Summary

- In H1 2007, economic growth accelerated to 6.4% from 6.1% in 2006 driven by strong investment and consumption.
- In July, industrial sales growth rebounded to 11.7% yoy after deceleration to 5.1% yoy in June.
- In January-July, the fiscal surplus accounted for 4.6% of projected full-year GDP against 4.1% as of the end of June and reached EUR 3.76 billion (Lev 7.35 billion).
- The government approved a fiscal framework for 2008-2010. The consolidated budget surplus is targeted at 2.5% of GDP in 2008, economic growth is forecasted at 6%, and consumer price growth will slow down to 3.7% next year and 2.6% in 2010.
- In July, external government and government guaranteed debt slightly increased to EUR 4.21 billion from EUR 4.09 billion in the prior month.
- In August, consumer prices as measured by the Consumer Price Index (CPI) surged 3.1% mom driven by a one-off shock in agriculture and related industries after drought damage in the region. In the first eight months of the year, CPI growth reached 7.5% (12% yoy).
- In January-July, the current account (CA) deficit widened to EUR 3.04 billion (11.4% of GDP). Foreign direct investment covered 87.7% of the CA deficit.
- The financial account surplus reached EUR 4.4 billion as compared to EUR 3.2 billion in the same period last year.

Economic Growth

The National Statistical Institute released preliminary data on GDP growth for the first 6 months of 2007. The GDP data shows that real GDP growth accelerated to 6.4% from 6.1% in 2006.

Real GDP Breakdown (%, yoy)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Consumption</th>
<th>Investment</th>
<th>Exports</th>
<th>Imports</th>
<th>By sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>4.5</td>
<td>4.2</td>
<td>8.5</td>
<td>8.1</td>
<td>5.0</td>
<td>Agriculture: 4.7</td>
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<tr>
<td>2003</td>
<td>5.0</td>
<td>5.9</td>
<td>13.9</td>
<td>10.7</td>
<td>16.4</td>
<td>Industry: 4.7</td>
</tr>
<tr>
<td>2004</td>
<td>6.6</td>
<td>5.4</td>
<td>13.5</td>
<td>12.7</td>
<td>18.4</td>
<td>Services: 4.7</td>
</tr>
<tr>
<td>2005</td>
<td>6.2</td>
<td>5.3</td>
<td>23.3</td>
<td>8.5</td>
<td>14.5</td>
<td></td>
</tr>
<tr>
<td>2006*</td>
<td>6.1</td>
<td>6.5</td>
<td>17.6</td>
<td>9.5</td>
<td>13.1</td>
<td></td>
</tr>
<tr>
<td>1H 2007*</td>
<td>6.4</td>
<td>6.5</td>
<td>17.2</td>
<td>4.2</td>
<td>15.2</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>Mining</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Electricity, Water and Gas</td>
<td>Index of Industrial Sales by Sector, % yoy</td>
<td></td>
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<td></td>
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</tr>
</tbody>
</table>

According to an NSI survey, managers in industry, construction, retail trade and service sectors confirmed either optimistic or "preserving the same" expectations on growth in their sectors. In August, the composite business sentiment indicator (CBSI) decreased by 1.9 pps compared to July. Industrial managers were more optimistic about production activity due to the current amount of orders from abroad and indicated higher inflationary expectations. Construction managers' expectations shifted toward "preserving the same" situation. The shortage of labor along with intentions to hire additional personnel in the next 3 months was cited among factors impeding growth in the sector. In retail trade, 61.2% of respondents expected the same trade sales volume while 36% of respondents expected improvement. In construction and retail sectors, managers indicated higher inflationary expectations. In the service sector, managers' expectations remained favorable regarding growth in the sector for the next 6 months; their expectations about employment in the sector improved, and expectations on selling prices indicated "no change".

Fiscal Policy

In July, the government's fiscal reserve increased by EUR 137 million (Lev 268 million) to EUR 3.76 billion (Lev 7.35 billion). Fiscal reserve coverage of government and government-guaranteed debt reached 65.3%. In January-July, the fiscal surplus accounted for 4.6% of full-year projected GDP compared to 4.1% at the end of June. Given the strong year-to-date revenue performance, the year-end fiscal surplus could reach 4.5% of projected GDP (excluding contributions to the EU budget) if the government maintains its restrictive fiscal policy.

In January-July, consolidated fiscal revenues reached EUR 6.76 billion (Lev 13.22 billion), an increase of 17.1% yoy (17.4% yoy in June). The revenue growth was driven primarily by corporate and individual tax collections. Tax revenue amounted to EUR 5.54 billion.
The government approved a 3-year fiscal framework (2008–2010) that incorporates government plans to continue tax and social insurance adjustments. The 2008 budget will be based on the fiscal framework and required changes will be introduced to the tax legislation. According to the framework, the consolidated budget surplus is targeted at 2.5% of GDP in 2008, economic growth is forecasted at 6%, and consumer price growth will slow to 3.7% next year and 2.6% in 2010. The tax legislation will be amended to implement the following policies: i) personal income tax will be reduced to a 10% flat rate, ii) the monthly wage floor will be raised to EUR 112 (Lev 220) from the current EUR 92 (Lev 180), iii) the monthly income ceiling subject to social insurance charges will be increased to EUR 1,022 (Lev 2,000) from the current EUR 715 (Lev 1,400), iv) pension adjustments will be equal to 50% of forecasted consumer price (CPI) growth and 50% of income growth in the prior year (pensions were raised by 10% in July and will be further increased by 10% as of October 1st), and v) the excise tax on cigarettes will be increased by 50% for two consecutive years and the excise tax on fuel will go up by EUR 0.026 (Lev 0.05) per liter in 2008.

The government continues to implement its public debt management strategy, which targets reduction of government and government guaranteed debt and service costs. According to the Ministry of Finance, government and government guaranteed debt increased slightly over the month to EUR 5.76 billion (Lev 11.262 billion) from EUR 5.75 billion (Lev 11.256 billion) at the end of July. On an annual basis, government and government guaranteed debt decreased by 9.6%. The debt to GDP ratio was 21.6%, unchanged from the previous month.

In July, external government and government guaranteed debt slightly increased to EUR 4.21 billion from EUR 4.09 billion in the prior month. The average weighted residual term to maturity of external debt was nine years and six months. In the debt structure, global bonds and euro bonds accounted for 41.9%, debt to the World Bank was 21.1%, government investment loans and guaranteed loans accounted for 14.6% and 13% respectively, and obligations to the EU and Paris club stood at 7.8%. Domestic government debt decreased slightly to EUR 1.54 billion from EUR 1.55 billion in June. The share of government securities denominated in Lev decreased to 74.3% and securities denominated in EUR and USD stood at 25.7%. The maturity structure of government debt slightly changed. Long-term securities grew to 65.2% and medium-term securities dropped to 34.3%.

In August, consumer prices in foods, catering and services sectors increased 7.3% mom, 4.8% mom and 0.3% respectively while consumer prices in non-foods have not changed for the second month in a row. On an annual basis, food prices grew 24.1%, prices in services and catering grew 7.5% and 15% respectively, and prices in the non-foods sector edged up 2.1%. Despite the drought this summer, the increasing wage demands due to the shortage of qualified labor, foreign financial inflows as well as price adjustments to EU average levels all exert inflationary pressure on the economy.

The harmonized index of consumer prices (HICP), calculated on the basis of consumer weights and standardized product groups of EU countries, increased 9.3% yoy in August (6.8% yoy in July). The difference between the HICP and the national CPI is attributed to the larger weight of catering and services in the consumer basket of the EU. The HICP is used to measure the country’s performance toward meeting the price stability criterion for joining the EMU.

The Bulgarian National Bank (BNB) released preliminary data on gross external debt as of the end of June. Gross external debt increased by EUR 467 million (2.25% mom) to EUR 21.18 billion. On an annual basis, gross external debt increased 22.5% and reached 79.2% of GDP. Short-term liabilities accounted for 31% of total debt (EUR 6.57 billion). After a 7.2% mom decline in May (transfers of reserve funds released by the BNB after abolishment of credit restrictions on January 1, 2007), liabilities in the banking sector increased 6.2% mom to EUR 3.67 billion. Inter-company lending (direct investment liabilities) grew 0.7% mom to EUR 6.48 billion, and other sectors debt increased 1.3% mom to EUR 7.8 billion. Since the start of the year, inter-company lending showed the highest growth rate of 15.8% (EUR 885 million), buying sector liabilities increased by 8.4% (EUR 282 million) and third sector external debts posted growth of 11.6% (EUR 814 million).
In July, producer prices measured by the producer price index (PPI) increased 7.7% yoy, up from 6.5% yoy growth in June. The growth of producer prices accelerated from 0.7% mom in May to 1.2% mom in June to 2% mom in July. While producer price growth was driven primarily by the mining sector in June, producer prices in the utilities sector contributed most to the increase in PPI in July. Prices in the utilities, manufacturing and mining sectors posted growth of 3.6% mom (0.2% mom in June), 1.2% mom (1.8% mom in June) and 4.2% mom (4.5% mom in June) respectively.

In August, broad money (M3) increased to EUR 19.3 billion (Lev 37.8 billion), a growth of 30.4% yoy (29.1% yoy in July). Narrow money (M1) grew to EUR 9.7 billion (Lev 18.9 billion), an increase of 30.3% yoy (28.9% yoy in July). The monetary base increased 2.7% mom to EUR 5.44 billion (Lev 10.6 billion). The money supply multiplier increased to 3.55 from 3.52 in July. The ratio of money supply to GDP increased to 72.3% from 69.6% in July.

Deposits with a maturity of up to 2 years increased to EUR 7.98 billion (Lev 15.61 billion), a growth rate of 30.6% yoy (29.6% yoy in July). Deposits redeemable at notice of up to 3 months amounted to EUR 1.67 billion (Lev 3.27 billion), an increase of 30.9% yoy (28.5% in July). Overnight deposits reached EUR 6.17 billion (Lev 12.06 billion), up 39% yoy (36.9% yoy in July).

The Bulgarian National Bank (BNB) decreased its base interest rate from 4.08% p.a. in September after an increase from 4.01% p.a. to 4.10% p.a. in August.

In August, claims on the non-government sector in foreign currencies decreased slightly to 48.4% from 48.7% in July. As of September 1st, the Bulgarian National Bank increased the minimum reserve requirement (MRR) of banks from 8% to 12% to slow down bank credit growth.

In July, the balance of trade in goods posted a deficit of EUR 601 million according to preliminary data from the National Statistical Institute. In January-July, the trade balance deficit reached EUR 3.89 billion (14.5% of GDP), an increase of 44.4% yoy. Data on foreign trade will be revised since it is now based on customs reports for non-EU countries and incomplete INTRASTAT files for EU states.

Export growth slowed to 4.3% mom in July from 7.4% in June and 7% mom in May. In January-July, Bulgarian exports grew to EUR 7.38 billion worth of goods, a growth of 6.5% mom in July after a considerable slow down to 0.9% mom in June and strong growth of 9.9% in May. In January-July, Bulgarian imports grew to EUR 11.27 billion, an increase of 18.78% yoy. The share of exports to EU countries decreased slightly to 62.2% and the share of imports from EU countries in total imports fell slightly to 59.3%.

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In July, the current account (CA) deficit widened to EUR 3.04 billion (11.4% of GDP). In July, the CA deficit narrowed to EUR 131.5 million from a deficit of EUR 273.4 million in June and EUR 472.1 million in May. The CA balance improvement is a result of seasonal improvement in the balance of trade in services. In July, the surplus of trade in services increased to EUR 457 million from EUR 278.4 million in June and EUR 91.6 million in May. In January-July, the tourist sector contributed EUR 1.35 billion, up 16% yoy.

In July, the growth of the foreign direct investments (FDI) slowed to EUR 301 million from EUR 488 million in June and EUR 492 million in May. In January-July, FDI reached EUR 2.67 billion (10% of GDP), an increase of 14.2% yoy. Equity investments increased by EUR 667 million to EUR 1.61 billion or 60.3% of all FDI inflow. In the first seven months of the year, foreign direct investment covered 87.7% of the CA deficit. The financial account surplus reached EUR 4.4 billion compared to EUR 3.2 billion in the same period last year.

The Ministry of Finance revised its forecast of the CA deficit for 2007 to 18% of GDP. In 2006, the CA deficit was 15.7%.

In August, the Bulgarian National Bank (BNB) rese...
“Eolica Bulgaria”, a Spanish-Bulgarian company, plans to invest EUR 85 million in a wind farm with a capacity of 60 Mw t near Varna in Northeast Bulgaria.

The KBC Bank and Insurance Group (Belgium) will acquire a 75% interest in the Economic and Investment Bank (EIBank) for EUR 295 million. EIBank is the ninth-biggest lender by assets in Bulgaria. The acquisition will be finalized after the approval by regulatory authorities in Bulgaria.

In privatization of the shipping company "Navigation Maritime Bulgare", twenty three companies bought tender documentation and three of them submitted letters of interest to buy a majority interest. The tender bids were submitted by Chartworld Shipping Corporation (Greece), Essar Shipping & Logistics Ltd (India) and a consortium of KG Maritime Shipping (Bulgaria) and Martrade Shipping Transport (Germany). The deadline for submitting preliminary bids is November 8th. Navibulgar employs over 4,000 people and owns 77 cargo ships. In 2006, company revenues were EUR 200 million.