

Low growth but solid economic fundamentals

General Information



GDP	USD54bn (World ranking 75, World Bank 2011)
Population	7.48 million (World ranking 97, World Bank 2011)
Form of state	Parliamentary Democracy
Head of government	Plamen ORESHARSKI
Next elections	2016, presidential



Strengths

- EU membership and good international relations
- Relatively low systemic political risk (broad policy continuity despite frequent government instability)
- Currency board has withstood global turbulences since 2008 and BGN is currently not overvalued
- History of sound fiscal policies
- Current account close to balance since 2010
- Generally adequate business environment

Weaknesses

- Failure to make progress on EU-required judicial reform and anti-corruption measures
- Economic recovery has lost momentum owing to continued tight credit markets and weak external demand
- High external debt burden
- Banking sector is vulnerable to financial contagion from the eurozone debt/banking crisis
- Current foreign exchange reserves cover just 75% of all external debt payments falling due in 2013

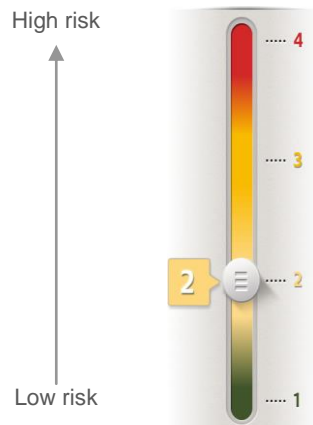
Country Rating

B2

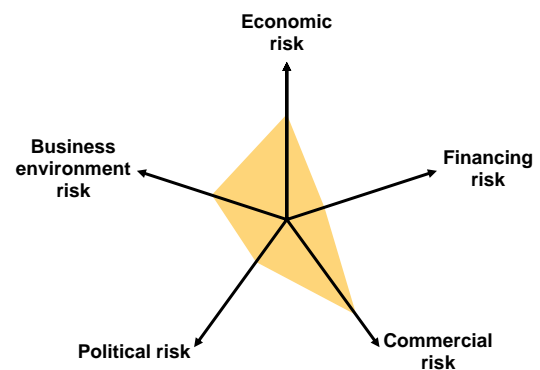
Country Grade



Country Risk Level

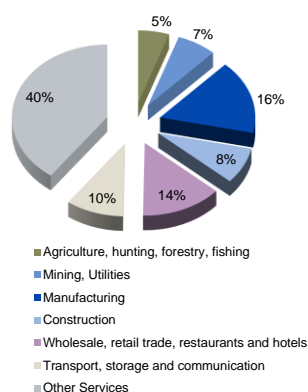


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2010)



Sources: Chelem, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2010)

By destination/origin

Exports	Rank	Imports	Rank
Germany	12%	16%	1
Italy	10%	12%	2
Romania	10%	7%	3
Turkey	8%	7%	4
Greece	6%	6%	5

By product

Exports	Rank	Imports	Rank
Non Ferrous Metals	13%	12%	1
Refined Petroleum Products	10%	7%	2
Clothing	5%	4%	3
Other Edible Agricultural Prod	5%	4%	4
Electrical Apparatus	5%	4%	5

Economic Forecasts

	Average 2000-08	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	5.8	-5.5	0.4	1.8	0.8	0.5	1.5
Inflation (% end-year)	6.9	1.6	4.4	2.0	4.2	2.8	3.0
Fiscal balance (% of GDP)	1.3	-0.9	-3.9	-2.0	-0.8	-1.4	-2.0
Public debt (% of GDP)	41.2	15.6	14.9	15.4	18.9	18.1	18.4
Current account (% of GDP)	-11.6	-8.9	-1.5	0.1	-1.3	-2.0	-1.8
External debt (% of GDP)	74.0	108.3	102.7	94.1	94.8	99.0	98.0

Sources: IHS Global Insight, national sources, Euler Hermes

Economic Growth

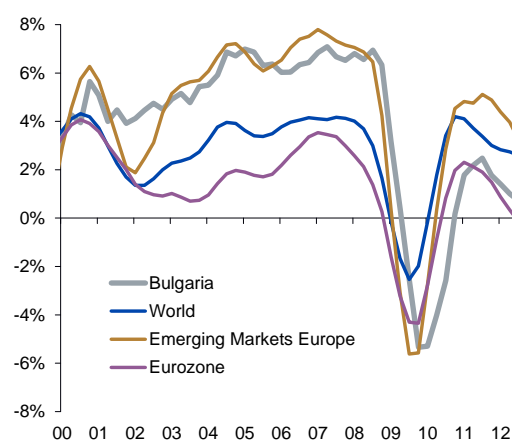
The economic slowdown in 2012 ...

The economy lost momentum in 2012 as external demand deteriorated markedly. Real GDP growth decelerated to +0.8% from +1.8% in 2011. Exports contracted by -0.4% in 2012 after it had increased by 12.3% in 2011. Imports continued to expand by +3.7% in 2012, albeit down from +8.8 a year earlier. Domestic demand kept the economy growing in 2012, with private consumption increasing by +2% and fixed investment by +0.8% while government consumption fell by -0.4%.

... will continue in 2013

Preliminary estimates indicate that seasonally adjusted real GDP growth slowed further to +0.4% y/y in Q1 2013 from +0.6% in Q4 2012. In q/q terms, growth remained almost flat in Q1 (+0.1%) as it had been in the previous four quarters. Details show a weakening of private consumption which contracted by -1.3% q/q in Q1 while government consumption expanded by +0.9% and fixed investment by +2.4%. Export growth of +1.8% q/q was outpaced by import expansion of +3.2%. We expect this growth pattern to continue in the next quarters and forecast full year growth to ease to about +0.5% in 2013, before it picks up to +1.5% in 2014.

GDP growth (% y/y, 4 qtrs cumulated)



Sources: IHS Global Insight, national sources, Euler Hermes

Currency board not at risk

Bulgaria has had a currency board since 1999 which pegs the lev (BGN) to the EUR at a rate of 1.95583 BGN/EUR. The arrangement has withstood the pressures from the 2008-2009 regional and global financial crises well and does not appear to be at risk in the short term. The real effective overvaluation of the BGN, which exceeded 15% from early 2008 to mid-2009, has given way to stabilisation, indicating that Bulgaria has regained relative competitiveness. Moreover, foreign exchange (FX) reserves continue to cover the monetary base (a requirement for a currency board) clearly. And, the Bulgarian authorities remain firmly committed to the currency board.

Inflation is volatile but under control

The currency board arrangement has not always been successful in keeping inflation under control. In mid-2008, headline inflation peaked at over 15% as a result of the then overheating economy. Since mid-2009, inflation has been better contained though it has remained somewhat volatile, markedly influenced by fluctuations in food and energy prices. These items pushed inflation to over 4% at end-2012 but since then it has fallen to 2% y/y in April 2013. We expect average annual inflation of around 3% in 2013-2014.

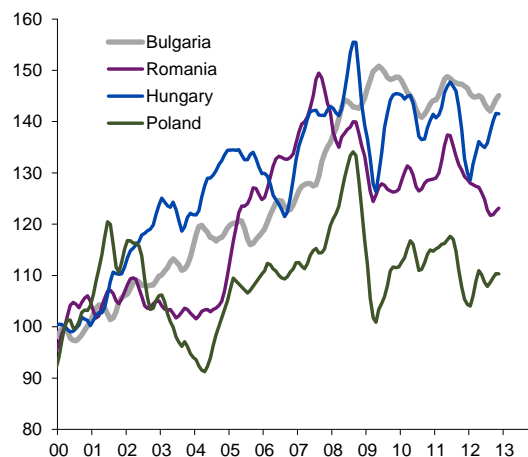
Banking sector needs close monitoring

The banking sector is a cause of concern even though it weathered the impact of the 2008-2009 global financial crisis relatively well. But its heavy reliance on funding from EU parent banks—whose subsidiaries dominate the sector (25% Greece, 15% Italy, 12% Hungary)—makes it vulnerable to financial contagion from the eurozone debt/banking crisis. Deleveraging by eurozone banks has had an adverse impact on Bulgaria's growth potential since 2012—as credit growth has almost come to a standstill—and could, in the worst case, cause financial disruption in the future. The refinancing of maturing debt may remain difficult for some banks and companies and could deepen in the event of an external shock.

Public finances are favourable

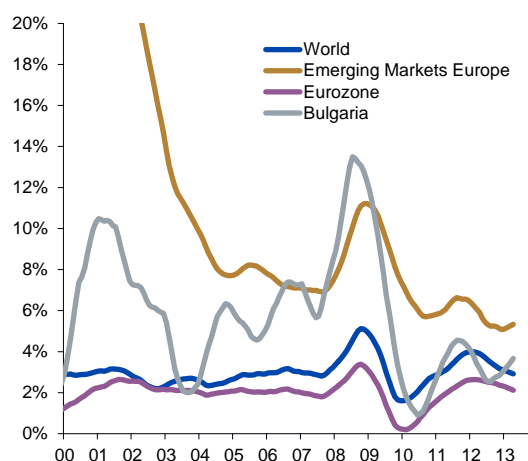
Since the currency board largely neutralises monetary policy, fiscal policy is the major tool to steer the economy. Bulgaria has had a long-lasting commitment to fiscal prudence, reflected in many years of fiscal surpluses (annual average 2.7% of GDP in 2004-2008). In the wake of the economic downturn since late 2008, however, the fiscal account deteriorated and shifted into deficit. But the annual deficit has narrowed quickly from a record 3.9% of GDP in 2010 to 2% in 2011 and 0.8% in 2012. We forecast the fiscal deficit to remain moderate at below 2% of GDP in 2013-2014. Public debt has rapidly declined from 75% of GDP in 2000 to just 15% in 2010. Although it has increased slightly since then, it should remain below 20% of GDP in the next two years, which is very low by EU standards.

Real effective exchange rate (2000=100)



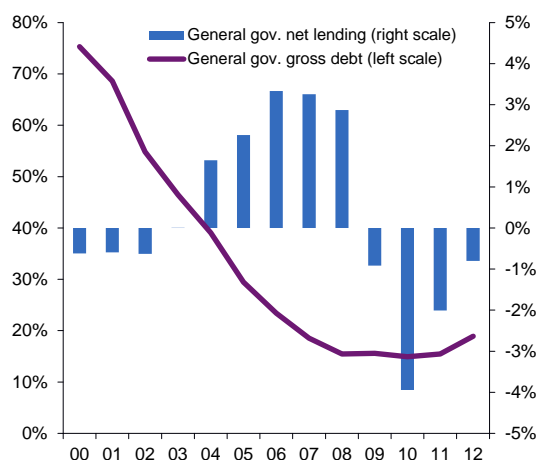
Sources: IHS Global Insight, Euler Hermes

Inflation rate (12-month moving average, %)



Sources: IHS Global Insight, national sources, Euler Hermes

Fiscal balance and public debt (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

External Sector

Current account has improved ...

Following several years of unsustainably large deficits, the current account has moved close to balance in the past three years. Net foreign direct investment inflows have remained robust and covered the 2012 current account deficit (1.3% of GDP) two and a half times.

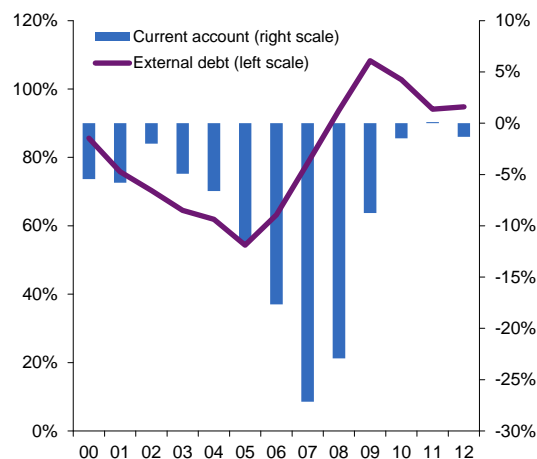
... but external debt remains a cause of concern

The legacy of the large current account deficits from 2003-2009 has left Bulgaria with a very high external debt burden. Strong foreign borrowing by banks and the private sector had pushed up gross external debt to a peak of EUR38bn in late 2008, since when it has remained close to that level, accounting for a worrisome 95% of GDP or 142% of export earnings in 2012. The private sector share of external debt has remained at 89% until February 2013, while total short-term debt as a share of gross debt has fallen to 28% from the 36% peak in late 2008. The external debt service remains hefty, forecast at around 25% of export earnings in 2013.

Foreign exchange reserves ...

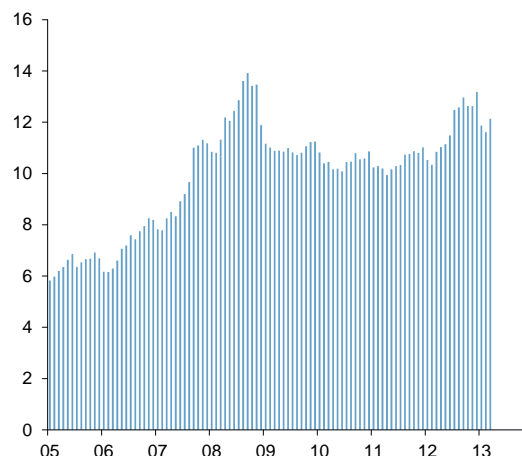
Following a peak of EUR13.9bn in September 2008, FX reserves hovered in the range of EUR10-12bn from end-2008 to mid-2012. Thereafter they have increased slightly and stood at EUR12.7bn in April 2013. The current level of FX reserves is comfortable with regard to import cover (more than five months). In other terms, however, reserves cover just about 75% of the estimated external debt payments falling due (ST debt plus principal repayments on M/LT debt) in the next 12 months. Although this ratio has improved from just 50% two years ago, it remains well below an adequate ratio of at least 100%.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

Foreign exchange reserves (EUR bn)



Sources: Bulgarian National Bank, Euler Hermes

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