Country Report

Bulgaria

November 2009

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The Economist Intelligence Unit

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Capital
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Executive summary

Highlights

November 2009

Outlook for 2010-11

- Citizens for European Development of Bulgaria (CEDB) will continue to govern alone, despite lacking a parliamentary majority. This should increase government effectiveness, but presents some risk to political stability.
- The EU will keep Bulgaria under close scrutiny, continuing to demand judicial reform, and results from efforts to combat corruption and crime.
- Given its large external debt and current-account deficit, there is an ongoing risk that Bulgaria will require some financial assistance from the IMF and the EU, although this risk has diminished in recent months.
- Real GDP is estimated to have contracted by 5.3% in 2009, because of limited external finance and the poor economic performance of the euro zone.
- Growth is forecast to rebound weakly, to 1%, in 2010, before trending up to 3.4% in 2011 as both private consumption and investment begin to grow again more strongly.
- Annual inflation is estimated at 2.7% in 2009 and is forecast to average 2.3% in 2010-11 as world oil prices remain relatively low and domestic demand recovers only slowly from the economic crisis.
- Owing to a sharp contraction in domestic demand, we estimate that the current-account deficit narrowed from 25.2% of GDP in 2008 to 12.1% of GDP in 2009, and forecast that it will average about 9% of GDP in 2010-11.

Monthly review

- The CEDB candidate for the mayoral election in Sofia, Iordanka Fandakova, looks set to win the contest; both the Blue Coalition and Ataka have indicated that they will support her rather than field their own candidates.
- The government said that it will apply in February 2010 for entry into the EU's exchange-rate mechanism (ERM2), but there is likely to be some resistance by other member states to Bulgarian entry.
- In September 2009 the appetite for government bonds increased sharply and the interest rates attached to these bonds dropped.
- The banking system remained stable at the end of August, despite the rising trend in bad loans, but credit activity remained depressed.
- In August the smallest year-on-year decline of industrial production was reported since December 2008, but retail trade showed no sign of strengthening, and the decline in construction output accelerated.
- The current account posted a monthly surplus for the second month in a row in August, after deficits in the first half of the year.

Outlook for 2010-11

Political outlook

Domestic politics

In the aftermath of a resounding victory in the parliamentary election in July 2009, the centre-right Citizens for European Development of Bulgaria (CEDB) has set out to govern alone, despite lacking a majority in parliament (the CEDB won 116 out of 240 seats). This presents some risk to political stability, although the prime minister and CEDB leader, Boiko Borisov—who until now was the mayor of the capital, Sofia—feels that this is the most effective path and hopes that the other centre-right and right-wing parties in parliament (Ataka; the Blue Coalition; and the Law, Justice and Order Party) will provide the CEDB with parliamentary support. If this arrangement were to prove unworkable, Mr Borisov thinks that the CEDB could win even more seats in a new election.

With 39.7% of the vote, the CEDB comfortably beat the incumbent Bulgarian Socialist Party (BSP), which won only 17.7% support. The mainly ethnic Turkish Movement for Rights and Freedoms (MRF), a member of the previous coalition, got 14.5%. The BSP's loss of popularity was unsurprising, as the party had been weakened by its association with scandals regarding EU funding and a general lack of progress in cleaning up governance. The CEDB will aim to crack down harder on organised crime and corruption, and to improve the management of EU funds. This is important both for its own sake and to avoid further suspensions or losses of the substantial EU funds allocated to Bulgaria until 2013. This will not be easy, given the ingrained nature of the problems, but pressure from the EU and the public will continue, and the Economist Intelligence Unit expects that some progress will be made in 2010-11.

The CEDB will be aware that since the fall of communism no government in Bulgaria has been elected for two terms in a row. The CEDB can thus be expected to honour at least some of its populist promises. This will be especially important in the context of the economic crisis, during which unemployment is still rising and incomes are suffering. The protests in mid-January 2009 against the outgoing government were not related directly to the economic crisis, and they have been followed by only small tremors of social unrest. However, expressions of unrest cannot be discounted during the remainder of 2009 and 2010, especially as the government will be implementing spending cuts in response to a growing budget deficit.

International relations

In 2008 the European Commission took a hard line with Bulgaria regarding EU funds. The suspension and loss of some EU funds has delayed the implementation of several important projects related to infrastructure, institution-building and agricultural development. However, it is also galvanising the authorities to demonstrate greater commitment to the kind of judicial and administrative reforms demanded by the Commission. These reforms, if continued, should deliver more tangible results in the fight against corruption and organised crime.

The previous government created a new role in the cabinet for overseeing the management of EU assistance. Additionally, the establishment of a new unit in the prosecution office to investigate EU-fund-related fraud was highlighted as a good initiative in the most recent interim report from the EU. However, the report also highlighted many failures, which the new justice minister is trying to address. Although the problems are widespread and entrenched, we expect some progress in 2010-11. Outside the EU, we expect that the CEDB will continue to maintain close ties between Bulgaria and the US.

Economic policy outlook

Policy trends

The new CEDB government will not want to jeopardise the policy anchor provided by Bulgaria's currency board system as the country prepares for euro adoption, which we do not expect to occur before 2013-14. However, there are slight risks to the maintenance of the currency board. Given the downward correction in currency values in several east European countries, there is a risk that Bulgaria's export competitiveness will be harmed by maintaining the current exchange rate. This could slow Bulgaria's recovery from the economic crisis. Additional pressure would arise if Latvia, Estonia and Lithuania were to give up their currency pegs, but even if this were to happen, any government in Bulgaria would be loth to change the currency board arrangement, fearing a repeat of the currency crisis that occurred in 1997.

As monetary policy is constrained by the currency board, the emphasis falls on fiscal policy. Since coming to power in July, the CEDB government has been tightening fiscal policy to try to avoid a deficit. Fiscal policy will remain tight in 2010-11, when the government plans to reduce the rate of social security tax in order to lower the tax burden on businesses to aid economic recovery. As well as reducing the state's redistributive role, the government intends to rationalise state holdings in the industrial sector in 2010-11.

Bulgaria does not have an IMF programme. However, given its large external debt and current-account deficit—as well as our assumptions for reduced access to borrowing and smaller inflows of foreign direct investment (FDI)—there remains a risk that Bulgaria will require some measure of external financial assistance from the IMF and the European Central Bank (ECB, the euro area's central bank). In such a scenario, we expect that the IMF would provide assistance.

Fiscal policy

In January-September 2009 general budget revenue declined by around 11% year on year, but expenditure increased by around 20%. As a result, the budget has deteriorated, recording a deficit of Lv541.1m (US$377m) for the first nine months of the year, or 0.8% of forecast full-year GDP. Although the monthly deficits in August and September were smaller, in response to fiscal tightening since July, we estimate a small deficit in 2009.

The budgetary measures announced by the CEDB aim to save Lv1.15bn (US$800m) by means of expenditure cuts. This will involve cost savings at the ministries and lower investment spending, particularly in the energy sector, but will not include reducing pensions or public-sector wages. The government hopes to boost revenue by a similar amount through cracking down on tax avoidance. Overall, according to the calculations of Simeon Djankov, the finance minister, this would lead to a balanced budget in 2009. However, given the poor outlook for budget revenue, we continue to estimate a small budget deficit in 2009. We expect the CEDB to make it a priority to bring the budget back into balance in 2010-11 and we forecast small surpluses in these years. Given the weak growth outlook in 2010-11, this will require markedly tight government spending.

Monetary policy

Under the currency board arrangement, the lev is tied to the euro, so the Bulgarian National Bank (BNB, the central bank) has limited discretion in adjusting monetary conditions. Owing to the tightness of international financial markets, in December 2008 the BNB reduced minimum reserve requirements for commercial banks in order to boost liquidity in the domestic market. The BNB may reduce these requirements further if it feels that banks will use the liquidity to increase lending and thus aid an economic recovery. Provided that the foreign parent institutions of Bulgarian banks do not run into serious financial problems themselves, we expect the steep slowdown in bank lending in 2009 to stabilise, before picking up slightly in 2010 and more strongly in 2011. We expect this to be a gradual process, given the ongoing need for balance-sheet adjustments, and the upward trend in non-performing loans (NPLs) will also prevent a quicker recovery of bank lending.

Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2008	2009	2010	2011
Real GDP growth				
World	2.8	-1.3	3.2	3.4
Italy	-1.0	-5.0	0.2	0.9
Euro area	0.6	-4.1	0.8	1.0
EU27	0.7	-4.2	0.7	1.2
Exchange rates				
¥:US$	103.4	93.8	90.0	89.0
US$:€	1.470	1.398	1.423	1.398
SDR:US$	0.629	0.645	0.637	0.640
Financial indicators				
€ 3-month interbank rate	4.65	1.22	1.08	2.50
US$ 3-month commercial paper rate	2.18	0.25	0.55	1.50
Commodity prices				
Oil (Brent; US$/b)	97.7	62.0	74.0	70.0
Gold (US$/troy oz)	870.2	960.2	1,043.8	976.3
Food, feedstuffs & beverages (% change in US$ terms)	29.5	-20.0	6.0	1.3
Industrial raw materials (% change in US$ terms)	-5.1	-28.8	18.6	6.0

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Recent data suggest that the worst of the global economic downturn may now be ending, but we remain cautious about the prospects for recovery of the world economy over the short term, in part because of the large balance-sheet adjustments still required by companies and consumers, as well as the likely worsening of the default cycle. We estimate a fall in world output of 1.3% in 2009 at purchasing power parity (PPP) exchange rates. Euro area GDP is estimated to have contracted by 4.1%. The recovery in 2010 is expected to be modest, with world growth picking up to 3.2% at PPP exchange rates, and the euro zone economy growing by just 0.8% (revised up from a previous forecast of 0.5%). The weakness of demand in the EU will continue to curtail Bulgarian exports of goods and services. We estimate the average price for dated Brent Blend crude oil to reach US$62/barrel in 2009, rising to US$74/b in 2010, before slipping to US$70/b (previously US$67/b). We forecast that the US dollar will depreciate mildly in 2010 as risk aversion continues to diminish.

Economic growth

Gross domestic product by expenditure

(Lv m at constant 2000 prices where series are indicated; otherwise % change, year on year)

	2008[a]	2009[b]	2010[c]	2011[c]
Private consumption	29,886.8	27,984.9	28,272.5	28,992.4
	4.8[d]	-6.4[d]	1.0[d]	2.5[d]
Public consumption	5,914.4	6,091.8	5,970.0	5,999.8
	0.0[e]	3.0[e]	-2.0[e]	0.5[e]
Gross fixed investment	15,072.5	12,585.5	12,724.0	13,271.1
	20.4	-16.5	1.1	4.3
Final domestic demand	**50,873.7**	**46,662.2**	**46,966.4**	**48,263.3**
	8.4	-8.3	0.7	2.8
Stockbuilding	2,588.5	-100.0	0.0	280.0
	-1.2[f]	-6.4[f]	0.3[f]	0.7[f]
Total domestic demand	**53,462.1**	**46,562.2**	**46,966.4**	**48,543.3**
	6.9	-12.9	0.9	3.4
Exports of goods & services	27,523.5	22,899.5	23,223.0	23,886.9
	2.9	-16.8	1.4	2.9
Imports of goods & services	-39,246.1	-29,937.3	-30,267.4	-31,150.2
	4.9	-23.7	1.1	2.9
Foreign balance	**-11,722.6**	**-7,037.8**	**-7,044.5**	**-7,263.3**
	-2.7[f]	11.2[f]	0.0[f]	-0.5[f]
GDP	**41,853.9**	**39,638.7**	**40,036.3**	**41,394.3**
	6.0	-5.3	1.0	3.4

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Includes government-financed services (such as health and education) provided to individuals. [e] Covers only collective consumption; excludes government-financed services (such as health and education) provided to individuals. [f] Contribution to real GDP growth (as a percentage of real GDP in the previous year).

In the first and second quarters of 2009 the economy contracted by 3.5% and 4.9% year on year, respectively, with significant declines in industrial production and retail sales, as well as rising unemployment. Real GDP is contracting because of falling domestic demand and the lack of external demand for Bulgarian exports. Private consumption is declining significantly as a result of the poor outlook for jobs and wages, limited availability of borrowing, the repayment of debt, and the negative wealth effect from falling house prices. The scarcity of external finance is leading to an abrupt scaling back of investment activity. The weak outlook in Bulgaria's main export markets means that foreign sales are suffering a sharp decline in 2009, but we expect the fall in imports to continue to be greater, which will help the ongoing correction of the large current-account deficit and is allowing trade to make a positive contribution to growth in 2009.

Real GDP declined by an estimated 5.3% in 2009. A weak recovery in GDP growth is forecast for 2010, at just 1%, as domestic demand will remain subdued owing to high unemployment, slow wage growth and limited borrowing opportunities. Furthermore, government consumption is likely to contract in 2010, given the need for fiscal tightening. We expect that in 2011 households and companies will have worked through some of the necessary balance-sheet adjustments and that demand will start to bounce back, also helped by better borrowing conditions and a more positive outlook in the euro zone. We forecast growth to recover to 3.4% in 2011.

The downside risks to this forecast include that bottlenecks in foreign financing could still worsen and force a sharper than expected reduction in external economic imbalances, that there could be a steeper collapse in the property market, and that the rise in NPLs could be above expectations.

Inflation

With world oil prices expected to remain relatively low compared with 2008 and domestic energy prices falling, we expect that consumer price inflation will continue to trend downwards for the remainder of the year. It is not only cost-push inflation that is waning, but inflationary pressures from the demand side also look minimal for the remainder of 2009 as private consumption and investment contract in real terms. As a result, we estimate inflation to average 2.7% in 2009. We forecast that inflation will remain low in 2010, at an average of 2%, before picking up slightly, to 2.5%, in 2011 as private consumption and investment spending recover more strongly from the economic crisis.

Exchange rates

Political commitment to the currency board arrangement remains strong, and the arrangement is expected to stay in place until euro adoption in 2013-14, with the lev fixed to the euro at the rate of Lv1.95583:€1. The government will apply for entry into the EU's exchange-rate mechanism (ERM2) in February 2010, although we consider that unanimous acceptance by EU members is unlikely straight away. Despite a sharp drop in inflation compared with 2008, the real effective exchange rate (REER) of the lev is continuing to appreciate in 2009, owing to the fall in the value of the currencies of many of Bulgaria's trade competitors. In 2010 we expect that the effective strength of the lev will remain stable. At this stage, concerns about competitiveness are not likely to prompt a move away from the currency board, but additional pressure would arise if Latvia and the other Baltic states were to give up their currency pegs.

External sector

The expansion of the merchandise trade deficit has been the main factor behind the growth of the current-account deficit. We estimate the current-account deficit to moderate to 12.1% of GDP in 2009 and forecast that it will average 9.1% GDP in 2010-11, down from 25.2% of GDP in 2008. This forecast depends on a sharp contraction in imports—sharp enough to outweigh the estimated contraction in exports in 2009—as incomes fall, consumers become more cautious, and firms import fewer goods for fixed investment in response to the depressed economic outlook and a scarcity of external finance.

We expect that FDI inflows in 2010-11 will be much lower than in 2006-08, and that inter-company lending, although much diminished, will remain a source of some external finance for foreign-owned companies in Bulgaria. Lower FDI inflows and the tightness of international liquidity mean that Bulgaria will record a balance-of-payments deficit in 2009, but a healthy stock of foreign reserves should be enough to avert a crisis. Although currently able to obtain the external finance that it requires to roll over its external debts, there remains a risk in 2010-11 that Bulgaria will require some measure of external financial assistance from the IMF and the EU.

Forecast summary

(% unless otherwise indicated)

	2008[a]	2009[a]	2010[b]	2011[b]
Real GDP growth	6.0[c]	-5.3	1.0	3.4
Industrial production growth	0.8	-16.0	0.4	3.0
Gross agricultural production growth	24.6	-2.5	0.8	1.5
Unemployment rate (av)	6.3	9.1	9.0	7.3
Consumer price inflation (av; national measure)	12.3[c]	2.7	2.0	2.5
Consumer price inflation (year-end; national measure)	7.8[c]	0.9	2.2	2.6
Consumer price inflation (av; EU harmonised measure)	12.0	2.2	1.7	2.4
Short-term interbank rate	10.9[c]	11.1	10.9	10.4
Consolidated budget balance (% of GDP)	3.0	-1.3	0.3	0.7
Exports of goods fob (US$ bn)	22.7	16.2	17.5	19.0
Imports of goods fob (US$ bn)	35.6	23.3	24.0	25.1
Current-account balance (US$ bn)	-12.6	-5.9	-5.1	-4.5
Current-account balance (% of GDP)	-25.2	-12.1	-9.9	-8.3
External debt (year-end; US$ bn)	50.2	49.8	49.9	48.1
Exchange rate Lv:US$ (av)	1.33[c]	1.40	1.37	1.40
Exchange rate Lv:€ (av)	1.96[c]	1.96	1.96	1.96
Exchange rate SDR:Lv (year-end)	0.479[c]	0.473	0.456	0.458

[a] Economist Intelligence Unit estimates. [b] Economist Intelligence Unit forecasts. [c] Actual.

Monthly review: November 2009

The political scene

The right will support the CEDB in the mayoral election

After the parliamentary election in July 2009 Citizens for European Development of Bulgaria (CEDB) formed a minority government, having won 116 out of 240 seats in parliament. The other centre-right and right-wing parties in parliament—the Blue Coalition, comprising the Union of Democratic Forces (UDF) and Democrats for a Strong Bulgaria (DSB); the Law, Justice and Order Party; and Ataka—broadly assented to support the government. According to a poll by Alpha Research in September, the government still enjoys strong public support, with 44% positive about the government, 47% neutral and only 9% negative. This support rests to a large extent on the popularity of Boiko Borisov, the prime minister, who, with an approval rate of 57% and only 10% of respondents disapproving, remains the most popular politician in the country.

This level of public support provides the platform for the government to enact its policy priorities so long as the CEDB can retain the backing of its allies in parliament. In the months since the election the CEDB has been largely successful in this. There has been some criticism of economic policy, notably from Martin Dimitrov, the leader of the UDF, but the government has not encountered any sustained or serious opposition. This status quo seems to be continuing in the run-up to the mayoral election for the capital, Sofia, due to be held on November 13th. However, there has been disagreement within the Blue Coalition and the UDF in particular on this matter.

A mayoral election needs to be held to choose the replacement for Mr Borisov, as he relinquished the post to become prime minister. The CEDB's candidate is Mr Borisov's former deputy and the current education minister, Iordanka Fandakova. Both the Blue Coalition and Ataka have indicated that they will support Ms Fandakova rather than field their own candidates. The Law, Justice and Order Party (with ten seats in parliament, compared with 21 for Ataka and 15 for the Blue Coalition) will put forward a contestant. However, the decision by the Blue Coalition came after significant internal struggle. This struggle was mostly within the UDF. Borislav Borislavov, chief of the UDF in Sofia, and Lyuben Petrov, the UDF's deputy chair, both confirmed the UDF's decision to support the CEDB candidate. In previous weeks, however, Mr Dimitrov had expressed his wish that the UDF should field its own candidate. At the UDF's yearly national congress on October 17th he again criticised the decision, saying that the agreement being brokered between the CEDB and the Blue Coalition was an empty one. This criticism may be a response to the failure of the UDF and the DSB to agree with the CEDB that they would gain deputy mayoral positions.

Despite dissent within the UDF, the final decision of the Blue Coalition (and Ataka) to support the CEDB's candidate provides a boost to Ms Fandakova's chances of winning the contest, for which she is already the favourite, according to recent polls. Furthermore, the Bulgarian Socialist Party (BSP), the main opposition party, is in disarray. Georgi Kadiev, the party's candidate for the mayoral position, came in for criticism from Sergei Stanishev, the leader of the BSP and a former prime minister, but hit back by claiming that he did not seek Mr Stanishev's support.

The government will apply in February 2010 for ERM2 entry

After assuming power, the CEDB announced its intention to apply as soon as possible for entry into the EU's exchange-rate mechanism (ERM2), the two-year mechanism to test currency stability in advance of euro adoption. The initial date mentioned was November 2009, but in late September the government said that it planned to apply in February 2010. The policy remains a priority, and the government believes that it would boost investor confidence and therefore be positive for the country's recovery from the economic crisis. However, widespread concern among EU member states about Bulgaria's manifest institutional failings may hinder the country's attempt to join ERM2.

Entry into ERM2 does not depend only on defined economic criteria, but is also subject to wider considerations and requires unanimous support from EU members. Since joining the EU in 2007, Bulgaria's high rate of inflation and large current-account deficit, which reached 25% of GDP in 2008, prevented Bulgaria from joining ERM2. Inflation has rapidly come under control and the current account is correcting sharply. These developments, together with a relatively healthy budgetary position and the maintenance of a currency peg to the euro since 1998, suggest that Bulgaria will soon have a plausible case for joining ERM2 on economic grounds (although EU members may consider that the current-account deficit is still too large and therefore a source of vulnerability).

However, Bulgaria does not have a good image in the EU, as a result of past and ongoing problems with the absorption of EU funds, the judiciary, corruption and organised crime. In addition, the EU has recently warned Bulgaria about four serious examples of "failure to provide adequate protection for its natural heritage"; if necessary, the commission could take legal action against Bulgaria to address these issues. Given these considerations, it is likely that there will be significant resistance to Bulgarian entry as early as 2010.

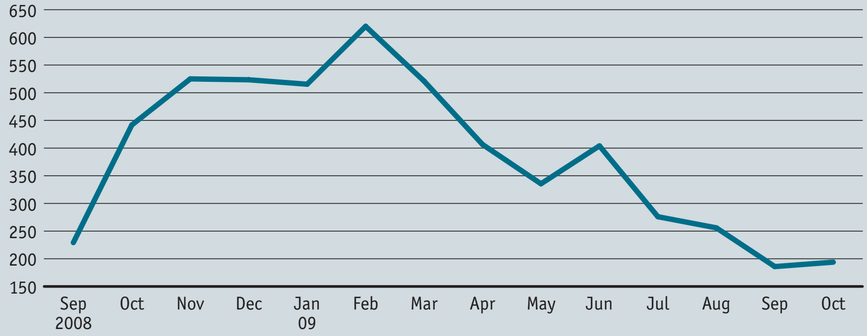
Economic policy

Government bonds are in high demand in September

In September the appetite for government bonds increased sharply and the interest rates attached to these bonds dropped. On September 28th the government offered ten-year bonds totalling Lv30m (US$21m). Orders were 3.3 times greater, whereas at the previous auction, in July, orders were one-third less than the proposed amount of the issue. There was strong demand in the latest auction from pension funds, insurance companies and investment firms. As a result, the interest rate on the bonds declined to 7.27%, compared with 8% in July. Two days after this auction, the Ministry of Finance decided that it would issue another Lv30m of ten-year bonds, owing to the high level of demand. Investors responded well to this and the interest rate edged down further, to 7.25%.

Although these auctions were not large issues, the strong demand in contrast to the previous auction and the lower interest rates are a reflection of improved sentiment regarding government economic policy, especially the tightening of fiscal policy. When commenting on the success of the bond issues, the finance ministry pointed out that the price of sovereign credit default swaps (CDSs; an indicator of risk) on Bulgaria has fallen dramatically, from over 600 basis points in February to 190 basis points at the end of September.

Sovereign credit default swap spread
(basis points; monthly average)



Source: Bloomberg.

The revised data for the government budget in August revealed that the deficit was Lv92m, compared with Lv105m according to preliminary data. This means that for January-August the cumulative deficit was Lv478.8m. In September the deficit expanded to Lv541.1m, but the monthly deficit was only Lv62m, which may suggest that the government's tightening of fiscal policy is growing in effect. The decline in budget revenue in January-September was 11% year on year, which is the same as in January-August, but expenditure growth tightened slightly, from 21.9% in January-August to 20.2% in January-September. Furthermore, in the first half of October there has been an increase in the government's deposit with the Bulgarian National Bank (BNB, the central bank), which is often an indication of improved fiscal performance.

With the budget deficit starting to come under control, the finance minister, Simeon Djankov, said that an IMF deal looked increasingly unnecessary. However, Mr Djankov suggested that Bulgaria may issue Eurobonds in 2010, when the government will again have to keep fiscal policy tight, especially given the continuing rise in unemployment.

Bank lending remains subdued in August, but system is stable

The banking system was stable at the end of August, despite the rising trend in bad loans, but credit activity remained depressed. The banking system's total assets stood at Lv69.1bn (US$49.4bn), almost the same as at the beginning of the year (in January they were Lv69bn), but the capital of the banks has increased from Lv8.1bn in January to Lv9.1bn. About one-half of the increase stems from 2009 profits, and the remainder has been financed by the owners of the banks. In August impairment costs hit a historical high, increasing by Lv125m during the month. Despite this impairment, the banking system generated a monthly profit, and the cumulative profit from the beginning of the year reached Lv577m. However, this profit is much lower than in previous years, and the rise in impairments is holding back lending activity. Total loans in August to enterprises and households remained unchanged from July, at Lv50bn, as a small increase in retail loans was accompanied by a slight decline in loans to the corporate segment. Domestic credit growth was 5.9% year on year, which is the lowest rate so far in 2009.

The BNB made a stress test of the banking system based on the previous IMF forecast for a 7% decline in real GDP in 2009, followed by a 2.5% drop in 2010 (the IMF forecast has since been revised up slightly). With this assumption, the banking system's capital-adequacy rate of 17.6% before the test would fall to between 11.6% and 14.5%, which is still higher than the 8% regulatory minimum in the EU. In addition, the banking system has been building up buffers in the form of provisions for impairment. This test suggests that the banking system is well placed to withstand the difficult period ahead.

Economic performance

Signs of economic recovery remain weak and mixed

In August the smallest year-on-year decline of industrial production was reported since December 2008, but retail trade showed no sign of strengthening and the decline in construction output accelerated.

Industrial output registered a 15.9% year-on-year decline in August, the smallest annual decline in 2009. The decline in July was 18.7% year on year and the fall in industrial output in the first half of 2009 was 18.9%. Mining and quarrying output was down by 17.7% year on year after dropping by 23.5% year on year in January-July, and manufacturing production was 18.8% lower than in August 2008, compared with a year-on-year decline of 23.1% in January-July. Some subsectors, such as the production of textiles, chemicals and wearing apparel, continued to suffer acutely from low demand, with month-on-month declines in August of 33%, 23.5% and 21.2%, respectively. Subsectors that recorded a significant monthly increase in production in August included tobacco products (20.8%), pharmaceutical products (10.1%) and other transport equipment (42.6%).

The above suggests a tentative overall improvement in August, although industrial turnover remained subdued. The National Statistical Institute's industrial turnover index decreased by 23.2% year on year, which is only slightly better then the drops of 24.2% and 23.8% in June and July, and worse than the 21.1% decline in January-July. The continuing low level of producer prices is one limiting factor on industrial turnover. In August producer prices increased by 0.2% month on month, but were 10.7% lower year on year, which is the fastest rate of producer price deflation since the beginning of the economic crisis.

High-frequency economic indicators, 2009

(% change, year on year, unless otherwise indicated)

	1 Qtr	Apr	May	Jun	Jul	Aug
Industrial output	-17.6	-20.2	-22.1	-18.2	-18.7	-15.9
Retail sales	-5.6	-9.4	-10.4	-10.5	-9.3	-9.5
Construction output	-6.4	-8.7	-14.9	-9.1	-14.4	-17.0
Unemployment rate (% of labour force)	6.7	7.0	7.1	7.3	7.6	7.9
Loans to non-financial corporations, households & non-profit institutions serving households	27.4	20.2	15.5	11.2	7.6	5.4

Sources: National Statistical Institute; Bulgarian National Bank.

Retail sales data suggested that consumer demand, although not picking up, may have stabilised for now. Retail sales fell in volume terms by 9.5% year on year in August, following contractions of 10.5% and 9.3% in June and July, respectively. Other indicators suggest that a recovery is not imminent. Construction output, for example, continued to trend downwards, falling by 17% year on year in August, compared with a 14.4% drop in July and a 9.1% drop in June. Furthermore, the growth of unemployment shows no sign of abating—the number of unemployed increased by almost 30,000 in May-August, causing the unemployment rate to climb from 7.1% in May to 7.9% in August. In September a further 5,648 workers became unemployed, pushing the rate to about 8%. The ongoing problems in the real estate market and the increase in unemployment are likely to keep providing impetus to the rise in non-performing loans (NPLs) for the remainder of 2009 and into 2010. Although the banking sector still remains sound, this development will strain balance sheets and hold back a recovery in lending, which in turn will act as a brake on economic growth in 2010.

The current account is in surplus in August

In August the current account posted a monthly surplus for the second month in a row, after deficits in the first half of the year. This surplus amounted to €284m (US$405m), compared with €102m in July, and outweighed the deficit on the financial account (although a negative for net errors and omissions caused a deficit in the overall balance of payments). This monthly current-account surplus is a sign of the sharp adjustment that started after the worsening of the financial crisis in October 2008, when the monthly current-account deficit reached a record level of €1.2bn (US$1.7bn).

This correction to the current-account deficit mostly stems from the larger fall in goods imports than the fall in goods exports year on year. In August exports fell by 25.4% year on year, which is the slowest rate of decline since the beginning of 2009 (the fastest decline was in April, when exports shrank by almost 40% year on year). Imports contracted by 34% year on year, which is also an improvement compared with the 42% drop year on year in June. Because of the faster decline in imports than exports, the trade deficit in August was Lv500m, the smallest since the beginning of 2009—a contraction of 54.4% year on year. The trade deficit for January-August 2009 was Lv6bn, which is around 44% smaller than in the year-earlier period, when the deficit was Lv10.9bn.

However, it is worth noting that in August (as in July) the current-account surplus can also be explained to a significant degree by an increase in the services surplus, which increased by 16% year on year, to Lv460m. This was partly the result of an increase in the credits from travel services, suggesting a successful tourist season. In addition, the income balance recorded a surplus, owing to a smaller repatriation of income earned from investment.

The financial account, however, was negative (with a deficit of €89.8m) and contributed to an overall deficit on the balance of payments. Net inflows of foreign direct investment (FDI) were under €50m in August, bringing the total to €1.9bn for January-August—a drop of 54.8% year on year. For January-August the balance-of-payments deficit reached almost €1.2bn, whereas in the year-earlier period there was a surplus of €2.4bn. This causes a drop in the foreign-currency reserves of the central bank and thus is a source of risk to the currency board arrangement. However, in August foreign reserves increased to Lv23.7bn, which is their highest level since December 2008, largely owing to €517m worth of funds received from the IMF, which came as part of an anti-crisis disbursement by the Fund to its members. A further €148.7m was received from the IMF in September.

Data and charts

Annual data and forecast

	2005[a]	2006[a]	2007[a]	2008[b]	2009[b]	2010[c]	2011[c]
GDP							
Nominal GDP (US$ m)	27,260	31,690	39,551	50,153	48,751	51,623	54,233
Nominal GDP (Lv m)	42,797	49,361	56,520	66,728	68,203	70,978	75,900
Real GDP growth (%)	6.2	6.3	6.2	6.0[a]	-5.3	1.0	3.4
Expenditure on GDP (% real change)							
Private consumption	6.1	9.5	5.3	4.8[a]	-6.4	1.0	2.5
Government consumption	2.6	-1.4	3.1	0.0[a]	3.0	-2.0	0.5
Gross fixed investment	23.3	14.7	21.7	20.4[a]	-16.5	1.1	4.3
Exports of goods & services	8.5	8.7	5.2	2.9[a]	-16.8	1.4	2.9
Imports of goods & services	13.1	14.0	9.9	4.9[a]	-23.7	1.1	2.9
Origin of GDP (% real change)							
Agriculture	-0.9	0.1	-29.7	24.6	-2.5	0.8	1.5
Industry	3.4	3.6	14.0	3.0	-14.0	0.4	3.0
Services	9.0	5.6	7.5	5.9	-2.0	1.3	3.8
Population and income							
Population (m)	7.7	7.6	7.6	7.5	7.5	7.4	7.4
GDP per head (US$ at PPP)	9,406[b]	10,395[b]	11,426[b]	12,445	12,000	12,366	13,042
Recorded unemployment (av; %)	11.5	9.6	7.7	6.3	9.1	9.0	7.3
Fiscal indicators (% of GDP)							
Consolidated state budget revenue	42.1	40.6	42.6	40.9	36.5	36.5	36.4
Consolidated state budget expenditure	39.0	37.0	39.1	38.0	37.7	36.2	35.8
Consolidated state budget balance	3.1	3.5	3.5	3.0	-1.3	0.3	0.7
Public debt (ESA measure)	29.2	22.7	18.2	14.1	21.3	24.0	24.1
Prices and financial indicators							
Exchange rate Lv:US$ (end-period)	1.66	1.49	1.33	1.39[a]	1.32	1.41	1.39
Exchange rate Lv:€ (end-period)	1.96	1.96	1.94	1.93[a]	1.96	1.96	1.96
Consumer prices (end-period; %)	6.5	6.5	12.5	7.8[a]	0.9	2.2	2.6
Stock of money M1 (% change)	20.8	29.2	28.9	-4.1	-13.4	2.9	8.1
Stock of money M2 (% change)	24.5	27.6	31.3	8.8	0.1	4.7	7.5
Lending interest rate (av; %)	8.7	8.9	10.0	10.9[a]	11.1	10.9	10.4
Current account (US$ m)							
Trade balance	-5,450	-7,028	-10,071	-12,934	-7,098	-6,542	-6,063
Goods: exports fob	11,754	15,101	18,575	22,706	16,212	17,485	19,041
Goods: imports fob	-17,204	-22,130	-28,646	-35,640	-23,310	-24,027	-25,104
Services balance	1,000	1,189	1,515	1,302	1,522	1,576	1,657
Income balance	90	-679	-624	-1,808	-950	-998	-1,031
Current transfers balance	1,013	844	464	795	651	844	925
Current-account balance	-3,347	-5,673	-8,716	-12,645	-5,876	-5,120	-4,513
External debt (US$ m)							
Debt stock	15,700	20,990	32,968	50,179	49,816	49,925	48,098
Debt service paid	3,965	2,735	4,239	5,234	7,342	9,467	10,278
Principal repayments	3,352	1,992	3,034	3,530	5,963	8,072	8,308
International reserves (US$ m)							
Total international reserves	8,699	11,758	17,538	17,927[a]	16,535	15,683	15,534

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts.

Source: IMF, *International Financial Statistics*.

Quarterly data

	2007		2008				2009	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Consolidated government finance[a] (Lv m)								
Revenue	6,082	6,731	6,744	7,287	6,821	6,465	6,400	6,555
Expenditure	4,888	7,973	5,080	5,169	5,627	9,440	5,885	6,885
Balance	1,193	-1,242	1,664	2,118	1,194	-2,975	514	-330
Output								
GDP at current prices (US$ bn)	11.1	12.1	10.3	12.7	14.3	12.6	9.3	11.4
GDP at constant prices (% change, year on year)	4.9	6.9	7.0	7.1	6.8	3.5	-3.5	-4.9
Employment, wages and prices								
Employees with labour contract ('000)	2,337	2,306	2,450	2,502	2,495	2,436	2,413	2,402
Employees with labour contract (% change, year on year)	1.9	2.6	6.2	6.8	6.8	5.6	-1.5	-4.0
Registered unemployment ('000)	259.6	250.2	264.6	230.4	218.0	221.9	252.5	264.3
Unemployment rate (% of the labour force)	7.0	6.8	7.1	6.2	5.9	6.0	6.7	7.4
Average nominal monthly wages (Lv)	427	457	484	510	523	549	563	588
Average monthly wages (% change, year on year)	21.7	23.2	24.4	24.2	22.6	20.1	16.2	15.4
Consumer prices (Dec 1995=100)	5,265	5,472	5,675	5,790	5,906	5,978	6,015	6,030
Consumer prices (% change, year on year)	11.2	12.5	13.3	15.0	12.2	9.3	6.0	4.1
Producer prices (2000=100)	123.4	126.7	129.3	133.9	139.0	132.6	125.1	124.9
Producer prices (% change, year on year)	7.6	10.8	13.9	13.0	12.7	4.7	-3.2	-6.7
Financial indicators								
Exchange rate Lv:US$ (av)	1.42	1.35	1.30	1.25	1.30	1.49	1.50	1.43
Exchange rate Lv:US$ (end-period)	1.38	1.33	1.24	1.24	1.37	1.39	1.47	1.38
Deposit rate (av)	3.7	3.8	3.9	4.1	4.1	5.7	6.0	6.3
Lending rate (av)	9.9	10.2	10.6	10.8	10.8	11.3	11.3	11.3
Money market rate (av)	4.1	4.5	4.8	5.0	5.3	5.6	3.6	2.3
M1 (end-period; Lv bn)	19,174	20,727	19,848	20,327	20,525	19,867	17,750	17,910
M1 (% change, year on year)	30.0	28.9	22.0	14.2	7.0	-4.1	-10.6	-11.9
M2 (end-period; Lv bn)	38,221	42,042	42,210	43,929	45,632	45,688	44,842	45,497
M2 (% change, year on year)	29.2	31.3	29.0	24.3	19.4	8.7	6.2	3.6
Foreign trade (US$ m)								
Exports fob	4,933	5,334	5,488	6,396	6,264	4,336	3,486	3,736
Imports cif	7,380	8,678	8,141	10,265	9,289	7,414	4,977	5,436
Trade balance	-2,447	-3,344	-2,653	-3,869	-3,025	-3,077	-1,492	-1,700
Balance of payments (US$ m)								
Merchandise trade balance fob-fob	-2,447	-3,344	-2,653	-3,869	-3,025	-3,077	-1,492	-1,700
Services balance	1,159	-301	-357	341	1,488	-249	-126	353
Income balance	-571	-381	-147	-811	-427	-571	-381	-479
Net transfer payments	103	159	212	544	85	-46	152	285
Current-account balance	-1,757	-3,867	-2,946	-3,794	-1,880	-3,943	-1,846	-1,542
Reserves excl gold (end-period)	15,653	16,478	17,956	19,680	19,965	16,816	14,546	15,604

[a] Includes local government budgets and social security.

Sources: National Statistical Institute, *Statistical Journal*; Bulgarian National Bank, *Monthly Bulletin*; IMF, *International Financial Statistics*.

Monthly data

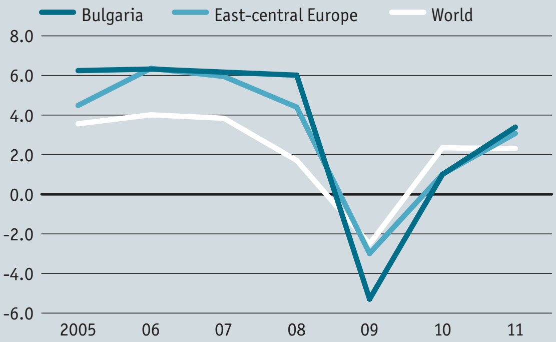
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate Lv:US$ (av)												
2007	1.51	1.50	1.48	1.45	1.45	1.46	1.43	1.44	1.41	1.37	1.33	1.34
2008	1.33	1.33	1.26	1.24	1.26	1.26	1.24	1.31	1.36	1.47	1.54	1.46
2009	1.48	1.53	1.50	1.48	1.43	1.40	1.39	1.37	1.34	n/a	n/a	n/a
Exchange rate Lv:US$ (end-period)												
2007	1.51	1.48	1.47	1.43	1.45	1.45	1.43	1.43	1.38	1.35	1.33	1.33
2008	1.32	1.29	1.24	1.26	1.26	1.24	1.25	1.33	1.37	1.53	1.54	1.39
2009	1.53	1.55	1.47	1.47	1.39	1.38	1.38	1.37	1.34	n/a	n/a	n/a
Real effective exchange rate												
2007	199.93	199.60	206.04	215.54	218.54	217.75	229.32	230.21	237.27	248.62	264.00	255.30
2008	260.17	261.68	289.57	293.63	287.04	286.52	295.88	275.72	256.18	229.79	212.20	223.78
2009	219.66	206.47	216.07	219.67	234.98	243.57	245.00	248.96	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2007	3.6	3.6	3.7	3.7	3.6	3.7	3.7	3.7	3.6	3.7	3.7	4.0
2008	3.7	4.1	4.0	4.0	4.1	4.2	4.0	4.0	4.2	4.5	5.3	7.2
2009	6.5	5.8	5.7	6.2	6.2	6.5	6.5	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2007	9.9	9.8	10.0	10.1	10.0	9.7	9.9	10.0	9.9	10.1	10.3	10.3
2008	10.5	10.6	10.7	10.7	10.8	10.8	10.7	10.9	10.8	11.2	11.4	11.4
2009	11.5	11.1	11.1	11.2	11.2	11.4	11.5	n/a	n/a	n/a	n/a	n/a
M1 (% change, year on year)												
2007	34.8	32.7	31.5	32.1	28.7	32.4	28.9	30.3	30.0	28.5	27.2	28.9
2008	24.6	22.4	22.0	22.3	20.7	14.1	14.0	10.2	7.0	2.6	-0.4	-4.1
2009	-6.2	-8.4	-10.6	-12.8	-13.7	-11.9	-15.1	n/a	n/a	n/a	n/a	n/a
M2 (% change, year on year)												
2007	29.8	28.4	28.7	30.0	27.9	28.5	29.5	30.9	29.7	29.1	30.9	31.3
2008	31.1	30.0	29.0	28.4	27.6	24.7	23.7	20.7	19.5	15.1	10.9	8.8
2009	8.2	7.5	6.2	5.0	4.1	3.0	1.1	n/a	n/a	n/a	n/a	n/a
Industrial production (% change, year on year)												
2007	5.2	13.5	13.2	12.4	8.8	6.8	13.6	7.7	8.5	11.4	8.9	5.9
2008	7.5	5.2	-1.0	7.0	5.6	4.2	4.3	-3.9	3.4	-3.3	-9.1	-8.5
2009	-18.4	-17.7	-16.9	-20.2	-22.1	-18.2	-18.7	-15.9	n/a	n/a	n/a	n/a
Retail sales (% change, year on year)												
2007	22.4	22.8	24.9	23.0	21.1	19.3	18.6	17.0	16.1	16.2	14.8	16.1
2008	8.3	8.3	6.8	7.9	3.9	4.3	4.1	1.4	1.0	1.0	-1.1	-3.3
2009	-1.8	-6.4	-8.4	-9.4	-10.4	-10.5	-9.3	-9.5	n/a	n/a	n/a	n/a
Stockmarket index (SOFIX; end-period, Oct 20th 2000=100)												
2007	1,339	1,305	1,278	1,274	1,336	1,412	1,570	1,606	1,850	1,934	1,764	1,768
2008	1,403	1,430	1,255	1,138	1,260	1,154	1,014	1,028	792	492	363	359
2009	287	265	278	359	380	357	356	454	480	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2007	7.1	4.5	4.1	4.2	4.3	5.6	8.4	12.0	13.1	12.4	12.6	12.5
2008	12.5	13.2	14.2	14.6	15.0	15.3	14.5	11.2	11.0	10.9	9.1	7.8
2009	7.1	6.0	4.9	4.8	3.9	3.7	1.6	1.3	0.2	n/a	n/a	n/a
Producer prices (av; % change, year on year)												
2007	7.9	5.4	6.8	6.7	4.9	5.2	6.8	7.7	8.1	9.9	12.2	10.2
2008	12.4	14.0	15.3	13.3	12.7	12.9	13.6	12.7	11.8	9.9	4.0	0.2
2009	-1.1	-3.0	-5.5	-6.1	-6.7	-7.3	-10.6	-10.7	n/a	n/a	n/a	n/a

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Total exports fob (US$ m)												
2007	1,129	1,185	1,489	1,405	1,504	1,597	1,704	1,561	1,669	1,856	1,862	1,616
2008	1,640	1,791	2,057	2,162	2,059	2,175	2,403	1,974	1,887	1,720	1,365	1,252
2009	1,072	1,150	1,264	1,097	1,240	1,398	1,448	n/a	n/a	n/a	n/a	n/a
Total imports cif (US$ m)												
2007	1,878	1,793	2,167	2,078	2,281	2,313	2,522	2,355	2,503	2,859	3,028	2,792
2008	2,537	2,665	2,939	3,364	3,310	3,590	3,587	2,814	2,888	2,987	2,316	2,111
2009	1,529	1,599	1,850	1,723	1,836	1,877	2,043	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US$ m)												
2007	-749.8	-608.3	-677.1	-673.1	-776.7	-716.3	-818.4	-794.4	-834.0	-1,002.2	-1,166.0	-1,175.3
2008	-896.9	-873.4	-882.6	-1,202.3	-1,250.5	-1,415.8	-1,183.9	-839.7	-1,001.5	-1,267.2	-951.4	-858.5
2009	-457.0	-448.9	-586.0	-625.4	-595.8	-479.0	-595.3	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US$ m)												
2007	10,284	10,408	11,112	11,644	11,263	12,089	12,655	13,295	15,653	16,077	16,746	16,478
2008	16,185	16,441	17,956	18,994	18,745	19,680	20,131	20,113	19,965	17,170	17,193	16,816
2009	14,365	13,982	14,546	14,517	15,359	15,604	15,354	16,100	n/a	n/a	n/a	n/a
Budget revenue (Lv m)												
2007	1,494	1,393	2,164	2,205	2,141	1,854	1,972	2,019	2,091	2,012	2,351	2,369
2008	2,083	1,798	2,863	2,873	2,140	2,275	2,411	2,188	2,222	2,215	2,122	2,128
2009	2,616	1,651	2,133	2,701	1,943	1,910	1,797	1,830	n/a	n/a	n/a	n/a
Budget expenditure (Lv m)												
2007	1,391	1,516	1,605	1,475	1,563	1,541	1,713	1,564	1,611	1,814	1,943	4,216
2008	1,643	1,663	1,774	1,832	1,539	1,798	1,974	1,775	1,878	2,152	2,563	4,725
2009	1,709	1,971	2,206	2,540	2,063	2,282	2,367	1,923	n/a	n/a	n/a	n/a
Budget balance (Lv m)												
2007	102.9	-122.9	559.4	729.9	577.7	313.3	259.0	454.5	479.6	197.5	408.1	-1,847.4
2008	440.3	134.4	1,089.2	1,040.7	600.8	476.6	437.1	412.8	344.0	63.5	-440.9	-2,597.3
2009	907.2	-319.5	-73.4	161.2	-120.0	-371.6	-570.3	-92.4	n/a	n/a	n/a	n/a
Unemployment rate (%)												
2007	9.7	9.5	8.9	8.4	7.8	7.4	7.3	7.0	6.8	6.7	6.6	6.9
2008	7.4	7.3	6.8	6.5	6.2	6.0	6.0	5.9	5.8	5.9	5.9	6.3
2009	6.5	6.7	6.9	7.0	7.1	7.3	7.6	7.9	8.0	n/a	n/a	n/a
Average monthly wages (% change, year on year)												
2007	17.2	18.8	16.9	18.1	20.6	20.1	22.3	21.7	21.1	22.5	24.7	22.4
2008	25.4	23.1	24.7	26.4	21.2	25.0	22.2	22.1	23.4	23.4	19.4	17.9
2009	16.3	16.7	15.8	15.8	16.3	14.0	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, *International Financial Statistics*; Haver Analytics.

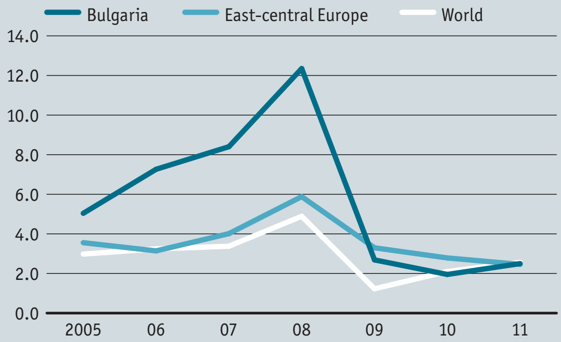
Annual trends charts

Real GDP growth
(% change)



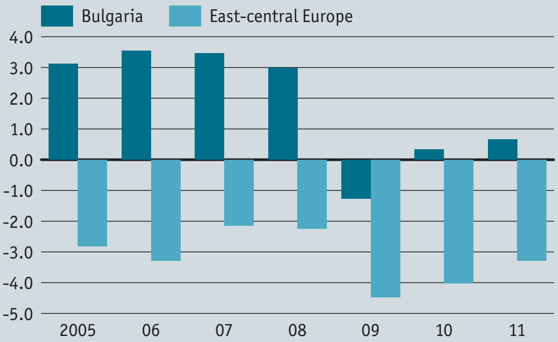
Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



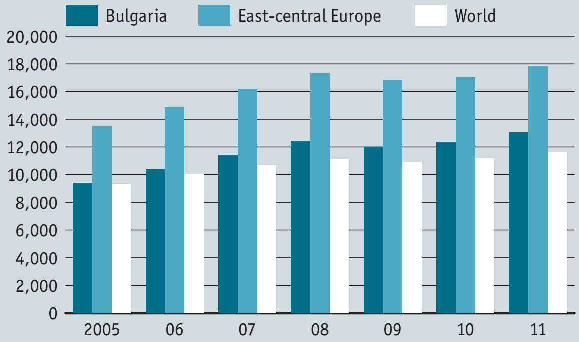
Source: Economist Intelligence Unit.

Budget balance
(% of GDP)



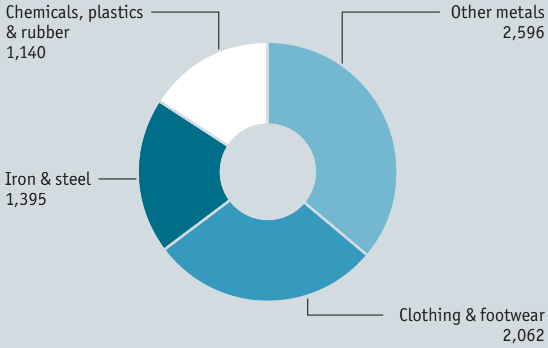
Source: Economist Intelligence Unit.

GDP per head
(US$; PPP)



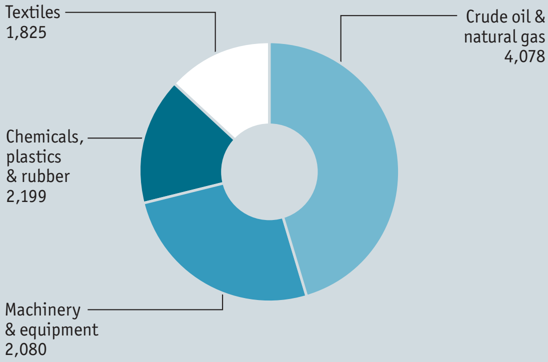
Source: Economist Intelligence Unit.

Principal exports fob, 2008
(US$ m)



Source: Economist Intelligence Unit.

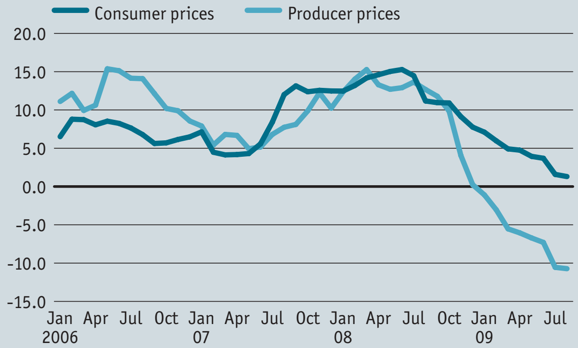
Principal imports cif, 2008
(US$ m)



Source: Economist Intelligence Unit.

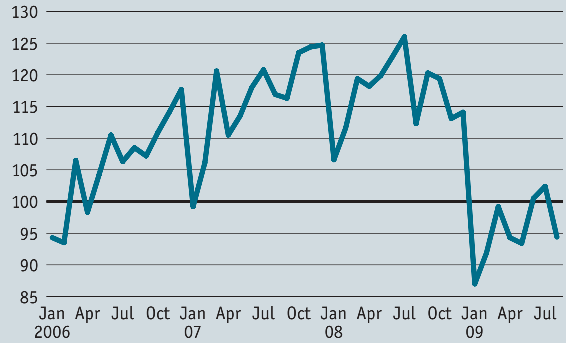
Monthly trends charts

Price inflation
(% change, year on year)



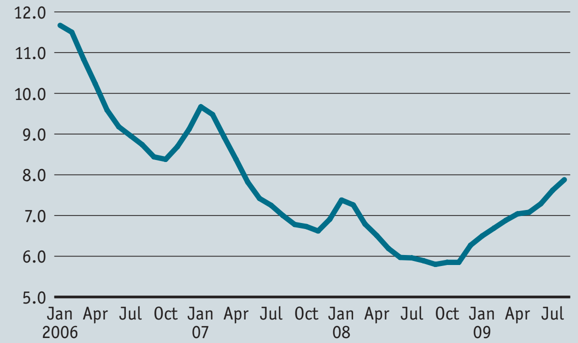
Source: Economist Intelligence Unit.

Index of industrial activity
(av; 1996=100)



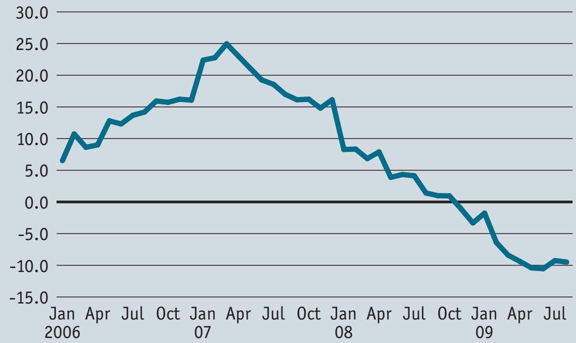
Source: Economist Intelligence Unit.

Unemployment rate
(%)



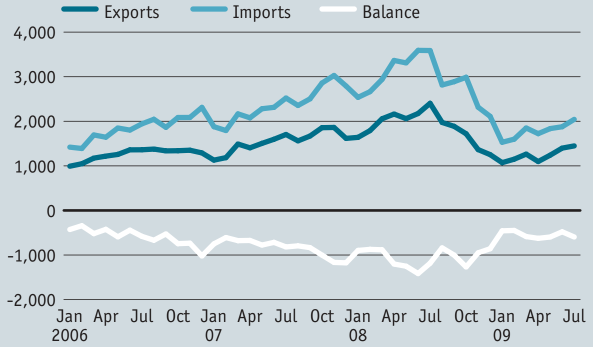
Source: Economist Intelligence Unit.

Retail sales
(% change, year on year)



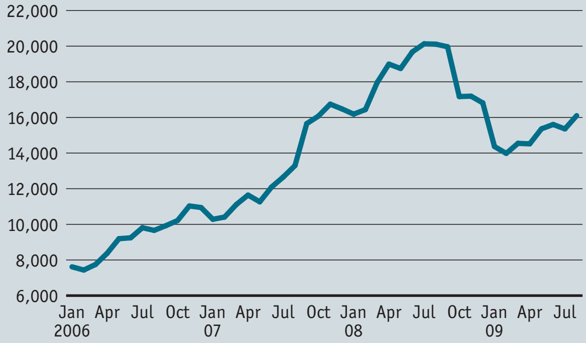
Source: Economist Intelligence Unit.

Foreign trade
(US$ m; goods only)



Source: Economist Intelligence Unit.

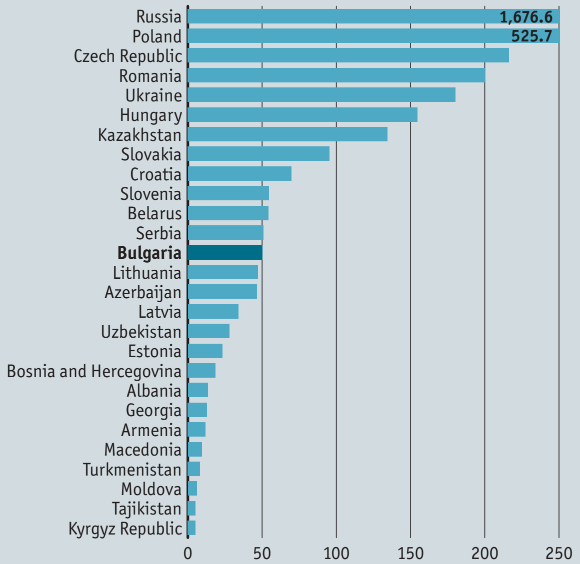
Foreign-exchange reserves
(US$ m)



Source: Economist Intelligence Unit.

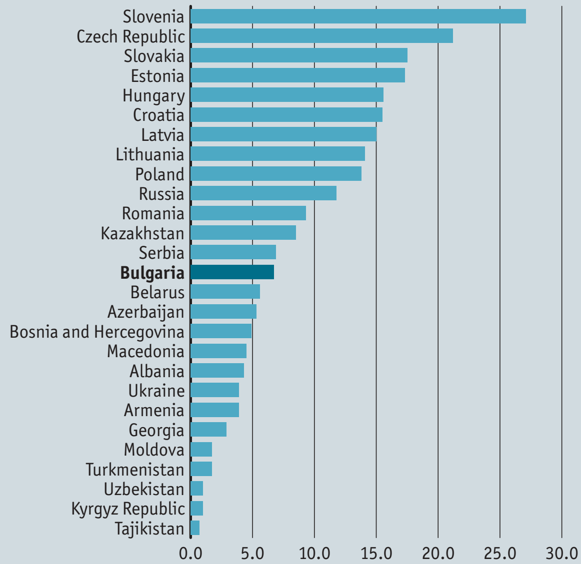
Comparative economic indicators, 2008

Gross domestic product
(US$ bn; market exchange rates)



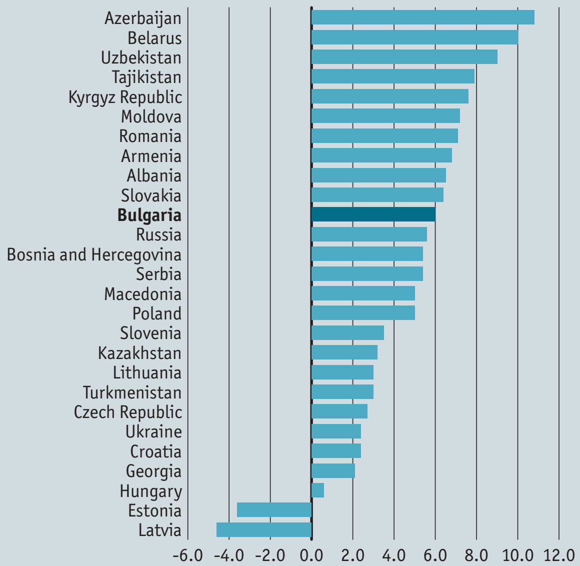
Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product per head
(US$ '000; market exchange rates)



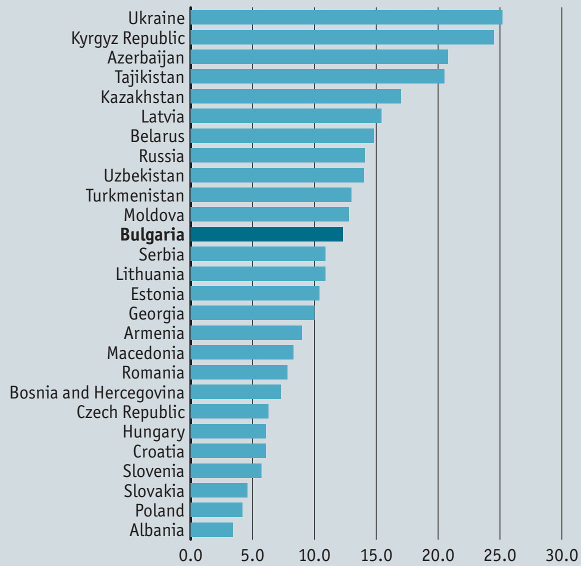
Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

Consumer prices
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

Country snapshot

Basic data

Total area	111,002 sq km, of which 28% is arable land and 33% forest
Population	7.61m (December 2008)
Main cities	Population in '000 (December 2007)[a]

Sofia (capital)	1,241	Stara Zagora	356
Plovdiv	705	Blagoevgrad	329
Varna	460	Pleven	298
Burgas	420	Pazardzhik	294

[a] Population figures relate to planning districts (oblasts) rather than cities.

Climate	Continental
Weather in Sofia (altitude 550 metres)	Hottest month, July, average temperature 21°C; coldest month, January, average temperature -2.3°C; driest month, April, 18 mm average rainfall; wettest month, June, 91 mm average rainfall
Language	Bulgarian
Weights and measures	Metric system
Currency	Lev (Lv) = 100 stotinki; the plural of lev is leva
Time	Two hours ahead of GMT in winter; three hours ahead in summer
Fiscal year	Calendar year

Political structure

Official name	Republic of Bulgaria
Legal system	Based on the constitution of July 1991
National legislature	Unicameral National Assembly of 240 members, elected by proportional representation. Following the election in July 2009, Citizens for European Development of Bulgaria is the largest parliamentary party
Electoral system	Universal direct suffrage from the age of 18
National elections	October 2006 (presidential) and July4th 2009 (parliamentary). Next presidential election due in October 2011; next parliamentary election due in July 2013
Head of state	Georgi Purvanov, re-elected president in October 2006
National government	Minority government comprising only the Citizens for European Development of Bulgaria
Main political parties and groupings	Bulgarian Socialist Party (BSP; previously the Bulgarian Communist Party); National Movement for Stability and Progress (NMSP; formerly the Simeon II National Movement, centred on the former king Simeon Saxe-Coburg); Movement for Rights and Freedoms (MRF; formed mainly from the ethnic Turkish minority); Bulgarian New Democracy (BND; formed by rebel NMSP deputies in December 2007), Blue Coalition (comprising the Union of Democratic Forces/UDF and Democrats for a Strong Bulgaria/DSB, a party made up of former members of the UDF); Bulgarian People's Union (BPU; a centre-right grouping, most of whose members were previously in the UDF); Ataka (Attack; a nationalist grouping that emerged just before the parliamentary election in June 2005); Citizens for European Development of Bulgaria (CEDB; led by Boiko Borisov, the former mayor of the capital, Sofia); Napred is a coalition of three parties: the Internal Macedonian Revolutionary Organisation-Bulgarian National Movement (VMRO-BND), the Liberal Initiative for Democratic European Development (LIDER) and the Agricultural National Alliance (ZNS); Law, Justice and Order Party

Council of ministers	**Prime minister**	Boiko Borisov
	Deputy prime minister & finance minister	Simeon Djankov
	Deputy prime minister & interior minister	Tsvetan Tsvetanov
Key ministers	**Agriculture & food**	Miroslav Naidenov
	Culture	Vezhdi Rashidov
	Defence	Nikolai Mladenov
	Economy, energy & tourism	Traicho Traikov
	Education, youth & science	Iordanka Fandukova
	Environment & water	Nona Karadzhova
	Foreign	Rumyana Zheleva
	Health	Bozhidar Nanev
	Justice	Margarita Popova
	Labour & social policy	Totyu Mladenov
	Regional development	Rosen Plevneliev
	Sport	Svilen Neikov
	Transport, communication & IT	Aleksandur Tsvetkov
	Without portfolio	Bozhidar Dimitrov

Recent articles on Bulgaria from *The Economist*

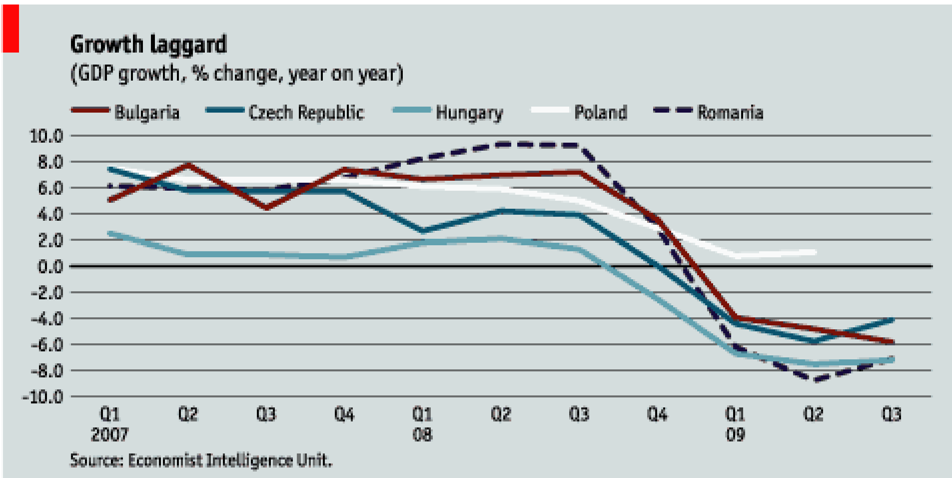
Bulgaria economy: Behind the curve

November 23rd 2009

FROM THE ECONOMIST INTELLIGENCE UNIT

Bulgaria stands alone among the EU's eastern members as the only one yet to show an improvement in GDP performance. Worryingly, the authorities suggest that the bottom may not be reached until the first quarter of 2010, and a return to growth may not happen until the end of that year. Several factors might explain this: export problems as a result of the fixed-exchange rate and structure and destination of exports; particularly poor foreign direct investment (FDI); and plunging domestic demand. It seems that the main factors explaining Bulgaria's sluggish recovery are a late start in the process of cutting jobs and wages, plus a tight fiscal policy that limits the government's ability to support the economy while private consumption is in retreat.

Unlike its fellow east-central European countries, Bulgaria saw its year-on-year decline in real GDP worsen in the third quarter of the year--to -5.8% year on year, from -4.8% in May-June. The Czech Republic, Hungary, Slovakia, Slovenia and the Baltic states all reported an improved performance in the third quarter, and it is widely expected that Poland--the only regional state to have kept growing during the global downturn--will do likewise.



If Bulgaria were to show signs of turning the corner in the fourth quarter, just one quarter after its east-central European peers, this would not be a cause for great concern. However, the country's finance ministry and the IMF both estimate that real GDP will fall by over 6% this year, which implies a worsening in performance in the fourth quarter. The influential finance minister, Simeon Djankov, has said that the worst of the current recession will be either the fourth quarter of this year or the first quarter of next year. If, as he suggests, Bulgaria does not start to turn the corner until the second quarter of 2010--and thus may not register year-on-year GDP growth until the end of that year-it would be a source of concern.

Across east-central Europe, the same factors are driving a slight upturn in GDP performance: external demand is recovering, thus providing a boost to exports and industrial output. As a result, headline GDP performance is improving even though private consumption is declining ever more steeply. Given the high profile of passenger cars within east-central Europe's export mix, and the short-term stimulus to car demand in western Europe provided for scrappage schemes ("cash for clunkers"), it may be that this export and industrial recovery will not be sustainable. Nevertheless, given these external factors, it is interesting to ponder why Bulgaria has not yet shown any signs of improvement--and why the government and IMF do not expect it to do so before some point in 2010.

The usual suspects

Possible reasons for Bulgaria's lagging performance are: weak export performance, as a result either of the country's fixed exchange-rate or the structure and destination of exports; a poorer-than-average performance in attracting foreign direct investment (FDI) within the east-central European context; or worse than average domestic demand, comprising the government and households.

With regard to exports, there are grounds for believing that Bulgaria has lost competitiveness vis-à-vis its regional counterparts. The Czech, Hungarian, Polish and Romanian currencies have weakened against the euro over the last year, whereas the Bulgarian lev has stayed fixed to the euro under the country's currency board. This inevitably puts it at a disadvantage. Moreover, relative to the Visegrad economies (the Czech Republic, Hungary, Poland and Slovakia), Bulgaria is exposed to export markets that are still struggling to grow. For the Visegrad states, Germany is the most important market (taking 20-30% of total exports by value in 2008) and France and Italy also figure prominently for some; all three of those large West European economies are now out of recession. Bulgaria, by contrast, sent 9.8% of its exports to Greece in 2008, 9.1% to Germany, 8.9% to Turkey and 8.5% to Italy-and both Greece and Turkey are still in recession. Moreover, compared with the Visegrad economies, which rely heavily on manufactured goods, Bulgaria's export profile is dominated by iron and steel and metals. Because some of the largest consumers of these goods are construction firms, and the construction sector across Europe is still in a deep recession, it would not be surprising to see that Bulgarian exports were failing to recover in the manner of Visegrad exports.

Nevertheless, there are indications that the foreign balance made a positive contribution to GDP in the third quarter, even though the headline figure declined compared with the second quarter. The flash estimate was accompanied by a comment that the export decline softened whereas the import decline deepened.

On the FDI front, Bulgaria is yet to turn the corner. Fixed investment fell by 16.3% year on year in the second quarter, and by 22.9% in the third quarter. Estimates from the central bank and private-sector analysts suggest that FDI could fall by 50% in 2009 from the €6.5bn received in 2008. As with exports, Bulgaria's customary FDI structure is unfavourable. In recent years, a high proportion of FDI has flowed into rest estate and financial intermediation-two sectors that remain in the doldrums. Perhaps for this reason, the government is signalling that FDI performance in 2010 may be as bad, or even worse, than in 2009. This would certainly help to explain the official pessimism regarding the timing of the economic recovery.

With regard to domestic demand, private consumption is falling in Bulgaria just as it is doing elsewhere in east-central Europe. The key to the country's sluggish recovery may lie in government consumption. Most EU members are running sizeable budget deficits at present, whereas Bulgaria is obliged to seek balanced budgets. Although it is likely to return a general government deficit of around 0.5% of GDP this year, this is miniscule compared with deficits of 5-8% of GDP in the Visegrad states. Moreover, government consumption plays less of a role in Bulgaria than central Europe. In 2008, the share of government consumption in GDP was just 8.7%; the figures for the Czech Republic, Poland, Slovenia, Slovakia and Hungary are 20.3%, 17.2%, 17.9%, 17.2% and 9.5%.

Unavoidable cuts

With regard to the gloom that surrounds Bulgaria's short-term recovery prospects, two factors stand out. First, the real sector is still in a process of adjustment, whereas elsewhere in east-central Europe this process is at or near completion. The increase in unemployment was greater in the third quarter than in the second quarter, at 28,000 compared with 15,000, which suggests that when the downturn began firms avoided shedding workers but are now being forced to do so. A similar process is evident in wages: although they fell quarter on quarter in July-September, they had grown in the first two quarters of the year. Moreover, in the third quarter real wages were still up by around 10% year on year. Given the wage shrinkage seen in other states, and the fact that Bulgaria's exchange rate has not taken any of the burden of adjustment, it is reasonable to assume that further wage declines are in store. Added with an expected further rise in unemployment, this is a double-whammy for private consumption. Consumers are also likely to be less confident in their spending given the collapse in house prices.

Second, fiscal policy is tight and will remain so. This is not only because of the currency board and the need to control inflation via fiscal policy because there are few monetary levers. The new Bulgarian government, headed by Boiko Borisov, has an ideological commitment to shrinking the state in order to narrow the field for corruption and encourage private enterprise. This has increased the likelihood of Bulgaria delivering on its intention to run a balanced budget in 2010. As a result, the government will provide less support to the economy than its peers among the EU new member states. And moreover, given that getting the budget back into balance is likely to involve cuts in the public sector workforce, there will be a reduction in the number of salaried state employees, which will act as a drag on private consumption.

Bulgaria may yet find that it is not alone in struggling to recover. The export-oriented output gains seen in the Visegrad economies (minus Poland) could prove short-lived as the scrappage schemes wind down and west European governments withdraw fiscal stimulus. Romania's third-quarter GDP result was unexpectedly good--most analysts had expected a deterioration compared with the second quarter--but it is possible that this could either be revised or prove to be a blip. Nevertheless, it is tempting to conclude that Bulgaria is in this regard a victim of its fixed exchange rate and tight fiscal policy, the limited role of state spending in the economy and its reliance on basic exports and foreign investment into real estate.

Bulgaria rejects its government

Borisov's turn

Jul 9th 2009 | SOFIA
From The Economist print edition

Bulgarians have elected a popular but unpredictable new leader

EXASPERATED voters boot out a bad government and install an unknown one. That is the Bulgarian election in a nutshell, after the defeat of the Socialists (ex-communists) by a centre-right populist party led by Boyko Borisov, a cigar-chomping ex-bodyguard. Citizens for European Development of Bulgaria, known by its Bulgarian acronym of GERB, took 39.7% of the vote on July 5th, entering parliament and government for the first time.

Few doubted that the Socialists would lose or that GERB would do well. Bulgaria's leaders have been the subject of humiliating criticism by the European Commission, worried about endemic corruption and links between organised crime and some bits of government. Mr Borisov has been a lively mayor of Sofia who has shaken up the capital's administration. But few expected voters' discontent to be so strong. Turnout was high, at 60%. Mr Borisov won support from change-hungry voters, even if they felt queasy about his headstrong personality and spotty past.

Instead of needing to broker a coalition with the Socialists, Mr Borisov will now be able to govern with a smaller coalition partner. His most likely ally is a "blue coalition" of two centre-right parties. But Mr Borisov says he will talk to everybody, even Ataka, a racist far-right party that took 9% of the vote.

Denouncing corruption is one thing. Extirpating it is quite another. Mr Borisov says he wants to investigate and jail his predecessors. But few expect quick results. Bulgaria's rich and powerful have shown remarkable agility in dodging the lethargic courts. Mr Borisov has already won plaudits by appointing outside professionals to his cabinet, including Simeon Djankov, an economist at the World Bank who will be the new finance minister. Mr Djankov will have to deal with plunging tax revenues, a GDP fall of perhaps 5% this year and a huge current-account deficit.

A good way to start would be overhauling the country's shambolic public administration. Another idea would be to look into the overlaps between politics and business in the Movement for Rights and Freedoms, which represents the country's Turks. A fixture in government for some years, this party has been criticised by anti-sleaze campaigners, especially those concerned with the misuse of EU funds. The party's unabashed influence-peddling has increasingly scandalised Bulgarians. Its leader, Ahmed Dogan, has publicly boasted of his ability to channel state funds and wield political power.

Such displays of arrogance dented the Socialists' image, as did worries about the pervasive hold of the communist-era secret services and rising Russian influence, notably in energy. The outgoing government's counterattack largely failed to dispel these concerns. It consisted mainly of tweaking the electoral law to penalise small parties and political independents, helped by a costly series of negative television ads. The coalition's unpopularity sent its other member, the liberal party of former King Simeon, out of parliament.

In its place came a new party campaigning against corruption, Order, Law and Justice. Its leader, Yane Yanev, has a habit of producing classified information to back up his claims. That has prompted accusations, which he denies, that he is a front for the secret services. Bulgarian politicians may not yet be able to govern cleanly. But voters have certainly shown that they want it.

Charlemagne

Bulgarian rhapsody

May 14th 2009
From The Economist print edition

Why the European Commission imposed sanctions on its poorest Balkan member

FOR a man facing the threat of bankruptcy in six months' time, thanks to European Union sanctions on his country, Stefan Petrov has pretty warm words for Brussels. Mr Petrov is a dairy farmer from the rolling hills of northern Bulgaria. Two-and-a-half years after his country joined the EU, his business is in peril after €800m ($1.1 billion) in transitional aid for new members, including farm aid, was frozen by the European Commission last year, amid complaints about fraud, contract-padding and conflicts of interest. About €220m of the frozen money has been lost for ever, after a deadline for spending the cash expired in November. The pot of €110m that includes Mr Petrov's grant is due to expire at the end of this year. Yet the farmer does not quarrel with the logic of the decision to freeze Bulgaria's aid, which is the toughest sanction ever imposed on any EU member. "Those who govern us tried to steal the funds, and partly succeeded," says Mr Petrov, when asked why the European money was blocked. The EU, he insists, is "good for farmers".

To meet European standards, Mr Petrov had to connect his cowsheds to the water mains. He has just installed a gleaming new Swedish milking parlour, replacing an old system of pipes and pumps that, to the amateur eye, seemed to be held together by rust and cobwebs. He had an EU grant equivalent to €50,000 approved last autumn. That was why a local bank lent him money with minimal fuss, even though he had to put up his four cowsheds—large barns from an old collective farm, filled with twittering swallows and the sweet smell of dung—as collateral. A former trolley-bus driver under communism, he started with one cow in 1991 and now has 230, making him one of the biggest farmers in his district, near Pleven. His EU grant application included a chunk of money for a new, Czech-built tractor, to increase his business's profitability.

The tractor is already roaring about the farmyard, but the EU money is another story. The grant awarded to Mr Petrov comes from a special pot of transitional farm aid, known as SAPARD funds. The Bulgarian government says it has fixed problems identified by the EU, and will pay urgent grants out of national coffers. Gloomy European officials say Bulgaria still seems in no hurry to fix the problem, as different ministries squabble and continue to protect cronies. Mr Petrov was expecting his grant two months ago. With milk prices low at the moment, he thinks he can make loan interest payments for another six months, then he will go under. Yet he still declares: "Our hope is with Europe."

His views are widely shared. Most Bulgarian voters tell pollsters they trust EU institutions. As many as three-quarters say they distrust their national parliament and government. But will Bulgarian tolerance last if funds remain frozen much longer or if other bits of EU funding have to be frozen in the future? It is a question which resonates far beyond Bulgaria.

Plenty of diplomats and politicians in Brussels say that Romania and Bulgaria were admitted too soon, arguing that once such countries get into the club, the EU loses most of its leverage over them. (Many say much the same of Cyprus as well.) The counter-argument is that admitting countries like Romania and Bulgaria is the best way to protect and encourage internal reformists who are the best hope for the future.

Either way, what is clear is that the decision by the European Commission to freeze funds for Bulgaria was not just a technical measure. It was a deeply political experiment—nothing less than an attempt to claw back leverage over governments after they entered the union. The success of the experiment matters. The next countries hoping to join the EU mostly come from the Balkans, and many will display the same problems as Bulgaria and Romania in even more extreme form. If the EU can use the tough love of frozen funds in Bulgaria and yet still maintain voter support, that will be a boost not only to reformers in that country, but also to the whole cause of future enlargement. If, on the other hand, EU sanctions trigger a backlash against Europe in Bulgaria, the commission's experiment could turn out less well.

When sanctions work

The fate of EU funds has become a big political issue in Bulgaria, which will hold a general election in July, a month after the election of a new European Parliament. Although the current Socialist-led government trumpeted the release of €115m in EU road cash on May 12th, much more money remains frozen. Opposition leaders such as Boyko Borisov—an ex-wrestler and police chief who now serves as mayor of Sofia—say that government corruption gave Brussels "no choice" but to impose sanctions. Mr Borisov, whose party leads in the polls, offers few concrete plans for cleaning up the system, but he makes such stirring promises as "we will do what it takes for Europe to approve of us." Mr Borisov also notes the "paradox" that Bulgarians' trust in European institutions "actually increased when the money was frozen".

Back on the farm, Mr Petrov signals that his patience is not infinite. The freezing of EU funds was the "right" sanction, he admits. But the EU should think of another way of delivering money, he says, bypassing the government in Sofia if need be. A local mayor says 50 of his neighbours are in the same boat at Mr Petrov. The road to the nearest town was going to be fixed with funds that are now frozen, the mayor adds: yet locals still trust the EU.

The next wave of EU spending planned for Bulgaria adds up to more than €10 billion. If that money flows smoothly, EU popularity should not be a problem. But if Bulgarian corruption forces Brussels to freeze even bigger sums, plausible political consequences could range from a reformist revolution to a slide into nationalism. EU enlargement was always something of an experiment: it may be poised to enter uncharted territory.