

### Economic

#### Credit Agencies

Moody's: Ba1

S&P: BBB

Fitch: BBB

#### Nominal GDP (2005)

USD26.1bn

#### Population (2005):

7.7 million

#### Total Trade / GDP:

83.7%

#### Currency:

Bulgarian lev

#### Exchange regime:

Currency Board, peg to the EURO.

#### Merchandise imports from Canada:

\$Cdn51 million

#### Main sources of Foreign Exchange (excl. FDI):

Textiles and furniture exports

#### Largest Merchandise Trading Partner:

Italy (15%)

Germany (10%)

#### Main imports:

Machinery and equipment (16%)

#### Risks to the Outlook



Faster structural reforms.



Higher political uncertainty; delays to privatization; unchecked current account deficit.

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**Market Spotlight:** Strong domestic demand, prudent macroeconomic policy and a benign external environment catalyzed economic growth for Bulgaria in 2005. Growth in 2005 accelerated marginally by 0.1% from the 5.6% recorded in 2004. Of particular note, however, is the current account deficit, which burgeoned to EUR 3.16bn or 14.9% of GDP as a result of soaring imports.

**Recent Economic Developments:** 2005 marked the fifth straight year of consecutive, strong economic growth. However, with the sharp rise in imports, the current account deficit has ballooned to 14.9% of GDP; thus, raising questions of sustainability in the event that the external environment becomes unfavorable. The rise in the current account deficit, driven by import growth of 26.3% partially masked the strong performance of exports, which increased by 18.4%. While higher energy costs are to blame, recent minimum wage increases and low savings rate contributed equally with furniture, consumer goods, household appliance, and vehicle imports rising strongly. Furthermore, unlike previous years, inflows of foreign direct investment covered only 60% of the current account deficit in 2005, a sharp fall from the 138% recorded in 2004. While sustainability is not an immediate concern given the relatively benign external conditions, care must be taken to moderate fiscal spending and credit growth so as not to exacerbate the current account deficit.

**Monetary and Exchange Rate Policy:** Bulgaria introduced a Currency Board arrangement in July 1997, under which the Lev is fixed at the rate of 1€=1.94578 Bulgarian Lev. This arrangement was largely instrumental in underpinning Bulgaria's monetary stability and credibility, thus reducing price instability. However, the currency peg to the Euro means that the real exchange rate has appreciated against its trading partners due to Bulgaria's higher inflation rate. At this point the Lev does not appear to be overvalued, judging from export performance, though the surging pace of imports could give rise to concern if the peg was maintained over the medium- to long-term. Given the policy restrictions naturally placed on the authorities from such an exchange arrangement, policies, in particular fiscal and labor market must be prudent. Needless to say, the Bulgarian authorities have proven adept at maintaining policy credibility.

**Fiscal Policy:** The authorities have been remarkably successful in generating fiscal surplus, with 2.4% of GDP in 2005 and a projected surplus of 3.0% in 2006. Part of this success is undoubtedly the result of strong revenue growth thanks to rapid GDP expansion, but the authorities have exercised remarkable success at maintaining public expenditures under control. Nevertheless, the government faces a number of continuing medium-term structural fiscal challenges, including: reducing the tax burden; targeting depressed economic areas for minimal tax rates; lowering personal income taxes by raising thresholds, and increasing excise taxes to EU levels by 2006 in preparation for the 2007 EU accession.

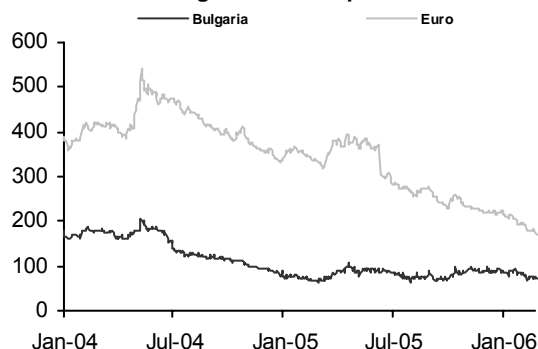
**Structural Reforms:** Heightened focus on adopting EU rules and regulations ahead of the 2007 EU accession date is already yielding substantial economic benefits. Progress achieved so far include completing financial sector privatization and implementing a new energy law, and setting the stage for electricity sector liberalization by 2007.

**Outlook:** Bulgaria's stabilization and rapid economic growth have provided a strong underpinning to the country's creditworthiness, setting it as a reformer and policy trendsetters in the region. Though the current account deficit is symptomatic of countries at this stage of developments, this and other concerns such as rapid domestic credit growth and labor rigidity will need to be tackled to support strong future growth. Nevertheless, the Bulgarian authorities have shown policy astuteness and the will-power to deal with pressing issues in a competent, efficient manner. Going forward, the maintenance of prudent policies, fiscal management and strong growth will increasingly bear fruit in terms of rising foreign investment, EU accession and eventual Euro adoption as well as declining bond spreads.

#### Economic Indicators

	2000-2004	2005(f)	2006(e)	2007(f)
GDP (% growth, real)	4.9	5.7	4.3	4.4
Inflation (% , year-end)	6.4	5.0	5.8	4.2
Fiscal Balance (% of GDP)	-0.2	2.0	2.8	1.4
Exports (USD bn)	5.4	9.2	10.3	11.4
Imports (USD bn)	7.0	12.1	13.4	14.8
Current Account (%GDP)	-7.2	-15.1	-13.4	-11.7
Reserves (month of imports)	6.0	5.1	4.9	4.7
External Debt (USD bn)	74.4	62.8	62.1	59.8
Debt Service ratio	14.9	14.4	13.9	14.4
Currency (per Euro), year-end	1.95583	1.95583	1.95583	1.95583

#### Bulgaria - Bond Spreads



### General Political Environment:

The June 2005 legislative election saw the victory of the Bulgarian Socialist Party (BSP) with 31% of the vote. Coalition-building proved difficult, with three attempts required to negotiate a workable alliance. The alliance is, surprisingly, still functioning after eight months. This is perhaps due to the significant checks and balances demanded by the National Movement Simeon II (NDSV) including the arrangement that all major government decisions be taken by consensus. Movement for Rights and Freedoms (DPS) is the third party in the coalition.

The government's three priorities are EU integration, economic growth and social responsibility. The chief negotiator from the NDSV administration has been reappointed as Minister for European integration. European Union accession is the government's single most important domestic and foreign policy goal. Bulgaria signed off the last of its 31 negotiation chapters in 2004. The country is expected to accede in January 2007.

The big surprise of the elections was the rise of the ultra-nationalists, the Ataka (Attack) coalition. Not even founded as a party until April 2005, it gained 8% of the vote and secured 21 deputies in the National Assembly, making it the fourth largest group in parliament. Ataka rhetoric has been anti-Turkish, anti-Muslim, anti-Roma, anti-foreigners and calls for the dissolution of political parties of these groups. Ataka is also unenthusiastic about foreign investment. Ataka's popularity has risen since the election and nationalism has become increasingly common in Bulgarian political debate.

### Investment Environment:

Despite a positive attitude towards foreign investment, foreigners still encounter numerous bureaucratic obstacles when investing in Bulgaria. Corruption and organized crime (see Political Violence) are the main concerns for investors. Collusion and cooperation between some senior politicians, judges and three organized criminal gangs were alleged in an interior ministry report. When the former government did not pursue the named politicians, the report's author resigned and the issue was dropped by the government.

Parliament passed the first draft of a new investment law in November 2003. The law promotes a level playing field for domestic and foreign investors alike.

Efforts to harmonize Bulgarian laws with EU standards are leading to some improvements in the legal environment. However, the principal problem, as in many countries in the region, is one of implementation and effective enforcement of the existing laws.

### Political Violence:

Organized crime syndicates are second in size and strength in Eastern Europe only to those in Russia and extortion can pose a threat to business. Bulgaria is a major drug transit route and drug-related crime is common.

## Political

### Political Structure

Parliamentary Republic

### President

Georgi Parvanov

### Prime Minister

Sergei Stanishev (BSP)

### National Legislative Body

Unicameral Legislature:  
National Assembly (240 seats, elected by proportional representation).

### Major Parties (seats in assembly after election)

- Coalition for Bulgaria / (KzB), dominated by the Bulgarian Socialist Party (BSP); 82 seats
- National Movement Simeon II / (NDSV); 53 seats
- Movement for Rights and Freedoms / (DPS); 34 seats
- Attack / Ataka; 21 seats

### Last Elections

- Legislative: June 25 2005
- Presidential: November 2001

### Next Elections

- General Election: 2009
- Presidential Election: November 2006

### Press Freedom Survey:

- 2006 Score: 35 Partly Free  
(0: Free; 100: Not Free)  
[freedomhouse.org](http://freedomhouse.org)

### Control of Corruption Index:

- 2006 Score: -0.04  
(-2.5: Worst; +2.5: Best)  
[worldbank.org](http://worldbank.org)

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### Political Outlook

Organized crime and corruption are the two main factors affecting Bulgaria's long-term outlook. Both are expected to be ameliorated by EU accession due to the EU-related legal reforms undertaken which should strengthen the judicial system. However, crossover between politicians, the judiciary and organized crime is often alleged. Thus, it is likely that corruption will not be substantively addressed until the country's power structure – which groups have power and the relationship between these groups — is altered.