

**COUNTRY PROFILE:****REPUBLIC OF BULGARIA****DATED:****JUNE 2009****CREDIT GUARANTEE:**

IES/02: ATTACHMENT A

***Recent Political Highlights***

- ❑ The Constitutional Court rejected an amendment to the electoral threshold rules which were thought to be part of efforts to thwart opposition's prospects at this year's elections. Bulgarians will head to the polls on July 5 in parliamentary elections likely to replace the ruling coalition led by Socialist Prime Minister Sergei Stanishev. Citizens for European Development of Bulgaria (CEDB) the main opposition party, is expected to lead the government. Current president is Georgi Parvanov and the next presidential election is scheduled for 2011.
- ❑ The EU will keep Bulgaria under scrutiny, continuing to demand judicial reforms, as well as concrete results against corruption and organised crime; Bulgaria's entry into the EU was delayed by worries over corruption, organised crime and slow judicial reform. When it joined in 2007, the European Commission was given a mechanism for co-operation and verification that lets it monitor reforms and impose sanctions. The European Commission has released €115m of pre-accession infrastructure funds under the Ispa programme which were frozen in 2008.

***Recent Economic Highlights***

- ❑ The economy contracted by 3.5% y/y in Q1'09, after registering a growth of 3.5% in Q4'08. Industrial production and retail sales declined 17.1% y/y and 8.4% y/y respectively in March. Bulgarian exports shrank 17.4% y/y in Q1'09 from a 6% drop in Q4'08. Imports contracted by 21.1%. Data showed consumption, which has been the key driver of booming economic growth in the past several years, declined on an annual basis by 5.4% in Q1'09 from a 1.4% rise in Q4'09. Agriculture dropped 4.8%. Investments plunged 14.1% in Q1'09 from a 15.8% growth in Q4'08. The Finance Ministry forecasts growth to shrink between 2% and 3% this year. The EIU expects real GDP to contract 3.8% this year, mainly because of limited access to external finance and the poor economic outlook for the euro zone. Growth is forecast to rebound to a modest 0.9% in 2010.
- ❑ A total of 12,432 vehicles were sold in Bulgaria in the first five months of 2009 which is 50.3% fewer compared to the same period of 2008. The Bulgarian market of heavy trucks declined by 80%, light trucks 65% and cars 45%. 80% of Bulgaria's small and medium-sized tourism firms are on the verge of bankruptcy as the number of foreign tourists is expected to drop sharply. Tourist arrivals decreased by 5.4% in April compared to the same month last year.
- ❑ The IMF has called on Bulgaria to revise its 2009 budget insisting that the existing plans to curb spending will not be sufficient to avoid a deficit. According to the IMF, from its September budget, the Cabinet now risks a shortfall of at least 1% of GDP unless it slashes expenditure by a further 10%. Bulgaria's finance ministry is working on a plan to cut spending that will be submitted to Cabinet to avoid a budget deficit at year-end.
- ❑ Given Bulgaria's large external debt and current account deficit, the EIU foresees that Bulgaria will require some financial assistance from the IMF and the EU. The government maintains that Bulgaria's public finances are in good shape and standard IMF funding is not necessary now. Bulgaria's finance ministry has denied holding talks with the IMF, rejecting claims by the opposition that the government had approached the fund to seek a loan. Owing to a sharp contraction in domestic demand, the EIU forecasts that the current account deficit will narrow to 13.3% of GDP in 2009 and 9.7% of GDP in 2010, from 25% of GDP in 2008. The IMF forecasts the current account deficit will shrink to 12% of GDP this year.
- ❑ Bulgaria may attract a third less foreign investment this year than in 2008 as the global financial crisis makes investors more wary of emerging market economies. Foreign investment accounted for 18% of GDP last year and FDI covered 59.9% of the current account gap in Q1'09. FDI is expected to account for about 7% of GDP this year. The government is banking on low taxes (Bulgaria has the lowest personal income and corporate taxes in the EU at 10%) and cheap labour (Bulgaria has the lowest labour costs in the EU with a monthly salary averaging €350) to keep Bulgaria attractive to invest in renewable energy or outsource production of car parts. Q1'09 foreign investment amounted to €650m, half of which was in real estate and came mostly from British investors.
- ❑ Bulgaria risks having its credit rating cut to below investment grade as it struggles to shrink the highest current account deficit in emerging markets. Bulgaria's current account deficit reached 25% of GDP in 2008, the highest ratio of the 80 emerging market countries rated by Fitch Ratings, leaving it vulnerable to increased financing costs as the global economy sinks into the most severe recession. In May, Fitch affirmed Bulgaria's long-term currency issuer default rating to BBB- and long-term local currency at BBB and their revised respective rating outlooks to negative from stable.
- ❑ Following the economic crash in 1996-97, Bulgaria operates under a currency board regime which pegs the lev to the euro and curtails central bank monetary operations. All political parties in Bulgaria agree that the 1.95583 lev per euro peg will remain unchanged regardless of the crisis. Due to the global financial crisis, Fitch Ratings forecasts euro adoption for Bulgaria in 2015. The IMF recommended that the EU's Eastern members consider using the common currency without formally joining the euro area to help repay foreign-currency debt.

***Latest Trade Developments***

- ❑ Major exports: clothing, footwear, iron and steel, machinery and equipment and fuels. More than 60% of the country's exports are destined for Europe.
- ❑ Major imports: machinery and equipment, metals and ores, chemicals and plastics, fuels, minerals and raw materials.
- ❑ South African exports to Bulgaria totaled R370.8m in 2007 and R251.5m in 2008 and R10.7m in the year-to-March 2009.