Summary

- In Q1 2007, Bulgaria posted robust economic growth. By the end of March, industry expanded 9.8% yoy underpinned by particularly strong performance of the manufacturing sector.
- In March, the consolidated budget achieved a surplus of EUR 275 million (Lev 539 million) compared to a deficit of EUR 10 million (Lev 19.9 million) in February. The fiscal reserve of the government increased to EUR 2.9 billion (Lev 5.67 billion) from EUR 2.6 billion (Lev 5.12 billion) in February.
- Consumer price inflation (CPI) accelerated slightly to 4.2% yoy\(^1\) in April, which was a substantial deceleration as compared to 8.1% yoy growth in April 2006.
- In Q1 2007, the current account (CA) deficit widened to EUR 1.5 billion (5.6% of GDP) as compared to EUR 1.1 billion (4.4% of GDP) for the same period in 2006. The financial account posted a surplus of EUR 0.65 in March and EUR 1.55 in Q1 2007.
- Net foreign direct investment (FDI) inflow accelerated 6.6% yoy to EUR 0.3 billion in March.
- In March, the BNB reserve assets increased by EUR 0.48 billion to EUR 9 billion.

Economic Growth

The National Statistical Institute (NSI) restated real GDP growth rates for 2002–2006 after revision of its methodology for GDP calculation. The NSI revision was caused by new methodology for indirectly estimated services of financial intermediaries (FISIM) and Bulgarian National Bank (BNB) adjustments of data on foreign trade. The released GDP data shows that the real GDP growth rate slightly decelerated to 6.1% in 2006 from 6.2% in 2005 (revised from 5.5%) and 6.6% in 2004 (revised from 5.6%).

<table>
<thead>
<tr>
<th>Real GDP Breakdown (% yoy)</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006*</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>4.5</td>
<td>5.0</td>
<td>6.6</td>
<td>6.2</td>
<td>6.1</td>
</tr>
<tr>
<td>Consumption</td>
<td>4.2</td>
<td>5.9</td>
<td>6.4</td>
<td>6.3</td>
<td>6.5</td>
</tr>
<tr>
<td>Investment</td>
<td>8.5</td>
<td>13.9</td>
<td>13.5</td>
<td>23.3</td>
<td>17.6</td>
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<tr>
<td>Exports</td>
<td>8.1</td>
<td>10.7</td>
<td>12.7</td>
<td>8.5</td>
<td>9</td>
</tr>
<tr>
<td>Imports</td>
<td>5.0</td>
<td>16.4</td>
<td>14.5</td>
<td>13.1</td>
<td>15.2</td>
</tr>
<tr>
<td>By sector</td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Agriculture</td>
<td>4.7</td>
<td>-2.3</td>
<td>2.3</td>
<td>9.5</td>
<td>-1.9</td>
</tr>
<tr>
<td>Industry</td>
<td>4.7</td>
<td>5.7</td>
<td>4.1</td>
<td>4.8</td>
<td>8.3</td>
</tr>
<tr>
<td>Services</td>
<td>5.9</td>
<td>4.7</td>
<td>5.7</td>
<td>8.2</td>
<td>6.1</td>
</tr>
</tbody>
</table>

*Preliminary data by National Statistical Institute

In 2006, investment expressed by gross capital formation reached EUR 15.7 billion (EUR 8 billion) or 31.9% of GDP as compared to 28% of GDP a year earlier. Investment continued to be the fastest growing component of GDP (with a growth rate of 17.6% yoy) despite the moderate slow down from 23.3% yoy growth in 2005. Consumption grew at 6.5% yoy and reached Lev 42.5 billion (EUR 21.7 billion). The increase in consumption is driven primarily by individual consumption, which surged 7.1% yoy; its share in total consumption is 89%. The share of final consumption in GDP decreased slightly to 86.6% from 88.2% in 2005.

Underpinned by robust investment and consumption growth, industry and services expanded 8.3% yoy and 6.1% yoy respectively. The share of industry in GDP increased to 25.6% from 24.2% in 2005. The services sector slightly decreased its share in GDP to 48.8% from 50.4% in 2005. The services sector has the greatest share in Gross Value Added (60% in 2006, down from 61.2% in 2005). The industry contribution to value added increased to 31.4% from 29.4% in 2005.

The agricultural sector decreased for the second year in a row. The 9.5% yoy drop in 2005 and further decline of 1.9% yoy in 2006 is the result of insufficient investments, small agricultural land parcels and undeveloped agricultural distribution infrastructure as well as unfavorable weather conditions in 2005. The agricultural contribution to value added is down to 8.6% (9.4% in 2005).

In 2007, the government forecasts a further deceleration of GDP growth to 5.8%. The GDP growth rate is forecasted to recover to 6.4% in 2009 driven by sustained high growth of investment and consumption.

Fiscal Policy

In March, the fiscal reserve of the government increased to EUR 2.9 billion (Lev 5.67 billion) from EUR 2.6 billion (Lev 5.12 billion) a month earlier. The government continues to pursue its fiscal objective of budget surplus at 2% of GDP in 2007. The current level of fiscal reserve is above the threshold of EUR 1.84 billion (Lev 3.6 billion) set in the budget law for 2007. The stock of fiscal reserve is forecasted to grow at a fast pace in the forthcoming months as a result of seasonal factors, changes in tax policies and strong fiscal revenue performance shown in the first quarter 2007.

The consolidated budget achieved a surplus of EUR 275 million (Lev 539 million) in March compared to a deficit of EUR 10 million (Lev 19.9 million) in February. The first quarter consolidated budget surplus accounts for 1% of the projected full-year GDP. The revenue growth accelerated to 15.4% yoy up from 6.8% yoy growth in January-February despite a reduced corporate profit tax, an increased personal income tax-free threshold and lower customs duties. The Q1 tax revenue increased to EUR 2.12 billion (Lev 4.15 billion), which is 82% of the total revenue of EUR 2.58 billion (Lev 5.05 billion). On an annual basis, tax revenues are up 12.2% as compared to 1.9% in January-February. Income tax related duties and insurance contributions performed strongly while VAT revenue is down by 7.2% yoy due to VAT payment delays (45 days) on imports. The budget revenue growth is forecasted to accelerate further as a result of strong consumer demand and improved VAT performance on imports.
The first quarter expenditures of the consolidated budget amounted to EUR 2.26 billion (Lev 4.33 billion), an increase of 9.8% yoy. The consolidated national budget allocated EUR 0.89 billion (Lev 1.74 billion) to social expenditures and EUR 0.19 billion (Lev 0.38 billion) to capital expenditures according to the national strategy of social sector and infrastructure development. Social expenditures account for 40% of all budget allocations. Capital expenditures increased 48% yoy as a result of government commitments to improve infrastructure in the country. Wages and salaries and maintenance allocations increased to EUR 0.34 billion (Lev 0.65 billion) and EUR 0.42 billion (Lev 0.83 billion), with growth rates of 9% yoy and 6.9% yoy respectively.

According to the Debt Management Strategy, the government continues strict debt level monitoring and reduction of public debt and service costs. The stock of public and publicly guaranteed debt dropped 5% mom to EUR 5.86 billion in February due to payments of EUR 320 million of external and Lev 111.8 million (EUR 57.2 million) of domestic debt. In March, public debt is expected to decrease further due to the planned repayment of the entire outstanding debt of EUR 230 million to International Monetary Fund (IMF).

The debt to GDP ratio fell to 22.4% in February, down by 1.3 pps from January's level. Domestic and external debt to GDP stood at 5.6% and 16.8% respectively. The government accumulated fiscal reserve covers 44% of public and government guaranteed debt. External debt amounted to EUR 4.39 billion, including EUR 3.84 billion in government debt and EUR 0.55 billion in government guaranteed debt. Domestic and external debt shares in the public debt structure were 25.2% and 74.9%. Euro denominated debt changed slightly to 50.9% and debt in US dollars reached 21.9%, while Bulgarian Lev debt was 18.3% and 8.9% in other currencies. In the debt interest structure, fixed interest rate debt was 66.2% and debt with floating interest rates was 33.8%. In the structure of external debt, the share of Eurobonds was 30.7%, government securities 25.1%, obligations to the World Bank 13.4%, government investment loans and guaranteed debt 19.3%.

Gross external debt decreased by EUR 376.8 million to EUR 19.3 billion (72.2% of GDP) as of the end of January. Long-term liabilities accounted for 70.9% of total external debt. Gross external debt service was EUR 684.2 million (2.6% of GDP). External borrowing is expected to increase after the national bank abolished credit restrictions on January 1, 2007.

In March, claims on the non-government sector grew by 37.5% yoy in contrast to 29.6% yoy in February. The monthly increase in loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%.

In March, the monetary base and money supply grew by 1.27% mom and 2% mom respectively. Broad money (M3) reached EUR 16.75 billion (Lev 32.76 billion) and narrow money (M1) increased to EUR 8.32 billion (Lev 16.27 billion). On an annual basis, the growth of money supply is 28.2% as compared to 27.8% in the prior month. The money supply multiplier was 3.17 versus 3.14 in February. The ratio of money supply to GDP increased to 62.7%. The deposits with a maturity of up to 2 years grew by EUR 164.8 million (Lev 323.2 million) to EUR 6.92 billion (Lev 13.54 billion), posting an annual growth rate of 25.1% (23.1% in February). The deposits redeemable at notice of up to 3 months increased by EUR 28 million (Lev 54.8 million) to EUR 1.49 billion (Lev 2.9 billion), up 24.5% yoy. The fastest growing component of the money supply was overnight deposits, which had a growth rate of 42.7% yoy, down from 45.1% yoy in February. Overnight deposits reached EUR 5.3 billion (Lev 10.36 billion). Deposits in foreign currencies constituted 46.1% of all deposits, up from 45.7% a month earlier.

The Bulgarian National Bank increased its base interest rate to 3.68% p.a. in April and 3.81% p.a. in May. In March, claims on the non-government sector grew by EUR 0.57 billion (Lev 1.12 billion) and amounted to EUR 13.27 billion (Lev 25.95 billion), which is an increase of 36.6% yoy (31.1% yoy in January). The share of claims in foreign currency is 47%. Loans to non-financial corporations surged 37.5% yoy in contrast to 29.6% yoy in February. The monthly increase in loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%. Loans to non-financial corporations surged 47%.
In March, the trade deficit widened to EUR 0.55 billion (Lev 1.09 billion) driven by strong private consumption, up from a EUR 0.46 billion (Lev 0.89 billion) trade deficit in February. In Q1 2007, the annual deterioration in the trade deficit was 43.4%, although the deficit expanded 31.8% yoy in March. Imports continue to grow faster than exports, posting 16.4% yoy growth, while exports advanced 9.7% yoy. On a positive note, export growth accelerated 7.1 pps from Q1 2006. In March, the CA deficit expanded by EUR 0.51 billion (EUR 0.43 billion in February) due to the trade deficit in goods and services. The financial account posted a surplus of EUR 0.65 billion in March and EUR 1.55 billion in Q1 2007. Net foreign direct investment (FDI) inflow accelerated 6.6% yoy to EUR 0.3 billion in March. According to preliminary data, FDI amounted to EUR 0.77 billion (2.9% of GDP) in Q1 2007, down from EUR 0.79 billion (3.1% of GDP) in Q1 2006. In March, net FDI covered 59% of the current account deficit. The Bulgarian government forecasts continued growth in net FDI inflows to EUR 2.7 billion in 2007 (11.8% of GDP) due to a favorable investment climate, predictable macroeconomic environment and transparent legislation.

In March, the BNB reserve assets increased by EUR 0.48 billion to EUR 9 billion as opposed to a decrease of EUR 0.43 billion in January-February 2007. The reserve assets grew 28% yoy due to external debt financing and net FDI inflows.

International Programs

The Ministry of Finance made the last payment of SDR 204.8 million (EUR 230 million) under the 3 year Extended Agreement with the IMF signed on September 25, 1998. The IMF Executive Board successfully completed the final review of the country’s performance under the precautionary Stand-by Arrangement (SBA) for the period from August 6, 2004 to March 31, 2007. In the letter of intent, the government announced that it does not plan to enter into a successor arrangement, and cooperation with IMF will continue on a general basis.