Bulgaria strongly grew by 17.3% yoy. This widened the current account deficit in January-August 2007.

The NSI released its monthly "Business Conjuncture". The total business climate indicator (CBSI), which is calculated as a weighted average of four branch business climate indicators in industry, construction, retail trade and the service sector, was down 1.4% in September 2007 from August. The worse expectations are related to more moderate manager opinions about decreasing sales due to inflation pressures and increasing imports (the opinion was changed from "better" to "the same").

However, the strong accumulation of investments in 2007 as well as growth in industrial production set favourable expectations for the medium term. It is likely that GDP growth in Bulgaria will accelerate to about 6% yoy in 2007, driven by investments. The forecast for 2008 is slightly lower at to 5.9% yoy. It corresponds to the general GDP growth of 6.0% yoy in Southern and South-Eastern Europe for the same period.

Fiscal Policy
Bulgaria's fiscal policy was focused on budget expenditure containment because of high inflation in 2007. In January-August, consolidated expenditures amounted to EUR 6.1 billion (Lev 12.0 billion) while revenues reached EUR 7.8 billion (Lev 15.2 billion) or 29.2% of GDP.

The general revenues growth in the budget reached 18.3% yoy and was mainly driven by increasing tax revenues, due to a corporate income tax reduction to 10%, the widening tax base thanks to industrial production and import growth. In January-August, the profit tax was almost fully collected (99.6% of the amount approved by the Budget Law). It could be a result of higher company profits, lower unemployment (which continued to decrease in September and stood at 6.78%, down 0.22% mom and 1.66% yoy) and also a possible underestimated annual forecast for profit tax because of the fiscal impact of tax legislation changes.

In January-August 2007, consolidated budget expenditures amounted to EUR 6.1 billion (Lev 12.0 billion), increasing by 9.2% yoy. Budget expenditure execution was equal to 23% of GDP. The general expenditures structure (current and capital expenditures) was changed. These changes on 2.9 percentage points were concerned with increasing the share of capital expenditures (capital expenditure, state reserve gain and purchases of agricultural production, subsidies) from 15.3% to 18.2%. The growth rate of capital expenditures in comparison to the previous year was 26.7% yoy.

Current expenditures (wages and salaries, social and health insurance contributions, maintenance, interests payments and other social expenses) in January-August 2007 amounted to EUR 5.2 billion (Lev 10.2 billion). The growth rate for those expenditures was 6.5%, with the growth rate for wages and salaries at 12.2% yoy and maintenance at 5.6% yoy (which has an impact on household incomes increasing.) The share of current expenditures is 81.8%, while it was 84.7% in the same period of 2006. These changes in the structure of budget expenditures show a well designed social policy and good management of current liabilities. It allows for investment of budget resources into long-term programs, including structural reforms. Structural reforms that are aimed at raising the efficiency of the public sector have to be taken into account for development and achievement of public policy, aimed at promoting sustainable economic growth and improving the business climate.

As a result of revenues increasing and tight control over expenditures, the fiscal surplus in January-August was equal to EUR 1.5 billion (Lev 2.9 billion) or 5.5% of GDP. According to the Bulgarian "National Reform Programme (2007–2009)", one of the medium-term goals is to maintain a budgetary sur-
Bulgaria's debt policy is focused on debt reduction, which is why the public debt to GDP ratio decreased from 28.2% in January 2006 to 22.1% in August. The low level of public debt in Bulgaria and good credit rating ensure easy access to foreign financial markets. It helps to have a well-presented debt structure by residual maturity: long-term securities (7–10 years) dropped to 63.5% and medium-term securities (1–5 years) grew to 36.3%. The share of short-term securities (up to 1 year) totalled just 1.12%.

According to statistical data from the Ministry of Finance, the share of external debt in the debt structure was 73.1% at the end of August, while domestic debt was 26.9%. This proportion shows that external borrowings are more accessible and cheaper than domestic borrowings. But it could also have a negative impact on domestic market development. Public debt repayments in January-August were higher than new government borrowings (Lev 0.3 billion) which was one of the factors limited currency flows into the economy.

The Bulgarian National Bank (BNB) released preliminary data on gross external debt as of July 2007. In January-July, gross external debt increased by EUR 1.89 billion (9.4%) to EUR 22 billion. The share of gross external debt in GDP reached 82.3%. On an annual basis, gross external debt increased by EUR 3.97 billion or 22% yoy in comparison to January-July 2006. Since the start of the year, the banking sector has the highest growth rate at 27.2% (EUR 795.1 million) which was caused by strong demand for credit resources from the private sector.

**Monetary Sector**

The inflation level in Bulgaria has increased to the maximum monthly rate for the last 2 years. In January-September 2007, the CPI surged 13.1% yoy. The high CPI rate was driven by price increases on foods and catering, which is a concern with unfavourable weather conditions this spring and, as a result, a lower yields of basic crops in Bulgaria. The prices for foods grew faster than other CPI components. For the first 9 months of 2007, food prices increased 25.1% yoy, catering prices increased by 18.3% yoy, while prices for non-foods and services grew 3.7% and 7.6% yoy respectively. The highest level of prices for food and catering was in July and August. During these months, food prices increased 3.9% mom in July and 7.3% mom in August, while catering prices grew 1.3% mom in July and 4.8% mom in August (due to heightened demand due to the tourism season’s peak, when restaurant and hotels prices showed the highest growth rate of 17.7% yoy).

In general, CPI in January-September 2007 is three times higher than the government inflation target for 2007 (4.4% yoy). The high CPI shows a problematic situation with monetary instruments, which are used for the inflation control in Bulgaria. Monetary policy in January-September shows a faster growth of monetary aggregates. In September, broad money (M3) increased to EUR 19.5 billion (Lev 38.2 billion), a growth of 29.1% yoy, as a result of the credit boom in Bulgaria. This has an impact on the acceleration of consumer inflation. Narrow money (M1) grew to EUR 9.8 billion (Lev 19.2 billion), an increase of 30% yoy. This state of affairs could influence or delay the process of access to the Exchange Rate Mechanism (ERM II).

**International Trade and Capital**

Strong consumer demand and the domestic industries’ output slowdown negatively affected net export flow in August. The deficit during January-August 2007 stood at EUR 3.2 billion (12% of GDP), resulting...
from a large deficit of trade balance. During the first eight months of 2007, the trade balance deficit reached EUR 4.47 billion (16.7% of GDP).

As expected, import growth in January-August 2007 was higher than exports and accelerated to 17.3% yoy compared to 8.3% yoy. Bulgarian exports grew to EUR 8.53 billion worth of goods; imports grew to EUR 13 billion. In contrast to balance of goods, the balance of trade in services in August was positive and reached EUR 1.1 billion.

Based on macroeconomic indicators the Current Account Balance (CAB) in 2007 should accelerate to 19%. It could be slightly lower (18.0%) in 2008. In general, these expectations are absolutely appropriate for the current trends in Bulgaria (in 2006, the annual CAB deficit was 15.7%, while the Ministry of Finance’s forecast for 2007 is 18% of GDP).

Nevertheless, the financial and capital account, helped by foreign debt accumulation by the private sector, managed to fully cover the CA deficit in January-August 2007. The total amount of FDI reached EUR 3.4 billion (12.7% of GDP for the first eight months of the year), an increase of 21.7% yoy. As a result, net FDI inflow covered 102.4% of the CA deficit in the first eight months of the year. The financial account surplus reached EUR 5.4 billion (70.3% yoy) compared to EUR 3.2 billion in the same period last year. Thanks to robust FDI inflow and external crediting, the Bulgarian National Bank reserve assets increased by EUR 1.4 million in August to EUR 11.7 billion, a growth of 38.7% yoy.

Taking into account Bulgaria’s increasing gross external debt, the larger share of debt-financing of the CA gap makes the economy more dependent on external shocks in world financial markets (like the mortgage crisis in the US). Because of this, the Government should attract the FDI flow at modernization in industrial and service sectors.

Other Development and Reforms Affecting the Investing climate

The World Bank recently released “Doing Business 2008”. The report noted that Bulgaria is in the top 10 reforming countries from 178 total countries, which helped take the country from 56th to 46th place in the total rankings. The strong economic growth during last few years and effective fiscal policy facilitated the investment climate improvement.