% of GDP)	-17.1	-20.7	-22.9	-9.8	-1.6	-3.1	-3.9
Inward FDI (% of GDP)	23.3	31.4	19.1	9.4	4.2	7.9	11.4
Foreign debt (% of GDP)	63	78	73	81	75	72	69
Foreign debt (% of XGSIT)	91	117	110	148	115	107	101
International investment position (% of GDP)	-61.1	-87.1	-93.9	-110.8	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	29	43	55	86	76	66	60
Interest service ratio incl. arrears (% of XGSIT)	3	4	5	4	3	3	3
FX-reserves import cover (months)	5.0	5.9	4.9	7.5	6.3	6.3	6.2
FX-reserves debt service cover (%)	162	135	89	75	62	74	80
Liquidity ratio	114	105	89	93	94	98	101

Source: EIU