Summary
In September, the economy performed extremely well. The impressive growth of the country’s industrial sector (28.4% year-on year (yoy)), retail trade (13.3% yoy) and service sector (driven by a 16.3% yoy increase in the number of foreign tourist visits) was the main cause of this improvement.

The Bulgarian government has maintained prudent fiscal policies, generating a cumulative fiscal surplus in January-October of EUR 0.75 billion, which represents a 52% yoy rate of growth. Budget revenues grew by 12.1% yoy and reached EUR 6.64 billion. Government and government-guaranteed debt decreased by EUR 7.3 million in September and amounted to 42.3% of the country’s GDP. In November, the parliament rejected an amendment to the VAT law that would decrease VAT, keeping it at 20%; personal income tax was reduced to 10–24% from the current 15–29%.

The Bulgarian National Bank (BNB) has maintained an effective monetary policy. In October, the consumer price index (CPI) dropped to 5.8% yoy from 6.3% yoy in the previous month; the producer price index (PPI) grew from 6.9% yoy in September to 8.4% yoy in October. The base interest rate grew to 2.44% in October from 2.39% in September. Official foreign reserves grew by EUR 90 million and reached EUR 6.43 billion in October.

In September, the retail trade sector demonstrated some acceleration compared to the previous month. Growth in this sector improved to 13.3% yoy from 13.2% yoy in August, bringing the overall performance of retail trade in January-September to 13% yoy. The wholesale index increased from 16.3% yoy in August to 17.9% yoy in September, or a 13.3% yoy growth in January-September.

In January-October, growth in the service sector was driven by a 16.3% yoy increase in the number of foreign tourist visits, which accounted to some 4.1 million visits.

In September, the manufacturing sector grew by 28.4% yoy in September, compared to a revised figure of 22.9% yoy in August. However, industrial output picked up at a lower rate of 18.4% yoy in September compared to 18.3% yoy in August. The breakdown shows a hike in production of metal-based products supported by a 21.6% yoy increase in mining of metal ores, up from 17.4% yoy in August.

In September, the manufacturing sector accelerated its growth from 26.9% yoy in the previous month to the current 33.4% yoy. Manufacturing of basic metals showed the highest rate of growth within the Bulgarian manufacturing sector (94.1% yoy). Manufacturing of office machinery and computers grew by 65.9% yoy, while fabricated metal products, except machinery and equipment grew by 47.6% yoy. On the other hand, certain sectors demonstrated some slowdown and even a decrease in the rate of growth compared to their previous performance. The deepest decrease appeared in manufacturing of motor vehicles, trailers and semi-trailers (by 28.2% yoy).
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2005. The passed changes will reduce the VAT reimbursement period on exported goods from 45 to 30 days. The Parliament also approved several personal income tax amendments, the planned tax to a range of 10–24% in 2005 from the current 15–29%.

Monetary Sector

Composition of the Foreign Currency Reserves in October, %

<table>
<thead>
<tr>
<th></th>
<th>Jan-Sep</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities</td>
<td>20.9%</td>
</tr>
<tr>
<td>Other National Central Banks, BIS and IMF</td>
<td>0.6%</td>
</tr>
<tr>
<td>Banks Headquartered Outside the Reporting Country</td>
<td>78.6%</td>
</tr>
</tbody>
</table>

Source: Bulgarian National Bank

In October, consumer price index (CPI) inflation slid to 5.8% yoy from 6.3% yoy in September. The change was driven by a decline in food products from 6.9% yoy in September to 4.9% yoy in October. The disinflation move was expected due to the high base from last year. CPI inflation is above the government's forecast of 4% annual inflation. However, the decrease in oil prices, the weakening of the US dollar against the Euro, and positive supply shocks on the grain market could further decrease CPI inflation.

In September, the foreign trade gap widened at a slower rate. The merchandise foreign trade deficit widened by 17.3% yoy and reached Lev 305 million (EUR 156 million), which represents an increase of 26.3% yoy. The January-September cumulative trade deficit reached Lev 3.44 billion (EUR 1.76 billion).

In September, exports grew faster than imports (24.7% yoy and 23.2% yoy, respectively). However, the pattern was different in January-September. Exports grew at a rate of 16% yoy and imports at 18.3% yoy. In January-September, import and export prices grew at different rates. Import prices surged by 9.2% compared to the 2003 average level, while exports prices increased by 6.9%. This negatively affects the country's trade balance.

In September, the current account (CA) balance improved at a very solid pace, bringing the annualized deficit down to 6.8% of projected GDP. In January-September, the CA deficit narrowed by 23.4% yoy and amounted to EUR 568 million. These improvements are mainly due to high metal prices, which positively affect export-oriented sectors and cause steady growth in the tourism sector. These effects of the improvements in the CA have exceeded the negative effects caused by high oil prices.

In January-September, the net inflow of FDI reached EUR 1.06 billion, a growth of 15.9% yoy. Solid growth in FDI has kept a high surplus in the financial account, bringing it to EUR 1.23 billion in January-September. The highest share of FDI came in the form of equity capital (51% of total FDI). Significant growth in FDI is supported by the large-scale privatization of the local retail power distribution network.

International Programs

Bulgaria’s two-year precautionary standby arrangement with the International Monetary Fund (IMF) will expire on September 5th, 2006. At the beginning of December, the IMF regular mission to Sofia began to assess the fiscal performance of Bulgaria for the year. The mission is also reviewing next year’s budget targets and the country’s compliance with the performance criteria and benchmarks agreed upon in the standby arrangement. The IMF insists on the need to impose new bank restrictions aimed at taming rapid credit expansion and limiting import demand.

In late November, the European Bank for Reconstruction and Development (EBRD) approved two credit lines of EUR 10 million each. Both will be directed to the country’s largest lender, DSK Bank. In addition, a separate EUR 10 million credit line will be provided for the country’s third largest bank, United Bulgarian Bank (UBB). These credits are meant to facilitate financial support for the country’s SME sector through better access to financial resources.

Other Developments

The EBRD’s new Transition Report lists Bulgaria as one of the leading countries in Southeast Europe in implementing market oriented reforms. Despite some problems with infrastructure, the country has achieved significant progress in improving the overall investment climate. The EBRD expects economic growth in Bulgaria to reach 5.5% this year and to slow down to 5% next year.

In November, Moody’s upgraded the Bulgarian foreign currency ceiling and the ratings on the government’s foreign and domestic currency bonds by one notch to Ba1 from Ba2. The ceiling on foreign currency bank deposits was raised by two notches to Ba1 from Ba3. The outlook on all ratings was moved to positive.

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keeps the country's ceiling one notch below investment grade and one notch below the other two major rating agencies, S&P and Fitch. The country's future membership in the EU in 2007 and related reforms are the major reasons for further upgrades.

A multi-country tax survey done by KPMG, covering EU candidates and the new EU-member states, ranks Bulgaria in the group of countries with the lowest direct taxes. Bulgaria was put in the group with the highest rates for mandatory social insurance along with the Czech Republic, Hungary, Romania, and Slovakia. The planned 2005 tax cuts for corporate profits (from 19.5% to 15%) and personal incomes (from 15–29% to 10–24%) will further move Bulgaria into the group of countries that are best for doing business.

The World Bank (WB) has finished its study on health care problems in Bulgaria and concluded that they are related to the high level of corruption in this sector. Bulgaria's health care system does not provide care for the poor or people in distant regions. Since 2000, health care reform in Bulgaria has been carried out with funds from a WB loan worth EUR 68 million. The term of the loan expires next year, and so far only 50% of the money has been utilized.